# The INSURANCE RECEIVER

*Promoting high ethical standards in the administration of Insurance Receiverships.*

Volume 6, Number 1

SPRING 1997

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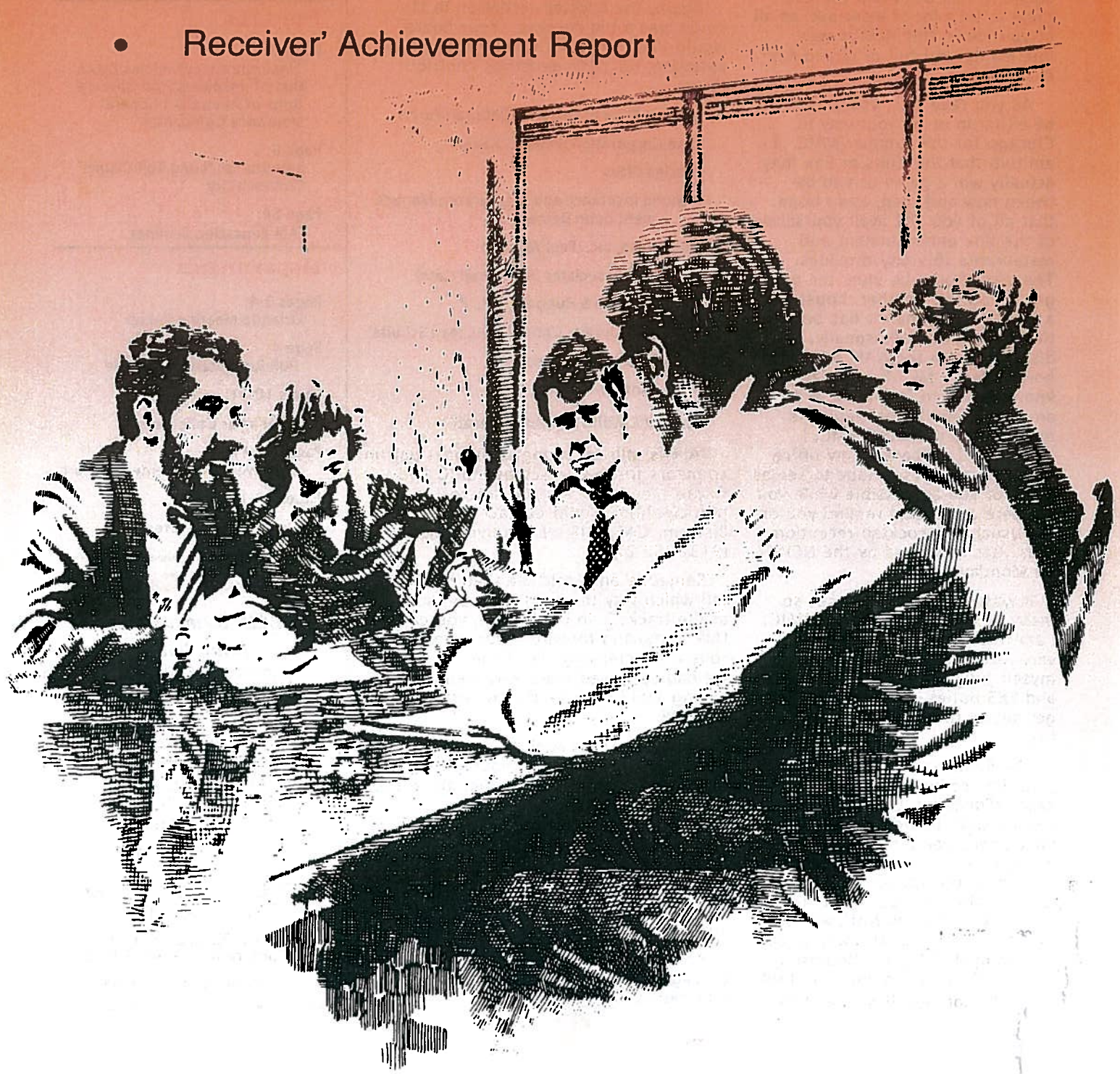

# President's Message

*By Dick Darling, CIR*
*Chief Operating Officer, Illinois Department of Insurance*

Its spring in Chicago, or so I am told. I do not get to spend a lot of time outside of my office these days. 8 insolvencies in 10 months are keeping all of us very busy. But, on the other hand, its good to exercise your intellect and experience in a productive manner again. It has been and will continue to be a lot of work but, as all of you know, this field is very interesting and full of day-to-day challenges.

As you read this, you all should be either in or on your way to Chicago for the summer NAIC. I am told that the Cubs or Sox may actually win a game or two between now and then, and I hope that all of you will avail yourselves of the fine entertainment and restaurants this city provides. The lake should be blue, the parks green and the weather, hopefully, a little warmer than it has been this past winter. Personally, I dislike it when the NAIC is in my home town. My office always knows where to find me and if I am not grumbling through the meeting rooms of the NAIC, I usually end up back at my office juggling creditors. I hope to see as many of you as possible while you are here and would remind you of the usual IAIR cocktail reception (this year co-hosted by the NCIGF) on Monday night.

It was equally good to see so many of you at the Orlando NAIC. I am told the weather was really very nice. Although I found myself juggling E-mail, Voice-mail and EX5 duties, I did manage to get out by the pool for an hour or two.

The Reinsurance Roundtable on Saturday, co-hosted by Paula Keyes (Education Chair) and Liz Lovette (IAIR Board member), was once again well attended and brought some interesting perspectives from the speakers. Paula tells me that the roundtable to be held at the Chicago NAIC will be just as interesting, and will be co-hosted by Phil Curley (Robinson, Curley, Clayton). In addition, IAIR is sponsoring an educational event with the Society of Financial Examiners planned for June 8th at the NAIC. Further, your Educational Committee is working on a staff training educational seminar to be held on June 26-27, 1997. Your board hopes that many of you will be able to attend one or all of these events.

Again, the cocktail reception in Orlando was a big success. Your board would like to thank the following patron sponsors for their generous contributions:

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IAIR is still accepting additional patron sponsors for the September NAIC and future meetings. Anyone interested in participating should contact Frank Bistrom, CAE, IAIR's Executive Director, at (913) 262-2749.

Someone once told me that "you can't tell which way the train went by looking at the tracks." In IAIR's case, you can tell; IAIR is moving forward. Our membership rolls are increasing. As of the end of April we had approved more new members during 1997 than we did the entire year of 1996.

The board continues to strongly encourage you to solicit your associates, employees, or other professionals in the field to join IAIR.

Our mission of education and professionalism, as well as our accreditation standards, can certainly be assisted by an increased membership to allow us to accomplish the goals and directions of your organization.

Again, I hope to see many of you in Chicago and wish you a very productive and satisfying summer.

*The* **INSURANCE RECEIVER**
Volume 6, Number 1
Spring 1997

## In this Issue

### Features



### Departments



### Mark Your Calendar

***IAIR Reinsurance Roundtable***
Co-Hosted By Phil Curley; Robinson, Curley, Clayton
June 7, 1997 1-5 p.m.
Chicago, Illinois

***IAIR/SOFE***
June 8, 1997 at the NAIC
Panel Discussion
Chicago, Illinois

***IAIR Educational Seminar***
June 26-27, 1997
University Place Executive Conference Center & Hotel
Indianapolis, Indiana

# Orlando Meetings Recap

*By Mary Cannon Veed*

Like the blind men with the elephant, who wanted to describe the beast in terms of the pieces they had hold of, my own view of the Orlando meeting was mostly of the Interstate Compact. The Receivership Law Advisory Group held a meeting on Saturday which was well attended by observers, causing an uncharacteristic degree of reserve to dominate the discussions.

The RLAG usually meets for two-day sessions in between NAIC's, and we scheduled the NAIC sessions, which are shorter and lots more visible, mostly to give other people a chance to see what was going on, and react to it. I guess it's working, because they sure did!

So what were we up to? The RLAG's basic plan has been to spend the first half of its drafting time discussing topics which the members identified as potential trouble spots, and playing with possible solutions.

The most definitive decision making we have been doing has been to adopt some "sense of the group" resolutions, binding on nobody, when it appeared that a consensus existed on some concept or other. Grizzled veterans of NAIC wars are constitutionally skeptical of any committee that claims not to have made up its mind in advance of the meetings, and they just can't believe that the RLAG isn't a front for somebody's devious scheme to destroy liquidation law as we know it.

So the Group has been plagued with all sorts of outraged reactions by people who have heard that the Group is "going to" do something scary. The group is very diverse, and populated with a number of people who know their business.

The only way it is going to decide on something is out loud, in public, and in plain English. Any suggestion to the contrary brands the suggester as uninformed, or maybe dishonest.

That isn't to say that there aren't some kind of interesting ideas being floated. Without exception, they are all in the "what-if" stage, and although some of them are beginning to attract support, even that is contingent on not discovering some unsolvable complication.

One good example is the idea of a "unitary proceeding". The Model Act and the existing laws of the compacting states are not consistent, either internally or across state lines, in the civil procedure they apply, or even in the uses to which the various stages are put. Moreover, real world practice doesn't match the statutes and decisional law very well.

The *non sequitur* results of the statutory distinction between rehab and liquidation seem to be that, first, once liquidation is started, perfectly useful remedies are unavailable to the liquidator, and second, if rehabilitation of an insolvent company is chosen, the rehabilitator has to pretend his intent is to return the company to "normal" operation, when, in most cases, it isn't and shouldn't be.

Just to add insult to injury, the various statutes have overlapping and sometimes contradictory layers of procedural instructions, tailor made for malicious mischief by people whose agendas do not include the protection of policyholders, which it would be a crime to perpetuate.

