INTERNATIONAL ASSOCIATION OF INSURANCE RECEIVERS
PROMOTING PROFESSIONALISM AND ETHICS

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James Kennedy, Esq.

PRESIDENT'S MESSAGE

IAIR has had very a productive year, and there is more to come. Here is a recap of recent activities, and a preview of upcoming events:

TDS RETURNS

IAIR held the sixth program in its Technical Development Series in October. For the first time, we collaborated with the University of Connecticut School of Law on the program, which gave law students an opportunity to participate. Some of the highlights were the keynote address by Tom Sullivan with the Federal Reserve Board, and a question and answer session with Sharon Williams with the U.S. Department of Justice. UConn was a wonderful host, and Program Chair Bill Goddard and the IAIR Education Committee did a great job bringing this event together. We also appreciate the contributions of the workshop sponsors - Day Pitney LLP, Mazars, and Morgan Lewis. Check out the article about the TDS on Page 2.

CALIFORNIA, HERE WE COME

IAIR's has a full schedule of activities at the Fall NAIC meeting. The Issues Forum is on Friday, November 16th. Education Co-Chair Kathleen McCain has put together a line-up of topics, including California regulatory issues, how Insurtech is changing the insurance industry with new technology, an update from the Conservation and Liquidation Office, and Guaranty Association "Problem Busters". After the Issues Forum is our Annual Meeting and election, followed by a reception. At the meeting we will elect officers for 2019 - which brings us to the next item.

CHANGING OF THE GUARD

Earlier this year, Jonathan Bing left the IAIR board of directors. Jonathan made a tremendous contribution as First Vice President and Chair of the Governance Committee. The board appointed Jan Moenck to fill his vacancy. The terms of five board positions will end at the close of 2018, and Alan Gamse, Lynda Loomis, and Lowell Miller will be leaving the board. Alan worked tirelessly as Secretary for many years; Lowell has been our trusted Treasurer; and Lynda has co-chaired the Receivers & Guaranty Funds Relations Committee. It has been a privilege to serve with all of them, and we appreciate their hard work on behalf of IAIR.

JOIN THE RESOLUTION

IAIR's annual Insurance Resolution Workshop will be in New Orleans February 13-15, 2019. The program chairs have put together an outstanding workshop that includes current and former commissioners and other regulators, industry leaders and other experts. Don't miss out on this program, and the opportunity to have beignets and Café au Lait for breakfast.

I look forward to seeing you soon at one of our events.

Pat Hughes of Faegre Baker offers his View from Washington at the Summer 2018 NAIC in Boston

MARK YOUR CALENDARS FOR THESE UPCOMING EVENTS

IAIR 2019 Insurance Resolution Workshop	Feb 13 – 15, 2019 - New Orleans, LA
NAIC Spring 2019 National Meeting	April 6-9, 2019 - Orlando, FL
NAIC Summer 2019 National Meeting	Aug 3-6, 2019 - New York, NY
NAIC Fall 2019 National Meeting	Dec 7-10, 2019 - Austin, TX

Hal Horwich moderates The Prepackaged Rehabilitation and Other New Tools panel.

TDS VI: THE END OF THE ROAD: ISSUES IN CLOSING RECEIVERSHIPS

By William Goddard, Partner, Day Pitney LLC

Regulators and professionals from around the country gathered at the University of Connecticut School of Law for the 6th Technical Development Series (TDS). Over two days, the participants tackled one of the most vexing issues for insolvency practitioners, closing receivership estates. Students and faculty from the Insurance Law Center at UConn, including the staff of the Connecticut Insurance Law Journal, joined in the audience. The workshop led off with a lively discussion to frame the conference. David Axinn, Special Deputy Superintendent and director of the New York Liquidation Bureau and David Wilson, CEO and Special Deputy Commissioner of the California Conservation and Liquidation Office spoke about how the trend toward closing estates has come front and center. They reviewed the changing pipeline of the waning of long tailed claims and the rise of more stringent financial supervision. They explained how receivership offices are moving to a smaller/leaner model and how the focus on moving estates to closure begins from the moment the petition is filed. They also talked about the tool kit available to receivers to move an estate toward closing. The panel also walked through a case study of the CastlePoint receivership from both the California and New York perspectives. The audience heard how targeted and thoughtful pre-receivership planning transitioning into a plan for the life of an estate has supplanted the ancient mantra of "chuck it over the wall."

