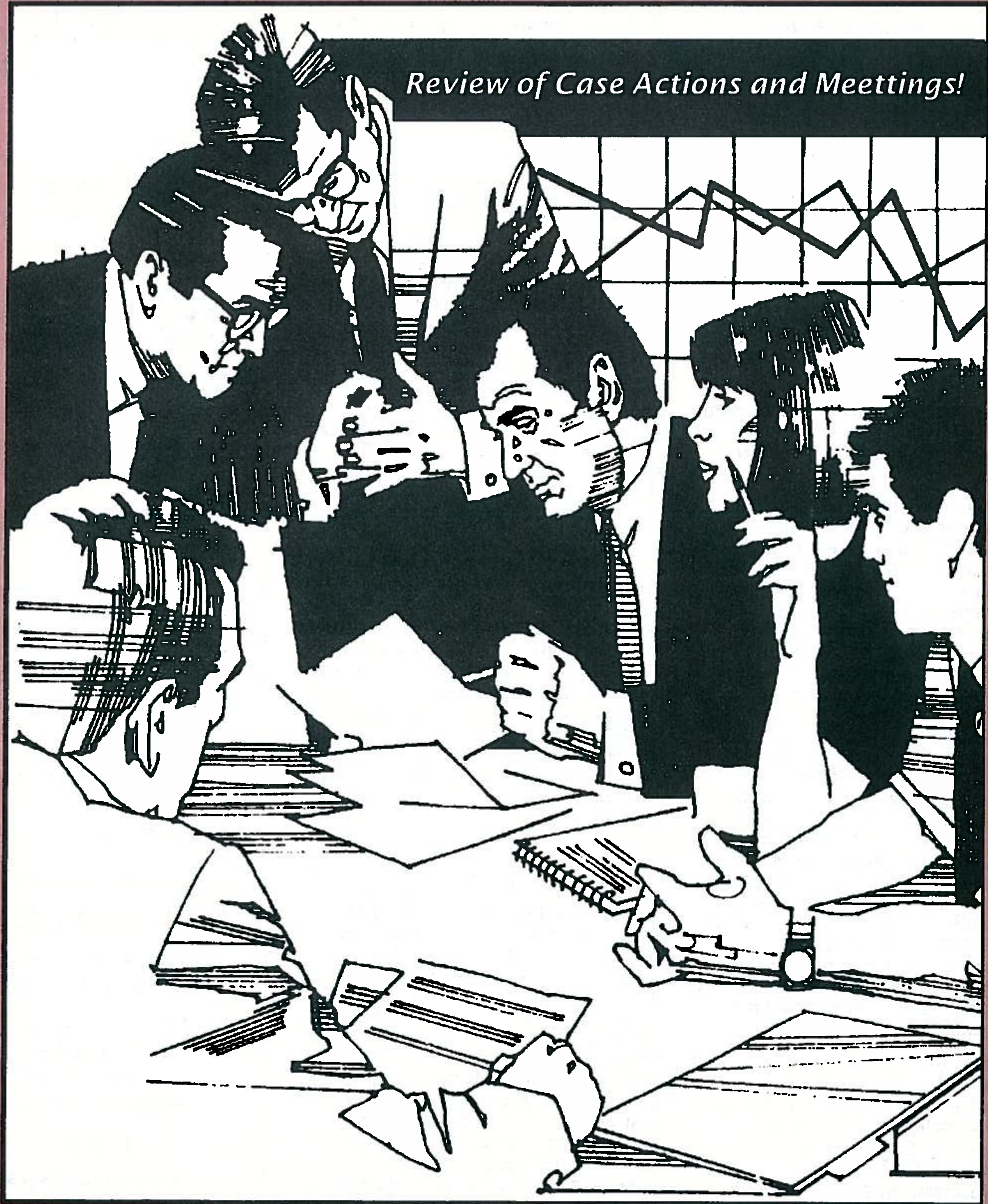
The Insurance Receiver

Promoting high ethical standards in the administration of Insurance Receiverships.

Fall 1996



President's Message

By Dick Darling
Chief Operating Officer, Illinois Department of Insurance

It's snowing in Chicago! I have lived in Chicago for fifty years (That's right, I'm one of those baby boomers), and I still do not like to look at it, drive in it, walk in it, or shovel it! Anybody need a Receiver in the South or West? We are approaching the end of the year, as well as my tenure as President of the International Association of Insurance Receivers. I can tell you, it has been a very busy year and I want to thank all of your board members as well as Frank Bistrom, CAE for their assistance since last December.

The September 1996 roundtable in Anchorage was, once again, a success. The board wishes to thank the meeting Chair, Joyce Wainscott, for her assistance.

Since last we communicated, your board of directors had the unpleasant task of accepting the resignations from the board of both Michael Miron and Nelson Burnett (Paripassu). Mike found it necessary to resign as his current endeavors do not allow him sufficient time to devote to IAIR or provide him with sufficient receivership activities to warrant continuation on the board. The board wishes to thank Mike for all of his assistance, as both a past president and founding board member. Nelson is no longer associated with the Alabama Receivership Office and felt it appropriate to open up a position on the board for someone who could be more active on a day-to-day basis. The association will miss both Nelson and Mike's contributions to the board, as well as their expertise in moving our education agenda forward.

It is with pleasure however, that I advise the board vacancies were filled at the Anchorage meeting by Jim Gordon, Special Deputy Insurance Commissioner of Maryland First Financial Services Corporation in Baltimore, and Elizabeth Lovette, the Special Deputy Receiver for the Indiana Insurance Department. Both Jim and Liz have extensive experience in receiverships and their expertise and energies will be a valuable contribution to the board.

I recently returned from Tampa, Florida where IAIR conducted its second IAIR/NCIGF co-sponsored seminar, "Moving Forward Together: Addressing Today's Concerns-Reinsurance Issues." With over 130 IAIR/NCIGF members attending, initial indications are that this event was once again a resounding success. The board wishes to thank all IAIR members, who, once again, graciously donated their time to assist in the various presentations. The event was co-chaired by Kristine Bean, IAIR Educational Chair and Holly Bakke, NCIGF Education Chair. Our thanks to both Kristine and Holly for a job well done.

Speaking of Kristine Bean (Peterson Consulting), the Tampa co-sponsored seminar was her last effort as IAIR Educational Chair. Over the last three years, Kristine has donated an amazing amount of time and effort helping all of our functions to be both successful and a useful educational tool for IAIR. The board once again wishes to thank Kristine for her efforts. She has assured the board that she wishes to remain extremely active in association activities.

Replacing Kristine as Education Chair will be Paula Keyes (Chiltington Intermediaries-Orlando, Florida). Paula's first task will be the 1997 Insolvency Workshop co-sponsored by the National Association of Insurance Commissioners as well as IAIR. This popular annual event will be held January 16-17, 1997 at the Hyatt Regency Hill Country Resort in San Antonio, Texas. Paula and her committee, working with the NAIC, promise new and interesting topics that will be of interest to all insolvency practitioners. Although all members will receive information regarding the workshop, registration

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Mark Your Calendar

NAIC/IAIR Insolvency Workshop
January 16-17, 1997
Hyatt Regency Hill Country Resort
San Antonio, Texas
See Page 10 For Details

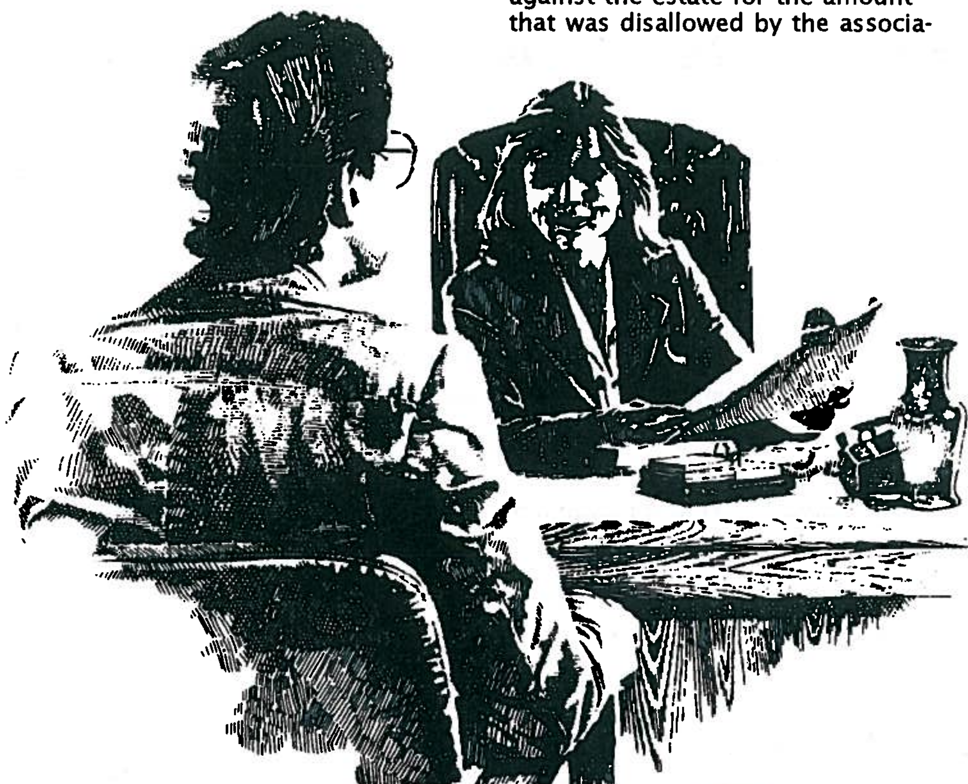
INSOL International '97
March 23-26, 1997
New Orleans, Louisiana, USA
Information has been mailed!

State Guaranty Association Claims For Asserting Guaranty Fund Statutory Defenses

By: **William D. Leader, Jr. and Karyn C. Bryant**
(The authors regularly represent The Tennessee Insurance Guaranty Association.)

An issue that may continue to arise as more liquidations are closed is the obligation of liquidators to allow state insurance guaranty association claims for litigation-related expenses, particularly those expenses incurred in litigating and defending an association's statutory defenses under each state's insurance guaranty association act. By statutory defenses we mean those defenses to payment under a state's insurance guaranty association act that are particular to an individual state.

