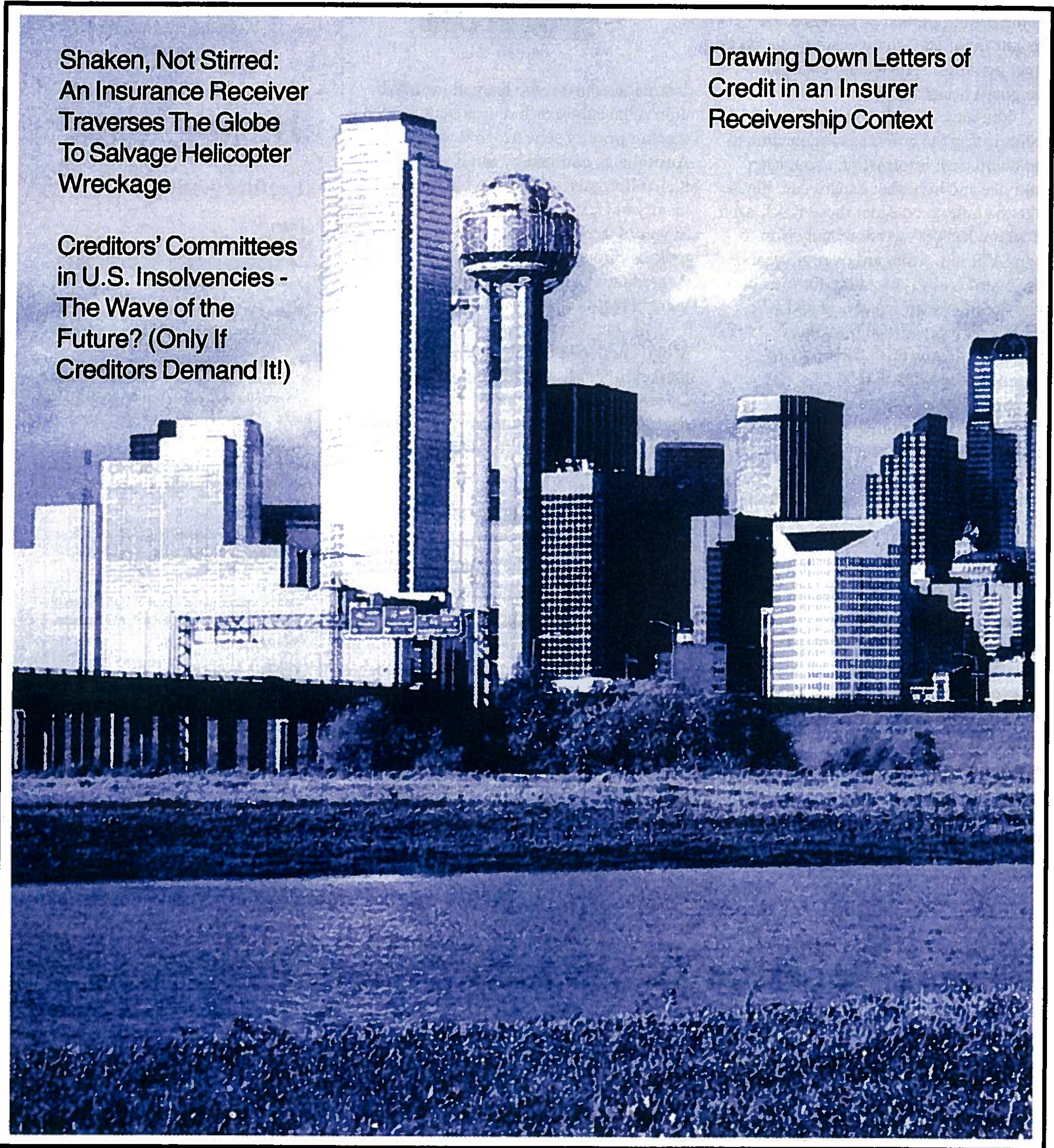
The
INSURANCE RECEIVER

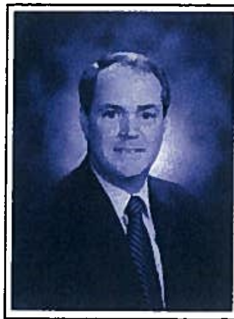
Promoting professionalism and ethics in the administration of insurance receiverships.

Volume 9, Number 3 Fall 2000



President's Message

By Robert Craig, Lamson, Dugan, & Murray


Robert Craig

Get Out the Vote!

Every year membership on our board changes. New faces and ideas come to the board room while members who've given us the benefit of their experience and insight for at least three years move on to other activities. The annual changing of the guard is coming up.

You have recently received your ballot listing the nominees for election to the board with information about each nominee and his or her experience. Please take the time to consider these folks, each of whom has devoted time and effort to help IAIR move forward over the years. The board is always looking for members who are interested in serving and who effectively represent our members' interests. Clearly, this year's slate of nominees does just that.

Special thanks goes out to Dick Darling and his committee, Rheta Beach, Betty Cordial, George Piccoli, Ellen Robinson, Mike Surguine and Tom Wrigley for all their hard work recruiting these nominees.

Continuing to Expand the "I" in IAIR

At it's spring meeting the board formed an international committee chaired by Vivien Tyrell in London. The objective: to further our international presence. As reported in my summer column, the committee's initial undertaking, it's London insolvency program, was a sellout and oversubscribed by half. Continuing that effort, in September Bob Loiseau brought us an all international program for the Dallas roundtable starting with keynote speaker, Texas Commissioner Jose Montemayor. We learned (or maybe didn't) the subtle differences between the creditor priority schemes in Bermuda and Australia as outlined by Ian Kawaley and Kulen Ratneser; received a lesson in the history of U.S. insurance from Philip Singer of the UK; and George Gutfreund took us through the process for the Accreditation and Licensure Of Insolvency Practitioners In Canada.

To round out the afternoon Alex Moglia not only explained the evolving market in South America but also gave us an exhibition of how the otherwise mundane world of insurer insolvency can provide great material for stand-up comedy.

No Boston Round Table - Attend the FORC/ABA Program "GLB - One Year Later" and Stay for the Annual Members Meeting and Election of Directors

To give our members an opportunity to attend the Saturday FORC/ABA program "Gramm-Leach-Bliley Act: The Experts Look At The Marketplace One Year Later" there will be no round table in Boston. We are encouraging our members to attend this program organized by IAIR board member Charlie Richardson. IAIR's annual meeting will follow immediately after.

Get involved.

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Other News & Notes

By Charles Richardson

As I write this column from my relatively new digs in Washington, D.C., the political atmosphere enveloping me here is electric as Vice President Gore, Governor Bush, and their newly named running mates Lieberman and Cheney square off for what most everyone predicts will be the closest election since 1960. Frankly, what's the fuss? While I admit a Presidential election is important and deserves close interest, the real action comes a week after November 7 ...

Joint IAIR/NCIGF/NOLHGA Seminar Workshop November 15-17

For the first time, all three insurance insolvency organizations are teaming up to produce a unique workshop experience for receivers, regulators, guaranty associations, consultants and industry representatives. The format will be based on a problem solving exercise in the post Gramm-Leach-Bliley world. A new financial holding company with a bank, two insurance companies, and financial problems bigger than the state of Texas has come to us for help. We'll meet in San Antonio over three days to come up with a strategy to deal with the financial and legal realities of financial modernization, and, in the process, get hands-on experience with what all of us need to know about the GLB receivership land-scape.

A Bubbling Brook of Change

GLB continues to capture everyone's attention as we approach the one-year anniversary of President Clinton's signature of the Act on November 12. In fact, the Federation of Regulatory Counsel and the American Bar Association's Public Regulation of Insurance Law Committee of the American Bar Association Tort and Insurance Practice Section are sponsoring a half-day CLE seminar on Saturday afternoon, December 2, at the Boston NAIC meeting, to look at what GLB has meant to the industry so far. There will be distin-guished panelists from the ranks of regulators, associations, bankers, insurance types, practitioners, etc.

Here are few of the financial modern-ization hickeys since our last kiss of this subject in the Insurance Receiver:

The NAIC's nine post-GLB Working Groups have been hard at work. Indeed, the NAIC's leadership has made the potential improvement of state insurance regulation in light of the new financial and legal dynamics of the marketplace their primary focus since the adoption in March of the NAIC's Statement of Intent: The Future of Insurance Regulation. The agenda for the June NAIC meeting was completely rearranged at the last minute to permit all nine Working Groups to do their thing without interruption.

It looks like the NAIC will adopt a model privacy rule/legislation so that individual states can get their privacy ducks in a row by the November 12 deadline, just as the federal agencies have done. The assumption is that all privacy compliance effective dates will be July 1, 2001.

The debate within the industry over the shape of insurance regulation continues, with both the life and property/casualty trades floating various propos-als. Look for everyone to be cautious until after the November 7 elections when we see who will be making the political decisions, particularly in the U.S. House of Representatives.

While there have been 365 new GLB financial holding company filings so far with the Federal Reserve Board from a variety of domestic (341) and foreign (24) financial interests, the financial services industries are going slowly in terms of formal bank/insurance company mergers and acquisitions. But the pace of "affilia-tions" continues as banks look for ways to penetrate insurance markets and insurance companies look for new distribution channels.

Finally, the pre-GLB tension between the Federal Reserve Board and the OCC over who should do what in the way of federal regulation in the new era of financial modernization seems to have resurfaced. John Hawke, who heads the OCC, has been making diplomatic, yet pointed warnings recently that the Fed's Alan Greenspan should not be making too much out of his "umbrella supervisor" role.

A Swirling Cauldron of Controversy

Two other issues have produced more than just bubbles in the brook of insurance regulation. The resignation of California Insurance Commissioner Chuck Quackenbush after a hailstorm of contro-versy and disturbing investigations left everyone in the country's largest state off balance and not exactly pleased with the attention the matter has brought to the insurance industry and its regulatory apparatus.

On the other hand, the public debate that started at the June NAIC meeting with Rev. Jesse Jackson's remarks about race-based underwriting, followed by American General's $208 million settlement of charges concerning such practices, have brought another round of not so great publicity. This particular issue has the interest of not only the class action plaintiffs' bar who are letting loose with new rounds of lawsuits, but also of regulators who want companies to dig deep (i.e., back decades and decades) to find out the truth. The remedy for past practices may shake the foundations of small companies.