It has been proposed that the new law describes receivership procedures as a continuum from temporary relief through various remedies, with a logical progression of procedure, notice, standards of proof, and remedies, a consolidated set of grounds for action, and so on, in place of the current patchwork quilt.

This is a change in the organization of the receivership law, but would entail little change in the substance of it, except to make clear what ought to go without saying: that an order of liquidation, with or without the finding of insolvency, does not restrict the liquidator's ability to employ non-traditional resolution procedures with the approval of the supervising court.

Obviously, one would want to be careful that no change was accidentally effected to the trigger points for guaranty organization liability, or to any other worthwhile artifact of the old laws, but with all the *kibitzing* we're getting, there is no reason why that should happen.

A related but separate proposal is to improve communications among the court, the liquidator, and interested parties through better notice and reporting procedures, clearer standards for who gets notice of what, and the option of streamlined and less labor-intensive interested party access to key receivership records through a documents depository system.

These modest proposals have triggered a small firestorm of rumors, reminiscent of that "telephone" game one played as a child.

Through repeated retransmission, they have transmogrified into an assault on guaranty fund prerogatives or a backdoor effort to adopt the federal Bankruptcy Act and impose it on the states. Hogwash!

The first rule of the Uniform Law is "Don't mess with the GAs!", and even if we felt mutinous, there's an explicit provision in the Compact Law to the same effect. And, while no one is averse to plagiarizing the Bankruptcy Act when it suits, most of it doesn't, which is why we started this exercise in the first place.

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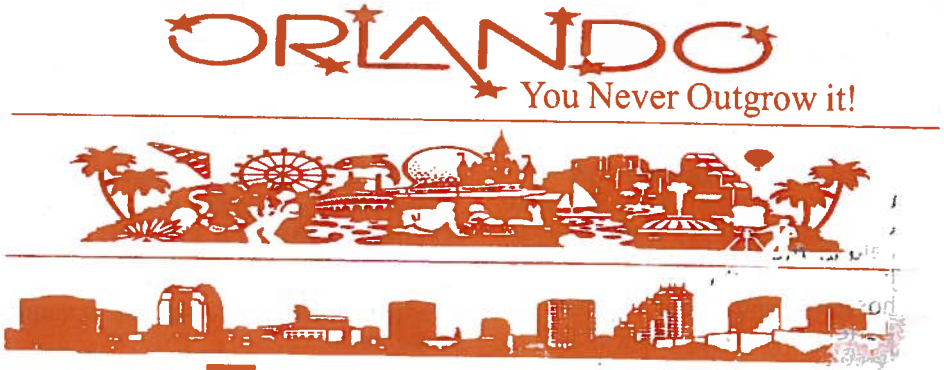

## Orlando Meetings Recap

*(Continued from Page 3)*

What were the rest of you up to? It seems to have been a fairly useful meeting, all in all.

The last version of the Receivers Handbook was finalized, and the tenacious committee members turned their attention to next year's version. Initial topic assignments were made, on an amazing variety of topics. If this field would quit changing all the time, we might be able to catch up with it.

The Model Act Working Group passed its derivatives language up to EX5, where it is parked for a little extra scrutiny from regulators, presumably until next meeting. The group settled down to work on its new charges, which include some thinking about liquidation claim procedures.

The most obvious thing the Guaranty Fund Issues group accomplished was to set up a public hearing for next time on the presently proposed changes to GIC coverage.

It also began to noodle around with its next charge, figuring out how, or if, health coverage provided by "hybrids" ought to be covered, and how to describe the right coverage when the products and entities themselves keep "morphing" every-six weeks or so. Next step is a joint meeting with the Health Insurance Policy Group.

But the truly interesting event was a sort of colloquy between the audience and the Group about where the GIC issue is going.

For a while, the waters seemed pretty smooth. Industry representatives reported candidly that consensus had developed that GIC sellers wanted to be neither assessed as insurance products or guaranteed like them.

Their principal competition, of course, is financial instruments, and the added costs could handicap them. Now, that is sort of interesting, because it says something about the benefit which industry perceives it obtains from GA coverage.

One could speculate that GA coverage would give GICS a competitive advantage, since some of those ·peting instruments can't match ·vel of financial security. Is it something about the slow ! general fuzziness of GA responses to insolvency that GIC marketers are saying "No, thanks"?

Would the rest of the market say the same thing if it had the chance? Or do the GAs simply have a really bad marketing problem?

Bemused by that speculation, I almost missed one of the better pieces of mischief at the meeting: Peter Gallanis inquired whether, since everyone seemed to be agreeing that GICs should not have GA coverage because they were really investment products and had nothing to do with insurance, wasn't it also true that they should receive general creditor status in liquidations, and maybe investment contract treatment by the IRS? Whereupon, the meeting adjourned in a buzz.

Correspondent Bob Greer reported an interesting bit of scuttlebutt that seems worth passing on.

Although they used to just ignore the problem, liquidators, especially life liquidators, have become increasingly aware of the tax implications of their tactics.

One tactic I hadn't encountered before is the creative use of 501c(15) status, which tax exempts P&C insurers with less than $350,000 a year in premium income.

That would seem to apply to many companies in liquidation, and it has a gratifying effect on any number of tax headaches, such as the imaginary taxable income the company is apt to be blamed for from such liquidation-related events as debt forgiveness or D&O recoveries.

Not, apparently, as gratifying to the IRS, which has issued proposed regulations that would treat the change to a 501c(15) as a taxable transfer and pretty much ruin the fun. Comments were supposed to have been made by April 15, and apparently some liquidators have done so. Late comments are presumably still feasible if from a worthy enough source.

Next meeting is, of course, Chicago in June. We are looking forward to extending some Chicago-style hospitality and maybe even decent weather. Tickets for the Cubs (vs. the Mets) and Sox (Baltimore) should be easy to come by. Whether the product qualifies as baseball remains to be seen.

### IAIR Roundtable Schedule

NAIC Meeting - June 8-11, 1997
Chicago, Illinois
**IAIR Roundtable - June 7, 1-5:00 p.m.**

NAIC Meeting - September 21-24, 1997
Washinton, D. C.
**IAIR Roundtable -**
**September 20, 1-5:00 p.m.**

NAIC Meeting - December 7-10, 1997
Seattle, Washington
**IAIR Roundtable -**
**December 6, 1-5:00 p.m.**

NAIC Meeting - March 15-18, 1998
Salt Lake City, Utah
**IAIR Roundtable - March 14, 1-5:00 p.m.**

NAIC Meeting - June 21-24, 1998
Boston, Massachusetts
**IAIR Roundtable - June 20, 1-5:00 p.m.**

**The INSURANCE RECEIVER**

The IAIR newsletter is intended to provide readers with information on and provide a forum for opinion and discussion on insurance insolvency topics. The views expressed by the authors in the IAIR newsletter 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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**Directors:** Betty Cordial; James Gordon, CIR; Michael Surguine; Robert Craig; Elizabeth Lovette; Lennard Stillman, CIR & Philip Singer.

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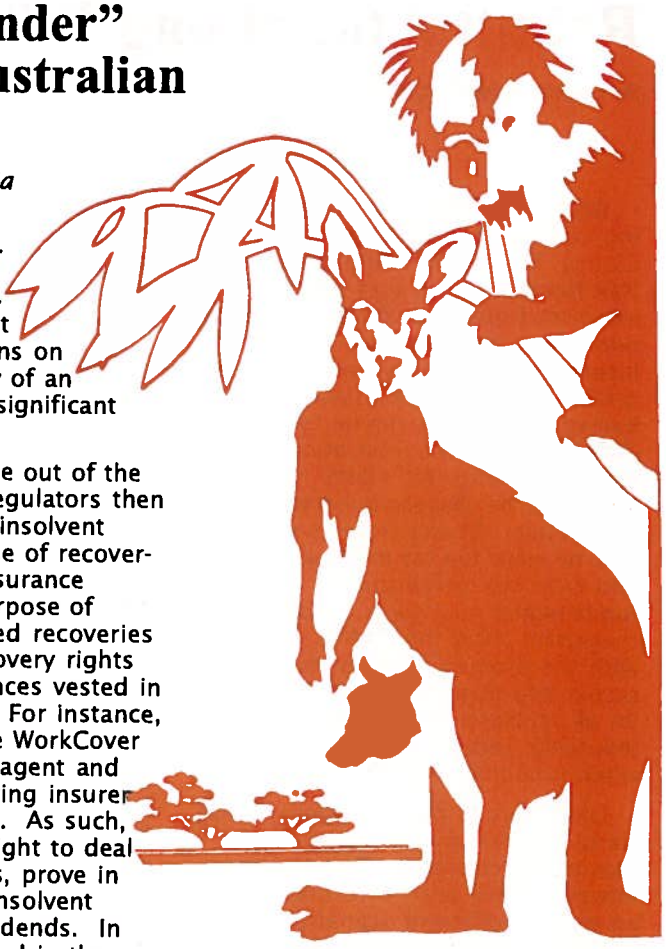
# "Insurance Insolvencies Down Under" Insolvency Administrations of Australian General Insurance Companies

*by Dominic Emmett, Norton Smith & Co, Sydney, NSW, Australia*

***Editors Note:*** *This is an update of an article on Insurance Insolvencies in Australia. This is a fuller description than the half page article that ran 2 years ago.*



Several important and unusual features of Australian law relating to insolvencies of general insurance companies may be of interest to practitioners from other parts of the world. Two such characteristics are discussed in this article. The first concerns the relative ranking of policyholders to general creditors. The second is the territorial approach adopted by the Australian legislature toward insolvencies of insurance companies in Australia.