There are numerous instances where individual state insurance guaranty associations have litigated issues pertaining to statutory defenses, such as caps limiting the amount of payment, net worth provisions, state residency requirements for claimants and failure to exhaust other insurance. In each of these cases, the individual guaranty association, by asserting defenses sometimes peculiar to its state's insurance guaranty act, often incurs expenses for which the association then makes a claim against the liquidator. Though the individual insurance guaranty association may avoid payment of a claim in part or in its entirety, the claimant or insured may thereafter make a claim with the liquidator for the amount denied based on the statutory defense. Some liquidators believe that there is no net effect on the insolvent estate, despite the best efforts of the insurance guaranty associations successful defense of a statutory provision. Some liquidators have taken the position that the insurance guaranty association's successful assertion of a statutory defense is of no benefit to the liquidation estate. Liquidators in making this determination reason that even though the insurance guaranty association successfully asserted a statutory defense, the estate is no better off because the claimant, against whom the defense was asserted, will then file a claim against the estate for the amount that was disallowed by the association. As a result, several liquidators have begun to summarily deny the expense claims of insurance guaranty associations arising from the assertion of statutory defenses that they believe do not directly benefit the insolvent estate.



An example of the issue presented follows: The insured of an insolvent insurer files suit against the state guaranty association to recover the $500,000.00 it paid to settle a third party claim for personal injuries due to the insolvency of its primary carrier. The guaranty association denies that the insured is entitled to recover the total amount paid based on "statutory defenses" peculiar to that particular state, including caps on medical expenses, failure to exhaust other avenues of recovery (other applicable insurance available), non-duplication of recovery provisions, residency in another state or perhaps a net worth provision. The state guaranty association act at issue places significant and material limitations on the authority and obligation of the association to pay covered claims, and specifically limits the association's obligation in this situation to paying the claimed amount. In short, the guaranty association, bridled by its statutory mandate, cannot pay a claim unless a provision allowing payment is set forth in its statute. After denying payment, the insured files suit against the guaranty association and the guaranty association defends on the basis that its statute does not allow the requested payment. The parties litigate the insured's right to recover all of the amounts paid. The court finds that the guaranty association's statutory defenses are valid. However, the guaranty association has incurred $40,000.00 in litigation-related expenses to achieve this result. Having "saved" the estate $500,000, the guaranty association submits a total claim to the liquidator in the amount of $40,000.00. The insured submits a claim with the liquidator for $500,000. The liquidator is now faced with claims totaling

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State Guaranty Association Claims For Asserting Guaranty Fund Statutory Defenses

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$540,000.00, denies the insurance guaranty association's claim for litigation expenses, claiming the actions of the insurance guaranty association did nothing to benefit the estate.

Is the liquidator justified in denying the insurance guaranty association's claim for defense expenses? Liquidation statutes generally provide priority compensation for claims made by state guaranty associations or similar organizations. Most liquidation statutes provide no limitation on what types of expenses must comprise claims in order for the claim to be allowed.

Our review of various liquidation statutes and insurance guaranty association acts has not located any provision providing liquidators the right to deny the expense claim of an insurance guaranty association on the basis that the assertion of a "statutory defense" did not benefit the liquidation estate. Further, we have located no case law on point.

The absence of case law or statutory authority justifying the denial by a liquidator of an expense claim based on the assertion of a statutory defense serves as an additional reason why such actions by a liquidator are unwarranted.

Liquidators should permit claims of state guaranty associations for litigation-related expenses incurred in asserting statutory defenses. State liquidation statues expressly allow state guaranty associations to submit claims for expenses incurred in handling claims made under insolvent insurer's policies and do not exclude expenses incurred in asserting statutory defenses.

State guaranty associations provide an important service for liquidators in administering claims — a service that would not otherwise be provided. Disallowance of such claims would serve as a disincentive to guaranty association which are acting as prudent claims managers of the assets of the insolvent insurer and acting within the authority provided by state insurance guaranty acts.

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.

The Insurance Receiver is published quarterly by the International Association of Insurance Receivers, 5818 Reeds Road, Mission, Kansas 66202-2740 (913) 262-2749 FAX: (913) 262-0174. Frank Bistrom, CAE, Executive Director; Jane Male, CAE, Associate Executive Director. **Editorial Board:** Doug Hartz, Publications Committee Chair; Morty Mann, Managing Editor; Michael Cass, Jim Stinson, and Mary Veed, Assistant Editors. **IAIR Officers:** Richard Darling, President; Doug Hartz, Vice President; Mike Marchman, Treasurer; Robert Deck, Secretary. **Directors:** Thomas Wrigley, Philip Singer, Betty Cordial, Michael Surguine, Robert Craig, James Gordon, and Elizabeth Lovette. Copyright 1996 by the International Association of Insurance Receivers.

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Anchorage Meetings Recap

By Douglas A. Hartz, Missouri Receivership Supervisor

Mary Veed has been very involved in the Interstate Compact's Receivership Law drafting. So Mary's Meeting Recap Department report and opinion has dropped to your humble editor. Recapping the meeting in Anchorage - We met. Perhaps, that is too brief.

Obviously, my notes are not as good as Mary's and I will not be able to do this as well as she has for the Detroit and N.Y. meetings.

The meeting was fairly well attended despite what some may have considered an exotic location.

Joyce Wainscott did an excellent job chairing the Saturday Roundtable Meeting and has told me that she received many favorable comments about returning to the old open forum format where any topic may be introduced, we avoid the "talking heads" presentations, and only a few planned topics are covered with a limited introduction of the topic to start discussions.

Perhaps we should plan on doing something similar in Orlando for the Spring Meeting. Which brings up the fact that we will be needing someone from Florida to serve as Chair of the Orlando Roundtable and look forward to your suggestions and nominations even if we do not see a quick volunteer.

Another bit of interesting news came to me just before taking off for the Anchorage meeting. Stanford O. Bardwell let me know that he would not be making it to the meeting as he was resigning as Receiver in Louisiana. Yes, he was not just a Special Deputy Receiver, but he was not, as most of us would assume, the Commissioner. You see, at some point in 1994 it was decided that the Commissioner did not really need to be the Receiver for all of those sticky, nasty insurance insolvencies.

The Court, which as I understand it is the one court for insurance insolvencies in Louisiana, said that sounded just fine (I do not know if anyone ever considered what that did to the definition of reciprocal state for Louisiana, but the statutes still seemed to require that the Commissioner be the receiver so perhaps Louisiana did not temporarily lose its reciprocal status) and Stan Bardwell, I believe a former U.S. Attorney, was appointed as Receiver separate and apart from the Insurance Department. For those of you who did not get to know him, for about a year-and-a-half he was in charge of the many receiverships in Louisiana and closed about seven in that time.

Things seem to be in the process of moving back into the Insurance Department so the job of independent receiver is probably going away. Hopefully, Mr. Bardwell will still be involved in some way as he seemed to have caught-on to insurer receivership very quickly and actually closed some estates.

The working group sessions on UDS and Receiver's Handbook, were respectively, short (under 5 minutes) and long. The Handbook session was very productive with a great deal of detailed editing accomplished in a nose-to-the-grindstone fashion. Not pretty to watch, but progress was definitely made.

On the Guaranty Fund Issues and Model Act working groups, the public hearing concerning proposed amendments to the Life & Health Insurance Guaranty Association Model Act went as expected with only a couple of issues remaining to be resolved and the Model Act group distributed a new and remarkably well annotated section on derivative investments thanks in part to the efforts of a couple of IAIR members, Bill Latza and Bob Craig.

In Federal Issues the usual review of what is going on in relationship to the federal government was supplemented by Peter Gallanis explaining what Illinios was doing to get some final resolution on the federal "we don't need no stinking badges' issues faced in the Reserve Insurance receivership so that the estate, open since 1979, might finally be closed.

I would recommend reading what has been filed by Illinois to supplement your reading on the *Fabe* matter in Charles Richardson's update in this issue of the IAIR newsletter, page 4.

I would note that Charlie's review in regard to the super-priority issue is less humorous than when he covered the topic six or seven years ago in Salt Lake in a piece in part titled, "Don't Mess with Uncle Sugar."

But, then it must be noted, that the issue is becoming less humerous with each passing year.

Sometimes there just isn't an answer when you want to close and no one can predict what the Feds may do on an issue and no one really wants to ask for fear of the possibly very nasty answer.

Fabe Update

By Charles T. Richardson
Baker & Daniels

The NAIC, IAIR and other groups interested in insurance insolvencies have been doing a "Fabe Update" off and on for the past three years. The reasons for that are pretty obvious: every receiver is concerned about where potential federal claims fit in the priority pecking order, and every policyholder and creditor is interested in whether Uncle Sam is potentially going to take money out of the liquidation estate ahead of everyone else. Those parallel concerns remain, notwithstanding Fabe-I, Fabe-II, and other recent decisions that deal with federal priority questions. That being so, here is a Fabe Update that will bring you current on where things stand today, particularly with various Fabe cure pieces of legislation.

Fabe-I

The United States Supreme Court's 1993 Fabe-I decision, 113 S. Ct. 2202 (1993), held that the federal superpriority statute preempts only the portions of Ohio's insurance liquidation priority statute to the extent the statute does not regulate the business of insurance. To put it more positively, the Court ruled 5-4 that the federal government's claim against an insolvent insurance company comes after the payment of administrative expenses and policyholder claims because the state's establishment of priority for those claims is the regulation of the business of insurance. In what was destined to be a key paragraph of the Court's opinion, even though many of us did not realize it at the time, Justice Blackmun said:

> By this decision, we rule only upon the clash of priorities as pronounced by the respective provisions of the federal statute and the Ohio Code. The effect of this decision upon the Ohio Code's remaining priority provisions--including any issue of severability--is a question of state law to be addressed upon remand.

113 S. Ct. at 2212 (emphasis added).

The case was remanded to the federal district court where

severability of the Ohio priority statute — whether claims entitled to federal priority could be inserted between policyholder claims and general claims in the priority scheme — was argued. That is where the issue stood when IAIR took up this subject at its roundtable at the June, 1995 NAIC meeting in St. Louis.

Fabe-II

The bombshell exploded on August 15 of last year two years after the Supreme Court supposedly resolved the federal superpriority problem. In a top-to-bottom victory for the federal government, the district court the same judge that entered the decision against the Ohio Liquidator the first time around ruled in Fabe-II, No. C2-88-778 (S.D. Ohio 1995), Mealey's Ins. Insolv., vol. 7, #8, p B-1, that the preempted provision of the Ohio statute was not severable. That meant as the district court punched home with vigor, that the Ohio priority statute was "invalid in its entirety and is not applicable in the present case." Mealey's at B-8. The court granted summary judgment to the federal government and overruled the Liquidator's motion to certify the state law severability issue to the Ohio Supreme Court. In applying what it considered to be the Ohio rules of construction, the federal court simply refused to take a drafting pencil to the Ohio priority statute.