IAIR Roundtable Schedule

NAIC Meeting - December 2-6, 2000
Boston, Massachusetts
The will not be a roundtable.

NAIC Meeting - March 24 - 28, 2001
Nashville, Tennessee
IAIR Roundtable
March 24, 1:00 - 4:00 p.m.

NAIC Meeting - June 9 -13, 2001
San Francisco, CA
IAIR Roundtable
June 9, 1:00 - 4:00 p.m.

***The* INSURANCE RECEIVER**

is intended to provide readers with information on and provide a forum for opinion and discussion of insurance insolvency topics. The views expressed by the authors in *The Insurance Receiver* are their own and not necessarily those of the IAIR Board, Publications Committee or IAIR Executive Director. No article or other feature should be considered as legal advice.

The Insurance Receiver is published quarterly by the International Association of Insurance Receivers, 174 Grace Boulevard, Altamonte Springs, FL 32714, (312) 961-4199, Fax: (773) 395-8786, Email: IAIRHQ@aol.com.

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EDUCATION PROGRAMS

IAIR/NCIGF/NOLHGA Workshop
November 16 -17, 2000
La Mansion del Rio Hotel
San Antonio, Texas

FORC/TIP
Gramm-Leach-Bliley Act:
The Experts Look At The Marketplace One Year Later
December 2, 2000 12:30 - 5:00 p.m.
Essex/North/Center Ballroom
Westin Copley Place Hotel, Boston

IAIR/NAIC Insolvency Workshop 2001
"Back To Basics, Back To The Future"
January 18 - 19, 2000
Sirata Beach Resort
St. Petersburg, Florida

For more information, visit www.iair.org.

A SPECIAL THANK YOU

We would like to thank those companies that served as Patron Sponsors of our quarterly reception held in Dallas during the NAIC Meetings:

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Jack Webb, CIR of Jack Webb & Associates presents a plaque to Commisioner Jose Montemayor, Texas in appreciation of his presentation at the Dallas Roundtable.

ANNUAL MEETING

The annual meeting will be on Saturday, December 2, 2000 at 5 p.m. in the Essex/ North/Center/Ballroom, Westin Copley Place Hotel, Boston. The election of five Board of Directors will be held. The following are the nominees:

Rheta Beach, Southern American Insurance Company in Liquidation
Francesca Bliss, New York Liquidation Bureau
Tom CLark, Crawford & Lewis
Jay Deiner, Ormand Insurance & Reinsurance Mgt. Services
Steve Durish, Texas P & C, Insurance Guarantee Fund
Patricia Getty, Paragon Reinsurance Risk Management Services
James Gordon, CIR-P&C, Maryland First Financial Services
Bob Loiseau, Jack M. Webb & Associates
Al Maloof, Genovese, Lichtman, Joblove & Battista
Daniel Orth, III, Illinois Life & Health and Illinois HMO Guaranty Associations
Stephen Phillips, AIR, Cunningham, Porter & Phillips
Debra Roberts, Debra Roberts & Associates, Inc.
Hank Sivley, CIR-ML, MC Consulting

CONGRATULATIONS

The following members have earned CIR designations:

Patrick Cantilo, CIR-ML
James B. Mzyk, CIR-L&H

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The Arizona Department of Insurance seeks applicants for a Deputy Receiver/Legal Analyst position, responsible for overseeing insurance receiverships and for providing legal research and analysis to the Department's Financial Affairs Division on corporate transactions and solvency issues. To be considered for this position, furnish a résumé and cover letter to Sara M. Begley, Deputy Director of Insurance, 2910 North 44th Street, Suite 210, Phoenix, Arizona 85018-7256.

*Note: This position is exempt from Arizona's state personnel merit system.

The Arizona Department of Insurance is an equal opportunity employer that complies with the Americans With Disabilities Act ("ADA") of 1990. Candidates that require accommodation for a disability may contact the Department's ADA Coordinator at (602) 912-8402.

SHAKEN, NOT STIRRED:

AN INSURANCE RECEIVER TRAVERSES THE GLOBE TO SALVAGE HELICOPTER WRECKAGE

By Bob Loiseau

It's a fact of modern life that helicopters, like computers, go down for no apparent reason. The aftermath is often tragic, but there are cases where everyone involved survives intact and all that remains to be done is deal with the wreckage and try to apportion the loss among those with the deepest pockets. Usually, that's the insurance company's job, but when the carrier is insolvent, the insurance receiver takes over.

Here then, culled from the files of one of our nation's largest aviation insolvencies, is a report and a score card on the winners and losers in three highly unusual helicopter crashes.

Celebrity Jeopardy

"Hitting the slopes" takes on an entirely different meaning when it's your chopper, not your skis, doing the hitting. Take the case of supermodel Christie Brinkley. On her first (and presumably, last) heli-skiing adventure, she and her entire party survived a crash into a mountaintop near Telluride, Colorado.

The insurance carrier, American Eagle Insurance Company, settled a multitude of resulting claims within its $10 million policy limits, no doubt contributing to its subsequent insolvency. In the process, fueled by the aura of celebrity, American Eagle's claims staff amassed one of the company's thickest (13 volumes) and most popular claim files. What American Eagle didn't do was find a way to dispose of the wreckage of the two year old helicopter, on which it paid a hull loss of nearly $900,000, in addition to considerable recovery costs.

Enter the receiver. What does one do with a badly damaged hulk which had accumulated substantial storage fees as well as a thick coating of grime in the four years since it was plucked from the mountain? Sell it to someone from Hollywood, of course.

In this case, a buyer appeared in the form of a movie producer, less interested in the Christie Brinkley connection than in acquiring a real helicopter cheaply; one that could be blown up in a movie. After protracted negotiations, the producer agreed to buy the salvage from the receiver and pay the storage charges. He then used the wreckage and a few hundred pounds of high explosives for the climactic helicopter destruction sequence in an as-yet-unreleased action movie.

Scorecard. The Winners: The receiver, who collected a whopping $3,500 on top of getting the buyer to pay the storage fees, and Christie Brinkley, who not only survived the crash, but made the cover of People Magazine as a result. **The Loser:** Rock musician Billy Joel, who was divorced by Ms. Brinkley shortly thereafter. (Ms. Brinkley later married one of her fellow crash survivors).

Chicken of the Sea

One of the more bizarre uses for a helicopter was employed by the owner of the Hornet III, a California-based commercial tuna boat insured by American Eagle. Among the Hornet III's optional equipment was a small helicopter which the captain used to scout for tuna, preferring this method to reliance on traditional fish finding techniques like sonar and satellite reconnaissance.

One hot summer morning, while searching for tuna in the far reaches of the South Pacific, near Guam, the helicopter began shaking violently, lost power and made an emergency autorotation "landing" into the sea. Fortunately for the ship's captain and his pilot, the helicopter from a competing tuna boat noticed their splashdown and rescued them. But the Hornet III's helicopter, along with all evidence concerning the cause of its crash, went straight to the ocean floor, far too deep to salvage. Sorry, Charlie.

The ensuing litigation--at least before receivership--was reminiscent of a pro wrestling tag team event. The Hornet III's captain and his pilot sued the vessel's owner for personal injuries, alleging the owner's negligence in the maintenance and operation of the helicopter. They also sued the manufacturer. Interestingly, the captain was the owner of the Hornet III and the helicopter (through a joint venture entity) and he and the pilot were the only people responsible for the helicopter's upkeep. In effect, the captain sued himself for his own negligence, with venue conveniently lodged in California, one of the few jurisdictions where suing one's self is legally and socially acceptable.

Unfortunately for the captain, the receiver scuttled his hopes for a bountiful catch by intervening in the suit, and asserting American Eagle's subrogation interest for its payment of the hull loss and medical expenses. Rather than litigate with a receiver for a claim against an insolvent carrier, the captain jumped ship, so to speak, and joined forces with the receiver in the product liability action against the manufacturer, magnanimously agreeing to forego his claims against himself. In the end, faced with united plaintiffs and a strong circumstantial case, the manufacturer settled all claims shortly after jury selection began.

Scorecard. The Winners: The captain, who got a new helicopter and a settlement worth more than a whole boatload of tuna, and the receiver, who collected the value of the sunken helicopter. **The Loser:** The helicopter manufacturer, which had to admit during discovery that it was forced to make certain tail rotor "improvements" to the military version of the helicopter, because the Air Force deemed the Hornet III's civilian model unsafe.

Sweet Home Madagascar

Sometimes helicopters are actually used for their intended purposes. Aerial photography is one example. Our final adventure involves a brand new helicopter, just purchased by the Cousteau Society, and insured by American Eagle. Transported aboard the Calypso to the remote island nation of Madagascar, and accompanied by a National Geographic photographer, this helicopter was a marvel of modern aeronautical engineering. Regretably, it crashed upon taking off for its first photographic sortie. But it was over land when its engine failed, and the skilled pilot managed an autorotation landing on the beach, from which he and the photographer walked away. They repaired aboard the Calypso to ponder their misfortune, only to watch in horror as their helicopter spontaneously ignited, burning up more than $80,000 worth of photographic equipment, as well as the helicopter itself.

Notified of the loss, and mindful of the stature of its insured, American Eagle promptly paid the claim and mounted a salvage operation; no easy matter when the wreckage is half a world away, on a beach so remote that no roads penetrated the surrounding jungle.

But the salvage party ultimately did reach the crash site, where they made a startling discovery: there was nothing left of the helicopter, only charred sand and tiny bits of debris. A government investigation later concluded that enterprising natives had mounted their own salvage operation, and then melted down what remained of the helicopter to make new pots, pans and other domestic accessories. So much for the salvage recovery.

Reasoning that the helicopter must have been defective or else it wouldn't have crashed, American Eagle hired contingent fee counsel to sue the manufacturer. The receiver took over the litigation, and things looked promising until the pilot gave his deposition. It seems that in the excitement of the crash, he forgot to turn off the helicopter's electrical system, which expert witnesses concluded was the only possible cause of the fire that consumed the craft. Faced with bad facts, a distant forum and witnesses who didn't speak English, the receiver settled the case for approximately one fourth of American Eagle's losses.