## Relative Ranking

The relative ranking of policyholders to creditors is one which is quite different from that in most U.S. States or the U.K.

Under Australian law, policyholders of a general insurer in liquidation are given two distinct advantages over the rights of general creditors.

### • Direct Access to Reinsurance Recoveries

Section 562A of the Australian Corporations Law gives a policyholder the right to receive reinsurance recoveries relating to its claim, bypassing the insolvent insurer. However, in practice it will be the insolvent insurer's liquidator who administers collection of the recoveries - being in possession of the general insurer's books and records. In doing so, the liquidator is entitled under section 562A to deduct the expenses of or incidental to getting in those recoveries before paying policyholders.

### • Direct Access to Policy-Related Recoveries

Various pieces of legislation in Australia dealing with different sectors of the insurance industry allow insurance regulators to levy the insurance industry to establish funds to meet claims of policyholders of insolvent insurers. For instances, in New South Wales funds have been established under the Workers' Compensation Act 1987. Those funds are administered by the State WorkCover Authority which Authority can call for contributions from relevant insurers. If those insurers do not make such contributions on time they will be guilty of an offense and liable for significant interest charges.

If payments are made out of the funds, the insurance regulators then step into the shoes of insolvent insurers for the purpose of recovering monies under reinsurance policies and for the purpose of recovering policy-related recoveries generally. Indeed, recovery rights are in some circumstances vested in the relevant regulator. For instance, in New South Wales the WorkCover Authority is appointed agent and attorney of the underlying insurer of the insolvent insurer. As such, the Authority has the right to deal with and finalize claims, prove in the liquidation of the insolvent insurer and receive dividends. In addition, all rights vested in the insolvent insurer arising from or relating to the relevant insurance policy are vested in the underlying insured - in respect of whom the Authority is agent and attorney - as mentioned above.

These rights of "subrogation" mean that in many circumstances the regulators assume a major role in the winding up of Australian insurance companies through their increased voting power as major creditors.

Armed with these rights of direct access through to reinsurance and other policy-related recoveries, policyholders in Australia assume greater priority than policyholders in most non-U.S. jurisdictions, although they are not entitled to the generally higher priority that policyholders of insolvent U.S. companies enjoy.

As readers will appreciate, the practical effect is that Australian insolvency practitioners fulfill a dual role in the administration of insolvent insurance companies. First, they collect assets (such as investments) which are not reinsurance or policy-related for distribution to general creditors. Secondly, they administer, supervise or oversee the direct access procedure - often in conjunction with the regulators who, as major creditors, pursue reinsurance and other policy-related recoveries.

### The Territorial Approach

In short, the territorial approach means that an insolvent general insurer's Australian assets must be applied in discharge of its Australian liabilities - section 116(3) of the Insurance Act 1973. This requirement applies whether the insurer is incorporated in Australia or outside Australia.

In this context the recent decision of McLelland CJ of the Supreme Court of New South Wales in *National Employers' Mutual General Insurance Association Limited (in Liquidation) ("NEM")* is relevant.

NEM was an insurance corporation incorporated in the UK and registered as a foreign company in New South Wales. Winding up orders were made in both Australia and the UK and separate liquidators appointed in each jurisdiction. Bef the Court was a proposal from

*(Continue*

# Rebuttal to: "Long Tail Claims" Commentary

*By Debra J. Hall and Anthony J. Mormino*[1]

**Editors Note:** Since Publications Chair's comments are mentioned, the editing of this rebuttal was left to our Article's Editor. Please see our disclaimer on page 4 and note the language about providing a forum for opinion and discussion.

Douglas A. Hartz wrote an interesting commentary on "Long Tail Claims" for the Fall 1996 Issue of the IAIR Newsletter. In that article, he expressed his frustrations regarding reinsurers and insurance company insolvencies generally, and the claim estimation issue specifically. Reinsurers share a similar, yet different, sense of frustration with the issue. While Mr. Hartz may justifiably be disheartened with the early estate closure issue, we believe that he went too far in his assertions and criticism of reinsurers. The fundamental mistake is to take a few reinsurers' (and the RAA's) dealings with the problematic Mission receivership and transpose that situation on all reinsurer interaction with all insurance receiverships, especially when it comes to claim estimation.

Like many of his colleagues, Doug Hartz is a reasonable person with reasonable concerns. Reinsurers, however, have been confronted with an entirely different scenario in the Mission insolvency. It is experiences like Mission that lead reinsurers around the world to view the U.S. liquidation process in a very negative light.

In his article, Mr. Hartz complained that reinsurers are "getting so personal about the [early estate closure] problem." As an example of these personal attacks, he pointed to "numerous negative remarks" about the Mission receivership he heard at an IAIR/NCIGF Seminar in Tampa, Florida. In the same vein, he quoted the RAA's commentary in Mealey's that responded to a sales pitch expounding upon the virtues of the Mission claim estimation plan in an article written by the Mission receiver. Despite these views, Mr. Hartz praised reinsurance industry efforts to find a solution to early estate closure, such as an alternative to claim estimation, that could serve the interests of receivers and reinsurers alike.

Why do reinsurers have such difficulties with that "receivership on Wilshire Boulevard?" Because no receivership has so blatantly demonized reinsurers even as its efforts to do so have been rebuffed so consistently by the courts.

The RAA has had no such negative experience with any other insurance company liquidation, particularly in dealing with the claim estimation issue. In fact, the RAA has opposed the claim estimation plan proposed in the Integrity liquidation and the Holland-America liquidation and yet it still maintains amicable and productive business relations with the parties involved. Those good relationships may someday result in a mutually beneficial, legislative solution to the early closure issue.

There are many examples to illustrate reinsurers' claims regarding Mission, but space allows only a few. First, we can look at the interesting interaction between the Mission receiver and the RAA. As you may recall, the RAA (and others) opposed the Mission plan for claim estimation (also known as the Final Liquidation Dividend Plan) as a basis for calculating reinsurance recoveries. This opposition eventually resulted in an opinion by the California Court of Appeal vindicating the reinsurers' position and striking down the plan as unlawful. *Quackenbush v. Mission Ins. Co.*, No.B094721 (Calif. Ct. App. Jun. 14, 1996).

During the hearings on the original plan before the Mission liquidation court, the Mission receiver made no bones about his contempt for reinsurers. On the record, the Mission receiver voiced his theory that reinsurer opposition to the claim estimation plan was based on their desire to "try to cut off their own liability . . . [and] avoid their own future liability to these underlying policyholders . . . their theory is that they get to skate, so to speak, on their own liabilities." *Garamendi v. Mission Ins. Co.*, No. C-572-724 (Calif. Sup. Ct., Los Angeles County, Mar. 23, 1995), Transcript of Proceedings at 14-15 ("Transcript of Proceedings"). The receiver made these allegations throughout the proceedings. See Transcript of Proceedings at 25, 140-141, 146.

The Mission receiver's "theory" might be okay if it was based in reality. However, reinsurer opposition has never been based on any such "theories" as postulated by the Mission receiver. Reinsurers have constantly, consistently, and expressly objected to claim estimation because it violates the terms of their contracts, as well as state law and constitutional guarantees, and because it impermissibly denies them important rights and protections. In no instance has the RAA, or its members, advocated a "cut-off" of their liabilities. Just the opposite, reinsurers have sought to enforce their contracts as written — meaning that they pay reinsurance recoveries on known losses as they are developed and adjudicated.

Next, consider the numerous stories in the on-going saga between the Mission estate and Allstate Insurance Company. Most of them center around their dispute in *Quackenbush v. Allstate Ins. Co.*

In his briefs to the *Quackenbush* Court, the Mission receiver included numerous allegations of fact for which there was no support in the record, including the repeated charge that Mission's reinsurers caused its insolvency. Not only was the assertion irrelevant to the case at hand, but a well-known federal study of the Mission insolvency found the opposite to be true; that the "Mission failure is really a tale of reckless and incompetent management." Subcomm. on Oversight & Investigations of House Comm. on Energy & Commerce, *Failed Promises: Insurance Company Insolvencies*, Committee Print 101-P, 101st Cong., 2d Sess., 11-19 (1990) ("Failed Promises"). And that recklessness included "abuses of the [reinsurance] system," through "excessive use of

*(Continued on Page 7)*

[1] *Ms. Hall is Vice President and General Counsel for the Reinsurance Association of America; Mr. Mormino is Associate Counsel for the Reinsurance Association of America. The views expressed herein are those of the authors alone, and do not represent the express or implied opinions of the Reinsurance Association of America or any of its member companies.*

reinsurance," and by knowingly deceiv[ing] the reinsurers who relied on them." Failed Promises at 10, 12, 14. California courts recently confirmed the massive fraud perpetrated by Mission on its reinsurers. See *Garamendi v. Abeille-Paix Reassurances*, No. C83233 (Cal. Sup. Ct., Los Angeles, Feb. 2, 1995)(referees' "Statement of Decision"); *Copenhagen Reinsurance Co. v. Superior Court*, No. C683233 (Sept. 19, 1996)(order granting entry of judgment based on referee decision).

Not only does the overwhelming weight of evidence contradict the Mission receiver's assertion that reinsurers caused Mission's insolvency, but worse yet, the Congressional study of the Mission insolvency further found that the Mission receiver himself "refused to acknowledge that the noxious management behavior at Mission observed by the subcommittee constituted fraud, as it might well have ruined his civil actions to recover $2.2 billion from Mission's reinsurers if he had admitted that fraudulent behavior had occurred." "Failed Promises" at 62. (The federal study findings were based on its "extensive contacts" with the Mission receiver. "Failed Promises" at 11.)