The Ohio Superintendent of Insurance filed an appeal of the district court's decision, but later withdrew the appeal in favor of pursuing the application of a revised Ohio priority statute that went into effect a few days after the IAIR roundtable in San Antonio last December. Ohio Rev. Code Ann. § 3903.42 (Baldwin 1996). The Fabe cure legislation amended the Ohio liquidation priority statute to put administrative expenses clearly in Class 1, policyholder claims in Class 2, federal claims in Class 3 and others down the line thereafter. The Ohio legislature added a specific severability protection to the priority statute. The revised priority statute also contained a provision giving the Ohio Supreme Court jurisdiction over any action challenging the validity of the revised priority statute. Pursuant to this provision, the Superintendent petitioned for the Ohio Supreme Court's approval of the retroactive application of the revised priority scheme to Ohio's existing insurance company liquidations and dismissed his federal appeal of the district court's Fabe-II decision.

Yogi Berra said, "When you come to a fork in the road, take it." Unfortunately, it is still not clear whether the Ohio Superintendent took the fork leading to the quickest determination of a Fabe cure in Ohio. The Ohio Supreme Court, by order dated February 27, 1996, dismissed the Superintendent's most recent action for lack of jurisdiction on the grounds that the Superintendent was not challenging the revised priority statute or its application as required by the new statute for Supreme Court jurisdiction. So we will have to wait to see what happens with the new Ohio legislation.

Fabe Cure Legislation

As you might guess, the Fabe-II decision has caused the stomachs of

Fabe Update (Continued from page 3)

some Liquidators around the country to resume their pre-Fabe-I spastic uproar. If the state where your liquidation is pending has a priority statute anything like Ohio's and if your state's severability principles are also anything like Ohio's--and virtually all of them are--then the gleaming gemstone of Fabe-I may need to be freshened up a bit with legislative polish.

Liquidators should be thinking about legislative relief to take advantage of Fabe-I and keep it from being flushed down the severability toilet. You cannot ignore the possibility that other courts like the Ohio court are going to be reluctant to rewrite liquidation priority statutes to make them fit the Fabe-I paradigm, and the best course may well be to get the legislature to clear up the ambiguity quickly and cleanly.

At last count, at least 12 states have enacted Fabe cure legislation, namely, Colorado, Florida, Hawaii, Indiana, Illinois, Kentucky, Louisiana, Missouri, Ohio, Pennsylvania, Utah, and Virginia. Other states, like Michigan, are considering the matter. The key here, as Kevin Harris and Barb Cox of the NCIGF have laid out in their suggestions for drafting Fabe cure legislation that many of you have seen, is to craft the cure carefully in such a way that the federal disease does not come back. Let me paraphrase their advice.

Great deference is afforded the legislature when it voices an intent regarding how an amendment should apply to existing matters. To make sure the Fabe cure vaccination is effective, it should be documented, preferably in the text of the bill, that the legislature intends for the amendment to apply to pending and future claims in existing insolvencies as well as to claims in future insolvencies. This position can be further buttressed by an expression by the legislature that it considers the amendment to be curative and remedial, and that the law it amends is "procedural" and "remedial" and no "substantive" rights are affected.

The legislature should further express that the amendment fulfills a goal of protecting policyholders of insurance companies as a matter of public interest and providing for an organized scheme of insurance company liquidation. Moreover, the legislation should say that it cures any potential defect in the validity of the present priority statute that may result from the Fabe decision, leaves the rest of the priority scheme undisturbed, and, as closely as possible, preserves the original intent of the legislature with regard to the priority of payment in liquidation. Finally, the legislature could characterize the amendment as one which settles an ambiguity in the state - either whether the statute is severable or how the Fabe-I decision will impact liquidations in the state.

Although it may be tempting to use this opportunity to effect other desired changes to a priority scheme, the Fabe cure amendment should be narrowly tailored to address **only** *curing residual Fabe issues. In fact, the cleanest way to approach the matter is to make the Fabe cure the only purpose of the legislation. This avoids any discussions concerning which changes are substantive and also will make a legislature more comfortable in reciting the desired intent.*

Other Post-Fabe Questions

As was discussed at the IAIR roundtable in New York City this past June, the Fabe-I decision has left a few important issues besides severability unresolved and invites further litigation on the validity and effect of the Ohio-type priority statutes. The other unanswered questions would seem to include:

How should federal tax claims be treated?

Are the claims of the federal government under bonds or other policies entitled to priority as policyholder claims, or do those claims receive a lower priority?

The government's claims in Fabe were policyholder claims, but the Supreme Court's decision seems to indicate that the Ohio priority statute effectively subordinates the government's policyholder claims to other policyholder claims. Yet, let us not forget that the federal government in the early Fabe proceedings still said that its claims were policy claims, not claims of the federal government in its capacity as such.

In short, do not assume that Fabe-I and Fabe-II will answer all your questions in dealing with federal claims. There are issues that often come up with federal claims, quite apart from the question of where federal claims fit in the priority scheme. For example, is a fiduciary like the Federal Deposit Insurance Corporation the "government" for federal superpriority purposes? Similarly, there have been recent indications from the Internal Revenue Service that it might still argue that tax liabilities, at least those triggered post-liquidation, are really administrative expenses and are not even in the same league with federal bond or policy claims. In other words, be prepared for the IRS to say that tax claims are in a different category than the federal bond claims that were on the Supreme Court's docket in Fabe-I and are right at the top of the priority heap.

You can get a sense of the remaining Fabe issues if you scan the post-Fabe cases listed at the end of this article. For example, filing deadlines may not apply to Uncle Sam, a very distressing prospect for receivers trying to get the claims in the door timely, adjudicate them, divide up the pie and shut down the estate quickly. The IRS takes the position that it does not need to file a proof of claim, period.

Conclusion

The NAIC has changed the liquidation priority section in the model rehabilitation/liquidation act to put policy-type claims of the federal government into Class 3 with policyholders, and tax and other federal claims into Class 4 ahead of general creditors.

The discussion and debate in the NAIC and in state legislatures of what to do with federal claims is likely to continue, with states ending up all over the map unless they can all be convinced to adopt new § 46 of the NAIC model. Peter Gallanis heads a new Federal Issues Working Group established in 1996 that will surely give good leadership through any continuing Fabe swamp.

In a nutshell, Fabe-I is a good read, but as we have learned from Fabe-II, it is not completely the end of the story. You have to continue to walk gingerly through the superpriority mine field, using Fabe cure legislation as a mine-sweeper.

It will take continuing creativity and legal maneuvering by receivers to make sure that federal claim surprises are not destructive of policyholder protection.

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Meet Your Colleagues

Linda M. Lasley

After close to 20 years with a large downtown Los Angeles firm, Linda left in May 1994 to form Reinsurance Counsel, a boutique practice specializing in reinsurance and insolvency issues, in Pasadena, California.

Since forming Reinsurance Counsel, Linda has continued to devote time to a variety of insurance-related professional organizations. She is a Vice Chairperson of the American Bar Association Excess, Surplus Lines and Reinsurance Committee, and is a Contributing Author to the NAIC Receivers Handbook. She is also a past president of the Conference of Insurance Counsel, and is an active member of the Defense Research Institute and the International Association of Insurance Receivers. In addition, she is a contributing author to The Law of Insurance, a newsletter published by Reinsurance Counsel.

After living and studying in France for nearly two years, Linda received her B.A., summa cum laude, in French Language and Literature, from the University of Redlands, Redlands, California; an M.A. in French Literature from Arizona State University, Tempe, Arizona; and her J.D. from the U.C.L.A. School of Law, Los Angeles, California, where she was an associate editor of the U.C.L.A. Law Review.

Linda, a California native, has her main residence in Pasadena, a short walk from her office. When she can, she packs up the cats and spends time at her southern office on the beach in San Diego County. She enjoys cats, the beach, rollerblading, all kinds of music, fixing up dilapidated old Craftsman houses and, of course, work. She also enjoys traveling to places that no one in their right mind would go to, such as Antarctica and Papua New Guinea. She has been accused of being a health nut, just because she won't join a gym but gets up at 5:00 a.m. (and risks mugging by the local coyotes) to jog.

Betty Cordial

Betty Cordial is president of Vista Consulting Group and currently serves as the Special Deputy Insurance Commissioner for the State of West Virginia, with responsibility for the state's domestic insurance receiverships.

After starting her career in the insurance industry, in 1971 Betty became the administrator and manager or the Conservation and Liquidation Division in California. Since 1982, serving as a consultant on rehabilitation or insolvency cases or as a special deputy receiver, she has provided services to 15 state insurance departments, a foreign country and the federal government.

In addition to her receivership consulting role, since 1985 Betty has served part-time as the reinsurance and liquidation consultant and special services coordinator for the National Association of Insurance Commissioners. In this capacity, she provides technical expertise to insurance regulators in the areas of reinsurance, surplus lines, international insurance and fraudulent activities within the insurance industry. She represents regulators with state, federal and international law enforcement authorities, playing a major role in insurance financial fraud investigations.

Betty serves on the Board of Directors of the International Association of Insurance Receivers, and is a member of the International Association of Insurance Fraud Agencies. She speaks frequently to law enforcement agencies, United States and foreign insurance regulators, the U.S. Department of Justice, and other regulatory and industry groups about insurance receivership issues and financial fraud in the insurance industry. She has regularly served as a guest lecturer at the FBI Academy at Quantico.

When not traveling, Betty divides her time between her offices and homes in Glenview, Illinois and Charleston, West Virginia.

Ipe Jacob

Ipe Jacob is a partner at Robson Rhodes, a leading 100 year old UK firm of chartered accountants and the UK member of RSM International, one of the principal international associations of accountants.

Educated in India and England, Ipe qualified as a chartered accountant in 1976. In 1985 he set up the first multi-disciplinary partnership of accountants and lawyers in the UK, which merged with Robson Rhodes in 1988.

As a licensed insolvency practitioner specializing in corporate recovery, the core of Ipe's experience concerns the identification and maximization of the strategic value of businesses. He is therefore regularly involved in the investigations, business analysis and the development of reconstruction strategies for all types of industrial and commercial operations.

Over recent years Ipe has become increasingly involved in the insurance industry, in both the Lloyd's and London Company Markets. He designed the skeleton scheme to share litigation proceeds between "upstream" and "downstream" Names in the Lloyd's related litigation and also advised the Litigating Names Committee on the consequence of a possible systemic collapse of the Lloyd's Market. He is also involved with devising packaged solutions for insurance companies wishing to exit the London Market. Recently he has been appointed provisional liquidator of UIC Insurance Company Limited and Pan Atlantic Insurance Company Limited.

