The INSURANCE RECEIVER

Promoting professionalism and ethics in the administration of insurance receiverships.

Volume 7, Number 3 **FALL 1998**

President's Message

By Douglas Hartz, Missouri Department of Insurance

A few matters regarding change are covered in this column, which is a few weeks late. There are at least two reasons for my tardiness. First, there have been changes in certain receiverships here in Missouri. Second, on October 1, 1998 my Director, Jay Angoff announced his resignation to return to pursuing his piano-playing career. That may change. I will miss working for Jay, he asked hard questions about what we do in insurer receiverships and why we do it. These changes cost me time. If change did not take up so much of the precious little time we have here, then it would be no trouble.

However, it was noted long ago, "We shrink from change; yet is there anything that can come into being without it?"[1] For an example of a good change, the Membership Committee has come up with a new program that appears sure to produce an increase in IAIR membership. This is detailed in the flier accompanying this issue of the Insurance Receiver. This is an important change and I hope that all of our current members will take advantage of the opportunity.

Onto another change, I left off in my last message the phrase "or don't believe in" from the end of the sentence about ethics being between a person and whatever god they believe in. Reading it as a critique of legislating morals was only one meaning. Yes, in many cases asking legislators, many of whom are politicians, to legislate on morality is a lot like asking professional wrestlers to give acting lessons. Another reading is that one may have ethics without belief, which I doubt. This is one of those "what happened before time began?" type puzzles[2] that people deserve to have to think about every now and then.

Not everyone appreciated our change replacing the IAIR Roundtable with CLE courses and the Issues Breakfast at the last NAIC Meeting. See Mary Veed's Meetings Recap herein. The Issues Breakfast was interesting thanks to its sponsors and the panel of experts, including Vincent Laurenzano, CFE. If I understood what I heard from the panelists Jonathan Rosen and Richard O'Rourke, CPCU and read in Nigel Montgomery's article in the Summer 1998 issue of The Insurance Receiver, there exist something called consensual ...(get your mind out of the gutter) claims estimation. I'm not terribly fond of the term because it sort of implies other things non-consensual, which are called by the shorter term, starts with "r" and ends with ape, which is not in any way the concept in claims estimation. On the other hand, if consensual claims estimation gets known claimants paid as much as possible as soon as possible, then don't we have to be all for it?

For those of you who could not make it to the Sunday morning breakfast, I did continue on the topic of professionalism noting that the problem with the goal of increasing this is in how to measure any progress. How do you spell progress? How about "I-G-O-T-P-A-I-D"? Note that this I-got-paid indicator is not measured from the point of view of the Special Deputy Receiver ("SDR") and others who are paid for working on receiverships. As SDR's and others administrating liquidations, our rights and liabilities are not fixed by a liquidation order or modified by a rehabilitation order. Under our state statutes we are not, really, the interested parties. We are not the beneficiaries. No, the I-got-paid ("IGP") indicator of progress is measured from the point of view of the priority claimants. Usually this means claimants in classes 2 through 8, which means not the ownership claimants. Yes, the state guaranty funds ("SGFs") are priority claimants. The IGP ratio is simply the total administrative expenses over the total distributions to the priority claimants or beneficiaries. The measure is whether the statutorily intended beneficiaries are getting paid as much as possible as soon as possible.

This IGP measure is useful. We probably would not have 30, 20 or even 10-year long liquidations if we, as SDR's and others administrating liquidations, could not be paid until after completion of the job. Face it, monthly billings and, more important, monthly payments create a built in bias to drag out the job. Professionalism and duty to the commissioners and directors that hire us to handle insurer receiverships require us to work against that bias.

We can tell if IAIR is increasing professionalism by tracking this IGP ratio in all

(Continued on Page 10)

The Insurance Receiver
Volume 7, Number 3
Fall 1998

In this Issue

Features

Page 6-10:
U. S. Implications for U.K. Solvent Schemes of Arrangement, and More (Can This Work with a U.S. Insurer?)

Page 17:
Guaranty Fund Matters

Page18-20:
Super-Priority Update

Page 21-23:
A New Way to Fill the Hole Identifying Unidentified Reinsurance Recoverables

Page 24
Attorney Lien Update

Departments

Pages 3 - 4:
New York Meetings Recap

Page 4:
IAIR Roundtable Schedule

Pages 5:
Other News & Notes

Pages 12 -13:
Meet Your Colleagues

Pages 14 -16:
Receivers' Achievement Report

WANTED

IAIR is seeking an administrator to perform duties for the group. Increasing membership and other revenue sources are a high priority. Duties include, maintenance of central office, membership recruitment and dues maintenance, meeting coordination, production of publications, performing all financial and reporting services. If you are aware of someone who is interested in serving as IAIR's administrator, please have them send a resume to: jgordon@md1st.com

New York Meetings Recap

By Mary Cannon Veed

I came home from New York with a fine plan for this recap; it was supposed to be a parody of the Starr report, hurling innuendo at the mostly inoffensive denizens of the Fall Meeting. But that was before the videotapes, and the audiotapes, and the discovery that my 8th grader was studying the impeachment process, and the grounds for impeachment, in his otherwise very staid parochial school civics class. I thought better of it. It's not funny anymore.

Many of us live and work in an environment where we depend on at least tacit public acceptance of who we are and what we do. If the day comes when being the subject of a salacious rumor (even a truthful one) is a disqualification; I don't want the job. If the day comes (and maybe it already has) when any public official can be subjected to the invasive scrutiny of a Starr chamber as a condition to remaining in office, we will have to make do with officeholders whose reputations are so bad they couldn't possibly get any worse. If we tolerate this treatment from our opponents, who will defend us when the tables turn?

So, die-hard Republican that I am, I have repented. I will abstain from Lewinsky jokes, and scowl at others who make them. Unfortunately, since no other themes occurred to me, this recap will be sort of bland, not to say self-righteous.

Well, so what happened? They had a Handbook meeting, about which 'nuff said. The UDS group treated receivership accounting standards like the weather, in spite of their charge: they talked about them but didn't do anything. A technical task force is threatened. Remember the trouble Guaranty Fund Issues had trying to draft on the fly to define and exclude charitable gift annuities? Left some peace and quiet, they got the right words, but no sooner slew that dragon than somebody raised "equity indexed annuities". The perennial inability of the solvent industry to distinguish between what a receiver does and what a GA does popped up, with the suggestion that a liquidator might need some extra authority to "restructure" these contracts to eliminate their non-standard characteristics and make them more assumable. Actually it's the GA's job, ordinarily, to do that, and in most cases they have all the precedent and authority they need. (So would a rehabilitator, under the umbrella of Pacific Mutual, but it seems unlikely to be used if there are GA's around.) However the endless ingenuity of the industry has invented some contracts that have no agreed value except at the beginning and the end, and that has a few people wandering in circles. Does that mean the GA only pays death benefits, since there isn't any cash value? Or does common sense prevail and they use a sensible estimate?

Interesting point, for which I thank Dick Darling: a variable annuity contract converts itself more or less automatically to a fixed one by virtue of the Moody's "haircut". But that doesn't quite answer the problem of the "point-to-point" annuity. Considering the quantity of money pouring into these vehicles lately, and the panic going on in the stock market that could easily bring some minimum guarantees into play while simultaneously upsetting everybody's "hedge" strategies, there may be a few surprises ahead.

The IAIR meetings were notable chiefly for not happening. Somebody got the bright idea that, since there were going to be very interesting CLE sessions on confidentiality and the Internet on Saturday, we should forego the Roundtable. Bad idea. I understand the CLE sessions were good, but there's more to an IAIR meeting than the simple acquisition of information. RSI and Stroock and Stroock and Lavan filled the gap somewhat with their "issues breakfast." I admit to a qualm about the sales pitch in a sponsored event, but it was mitigated by some good food and some really intriguing ideas from the speakers. I'd like to see other firms try to one-up them.

Now I get to harp on my favorite subject again, that being the Interstate Compact, probably for the last time. It is a fact that the most interesting thing that happened in New York was the (re) adoption by the Compact Commission of the proposed Uniform Receivership Law, and probably more interesting, its rapturous reception. When was the last time you saw the trades, the guaranty organizations, legislators and regulators all praising the same thing at once? NCOIL, which has some bragging rights on the subject, has announced hearings on the law to be held in San Diego on November 19th, with a view to suggesting that the Compact states adopt the Law, and that non-Compact states join.

It makes an interesting commentary on what works in the interstate regulatory arena, and what doesn't. A few years back, in the backwash from the Dingle Commission and those pesky network television cameras, the organization became obsessed with secrecy, and diligently avoided any public appearance of discord – or even intelligent thought – at NAIC meetings. Executive sessions became commonplace, the role of industry was curtailed to avoid the appearance of too much coziness, major policy decisions took place in unexpected venues to prevent the development of visible opposition – and the standing of the NAIC as a forum for harebrained legislative schemes proliferated, and showboating politicians, some of them insurance commissioners, hogged the spotlight to propose superficial solutions to whatever was "hot" on the evening news. The Fabe fiasco, HR 10, and Senator Grassley's bright idea that there was no consumer protection in an HMO insolvency are direct results. So is the proliferation of federal and state "mandated benefits" in health insurance.

The Compact, however, adopted an opposite strategy: they constructed a drafting process that was self-consciously inclusive, and licensed the drafters to use their accumulated expertise and experience to build a law that actually worked without constant patching, propping, and interpreting. The effort attracted a blue-ribbon panel of volunteers, not only to make token appearances but also to put in twelve-hour days, month after month after month. The public missed a lot of good drama by not coming to the "public meetings – they were always intense, sometimes raucous, and often hilarious. Over time the thing took on a life of its own, and whatever their initial differences all the members became intensely commit-

(Continued on Page 4)

IAIR Roundtable Schedule

NAIC Meeting - December 5 - 9, 1998
Orlando, Florida
IAIR Roundtable
Belinda Miller, Chair
December 5, 1:00 - 5:00 p.m.

NAIC Meeting - March 6 - 10, 1999
Washington, D.C.
IAIR Roundtable
March 6, 1:00 - 5:00 p.m.

NAIC Meeting - June 5 - 9, 1999
Kansas City, Missouri
IAIR Roundtable
June 5, 1:00 - 5:00 p.m.

NAIC Meeting - October 2 - 6, 1999
Atlanta, Georgia
IAIR Roundtable
October 2, 1:00 - 5:00 p.m.

The INSURANCE RECEIVER

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.**

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New York Meetings Recap

(Continued from Page 3)

ted to the quality of the work product - and to finishing it.

The diversity of viewpoints on that committee made for some vigorous debate, and burned prodigious quantities of fax paper. But it also immunized the group against tunnel vision. Every provision was scrutinized by life people, casualty people, both kinds of guaranty funds, receiver-types, bankruptcy-types, regulators and industry. Assumptions were challenged; habits were scrutinized; common ground was tested. There is probably something wrong with the Uniform Receiversip Law, but it will take a while to find it.

The payoff is now clear; even though we have what looks and feels like a radical change to the status quo, it's attracting support and respect, not catcalls and criticism. If the Compact's supporters can remember to employ the same daring tactics in the states, it might even be widely adopted.