Despite the fact that a unanimous U.S. Supreme Court ruled against Mission and in favor of reinsurers in the *Quackenbush* case, the Mission receiver has claimed victory to the world — and no doubt his clients. Commentary on *Quackenbush v. Allstate Ins. Co.*, [116 S. Ct. 1712 (June 3, 1996)], *Mealey's Litigation Reports: Reinsurance*, Vol. 7, No. 4 (June 26, 1996). To say that the Mission receiver's Commentary was full of overstatement would be an understatement.

The revisionist history of the Mission receiver's Commentary is best demonstrated in his claim that the California Insurance Commissioner had "conceded, for the purpose of argument and the crisp presentation of issues, that the underlying case was a damages case." In fact, throughout the Commissioner's brief to the *Quackenbush* Court, he repeatedly asserted that he had all along made requests for "equitable" relief to the district court, including a request for a declaratory judgment of the parties' rights under the reinsurance contracts. *See e.g., Quackenbush v. Allstate Ins. Co.*, supra, Br. of Petitioner at 2, 4, 12, 13, 15. All of the courts hearing the case rejected such assertions as untimely. *See e.g. Quackenbush v. Allstate Ins. Co.*, No. CV90-4713-WMB at 6 (C.D. Calif. filed Sept. 13, 1996) (explaining that all courts rejected liquidator's argument regarding discretionary relief as waived because liquidator raised argument too late).

To wit, once he realized that he would win or lose in *Quackenbush* based on the "at law/in equity" distinction, the Liquidator hurriedly and repeatedly tried to change his story on what he wanted from Allstate. In his petition for rehearing to the 9th Circuit, before he appealed to the U.S. Supreme Court, the Liquidator argued "for the first time, that the underlying complaint sought more than simple legal relief because it included a request for a declaration that the defendants owed the Commissioner the amounts he sought in his breach of contract claim." *Garamendi v. Allstate*, No. 91-55855 (9th Cir. filed May 19, 1995) at 2. The court denied the Liquidator's petition and argument because he "waived it by failing to raise it prior to his petition for rehearing." *Id.*

Amazingly, the Liquidator re-raised the matter before the U.S. Supreme Court. The Court simply ignored the assertions and diplomatically cited to the 9th Circuit rehearing denial, stating that "the Commissioner appears to have conceded" that there was no equitable relief in issue because he failed to timely raise the matter — there was nothing voluntary about it, as the Commentary implies. *Quackenbush* at 23. Then, after the U.S. Supreme Court ruled against the Mission receiver, and sent the *Quackenbush* case back to the federal district court for further proceedings, "undaunted, the Liquidator again [asked the district court] to abstain from hearing all or part of the federal litigation," because, the Liquidator claimed, there were equitable issues at bar. C.D. Calif. Slip Op. of 9/13/96 at 4. The district court also referred to the 9th Circuit's denial of the Liquidator's rehearing motion, and dismissed the argument as waived. Id. at 6. The receiver then filed a third abstention motion based upon the same grounds. It was similarly rejected out of hand by the district court. This example serves to demonstrate the typically repetitive and wasteful tactics of the Mission estate — at the expense of Mission's creditors. Neither reinsurers nor anyone else should tolerate these methods.

But there's more to the Allstate/Mission saga.

The procedural abuses in the Mission receivership recently forced Allstate to raise the matter to the California Court of Appeal. Allstate moved the appellate court — albeit

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# Rebuttal to: "Long Tail Claims" Commentary

*(Continued from Page 7)*

unsuccessfully — to recuse the liquidation court judge for evident bias in the receiver's favor (included were allegations similar to those of Copenhagen Re, discussed below), and to attempt to stop the liquidation court from going forward on the merits of a setoff issue when arbitration of the same matter had been ordered by the Federal District Court for the Central District of California, on the authority of the *Quackenbush* decision.

In that same proceeding, Allstate detailed the repetitive and wasteful strategies employed to defeat non-liquidation court jurisdiction and stymie arbitration, all at the expense of Mission's creditors. In this regard, the Mission has, among other things:

- Filed three unsuccessful abstention motions before the federal district court, where the second and third motions were premised on the very same grounds the U.S. Supreme Court had already rejected on the first motion;
- Filed an April 30, 1996 "notice of rejection" seeking to litigate in the Mission liquidation court the same issues on which federal courts refused to abstain;
- Unsuccessfully asked the federal district court to reconsider its own order compelling arbitration based on the receiver's own re-characterization of the relief he seeks;
- Opposed Allstate's Superior Court motion for a stay pending arbitration on the same grounds that the federal district court already rejected;
- Unsuccessfully asked the federal district court to disqualify all of the arbitrators appointed by Allstate;
- Unsuccessfully asked the federal district court to stay its order compelling arbitration pursuant to *Quackenbush* pending his purported cross-appeal; and
- Asked the United States Court of Appeals for the Ninth Circuit to stay the order compelling arbitration pending that cross-appeal.

Finally, and most illustrative, is the Copenhagen Re story, which demonstrates quite well the evident bias against reinsurers that has characterized the Mission receivership.

The controversy involves the February 2, 1995 Statement of Decision by a panel composed of three retired state court judges: the Mission receiver agreed to submit a dispute with certain reinsurers to the panel for findings of fact and particular findings of law; after 92 trial days over 18 months, the panel ruled against the receiver on all counts (and even awarded attorney fees to the reinsurers), finding, among other things, massive fraud by Mission against the reinsurers, and that the Mission receiver should receive none of his demands. This result effectively nullified or "rescinded" the reinsurance agreements. For the chronology of events and facts, see *Copenhagen Reinsurance Co. v. Superior Court*, No. B099422, Motion to Recuse Superior Court Judge in Order to Enforce Writ of Mandate (Calif. Ct. App. Filed Aug. 29, 1996) ("Motion to Recuse").

The reinsurers moved in the Mission liquidation court for entry of judgment in their favor based on the Statement of Decision. During a hearing on the matter, the liquidation court judge likened himself to "Horatio at the bridge, and I'm about to give up my post, and I guess the policyholders can just suffer the loss." Motion to Recuse at 17. The reference is to Horatio, the legendary Roman hero who, almost single-handedly, held off invading Etruscan hordes at the entrance to the bridge that led across the Tiber River into Rome. Id. Later in the same hearing, the court expressed disdain for reinsurers' fraud defense, stating that the fraud defense was merely a "throw-in," and that raising the defense is "what you do when you're stuck on a contract by its letter." Id. The major problem with this remark is that the court made it without ever having heard the evidence which was found so compelling by three retired state court judges, as reflected in their issuance of their "Statement of Decision," which included findings of fact and conclusions of law in favor of reinsurers. *See Garamendi v. Abeille-Paix Reassurances, supra.* Therefore the court had no basis for making the statement.

Not surprisingly, given its views regarding reinsurers' rights, on December 28, 1995, the court denied reinsurers' motion for judgment in their favor, and vacated the retired judges' Statement of Decision on the receiver's motion.

The reinsurers appealed, and on May 25, 1996, the California Court of Appeal issued a Writ of Mandate, ordering the Mission liquidation court to enter judgment in favor of reinsurers based on the Statement of Decision, and vacate its contrary orders.

The Court of Appeal, on the Mission receiver's motion, then modified its Writ for a technicality on June 21, 1996. In what might be the boldest maneuver yet, the Mission receiver mischaracterized the Writ of Mandate as requiring the liquidation court to enter judgment in his favor. He claimed that "it's all over . . . judgment should be entered for us . . . we think we won fair and square." Motion to Recuse at 8. Worse yet, the receiver then went on to urge the liquidation court to disregard the Writ of Mandate compelling judgment in the reinsurers' favor. And the main authority for these assertions was the now discredited, June 25, 1991 opinion of the same Mission liquidation court denying reinsurers' right to a defense of setoff, fraud, and rescission. See *Prudential Reinsurance Co. v. Superior Court*, 842 P.2d 48 (Cal. 1992); see also *In Re Liquidation of Union Indemnity Insurance Company*, No. 243 (N.Y. Ct. App. Nov. 14, 1996).

The Mission liquidation court not only accepted the receiver's fallacious arguments, but added its own, stating that "I can't obey the direction of the Court of Appeals" because the Writ contained, in the liquidation court's view, internal contradictions. Motion to Recuse at 8.

This refusal by the liquidation court to comply with the Writ forced the reinsurers to raise the matter again with the appellate court.

In response, on September 10, 1996, the appellate court issued another Writ of Mandate to the liquidation court, threatening the judge with 10 days in jail and a $1,000 fine if he did not enter judgment in favor of reinsurers based on the Statement of Decision within 10 days of the date of the new Writ.

One day before the deadline, the Mission liquidation court complied by issuing an order adopting the

Statement of Decision and entered judgment for the reinsurers. However, the court then refused to sign the actual judgment itself.

Based on this pattern of behavior by the Mission liquidation court, the court of appeal found that the lower court "does not serve the administration of justice and erodes confidence in the judicial system," and recused the Mission court from deciding any further matters in the Copenhagen Re case. *Copenhagen Reinsurance Co. v. Superior Court*, No. C683233 (Calif. Ct. App. Nov. 12, 1996). The appellate court then transferred the case to another judge.

In sum, the above are only a few examples of the reason there exists so much enmity between the Mission estate and reinsurers.

But it is inaccurate to take the reinsurers' unfortunate dealings with one problematic estate, and transpose that situation on "all" reinsurer interaction with insurance receiverships.

As explained above, reinsurers generally have fine relationships with receivers that often yield very productive results. Unfortunately, the Mission estate is a very prominent exception to the general rule.

Receivers and insurance departments should consider whether they can support — or afford — a repeat of the Mission scenario.