Outside office hours Ipe can usually be found indulging in one of several pursuits including: coaching his three young children in the art of insurance brokering (they were going to be lawyers until just a few years ago!), learning to fly a microlight, or embarking on a search for the ultimate curry!

Paula Keyes, ARe, CPCU

Paula Keyes is an Assistant Vice President in the Orlando office of Chiltington, Inc. She has over 13 years reinsurance experience working with major international multi-line insurance companies, as well as 2 years with a state liquidation office.

Since joining Chiltington six years ago, Paula has worked on a number of projects related to several state and foreign insurance companies. She has assisted in on-site inspections of underwriting, claims, and accounting records and has been instrumental in the reconstruction of reinsurance coverage for insolvent companies.

Prior to joining Chiltington, Paula worked in a state liquidation office where she managed a unit in running-off the reinsurance books of six liquidated companies and collecting reinsurance recoverables.

Paula has earned the Associate in Reinsurance (ARe) designation and completed the requirements for her CPCU this year. Paula has recently become involved in IAIR's program committee and will be very active planning educational events over the next year.

When her 18 year old son and two puppies, Buffy and Cookie, aren't keeping her busy, Paula has many professional and social interests. She is a member of the Orlando chapter of the National Association of Insurance Women-where she recently received the CPIW designation.

Paula is also a member of Toastmasters, International in Chicago and Past Vice President of the Herb Society (smokeless!) of Central Florida in Orlando. When not unraveling estates, she enjoys shooting pool, bike riding, reading, gardening, and canoeing.

President's Message

Continued from Page 2

is now open (deadline 12/20/96). Interested members may now contact the NAIC Education and Training Department at (816) 374-7192. This has always proved to be an extremely popular event, so early registration is recommended.

It was good to see many members at the IAIR cocktail reception in Anchorage. The board would once again like to thank Michael Cass (R.M. Cass & Associates), Chiltington-Omni, and Hebb & Gitlin for, again, providing patron support to the reception.

Any IAIR members interested in being a patron for the cocktail reception in Orlando should contact Executive Director, Frank Bistrom at association headquarters (913) 262-2749.

Over the past few months, all IAIR members should have received information regarding the IAIR Accreditation Committee plans to have the first accreditation designations announced at the Atlanta meeting.

Speaking of Atlanta, we will once again have a cocktail reception, co-hosted by NOLGHA on December 16. Additionally, all IAIR members will shortly be receiving information regarding IAIR activities planned for Saturday, December 14, which will include the annual membership meeting, election of directors, and officers. The entire board hopes to see as many members as possible present.

In closing, I would just like to say that it has truly been a pleasure to assist the board in leading your organization over the last year. The purposes and objectives of IAIR, including the promotion of high standards in the administration of insurance receiverships, and uniform of professional standards for insurance receivers, a uniform code of ethical standards for insurance receivers, and developing educational and training programs to enhance the qualifications of persons working in the field of insurance receiverships, has been an uplifting and rewarding experience in my professional growth.

I hope to see as many of you as possible in Atlanta, But be careful, I may be carrying pictures of the latest addition to the Darling family (Mikell, 9/20/96.)

I would also like to extend my personal wishes and those of your Board to each of you and your families for a Happy Holiday Season and a very prosperous New Year.

For the First Time –

Accredidations and Certifications Granted

The Board of Directors have approved the recomendations of the Accredidation and Ethics Committee, granting two Accredited Inusrance Receiver (AIR), four Certified Insurance Receiver - Property & Casualty and eight Certified Insurance Reciever - Multiple Line (CIR) designations.

The members will be presented with their plaques at the IAIR Annual Meeting to be held Saturday, December 14, 1996, from 5:30 - 6:30 p.m. in the Rio Grande, McKenzie and Yukon rooms on the hotel's lobby level. The meeting will be held in conjunction with the NAIC meeting at the Marriott Marquis Hotel in Atlanta, Georgia.

Those who have been accredited or certified are:

Robert L. Howe	AIR
Nicholas J. Marfia	AIR
J. Burleigh Arnold	CIR - P&C
Robert M. C. Holmes	CIR - P&C
Jo Ann Howard	CIR - P&C
Jeanne Barnes Bryant	CIR - ML
Richard Darling	CIR - ML
Robert A. Deck	CIR - ML
Michael Marchman	CIR - ML
Lennard Stillman	CIR - ML
Jack Traylor	CIR - ML
Lawrence J. Warfield	CIR - ML
Thomas G. Wrigley	CIR - ML

Fabe and its Progeny

Continued from Page 7

United States Dep't of Treasury v. Fabe, 113 S.Ct. 2202 (1993)

Duryee v. United States Dept. of Treasury, No. C2-88-778 (S.D. Ohio 1995), Mealey's Ins. Insolv., vol. 7, #8, p B-1

Costle v. Fremont Indem. Co., 839 F.Supp. 265 (D. Vt. 1993)

Curiale v. United States, 113 S.Ct. 2989 (1993)

Garcia v. Island Program Designer, Inc., 4 F.3d 57 (1st Cir. 1993)

Grode v. Mut. Fire, Marine & Inland Ins. Co., 8 F.3d 953 (3d Cir. 1993)

U.S. Fin. Corp. v. Warfield, 839 F.Supp. 684 (D. Ariz. 1993)

Kachanis v. United States, 844 F.Supp. 877 (D.R.I. 1994)

Owensboro National Bank v. Stephens, 44 F.3d 388 (6th Cir. 1994)

Curiale v. United States, 627 N.Y.2d 655 (June 8, 1995)

First Advantage Insurance, Inc. v. Green, 652 So.2d 562 (La. Ct. App. 1995), cert denied, 654 So.2d 331 (La. 1995)

Garcia v. Island Program Designer, Inc., 875 F.Supp. 940 (D. Puerto Rico 1994), affirmed on appeal, Garcia v. Island Program Designer, Inc., 62 F.3d 1411 (1st Cir. 1995)

Stephens v. American International Ins. Co., 66 F.3d 41 (2d Cir. 1995)

American Deposit Corp. v. Schacht, 84 F.3d 834 (7th Cir. 1996)

Barnett Banks of Marion County, N.A. v. Nelson, 116 S.Ct. 1103 (1996)

Stephens v. National Distillers and Chemical Corp., 69 F.3d 1226 (2d Cir. 1996)

United States v. Rhode Island Insurers' Insolvency Fund, 80 F.3d 616 (1st Cir. 1996)

Receivers' Achievement Report

Jim Dickinson, 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)

Our IAIR achievement news received from United States' reporters covering the first and second quarters 1996 is as follows:

RECEIVERS' ACHIEVEMENTS BY STATE

Alaska (Joyce Wainscott, State Contact Person)

Disbursements made to Guaranty Associations & Other Claimants (2nd Quarter, 1996)

Receivership	Amount	
Pacific Marine Insurance Company of Alaska	$1,113,822	· Guaranty Associations
	383,299	· Other Claimants

Delaware (Richard Cecil, State Contact Person)

Estates Closed	Year Action Commenced	Insurance Category	Dividend Percentage
Pacific American Insurance Co	1984	P&C	Various
Ancilliary Receiverships:			
Allied Fidelity Insurance Co	1989	P&C	N/A
Ideal Mutual Insurance Co	1989	P&C	N/A
Transit Casualty Co	1989	P&C	N/A

Illinois (Mike Rauwolf, State Contact Person)

Estates Closed	Year Action Commenced	Insurance Category	Dividend Percentage
Multicare, HMO	1991	HMO	Class A (100%) $301,729 Class D (37.6%) $640,061

Disbursements for the First & Second Quarters 1996

Receiverships	Amount
American Mutual Reinsurance Company	$3,242,893
Associated Life Insurance Company	34,512
Centaur Insurance Company	228,270
Inter-American Insurance Company	1,228,454
MedCare HMO, Inc.	560,983
Merit Casualty Company	909,873
Millers National Insurance Company	998,621
Pine Top Insurance Company	2,291,056
Prestige Casualty Company	41,990
Sub-total	$9,536,652
Plus ten (10) additional estates where disbursements for each estate were below $25,000	72,291
Total	$9,608,943

Summary by Disbursement Category:

Payments to various guaranty funds/associations (including administrative expenses)	$2,368,268
Payments to policyholders/contractholders (including loss adjustment expenses)	2,679,180

Continued on page 12

Receivers' Achievement Report continued from page 11

Return premiums & transfers to insurance departments	102,342
Payments to ceding companies	4,459,153
Total	$9,608,943

Louisiana (Emery Bares, State Contact Person)

Estates Closed	Year Action Commenced	Insurance Category	Dividend Percentage
U.S. Indemnity Assurance Group, Inc	1989	P&C	N/A
Magnolia Fire & Casualty Co	1992	P&C	N/A
First American Life Insurance Co	1983	Life	36.9%

Disbursements made to Guaranty Association (2nd Quarter, 1996)

Receivership	Amount	
Sunbelt Southern Insurance Co	$ 1,417	· Louisiana Insurance Guaranty Fund
Magnolia Fire & Casualty Insurance Co	300,036	· Louisiana Insurance Guaranty Fund
Anglo-American Insurance Co	1,960,524	· Louisiana Insurance Guaranty Fund
	1,604,997	· Georgia Insurers Insolvency Pool

Missouri (Robert Deck and Doug Hartz, State Contact Persons)

Estates Closed	Year Action Commenced	Insurance Category	Dividend Percentage
Missouri National Life Insurance Co	1989	L&H	15.2%

New Jersey (John Kerr, State Contact Person)

Disbursements made to Guaranty Associations and Policyholders (1st & 2nd Quarters, 1996)

Receivership	Amount
Integrity Insurance Company	$2,268,774 Guaranty Associations
	3,803,150 Policyholders
Warwick Insurance Company	3,943,542 Guaranty Associations

Pennsylvania (William Taylor, State Contact Person)

Estates Closed	Year Action Commenced	Insurance Category	Dividend Percentage
American Health & Accident Insurance Co	1994	A&H	N/A Class A
			100.0% Class B
			5.3% Class C (Policyholders)
National Security General Insurance Co	1992	A&H	N/A Class A
			100.0% Class B
			1.0% Class C (Policyholders/ PLHIGA only)
Shenandoah Mutual Insurance Co	1989	P&C	N/A Class A
			100.0% Class B
			89.0% Class C (Policyholders)

Early Access Disbursements Made to Various State Guaranty Associations during First & Second Quarters 1996

Receivership	Amount
Corporate Life Insurance Company	$ 9,700,000
Life Assurance Company of Pennsylvania	3,610
Westmoreland Casualty Company	14,900,000

Receivers' Achievement Report

Other Developments

Joyce Wainscott (AK) advised that with **Pacific Marine Insurance Company of Alaska**'s second partial distribution this year of $1,497,121, total disbursements to-date have been made of $2,701,041, representing a fifty percent distribution covering all approved timely filed claims.