The consensus behind the Uniform Receivership Law got its first real test in the Commission meeting, when a last-minute controversy erupted. It involved life reinsurance, was intensely technical, and (although most of the parties don't know it yet) was based on a simple conflict of assumptions compounded by a refusal to communicate (not the Commission's). I'm not going to explain it because I put two successive sets of dinner companions to sleep trying, and Jim Stinson limits these things to 2000 words anyway. Suffice it to say that the consensus held, and, applying the rules I put in the first part of this note, controversy is no disgrace. Discussion continues, and should.

If imitation is flattery, the suggestion now being made that, instead of joining the Compact, states should simply plagiarize the Uniform Receivership Law should have me beaming, but it doesn't. Adopting the Law without adopting the Compact would be like the drunk abandoning his addiction to bourbon in favor of Scotch. It's a little more stylish, but doesn't solve the real problem. I guarantee that there will eventually be something seriously wrong with the Uniform Receivership Law. Within the next five years we will find whole catastrophes we failed to plan for. The problem with the Model Act is that it was impossible to really repair. The Compact is flexible and self-healing. Granting that some flexibility makes people nervous, there are plenty of safeguards in the system to prevent dark-of-night changes in basic principles without the consent of the states. The Uniform Receivership Law demonstrates how much more sense liquidation can make when law reflects technical proficiency. But like any other technology, liquidation technique won't stand still, and the Uniform Receivership Law shouldn't either.

I learned another worthwhile thing from the New York meeting, but not until two weeks later: I learned how to get NAIC meeting minutes off the NAIC web site. I have to admit to considerable skepticism about this idea - it's pretty trendy, but it looked like another way to dole out information late and in small quantities while pretending to be fair and even-handed. I still don't like the fact that you have to wait (in this case 2 weeks) after the meeting to learn what happened there. But they are getting better at this. Unlike Boston, the minutes appeared on time and intelligible. And glory of glories, they were so nearly complete that the meeting makes better sense on paper than in person!

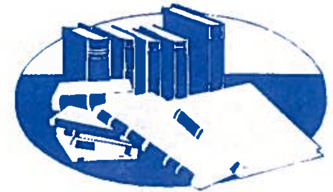
There are some actual gems in the download, like the complete text of the Examinations Team's report on Lloyds, the Mutual Holding Company and Commercial Lines Re-engineering white papers, and actual minutes of the interim meetings for most committees. There are some poignant moments, like the Blue Cross Committee quietly disbanding itself, and the Inter-Affiliated Pooling group admitting that there was not a way to fix its assigned problem that didn't slaughter a sacred cow, and Liability-base Restructuring settling down to concentrate on assumption reinsurance instead of hunting for a magic bullet that would have saved CIGNA. A technical tip: One of the files is a "synopsis" which covers every agenda item on every task force, and makes a handy, albeit voluminous, guide to what you missed.

Things I wish they would fix: all the unreadable computer gobbledegook that doubles the size of every file I downloaded (something is adding on non-word processing text to all the minutes); the disappear-

(Continued on Page 11)

Other News & Notes

By Charles Richardson



1999 NAIC/IAIR Insolvency Workshop

First a plug. . . . Make your plans right now for the NAIC/IAIR Insolvency Workshop next February 4-5 in Palm Beach, Florida. Case studies, 1997-99 legal update, and presentations by recognized experts on all the hot receivership topics — the workshop will have it all, and no one reading this article can afford to miss it. Dick Darling and Charlie Richardson are chairing the event, with help from a distinguished planning committee consisting of Steve Durish, Kevin Harris, Paula Keyes, Dick Klipstein, and Mike Surguine.

Interstate Compact

Now for the substance. . . . Like many of you, I attended the meeting at the Boston NAIC meeting in June of the Interstate Insurance Receivership Commission. The Commission received the exposure draft of the proposed Uniform Receivership Law (URL), the culmination of an 18-month effort of heroic proportions by a talented group of insolvency experts, mostly IAIR members, who comprise the Receivership Law Advisory Committee. Several other experts were contributors to the Committee's work. The end result was an impressive legal compendium designed to improve receivership law efficiency and clarity. Written comments on the exposure draft were submitted in Boston by several groups, including NOLHGA, NCIGF, RAA, NAMIC and ACLI. Most of those comments found their way into the URL after more discussion in Chicago on September 4, approval of the URL on September 8 by the Commission and final modifications at the Commission's meeting on September 14 at the New York NAIC meeting.

No one knows how successful the Compact will be. Will it expand beyond the three current members? Will the compact idea itself catch on, now that the Commission is up and running, with a shiny new legal bible — the URL — to guide it? Will champions of the compact idea, lead by Jim Jackson of Transamerica, be able to look back on the completion of URL as a turning point?

At a minimum, the NAIC, state legislators and industry groups will not be able to ignore the URL when any discussion of insolvency practice turns to the subject of making statutory improvement. Don't kid yourself, the URL will — and almost certainly should — be the template from here on out when it comes to updating rehabilitation/liquidation laws.

That being so, I want to quote from the Receivership Law Advisory Committee's letter to the Commission transmitting the final version of the URL. This letter captured the key changes from existing law embedded in the URL. Each of you needs to read the list that follows. This is where the law and our receivership "best practices" are headed. So don't stop after one or two sections — go to the end. That is your duty as an IAIR member.

The URL:

" • Reflects a balance in many areas of controversy which should tend to minimize expenditure of estate assets on litigation where the law has developed in recent years — recognizing that parties against whom actions are pursued by the receiver may have a right to litigate outside the receivership court, but making clear that claims against the estate and which concern the corpus of the estate are exclusively before the receivership court.

" • Creates an effective and workable automatic stay to ensure the benefits of an immediate and easily enforceable statutory stay of proceedings.

" • Clarifies the types of entities that may be placed into receivership and the extent of the receiver's authority over those entities.

" • Clarifies the civil procedure of receivership, and improves communication to and access by interested parties and the public. Establishes consistent standards for notice to interested parties and preserves their ability to participate meaningfully in the receivership proceeding. Improves access to information about the receivership by establishing public record document depository.

" • Contains a number of provisions that satisfy important guaranty association concerns, including class one priority treatment for expenses, an express right to intervene and strengthened "early access" provisions. It also retains a number of useful NAIC Model Act provisions. Nonetheless, the Interstate Compact itself forbids the promulgation of rules "directly relating to guaranty associations . . ." Readers of the URL will note that many references to guaranty associations are underlined and in italics. We did this so the Commission could easily segregate guaranty association references and, if thought appropriate, allow them to be submitted as companion legislation, not part of the Commission's URL.

" • Requires the filing and approval of a Receivership Plan, early in the receivership process in both rehabilitations and liquidations, to ensure that decisions are made at appropriate times about where the estate is headed.

" • Provides broader, explicit authority for a receiver to fashion remedies and alternatives to allow for more sophisticated and custom-tailored rehabilitations, run-offs or liquidations to best meet the needs of individual, and often unique, receivership estates.

" • Balances the recognition of broad claimant inclusion in the receivership process with the effects on other parties and estate closure, allowing estimation of known claims that are contingent or unliquidated, and allowing estimation of IBNR for limited purposes but not for the purpose of accelerating reinsurance recoveries, except as part of a court-sanctioned commutation process.

" • Preserves the trade-off reflected in state receivership laws since the 1930's — requiring that reinsurers pay on the basis of claims allowed, rather than indemnity, but preserves reinsurers' statutory and contractual rights to receive notice and to participate in the adjudication of claims.

(Continued on Page 11)

U.S. IMPLICATIONS FOR U.K. SOLVENT SCHEMES OF ARRANGEMENT, AND MORE

(CAN THIS IDEA WORK WITH A U.S. INSURER?)

by: Larry J. Nyhan and James F. Conlan, Partners
David A. Goldberg and Jason G. New, Associates[1] - Sidley & Austin - Chicago, Illinois[2]

I. Introduction

The potential benefits of a solvent scheme of arrangement hold great promise for the creditors and equityholders of U.K. insurers with the appropriate characteristics. If, however, the U.K. (or other non-U.S.) insurer has written substantial amounts of U.S. business, that potential may be thwarted by U.S. policyholders and other creditors who can force the scheme administrators to respond to litigation in various state and federal courts around the U.S. We discuss the availability of protection against such an eventuality below.

We also invite those with interests involving U.S. insurers to consider whether the concept of a solvent scheme of arrangement might be applied to a U.S. insurer under applicable state law.

II. Ancillary Proceedings in the U.S.

The following is a limited discussion of certain basic principles relevant to a solvent U.K. insurance company that wishes to initiate a U.S. proceeding that is ancillary to its U.K. proceeding. A U.S. ancillary proceeding is typically initiated pursuant to Section 304 of the United States Bankruptcy Code, 11 U.S.C. §§ 101 et seq. (the "Code").[3]

A. An Official Case Administrator in a Proceeding Under the United Kingdom Insolvency Act of 1986 or the English Companies Act of 1985 may Commence an Ancillary Case under Section 304 of the Code.

Bankruptcy courts in the United States have consistently recognized that a proceeding under either the United Kingdom Insolvency Act of 1986 (the "Insolvency Act") or the English Companies Act of 1985 (the "Companies Act") (collectively, the "U.K. Acts") constitutes a "foreign proceeding"[4] within the meaning of Section 101(23) of the Code, and that an official appointed to administer such a proceeding (i.e., a provisional liquidator or administrator)[5] constitutes a "foreign representative" within the meaning of Section 101(24) of the Code.[6] Consequently, a U.K. administrator in a case under one of the U.K. Acts may commence an ancillary case under Section 304 of the Code.

Further, beyond simply qualifying for the commencement of an ancillary case, U.S. courts have been favorably disposed toward the granting of relief to U.K. administrators in cases under the U.K. Acts. See, e.g., In re Brierly, 145 B.R. 151, 166-68 (Bankr. S.D.N.Y. 1992) ("The congruence of the [Insolvency Act] and the Bankruptcy Code ... supports a grant of Brierly's ancillary petition [and] ... an injunction permanently prohibiting suits against [the debtor], its property and the administrators arising out of [pre-petition] claims"); In re Gercke, 122 B.R. 621 (Bankr. D.C. 1991) (granting English administrator a Section 304 injunction staying state court litigation against Dominion International Group, Plc, then-operating under the Insolvency Act); In re Boys-Stones and Bird, as Joint Provisional Liquidators of Andrew Weir Insur. Co. ("In re Andrew Weir"), Petition under Section 304, Case No. 92-B-46894 (Bankr. S.D.N.Y. 1992) (permanent injunction granted based upon U.K. proceeding under Section 425 of the Companies Act); In re Boys-Stones and Bird, as Joint Provisional Liquidators of Trinity Insur. Co., Ltd. ("In re Trinity"), Case No. 92-B-43498 (Bankr. S.D.N.Y. 1994) (same); Marialuisa S. Gallozzi, "Insurer Insolvencies in the London Market: Consequences for the U.S. Policyholder," 4 No. 3 Coverage 1 (May/June 1994).[7]

1. A non-U.S. insurance company that engages in the insurance business in the U.S. may be the subject of an ancillary case under Section 304 of theCode.