Receivers who pursue expensive and largely futile crusades against reinsurers not only create bad case law and waste the very assets they are appointed to conserve, but create ill will toward receivers generally and global criticism of the way in which U.S. receiverships are administered.

The "receivership on Wilshire Boulevard" is an aberration that no one can afford.

## "Insurance Insolvencies DownUnder" Insolvency Administrations of Australian General Insurance Companies

*(Continued from Page 5)*

Australian liquidators to pay a differential interim dividend to Australian creditors, i.e., two cents on the dollar for those with "preferential claims" and five cents on the dollar for all other Australian creditors. The "preferential claims" arose as a result of the "direct access" provisions under the predecessor to section 562A of the Corporations Law and, the Workers' Compensation Act 1987 as mentioned above. The proposal was being put to the Court by the Australian liquidators so as to enable claims by all Australian creditors ultimately to be equalized by the English liquidators applying a "hotchpot" principle. McLelland CJ refused to provide court approval for the proposal as such proposal would not be consistent with the general law in Australian liquidations that all creditors be treated equally. In other words, pursuant to section 116 mentioned above, all Australian assets have to be applied and discharged of its Australian liabilities on a pro-rata basis.

It is interesting to note that although McLelland CJ did not allow for differential dividend payments in the Australian liquidation, it was envisaged clearly by him that monies received by Australian creditors, whether by virtue of the predecessor to section 562A, or section 116, would be taken into account in the English liquidation whereby no dividends would be paid by the English liquidators to any such "preferred" Australian creditors until all other creditors in the English liquidation had received dividends "equal to the benefits received by the preferred Australian creditors in the New South Wales winding up".

One should imagine that this could lead to a very complicated calculation when administering the liquidation in England.

In summary, therefore, any insolvency of a UK or US insurer involving Australian assets and Australian liabilities will require implementation of a "separate liquidation" in Australia.

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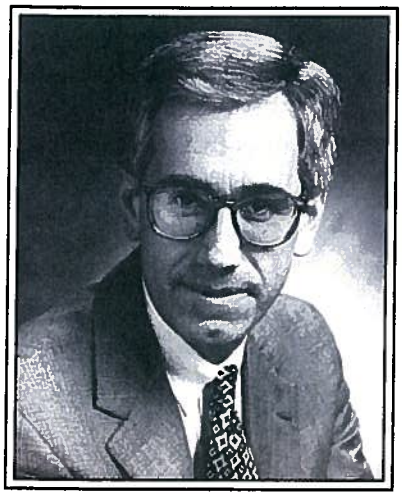

## Charles T. Richardson

Charlie Richardson is a partner in the Indianapolis law firm of Baker & Daniels, with offices in three other Indiana cities and in Washington, D.C. He chairs the Firm's insurance department.

Charlie concentrates his practice in both insolvency and corporate/regulatory areas of insurance. He started practicing insolvency law in 1974 and continues to concentrate in the area of insurance company rehabilitations and liquidations, including representation of the National Organization of Life and Health Insurance Guaranty Associations. He serves as NOLHGA Project Manager in the Confederation Life Liquidation. He has also represented receivers in Indiana in property/casualty, life, and health maintenance organization rehabilitations and liquidations. In the corporate/regulatory arena, Charlie assists insurance companies with change in control proceedings, all types of regulatory, agent, policy approval, accounting, mergers and acquisitions, and reinsurance.

Charlie is a frequent speaker and author on insurance subjects and has been active in committees and working groups of the NAIC. He currently serves as Co-Editor of the NAIC Receivers Handbook and is a contributing author. He has spoken at several IAIR workshops and often updates us on *Fabe* developments.

Charlie is a Director of the Federation of Regulatory Counsel. He also is a Director of Monroe Guaranty Insurance Co. and Federal Home Life Insurance Co. He is a graduate of the University of Michigan Law School in 1972 and Indiana University in 1969. He and his wife have a college-age son and daughter.

## Dale F. Stephenson

Dale F. Stephenson has been president of the National Conference of Insurance Guaranty Funds (NCIGF) since June 1, 1990. The NCIGF, formerly the National Committee on Insurance Guaranty Funds, is a private non-profit association of property and casualty insurance guaranty funds.

Prior to joining the NCIGF, Dale served as executive director of the Indiana Guaranty Funds (the Indiana Insurance Guaranty Association and the Indiana Life and Health Insurance Guaranty Association). Dale, who is a certified public accountant, began his professional career with Arthur Anderson & Co. His experience includes 14 years with Anthem (formerly Blue Cross & Blue Shield of Indiana), where he was director of national division operations after serving several years as the corporate internal auditor. He subsequently worked with Blue Cross & Blue Shield of Michigan to install a National Account Contract Control Program.

Dale is a member of the International Association of Insurance Receivers, the American Institute of Certified Public Accountants and the International Institute of Internal Auditors.

Dale and his wife Judi are devout parrot heads, and their favorite vacation spot is Key West, Florida. Dale has a married son (his pride and joy is his two-year old grandson), a daughter who graduated from Purdue University in 1996 and a step-son who is getting married in June of 1997. In addition to living on a small lake in Indianapolis, Dale and Judi have purchased a lot on Lake Tawakoni in east Texas, where they plan to eventually build their retirement home.

Dale completed his degree in accounting at Ball State University in 1970.

## Ellen Fickinger

Ellen Fickinger is Claims Manager for the Office of the Special Deputy Receiver Representing the Illinois Director of Insurance. Ellen has been with the OSD in Chicago since April, 1991. As Claims Manager, she is responsible for the handling of property and casualty, life and A & H claims for all companies in conservation, rehabilitation and liquidation in Illinois.

Ellen's day-to-day responsibilities require the usual evaluation and adjudication of claims as well as the coordination of claims activity with guarantee funds and associations. As a representative of the OSD, she is also involved in assisting the Illinois Insurance Exchange with claims matters for the three syndicates in liquidation.

Like most claims professionals today, Ellen is heavily involved in the handling of long-term exposure claims and the estimation process.

A graduate of Denison University, Ellen began her insurance career with L.W. Biegler where she initiated her extensive experience specializing in professional liability coverage. Her credentials in claims management include positions with Professional Managers, Inc. in Chicago as well as Fremont Insurance Company and Equity General Insurance Company, both in Los Angeles.

A native of the Chicago suburb of Winnetka, Ellen now resides in Chicago with an eight-minute commute to the office. She is an avid reader and enjoys the theater and the arts. With recent trips to London, Mackinack Island and the Cayman Islands, its easy to see that Ellen doesn't mind the travels that come with the job of managing claims for insurance companies in liquidation.

## Cynthia Clark Campbell

Cynthia Clark Campbell is currently the owner of The Campbell Law Firm in Kansas City, Missouri, which engages principally in litigation practice.

Cynthia graduated from the University of Missouri Columbia School of Law and began her career as an Assistant Prosecuting Attorney in St. Joseph, Missouri, where she specialized in felony prosecutions for murder, rape, arson, burglary and drug offenses. She was next appointed as an Assistant U.S. Attorney in Kansas City, Missouri, where she was in charge of the Appellate section and was a member of the economic crime trial unit specializing in insurance bankruptcy, tax, securities and mail fraud prosecutions.

After leaving the government, she handled several high profile cases in the area of asbestos cost recovery, securities fraud and director and officers liability action for the FDIC and the RTC. Interestingly enough, it is the litigation of these exposures which is currently concerning the insurance and reinsurance community. Loss and expense coverage issues, as well as allocation questions, will face liquidators for many years.

In February, 1994, Cynthia was appointed as Special Deputy Receiver for Professional Medical Insurance Company and Professional Mutual Insurance Company Risk Retention Group. She now has before the U.S. Supreme Court the *Murff* case on a writ of certiorari. IAIR has provided an amicus brief in this case with *Fabe* pre-emption implications, and Cynthia believes the Court's request for opposition briefs is a positive sign the case will be heard on the merits.

While having had an extensive legal career, Cynthia and her husband Bruce, a corporate lawyer, are also avid mountain climbers who are working on completing climbs of all the 54 Colorado peaks over 14,000 feet. So far they have scaled 43 summits.

Cynthia currently serves on IAIR's Education Committee.

# Receivers' Achievement Report

**Ellen Fickinger, Chair**

*Reporters:* ***Northeastern Zone*** *- William Taylor (PA);* ***Midwestern Zone*** *- Ellen Fickinger (IL), Brian Shuff (IN);* ***Southeastern Zone*** *- Roger Hahn (FL), James Guillot (LA);* ***Western Zone,*** *Mark Tharp (AZ), Jo Ann Howard (TX);* ***International*** *- Philip Singer (England), John Milligan-Whyte (Bermuda)*

## Western Zone Report

### Farm and Home Life Insurance Company

*Litigation Against Former Officers and Directors and Former Professionals:*

On December 15, 1994 the Receivership Court approved a Settlement Agreement between the Receiver and former Officers and Directors of Farm and Home for $78.8 million, payable over a seven-year period. Subsequently, certain other non-settling Respondents in the litigation filed an appeal with the Receivership Court, which appeal was dismissed on April 11, 1996. The non-settling Respondents filed a **Petition for Review** with the Arizona Court of Appeals seeking reversal by the Arizona Supreme Court, which was denied on July 2, 1996. The ninety-day period during which the non-settling Respondents had to file a **Petition for Writ of Certiorari** expired on October 1, 1996, thereby finalizing the Settlement Agreement. The Receiver has now collected approximately $32 million of the $78.8 million.

Subsequently, during the fourth quarter of 1996, the former professionals entered into Settlement Agreements with the Receiver which will result in additional cash payments of $13,250,000 to the Farm and Home estate, during 1997.