Bill Taylor (PA) in updating his last report on **Fidelity Mutual Life Insurance Company ("FML")** reported that policyholder death benefits and annuity payments continue to be paid at 100 percent. No guaranty association assessments are anticipated due to the continually improving financial condition of FML. The relaxed moratorium provisions approved by the Court were implemented effective August 1, 1996, a full two months earlier than required by the court order. Policyholders can now exercise all contractual provisions with the exception of unlimited cash access. Thus far, demand for exercising the restored options has been less than anticipated. Crediting rates were increased by .5% effective July 1, 1996, to take effect on the policy anniversary date. The Rehabilitator's Second Amended Plan was filed in late June, along with proposed bid procedures for the selection of a minority investor. The Agent's Legal Fund and the court-appointed Policyholder Committee have raised various objections to the Second Amended Plan and bid procedures which will likely require discovery and hearings before the Court. A court-approved bid process is unlikely to begin before 1997.

Bill Taylor (PA) also advised that in the rehabilitation of **Mutual Fire, Marine & Inland Insurance Company** the adjusted claims of policyholders (Class 4 claims), surety bond claims (Class 5 claims) and general creditor claims, including cedents' claims (Class 6 claims) were paid at 100 percent, together with late filed Class 6 claims. Funds have been set aside to pay all remaining valid claims once they are adjusted and Court approved.

A petition seeking the discharge of **Mutual Fire**'s rehabilitator was filed with the Commonwealth Court on October 2, 1996. This is a real success story considering that **Mutual Fire** was reputed to be insolvent in excess of $400 million when the rehabilitation proceeding commenced.

John Camacho and Rosita Owen (Guam) reported that the Territory of Guam has placed the **National Pacific Insurance, Inc.** under a liquidation proceeding. John and Rosita will hopefully let us know if they need any advice or assistance pertaining to its liquidation from their peers on the U.S. mainland.

Jim Dickinson (KY) reported that a creditors dividend payment plan for **Delta America Re Insurance Company** was filed with the Franklin Circuit Court on September 20, 1996, and was approved by Judge William Graham in mid-November. Only one objection was filed in opposition to the Plan which was overruled by the Court at that time. The Plan provides for payments initially of cedents' approved claims covering due and owing claims, plus the present value of outstanding claims using a composite discount rate of 13 percent.

Doug Hartz (MO) reports that in addition to the closure of **Missouri National Life** in June, 1996 as reported on the proceeding page, two 'as-close-as-you-can-get-to-receivership' administrative supervisions, which shall remain nameless, were closed and four other receivership estates were closed in 1996.

The four other closed liquidations are, listed with each followed be the month and year opened and closed, **Professional Mutual Ins. Co.** - 10/87 to 05/96, **Continental Security Life Ins. Co.** - 07/89 to 09/96, **American Independence Life Ins. Co.** - 04/90 to 02/96, and **Protective Casualty Ins. Co.** - 05/91 to 07/96. The Deputy Receivers on these estates were Robert Deck and William O'Bryan. This achievement (the five estates were closed in an average of 81 months or 6.75 years) is especially notable because these were difficult estates with problems ranging from long-tail claims (professional malpractice exposures) to hundreds of unlocateable claimants (mental health patients) and with several complex ground-breaking legal questions (phase III tax issues).

Additionally, the currently oldest estate in Missouri, **Saint Louis Metropolitan Health Plan,** in Liquidation - 12/81, is scheduled to be closed in December.

WANTED

Your Articles for *the Newsletter*

If you have an article you would like to submit for publication in *the Newsletter*, please submit it in MS Word 6.0, or Wordperfect 5.0 or 5.1 on an IBM formatted 3.5" floppy disc. Mail it to IAIR Headquarters, attention Heather.

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.

MISSOURI APPELLATE OPINION IN HOLLAND-AMERICA RECEIVERSHIP CASE AFFIRMS RECEIVER'S POWER TO ESTIMATE UNLIQUIDATED CLAIMS, INCLUDING IBNR LOSSES, TO AID RECOVERY OF REINSURANCE ASSETS

*By John C. Craft and William C. Jolley**

[Article for International Association of Insurance Receivers Newsletter concerning October 29, 1996 opinion by the Missouri Court of Appeals in Angoff v. Holland-America Insurance Company Trust (Reinsurance Association of America and Borg-Warner Corporation) (Mo. App. W.D. No. 51572):]

On October 29, 1996, the Missouri Court of Appeals handed down its opinion in the case of *Angoff v. Holland-America Insurance Company Trust (Reinsurance Association of America and Borg-Warner Corporation)* (Mo. App. W.D. _ 51572, Oct. 29, 1996), which held in favor of the Holland-America Receiver on the issue of whether a reinsurer's obligation to the estate of the insolvent ceding company includes liability (based on policy holders' and cedents') incurred but not reported ("IBNR") losses determined by estimation. When Missouri Director of Insurance Jay Angoff, as Receiver, submitted the proposed Final Dividend Liquidation Plan for the Holland-America Insurance Company ("HAIC") Trust to its domiciliary receivership court, the Circuit Court of Jackson County, Missouri, in May, 1995, the liquidators estimated that a "run-off" of all claims against the Mission Companies estates, including Holland-America, could take as long as thirty years.

The California Insurance Commissioner had submitted a similar liquidation plan to the California Superior Court supervising the liquidation of the trust estates of Holland-America's affiliates, the Mission Insurance Group companies incorporated in California (which plan has been twice amended after the original order of approval was reversed on appeal).[1] Many Holland-America and other Mission policyholders and cedent creditors filed claims, typically "long-tail" tort claims, for undetermined amounts, including claims for losses incurred but which had not yet been reported to the policyholders or their insurers ("IBNR claims"). Director Angoff proposed a liquidation plan designed to accelerate the resolution of claims against the HAIC estate by means of estimation, rather than delay distribution of assets for the decades that a run-off of the "tail" could require.

The *Angoff* opinion (which is not yet considered final pending the disposition of post-handdown motions) affirmed an order issued August 17, 1995, by the receivership court, approving procedures by which the HAIC Receiver will determine unliquidated claims, including IBNR losses, "by estimate, using methods based upon actuarial evaluations or other accepted methods of valuing claims with reasonable certainty as described in RSMo § 375.1220."[2] In arguments before the receivership court and in its appeal, the Reinsurance Association of America ("RAA") and the other appellants asserted that a run-off of the claims must occur in order for the Receiver to collect reinsurance on the basis of the ceding company's liabilities, and that reinsurers cannot constitutionally be required to pay the HAIC Trust estate based on the Receiver's estimates of the value of IBNR losses and other unliquidated claims. The Court of Appeals rejected the RAA's arguments, holding that because the HAIC reinsurers received premiums which were established by taking into account reserves for projected losses, including IBNR losses, it would be unjust to allow "reinsurers to avoid obligations based on a ceding company's liability for IBNR losses."[3]

One of the most significant parts of the Court of Appeals' opinion in *Angoff* held that the Missouri statute authorizing estimation of claims applies retroactively to the Mission/Holland-America proceeding as a procedural statute.[4] Thus, the case stands as precedent for the principle that a newly enacted statute authorizing a receiver to determine claims by estimation can be utilized in pending receiverships, and this ruling may encourage other state insurance departments to seek similar legislation.

The Court of Appeals decision affirmed the Circuit Court's findings,

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** John C. Craft is the chairman of Craft Fridkin & Rhyne, the Missouri Receiver's counsel in the Holland-America Insurance Company Trust liquidation proceedings. William C. Jolley is a partner in the firm. The views expressed in this commentary are solely those of the authors and are not intended to represent statements, opinions or positions of the Missouri Department of Insurance or the liquidators of the Holland-America Insurance Company Trust or any other company or estate in receivership proceedings.*

[1] ***Garamendi v. Mission Insurance Company*, No. C572 724 (Cal. Super. Ct., L.A.Co., Dec. 28, 1994), *rev'd Quackenbush v. Mission Insurance Company (Boozell)*, 46 Cal. App. 4th 458, 54 Cal. Rptr. 2d 112 (1996). A hearing on the revised amended final liquidation dividend plan is set for January 9, 1997 in the Los Angeles Superior Court liquidation proceedings of the Mission Insurance Croup.**

[2] **Angoff, *slip op. at 4.***

[3] **Angoff, *slip op. at 8.***

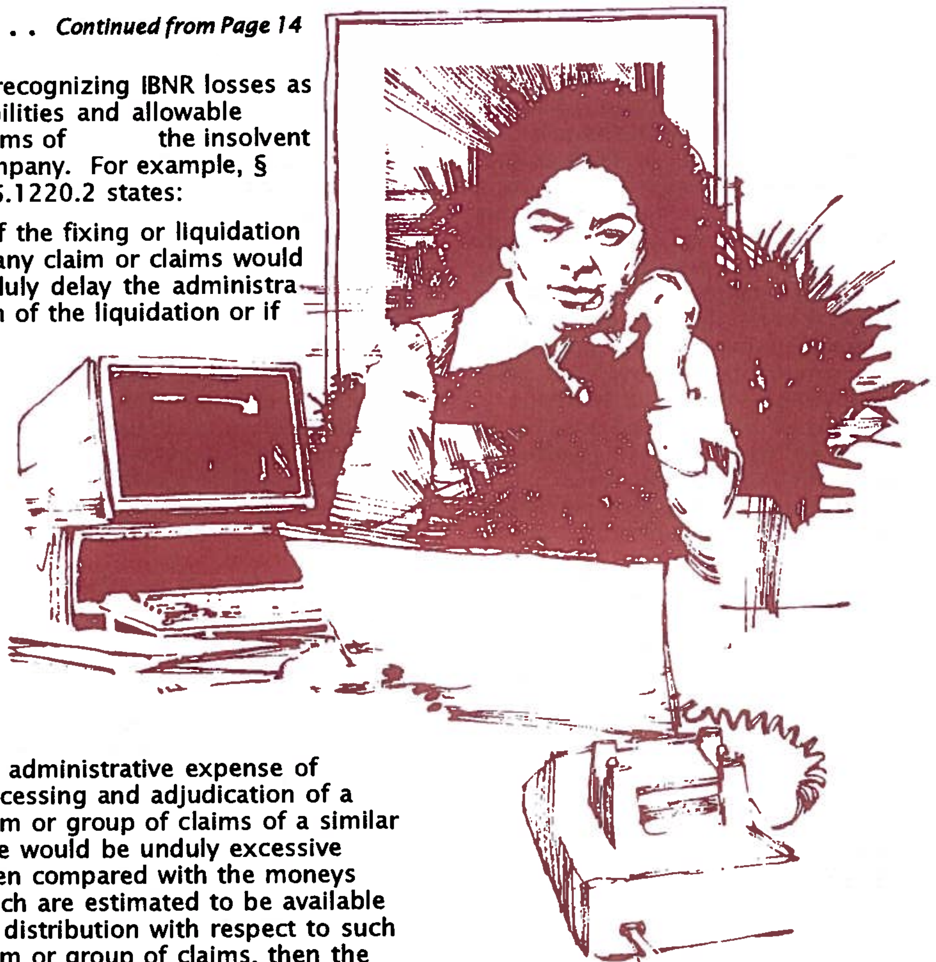
[4] **Angoff, *slip op. at 10; RSMo § § 375.1158.1 and 375.1220.2 (1994).***