Although a non-U.S. insurance company that engages in the insurance business in the U.S. cannot be a debtor in a case under Chapter 7 or 11 of the Code (i.e., an ordinary bankruptcy case), see 11 U.S.C. §§ 109(b)(3), and 109(d), such a company may be, and has frequently been, the subject of an ancillary case under Section 304 of the Code. See, e.g., In re Laitasalo, 193 B.R. 187, 189-91 (Bankr. S.D.N.Y. 1996); In re Rubin, 160 B.R. 269 (Bankr. S.D.N.Y. 1993); In re Hughes and Bond, as Joint Provisional Liquidators of Kingscroft Insur. Co., et al., Case Nos. 92-B-41974 - 92-B-41977 (Bankr. S.D.N.Y. 1992); In Re Hughes and Bond, as Joint Provisional Liquidators of Walbrook Insur. Co., Case No. 92-B-44623 (Bankr. S.D.N.Y. 1992); In re Andrew Weir, Case No. 92-B-46894 (Bankr. S.D.N.Y. 1992). See also, Richard A. Gitlin and Evan D. Flaschen, "The International Void in the Law of Multinational Bankruptcies," 42 Business Lawyer 307, 319

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[1] Larry Nyhan and James Conlan are partners in Sidley & Austin's Bankruptcy Group. Jason New is an associate in the Bankruptcy Group, and David Goldberg is an associate in the Reinsurance and Insurance Insolvency Group. They have worked extensively in the are of mass tort insolvencies, including the Dow Corning bankruptcy as well as other multi-billion dollar bankruptcies that present issues of claims estimation.

[2] © Copyright Sidley & Austin 1998. The authors gratefully acknowledge the assistance of their colleagues at Sidley & Austin in the preparation of this paper, including James Stinson, the partner in charge of the Reinsurance and Insurance Insolvency Group. The views expressed in this paper, however, are solely those of the authors and not those of Sidley & Austin or any of its clients, nor may they be viewed as legal advice.

(Feb. 1987) ("Section 304 relief should be available regardless of the limitations on eligibility in section 109(b)"). Cf. Goerg v. Parungao (In re Goerg), 844 F.2d 1562, 1568 (11th Cir. 1988), cert. denied, 488 U.S. 1034 (1989) ("we conclude that the debtor in a Section 304 proceeding need not qualify as a 'debtor' under the [United States Bankruptcy] Code's definition of that term.").

2. The solvency of the debtor in a case under one of the U.K. Acts should not render it ineligible for relief under Section 304 of the Code.

The solvency of a debtor in a case under one of the U.K. Acts is not likely to impact a United States bankruptcy court's decision on whether such a case is a "foreign proceeding," whether the U.K. administrator is a "foreign representative," or whether relief under Section 304 should be granted. This follows from American bankruptcy jurisprudence which holds that even a party that is solvent may qualify as a debtor in an ordinary (i.e., chapter 7 or 11) bankruptcy case under the Code. See, e.g., In re Texaco Inc., 92 B.R. 38, 42 (S.D.N.Y. 1988) (noting that besides a large jury verdict, debtor was a "solvent concern" and remained a major worldwide oil company); In re Gagel & Gagel, 24 B.R. 671, 673 (Bankr. S.D. Ohio 1982) ("the Code does not require insolvency to invoke Chapter 11 jurisdiction"); In re Ford, 74 B.R. 934, 938 (Bankr. S.D. Ala. 1987) (same). Indeed, even if insolvency were a prerequisite to relief under Chapter 7 or 11 of the Code, it is quite possible that a solvent debtor in a case under one of the U.K. Acts would nevertheless be eligible for relief in an ancillary case under Section 304 of the Code. This follows from the working proposition that although consistency with U.S. law is a great advantage in obtaining recognition of a foreign proceeding, it is not a prerequisite.

B. General Summary of Section 304 Procedures.

An ancillary proceeding under Section 304 is initiated upon the U.K. administrator's filing of a petition with the bankruptcy court in the federal district where the debtor has its principal place of business, or principal assets, in the United States.[8] 11 U.S.C. § 304(a); 28 U.S.C. § 1410.[9] The clerk of the bankruptcy court then serves the petition upon any parties against whom the debtor is seeking relief. Fed. R. Bankr. P. 1010. Any party in interest may contest the petition, but objections must generally be presented within 20 days after the petition is served. Fed. R. Bankr. P. 1011. In general, all actions to contest a Section 304 petition will be adjudicated, as would any other adversary proceeding in a case under the Code, by the bankruptcy court's application of ordinary rules of bankruptcy and/or federal civil procedure. Fed. R. Bankr. P. 1018 .

Once the ancillary proceeding has been commenced and proper service has been made, the ancillary (bankruptcy) court will consider requests for relief. Such relief commonly takes the form of a temporary restraining order ("TRO"), thereby preventing creditors from commencing or continuing actions against the debtor or its property for generally a short period of time (typically up to 30 days).[10]

If the need for further relief is established, the TRO may be converted into a preliminary injunction (valid for 30-90 days in ordinary cases), which may also be periodically extended as circumstances warrant. Such extensions are routinely granted, but typically require testimony on the progress in the U.K. proceeding. A request for permanent relief from the U.S. bankruptcy court typically occurs once the U.K. court has approved the debtor's scheme of arrangement or liquidation plan and the debtor requires an order from the U.S. bankruptcy court enforcing the scheme of arrangement or liquidation plan in the U.S. through, *inter alia*, the issuance of a permanent injunction.

III. . A Modest Proposal to Liquidate Solvent U.S. Insurance Companies in a Timely, Cost Effective Manner that Benefits Policyholders, Creditors and Equityholders.

In the U.S., of course, insurance company insolvency proceedings are governed by state law. Generally, this means the law of the state in which the subject insurer is domiciled. In each of the 50 states, insurance codes call for appointment of the domiciliary insurance regulator as the receiver, whether conservator, rehabilitator or liquidator, of the insolvent insurer. The regulator, as receiver, is responsible for administering the insolvency, subject to supervision by the domiciliary state court. Nothing analogous to the U.K. scheme of arrangement exists for U.S. insurers. In fact, creditors historically have had a very limited role in U.S. insurer insolvency proceedings. Nonetheless, there may be no legal reason why the benefits of a U.K. solvent scheme of arrangement cannot be achieved by the creditors and equity holders of a U.S. insurer.

A legal framework for accelerated run-off of claims against U.S. insurers exists in some states already and is being adopted in others. The approach would call for fixing creditors' contingent and unliquidated claims through estimation, similar to what might be done in a cut-off scheme of arrangement in the U.K. By analogizing to how similar problems have been solved using U.S. bankruptcy laws, a solution may be found to the problem of how to liquidate a solvent U.S. insurance company in a timely, cost effective manner that benefits policyholders, creditors, and equity holders.

A. Claims Estimation in the U.S.

Historically, U.S. insurance receivership law has either been silent on or antagonistic toward estimation as a means of fixing claims. In two cases the California Court of Appeal struck down the estimation provisions of the Mission Insurance Companies liquidator's "Final Liquidation Dividend Plan" for violating the California Insurance Code (Quackenbush v. Mission Ins. Co., 46 Cal. App. 4th 458 (1996)), and the New Jersey Superior Court is being asked to do the same in the context of the Integrity Insurance Company final liquidation plan. The Integrity case, in which the liquidation court has approved the concept of estimation as against a statutory challenge by reinsurers, should be instructive because the operative language of the New Jersey statute, N.J.S.A.: 17:30C-28(a), is based on a provision adopted by most states beginning in the 1930's and which some states still have as law. See, In The Matter Of The Liquidation Of Integrity Insurance Company, Docket No. C-7022-86, Superior Court of New Jersey, Chancery Division: Bergen

(Continued on Page 8)

U.S. IMPLICATIONS FOR U.K. SOLVENT SCHEMES OF ARRANGEMENT, AND MORE . . .

(Continued from Page 7)

County, General Equity Part, Opinion, Nov. 15, 1996.

The insurance receivership sections of the insurance codes of Illinois, Missouri and Utah have recently been amended to allow estimation of unliquidated and contingent claims in certain circumstances. In Illinois, reported direct claims, as well as assumed reinsurance claims, both reported and IBNR, are being fixed and valued by estimation, and billed to reinsurers and retrocessionaires in the liquidation of Pine Top Insurance Company (Ill.). In Utah, the liquidator of Southern American Insurance Company filed. A request for approval to estimate claims in June. Reported direct and assumed reinsurance claims will be fixed by estimation. Further, pursuant to Utah's unique statute, the liquidation court may order reinsurers to negotiate with the liquidator a commutation which includes payment based on IBNR estimates. Failing agreement, the parties must submit to binding arbitration. See, Utah Code Ann. § 31A-27-330.6.

In Missouri, pursuant to statute and a liquidation plan approved by the appellate court over reinsurer objections (Angoff v. Holland-America Ins. Co. Trust, et al., Case No. WD 51572, slip. op. (Mo. Ct. App. Oct. 29, 1996)), reported claims and IBNR claims are being fixed and valued by estimation.

The NAIC Insurers Rehabilitation and Liquidation Model Act also has been amended to provide for estimation of claims. The exposure draft Uniform Receivership Law, which is being considered for promulgation by the Interstate Insurance Receivership Commission pursuant to a Compact enacted by Illinois, Michigan and Nebraska, would allow the valuation of known contingent claims by estimation as part of a plan. In a liquidation with sufficiently developed losses, a plan also may include a mechanism whereby reinsurers must submit to mandatory negotiation and arbitration.

The foregoing legislative amendments and litigation regarding estimation of claims have all arisen as insurance company liquidators have struggled to find ways to close ten-year old estates that would take another 20 years or more to close if the claims were allowed to run off. Although none of the existing statutes specifically contemplate their being used in the case of a solvent insurer, the statutes do not seem to prohibit estimation of claims in that context so long as the insurer is in receivership, or in some cases, liquidation. Further, all states provide that a vote of the board of directors or shareholders is basis for the domiciliary insurance commissioner to place a company into receivership or liquidation, See, e.g., 215 ILCS 5/188(13). Thus, a legal means exists to place a solvent insurer into receivership or liquidation. The question then becomes whether estimation appropriately may be used in the case of a solvent company. For guidance and authority, we turn to U.S. bankruptcy practice.

B. Analogizing to Bankruptcy Law.

Although a domestic insurance company cannot be the subject of a U.S. bankruptcy case, the concepts and case law developed in U.S. bankruptcy cases might be urged in analogous U.S. insurer insolvency proceedings that are administered in the state courts of the domiciliary state, in contrast to federal bankruptcy courts. The following is a brief discussion of concepts developed in U.S. bankruptcy cases that might be employed to achieve the desired objective in U.S. insurance insolvency proceedings.

U.S. federal courts, sitting in bankruptcy, have sanctioned distributions of considerable value to the equity holders of companies that are confronted with massive exposure to both contingent and unliquidated claims where (i) the potential aggregate "liquidated" value of the claims is fairly estimated; (ii) sufficient value is reserved to assure full payment of the estimated exposure; and (iii) a significant majority of claim holders votes in favor of the proposed reorganization. Thus, for example, in the A.H. Robins bankruptcy case — a mass tort bankruptcy case precipitated by tens of thousands of claims resulting from injuries allegedly sustained by women who used the Dalkon Shield, an intrauterine birth control device manufactured by A.H. Robins — the court estimated the unliquidated claims of women who had manifested injuries as well as the contingent claims of women who had not yet manifested any injury. The debtor then proposed a plan of reorganization calling for the sale of the company for an amount significantly in excess of the court's estimation, the funding of a trust for the benefit of the Dalkon Shield claimants in an amount sufficient to pay the estimated exposure (excluding punitive damages) in full and the distribution to equity holders of the remaining value (in excess of $500 million).