*Arbitration Settlement*

In October, 1996, the Receiver of Farm and Home negotiated an arbitration settlement with an affiliated ceding company, resulting in a $4 million payment to the estate.

*Tax Exempt Status Under I.R.C. 501(c) 15*

During the third quarter of 1996, Farm and Home applied for and was granted tax exempt status, commencing January 1, 1994.

*Early Access Distribution*

On December 31, 1996, the Receiver of Farm and Home made an early access distribution of $424 million to the Arizona Life and Disability Insurance Guaranty Fund (ALDIGF).

*Final Funding of I.R.C. 1035 Exchange Transaction*

On October 15, 1996, the Receiver and the ALDIGF tendered the final installment to Metropolitan Life Insurance Company, culminating the three-year plan for annuitants representing approximately $93 million of contract balances.

*Settlement of Claim Under I.R.C. 815*

During the fourth quarter of 1996, the Receiver of Farm and Home settled claims against the United States of America under I.R.C. 815 (Phase III), resulting in a payment to the estate of approximately $894,000.

### AMS Insurance Company

*Tax Exempt Status Under I.R.C. 501(c) 15*

During the third quarter 1996, AMS applied for and was granted tax exempt status, commencing January 1, 1995.

*Settlement of Claim Under I.R.C. 815*

During the fourth quarter of 1996, the Receiver of Farm and Home settled claims against the United States of America under I.R.C. 815 (Phase III), resulting in a payment to the estate of approximately $30,000.

### American Bonding Company

*Plan of Rehabilitation*

On December 20, 1996, the Receivership Court heard the Receiver's Proposed Plan of Rehabilitation and parties objecting to the Plan. One objecting party was allowed additional time to brief its objection. On February 27, 1997 an order was signed approving the Plan of Rehabilitation as filed. Key features of the plan are as follows:

- **Claim process that provides for an adjudication timeline.**
- **Special Master provision provides an independent and cost effective forum to adjudicate certain claim matters including those stayed by the Receivership Order.**
- **A mechanism to allow special deposits held by various state insurance departments to be accessed and dedicated for benefit of the respective state's policyholders' claims.**
- **Cancellation of exposure for unaccounted for bond powers.**
- **Allow Class 1 through 4 (Senior Creditor Obligations) to be paid per provisions of the Plan of Rehabilitations; subordinate creditors are subject to a formal proof of claim process and payment in full of Senior Creditor Obligations.**

*Claims*

- **Payment of obligations under surety bonds and commercial insurance policies were temporarily suspended. A claim moratorium was imposed in November 1996. During this moratorium, only Class 1 expenses have been paid.**

*(Continued on Page 14)*

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## Receivers' Achievement Report *(Continued from Page 12)*

This initial moratorium is expected to be lifted some time in the second quarter of 1997.

- Prior to the moratorium and since the inception of the receivership, ABC has paid gross loss and loss adjustment expenses totaling $18,714,366. Payment of obligations under bond and insurance policies are projected through the year 2003.

*Litigation*

- In many instances, litigation has been stayed pending the implementation of the Rehabilitation Plan.
- The Receiver has selectively initiated and defended litigation to enable the Receiver to meet its cash flow projection benchmarks necessary for the Rehabilitation Plan to succeed.

### United Life of North America

- Estate closed 12/31/96
- life insurer
- licensed
- placed in receivership1992
- payout percentage: 95.13%

### Western Employers Insurance Company of America

- Estate closed 12/31/96
- ancillary receivership
- property and casualty insurer
- licensed
- ancillary receivership commenced 1995
- payout percentage: 100% of Arizona workers' compensation claims

### National Annuity Life Insurance Company

- Estate closed 12/31/96
- life insurer
- licensed
- placed in receivership in 1994
- payout percentage: 14.1%

### Great Global Assurance Company

- $10,000,000 early access distribution to various state guaranty associations

### National Annuity Life Insurance Company

- $90,948 final distribution to Arizona Life and Disability Insurance Guaranty Fund

### United Life of North America

- $1,116,827.52 final distribution to Arizona Life and Disability Insurance Guaranty Fund

### Western Employers Insurance Company of America

- $6,544 final distribution to Arizona State Compensation Fund
- $474,351.09 to Domiciliary Receiver (CA)

## *International Zone Report*

### Schemes of Arrangement Under Bermuda Law

A Scheme of Arrangement, in relation to an insolvent or solvent company, is an arrangement

(a.) between the company and its creditors and/or its shareholders which has been approved by a majority in number representing three quarters in value of all creditors and/or shareholders present and voting in person or by proxy at a meeting called for such purpose;

(b.) which has been sanctioned by the Supreme Court by an order which is delivered to the Registrar of Companies; and

(c.) which, when it takes effect, is binding on all of the company's creditors and/or shareholders, including a dissenting minority, and the company.

The relevant provisions of the Companies Act 1981 are as follows:

**"Power to compromise" with creditors and members**

99. 1. Where a compromise or arrangement is proposed between a company and its creditors or any class of them or between a company and its members or any class of them, the Court may, on the application of the company or of any creditor or member of the company, or, in the case of a company being wound up, of the liquidator, order a meeting of the creditors or class of creditors, or of the members of the company or class of members, as the case may be, to be summoned in such manner as the Court directs.

2. If a majority in number representing three-fourths in value of the creditors or class of creditors or members or class of members, as the case may be, present and voting either in person or by proxy at the meeting, agree to any compromise or arrangement, the compromise or arrangement shall, if sanctioned by the Court, be binding on all the creditors or the class of creditors, or on the members or class of members, as the case may be, and also on the company or, in the case of a company in the course of being wound up, on the liquidator and contributories of the company.

3. An order made under subsection (2) shall have no effect until a copy of the order has been delivered to the Registrar for registration, and a copy of every such order shall be annexed to every copy of the memorandum of association of the company issued after the order has been made.

4. If a company makes default in complying with subsection (3), the company and every officer of the company who knowingly or willfully authorizes or permits the default shall be liable to a fine of ten dollars for each copy in respect of which default is made.

**Information as to compromises with creditors and members**

100. 1. Where a meeting of creditors or any class of creditors or of members or any class of members is summoned under section 99 there shall -

a. with every notice summoning the meeting which is sent to a creditor or member, be sent also a statement explaining the effect of the compromise or arrangement and in particular stating any material interests of the directors of the company whether as directors or as members or as creditors of the company or otherwise, and the effect thereon of the compromise or arrangement, insofar as it is different from the effect on the like interests of the other persons; and

b. in every notice summoning the meeting which is given by advertisement, be included either such a statement as aforesaid or a notification of the place at which and the manner in which creditors or members entitled to attend the meeting may obtain copies of such a statement as aforesaid.

2. Where the compromise or arrangement affects the rights of debenture holders of the company, the said statement shall give the like explanation as respects the trustees of any deed for securing the issue of the debentures as it is required to give as respects the company's directors.

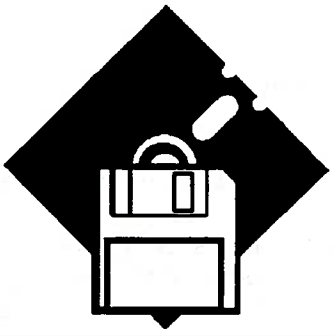
3. Where a notice given by advertisement includes a notification that copies of a statement explaining the effect of the compromise or arrangement proposed can be obtained by creditors or members entitled to attend the meeting, every such creditor or member shall, on making application in the manner indicated by the notice, be furnished by the company free of charge with a copy of the statement.

4. Where a company makes default in complying with any requirement of this section, the company and every officer of the company who knowingly or willfully authorizes or permits the default shall be liable to a fine of one thousand dollars, and for the purpose of this subsection any liquidator of the company and any trustee of a deed for securing the issue of debentures of the company shall be deemed to be an officer of the company:

Provided that a person shall not be liable under this subsection if that person shows that the default was due to the refusal of any other person, being a director or trustee for debenture holders, to supply the necessary particulars as to his interests.

5. It shall be the duty of any director of the company and of any trustee for debenture holders of the company to give notice to the company of such matters relating to himself as may be necessary for the purposes of the section, and any person who makes default in complying with this subsection shall be liable to a fine of two hundred dollars.

*(Continued on Page 16)*



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Article(s) must be received by the first of the month, one month prior to publication date. All submissions become property of IAIR and may or may not be chosen for publication.

If you wish to have your diskette returned, please enclose a 6"x9" SASE.

## Receivers' Achievement Report *(Continued from Page 15)*

There are, broadly speaking, two types of Scheme which have been recently implemented under Bermuda law.

a. a cut-off Scheme, where a claims filing deadline is set off and all claims must be filed within that deadline, irrespective of the status of maturity of claims at an early stage of the run-off or liquidation(e.g., Mentor, an insolvent Scheme);

b. a cash-based reserving Scheme, where the claims are paid in part as they are processed in the ordinary course of business in a run-off which lasts for several years (e.g., Mutual Reinsurance Company Ltd., a member of the KWELM group of companies, and The Bermuda Fire & Marine Insurance Co. Ltd. - In Liquidation Scheme).

While the use of Schemes of Arrangement to effect an orderly run-off of an insolvent insurer is fairly well-known, a 1995 Bermuda innovation of implementing a cut-off scheme at the outset of a solvent run-off to avoid the spectre of a liquidation and add certainty to the run-off is an achievement worthy of recognition.

The salient features of this Scheme will be summarized below.

### The Solvent Captive Insurance Company Run-Off Scheme

A recently implemented Scheme adopted with effect from June 30, 1995 by a local captive managed by International Risk Management (Bermuda) Ltd. outside of liquidation between the captive, its creditors and its shareholders is perhaps the first precedent for a non-insolvent insurance run-off Scheme under Bermuda law.