MISSOURI APPELLATE OPINION . . . *Continued from Page 14*

conclusions and order allowing the Holland-America Receiver to estimate contingent, unliquidated and/or undetermined claims, including incurred but not reported claims. The Court of Appeals upheld the Circuit Court's ruling that the Receiver's determinations of claims against the HAIC Trust estate, including estimates made in accordance with the Plan, constituted a reasonable method of determining the amount of the claims allowed against the estate, and a liquidation of HAIC's liability as of the date of insolvency, for all purposes, including the collection of reinsurance proceeds from HAIC's reinsurers.[5]

The dispute between the reinsurers and the HAIC Receiver focused on whether reinsurers will be treated fairly in the process of determining the value of claims on an expedited basis. The question also arises in the case of the Mission Companies' estates, and likely in other major insolvencies as well, from the fact that these receiverships are exposed to significant environmental and product-liability tort claims which have a much longer "tail" than the claims experienced by past receiverships. Unlike receiverships of an earlier era, the estates of today's large, multi-state casualty companies such as the Mission Companies and Transit Casualty Company in liquidation are subject to numerous asbestos and other products liability and toxic tort claims with lengthy reporting periods. The advent of insolvencies with substantial long-tail business challenges the capacity of the regulators to close the estates within a reasonable time without foregoing collection of significant reinsurance assets. The Mission/Holland-America liquidators concluded that resolving claims liabilities by estimation was the only practical solution to the problem.

In its opposition to the HAIC Plan, the RAA contended that the Circuit Court and the Receiver do not have discretion to accept IBNR losses as claims on the ground that Missouri law does not permit such claims because they cannot be proven with reasonable certainty. In response, the Receiver cited Missouri statutes, particularly RSMo § § 375.1220.2, 375.1210 and 375.1212.4, to demonstrate that the Missouri General Assembly has endorsed the concept of recognizing IBNR losses as liabilities and allowable claims of the insolvent company. For example, § 375.1220.2 states:



If the fixing or liquidation of any claim or claims would unduly delay the administration of the liquidation or if the administrative expense of processing and adjudication of a claim or group of claims of a similar type would be unduly excessive when compared with the moneys which are estimated to be available for distribution with respect to such claim or group of claims, then <u>the determination and allowance of such claim or claims may be made by an estimate. Any such estimate shall be based upon an actuarial evaluation made with reasonable actuarial certainty or upon another accepted method of valuing claims with reasonable certainty</u>. (Emphasis added)

After noting that a receiver has broad discretion in conducting and managing a liquidation, the Court of Appeals addressed the issue of whether IBNR losses are so speculative that placing a value on such claims falls outside of the "reasonable certainty" mandate of RSMo § 375.1220.2. The Court observed that "the obvious problem with IBNR losses is that they must, by definition, rest on estimates, and estimates rarely can be subjected to the definitive evaluation which RAA seems to demand."[6] The Court then reviewed other Missouri statutes pertinent to the issues and concluded that the Missouri General Assembly "specifically endorsed IBNR claims in [RSMo] § 375.1212.4. The statute provides procedures for determining disputed policyholder claims relating to `liabilities incurred, but for which claims related to such liabilities are not reported, accrued or claimed.'"[7]

The Court of Appeals held that the Missouri insolvency statutes grant the Receiver considerable discretion in evaluating and determining claims, and that this discretion includes determinations of IBNR losses to the extent that those types of claims can be determined with reasonable certainty. The Court also noted that the receivership court has the discretion to expedite closure of the estate. Accordingly, in the adoption of the Plan the Court found no abuse of discretion or that the claims determination procedure was arbitrary. The Court also rejected the appellants' assertions that the order approving the HAIC Plan was an unconstitutional violation of their right to due process or a "taking" without compensation.[8]

Continued on Page 16

[5]Angoff, *slip op. at 5-7.*

[6]Angoff, *slip op. at 7.*

[7]Id.

[8]Angoff, *slip op. at 9.*

MISSOURI APPELLATE OPINION . . . *Continued from Page 15*

Missouri enacted RSMo § 375.675 (Supp. 1990), the predecessor to RSMo § 375.1220.2, in 1989 as the first statute expressly authorizing an insurance receivership to determine and allow claims or groups of claims by estimation, based upon actuarial evaluations made with reasonable actuarial certainty or upon other accepted methods of valuing claims with reasonable certainty.[9] As other commentators[10] have observed, Illinois and Utah also adopted receivership claims estimation statutes in 1993 and 1996, respectively.[11] Claims estimation is also permitted under the federal Bankruptcy Code.[12]

The Missouri Court of Appeals expressly found that the HAIC receivership court's 1995 amended order adopting the Plan, with its provisions allowing estimation of IBNR losses as claims, was consistent with earlier claims administration orders that the Circuit Court entered in 1990 and 1992:

The circuit court's 1990 and 1992 orders confirmed the receiver's authority to determine claims by estimation and actuarial evaluations. The reinsurers do not challenge these earlier orders. Indeed, RAA acknowledges that the prior orders were correct but claims that the amended [1995] order was inconsistent with the previous orders because it permitted the receiver to treat speculative and unliquidated IBNR losses as claims chargeable against the reinsurers. We disagree.

All the orders acknowledge the receiver's authority to evaluate claims based upon proper estimates and to accept IBNR claims. The amended order cites § 375.1220 in stating that the estimates are to be "based upon actuarial evaluations or other accepted methods of valuing claims with reasonable certainty . . ." [13]

These earlier orders included provisions in which the receivership court confirmed its inherent power to establish fair, orderly and efficient claims adjudication procedures, consistent with statutes generally authorizing the circuit court to enter such orders in connection with the receivership proceeding as it shall deem advisable. *See* RSMo § 375.560.1 (1986), repealed by L. 1992, H.B. _ 1574, § A; *see also* RSMo § 375.670.1 (1986 and 1994).

It is the authors' opinion that the Court of Appeals' affirmance of the Holland-America receivership court's broad discretion to adopt claims procedures to expedite closure of the insolvent estate indicates that the Plan could have been approved in its entirety even in the absence of a statute specifically recognizing the Receiver's authority to determine claims or groups of claims by estimates. Regulators in states which have not yet adopted claims estimation provisions similar to those in the current version of the NAIC's Insurers Rehabilitation and Liquidation Model Act (the "Model Act")[14] may nevertheless attempt to craft liquidation plans to survive challenges posed by the cedent's reinsurers. For example, a recent decision by the New Jersey Superior Court approved the Integrity Insurance Company liquidation plan in the absence of a statute expressly authorizing estimation and lends further support to receivership claims estimation.[15]

In the *Integrity* opinion, the Superior Court approved the New Jersey liquidator's proposed plan for distribution of Integrity's assets after addressing a "threshold issue of statutory interpretation", i.e., "whether the Liquidator has the legal authority to estimate the value of IBNKR [incurred but not yet known or reported] losses and reported case reserves in order to allow such contingent claims to participate in the final distribution of assets."[16] In its decision, the Court considered the effect of N.J.S.A. 17:30C-28, which provides in part that (a) no contingent claim shall share in the distribution of assets except if the claim becomes absolute

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[9]Mo. L. 1989, S.B. _ 333, § A; repealed L. 1992, H.B. 1574, § A.

[10]*Jonathan F. Bank and Stuart M. de Haaff,* Estimating Claims in Insurance Insolvency Proceedings, *FORC QUARTERLY JOURNAL OF INSURANCE LAW AND REGULATION, Vol. VIII, Ed. 3 (September 28, 1996) at 3.*

[11]Ill. Ann. Stat. ch. 215, § 5/209(7)(West's Smith-Hurd 1996) and Utah Code Ann. § 31A-27-330.5 (West's 1996).

[12]11 U.S.C. § 502(c).

[13]Angoff, *slip op. at 7-8.*

[14]National Association of Insurance Commissioners, Model #555-1, § 41 (1995); see also American Bar Association, Reference Handbook on Insurance Company Insolvency, 3-45 (Cynthia J. Borelli ed., 3rd ed. 1993).