The court confirmed the debtor's plan over the objection of a minority of tort claimants (approximately 95% of voting tort claimants supported the plan) who were concerned that the court's damage estimates might ultimately prove to be significantly too low and the distribution to equity holders would effectively foreclose any further recourse. See In re A. H. Robins Co., Inc. 88B.R.742,747 (E. D. Va. 1988), aff'd, 880 F.2d 694 (4th Cir.), cer t. denied, 493 U. S. 959 (1989). In overruling the tort claimants' objections, the court concluded that certainty regarding full payment of contingent claims was not required; the law only required that adequate provision be made for the full payment of estimated exposure. See id. Implicit in the court's ruling was the notion that a reorganization cannot be held open (or held up) indefinitely waiting for contingent claims to liquidate in the normal course.

While we believe that the A.H. Robins rationale may have appeal in insurance insolvencies, there are a few points that ought to be stressed. First, a specific provision of the U.S. Bankruptcy Code empowers a bankruptcy court to estimate contingent and unliquidated claims for plan feasibility purposes. While an increasing number of state insurance insolvency statutes have similar provisions, most still do not.

Second, the Robins court relied heavily upon the facts that (a) an extensive and thorough estimation hearing permitted the court to fairly estimate, in the court's view, the debtor's aggregate exposure, (b) the debtor proposed to reserve for the full payment of this exposure and (c)

approximately 95% of the tort claimants (well in excess of the 66 2/3 % required for class acceptance) supported the plan. See id. at 747-50. Although this last criterion arguably need not be met in order to confirm a 100% payment plan under U.S. Bankruptcy law, the Robins' court's (and other courts') reliance on this factor suggests that any plan proposed in the insurance insolvency context be fashioned, if at all possible, in a manner that is likely to garner significant policyholder support.

Third, an insurance arrangement must take into account — indeed, probably requires the active support of — the insurance regulator in the relevant state. Since insurance regulators are generally charged with the responsibility of protecting policyholders, the need to ensure policyholder support appears to be critical.

Against this backdrop, we assume that a workable plan will require, at a minimum, adequate reserves to meet projected policyholder claims as well as an economic enticement to policyholders which, hopefully, will stimulate at least majority policyholder (and regulator) support. Incentives for policyholders to support such a plan might potentially be found in three areas: (a) sharing of the equity upside; (b) eliminating obstacles (together with the attendant litigation and administrative expense to both the insurance company and the policyholders) to coverage acceptance (such as, for example, by foregoing coverage disputes relative to the retroactive imposition of strict liability under U.S. environmental laws); and (c) avoiding the likely costs and inefficiencies of a traditional insurance insolvency. The following is one structure that would accommodate the foregoing:

The target insurance company could be, in effect, "mutualized," i.e. all of its assets (and liabilities) could be transferred to Newco, and the existing policyholders would become Newco's shareholders (either in proportion to their premium or claims history). As part of the transaction, excess cash (i.e. cash in excess of a reasonable reserve projection plus a cushion) would be distributed to old shareholders. Alternatively, old shareholders could receive preferred stock bearing a modest level of current yield and having mandatory redemption rights after a fixed period of time (say, 5, 7 or 10 years) so long as Newco meets, during the intervening years, certain performance thresholds. In this latter alternative, the redemption price could vary as a function of Newco's actual claims experience, but would have to recognize the policyholders' rights (now, as common shareholders) to share in value associated with favorable performance. Presumably, the preferred stock could be structured so that it would be easily tradeable, thereby affording liquidity to equity holders who are not prepared to wait for (or take a chance on) redemption.

The plan could provide that all occurrences under policies issued by the insurance company must be identified to Newco on or before a date certain in the future (e.g. 3 years) or be forever barred. More aggressively, the plan could further provide for the creation, after passage of the bar date, of reserves (in a prescribed fashion) in respect of timely filed claims, with a mandatory distribution of any excess value to equity holders. These provisions would provide real value to the equity holders in Newco (which could largely be policyholders) while, at the same time, affording policyholders a fair opportunity, depending upon the type of coverage involved, to ascertain whether they have claims. Of course, the modification to existing policy rights necessitated by these provisions could make them very difficult to sell.

Newco's board of directors would be nominated by the policyholders, although actual management of Newco's affairs could be handled by independent professionals compensated through some variety of a performance based contract.

Newco's board (and if necessary, its articles and by-laws) can ensure that Newco does not engage in dilatory or wasteful coverage disputes with policyholders. This facet of the arrangement should, presumably, appeal to policyholders and may soften their resistance to equity distributions. (Of course, reinsurers' and retrocessionaires' rights would have to be considered to avoid loss of this asset.)

One necessary ingredient for this structure is the agreement of the domiciliary regulator and the creditors in a given case that a plan whereby policyholders and other

creditors must value their contingent, unliquidated and in many cases unknown claims now, and in which substantial capital will be distributed to shareholders, is a good thing. We do not mean to minimize that challenge, but in a proper case, a solvent liquidation might benefit all interested parties.

[3] Section 304 provides:

(a) A case ancillary to a foreign proceeding is commenced by the filing with the bankruptcy court of a petition under this section by a foreign representative.

(b) Subject to the provisions of subsection (c) of this section, if a party in interest does not timely controvert the petition, or after trial, the court may—

(1) enjoin the commencement or continuation of—

(A) any action against—

(i) a debtor with respect to property involved in such foreign proceeding;

or

(ii) such property; or

(B) the enforcement of any judgment against the debtor with respect to such property, or any act or the commencement or continuation of any judicial proceeding to create or enforce a lien against the property of such estate;

(2) order turnover of the property of such estate, or the proceeds of such property, to such foreign representative; or

(3) order other appropriate relief.

[4] The Code defines a "foreign proceeding" as a: proceeding, whether judicial or administrative and whether or not under bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension, or discharge, or effecting a reorganization.
11 U.S.C. § 101(23).

[5] For simplicity, except as otherwise provided, the term "U.K. administrator" shall be used herein to

(Continued on Page 10)

U.S. IMPLICATIONS FOR U.K. SOLVENT SCHEMES OF ARRANGEMENT, AND MORE . . .

refer collectively to any type of official case administrator in a proceeding under the U.K. Acts.

6. The Code defines a "foreign representative" as a "duly selected trustee, administrator, or other representative of an estate in a foreign proceeding." 11 U.S.C. § 101(24).

7. See also Lindner Fund, Inc. v. Polly Peck Int'l Plc., 143 B.R. 807, 810 ("The procedures under the [Insolvency Act] are comparable to the procedures under the Bankruptcy Code, and therefore extending comity to such proceedings is appropriate"); In re Axona Int'l Credit & Commerce Ltd., 88 B.R. 597, 610 (Bankr. S.D.N.Y. 1988) (recognizing Hong Kong proceeding under Section 304); In re Gee, 53 B.R. 891 (Bankr. S.D.N.Y. 1985) (same regarding Cayman Islands' proceeding).

8. The appearance by the U.K. administrator in connection with a petition or request under Section 304 of the Code does not submit the U.K. administrator to the jurisdiction of any court in the U.S. for any other purpose, but the bankruptcy court may condition any order under Section 304 on compliance by the U.K. administrator with the orders of such bankruptcy court. See 11 U.S.C. § 306.

9. Although the language of 28 U.S.C. § 1410 (Venue of cases ancillary to foreign proceedings) may suggest a debtor needs to file petitions in every jurisdiction in which the debtor seeks to enjoin litigation (§ 1410(a)) or obtain turnover of its assets (§ 1410(b)), at least one bankruptcy judge has recognized that "[w]hen you need more relief [due to multi-jurisdictional matters and issues involving the debtor] ... you go with [§ 1410(c)] and it all gets done in a single district" (emphasis supplied). Transcript of Hrg. in In re Andrew Weir Insur. Co., Ltd., at 37-40 (Jan. 11, 1993) (Judge Abram) (cited in Gallozzi, at *5).

10. A discussion of additional issues that may arise, such as the turnover of U.S. assets to the U.K. administrator, is beyond the scope of this limited discussion. In this regard, it should be noted that a amendment was proposed to 11 U.S.C. § 304 which would would have made § 304(b) protection unavailable to a foreign representative with respect to the following assets of a non-U.S. insurer, if such assets are required by applicable state law:

(1) state deposits;
(2) multibeneficiary trusts that protect U.S. policyholders, or claimants against such policyholders; and
(3) multibeneficiary trusts that allow an insurer to take financial statement creditor for reinsurance ceded to the non-U.S. insurer.

A bankruptcy reform bill including the amendment above was not [assed before the end of the last Congressional session.

President's Message

(Continued from Page 2)

of the insurer receiverships. For example, the Integral Ins. Co. ("IIC") receivership has paid out over $130 million to its priority claimants or beneficiaries with administrative expense of about $5 million. For IIC then the IGP ratio is about 3.8% (5/130). Moreover, nearly all of claimants in IIC were paid as their claims matured or were allowed in the receivership proceeding so that the time value of money does not have to be factored in.

Anything lower than a 10% IGP should probably be considered excellent, lower than 15% good, and lower than 20% acceptable. In estates with opening assets under $1 million, including reinsurance balances recoverable, you would probably have to triple the above percentages. If an SDR wants a no risk way of improving their IGP they should make early access payments to the Guaranty Funds. With closer solvency monitoring, more estates will open with liquid assets close to enough to pay the policyholder priority class but with little reinsurance or other recoverable assets. Measuring progress based on recoveries in these cases will not give a meaningful result. Even where reinsurance recoverable is the largest asset, recovery is a function of proper claims handling and clerical systems. Ongoing insurers do not spend a high percentage in recovering reinsurance. Proper billing produces prompt payment. This should not change too much just because the company has gone into receivership, right?

Measuring progress based on the distribution percentage may be counter-productive as SDRs may hold up distributions to earn investment income to improve the distribution percentage. This is the adage "I can make any estate pay 100% to the policyholder priority claimants, just give me a few decades." The distribution percentage is a function of effective regulation and solvency monitoring more than what an SDR does or fails to do. The IGP ratio is a change from all of the various ways that have been used to try to measure progress in receiverships, but its advantages are comparability and focus on the beneficiaries. All that the beneficiaries care about is just how much did it cost me to get paid just this much. We need to improve on the answer.

1. Marcus Aurelius, Meditations, Book 7, Para. 18 – Transl. M. Staniforth, 1964.

2. For more see, Achilles in the Quantum Universe – The Definitive History of Infinity, R. Morris, 1997.

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1/8 page	2-1/4" x 2-3/8	$100	$ 90	$ 80	$ 70	$ 95
1/6 page	*2-1/4" x 4-7/8*	*$150*	*$130*	*$110*	*$ 90*	*$125*
1/3 page	2-1/4" x 9-3/4	$210	$190	$170	$150	$200
1/2 page	*7-1/4" x 4-7/8"*	*$275*	*$255*	*$235*	*$215*	*$300*
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Full page	7-1/4" x 9-3/4"	$530	$510	$490	$470	$550

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UPDATE: ILLINOIS APPELLATE COURT REVERSES CIRCUIT COURTAND HOLDS THAT ATTORNEYS CANNOT ASSERT RETAININGLIENS IN ILLINOIS LIQUIDATION PROCEEDINGS

By Ellen S. Robbins *

In "Lawyers Shouldn't Jump to the Front of the Line: No Place for Common Law Retaining Liens in Liquidation Proceedings," (Winter 1997 issue), the author argued that supervisory courts should not be permitted to displace the statutory provisions of the Insurance Code with their own notions of equity by allowing law firms to assert common law retaining liens to achieve higher priority status in connection with their claims for pre-liquidation attorneys' fees. The article was written following a supervisory court's ruling in connection with the Illinois liquidation proceedings respecting Coronet Insurance Company, which allowed a law firm which represented Coronet's insureds prior to its liquidation, David Kreisman & Associates ("DK&A") to assert a common law retaining lien in order to elevate its priority status from a general creditor (seventh level priority status) to that of an administrative claimant (first priority).