Suppose a reinsurance company is going into run-off and is technically insolvent but unaware that, as the run-off progresses, the position will not remain the same. There may be a rush of creditors, which tips the company into liquidation with the expense of paying liquidators and the risk of directors being pursued for any deficiency, with antecedent transactions being subject to careful scrutiny. Alternatively, despite the best efforts on management's part, reserves which today seem adequate may five years into the run-off look embarrassingly thin.

The generic problem of seeking to achieve order and certainty in an insurance run-off gives rise to the need to consider a this type Scheme. In this particular captive's case a cut-off Scheme with the following principal features was implemented on June 30, 1995:

a. a Final Claims Filing Deadline of June 30, 1999 was fixed;

b. the captive is not obliged to pay its retention, being only liable to pay what it collects on reinsurance;

c. all disputes under the Scheme must be referred to arbitration in Bermuda;

d. the Company's pre-Scheme Managers remain in place throughout the run-off;

e. the Scheme binds creditors and shareholders, who agree not to petition for the Company's winding-up;

f. the Final Meetings for the Scheme must be held by June 30, 2001, unless a later date is agreed by Scheme Creditors;

g. if Scheme Creditors are paid in full, shareholders are entitled to a distribution.

The captive's advisers in relation to drafting and implementing the Scheme included Ernst & Young, who provided financial advice, and Milliman & Robertson, who provided actuarial advice.

This Scheme, like all schemes of arrangement, was tailor-made to suit the unique needs of a particular insurer. And as a broad concept, the use of Schemes to better regulate solvent run-offs appears to have tremendous practical and commercial utility of which U.S. Receivers ought to be aware whenever the off-shore reinsurer of an insolvent U.S. insurer goes into liquidation in an English-law based domicile such as Bermuda.

### Bermuda Liquidation Achievement Report

An overview of the status of some Bermuda insurance liquidations is set out in the Appendix hereto.

The liquidation of NFL Insurance Ltd. - in liquidation has closed, while Cambridge Reinsurance Ltd. - in liquidation, Norad Reinsurance Ltd. - in Creditors' Voluntary liquidation and Dover Insurance Company Ltd. in liquidation are expected to follow suit later this year.

Star achievement award goes to the once maligned Mentor liquidation. A 5% dividend declared by Mentor's liquidators, Charles Kempe and Nigel Hamilton, in the first quarter of 1997 boosts the total payment to thus far to a whopping 68%! Further dividends can be expected, according to Ernst & Young's John

**Appendix** - Bermuda Liquidation Achievement Report

*Introduction* - Although no public record of all insurance insolvencies in Bermuda is available, an attempt will be made below to list significant developments in some of the best known insurance insolvencies in Bermuda.

*Liquidations Closed*

| Date of Liquidator's Release | Company | Liquidators | Wind-up Order |
|---|---|---|---|
| February 13, 1997 | NFL Insurance Ltd. | David E.W. Lines & Peter Mitchell | August 26, 1991 |

*Liquidations Likely to* be *Closed in 1997*

| Company | Liquidator | Winding-up Date | Total Dividend |
|---|---|---|---|
| Cambridge Reinsurance Ltd. | David E.W. Lines & Michael Jordan | May 17, 1985 | 18% |
| Dover Insurance Company Ltd. | Charles W. Kempe | February 21, 1983 | 40% (further 10% may be distributed) |
| Norad Reinsurance | Charles W. Kempe | October 10, 1988 | 27% |

*Distributions Made*

| Company | Liquidators | Date/% of Distribution | Total Dividends to Date |
|---|---|---|---|
| Mentor Insurance Ltd. | Charles Kempe & Nigel Hamilton | April 1997 / 5% | 68% |

*Scheme of Arrangement Implemented*

| Company | Liquidators | Effective Date of Scheme | Winding-up Order Date |
|---|---|---|---|
| The Bermuda Fire & Marine Insurance Co. Ltd. | Anthony Joaquin, John McKenna and Gareth Hughes | January 15, 1997 | December 16, 1994 |


# P|A|R|A|G|O|N

## Reinsurance Risk Management Services, Inc.

### Reinsurance Collections

### Commutation and Run-off Services

As the service arm of E.W. Blanch Holdings, Inc., Paragon has extensive experience in the technical aspects of reinsurance transactions. By unbundling this existing service capacity, Paragon offers a wide range of reinsurance consulting and related services to Rehabilitators and Receivers.

For Additional Information Contact:

David D. Grady, CPCU
Vice President
phone (800) 854-8523

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*A SUBSIDIARY OF E.W. BLANCH HOLDINGS, INC.*

# Other News & Notes

*by Doug Hartz, Dept. of Insurance - State of Missouri*

**Dateline: May 5, 1997 - Detroit, Michigan -**

Well, it's Cinco de Mayo and that has some significance in Denver although very little here or mid-Missouri. I've just missed my flight to St. Louis because of the time involved in reporting that the radio had been stolen from my rental car. You have got to love Detroit. At least the car was still driveable and I was able to make it to my appointment and to the airport, albeit late.

It was a curious feeling of being violated, finding the dash in the back-seat and not finding the radio. Even though it was not my car, I did miss that radio. I fear that I will feel more violated after being contacted by the car rental company.

You can expect a potpourri for a regular feature titled, "Other News and Notes". So here we go.

In the *Wall Street Journal* on May I appeared an article about the fact that Japan has an insurance insolvency. How many of our members speak Japanese? Being the carrion fowl that some of us are, you may be glad to know that the article also indicated that the economic conditions in Japan are such that numerous additional insolvencies are expected. In any event, here is a new source for members consistent with the International part of our name. Actually when you separate it that way - International AIR - it presents itself in a different light.

Also in Detroit, while I still had a radio, listening to National Public Radio I heard a fascinating discussion by two quantum physicists on the unexpected celestial topic of angels.

Quantum physicists are the guys with pentium chips in their heads who usually dream in terms of quarks and photons. These are people, so smart are they, who could convince you, by utter mathematical proof, that you do not exist - at which point you may want to stop. But, you are not there to do away with yourself, so you can't.

Anyway, these guys have a theory that the electromagnetic patterns we are detecting from our own sum, it is that the sun is ...ious and thinking. About ...vs. Inasmuch as angels are too numerous to count, these guys further postulate that since stars are also too numerous to count, that these intelligencia might actually be angels. Further, since they can manifest themselves without the constraints of space and time they can visit with us anytime they need. I am telling you, these guys are scientists. But, what do I know? About .01% of what I would like to know.

This brought to mind the passage by M. Scott Peck, M. D., "So let me get the bad news over with: I don't know anything . . . . But the real truth of the matter is that you don't know anything either. None of us does. We dwell in a profoundly mysterious universe."[1] Which led me to recall the song-lines, "So you think / So you think you can tell / Heaven from Hell . . . . / Can you tell a green field / From a cold steel rail? / Do you think you can tell?"[2] Is it really life's illusions we recall? Which brings us squarely to the topic of Early Access Advances to Guaranty Funds.

Since proposing that interest should be assessed on early access (EA) advances made to guaranty associations (GAs), and being asked, as a result, the dangling question of which type of rope I prefer, I have been giving a great deal of consideration to the idea of interest on EA advances. After all, an SDR shall file a plan to make EA advances on distributions as required by our Model Act provisions and most of our state statutes[3]. In the past I have, here and elsewhere, strongly argued:

1) that SDRs should make EA advances to the GAs,

2) that an SDR can be a hero and make any estate pay a 100% distribution - if the SDR waits a few decades while the interest compounds,

3) that SDRs avoid making EA advances because they sense it is inequitable and risky and, well, see the previous argument with the idea of having more for the intest to accrue upon, and

4) that our insurer liquidation statutes are designed to require EA advances to avoid unneeded assessments (which really gum up the works in states that allow premium tax offsets, which is about 1/3 of them) on GA member companies.

In regard to the first argument, note that these are advances. They are not interim distributions. An interim distribution requires the same percentage payment to all claimants in a priority class. An EA advance goes only to the GAs. The non-GA-covered (NGC) claimants have to wait for an actual distribution.

The issue really became clear to me when making an advance from a decendent's estate. If one heir takes an advance on their expected distribution from the estate, interest must be added to the advance made.

Otherwise the other heirs (in the same position as the NGC claimants) get short-changed. Sure, the heir getting the advance has the advance deducted from his or her share of the estate when it is finally distributed, but if that advance had been left in the estate the interest it earned would be added to each heir's share.

To illustrate, suppose six months after an estate opened it had $400 and paid the only GA involved $100 as an EA advance. Ten years later, the $300 left had grown to $600 (at 7% over 10 years any amount will double), but $100 was paid in administrative costs leaving $500 for the claimants whose claims total to $1,000.

At that time, a 60% (there is $600 to distribute because the $100 advance must be treated as an asset) liquidation dividend was declared on the GA claim of $500 and the only NGC claim of $500. If interest is not assessed on the $100 advance, the GA gets a $200 check ($300 less the $100 advance) and the NGC claimant gets $300.

However, if interest is assessed, then the $100 advance grows to $200 after ten years. Then a 70% ($700 because the advance with assessed interest of $200 is added to the $500 to get the total available for distribution) liquidation dividend is

declared on each claim of $500.

So if interest is assessed, the GA gets a $150 check ($350 less the $200 advance) and the NGC claimant gets $350. The long and short of this is, if interest is not assessed, the GA gets $50 more which is a preference at the expense of the NGC claimant.

Section 46 of the Model Act mandates that, "No subclasses shall be established within any Class . . . ." which is exactly what is done if interest is not assessed on the advances to the GA. The GA is made a preferred subclass within Class 3.