[15]In the Matter of the Liquidation of Integrity Insurance Company, *slip op. (N.J. Sup. Ct. No. C-7022-86, Nov. 15, 1996) (herein "Integrity").*

[16]Integrity, *slip op. at 2.*

MISSOURI APPELLATE OPINION . . . *Continued from Page 16*

on before the last day for filing proofs of claims against the assets, although (b) any person who has a cause of action against an insured of the insolvent insurer shall have the right to file a claim in the liquidation proceeding regardless of the fact that such claim may be contingent, and such claim may be allowed:

(1) if it may be reasonably inferred from the proof presented upon such claim that such person would be able to obtain a judgment upon such cause of action against such insured; and

(2) if such person shall furnish equitable proof, unless the court, for good cause shown, shall otherwise direct, that no further valid claims against such insurer arising out of his cause of action, other than those already presented, can be made; and

(3) if the total liability of such insurer to all claimants arising out of the same act of its insured shall be no greater than its maximum liability would be, were it not in liquidation.[17]

The Superior Court, finding no precedent which construed the pertinent provisions of the New Jersey Insurer Liquidation Act, N.J.S.A. 17:30C (also referred to therein as the "Act"), found pre-Act decisions instructive, particularly *In re: Citizen's Title Insurance and Mortgage Co.*, 127 N.J.Eq. 551 (Ch. 1940).[17] The Court also looked to the federal Bankruptcy Code and Rules for guidance.[19] The Court concluded:

"Based on the provisions of N.J.S.A. 17:30C, public policy concerns, pre-Act case law, the Federal Bankruptcy Code and case law applying its provisions, as well as the generally broad equitable authority granted to both a Liquidator and a supervising court, this court finds that the Liquidator has the legal authority to: (1) estimate the net present value of IBNKR losses and pending case reserves on behalf of future claimants as a class, [footnote omitted] and (2) allow such contingent claims to participate in the final distribution of Integrity's assets." [20]

The Superior Court in *Integrity* acknowledged that the New Jersey Insurer Liquidation Act treats policyholders and third parties differently with respect to contingent claims. The Court noted that, generally, for policyholders with contingent losses to participate in a distribution of assets, their claims must become absolute before the claims bar date. However, the Court also noted that it had permitted policyholders who did not know of actual or potential claims against them as of the claims bar date, March 25, 1988, to "reserve [their] rights to assert all future claims against Integrity . . . " in its 1987 liquidation order.[21]

Therefore, while N.J.S.A. 17.30C-28a may have arbitrarily eliminated contingent claims if they did not become absolute by the claims bar date, the Integrity liquidation court opted not to eliminate the contingent claims of policyholders by exempting that class of claimants from the filing deadline of March 25, 1988.

The Superior Court stated: "***In so ordering, this court preserved the actual or potential claims of policyholders by permitting them to reserve their rights to assert *all future claims* against Integrity."[22]

Further, the Court ruled that it had the authority to permit the liquidator to present contingent claims to the Court on behalf of future claimants as a class under its broad equitable power stemming from N.J.S.A. 17:30C-4d and N.J.S.A. 17:30C-5b.[23]

Although both may be subject to further appeals in the discretion of the Missouri Supreme Court and New Jersey Court of Appeals, respectively, the *Holland-America* and *Integrity* decisions suggest that insurance regulators will find support for the adoption of a liquidation plan which includes provisions allowing the

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[17] Integrity, *slip op. at 5-6.*

[18] Integrity, *slip op. at 7.*

[19] Integrity, *slip op. at 9-10.*

[20] Integrity, *slip op. at 12.*

[21] Integrity, *slip op. at 12.*

[22] Integrity, *slip op. at 13.*

[23] Integrity, *slip op. at 15.*

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1/3 page	2-1/4" x 9-3/4	$150	$141	$131
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1997 INSOLVENCY WORKSHOP

**Cosponsored by the
National Association of Insurance Commissioners
and the
International Association of Insurance Receivers**

DATE: January 16-17, 1997

PLACE: Hyatt Regency Hill Country Resort
San Antonio, Texas

Makeup: Workshop for state insurance regulators and others involved with insurance company insolvencies

Topics:

Asset Recovery - Locating, assessing, and liquidating the major assets of an insolvency.

Reinsurance Issues - Notice requirements to reinsurers, commutations, recoveries

Distribution of Assets - Early access, interim distributions, problems in calculating distributions

Pirates of the Caribbean, et at - Dealing with entities that operate in the seams of insurance regulation

Long-Tail Claims - The mechanics of estimation

Recent Developments in Insolvency Law - A review of case law and legislative changes in insolvency law in the past year

Recent Developments in the United Kindom - A discussion of developments regarding insolvency practice and insurance regulation

Post Mortem of an Insolvency - Confederation Life Insurance Company - A retrospective on the largest life insurer insolvency in history by two of the key players

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Rates are subject to 15% tax. The cut-off date for room reservations is December 20, 1996. Register early, these special rates will not be available when the NAIC block is filled.

For more information about Insolvency Workshop, contact Education & Training fax (816) 889-6840; phone (816) 374-7192.

More Info on IIRC

Receivership Law Advisory Committee

Robert Lange, Director of Insurance for the State of Nebraska and Chair of the Interstate Insurance Receivership Compact Commission, has announced the formation of a Receivership Law Advisory Committee to begin work on the drafting of the Compact's uniform receivership law. This nine member advisory committee, working with three reporters, has scheduled a series of public meetings and drafting sessions over the next year at which it will receive comments from interested parties and work on the development of a uniform receivership law.

The advisory committee includes James Schacht of Coopers & Lybrand and former head of the Office of the Special Deputy Receiver in Illinois, Kevin Harris, VP, Secretary and General Counsel of the National Conference of Insurance Guaranty Funds, Tony Buonaguro, General Counsel for National Organization of Life and Health Guaranty Associations, Jana Lee Pruitt, Senior Counsel, American Council of Life Insurance, Bruce Clements, V. P. and Deputy Counsel, U. S. Automobile Association, Debra Hall, V.P. and General Counsel, Reinsurance Association of America, James Stinson, Sidley & Austin in Chicago, Julia Goaltey, Dykema Gossett in Lansing, Michigan, and Gary Hernandez, Long & Levitt, LLP in San Francisco.

The three reporters (all IAIR members) are ***Robert Craig** of Kennedy, Holland, Delacy & Svoboda in Omaha, **Paige Waters** of Rudnick & Wolfe in Chicago and **Mary Cannon Veed** of Mary Cannon Veed & Associates in Chicago.*

The reporters will be primarily responsible for the actual drafting process, researching alternative approaches and incorporating the policies developed by the committee into the proposed law.

During the group's organizational meeting in Austin on November 19, the committee developed an agenda for its first drafting session to be held Saturday, December 14 at the Marriott Peachtree Hotel in Atlanta as an adjunct to the NAIC winter meeting. This committee meeting, which is scheduled for 1pm to 5pm that afternoon, will be open to all interested parties. Director Lange and the committee intend that the meeting serve as an open forum for the development of issues to assist the group as it addresses the policies and procedures to be incorporated in the uniform receivership law. In addition to the open format, the group has identified specific areas which it intends to address in detail during the Atlanta meeting, see the agenda below.

The group's long term goal is the development of a more uniform and cost effective approach to the handling of insurer insolvencies. The committee anticipates presenting a draft receivership law in the fall of 1997.

The interstate Insurance Receivership Compact Commission is required to develop within three years from last September, a "uniform law governing receiverships". It has appointed reporters and a "core" advisory group to write what ought to be a state-of-the-art law governing insurance company liquidation nationwide. Since states which join the compact after the law is adopted will automatically adopt the new law, even those states which are not presently Compact members are intensely interested in what develops.

The advisory Group will hold an **open hearing December 14 in the Rhine/Savoy rooms, Lobby Level of the Marriott Marquis Hotel in Atlanta**, in conjunction with the National Association of Insurance Commissioners meeting to receive suggestions, gripes, bright ideas and harangues. *This session will replace the IAIR Roundtable Program usually held by IAIR.* Registration for the NAIC is not required. Anyone who is interested in the improvement of insurance company liquidation law is encouraged to attend, listen, and participate.

The formal agenda includes:

1. The point in the regulatory scheme at which insolvency provisions come intoplay;
2. interstate relations;
3. rights, liabilities and roles of parties with an interest in the administration and outcome of a receivership;
4. the definition, handling and allowance of claims;
5. differences, if any, among provisions for P&C, Life, Health and specialty insurers. In addition, an open microphone will permit the raising of other issues that interest the participants.

MISSOURI APPELLATE OPINION . . .

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receiver to determine claims, including IBNR losses, by estimates for all purposes, in the following sources: insurance code provisions which give the receivership court and/or the receiver discretion in adopting procedures for the administration of an insolvent estate, particularly in the area of presentment and allowance of claims; pre-existing case law supporting the discretion of the receivership court and/or the receiver which is not specifically contradicted by subsequent legislative enactments; and indications from the structure of the insolvency statutes of a legislative purpose to encourage the prompt resolution of claims and the speedy distribution of assets. Based upon public policy and existing insurance insolvency statutes, insurance regulators can make a strong case that they should be permitted to make claims determinations by estimate, if necessary, to close a receivership estate within a reasonable time, without foregoing collection of significant reinsurance assets.

Other News & Notes

By Douglas A. Hartz,
Missouri Receivership Supervisor

Long Tale Claims - Perhaps that is how we should refer to these claims because of the lengthy stories that have developed from their existence in P & C receiverships. This is the hot topic these days. It was the main topic of discussion at the IAIR NCIGF Seminar, "Moving Forward Together: Addressing Today's Concerns-Reinsurance Issues" and has been on many of our minds recently. As examples of the tales that hang on long-tail claim issues we have the article in this edition, "Missouri Appellate Opinion in Holland American Affirms Receiver's Power to Estimate Unliquidated Claims, Including IBNR Losses, To Aid Recovery of Reinsurance Assets[1] (the title itself is almost a tale, but wait it gets better) the two or three foot stack of pleadings that have been filed in the Mission case in recent months, and the opinion pieces that Mealey's reprinted for IAIR members benefit to review at the N.Y. Meeting Roundtable. [2]

Long-tail claims are the bane of receivers everywhere. These claims are also distressful to the reinsurers of these insolvent P&C insurers. We must be vigilant to keep in mind that the problem is the long tail claims. The problem is not the reinsurers or the receivers. The problem is a situation. It is not a corporation, a group or a person. So, let us stop getting so personal about the problem.

For examples of this, in Tampa there were numerous negative remarks about that "Receivership on Wilshire Blvd." (If you don't recognize this it refers to Mission, which if you don't know it is pretty closely related to Holland America) and the line in one commentary describing this same receivership as behaving, "...like a child with a temper tantrum who picks up not only is own toys, but his friend's toys, and goes home." [3]

I am tired of reinsurers painting receivers as country bumpkins that are too stupid to understand the intricacies of reinsurance and must be smoking something that grows a lot down in Mexico. This is not the case. Really, many receivers just want to estimate these long tail claims, marshal the reinsurance assets, pay the claims and close their estates. Meanwhile, the reinsures do not want to pay more than is due and not before it is due. This approach has been styled "You'll not get a dime until it is time," or "Until it is certain - you'll just be hurtin'." I am sure the reinsurers are tired of being portrayed as Darth Vader, Simon Legree, and Ebenezer Scrooge.

Getting back to keeping in mind that the problem is the long trail claims, it is also important to note that this long tail claim situation results from many factors and societal trends beyond the control of the receivers and reinsurers. Over a period of many years beginning, perhaps, in the late 1960's, an increasing focus on the environment, the litigiousness of the U.S. economy, the trend to expansive readings of coverage provisions, increasing attention to consumer protection and major changes in state insolvency and guaranty fund laws, have all converged to bring about the long tail claim problem.