On July 24, 1998, the Illinois Appellate Court unanimously reversed the Circuit Court's ruling in In re Liquidation of Coronet Insurance Company, Nos. 1-97-2332 and 1-97-2523 (cons.) and adopted the arguments advanced by the appellants, the Illinois Director of Insurance and intervenor Illinois Insurance Guaranty Fund, and amicus curiae National Conference of Insurance Guaranty Funds.

First, the Appellate Court held that 1995 amendments to the Illinois Insurance Code, which required all persons to "immediately release their possession and control of any and all property, contracts and rights of action of the company to the Director including, but not limited to, . . .litigation files," effectively precluded the assertion of common law retaining liens, because attorneys no longer had any right to retain the files. The Appellate Court stated, "The mandatory duty announced within amended section 191 abolished the right to assert a common law retaining lien against an insolvent insurer in a liquidation action under the Insurance Code."

Second, the Appellate Court held that the Circuit Court erred in elevating DK&A to second priority secured creditor status, and then to first priority administrative claimant status, on the basis of a common law retaining lien, because this violated the specific priority of distribution provisions of the Illinois Insurance Code.

Significantly, the Appellate Court recognized that in a liquidation action, the Circuit Court was vested only with such discretion as permitted by the Insurance Code, and accordingly, the court could not exercise its equitable powers to alter the priority of distribution. Moreover, the Appellate Court found that the Circuit Court erred both in allowing DK&A's claim to be adjudicated outside of the proof of claim procedures set forth in the Insurance Code and in ordering that DK&A's claim be paid before the claim bar date, because in doing so, the Circuit Court ignored the provisions of the statute.

Finally, the Appellate Court noted that the Circuit Court's orders with respect to the DK&A claim were in opposition to the purpose of the liquidation provisions of the Insurance Code — to protect "policyholders and other claimants without permitting certain classes of creditors to place themselves in a superior position."[1]

[1] Lincoln Tower Ins. Agency, Inc. v. Boozell, 684 N.E.2d 900 (1997).

** Ellen S. Robbins is an attorney with the law firm of Sidley & Austin in Chicago. Sidley & Austin is counsel for the Illinois Director of Insurance in connection with the claim of David Kreisman & Associates against the estate of Coronet Insurance Company, in liquidation.*

New York Meetings Recap

(Continued from Page 4)

ance or disorganization of tabular material from attachments, and the need to order each committee report separately. Two suggestions: (1) Put an order form on the website so that, when the minutes of a given committee are ready, they can be e-mailed to meeting attendees, and (2) Allow "one stop ordering" to get a doubly compressed file containing all the minutes. I know it will be a big file, but so, in total, were all the files I downloaded one at a time (especially because of the goobledegook). The NAIC's server, which seemed to be coping reasonably well with the demands of downloaders on the first day, could probably be even more efficient sending email to a mailing list on its own schedule than supplying downloads on demand.

Next stop: Mickey Mouse. And they say this business has no sense of humor.

Other News & Notes

(Continued from Page 5)

" • Provides for effective and meaningful financial reporting to the commission and the receivership court with the assurance that such reports will be publicly available. Financial reporting ensures accountability.

As you can see from that list, but can fully appreciate only by reading the entire document, the Advisory Committee tackled a number of hot topics and tried to make the sometimes discordant voices in the insolvency choir sing more harmoniously. Amen.

Meet Your Colleagues

CHARLES A. GLASS

Charlie (he answers the phone "Charles," but never mind) was a Special Deputy Insurance Commissioner for Washington State as court appointed receiver for Pacific Marine Insurance Company.

He began his insurance career as assistant accounting manager of Pacific Marine in 1983, and was controller when appointed receiver in 1994. He is currently a consultant to the receivership as it nears conclusion, and also provides financial consulting and accounting services to the Washington State USL&H Assigned Risk Plan, representing the Plan before the IRS.

He has a BA in accounting, is an IAIR Certified Insurance Receiver, P&C, and an Enrolled Agent for practice before the IRS.

Charlie is also the managing member of Regulatory Resources, LLC, ("double-R") a recently formed multi-disciplined consulting group offering a wide range of services in addition to receivership work for insurance regulators.

The firm is also providing services to the insurance industry, including business planning and license application, actuarial and rate filing services, reinsurance and claims consulting.

Charlie's wife, Carol, often asserts that he has managed to combine the four dullest professions in the world: insurance, liquidation, accounting and taxes.

However, Charlie keeps his marriage on a high note with his guitar and piano playing, spiced with original poetry. He also hosts a non-denominational religion and spirituality chat room on the Internet.

When asked if he'd ever like to figure out what he ***really*** wants to do, his usual reply is, "I never figured out what I ***don't*** want to do."

JONATHAN F. BANK

Jonathan F. Bank is a partner in the firm of Chadbourne & Parke LLP, where he concentrates his practice in reinsurance and insurance regulatory matters. Jonathan is admitted to practice in California, New York, and Nebraska.

He is a member of, among others, the American Bar Association, Tort and Insurance Practice Section (TIPS), the International Association of Defense Counsel, the Association Internationale de Droit des Assurance, U.S. Chapter (AIDA), The Federation of Regulatory Counsel, Inc., and the Society of Financial Examiners.

He is a charter member of the International Association of Insurance Receivers and an associate member of the Excess/Surplus Lines Claims Association. He is past-president of the Los Angeles Conference of Insurance Counsel.

Jonathan previously served on the Advisory Committee on Reinsurance for the NAIC, and was a member of the NAIC Rehabilitators and Liquidators Task Force.

Jonathan is Vice-Chair of the TIPS Public Regulation of Insurance Law Committee, and a member of the Insurance Insolvency Task Force Steering Committee.

He is on the Board of Directors for Underwriters Re Group, Inc., as well as the editorial boards of California Insurance Law & Regulation Reporter, and a contributing editor of Insurance Law & Regulation. He also authors a column on reinsurance in Underwriters' Report.

Jonathan organized the first Mealey's Reinsurance & Insolvency Roundtable in 1994, and has chaired subsequent ones.

Jonathan particularly enjoys insurance insolvency, as it taps his earlier experience as a bankruptcy practitioner, and offers new challenges in dealing with the different approaches (and personalities) reflected in the various states.

PAIGE D. WATERS

Paige D. Waters practices law in the Chicago office of Rudnick & Wolfe. She began her insurance insolvency practice ten years ago when she joined the Office of the Special Deputy Receiver in Illinois (OSD).

Paige's experience as the receiver's senior counsel includes a variety of insolvencies and special receiverships, including health maintenance organizations and unauthorized insurers.

In December 1995, Paige joined Rudnick & Wolfe's insurance and health care practice groups, concentrating in insolvency, reinsurance, litigation and regulation. Her practice encompasses insurer insolvencies, mergers and acquisitions of insurers and HMOs, regulatory compliance issues and related litigation.

She assisted the NAIC Midwest Zone Compact Committee in drafting the enabling legislation creating the Interstate Insurance Receivership Compact, and has spent considerable time promoting the Compact.

She also serves as a reporter for the Interstate Insurance Receivership Commission - Receivership Law Advisory Committee which has drafted the new uniform receivership statute.

Paige is an active participant in the National Association of Insurance Commissioners and the National Conference of Insurance Legislators. She frequently writes and speaks to professional groups on insurance trends, practices and issues.

She is a long standing member of IAIR and the Chicago Bar Association. Paige received a B.A. from Miami University in Oxford, Ohio, and a J.D. from IIT Chicago-Kent College of Law in Chicago, Illinois.

Paige was raised in Lake Forest, Illinois and still resides in the area, where she enjoys playing golf on the weekends.

MICHAEL J. FITZGIBBONS

Michael J. FitzGibbons has been a principal in the consulting firm of FitzGibbons, Tharp and Associates, ("FTA") since its inception in 1994. This firm provides consulting and management services to regulators, receivers and selected insurance clients. From 1988 to 1994, he was a principal of CTF and Associates, which provided regulatory and receivership services to state insurance departments.

Mike has also been retained as an expert witness pertaining to reinsurance, insurance accounting and insurance insolvency matters. He currently acts as special deputy receiver, on behalf of FTA, for a number of Arizona domiciled insurers, and has consulted with a number of receivers throughout the U.S.

Mike began his insurance career as controller of Churchmembers Life Insurance Company. In 1978, he joined the Indiana Department of Insurance as an Insurance Examiner. Thereafter, he was appointed Rehabilitation and Liquidation Manager, and ultimately Chief Examiner and Deputy Commissioner.

In 1985, he again entered the private sector, as Vice President of Operations and Commutations for Universal Reinsurance Corp. a subsidiary of Armco, Inc., which had commenced run off. Mike was an elected officer of the intermediate holding company, and spent a year in the UK on a management assignment for an affiliate, British National Insurance Company.

Mike has always been a strong proponent of adequate financial reporting for insurance insolvencies. He was a key participant in the Financial Data Sub-Group of the NAIC National Receivership Database Working Group in creating the standardization of financial reporting schedules. These schedules are now in place and are annually compiled by several members of IAIR on behalf of the NAIC.

Mike contributes to IAIR upon request. He received both his Bachelor of Science Degree in Finance and a Masters of Business Administration from Indiana University. He is also a Certified Public Accountant and a member of the AICPA.

He spends most of his spare time with his wife and three children and trying to lower his handicap, which has proven to be a most difficult task.