Scorecard. The Winners: Outside counsel, who got the lion's share of the recovery and managed to make three trips to Paris before recommending settlement, and the Madagascar natives, who now cook their meals and decorate their huts with recycled helicopter parts. **The Loser:** Your intrepid reporter, who didn't have the presence of mind to insist on accompanying the receiver's counsel on any of the Parisian junkets.

Bob Loiseau is Vice President and Legal Counsel for Jack M. Webb & Associates, Inc. which serves as Special Deputy Receiver of American Eagle Insurance Company. He has been an insolvency practitioner since 1986, and involved with insurance insolvencies since 1993. Bob thanks Webb & Associates' subrogation specialist, Richard Humphreys, and outside counsel, Elizabeth Fuller, AIR, for their extensive work in making these recoveries and their contribution to this article.

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For Additional Information Contact:

David Grady, CPCU
Senior Vice President
Minneapolis, Minnesota
(612) 886-8315

Trish Getty
Vice President
Atlanta, Georgia
(678) 297-2631

Mike Stinziano, Ph.D.
Vice President
Chicago, Illinois
(847) 413-4923

GRAAM-LEACH-BLILEY

by Francis J. Mulcahy

The Financial Services Modernization Act of 1999 (also known as the "Graam-Leach-Bliley Act" or "GLBA") became effective on November 12, 1999 but the ramifications of the Act will only become clear as regulations are implemented and as experience demonstrates the effects in a variety of situations, including insurer receiverships, over the coming years. Nevertheless, trends are emerging and were discussed at some detail during a continuing legal education seminar at the Dallas NAIC meeting in September. The changes and their effects, of course, are so profound that no one conference, let alone this short summary, can fully explore all the issues.

Most notably, the Act breaks down the federal legal barriers preventing affiliation of banks, insurance companies and securities brokers and preempts state laws preventing those affiliations. The Act, nonetheless, lays out a division of jurisdiction over financial institutions under the umbrella of the Federal Reserve Bank (FRB). The need for cooperation among the various regulators, along with the provisions of the law itself, will have a major impact on the development of the law, including the ability of insurance receivers to rehabilitate or liquidate failing insurers.

Financial Holding Company (FHC) Regulation

In its most significant and wide ranging regulatory restructuring, the Act repeals the Glass-Steagall Act and, for the first time since the 1930's, allows banks, insurance companies and securities firms to combine under newly created FHC's. Banks which do not become part of FHC's retain the power to participate in insurance and other functions as permitted prior to the new Act and may also expand into other financial markets as may be permitted in the future by bank regulators.

The Federal Reserve Board (FRB) becomes the "umbrella regulator" for FHC's and their affiliates. As umbrella regulator, the Federal Reserve will provide supervision on a consolidated level aimed at assessing the risks associated with those activities that can cut across legal entities and business lines. The Act leaves "functional regulation" to existing regulators, such as the state insurance regulators with respect to insurance functions and the Office of the Comptroller of the Currency (OCC) with respect to national banks. To the extent that entities principally regulated by other agencies engage in insurance activities, such as sales or insurance administration, those functions are subject to state insurance regulators.

Insurance sales by banks and their affiliates are subject to a special combination of rules.

The division of regulatory authority among the federal and state regulators is, in many instances, mandated in the Act but in other instances, must rely on unprecedented cooperation among federal and state regulators. For example, the FRB will have access to and rely upon examinations performed by state insurance regulators and, if it needs additional information, must first request that information through the insurance regulator. The FRB, however, may obtain information directly from an insurer if necessary to assess a material risk to the FHC or any of its depository institutions subsidiaries or compliance within a federal law under FRB.

Under GLBA, state insurance regulators continue to approve or disapprove insurer changes in control under insurance holding company system laws but state review and action on proposed affiliations involving banks is now limited to sixty days prior to the effective date of the change. Furthermore, any order for a capital infusion related to the change of control must be made within sixty days of notification. Clearly these limitations on state insurance authority could affect the assets necessary to maintain solvency of an insurer or the assets available to a receiver after a company has failed.

In order to facilitate the necessary cooperation among federal and state agencies and to authorize regulatory information sharing, the various federal and state agencies have begun negotiating and entering information sharing agreements. For example an OCC complaint sharing agreement has been assigned by over fifty states and additional agreements are under negotiation with the Federal Reserve, the OCC, Securities Exchange Commission and state insurance commissioners and other regulators. Indeed, on the local level, many insurance and bank regulators are introducing themselves to their regulatory counterparts for the first time since they may now find themselves scrutinizing the same entities.

Banks and Insurance

While state regulators retain their jurisdiction over insurance, GLBA places new parameters on state regulatory authority. GLBA makes it abundantly clear that state insurance regulation may not be structured in such a way as to discriminate against banks by statute, regulation or practice. The new law specifically permits banks to engage in insurance sales and other insurance related activities, either directly or through subsidiaries, except that neither banks nor their subsidiaries may directly engage in insurance underwriting. Insurance underwriting may only be carried out through other affiliates. Furthermore, having repealed the Glass-Steagall Act at the federal level, the Act also preempts state anti-affiliation laws which, in some states, have prohibited affiliations between state banks and insurance companies or sales agencies.

State regulators are currently reviewing their laws and regulations as well as internal procedures and practices to ensure that there is no discrimination against banks or bank affiliates. The Act provides for an expedited dispute resolution process for insurance - bank issues with a directive to the courts that equal deference must be given to bank and insurance regulators.

Insurance Sales by Banks

Insurance sales by banks and their affiliates are subject to a special combination of rules. Not later than November 12, 2000, federal banking agencies are required to adopt sales-related consumer protection rules applicable to the sale of insurance by banks and their affiliates. State insurance regulators may, however, impose sales rules in thirteen "safe harbor" areas as long as those rules provide greater consumer protection than the federal rules and do not "prevent or significantly interfere with bank sales." Draft federal rules were proposed on August 21, 2000. The federal rules apply to sales at the office of a bank or on behalf of a bank and include alternative disclosure provisions for telephone and electronic sales and the physical segregation of deposit areas where practicable. The new rules also allow banks to pay a one time, nominal fee for referrals from employees who accept deposits but the fee cannot depend on whether the referral results in a sale. As part of State insurance regulation of insurance functions, bank employees or representatives who "sell or offer for sale" insurance products must have the same agent license as other agents.

Agent Licensing

GLBA compels major transformation of insurance agent licensing by virtual blackmail. GLBA gives state insurance regulators three years - until November 12, 2002 - to establish either "uniformity" or "reciprocity" in agent licensing or the National Association of Registered Agents and Brokers (NARAB) comes into existence as a subsidiary of NAIC. NARAB would become a new regulatory body through which insurance producers could be licensed in every state outside the state of residency upon filing only one application with NARAB. State insurance laws and regulations in conflict with NARAB would be preempted although state regulators would retain jurisdiction over agent actions.

GLBA imposes new privacy requirements on all financial institutions.

In order to avoid implementation of NARAB, NAIC and its member regulators have committed themselves to implementing reciprocity by 2002 and uniformity as soon thereafter as possible. In virtually every state, legislative action as well as regulatory changes are needed to achieve reciprocity as well as uniformity. To achieve the necessary reciprocity, a majority of the states must permit an insurance producer that has a resident license in another state to receive a license as a nonresident to the same extent that the producer is permitted to sell or solicit the purchase of insurance in its state of residency, accept a producer's satisfaction of its home State's continuing education requirements as compliance in its state, impose no requirement upon any non-resident producer that has the effect of limiting or conditioning that producer's activities because of its residence or place of operations, and grant reciprocity to residents of all of the other States that satisfy the reciprocity requirements.

To achieve the uniformity required by GLBA, a majority of the States must establish uniform licensing criteria for insurance producers, including the qualification and training of sales personnel in ascertaining the appropriateness of a particular insurance product for a prospective customer, establish uniform continuing education and ethics course requirements, uniform suitability criteria for products sold to consumers, and equivalent criteria for resident and nonresident agents.

Privacy Regulations

GLBA imposes new privacy requirements on all financial institutions, including insurance companies, and state insurance regulators will have the authority to enforce those regulations against insurers. States may adopt greater privacy protections for financial institutions but, in the event of a dispute as to which protections are greater, the Federal Trade Commission becomes the final arbiter.

Conclusion

Each section of GLBA opens new vistas of regulation. The drafters of the law clearly understood the needs and desires of banks but seem to have had a more limited grasp of the effect on insurance regulators, companies, agents and consumers, not to mention those of us who must sort through the debris of failed companies as receivers or guaranty funds. Be sure to buy a hard-bound volume of the new law because you will be using it for a long time to come.

Francis J. Mulcahy joined IAIR this year. He is an attorney with Tinsley Bacon Tinsley, LLC in Alpharetta, Georgia.

Meet Your Colleagues

JOHN B. "JAY" DEINER

Jay Deiner is Executive Vice President, Secretary and General Counsel of Ormond Insurance & Reinsurance Management Services, Inc., a reinsurance underwriting management and insurance and reinsurance consulting organization located in Ormond Beach, Florida. Jay began his insurance career in 1962 and prior to joining Ormond Re in 1977, held management positions with North Star Reinsurance Corporation, The Home Insurance Company and Allstate Insurance Company.

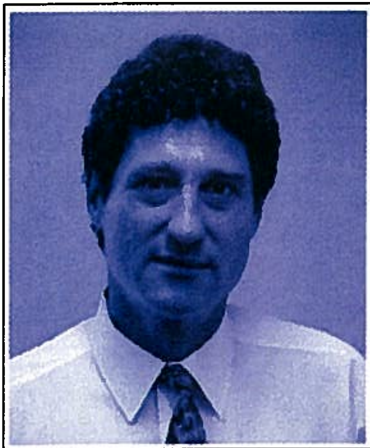
Jay earned his BS degree at Villanova University and his JD degree at Brooklyn Law School. Jay is admitted to the Florida Bar and in addition is a member of the American and the Volusia County Bar Associations.

In addition to being an active member of IAIR (Jay most recently served as host for the IAIR Roundtable held this June in Orlando in conjunction with the NAIC Quarterly Meeting), Jay is past President of the Excess/Surplus Lines Claim Association and past President of the Southeastern Claims Executive Association and remains active with both Associations. Jay is also a member of the Defense Research Institute and the Federation of Insurance and Corporate Counsel and is past Chair of the Excess and Surplus Lines Substantive Law Committee and past Chair of the Reinsurance Substantive Law Committee of the FICC. Jay is a Charter Member of ARIAS•U.S. and is a Certified Arbiter by ARIAS•U.S.