Patrick Cantilo led a vibrant panel with IAIR President James Kennedy, Ben Ensminger-Law of PIMCO, and Stephen Schwab of DLA Piper to discuss how to dispose of illiquid assets. Mr. Ensminger-Law took the audience though a methodology for structuring illiquid assets for sale and Mr. Schwab explained various techniques that can also be used when assets can't be sold easily.

Lori Jones of Scribner Hall led a panel discussing tax issues and federal releases. Sharon Williams of the Department of Justice carefully explained the process to obtain a federal release and encouraged receivers to begin communicating early. Ms. Jones and Tom Barber of Mazars USA walked the audience through the many federal tax wrinkles that go with moving an estate toward closure.

After a night at the beautiful Delamar Hotel in West Hartford and morning donuts, IAIR's Evan Bennett, James Kennedy, Barb Murray of PwC and Joe Scognamiglio of Quantum Consulting discussed how to liquefy hard to collect reinsurance. The panel discussed thorny collection issues and possible package and sale structures to get value out of lingering receivables.

A distinguished panel led by Barb Murray discussed long tail claims. The panel included Bill Barbagallo of PwC, Tom Cunningham of Sidley Austin, Washington Deputy Insurance Commissioner Doug Hartz and Gail Pierce-

Sipponen, Assistant Special Deputy Superintendent and Director of Creditor and Ancillary Operations of the NYLB. For those estates with asbestos and pollution exposures, the long process of claim development can be an impediment to closing estates. The panel discussed how to resolve these types of claims in the wind up of a receivership.

Ben Nissim of Day Pitney led David Heintz of Travelers and Bill Lohnes of The Hartford in a discussion of how solvent carriers interact with insolvent estates, especially those nearing closure. The great value gained in time and cost to both sides from orderly exchanges of data with the estate cannot be understated. The panel talked about metrics and channels to make the process work smoothly for the submission of all claims and especially setoff and contribution claims that arise towards the end of the process.

Hal Horwich orchestrated a panel consisting of Debora Hoehne from Weil Gotshal, Lynn Holbert from Hogan Lovells and this reporter. The panel carefully examined the monoline financial guaranty insurer insolvencies of the last financial crisis: Ambac and FGIC. Both companies exited receivership though rehabilitation plans. The panel examined those marks that the monoline receiverships have left on the insolvency landscape and the effects they will have on future receiverships.

At the end of Friday, Darren Ellingson of Darren Ellingson and Associates led former IAIR President Donna Wilson, Tamara Kopp from the Missouri Department and Jan Moenck from Risk & Regulatory Consulting on an adventure through the "everything else" that happens at the end of a receivership. There are so many things that might slip through the cracks that really need attention from employment to records to systems and the panel shared their experiences with it all.

When the day was over, the audience and the participants had shared generously of their time and experience. The IAIR members got the opportunity to become acquainted with the UConn Insurance Law Center (and its dozens of courses in insurance law and Insurance Law LLM) and the University was able to learn more about IAIR and its members' depth of knowledge and years of experience. After that, everyone headed out into the New England Autumn.

I hope we will be able to gather at UConn again in to the future to repeat this experience.

Tom Sullivan, Associate Dir., Board of Governors, Federal Reserve delivers the keynote address at the TDS VI.