From the reinsurers perspective these converging trends may look something like the following. Years ago we entered into contracts of reinsurance and accepted ceded premium, the amount of which seemed sufficient at the time, for assuming risks, the scope of which we thought we knew. But, the scope has been expanded and expanded for things we never thought we would have to pay like cleaning up the environment in the U.S. and all these nasty asbestos related claims. The risks expanded to the extent that it contributed to some of our ceding insurers becoming insolvent. Worse yet, some of our fellow reinsurers have become insolvent and they reinsured us on some of the risks we assumed. So we have ended up being debtors to a bunch of receivers, while also becoming creditors of our failed fellow reinsurers.

If it were not bad enough that we are paying for the fact that the U. S. has too many lawyers, treehuggers, and softhearted judges, the state legislatures went and completely changed the insurer receivership laws based on that crazy Wisconsin statute that put all policyholders in a priority class higher than general creditors. This wild consumerism idea, never existing before in any bankruptcy or insolvency law, results in such a large preferred class that the general creditors will never see any distributions. Of course, then the U. S. courts classified us as general creditors. Receivers then started denying our inalienable right to setoff. Since then, to quote the RAA:

Liquidators [have claimed] that (1) setoff constitutes a voidable preference, (2) there is no mutuality among multiple contracts or among assumed and ceded contracts and (3) there is no mutuality between the reinsurer and the liquidator since the liquidator is a different legal entity than the previously insolvent insurer. Additionally, liquidators claim that there is no common law right to setoff and that setoff does not apply in rehabilitation. [4]

And now to top off all of these conspiratorial violations of our constitutional, contractual, and common law rights, the Liquidators, "seek to unilaterally estimate a reinsurer's ultimate obligations to an estate and compel immediate payment based upon those estimates." [5] This estimation idea further changes the terms of our contracts and so, with all of the above, our contracts are being unconstitutionally impaired and our due process rights violated.

Well, the above reinsurers perspective is bleak. But, you have to consider that they are something like warehousers of the product, claim payments, that we liquidators are trying to deliver as much of as possible to the ultimate consumers to maintain policyholder confidence in an industry that has been hit fairly hard in recent times with insolvencies and more than its share of the costs of some societal change. The reinsurers are an integral part of this industry, but if we as an industry are serious about maintaining confidence, then (a) it is proper that reinsurers come after policyholders in the priority of distribution (b) we should try to find ways to close estates in something less than several decades and (c) make distri-

butions to policyholders in a time frame that is meaningful to them. That is, while they are still alive.

If we as an industry are really serious about maintaining confidence, we will focus on getting the policyholders paid timely and in the priority that the Supreme Court in *Fabe I* recognized as the reason for our state laws governing insurer insolvency. If we are serious, we will recognize that only to the extent that setoff by reinsurers violates the priority of distribution it should be restricted. If we are serious we must be able to devise a provision for setoff that would only restrict it in a liquidation, that encourages reinsurers to settle up balances prior to a liquidation order (avoiding the current incentive to hold up payments and let balances grow when an insurer appears to be slipping into financial trouble), that would not restrict setoff where it appears that the policyholder class will be paid in full, and that prevents inappropriate application to the mere calculation of what is actually due from each reinsurer. Yes, the concept of restricting setoff has been misunderstood and misapplied by liquidators and rehabilitators, but that is primarily because the restriction has never been properly defined. It ought to have been defined when the complete 'sea change' to a priority of distribution that did something that had never been done before (made the largest class of creditors preferred over the smaller classes of general creditors) was made.

Now on the charge that we liquidators just want to "unilaterally estimate a reinsurer's utlimate" liability and 'compel immediate payment' thus impairing reinsurers contracts and denying them due process, look here, we are simply trying to find a way to pay claims before the claimants die off or the reinsurers go out of business. I am not aware of any estimation plan that does not allow for the ultimate incurred to be discounted back to take into account the time value of money. Thus, if the rights and liabilities are fixed at the liquidation date, and the reinsurers are being asked only to pay the present value of what will be due from them anyway, then this does not appear to violate any substantive due process. As to the impairment argument, it rings very hollow when sounded out by witching it into the policyholder's situation upon an insolvency. This insolvency statute causes my loss payment, which is due today under my contract, to be delayed by a couple of decades and to be cut to some cents-on-the-dollar of what is due to me? Isn't that an unconstitutional impairment of my contract? No, not really. Only an Orwellian assumption that, "some animals are more equal than others" could support the idea that the policyholders contracts can be so impaired while the reinsure's contracts must be protected. Also, I vaguely recall some textbook Constitutional Law cases where the Court weighed this clause against the general police powers retained by the states, and if this weighing is combined with the concepts contained in the *Fabe I* case, it seems the power of the states to regulate the business of insurance toward the protection of policyholders outweighs the impact of the impairment clause.

On a lighter and brighter note, I was encourage by some of the discussion at the Reinsurance Issues Seminar that the industry insurers are also looking for ways to resolve the long-tail claims issues. One concept of particular interest was that the long-tail could be assumed by and turned over to the P&C guaranty funds. Interim distributions could be made by the liquidation to the point that the estate could be essentially closed with reserves made to account for the values of the yet to be incurred claims and the reinsurance that GF's would eventually collect in respect to those claims. Some form of trust would have to be set up for estates with non-GF-covered claims and the GF would have to administer these. The idea has some stumbling points, but let's face it, the GF's should be here to stay and our liquidation estates should not be here to stay.

Further on the idea of long-tail claims being the bane of receivers everywhere, these claims and the estimation of their value do not only provide grief while trying to close a liquidation, they can provide a different, if not more severe grief at the opening of a liquidation. Consider the following. Suppose you are the Rehabilitator of an estate, let's call it Common Insurer or "CI". CI has about $10 million in assets (all of which came from tax refunds because of CI's pre-receivership practice of chronic under-reserving, increasing income and providing the appearance of solvency, but leading

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Other News & Notes

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to the over payment of income taxes). CI has long-tail claims that you estimate at about $20 million. You have commuted all of the reinsurance then brought actions 'sounding a lot like fraud' against the former directors of CI (smartly avoiding the Union Indemnity problem of "management defrauded the policyholders so the policyholders should be punished, for being so ignorant, by allowing the reinsurers to avoid their obligations to the estate") for the deficit, which is then about $10 million.

Further suppose, you have used all the other assets and reinsurance commutation proceeds to favorably settle about $60 million in, well, lets just call them "shorter-tail"claims for just $50 million. This reduced the original deficit of about $20 million to its current $10 million level. But, continuing to rehabilitate by shaving the claims appears, 'futile' and as, you want to move this estate into liquidation so that you can apply estimation statute and equitably allocate the unavoidable loss of $5 million, assuming you recover the other $5 million from the directors. So you file your motion to move to liquidation.

Now, it only takes a moderately clever attorney for the former management of CI to look at this situation and realize the following. If we convince the Court that those long-tail claims are really only worth about $7 million, we can tell the court that we will pay that $7 million at 100 cents-on-the dollar. Meanwhile, the Receiver can only tell the Court that, using his estimates, only 50 cents-on the dollar can be paid, because he can't tell the Court that he is certain he will recover anything from us. Further, with a surplus of $3 million, which is more than the statutorily required surplus, we can ask the Court to release our cash cow from rehabilitation, whichmeans that we won't even have to defend that nasty action 'sounding a lot like fraud' since we will have CI back and can dismiss it. We can also sue the actuary that found we had a $20 million deficit because we will have an order saying we are solvent. Hopefully, no one will notice that all of the tax refund assets that we will have are also based on that actuary's findings.

There are two lessons here. First, it can happen to you. Check your statute in the sections providing for the movement of a rehabilitation into liquidation. Usually these provisions will be in the sections immediately proceeding the "grounds for liquidation"sections. the 1991 version of the NAIC Model, Section 16 - Termination of Rehabilitation, has the critical language on permitting the directors to petition the court for orders 1) paying their costs of fighting the move to liquidation and 2) for ending the receivership and restoring possession and control of the business.[6] As a suggestion, based on some real painful experience, these provisions need a clause preventing the directors from asserting these abilities if there are any pending actions against them filed by the rehabilitator.

The second lesson is to avoid obtaining only a consent to rehabilitation at the start of a receivership. If the insurer appears to be insolvent and its directors are willing to consent to rehabilitation, they are most likely going to be willing to consent to both rehabilitation and liquidation at that time. They may not be so willing later. It may be the case that litigation with them will develop during the rehabilitation period - and it may occur to them that the very best defense is not merely a good offense, but to fight to have the Insurer released from rehabilitation back into their direction and control. Its much like the old Debtor-in-Possession problem that arises in Bankruptcy proceedings. Debtors-in-Possession are notoriously bad at exposing their own misappropriations and other wrongdoing prior to Bankruptcy.

[1] It must be noted here that I am, after all, the Receivership Supervisor in Missouri and so, a) know a little bit about this Holland America case, and b) must add to our usual IAIR disclaimer, at page 3, that the views expressed here are not only not necessarily those of the IAIR Board, Publications Committee or IAIR Executive Director, they are not necessarily those of the Missouri Department of Insurance and may not even be my own views as they may be presented only to engender further discussion about IAIR members and others interested in the topic.

[2] The three commentaries in the reprint of Mealy's Litigation Reports - Insurance Insolvency were;

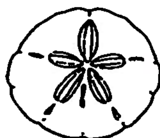
"Receivership: a Generational Commitment or Expeditious Solution", Richard L. White, V.7, #21 (April 3, 1996, "Response to Receivership: a Generational Commitment or Expeditious Solution", Karl L. Rubenstein, V.7, #23 (may 1, 1996, and "The Proof Is In the Pudding: Acceleration Of Reinsurance Recoveries", Debra J. Hall, V.8, #1 (June 1, 1996).

[3] Supra, note 2, "The Proof Is In the Pudding", at p. 3 of the reprint.

[4] At point II.4, - Setoff, Outline by Debra J. Hall, presented at the November 7-8, 1996 Seminar on Reinsurance Issues Sponsored by IAIR and the NCIGF.

[5] Id. at point II.1.

[6] This apparently derives from the 1969 version of the NAIC Model, then Wisconsin section of 645.35 which in turn cites to New York's law, then section 512. The power of the directors to petition for a return of control to them appears to have been added after 1978, a late and unfortunate addition to the NAIC Model.



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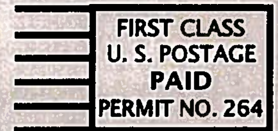

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