In addition to overseeing the assumed reinsurance activities of Ormond Re, Jay is active in the consulting operations of Ormond. He has assisted Receivers and Guaranty Associations in several states in connection with reinsurance matters and has done extensive work dealing with reinsurance receivable collections on behalf of Receivers of insolvent estates.

During his career, Jay has appeared as a speaker on various programs sponsored by DRI, FICC and the ABA on insurance and reinsurance related subjects.

Jay and his wife Sylvia live in Ormond Beach, Florida and both of their children are Florida State Seminoles. Their son, Brad, graduated Florida State in 1998 and is currently attending Life University in Atlanta, Georgia pursuing a chiropractic degree while their daughter, Nikki, is completing her last year at Florida State pursuing a degree in marketing. Jay travels on business extensively and when not too busy pursuing business activities or writing checks to pay under-graduate and graduate expenses, he tries to pursue some leisure time sport fishing off of Daytona Beach in his 38' Hatteras, "Deiner's Club". (At last calculation, fresh fish fillets caught aboard the Deiner's Club have been averaging about $67.53 per pound.)



JONATHAN ROSEN

Jonathan Rosen is Senior Vice President and Reinsurance Counsel of Risk Enterprise Management Limited, a claim and risk management organization in New York City. A native South African, Jonathan holds Bachelor of Commerce and Bachelor of Laws degrees and a Higher Diploma in Tax law from the University of Witwatersrand in Johannesburg. He is admitted to practice law in South Africa, New York and Massachusetts.

Prior to joining REM, Jonathan spent 15 years serving as outside legal counsel to numerous entities participating in the insurance and reinsurance industry, with his practice spanning the gamut of corporate, regulatory and litigation representation. During that time he was an active participant on NAIC advisory committees and working groups and wrote and spoke extensively in industry publications and at conferences; including authoring the Reinsurance chapter of the Receivers' Handbook on Insolvencies.

At REM, in addition to being a member of the executive management team, Jonathan is operational head of reinsurance, having authority over the run-off of a multi-billion dollar highly complex reinsurance portfolio. He is also responsible for a self-led internal legal resource servicing the discontinued reinsurance operations of various affiliated entities of the Zurich Group, including those of The Home Insurance Company.

An avid traveller to exotic places, Jonathan enjoys most forms of outdoor activity and, together with his wife Kim, who is an architect, spends most weekends at a vacation home on a lake in Massachusetts to escape from the rigors of New York City living.

FRANKLIN D. O'LOUGHLIN

Frank O'Loughlin is a partner in the law firm Rothgerber Johnson & Lyons LLP, in Denver, Colorado. He graduated with a Business Administration Degree from the University of Northern Colorado in 1973 and earned a Juris Doctorate Degree from the University of Montana in 1979.

His practice emphasizes life and health insurance matters, including litigation, transactional and regulatory work on a national basis. He is particularly proud of having served as counsel to the Receiver in the successful rehabilitation of a national risk retention group and to the Receiver in the successful rehabilitation of a fraternal benefit association. He serves as general counsel to the life and health insurance guaranty associations in Colorado, Wyoming and Montana and as special counsel to other state guaranty associations and to the National Organization of Life and Health Insurance Guaranty Associations ("NOLHGA") with respect to various multi-state insolvencies.

He is licensed to practice law before all state and federal courts in Colorado, Wyoming and Montana; the Ninth and Tenth Circuit Court of Appeals; and the United States Supreme Court. Frank is also a member of the American Bar Association, Colorado Defense Lawyers Association and the Lawyer-Pilots Bar Association. He is a member of NOLHGA's Legal Committee and of IAIR.

Frank is a frequent participant in insurance-related seminars including the ABA/TIPS Seminar in San Francisco in December 1999 and the NOLHGA Annual Legal Seminar held in Snowmass, Colorado in July 1999 where he acted as Chairman of the Legal Seminar Planning Committee. He has published numerous insurance-related articles in various periodicals, including Mealey's Litigation Reports and The NOLHGA Journal.

Frank and his wife, Sue, are active in a variety of organizations in the Evergreen area where they reside. They are both avid downhill skiers and enjoy mountain biking and road biking when the snow melts.

MARILYN WALCZAK

Marilyn Walczak is president of ZAK Consulting Services, Inc., a consulting firm providing management and reinsurance services to insurance companies and liquidators. Marilyn has over 25 years of experience in all phases of the insurance industry.

Since 1997 Marilyn has been under contract with the Michigan Insurance Bureau as On-Site Manager for a company in liquidation. She is responsible for administration of the liquidation's day to day affairs, including analysis of reinsurance agreements and collection of reinsurance and other recoveries, as well as assisting in research and evaluation of claims against the estate.

Prior to starting ZAK Consulting Services, Marilyn was Vice President of Commercial Underwriting for First Security Casualty Company. She supervised both the commercial underwriting and marketing staffs.

Marilyn began her insurance career with INA/CIGNA. She was with the commercial underwriting department of Insurance Company of North America for 12 years, where she worked her way up the ranks to Senior Production Underwriter. From 1984 to 1987 she worked on the agency side of the business as Underwriting Department manager for Republic Hogg Robinson Agency.

Marilyn joined IAIR in 1998 and has attended some of the educational seminars presented by IAIR. She looks forward to attending more. In addition to her IAIR membership, Marilyn is also a member of the Insurance Women of Metropolitan Detroit. She is currently President Elect and will serve as their President for the 2001-2002 term. Other memberships include INSOL International, National Association of Insurance Women, and Michigan Business and Professional Association.

In her spare time (of which she admits there is little) she enjoys traveling, golf, gardening, and most of all horseback riding on her Arabian gelding, Surrey.

Receivers' Achievement Report

by Ellen Fickinger

Reporters: Northeastern Zone - J. David Leslie (MA); W. Franklin Martin, Jr. (PA);
Midwestern Zone - Ellen Fickinger (IL); Brian Shuff (IN);
Southeastern Zone - Eric Marshall (FL); James Guillot (LA);
Mid-Atlantic Zone - Joe Holloway (NC);
Western Zone - Mark Tharp, CIR (AZ); Amy Jeanne Welton, AIR (TX); Melissa Eaves (CA);
International - Philip Singer, CIR (England); John Milligan-Whyte (Bermuda)

Our achievement news received from reporters is as follows:

Mike Rauwolf (IL) provided updated information on two companies under OSD supervision. **American Mutual Reinsurance, In Rehabilitation (AMRECO)** continues the reinsurance run-off of their business. Total claims paid inception to date; Loss and LAE $30,449, Reinsurance Payments $131,594,715, and LOC Drawdown disbursements $9,613,386. Further, **Centaur Insurance Company, In Rehabilitation** also continues the run-off of their business, total claims paid inception to date; Loss and LAE $51,329,160, Reinsurance Payments $4,945,493, and LOC Drawdown disbursements $13,876,555.

Dan Watkins (KS) reports that pursuant to an application to the court to distribute **West General Insurance Company, In Liquidation** assets for non-guaranty association claimants, approval was given for a distribution in September 2000, for a non-guaranty association Class 3 claim distribution of $2,792,112 representing 54.4% of allowed amounts.

We continue to receive collection information from **James Gordon, CIR (MD)** for **Grangers Mutual Insurance Company**. Collections during the first quarter of 2000 totaled $18,669.95.

Douglas Hertlein (OH) reports that on July 24th court approval was obtained to make an early access distribution in the **PIE Mutual Insurance Company** liquidation in the total amount of $101,131,094. As guaranty associations returned the requisite agreements, these payments were sent out in late July and early August.

Another update on the progress of **Fidelity Mutual Life Insurance Company (FML), In Rehabilitation**, was received from **Frank Martin (PA)**. Policyholder death benefits and annuity payments continue to be paid at 100%. Crediting rates are at or above policy guarantees. As of 6-30-00 **FML** showed a statutory surplus in excess of $152,000,000.

The Commonwealth Court authorized payment of all approved creditor claims if the creditors are willing to waive any interest or penalties which may be applicable. Most approved creditors have accepted that settlement and have been paid; however, a handful of the general creditors have chosen to wait and see what interest rate will be approved in the rehabilitation plan for payment at Closing. All of the guaranty associations settled for immediate payment of outstanding assessment claims. The assigned claims referee recommended denial of the claim of the Louisiana guaranty association for administrative expenses. No guaranty associations have ever been asked to fund any aspect of **FML** obligations; however, the Louisiana guaranty association had filed a claim for reimbursement of more than $30,000 in administrative expenses. They are also in the process of working out settlements with the taxing authorities that will allow them to retroactively credit the paid guaranty association assessments against any premium tax owed. This involves preparing and filing amended returns from 1993 forward for each state with an offset provision.

In response to a petition filed by the Rehabilitator, the Commonwealth Court established a Claims Bar Date of June 30, 2000. In contrast to the previous claim filing deadline in 1994, this process will forever bar any claims against **FML**, related subsidiaries, their officers and directors (during rehabilitation) and Pennsylvania Insurance Department employees. 85 claims were received and 10 of those were withdrawn soon after. The majority of the claims received were from policyholders. Notices of Determination have been mailed for all denied claims. Only 2 of the 85 claims were approved. A report of the results of the claim process was provided to the Commonwealth Court.

The Third Amended Plan and all related documents have been negotiated over the last two years with the court appointed Policyholders Committee. The plan proposes that **Fidelity Life Insurance Company (FLIC)**, a stock life insurance company, will assume and reinsure **FML's** obligations under all of its life insurance policies and other insurance contacts. No reduction will occur in cash value, death benefits, dividend accumulation or policy loan accounts. Substantially all of **FML's** assets will be transferred to **FLIC** to support these obligations. The plan proposes that creditors with approved claims will receive payment in full, in cash, with simple interest at 6% per year. Policyholders will receive both common and convertible preferred stock in the holding company for **FLIC, Fidelity Insurance Group (Group)**. An outside investor will be selected through court approved Bid Procedures to contribute additional capital to **FLIC** through the purchase of **Group** Stock. The investor will purchase a slight majority of the common stock and appoint the majority of the board of directors. Hearings on the Third Amended Rehabilitation Plan and the accompanying Stock Allocation Report concluded on September 21. The hearing process was unusual in that direct testimony and objections to that testimony were all submitted to the Court in writing. The hearings only consisted of cross-examination of the witnesses who had filed testimony. They now await a briefing schedule from the Court.