PRE-LIQUIDATION PLANNING IS KEY TO KEEPING THE INSURANCE PROMISE[1]

By Roger H. Schmelzer, President & CEO, National Conference of Insurance Guaranty Funds

Digitization of the insurance business is driving dramatic change to the statutory resolution functions. With the capability to transmit adjuster notes and payment histories electronically now fully developed, insolvency professionals have adapted to electronic records and imaged files a necessary response to handling claims in this new insurance environment. This sea change has made the case for pre-liquidation planning even stronger than it was in 2004 when the NAIC's Receivership and Insolvency Task Force (RITF) adopted a white paper titled ***Communication and Coordination among Regulators, Receivers and Guaranty Associations: An Approach to a National State-Based System.***

In its executive summary the authors noted:

> *"…effective communication and coordination among state regulators, their receivership operations and the guaranty associations is critical in providing essential protections to consumers in the event that insolvency ensues. Guaranty association involvement should be early enough that the guaranty associations can immediately undertake their statutory duties upon liquidation."*

Avoiding payment disruptions and continuing to uphold the insurance promise is important in all types of property and casualty business; claims data is key to continued servicing of claims. While immediacy requirements vary, mostly because individual claims types move at differing rates in the resolution process, a key fact remains: ***regardless of claim type, claims cannot be paid without necessary and accurate UDS records***.

It is also important to note that, as always, insolvent companies have limited resources. Pre-planning conserves remaining assets from which to make claims payments.

Some lessons that have been learned could lead to techniques that might make the transition process smoother:

1. Claim files are not always under the direct control of the now insolvent company. Files often reside with one or more third party administrators (TPAs). The TPA's interest in the smooth transition will likely not be as high as that of the receiver and affected guaranty associations. Periodic financial exams can often ameliorate these situations before they become problematic by requiring that information on existing TPAs and their contractual arrangements be readily available.

2. Digital images are typically large files, both individually and in aggregate. It's become common for liquidators to encounter 2-plus terabytes (approximately 150 DVDs of content) of stored images, either in the claims system itself or in a separate imaging system. Consequently, it takes time to transfer digital images. Not only is it time consuming to extract files from the company or TPA system, it also takes considerable time to convert those files to UDS format and load them onto the affected guaranty association's claim systems. This is a potential gap in the 21st Century policyholder protection environment and should be addressed on a more permanent basis.

3. The cyber security threat landscape continues to evolve and become more complicated, practically on a week-by-week basis. Cyber security should continue to be a high priority after company takeover. Computer infrastructure and software must to be built and maintained with security front of mind.

Regular financial examinations should be conducted more frequently, particularly if a company is in a troubled status. Once a liquidation is triggered, receiver focus is properly on the entire insolvent estate. Addressing the challenge of data preparation in partnership with the affected guaranty associations and NCIGF is a key to the success of the state-based insolvency system in the future.

There are several excellent vendors experienced in data transition issues. NCIGF itself has also taken this task seriously, converting multiple years of experience in data-related issues into Guaranty Support, Inc. (GSI), a wholly-owned subsidiary, to provide extraction and

[1] This article is adapted from a joint draft prepared for the IAIR Receiver and Guaranty Fund Relations Committee. The author acknowledges contributions made to the original draft by a subgroup of receivers and guaranty fund representatives, along with legal and IT staff of the NCIGF.

UDS conversion of insolvent company data. With its technology focus and legal protections, the GSI construct allows for direct work with insurance receivers on data management either pre-liquidation or later phases of a liquidation.

Given the cyber security risks that exist, NCIGF provides important member-paid core services that add significant value to UDS and in turn the shared liquidation mechanism. guaranty associations and receivers. For example, The NCIGF maintains the UDS Data Mapper, a web-based application that gives receivers a way to securely, quickly, and inexpensively convert claims data to UDS format. The Data Mapper was launched in 2010 and has been used to process nearly 100 million UDS records in more than 50 insolvencies. Additionally, the SUDS server, maintained by NCIGF, is a means to transmit data from the guaranty association to the receiver in an encrypted format.

While claim file transition is the most prominent area that has evolved in the resolution world over the past several years, other elements of insurance liquidation should also be addressed early, including:

Cost reimbursement practices. Ideally, receivers and guaranty associations should reach a common understanding of state statutes that address allowable expenses and protocols for expense submissions to the estate. Doing so pre-liquidation will help mitigate conflicts in later stages of the resolution.

Confidentiality arrangements. Under many circumstances the receiver may need to enter into a confidentiality agreement with the guaranty associations to disclose certain non-public information. Specific state law requirements may govern these arrangements and should be reviewed to determine when guaranty associations can be brought in and what information may be shared.