Receivers' Achievement Report

Ellen Fickinger, Chair

Reporters: Northeastern Zone -J. David Leslie (MA); William Taylor (PA); Midwestern Zone - Ellen Fickinger (IL), Brian Shuff (IN); Southeastern Zone - Belinda Miller (FL); Michael R. D. Adams (LA); Mid-Atlantic - Joe Holloway (NC); Western Zone - Mark Tharp (AZ); Amy Jeanne Welton (TX); Melissa Kooistra (CA); International - Phillip Singer (England); and John Milligan-Whyte (Bermuda)

Our IAIR achievement news received from reporters covering the first quarter of 1998 is as follows:

RECEIVERS' ACHIEVEMENTS BY STATE

Illinois (Mike Rauwolf, State Contact Person)

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

Receivership	Amount
Amreco	$2,209,191.00
Associated Life	$3,761.00
Centaur	$57,449.00
Coronet	$17,708.00
Heritage	$541,566.00
Pine Top	$17,525.00
Prestige	$22,259.00
Resure, Inc.	$9,342,128.00
State Security	$50.00
United Fire	$1,221.00
Total	**$12,213,038.00**

Maryland (James A. Gordon, State Contact Person)

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

Receivership	Amount
Trans-Pacific Insurance Co., et al	$10,000.00
Land Title Research of Maryland, Inc.	$581,719.07
Grangers Mutual Insurance Co.	$604,842.74
Total	**$1,187,561.81**

Pennsylvania (William S. Taylor, State Contact Person)

Receivership Estates Closed	Year Action Commenced	Licensed	Category	Dividend Percentage	
Columbia Life Ins. Co.	1991	Y	Life	44.3%	PH
Pilgrim Life Ins. Co.	1993	Y	Life	60.5%	PH
Northern Mutual Ins. Co. of Lancaster County	1994	Y	P & C	100%	
West Branch Administrators	1991	N	A & H	36.2%	PH

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

Receivership	Amount
Paxton National Ins. Co.	$161,036.28 VA G.F.
Rockwood Ins. Co.	$59,750.00 KS G.F.
Total	**$220,786.28**

West Virginia (Betty Cordial, State Contact Person)

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

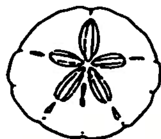
Receivership	Amount
Quality Ins. Co.	Class IV - 12.47%

Mark Tharp (AZ) reports additional achievements relative to the **Farm and Home Life Insurance Company (FHLIC)**. Litigation settlements of claims against former officers and directors resulted in cash payments to the receiver of $7,022,313.00 during the first quarter of 1998. These litigation recoveries were, in turn, distributed to the Arizona Life and Disability Insurance Guaranty Fund in the form of early access payments. Additionally, payment information was received in connection with **AMS Life Insurance Company (AMS)**. On March 13, 1998, the receivership Court heard and approved Petition No. 262, Petition for Orders Approving Settlement Agreement with McGladrey & Pullen, LLP, Dismissing McGladrey & Pullen, LLP and Barring Certain Claims, resulting in the payment of $5 million to the receiver by McGladrey & Pullen, LLP. Further, on March 30, 1998, the Receivership Court heard and approved Petition No. 264, Petition for Order Authorizing Additional Early Access Partial Distribution to Arizona, Illinois, Indiana, South Dakota and Texas Guaranty Associations, resulting in the payment of $13 million to such associations.

Mike Rauwolf (IL) advised that the Illinois receiver continues to manage the reinsurance run-off for **American Mutual Reinsurance Company (AMRECO)**, in rehabilitation. Reinsurance payments to date total $118,874,839.00, Loss and LAE $30,449.00 and LOC drawdown disbursements of $9,613,386.00. Additionally, Illinois continues to manage the run-off of **Centaur Insurance Company**, in rehabilitation. Total claims paid inception to date are $50,525,964.00 for Loss and LAE, $4,945,493.00 in Reinsurance payments and $13,876,555.00 in LOC Drawdown disbursements.

Boyce Oglesby (NC) reported that the North Carolina Commissioner of Insurance as liquidator of the **Investment Life Insurance Company of America (ILA)** obtained judgments against James Peterson and **ILA Corporation** for $7,000,000 and

(Continued on Page 16)



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Receivers' Achievement Report *(Continued from Page 14)*

$1,000,000 respectively. Further, the North Carolina Commissioner of Insurance as liquidator of **Twentieth Century Life Insurance Company** entered into an agreement to sell 32 acres of land in Lake Mary, Florida to Crescent Resources for $7,000,000.

James A. Gordon (MD) provided civil litigation and criminal prosecution updates for **Trans-Pacific Insurance Company, et al.**. In February of 1998, following his extradition to the United States from Liechtenstein, the U.S. District Court for the District of Maryland sentenced Martin Bramson to twelve years at a federal penitentiary for his involvement in the **Trans-Pacific Insurance Company** money laundering fraud. Further, collections during the first quarter of 1998 against former employees and rental income totaled $660.00.

Bill Taylor (PA) continues to provide updates on the status of the **Fidelity Mutual Life Insurance Company (FML)**, in Rehabilitation. Policyholder death benefits and annuity payments continue to be paid 100%. Crediting rates are at or above policy guarantees. As of March 31, 1998, **FML** showed a statutory surplus in excess of $73,000,000. Notices of Determination have been mailed to most claimants who filed proof of claims and the appeal period has expired for all the NOD's mailed. Out of 900+ notices, only 57 objections were received and 6 of those have been withdrawn. The Rehabilitator has requested a conference with the judge to discuss appointment of referees to handle the claim hearings.

In March, the Rehabilitator of **FML** filed a petition to settle certain unsecured creditor claims offering immediate payment of principle only for all allowed creditor claims if the creditor is willing to waive any applicable interest and penalty. The petition indicates that otherwise, the creditors will probably have to wait until closing for payment of their claims and there is no guarantee of what the rehabilitation plan will provide for their claims other than payment in full. Two objections were filed to the petition and responses have been filed to the objections, but no hearing has been scheduled. Also pending before the Court is a petition filed by one of the largest creditors asking the court to appoint a creditors committee, in addition to the Policyholders Committee already in place, a petition requesting authority for coordinated settlement of premium taxes and guaranty association assessments, a petition requesting authority for the purchase of officer/director liability insurance, and a petition for approval of a contract employing an investment banker to assist in implementing the rehabilitation plan.

On June 30, the Rehabilitator of **FML** filed a Third Amended Plan for Rehabilitation, proposed bid procedures for selection of an investor and a petition for approval of a new dividend scale, all of which had been negotiated over the last two years with the court appointed Policyholders Committee. The plan proposes the **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 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. The petition for approval of a new dividend scale would distribute, through a one-time dividend and increased crediting rates, approximately $90 million to policyholders over a 12 month period while maintaining minimum capital and surplus levels and meeting risk-based capital requirements for **FML**. On July 14, the Policyholders Committee filed a list of 25 objections to the notice package that had been submitted for Court approval to provide notice of the plan filing and related documents. No action is expected on those objections until late August or early September.

Philip Singer (UK) has reported that Joint Liquidators for **Grand Union Insurance Company Limited**, in Liquidation are seeking claims from creditors. **Grand Union** was a Hong Kong registered insurance/reinsurance company which has been placed in liquidation in both Hong Kong and England.

The English liquidation has made recoveries and, subject to the future costs of the liquidation, has approximately £800,000 for a potential distribution to the company's creditors. Some of the company's records were seized in Hong Kong and transported to London to aid the run-off, but these records are insufficient to identify all the creditors of the company and the Joint Liquidators (Philip Singer and Chris Hughes of Pricewaterhouse Coopers) are seeking claims from creditors. It is hoped that a dividend can be paid towards the end of this year or the beginning of next with a view to the closure of the liquidation.

Robert L. Greer, CIR-ML
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Guaranty Fund Matters

BY Barb Cox, Councel & Assistant Secretary NCIGF

California Appellate Court Rules on Treatment of Subrogation Recoveries Obtained by Guaranty Associations.

The proper treatment of subrogation recoveries obtained by guaranty associations has been an issue on which the funds and receivers often struggle.

Up until now, however, there has been little law on the books on this matter. This year, the issue was brought before the California appellate court.

On May 28, the Court of Appeal of the State of California, Second Appellate District rendered a decision in California Insurance Guarantee Association v. Insurance Commissioner of the State of California, No. B117653, 1998 WL 286820 (Cal. App. 2 Dist.) This case concerned whether the receiver for the Signal estate could properly offset amounts obtained by the guaranty fund as subrogation recoveries from the association's final distribution.

The association asserted that it bore the expenses of bringing subrogation actions. If the recovered amounts were then offset against its distribution then it would have no incentive to pursue subrogation action.

Further, whatever monies are not recovered from the estate for claims paid would be passed on to member insurers in the form of assessments.

These assessments would be recouped by the members by means of policyholder surcharge. Thus, any reduction in distribution would ultimately be borne by policyholders.

The Commissioner took the position that the subrogation recoveries were assets of the estate and offset was appropriate. The lower court sided with the Commissioner and the guaranty association appealed.

The Appellate Court decided that to the extent the guaranty fund paid claims out of its own assets, that is, not from early access distributions of the estate, it is entitled to retain the proceeds of any subrogation actions.

The California Insurance Guarantee Association was represented in the matter by Guerry Collins, Charissa Dorian and Mark Fall of Lord Bissell & Brook. The NCIGF amicus brief was prepared by Suzanne Sahakian of Dykema Gossett, PLC Detroit, Michigan.

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Super-Priority Update

By Barb Cox, Counsel & Assistant Secretary, NCIGF

Since 1993 when the U.S. Supreme Court rendered its decision in Dept. of the Treasury v. Fabe, there has been much speculating, adapting, struggling, pontificating, legislating, litigating and general gnashing of teeth as all parties to liquidation proceedings scramble to insulate themselves and their friends from the ever present threat of federal pre-emption by 31 U.S.C. § 3713. This federal law has become unaffectionately known as the federal "super-priority" statute. Most recently there is talk of an amendment to the statute itself, which, as Doug Hartz points out, was adopted in 1797, and, with its "the king gets paid first" mandate is just maybe a little out of sync with the times. The following is a capsule summary of what has happened lately and what we might expect in the near future:

The Cases

The most recent decisions are overwhelmingly favorable both from a liquidator's and a guaranty fund's perspective, with courts upholding guaranty association priority and the claims bar date as applied to claims made by the federal government.

We all celebrated on September 25, 1997 when Judge Ruben Castillo issued a ruling in Boozell v. United States, 979 F. Supp. 670 (N.D. Ill. 1997) holding, among other things, that the priority scheme set out in the Illinois Liquidation Act survives federal preemption. This "cured" scheme pays guaranty fund claims in the policyholder class and subordinates federal claims to a lower priority of payment from the estate. The federal government contended that the Illinois priority statute was preempted by § 3713 to the extent that the Illinois scheme places guaranty fund claims ahead of federal claims. A number of guaranty funds participated in this matter by filing an amicus brief in support of the Liquidator's position. The NCIGF and NOLHGA also filed a joint amicus brief. In this decision, the Illinois Court expressly rejected the narrow reading of Fabe suggested by the 1st Circuit in Garcia (See Garcia v. Island Program Designer, 4 F. 3d 57 (1st Cir. 1993)) in favor of the broader interpretation of "laws enacted to benefit policyholders" that the Stephens court favored. (See Stephens v. American Int'l, 66 F.3d 41 (2d Cir. 1995)) In a footnote, the District Court indicated that the Federal Government had to file their claims before the bar date established by the liquidation court, just like everybody else. The government initially appealed this decision to the 7th Circuit but subsequently dropped the appeal. We do not know exactly why, but suffice it to say that a reversal was not likely and a strong potential to affirm the District Court's decision existed.

In North Carolina, the Federal Government once again challenged a state distribution scheme. In State of North Carolina ex. rel. Long v. United States of America, No. 97-2108, (Fourth Circuit 1998), the North Carolina Liquidator appealed a ruling that certain federal tax claims were administrative expenses of the estate and properly paid in Class 1. In an alternative argument, the government asserted that the uncured North Carolina priority distribution scheme failed to survive federal pre-emption because employee wage claims and claims of guaranty associations were paid ahead of the federal government. The NCIGF and NOLHGA filed a joint amicus brief which explained why the guaranty association claims survived pre-emption. NCIGF and NOLHGA were represented by Tom Jenkins, Rowe Snider and Ron Lepinskas of Lord, Bissell & Brook along with Doug Davis of Hunton & Williams. As it turned out the matter was decided on the tax issue and never reached the super-priority matter. One thing this proceeding demonstrates, however, is that it is important for all of us to work together to get the word around on these things. NCIGF and NOLHGA were not even aware that mischief was afoot until after the appeal proceeding was initiated.