In June of 2000, the Rehabilitator filed an Amended Petition to Approve Policyholder Dividends and Declared Interest Crediting Rates which increased the previously proposed rates to approximately $70 million in dividends for policyholders (from $60 million) and approximately $15.5 million in interest credits both over a 12 month period following approval of the new dividend scale. Hopefully, court approval will be received sometime this fall.

RECEIVERS' ACHIEVEMENTS BY STATE

Illinois (Mike Rauwolf, State Contact Person)

Use and distributions made to policy/contract creditors and Early Access

Receivership Estates Closed	Year Action Commenced	Licensed	Category	Dividend Percentage
Heritage Ins. Co., In Liquidation	1985	Y	P & C	Class A - 68.57% - $3,074,948

Receivership	*Amount*
Amreco	$1,344,822.00
Centaur	$ 57,605.00
Coronet	$ 1,398.00
Illinois Ins. Co.	$ 75.00
Inland	$ 2,261.00
Intercontinental	$ 99.00
Pine Top	$ 70,361.00
Prestige	$ 60.00
State Security	$ 116.00
Total	**$1,476,797.00**

Maryland (James A. Gordon, State Contact Person)

Use and distributions made to policy/contract creditors and Early Access

Receivership	*Amount*	
Grangers Mutual Insurance Company	$ 45,366.40	(DC Guar. Assoc.)
Ins. Co. In Receivership	$ 35,641.63	(GA Ins. Pool)
Guaranty Funds	$ 246,115.93	(MD P&C Guar. Corp.)
	$ 60,210.56	(NC Guar. Assoc.)
	$ 52,607.54	(TN Guar. Assoc.)
	$ 19,391.22	(VA P&C Guar. Assoc.)
Total	**$ 459,333.28**	
Granger Mutual Ins. Co.	$ 12,630.45	(MD)
Policy/Contract Creditors	$ 2,481.06	(DC)
	$ 1,080.45	(GA)
	$ 179.00	(NC)
	$ 75.52	(TN)
Total	**$ 16,446.48**	

(Continued on Page 14)

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New York (F.G. Bliss, State Contact Person)
Use and distributions made to policy/contract creditors and Early Access

Receivership	***Amount***
Consolidated	$ 40.00
Cosmopolitan	$ 242,473.00
Dominion	$ 38,492.00
Horizon	$ 43,193.00
Ideal Mutual	$ 907,597.00
Long Island	$ 31,672.00
Whiting Nat'l	$ 2,600.00
Total	**$ 1,266,067.00**

Ohio (Douglas Hertlein, State Contact Person)
Use and distributions made to policy/contract creditors and Early Access

Receivership	***Amount***	
Ohio General Ins. Co.	$ 3,940,868.20	(EA to GF's)
Proprietors Ins. Co.	$14,725,112.34	(GC)
Total	**$18,665,980.54**	

Creditors' Committees in U.S. Insolvencies -

The Wave of the Future? (Only If Creditors Demand It!)

By Thomas W. McCarthy

Before I begin, I need to dispose of the mandatory disclaimers. While my law firm represents several insolvent estates, this article does not purport to represent the opinions of the liquidators of any of those estates, nor does it represent the opinions of my partners or my firm. It represents only the opinion of the author. Also, any references to departments of insurance do not mean any particular department or any particular regulator.[1]

There are many differences between the system used in the United Kingdom to wind up insolvent insurers and those used in the United States. One of the greatest differences, and the one dealt with herein, is the use of the creditors' committee. In the U.S. insolvent insurers have historically been administered and wound up by the same regulators who were charged with supervising their solvency, the state departments or divisions of insurance, supervised to a greater or lesser degree by the state courts. In the U.K., on the other hand, insolvent insurers are wound up by licensed professionals supervised, for the most part, by committees comprised of creditors of the insolvent company. There are substantive differences that result from these divergent approaches.

One of the most frequent complaints that is heard concerning insolvent estates in the U.S. is the failure to pay dividends quickly and regularly. In the U.K., dividend payments can be and usually are made early in the runoff. This is partially a function of the differences in the controlling statutes, but only partially.

The NAIC Model Act is a very flexible statute and in the hands of an innovative liquidator and an open-minded court could accommodate early distributions. Indeed, the statute specifically recognizes the needs of the state guaranty funds (hereinafter SGFs) to have access to early distributions, but there is no prohibition against others receiving early distributions, provided those distributions donot result in preferences to individual creditors. Innovations among U.S. liquidators in this area have been few. In the humble opinion of the author, a large part of the lack of innovation in the U.S. liquidations is due to a lack of incentive to innovate on the part of the liquidator. Under the current system, innovation brings few rewards if successful and potential criticism if unsuccessful. Creditors' committees could change all of that. Also, it is reasonable to expect that supervising courts would be heavily influenced by the desires of creditors since the assets in question do ultimately belong to them. As a result, those same courts might be more open to innovation.

Under the current system in the U.S., creditors have nothing to say about the way in which a company is liquidated. Those decisions are made entirely by a combination of the regulator - a special deputy assigned to wind up the estate, or alternatively, the judge - who supervises the liquidation. In the U.K., the creditors' committee participates actively in the design and implementation of the winding-up strategy, as well as in any changes made along the way. In fact, the U.S. creditors frequently have trouble getting pertinent information concerning the plan or progress of the winding up of a U.S. estate in a timely manner, if at all. The information that is made available is only made available as determined by the regulator, the special deputy and/or the supervising court. It may or may not be the information that the creditors believe that they need. In some instances, the regulators, no doubt with the best of motives, release information that the creditors would probably choose to keep confidential. For example, some states make commutation results public while others release all details of employment contracts. The former approach makes maximizing commutation results problematic, while the latter can have an extremely detrimental effect on employee retention.

Just like in designing the plan for winding-up, creditors' committees can be instrumental in determining the investment policy of the estate during the period of runoff. Due to the nature of insurance insolvency, the winding- up process may take many years. Thus, the creditors' committee may choose to invest a portion of the portfolio of the estate in equities. In the U.S., the investment strategy is dictated by statute, by the court, by the regulator and/or by the special deputy or a combination of the foregoing, but not by the creditors, who ironically have the most at risk and stand to lose the most from that decision. As a result, most U.S. estates end up using a very conservative investment policy. This is largely attributable to the responsible persons viewing themselves as trustees, who are unwilling to take any chances with the money entrusted to them. While it is very difficult to blame anyone who takes this view, it does not ensure that appropriate investment decisions are actually made when you consider that the opposite has also occurred in at least one estate where speculative investments cost the creditors millions of dollars. This begs the question: would this have occurred if the creditors had a voice in the decision making process?

The conventional wisdom among regulators in the U.S. responsible for runoffs is that the sooner the estate is wound up the better. This is, no doubt, based upon a desire to minimize administrative expenses and distribute money to the creditors as soon as possible. While these are laudable goals, the premise upon which it is based - insolvencies are all alike and should all be treated the same way - is obviously faulty. As such, just as each insolvency is unique, so is the composition of each creditor class.

For example, sometimes the maximization of reinsurance assets is dependent on the ability of the estate to wait out its debtors pending the maturation of long

(Continued on page 18)

Mealey's Insurance Insolvency Conference: HMO's in Crisis

By Debra J. Roberts

The central question running throughout this Mealey's conference dealing with HMO's in crisis could be summed up as follows: "When an HMO becomes financially impaired, what are the appropriate courses of action with respect to the less-than-crystal-clear issues surrounding regulation and enforcement of "winding-up" proceedings?" The bottom-line issue of whether or not an HMO meets the definition of an insurance company for the purposes of state regulation or whether its "hybrid" status throws it into the federal system for bankruptcy protection is complex and is only one of the many subjects covered in the day and a half meeting. The rocky road of an HMO in financial crisis was addressed in the conference via a series of mock meetings and court proceedings, which were all worthy of Academy Awards for outstanding performances from all involved. In addition, it was the perfect vehicle for clearly illustrating the twists and turns along the path of a financially-ailing HMO.

The subject of the conference case study was Healthy Masterplan Organization Corporation, "HMOC", a domestic health maintenance organization, set up as a for-profit "C" corporation located in Urbania county in the state of Urbania. After the opening panel that discussed the background and set the stage for some of the complex regulatory issues of the relatively young HMO industry, the first mock meeting began. This meeting was between the owner of the HMO (played by Jack Rohfritch of American Insurance Management) and the Deputy Insurance Commissioner (played by Robert Loiseau of Jack W. Webb & Associates). The owner evoked several "eye-rolling" groans from the audience with his promises to the regulator that everything was under control and there was nothing for the Insurance Department to be concerned about, in spite of reporting two consecutive quarters of substantial net losses. The HMO owner also illustrated the point that it is probably not a good idea for him to refer to the Insurance Department representative in the meeting as "Deputy Bob".

The substantive issues raised in the mock meeting (and yes, there were some) laid the foundation for the next two panels: "Formulating and Implementing a Turnaround Plan" and "Regulator Roundtable". It was obvious from the initial meeting between the owner and the Insurance Department that HMOC was facing some severe financial challenges relating to recent acquisitions, which had spawned major problems relating to systems integration, providers getting paid, inconsistent plan benefits and all of the headaches related to poor planning and inadequate capitalization. The regulator panel, moderated by David Leslie of Rackemann Sawyer & Brewster, consisted of the following "real-life" regulators: Nathaniel Shapo, Director, Illinois Department of Insurance; Neal Gooch, Utah Insurance Department; James Gerber, Michigan Insurance Division; and Jean LeMasurier, Health Care Financing Administration. The topics covered by this panel included the three phases of impairment and insolvency (administrative supervision, rehabilitation and liquidation) and how the regulators determine the appropriate response.

The luncheon keynote address was presented by Jack Reichman of Standard & Poor's. He gave a very informative discussion from the rating agencies' point of view of the criteria considered in assigning ratings to health plans. He pointed out that the consumers' rating of the service provided from a health plan may differ widely from the financial rating from a rating agency, i.e., those providing the best patient care may not necessarily be in the best shape financially.