One of the arguments against assessing interest on EA advances goes something like, "How can you charge us interest on money that we have already spent paying claims as required by statute?" At first this sounds like a pretty good argument. But, do not try this at home. I mean, imagine how your credit card company would react to, "How can you charge me interest on money I've already spent?" It sounds like an Ava Gabor line from a "Green Acre's" episode. I also get allergic smelling hay.

The next part of the GA's argument is, "But, we are out of the money because the statute requires us to pay on GA covered claims. We are not earning any interest on the money that we have paid out (and Section 38.B (5) only requires us to report the interest earned on what we have not paid out)."

Sounds pretty convincing, except the NGC claimant is also out the money (they expected payment and if they had gotten it they could be earning interest) and has an economic loss until a liquidation dividend is paid. The NGC claimant should not be considered in a lower priority than the GA simply because the NGC claimant is not statutorily required to suffer the loss.

As to the other part of the argument, what the GA may be required to report (may have to do with questions of how assessments are accounted for in relation to advances) does not necessarily have anything to do with how distributions are calculated or how the GA's claims are valued or how they should not be preferred vis-a-vis other claimants in the same class.

Look at this from another direction, assuming that interest is added to the underlying claim in its priority. The current version of the Model Act is silent as to interest in the Priority of distribution (Section 46). Prior versions, back to the 1969 Wisconsin statute that was the model, are also silent. In 1967 when Wisconsin adopted its act, which is the grandfather of versions of the prior model acts adopted in the various states, interest was placed in a lower priority class.

However, back in 1967 we did not exactly have the computing capabilities that we have now and interest was placed in a lower priority because, as the comment adopted with Wisconsin's act[4] states, "Interest might well receive the priority given the underlying claim. Practical considerations urge postponement . . . . [it] should be allowed before paying . . . ownership claims. . . . Interest does present special problems unless the liquidator is using automated equipment. These problems necessitate separate treatment." Today every liquidator is using "automated equipment". The "practical considerations" have changed. Adding interest can probably be done in most states.

In the example used above, what would result by adding interest to the underlying claims of the GA and the NGC? There is still only $500 for the claimants but their claims of $500 each will be increased by interest in the same priority.

Assuming that both claims were mature at the same time ten years ago, the GA claim will have grown to $800 ($400 doubled, net of the advance on which the GA does not get interest) and the NGC claim will have grown to $1,000. Then from the $500 a 27.77% ($500 is all there is to distribute because the $100 advance is not included) liquidation dividend is declared. The GA gets a $222 check (27.77% of $800) and the NGC claimant gets $278.

Applying this method answers another argument of the GAs to the effect that, "all assessing interest does is give a preference to those nasty NGC claimants (the great unwashed) who are frequently also the long-tail claimants that are mucking up our hopes of getting any final distribution and whose claims are not mature anyway."

Why is the receiver so concerned about these nasty NGC claimants? Because they are policyholders and those claiming through policyholders. (See the *Fabe* decision, which seems to indicate that we should be concerned.)

"But, the Legislature has spoken and chose not to cover the great unwashed and thus they are inferior." If the legislature wanted they could have easily made priority class 3A for the GA claims and 3B for the great unwashed. I am not aware of any states that have done this, except Illinois. The GA only steps into the shoes of the claimant they have paid and so only gets the priority that the claimant would have received.

The illusion here rests on whether it is better to assess interest on advances or to add interest to all of the Class 3 claims. I am suggesting that if an estate has EA advances to the GAs, then interest should be added to the unpaid matured portion of all of the GA and NGC claims. It is not fair to add interest to the immature, unliquidated or un-finalized claims. Adding interest from the date the claim is determinable, the date it would have matured despite the insolvency, may cure the problem of the great unwashed long-tail claimants. Think about what happens in the above example if the NGC claim matures at $500 ten years later than the GAs claim. I apologize for any brainstrain this may cause.

The GA claim will have grown to $800 and the NGC claim will have just matured at $500. From the $500 then available a 38.46% liquidation dividend is declared. The GA gets a $308 check (38.46% of $800) and the NGC claimant gets $192 (38.46% of $500). Did you here about the couple who put the contraceptive on their toast, got pregnant and sued? It said, "Jelly" right on the package. Something is missing in the above commentary and I will cover that in the next issue!

[1] Further Along The Road Less Traveled, 1993, Simon & Schuster, at 18.

[2] Pink Floyd, 1975, Wish You Were Here.

[3] Not in all states. For example, in Missouri, Section 375.1205.1 provides that, "Within one year . . . the liquidator may make application to the court for approval of a proposal to disburse . . . [to the GA having obligations because of such insolvency."

[4] See, p. 118 of the Reference Handbook on Insurance Company Insolvency, Third F TIPS (1993).

# I A I R's Education Seminar

**Thursday and Friday - June 26 & 27, 1997**
(Thursday is a full day and Friday is a half day.)

University Place
Executive Conference Center & Hotel
Indianapolis, Indiana

**This seminar should be attended by staff members of receiverships, insurance departments and vendors involved in the rehabilitation and liquidation of insurance companies.**

**Cost:** Prior to June 1 - $125 each for first two from **IAIR Member's firm** after June 1 - $175
Non-Member of IAIR - Prior to June 1 - $150 after - $200 each.

**Dress:** Casual business attire is appropriate.

**Hotel Information:** The meetings will take place at the University Place Conference Center & Hotel, 850 West Michigan St., Indianapolis, Indiana 46202-5198. Room reservations must be made by 5:00 p.m. on **May 25, 1997.** Sleeping Room Rate: $90/S; $102/D; Government Rates: $71/S; $86/D. Please call **(800)627-2700** and state you are with the **International Association of Insurance Receivers** to receive the preferred rate.

**Transportation Information:** You may fly into Indianapolis International Airport. All major airlines have service into this airport. You may reserve a rental car at the airport. The area is served by Avis, Dollar, Enterprise, Hertz and National, plus others. The hotel provides complimentary parking in their underground parking garage. If you do not plan to rent a car, Indy Connection Limousine is available at the airport. The cost is $8 one way, per person to the Conference Center.

## Accounting Track

### Thursday, June 26

***Taking Down a Company-***
***Controlling the Accounting Records***

Accounting & EDP - Take over & Administration
**Cynthia Starrett, C.J. Starrett, CPA**
**Fred Greve, Indiana Insolvency Office**

Marketable Securities, Real Estate & Mortgage Loans
**Peter Kane, Kane Corporation**

Fixed Assets & Other Misc. Receivables
**Elizabeth Biaett, EAB Associates**

Lunch

Agents Balances & Premium Receivables
**Allen Witkowski, Louisiana Ins. Dept.**

Receivership Reporting to Court, NAIC & Insurance Dept.
**Doug Hartz, Missouri Dept. of Insurance**

Policy & Claim Records - Life Assumption
**Brian Shuff, Brian Shuff, CPA**

Tax Compliance
**Stephen Phillips, Cunningham, Porter & Phillips**

***Questions and Answers***

### Friday, June 27

***Running Off a Receivership-Accounting Records***

P/H & Creditor Records -- POC Tracking Systems
**Ellen Fickinger, Office of Special Deputy**

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**ale Stephenson, NCIGF**

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## Claims Track

### Thursday, June 26

The Proof of Claim Process
**Mike Barbagallo, Transit Insurance Co.**

*This session will include information on notice, effects of bar dates, late-filed claims and contingent and policyholder protection claims.*

POC Tracking System EDP
**To be announced**

Guaranty Fund Covered vs. Non-Guaranty Fund Covered
**To be announced**

*The session will cover evaluating reserves before transfer to GF, Claims over and outside GF coverage, How GF's review coverage, Handling GF deductibles and differing caps, Bar dates and impact on GF's.*

Lunch

Claims Adjudication Process
**Alison Puckett, Florida Insurance Dept.**
**Lora Camporeale, Integrity Insurance Co.**

Coverage Issues
**Susan Stone, Sidley & Austin**

Emerging Issues
**Joseph DeVito, DeVito Consulting, Inc.**

### Friday, June 27

Contested Claims Process
**Kathy Walsh, McCarthy, Leonard, Kaemmerer, Owens, Lamkin & McGovern**

*This session will include information on objections to determination of the liquidator, objection to priority classifications, coverage disputes and reconsideration by the liquidator.*

10:30-12 Noon Mock Hearing
**To be announced**

**Cancellation:** Cancellations received before June 1 entitle registrants to a full refund.

Cancellations received after that date are subject to a 30% penalty. No refunds after June 13.

## Reinsurance Track

### Thursday, June 26

Introduction to Reinsurance
**David Grady, Paragon**

Basic Reinsurance Concepts
**Alan Meyer, Chiltington, Inc.**

Role of the Intermediary
**Patricia Getty, Paragon**

Reinsurance Accounting
**Corrina Conley, Paragon**

Lunch

Collections & Audits
**David Grady, Paragon**

Reinsurance Systems
**Reinsurance Solutions, Inc.**

Equitas and the New Lloyds
**Paula Keyes, Chiltington**

Reinsurance Claims
**Alan Meyer, Chiltington**

Questions and Answers

### Friday, June 27

Reinsurance & Guaranty Funds
**Dale Stephenson, NCIGF**

Terminations
**Charlie Richardson, Baker & Daniels**

Liquidations Panel
**Karen Ingalls, RSI, Inc.**
**Ingrid Dahlquist, RSI, Inc.**
**Mary Veed, Mary Cannon Veed & Assoc.**

**Registration:** Faxed registration (913) 262-0174 will be accepted provided a copy of your check request accompanies the seminar registration. Payment must be received by June 13 and/or presented at registration on June 26. Failure to give advance cancellation will result in your firm being billed for registration fee.