The West Virginia high court has decided to hear the United States appeal of the Kanawha County, West Virginia Circuit Court opinion in State of West Virginia, ex rel. Clark v. Blue Cross Blue Shield of West Virginia, Inc. (Civil Action No. 90-C-3825). This case basically centers around two issues. The first is whether the various claims of the federal agencies involved are properly paid at Class 2 (the policyholder class) or Class 3 (the all other feds class) in the West Virginia scheme. The second, and probably more far reaching, issue is whether the federal government is subject to the bar date established by the state liquidation court. The United States is objecting to the classification of their untimely filed claims in the late filer class, Class 7 in the applicable West Virginia scheme. Part of the basis for its position is that the subordinated classification would put federal claims beneath those of general creditors. This, in the government's view, is contrary to Fabe even though the claims in question were not timely filed. The Assistant Deputy Receiver for the estate (a/k/a Bob Greer) has garnered the support of the NCIGF and NOLGHA who will be jointly filing an amicus brief on the bar date issue. NCIGF and NOLGHA are represented

Barb Cox is Counsel and Assistant Secretary at the National Conference of Insurance Guaranty Associations (NCIGF). As a major part of her responsibilities she monitors legislative and litigation developments in the insurance insolvency area. The opinions expressed in this "Super-Priority Update" are those of Barb Cox and should not be attributed to the NCIGF.

in this matter by Jim Foley and Nina Webb of Vorys, Sater & Pease, Columbus, Ohio. Bob also expects amicus support from the NAIC.

The Fifth Circuit recently sided with the Oklahoma liquidator in Munich v. Crawford, 141 F. 3d 585 (5th Cir. 1998). In this case Munich Re and NAC Re wanted a dispute with the liquidator resolved by means of the arbitration process called for in the reinsurance contracts, provisions which would be upheld under the Federal Arbitration Act. This process conflicted with the Oklahoma law providing the receivership court with "exclusive jurisdiction" and broad statutory powers to enjoin interference with the delinquency proceedings. Once again, the federal court came out in favor of a broad interpretation of Fabe. The 5th Circuit said that the liquidation act provisions protected policyholders and therefore were encompassed by McCarran "reverse pre-emption." Thus, the state liquidation act provisions trumped the Federal Arbitration Act.

The Feds have demonstrated a complete lack of shyness in challenging state liquidation priorities, whether the governing statute be "cured" or uncured. In the trenches we expect, unless something drastic happens, that the "post Fabe" litigation will continue in various forums with a frequent cause for dispute being the clash between the state liquidation act distribution schemes and the federal super priority statute.

In no way related to insurance insolvencies, but still of some interest to those of us who are truly jaded, is United States v. Estate of Romani, 118 S. Ct. 1478 (1998) in which the U.S. Supreme Court held that the federal tax lien act as amended in 1966 trumped the super-priority statute. The Supreme Court remarks "[t]he text of the priority statute [31 U.S.C § 3713] on which the Government places its entire reliance is virtually unchanged since its enactment in 1797. As we pointed out in United States v. Moore, not only were there earlier versions of the statute, but 'its roots reach back even further into the English common law.' The sovereign prerogative . . . was exercised by the English Crown and by many of the States as 'an inherent incident of sovereignty..'' [Citations omitted] Can we at least infer that the current Supreme Court is less than crazy about § 3713?

A Federal Legislative Initiative?

Wearied by all the time and money spent in the litigation described above, various industry representatives, representatives of all major company trade associations, Pete Gallanis from The OSD, the NCIGF and NOLHGA, and some of their member guaranty associations met in Washington, D.C. last April to talk about amending § 3713. The statute does, after all, exempt cases governed under by the Federal Bankruptcy Code. According to Mark Goodman of Lord, Bissell & Brook, it also does not apply to insolvencies of national banks, federal savings and loans and federal savings banks, or to insolvencies of FDIC-insured states banks and savings and loans in which the FDIC is the receiver. This leaves little left for the statute to govern besides insurance insolvencies.

A successful effort in this regard would do away with the "clash of priorities" that brought about the voluminous litigation that preceded Fabe and the equally prolific court activity that we are seeing now. The amendment would most certainly eliminate much of the uncertainty receivers grapple with when they consider the federal claims of unknown magnitude which may or may not exist against their estates.

The discussion at the April meeting centered around whether it was feasible to amend the "Super-priority" statute and what form such an amendment would take. (Some favor a total exemption for insurance insolvencies, others feel the better approach may be to exempt only policy claims of the federal government.) Foremost on industry's mind was whether this initiative was "revenue neutral", that is, could it be done without a loss of some of the revenue that currently flows to the federal government by virtue of the provisions of the current § 3713? The folks at the meeting who dwell inside the beltway gave the rest of us a crash course on the federal "PAYGO" (Pay - As - You - Go) rules. It seems that if this amendment would cause a revenue loss the methodology for recouping this loss must be built into the proposal. It became clear that more specific information on the monetary effect of an amendment was needed. The group agreed that receivers should be surveyed to find out how much has actually been paid out based on the government's assertion of § 3713. Results are coming in to Cathy Travis at the OSD, Illinois.

Cathy reports she has received data on over one hundred estates so far. (If you received a survey and have not returned it, please do so soon. This information will help all of us!!) She expects to be able to provide a report on the survey results obtained to date at the September NAIC meeting. By the way, a sub-committee was designated to oversee this information-gathering project. Its members include Pete Gallanis, representing the NAIC; Kevin Harris, NCIGF; Dave Perry, NOLHGA; and Mike Marchman, representing IAIR.

The NAIC, seeing virtue in the idea of a federal code amendment which could conceivably lay this issue to rest, adopted a resolution in support of an amendment to § 3713 at the June meeting. The resolution sets out that the administration of insurance company receiverships is an integral part of the regulation of the insurance industry and the protection of policyholders. The NAIC "urges Congress to amend 31 U.S.C. § 3713 to explicitly exempt from its ambit the administration of insurance company receiverships in order to preserve to the states that which Congress intended in enacting the McCarran-Ferguson Act."

Mark Goodman points out that the climate may actually be pretty good right now to initiate something like this. The fact that the Republicans control both houses of Congress should mean, at a minimum, that an industry-supported proposal would not receive an automatic negative reaction. Additionally, considering that the federal government lost both in Fabe and in Boozell, we are coming from a position of relative strength. Further, we would not be asking Congress to overturn any controlling court decisions. It also may be something industry, state regulators and the NAIC can work together in supporting.

While no one has made any definite commitment to actively pursue this effort yet, it is generally agreed that a federal code amendment would go a long way to cut down on litigation and to remove much of the uncertainty receivers

(Continued on Page 20)

Super-Priority Update

(Continued from Page 19)

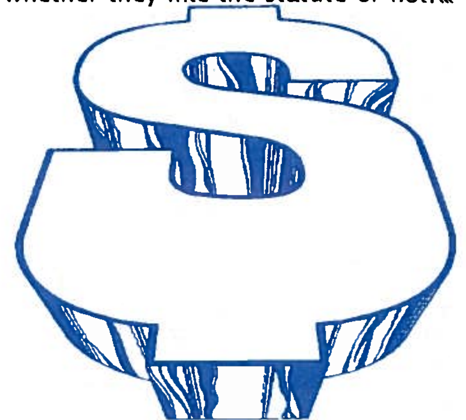
struggle with while the threat of unknown federal claims looms. Its also clear that this effort would be an uphill battle. But, at least in my mind, any hope of ending our "post-Fabe misery" is worth a shot.

The State Cures

While we await a clean sweep on § 3713 in the U.S. Congress, I feel compelled to provide you with the latest and greatest state "Fabe cure" report. To date, we know of 27 states which have enacted "cure" legislation. They are Arizona, Arkansas, California, Colorado Connecticut, Florida, Georgia, Hawaii, Indiana, Illinois, Iowa, Kentucky, Louisiana, Michigan, Missouri, Nevada, New Hampshire, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Tennessee, Texas, Utah, Virginia, and West Virginia. The most recent enactment is New Hampshire. (A state which is not on the list is not necessarily "non-conforming." Some distribution schemes may comply with Fabe as originally drafted. There may be some other states that have installed cures unbeknownst to us. Please let me know if you have information on a "cure" which does not appear on this list.) While the 1998 state legislative sessions did not bring about the flurry of activity we saw in 1997, it was obvious that the cure effort is still alive and well - we expect to see more states introduce bills next session.

And in Conclusion . . .

A federal code amendment is a good idea. Without it, Fabe will be continually poked and prodded with unpredictable result and a predictably high price tag. We can all speculate about what the Supreme Court might do if and when they confront the clash issue on a second go round. Without an amendment, the Supreme Court will be forced to deal with the 200 year old § 3713, whether they like the statute or not.



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A New Way to Fill the Hole

Identifying Unidentified Reinsurance Recoverables

*By Terence N. Quested **

It is axiomatic, but reinsurance recoverables are the primary asset [hopefully] found in most insolvent property/casualty estates. It follows that the prompt and thorough identification of insurance claims applicable to reinsurance is one of the most important tasks undertaken by a Receiver. However, a less well-known fact is that insurance carriers routinely fail to identify all reinsurance recoverables. Literally hundreds of millions of dollars fail to be ceded to valid reinsurance on an industry-wide basis. As a general observation, these valuable assets can and do remain undiscovered and unfortunately unrecovered forever. Why? The answer is both obvious and simple. Reinsurance processing often goes unaudited or the audit scheme utilized can be nothing more than a reprocessing of the claims data in the same manner as initially performed. The result is a substantial amount of slippage that costs cedant companies hundreds of millions of dollars. Why this slippage occurs and how you can better pursue as yet unidentified and unclaimed reinsurance recoverables through the use of artificial intelligence technologies are the reasons for this article.

Let's first examine "Why are any claims lost?" Simply stated, complex contractual relationships create an atmosphere where tolerable error ratios are utilized as a common business practice due to the belief that there is no more efficient methodology.

First, by its nature, reinsurance involves complex non-standardized transactions. By their nature, reinsurance contracts include varying layers of coverage and accompanying trigger points. The language of the contracts, triggers, and involvement of complex premium calculations all add to make a complex relationship at inception that much more difficult to process effectively.

Second, traditional means of processing claims are imperfect. Currently, many companies utilize relational database technology or human analysis to handle reinsurance claims processing. Obviously, the quality of processing you receive from an individual can vary widely from individual to individual. As for relational database technology, the binary system used by computers, requires a high level of accuracy during data input to produce solid results. As a result, even relational database technology is dependent upon human input and the resulting normal errors. It is impossible to ensure that every piece of data is entered without spelling, coding or other types of mistakes. Consequently, when systems are run to produce reports, there may be a small, even what is considered tolerable, error ratio. While filters and other methodologies help to address this issue, the complexity of operating systems may result in an increase in the number of opportunities for error. In the arena of reinsurance claim identification, this may mean significant recoveries being overlooked.