After lunch, there was a breakout session in which the conference attendees were divided into small groups to discuss the implications of the corrective steps that were announced by the Deputy Insurance Commissioner to the owner of HMOC at their meeting earlier this morning. Each breakout group discussed the same list of topics and then each group reported their opinions to the entire audience via a designated secretary. This session was followed by a mock state court proceeding contesting the Administrative Supervision Order. The judge in this mock hearing was the Hon. William Cahill, a former San Francisco Superior Court Judge who has recently joined JAMS/Endispute in San Francisco. The owner's attorney was ably played by Robert Craig of Lamson, Dugan & Murray, and the Insurance Department attorney was Kevin Baldwin of the Illinois Office of the Special Deputy Receiver. Despite excellent "out-of-town" representation by Robert Craig, the judge ruled in favor of the Insurance Department to uphold the Order of Administrative Supervision.

The panel which followed discussed what happens next at the health plan under the Order of Supervision and the complicated issues faced by an HMO under such circumstances. The final session of the day, prior to the cocktail reception, was a mock meeting between a disgruntled lender to the parent company of HMOC and an attorney from the Urbania Insurance Department. The Insurance Department attorney was played by Helen Duncan of LeBoeuf Lamb Greene & MacRae, and her feisty opponent was played by Susan Stone of Sidley & Austin. This session introduced an interesting issue regarding a loan to the parent of HMOC for medical equipment that was used to provide medical care to HMOC's members. While the loan was not directly issued to HMOC, the earnings stream from HMOC was a vital source of funds to service the loan at the parent company level, and the equipment itself was collateral for the loan. The lender's attorney was threatening to foreclose on the loan and call the collateral if the Insurance Department didn't allow funds to flow from HMOC to the parent to service the loan obligations.

Seizing the collateral would obviously impair the ability of HMOC to deliver certain medical services to its members. The tone of the meeting turned adversarial fairly quickly, as each side was somewhat unyielding in its position.

Day two began with a lively mock federal court proceeding in which HMOC was seeking federal bankruptcy protection and the Urbania Insurance Department was contesting the action. The bankruptcy judge was played by Hon. Tina Brozman, former Chief Judge, U.S. Bankruptcy Court, Southern District of NY. Robert Craig continued his role as the owner's attorney and the attorney from the Insurance Department was played by Howard Seife of Chadbourne & Parke. This session addressed the basic question of "how do you determine whether or not an HMO meets the criteria for being an insurance company, and therefore subject to state insurance regulation?" The Hon. Brozman was very clear in her analysis, and concluded that HMOC did qualify as an insurance company and therefore was subject to state insurance regulation.

The next session was a mock state court proceeding in which (surprise!) HMOC was contesting the Order of Liquidation as issued by the Urbania Insurance Department. The creditor's attorney, played by Patrick Trostle of Bingham Dana, also joined the proceeding, requesting priority treatment for its claims. While in real life these would have been two separate hearings, they were combined here for expediency. The judge (Hon. Cahill) denied the motion for the creditor to intervene, and ruled that HMOC was subject to liquidation.

The balance of the morning consisted of another breakout session, same format as the day before, in which the groups discussed and reported on the top five items that require immediate attention following a Liquidation Order. The final panel of the day discussed the major issues to be handled post-Liquidation Order.

While the conference certainly had its moments of levity, the over-riding message was very clear: the issues facing the financially-stressed HMO industry today are serious and quite complicated. The conference was very well done by Mealey's, the two co-sponsors, James Rubin and James Stinson, and all of the participants.

Debra J. Roberts is the president of Debra Roberts & Associates in Carlsbad, CA and a member of IAIR.

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CREDITORS' COMMITTEES IN U.S. INSOLVENCIES

(Continued from page 15)

tail claims. This approach requires more administrative expense, but is a decision that should lay with the creditors, because they will either suffer the consequences or reap the benefits.

If the creditors were in a position to participate meaningfully in the determination and timing of dividend distributions, there would be no need for early winding-up in order to get money into their hands quickly. There would also be no need for spending millions of dollars on estimation plans against the bitter resistance of reinsurers. In the context of liquidation in the U.S. today, the current claims estimation litigation is based on the honest desire of the regulators administering runoffs to get money into the hands of creditors as soon as possible. But this approach, while innovative and well intended, is potentially very expensive and the outcome is far from certain. If creditors' committees were in wide use in the U.S., this might well be unnecessary.

Another sensitive area is the retention and motivation of employees involved in a winding up. The one thing which a U.S. style liquidation can be assured an abundance of is criticism. Regulators, special deputies and courts now charged with the responsibility for winding up estates in the U.S. typically trend towards conservative practices in order to avoid criticism. However, in situations where they do innovate, as in the case of estimation, they become criticized for spending too much money. If the insolvency is of sufficient size as to need its own staff, the problem of finding and keeping competent people for a sufficiently long period of time to accomplish the task is very difficult and expensive. If the estate is to be wound up by a state liquidation bureau, motivating the people involved in making the extra effort that is frequently needed to maximize assets presents a challenge. However, if a creditors committees were in charge, the use of estimation could hardly be criticized, because the money at risk is that of the creditors. Similarly, the same would be true of personnel retention policies, whatever they might be, or the choice to use a state liquidation bureau. If the option were left to the creditors, there should be no complaints as the consequences of the decision fall only on the decision-makers chosen by the creditors.

Creditors' committees operating in the U.K. have an obligation to pass information along only to the creditors of the estate. Inquiring debtors, reporters or others can be dealt with on a one-off basis, because the runoff is clearly a private affair utilizing only private funds. While the use of only private funds is usually the case in the U.S., the involvement of state agencies in the winding-up tends to muddy the water as to what is public and what is private.

Under the current system in the U.S. creditors have nothing to say about the way in which a company is liquidated.

Since some states allow insurers contributing to the state guaranty fund a deduction or credit against premium taxes for that contribution, an argument is frequently made that taxpayer money is inevitably involved in the winding-up.

While this argument is surely specious, since it would also open up every company which took a job training credit or other similar credits to the dictates of the state and the inquiries of the press, it is also unnecessary. To give or withhold tax credits for contributions to a guaranty fund is a legislative decision that has nothing to do with winding-up an estate. In short, it doesn't matter to the creditors of the insolvent estate whether or not the deduction or credit is given or withheld. If state agencies were not involved, this question would not even occur. Where creditors' committees supervise the winding up, it is clearly a private affair. The control of information is clearly and correctly in the hands of those who would be affected by its release.

Due to the international nature of some of the larger insurance insolvencies in the U.S., the U.K. and Bermuda, many U.S. companies and law firms have been exposed to the use of creditors' committees and the effectiveness of those committees. As a result, U.S. creditors and their representatives are becoming more sophisticated in these matters. Anderson, Kill's Mark Keenan; Covington, Burling's Marialuisa Gallozzi; and Dickstein, Shapiro's Scott Gilbert and Betty Orr are, to name a few, law firms and their respective attorneys who are actively involved in representing creditors' groups on committees. In the U.K., clear limits have been set on the liability of those serving on creditors committees. The NAIC Model Act can accommodate reasonable protection for creditors' committee members as the Missouri version of that law clearly demonstrates. Creditors' committee members can enjoy judicial immunity, as long as they serve as officers of the court under the direction of the supervising judge. This may not be a perfect solution, but it is workable. In fact, the Transit Casualty estate, which has had an ad hoc committee of the state guaranty funds since its inception, has recently adopted a broad and representative receiver on the winding-up. The decision to establish this committee was reached by the special deputy receiver and the supervising court working together. With exception of the Mutual Fire estate in Pennsylvania, this is the only example of the use of creditors' committees in U.S. of which I am aware. The prospect of a creditor's committee has been warmly received by the Transit creditors.

The desirability of creditors' committees is manifest. After all, it is the creditors who paid good money for bad insurance. They are the only ones who are hurt by the insolvency. If a state wants to protect its taxpayers from the impact of tax credits for solvent insurers' contributions to state guaranty funds, then its legislature can repeal those credits. This is a collateral issue and should not detract from the clear view of the creditors (and through them the people which the insurance was procured to protect) as the only victims of an insurance company failure. The failed company should effectively become the property of the creditors for the purpose

of winding up and maximizing assets. In an insolvency the regulators, the shareholders and the management of the failed insurer have all had their chance and despite their best efforts, the company has been unable to deliver on its promise to pay claims. In these circumstances, the decisions of the creditors should dictate how the resulting mess is best cleaned up.

In my numerous discussions with creditors' counsel and creditors, there has been expressed a clear desire to expand the use of creditors' committees in U.S. insolvencies and to cloak those committees with true supervising authority. While the use of a creditors' committee, such as the committee in the Transit estate, is currently possible under the NAIC Model Act, statutory changes will be needed to give those committees both the authority to supervise the winding up of an estate and a reasonable amount of protection from liability while doing so. The statutory changes needed are not complicated, but they are a sea change for U.S. liquidations. As a result, it is my strong belief that any move to the use of creditors committees in U.S. insolvencies must be championed by creditors' groups. They will have to make their case first to the NAIC and then to the legislature of the states.

A reasonable person, especially one who has been involved in U.S. insolvencies, might ask who would oppose a move to the use of creditors' committees in the U.S.

Initial opposition will come from some regulators. Indeed in the past I have heard a few regulators refer to the greedy creditors and to declaim that you can't trust the creditors. This is a baffling mindset and is grounded, I believe in a view that the regulatory duty is to protect the public even from itself. It is also based on a misapprehension of the state's role in liquidations as mainly historic, as opposed to being grounded in any well thought out public policy considerations. Fortunately, there is no reason to believe that this view is widespread among regulators.There may also be concern among some regulators that the loss of control of liquidations to the creditors will adversely affect their regulatory performance.

I recall a very frank discussion with the head of an insurance department (not a department for which my firm has ever worked). The regulator told me that he worried about pursuing reinsurance recoveries too aggressively for fear of bankrupting reinsurance companies which were also under his regulatory control. While as a representative of liquidators and, therefore creditors, I completely differ with this regulator's approach, I do understand it. In effect, our statutory scheme which requires regulators to also be responsible for liquidations causes the regulator to attempt to carry water on both shoulders.

Requiring a regulator to aggressively pursue the collection of all reinsurance assets while preserving the solvency of all reinsurers under the regulator's supervision is a built-in statutory conflict and should be resolved statutorily.