Identification of unique circumstances. Some states have unique situations that are best addressed before the liquidation order is rendered. For example, a state may need a separate ancillary proceeding in its jurisdiction that will take time to implement. Sometimes funds are held in the state treasury and will require lead time to be made available for claim payment. Many of these situations can best be addressed up-front to tailor plans for unique situations.

Conclusion: Our joint mission continues to be the protection of the insurance promise and insurance consumers by way of a seamless transition for policy claimants if an insurer fails. The Dodd-Frank Act expressly left insurance insolvency to state regulators, receivers and state guaranty associations (but provides a process for the federal government to insert itself into the insurance liquidation process if deemed necessary). Adherence to established state statutory policies, collaboration with insurance receivers and full adoption of the technology on which the state-based mechanism depends is essential to fulfilling these responsibilities.

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FEBRUARY 13-15, 2019, ROYAL SONESTA, NEW ORLEANS, LA

UNIFORMS! WE DON'T NEED NO STINKING UNIFORMS![i]

By Douglas Hartz

Everything does not need to be uniform. That is the main proposal here. The title should, maybe, reference that it is uniformity (not uniforms), that we do not necessarily always need. But, stinking uniformity just didn't sound as good. Some things (bank card sizes, atomic measurements, time measurements, etc.), just absolutely have to be uniform. But, not everything. In fact, not most things. Which is not to say that uniformity is, in and of itself, a bad thing. Uniformity is merely a technology of ages past (the latest of which are the Agricultural and Industrial Ages). It and standardization were crucial in increasing the abundance provided by the technologies of those ages. But, actually, fewer and fewer things need to be uniform as certain technologies increasingly allow for us to be able to better deal with divergence and manage diversity. More on that toward the end of this article. The first focus here will be on the need for uniformity – or more so – on when it is needed and when it is not.

What is more important than uniformity? Actually, many things. Among them are basic fairness, advancing civilization, protecting consumers and increasing the use and usefulness of insurance in the socioeconomic systems that serve humanity. In the area of insurance regulation there are also some matters that absolutely have to be uniform among the states (for example, for NAIC Accreditation a state has to have authority to examine an insurer as needed[ii]), but there are likely many more matters that do not need to be uniform. There are 10 or more (if sub-parts are counted) questions regarding the 1st standard, Exam Authority, of Part A: Laws and Regulations – Excluding Risk Retention Groups, but there is only one for the 13th standard, Receiverships (does the state have a scheme similar to Model 555?), and for the 14th standard, Guaranty Funds (does the state have regulatory frameworks such as in Models 520, for life and health, and 540, for property and casualty?[iii]). Most of the Accreditation Standards follow the pattern of specifying very basic parts that need to be uniform across the states, but generally looking only to the substantial similarity (of what the state has) to some model. To sum, the Accreditation Standards require uniformity only with regard to certain very basic concepts in the models for which they require substantial similarity (which does not include the models for receiverships or guaranty funds). Or even shorter, uniformity only where it helps.

These fundamental and very basic thoughts on uniformity result partly from the recent major updates to the NAIC's Life & Health Insurance Guaranty Association (LHIGA) Model Law (Model 520) in an extremely quick process. These thoughts on uniformity also result from tracking the efforts in many states in updating their enactments of Model 520 since the model was updated in time for the 2018 legislative sessions.

"Major updates" includes – the updates to Model 520 expanded the assessment base for long term care (LTC), brought HMOs into the membership of the LHIGAs (after at least 30 years of their being out or the membership in the model and in the majority of states), and, finally, updated the model LHIGA's ability to modify LTC insurance benefits and proceed on premium rate applications. "Extremely quick" means the following. Model 520 was opened by the NAIC Exec. Committee at the 2017 Summer National Meeting on Aug. 7, 2017. Its revisions were adopted by Exec/Plenary on Dec. 21, 2017. That is 125 days or just over 4 months. Yes, there were months of discussions leading up to this. Charges for the Receivership Model Law (E) Working Group of the Receivership and Insolvency (E) Task Force to look at how to address LTC issues began on December 13, 2016. From January to April of 2017 a group of regulators, trade groups, consumer reps and others exchanged many thoughts (in a blind group where no participants, other than this author, were confirmed to be contributing, considering or even reading these thoughts) about how to deal with the legacy blocks of LTC business (LB LTC). Many in that group were the people that worked to move Model 520. Many of those people and others had been thinking about issues with Model 520 for years, but Model 520 still moved astonishingly fast and 125 days will, hopefully, stand as a record for some time. Finally, the practical and strategic approach of IAIR President, James Kennedy, who chaired the effort on Model 520, were also critical to the project moving so amazingly well.