An exercise performed at an insurer a couple of years ago really brought this issue to the fore. This was a sophisticated modern insurer with highly competent staff throughout their organization. The ceded reinsurance manager had noticed a couple of claims to their property per risk reinsurance treaties that did not have the appropriate catastrophe codes; however, the claims were clearly losses as a result of catastrophes. He thought this might result in the portion of loss applicable to their catastrophe treaties being unrecorded. The company, like many insurers, used a catastrophe code as their prime identifier in aggregating catastrophe losses. The claims department manager, the head of systems operations and the financial reporting division assured him that the instances he had unearthed were extremely rare and that all of their procedures flushed out missed claims. Having listened to numerous reinsurance brokers during the course of his duties he had developed a keen skepticism to assurances of any kind, so he decided it was worth taking a closer look anyway. Following an exhaustive search involving a team of over 15 qualified people and taking close to one full year, the manager was able to identify and recover almost $10,000,000 in additional reinsurance claims from two catastrophe events alone. This was found money. Absent the search these assets would never have made it to the insurers surplus.

Although not every insurer has catastrophe exposures, how an insurer with catastrophe losses handles a crisis is similar to how any insurer will operate in a crisis. When a catastrophe occurs, the environment in a claims department is anything but normal. Procedures and systems designed to handle a few hundred or a few thousand claims a day can suddenly be facing a far greater workload. Emphasis shifts from accurate data entry to volume production as the department operates in crisis mode. Personnel no longer have the luxury of time to double check entries or ensure completion of all data fields. Situations inevitably occur when data is incomplete or incorrect. The department's focus is understandably on satisfying as many claimants as possible in the shortest time possible, not on absolute adherence to procedures set out by someone who does not have to deal with the work load. Thus, aggregations of claims from the data produced will typically miss a significant number of potential reinsurance recoveries.

There is no easy answer to discovering every missing loss recovery, and although in the example used earlier the project was considered a success, what certainty is there for the insurance company to know if the search was complete? Further,

(Continued on Page 22)

**** Terry Quested is Senior Vice President at ReClaim Technologies & Services, Ltd., which specializes in the use of artificial intelligence to effect reinsurance recoveries. He has worked in the insurance and reinsurance community since 1974 in London, South America, Mexico, Bermuda and the U. S. A.***

A New Way to Fill the Hole

Identifying Unidentified Reinsurance Recoverables

(Continued from Page 21)

the insurer's other reinsurances, including many years of facultative reinsurance purchases, open casualty treaties covering long tail exposures, and clash covers could harbor considerable additional recoveries.

Experience has shown some companies cannot determine every instance where reinsurance has been purchased. One interesting example that illustrates this involves a former Lloyds of London underwriter who, to reduce his written line, would cede off a portion of the risk through facultative reinsurance. He was very diligent in ensuring that evidence was obtained, and he securely filed away the cover notes under the seat in the Lloyds underwriting box. Every few years or so this filing space was purged, and out went the evidence of ceded reinsurance. When the losses that apply turn up years later there is little chance reinsurance recoveries will be realized. When an insurer falls into the administration of another party it is possible some reinsurance purchases will never be discovered. Thus, electronic data, especially payments, can provide a good lead toward determining and quite possibly the only way to determine where reinsurance was purchased.

Another issue is comprehension of the applicability of the reinsurance terms. This often requires expert knowledge. Claims department personnel are often responsible for identifying reinsurance claims but they may have little training in reinsurance. Understanding that clash reinsurance, for example, which usually covers casualty loss incidences on separate policies involved in the same event, can also frequently provide ECO (extra contractual obligations) and XPL (excess of policy limits) coverage is critical if these instances are to be ceded. Frequently, this and many other nuances of reinsurance coverage is rare knowledge to those involved with administering reinsurance claims cessions.

An insurer's electronic data often also contains clues to actual reinsurance purchasing practices. The purchasing *practice* may provide more valuable information in a search than actual reinsurance underwriting *guides*. Underwriting guides cannot always take into account something required in an underwriting decision. What the underwriters actually did, as opposed to what their 'guide' says they should do, is the information required. Because insurers are unable to quantify what might have been missed many simply decide it is too speculative an effort to look, or they accept an assurance that the task really has been completed accurately. The resources required for performing in-depth manual and data searches, with potentially unproductive results, can be fairly large and expensive. Perhaps, for this reason, many efforts to address the issue are perfunctory. Bear this in mind when you are reviewing a situation where a claims reconciliation analysis has

Artificial Intelligence - A Layman's Guide

This writer claims no particular expertise with computer technology. Frankly, I've found it difficult to even keep up with the jargon required to understand IT managers, techno teenagers and the Internet crowd. But recognizing the need to appreciate the complexity of options that artificial intelligence and other technologies make possible, my research has led me to the following descriptions of certain generic forms. These technologies include Neural Networks (sometimes, Neural Nets), Fuzzy Logic, Genetic Algorithms and inductive rule extraction techniques. Each has a singular use but when the strengths of one are used in combination with the abilities of another, and/or with traditional relational data base methods, it is possible to produce very powerful search capabilities.

Neural Network: A neural network is a software (or hardware) simulation of a biological brain. The purpose of a neural network is to learn to recognize patterns in data. Once a neural network has been trained on samples of data, it can make predictions by detecting similar patterns in future data. The knowledge base acquired can be cumulative, making the neural network more proficient with experience.

Fuzzy Logic: A type of reasoning in which things are seldom black or white (it is not a teenager's thought process!). A database query using fuzzy logic will assign a degree of belonging to every record, indicating how well each record matches the query request. Operating on rules based instructions fuzzy logic nevertheless seeks data with some similarity, or "belonging" to the known rule.

Genetic Algorithm: A method used to evolve the most efficient solution to a problem by breeding data inquiry elements. The individuals of an imaginary population begin by randomly guessing the solution. The best guessers mate with the other best guessers, passing on combined knowledge to their offspring, while the worst guessers do not survive. Over successive generations the population will evolve toward the optimum solution to the problem. They are analogous to electronic test tube babies bred to perform desired functions and to grow more proficient with use and breeding. When introduced to a data retrieval process they act like an intelligent Pac Man, grabbing desired information and aligning it for output.

Inductive rule extraction: A method whereby the most efficient decision tree is extracted from a set of data. The extracted decision tree is used to show what rules are embedded in the data. Inductive reasoning is used to determine probability, whereas deductive reasoning can only provide a fact. In this way, even where a fact is not explicitly resident in electronic data, sufficient information may be available to make an accurate determination of the fact.

allegedly already been performed. Auditing for reinsurance claims can be an exhaustive exercise with many of the drawbacks described in the catastrophe example above. While staff will typically address these tasks with vigor at the outset, it can be shown that effectiveness will diminish as an audit exercise progresses. Even on a daily basis the mind-numbing repetition of tasks results in tapering efficiency and loss of accuracy. Clearly, the use of technology to solve what is in part a technology issue would appear to be the most rational approach to the solution. A machine, or software, does not get tired, sick or distracted.

Artificial intelligence (AI) technologies, which have mostly found applications in sophisticated high tech manufacturing and educational applications, hold out the promise for discovering many hidden treasures in data banks throughout the world, especially where expert business know-how can be incorporated with their capabilities. The ability to recognize patterns is one of the key attributes of certain forms of AI. Fraud detection programs operated by insurers, banks and law enforcement officials already make use of these tools. While data mining, at least according to technology sector magazines, would appear to hold out the most promises for obtaining marketing information for improved sales efforts, at least one high tech company has utilized artificial intelligence specifically to address the issue of reinsurance claims. Unlike operating systems and reinsurance processing programs that are used to administer claims and other data, the AI based services operate with whatever raw and flawed data is already available.

When an insurer is in trouble, it tends to lose control over its administrative operations even while all sorts of potentially valuable information is still being recorded. It is not hard to imagine what a nightmare it is for a receiver to sort it all out, particularly where the company being administered has mostly electronic data, possibly from several different operating systems and from different regional offices. When the individuals responsible, usually within the systems operations, discover the quality of the data they have to work with, they are likely to grimace at the idea of providing truly accurate reinsurance claims information. Because reinsurance recoveries are so important, locating all of these assets simply has to be performed. Electronic data, with the aid of AI, can be manipulated to provide unexpected and profitable results.

For example, in the Transit Casualty liquidation $1 billion in assets have been recovered so far, much of this is reinsurance related. Unraveling the millions of transactions involved in that case has surely been a mammoth job since the carrier was placed in liquidation in 1985. The team responsible should be highly commended for their successes to date. But while the Transit Casualty insolvency has been termed the "Titanic of property and casualty insolvencies" by the U.S. Congress, it would not be unreasonable to expect we may see other, possibly even more complicated insolvencies occur.

The 1990's trend of mergers and acquisitions, including recent deals involving groups from outside the insurance industry, hold an uncertain future. This applies not only for the companies involved but has implications for the rest of an insurance industry, which even in these bullish stock market days sees insurers under-performing at the operations level. Any number of forces may precipitate yet another series of insolvencies, not the least of which in an era of global warming and seismic uncertainty could be two large catastrophic events in one year.

Whatever the cause, when the situation arises it is important for those charged with the responsibility to take full advantage of emerging technologies and techniques.

To summarize, we should accept that valuable reinsurance assets often exist within insurance companies, but will not be discovered unless new methods are used to locate them. Technology can provide answers to this, and perhaps as yet unimagined applications. We need to encourage development of technology and offer our business knowledge in the configuration of the development. We should not always accept an engineer's word that something is not possible, as often, when you look at an issue from a different perspective, a solution presents itself. When we read insurance and technology articles, it seems a lot of new software applications only claim to improve or speed an existing application. What we require is new tools to accomplish tasks that have never been performed before at all. What Artificial Intelligence provides is the key element to develop these tools.

IN THE HIGH COURT OF JUSTICE

CHANCERY DIVISION

No. 0004298 of 1998

IN THE MATTER OF THE

BAI (RUN-OFF) LIMITED

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

Notice is hereby given that pursuant to an Order dated 30 July 1998 made in the above matter Dan Schwarzmann and Christopher Hughes of No 1 London Bridge, London SE1 9QL, were appointed Joint Provisional Liquidators of the above Company.

Dated this 28 day of August 1998

IN THE HIGH COURT OF JUSTICE

CHANCERY DIVISION

No. 004787 of 1998

IN THE MATTER OF THE

BLACK SEA AND BALTIC GENERAL INSURANCE COMPANY LIMITED

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

Notice is hereby given that pursuant to an Order dated 24 August 1998 made in the above matter Dan Schwarzmann and Colin Bird of No 1 London Bridge, London SE1 9QL, were appointed Joint Provisional Liquidators of the above Company.

Dated this 28 day of August 1998

IAIR Educational Events

(*IAIR Roundtable schedule is on page 4.*)

IAIR/NCIGF Joint Seminar
November 12-13, 1998
Hyatt Hotel
Monterey, California
Co-Chairs: Kristine J. Bean
Peterson Worldwide &
Holly Bakke
N J Property Liability IGA

NAIC/IAIR
Insolvency Workshop
February 3-4, 1999
West Palm Beach, Florida
Chairs: Charles Richardson
Baker & Daniels &
Richard Darling, CIR
Illinois Office of the
Special Deputy Receiver

IAIR
Staff Training
Seminar
May 1999 *(tentative)*
Chair: Paula Keyes,
Paula Keyes & Associates

IAIR/NOHLGA
Joint Seminar
November 1999

IAIR/ABA
Fourth National Institute
on Insurer Insolvency
December 1-2, 1999
Chair: Robert Greer, CIR
Greer Law Office

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