Finally, there will be the inevitable fear of job loss by some of those in regulatory liquidation departments. It is not much consolation to this group to say that times change and that this is in the best interest of the creditors, so keep a stiff upper lip, etc.

But I believe that it is valid to point out that there will always be some companies that are too small or too broke to support a private runoff. In those cases the creditors should be allowed to choose to have the state run off the company. Also, there will always be room in the private sector for the many competent people who now toil for the various states in liquidating companies and the rewards in the private sector should be greater.

Further opposition can be expected from some reinsurers who perceive that they have an easier time with state run insolvencies. This perception is due either to the emphasis on early closure at all costs, thus rewarding stubborn refusal to pay; or the potential for regulatory conflict which could cause a liquidator to pull his or her punches. Not all reinsurers, however, will be opposed.

It has been suggested to me that state guaranty funds might be opposed to creditors' committees, but this flies in the face of my own experience. State guaranty fund representatives with which I have dealt have been very helpful and experienced. The formalization of the creditors' committee should include guaranty funds statutorily so long as they remain creditors. They are a real asset to a liquidator and I would expect them to be welcome on any creditors' committee.

Still none of this opposition can be overcome by anyone other than the creditors of these insolvencies insisting on their rights as creditors to make their own decisions and demanding the statutory tools with which to accomplish the task. Representatives of injured third parties should not be hesitant to speak up. After all, it is their clients for whose benefit the insurance was purchased and maximization of assets is in the interest of that same group.

This is, however, something very new for this country and, like any other new idea, will encounter resistance. If creditors of insolvent insurance companies want to take control of their own destiny in the U.S., they will have to say so, firmly and repeatedly.

Thomas W. McCarthy is the senior partner in the law firm of McCarthy, Leonard, Kaemmerer, Owen, Lamkin and McGovern L.C. The firm serves as general counsel to the Transit Casualty receivership and as claims counsel to the Southern American liquidation, as well as having represented several foreign insolvencies and liquidators in various states. Mr. McCarthy serves as advisor or alternate for the creditors' committees of the KWELM estate in the United Kingdom and the Bermuda Fire & Marine Insurance Company estate in Bermuda.

[1] In particular, references to regulators are not references to regulators in either the Missouri or Utah Departments of Insurance.

DRAWING DOWN LETTERS OF CREDIT IN AN INSURER RECEIVERSHIP CONTEXT

By Robert M. Hall

Introduction

Statistics compiled by the Reinsurance Association of American demonstrate that over 40% of the reinsurance ceded by U.S. domiciled insurers to non-affiliates goes to non-U.S. reinsurers. Under U.S. credit for reinsurance laws, a ceding company cannot take credit for reinsurance ceded to an unlicensed or unaccredited reinsurer unless the reinsurer posts security, which often takes the form of a letter of credit. The letter of credit is designed to provide the cedent with a remedy if the reinsurer, due to insolvency or other reason, fails to pay its obligations when due. Nonetheless, there is a lack of clarity in case law, reinsurance contracts and business practice as to the precise rights of the parties with respect to letters of credit, particularly in the receivership context. The purpose of this article is to explore the regulatory, receivership and business issues involved in letter of credit drawn down when one of the parties to the reinsurance contract is in receivership.

U.S. Credit for Reinsurance Clauses

In order to determine the circumstances under which a cedent may take credit on its financial statements for reinsurance recoverables, every state has enacted credit for reinsurance laws. The purpose of these laws is to allow financial statement credit only if there are reasonable assurances that the reinsurer will pay losses when due. In general, credit is granted if the reinsurer is licensed or accredited in the cedent's state of domicile or if the reinsurer posts security in the form of assets in trust or a letter of credit, in an amount equal to the credit taken.

Letters of credit usually must be "clean", irrevocable and "evergreen" and be issued or confirmed by a financial institution meeting the standards stated in relevant state laws and regulations. A letter of credit must be "clean" in the sense that there can be no conditions on the ability of the cedent to draw it down. For instance, the cedent cannot be required to prevail over the reinsurer in an arbitration before drawing down on the letter of credit.

The letter of credit must be irrevocable in the sense that it cannot be terminated before its stated expiration date. Finally, the letter of credit must be "evergreen" meaning that it must continue unless the financial institution which issued or confirmed the letter of credit gives advance notice that it will not be renewed when its term expires. In essence, credit for reinsurance laws require that the letter of credit be the functional equivalent of cash.

The purpose of requiring a clean, irrevocable and evergreen letter of credit is to put funds in the hands of the cedent while a dispute between the parties to the reinsurance contract is being resolved. The purpose is not to resolve the merits of such a dispute through the liquidity of the security device.

Credit for reinsurance laws sometimes address the use that can be made of the funds that are realized by a draw on a letter of credit. For instance, Illinois and New York stipulate that the reinsurance contract provide that such funds may be used to reimburse the cedent for return premium, paid losses and other amounts which the cedent claims to be due under the reinsurance contract or to fund an account under control of the cedent which may include sums equivalent to unearned premium and loss reserves, including IBNR. Other states make such contractual provisions optional or have no equivalent requirements. Some states allow contractual provisions which require the cedent to pay interest on funds drawn down or to return funds in excess of those needed to pay the debts for which the letter or credit can be drawn upon. The considerable variation in state credit for reinsurance laws detract from their ability to resolve disputes over letters of credit.

Funding Clauses in U.S. Reinsurance Contracts

The considerable variation in state credit for reinsurance laws is exceeded only by the variation in the funding clauses by which letters of credit are required for reinsurers which are unlicensed or unaccredited in the necessary states. Some clauses match the more recent variations in state law concerning use of funds drawn down, payment of interest and refunding excess drawdowns. However, the clauses receiving scrutiny in current disputes often were drafted many years ago, before specificity in use of funds was required. Such clauses may provide little if any guidance on the circumstances under which the letter or credit can be drawn upon and the use of the funds that result.

Business Issues in a Receivership Context

Rightly or wrongly, reinsurance contracts usually are negotiated with the assumption that the parties thereto will remain solvent. When this proves to be untrue, the solvent party faces issues that may not be addressed in the reinsurance contract and for which it may be ill prepared to deal. Often, the solvent party may find itself in a race to secure its position in respect to creditors represented by the receiver.

When the Reinsurer is Insolvent

When a reinsurer is in or approaching receivership, the cedent faces difficult decisions. By definition, an insolvent reinsurer cannot pay all of its obligations. If the reinsurer is domiciled in the United States, the cedent is a general creditor of the estate and may receive nothing after obligations are paid to higher priority creditors.

It is the practice of some receivers of reinsurers to continue, but not increase,

letters of credit. It may be difficult, however, for the cedent to obtain sufficient assurances in this regard. A bank may be reluctant to renew a letter of credit and the assets supporting the letter of credit may become a target for other creditors or may be used to pay higher priority creditors. If the letter of credit is not renewed or is not increased to meet reserve development, the liabilities unsecured will be a direct reduction to the cedent's surplus. Under these circumstances, there is an incentive for the cedent to draw down the letter of credit and use the proceeds, and interest thereon, to pay its own losses. Given the liquid nature of the letter of credit, a cedent has the power to draw down the letter regardless of its contractual right to do so.

Recognizing the vulnerability of the estate to precipitous drawdowns of letters of credit, it is possible that the receiver would include in the liquidation order a limitation or prohibition on letter of credit draw downs. It is possible that such a limitation or prohibition would render the letter of credit "unclean" in that there is an impediment to draw down. This would cause the cedent to be unable to reduce its liabilities by the amount of the letter of credit.

When the Cedent is Insolvent

If the cedent becomes insolvent, a reinsurer which has posted a letter of credit faces a less difficult issue namely, whether to maintain and increase, as may be necessary, the letter of credit. A reinsurer typically pays a fee for the issuance of a letter of credit and assets are sometimes encumbered to secure the reinsurer's obligation to reimburse the issuing bank for any draws on the letter of credit.

Declining to renew a letter of credit securing obligations to an insolvent cedent is sometimes justified by funding clauses in the reinsurance agreement which link the obligation to provide the letter of credit with statutory accounting requirements for solvency. If the cedent is insolvent, the theory goes, a letter of credit is superfluous since financial statement credit is of little value at that point. However, this theory requires a reading of credit for reinsurance laws as requiring security merely for accounting purposes but not to provide assurance that reinsurance payables will be forthcoming when due.

A notice of non-renewal of a letter of credit issued on behalf of a reinsurer to a company in receivership encourages retaliatory action. The receiver may draw down the entire amount of the letter of credit when the receiver receives notice of non-renewal. In addition, the receiver may seek language in the liquidation order prohibiting reinsurers from non-renewing letters of credit when balances or reserves remain outstanding.

Legal Issues

The posting and drawing down of letters of credit raise a number of legal issues in the receivership process.

Solvent Reinsurer's Letter of Credit

When the cedent is insolvent and the reinsurer declines to increase or renew a letter of credit, the cedent may seek a remedy for breach of contract in the liquidation court or through an arbitration. Practically, however, it may be uneconomical to bring such an action until the reinsurer has actually defaulted on its obligations to pay claims. In addition, the reinsurer may dispute the receiver's calculation of the reserves to be secured on the basis that there must be a creditable foundation for these reserves. Since this may lead to extensive inquiry into the receiver's claim handling and reserving practices, the receiver might wish to bring an action against such a reinsurer only once he or she has developed sufficient familiarity with the loss portfolio and its development.

Solvent Cedent Drawing Down Letter of Credit

When the reinsurer is in receivership, the rights of the parties are fact intensive in terms of the reinsurance contract. Some older funding clauses merely require security but do not structure how it might be drawn upon or held. Reinsurance is a contract of indemnity meaning that the reinsurer has no liability until the cedent pays a claim or it is allowed in a receivership proceeding. Assuming that the reinsurance contract calls for indemnity for paid claims, it can be argued that under such an older funding clause the cedent has the right merely to draw down on the amount in default and cannot draw down the entire letter of credit to fund outstanding reserves, including IBNR.

Some of the more modern credit for reinsurance laws require reinsurance contracts to contain language which permits the cedent to draw on the letter of credit to create a fund equal to unearned premium, claims, reserves and IBNR which, in the normal course of events, would equal the entire letter of credit. However, this language may not be reflected in reinsurance contracts because they preceded enactment of the law or for some other reason. It might be argued that the language of the more modern laws should be read into reinsurance contracts, however, the philosophy of credit for reinsurance laws is that the parties may comply with such laws and receive credit or not comply and forgo credit, as they see fit. Even if the language of such statutes were read into reinsurance contracts, it is not clear how they would apply to upward development of losses that might be paid by interest on the funds produced by a letter of credit draw down.

The more modern funding clauses contain language that matches the requirements of the more modern credit for reinsurance law; however, there remains uncertainty in how certain facts situations should be addressed. For instance, funding clause 55 A appearing in the Contract Wording Reference Book of the Broker and Reinsurer Marketing Association allows the cedent to draw on the letter of credit to fund an account for the "reinsurer's obligations" and that interest on such account "shall accrue to the reinsurer." It is not clear whether the interest that accrues is paid to the reinsurer or is retained to meet the reinsurer's obligation to pay development on the cedent's losses.

Setoff

If contractual authority is questionable, setoff is an argument which might be used to support a letter of credit draw down in excess of paid or allowed claims by: (a) a solvent cedent who doubts the ability or will of a receiver of a reinsurer to

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DRAWING DOWN LETTERS OF CREDIT

(Continued from page 21)

maintain or increase the letter of credit; or (b) an insolvent cedent that similarly doubts the ability or will of the reinsurer to maintain security or that wishes to maximize the investment income of the estate. It can be argued that the cedent should be able to set off the funds drawn down and/or interest thereon against future claim development.

For setoff to apply, the debts between the reinsurer and the cedent must be mutual in terms of capacity and time. Mutuality of time requires that the debts to be set off be both pre-receivership or post-receivership and prevailing case law holds that subsequent reporting and development of losses under reinsurance contracts in effect prior to the receivership order are pre-liquidation debts. Thus, to achieve the required mutuality of time, the right to draw down and set off funds and/or interest must arise out of a pre-receivership reinsurance contract.

To meet the mutuality of capacity requirement, the parties must be acting in the same capacity i.e., contracting principles. For instance, salvage recoveries in the hands of a cedent are held in a fiduciary capacity for the reinsurer and may not be set off against funds due from the reinsurer as a contracting principle. More to the point, a cedent who wrongfully draws down a letter of credit becomes a constructive trustee and may not use such funds to set off reinsurance recoverables since the proceeds are not rightfully in the cedent's possession.

In this particular situation it appears that the tests for mutuality of time and capacity are functionally the same i.e., whether the right to draw down and set off the proceeds and/or interest are embodied in the reinsurance contract. If the cedent merely used the liquid nature of the letter of credit to obtain control of the funds without a contractual basis, there would be no mutuality of capacity or time. As a result, setoff appears to be a false issue since it reflects merely the outcome of the underlying contractual issue.

Preferences

A solvent cedent may realize a substantial benefit, in relation to other creditors, if it draws down the entire proceeds of a letter of credit issued on behalf of a company in receivership when a smaller amount is due or when the cedent retains interest on the funds drawn down. It appears, however, that such a draw down cannot be avoided as a statutory preference since this requires a transfer of property prior to the receivership. However, it can be argued that the pre-receivership issuance of a letter of credit to a cedent or providing collateral to a bank to support a letter of credit is a voidable preference if the receiver can show a lack of contemporaneous consideration or knowledge that the reinsurer was insolvent at the time the letter of credit was issued.

In addition, the draw down of a letter of credit may run afoul of other prohibitions against preferences, such as liquidation orders or post liquidation orders. Liquidation orders are designed to preserve assets for a proper distribution to creditors and commonly prohibit preferences to certain creditors over others. For instance, the liquidation order for Crown Casualty Company, an Illinois domestic, provides in part: "That all persons, companies and entities are hereby restrained and enjoined . . . from asserting or enforcing preferences . . . against the defendant, Crown or its property and assets . . .." More specifically, the order provides: "That the rights and liabilities of Crown, and its policyholders, creditors, and stockholders, and of all other persons interested in Crown's property of assets are hereby fixed as of the date of the entry of this Order of Liquidation . . .." This language could be interpreted to prohibit a cedent from retaining the excess portion of a draw down or interest thereon. A liquidator may also seek a post liquidation order more specifically focused on letter of credit drawdowns.

In addition, priority of distribution provisions in liquidation codes provide for payment of estate assets in accordance with a hierarchy of creditors. All claims in one class must be paid before claims can be paid to the next class. Ceding insurers, usually, are general creditors, which receive assets after expenses and policyholder, and guaranty fund claims are paid. As a result, retention of an excess draw down on a letter of credit, or interest thereon, can be viewed as a violation of the priority of distribution of estate assets.

Conclusion

A letter of credit issued on behalf of unlicensed reinsurers is a convenient means of securing reinsurance recoverables and obtaining financial statement credit for the reinsurance provided. When a receivership occurs, solvent or insolvent cedents have unfortunate but understandable motivations to draw down the entire letter of credit as a hedge against future development of losses and possible non-renewal of the letter of credit. A solvent reinsurer must resort to its rights under the contract when such a draw down occurs, however, an insolvent reinsurer may have an additional tool to prevent or limit drawdowns pursuant to court order.

The more modern credit for reinsurance laws and regulations, and their contractual counterparts, provide additional structure to the use of funds drawn down. However, additional issues remain that have not been resolved, such as interest on funds drawn down in excess of paid losses. It appears that such issues must be resolved in the receivership context through interpretation of contractual intent and the preferential impact on certain creditors over others.

Robert M. Hall is of counsel in the Washington D.C. office of Piper Marbury Rudnick & Wolfe. He is a former insurance and reinsurance executive and acts as an insurance consultant as well as an arbitrator and mediator of insurance and reinsurance disputes. The views expressed in this article are those of the author and do not represent the views of Piper Marbury Rudnick & Wolfe or its clients.
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THIRD CIRCUIT RULES IN FAVOR OF ARBITRATION OF RECEIVER'S CLAIMS

By Lewis E. Hassett and Jessica F. Pardi

Federal circuits are split as to whether state insurance insolvency laws preempt the Federal Arbitration Act (the "FAA") pursuant to the McCarran-Ferguson Act. After analyzing the receivership laws of Oklahoma and Utah, the Fifth and Tenth Circuits respectively, declined to enforce arbitration clauses in reinsurance agreements over a receiver's objection. Until recently, only the Ninth Circuit expressly had ordered arbitration over a receiver's objection. Now, the Third Circuit has evened the score, holding that a receiver may be compelled to arbitrate.

In 1998, the Fifth Circuit held that the provisions of the Oklahoma Uniform Insurers Liquidation Act ("OUILA") preempt the FAA and vest exclusive original jurisdiction of delinquency proceedings in the Oklahoma receivership court. Munich American Reins. Co. v. Crawford, 141 F.3d 585 (5th Cir. 1998). Thus, the receivership court was authorized to enjoin any action interfering with delinquency proceedings, including arbitrations, as such actions would impair OUILA by allowing an action to be resolved in a forum other than the receivership court. Id. at 594. The Fifth Circuit noted that the parties were free to petition the receivership court for an order compelling arbitration of their dispute. Id. at 595.

The Tenth Circuit also has refused to compel the arbitration of a claim brought against the estate of an insolvent insurer. See Davister Corp. v. United Republic Life Ins. Co., 152 F.3d 1277 (10th Cir. 1998). The Tenth Circuit held that arbitration impairs the enforcement of the state process designed to protect the interest of the policyholders. Id. at 1281. Like the Fifth Circuit, the Tenth Circuit held open the right of the parties to petition the receivership court for arbitration. Id.

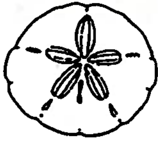
The Tenth Circuit also has refused to compel the arbitration of a claim brought against the estate of an arbitration insurer.

Previously, the Ninth Circuit upheld arbitration in the context of a receiver's claims brought against the debtor of the insolvent insurer. See Quackenbush v. Allstate Ins. Co., 121 F.3d 1372 (9th Cir. 1997) (claim of liquidator against Allstate to recover monies owed by Allstate to the liquidation estate found to be arbitrable). In finding in favor of arbitration, the court distinguished the enforcement of contractual rights, such as those created by a reinsurance agreement from statutory rights which the court indicated would not be arbitrable. The court further distinguished a receiver's claims against a debtor, which were held to be arbitrable, from a creditor's claims against the estate, which were held not arbitrable. Id. at 1380. This distinction is supported by district court cases directing arbitration of receivers' claims. See Costle v. Fremont Indemnity Co., 839 F. Supp. 265 (D.Vt. 1993); Koken v. Cologne Reins. Ltd., 34 F.Supp.2d 240 (M.D.Penn. 1999); Nichols v. Vesta Fire Ins. Corp., 56 F.Supp.2d 778 (E.D.Ky. 1999); and Bernstein v. Centaur Ins. Co., 606 F.Supp. 98 (S.D.N.Y. 1984).

In August of this year, the Third Circuit ruled in accordance with the Ninth Circuit and distinguished Munich American in two respects. See Suter v. Munich Reins. Co., 223 F.3d 150 (3rd Cir. 2000) (liquidator's action against reinsurer held to be arbitrable). First, Munich American involved a claim brought by a reinsurer against the estate, whereas Suter involved a claim brought by the receiver. Second, the court held that, because OUILA specifically vests the receivership court with exclusive jurisdiction of all delinquency proceedings, Munich American does not govern the arbitrability of disputes where the insolvency is not being administered in Oklahoma.

Lewis E. Hassett is a partner with the Atlanta, Washington, D.C. and Charlotte law firm of Morris, Manning & Martin, L.L.P. His practice includes the representation of receivers, reinsurers and assuming insurers in insurer rehabilitation and insolvency proceedings. Mr. Hassett also represents insurers and reinsurers in matters involving product torts, business torts, RICO claims and reinsurance disputes. Mr. Hassett received his Juris Doctor in 1979 from the University of Virginia School of Law.

Jessica F. Pardi is an associate in Morris, Manning & Martin, L.L.P.'s insurance department. Her practice includes various insolvency, insurance and regulatory matters. Ms. Pardi is a graduate of the University of Virginia School of Law (1996) and Boston University (1992).



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Secretary & General Counsel

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Senior Vice President

William T. "Bill" Long
Senior Vice President