Many viewed the potential for another LTC related liquidation, too soon after the Order of Liquidation on Penn Treaty, as a possible existential threat to our state-based national system of insurance regulation. Others in Washington may view the history of this differently, but one history of this is that we recognized very early in the drafting of Model 520 that, unless a great deal more flexibility were worked into the updates, we would not be able to adopt those updates in Washington. But, we also recognized that "the perfect should not be the enemy of the good" and that it was in the best interest of the state-based national system of insurance regulation to have this model updated. We informed all working on the updates that we would likely have to vote against the updates at the NAIC (because we would need to adopt something different in our state and a vote for the updates would likely be used to argue against that), but we also assisted as much as we could in completing the updates. We had already done much to set up the very quick action that followed to complete these updates to Model 520. There was (and still is) a belief that uniformity in all areas was not needed and that no accreditation exception would be created for Washington. If there is another existential threat to our state-based national system, we should all not be too sad to see the 125-day-record fall. Preservation of the state-based national system is paramount. It is like the Prime Directive in Star Trek[iv]. A geeky reference seemed timely to, at least, lighten the tone.

There is some chance that, at least over the near future, Washington's enactment of Model 520 will not be updated. If that develops, then it should not be an accreditation exception because a state only needs to have a regulatory framework for providing the consumer protections that Model 520 provides. Washington has an earlier version of Model 520 providing the needed protections. Most of the NAIC state requirements involve the states' enactments of the required models being substantially similar to the model, but Model 520 is different. This also applies to the other receivership related models – 540 on property & casualty guaranty associations and 555 on receiverships. Of course, I could be wrong about these points, but I did help draft the original accreditation standards in the late 1980's and helped move the review of states' enactments of the models to the NAIC's Legal Section while I was working at the NAIC in the early 2000's. So these may be, at least, somewhat reasonable positions. There is an argument that an assessment base has to be able to meet potential insolvency needs for the "regulatory framework for providing consumer protections" to be meaningful. But, if assessments can be made as needed, especially in an insolvency involving an insurer with a sizeable LB LTC, then a thinner assessment base may be workable.

The accreditation and model systems of the NAIC may produce something even more important through the preservation of state-based national regulation. They are part of a larger well-evolved system for addressing governmental problems through systematically diverse trials and rigorous safety planning. The first part of this, diverse trials, relates to the reality that each state has unique regulatory frameworks, insurance markets and other socioeconomic systems and has to adopt the models and meet accreditation requirements in that context. If intelligence is learning from your mistakes, then learning from others' mistakes may be super-intelligent. The second part of this, safety planning, relates to what is otherwise known as safety engineering. This is, simply, seeing that trial and error is not a good strategy for some problems (moon shots, nuclear weapons, bio hazards and artificial intelligence or AI). For these problems as much thought as possible needs to be given to addressing what might go wrong before you the begin the actual live run of the solutions.[v]

There is a recently updated description of the NAIC's role as the promulgator of models, as set out, in part, below (with emphasis added).

The NAIC model law development process <u>helps provide uniformity</u> while <u>balancing</u> the needs of insurers operating in multiple jurisdictions with the <u>unique</u> nature of state judicial, legislative and <u>regulatory frameworks</u>. While the value of a state-based regulatory system from a consumer protection perspective is the ability to tailor state laws and regulations to meet the needs of resident consumers, there is recognition that there are some areas where uniformity and consistency across state borders is beneficial to all. It is primarily through the states' adoption of NAIC model laws and regulations that the legal framework for insurance regulation has been largely <u>harmonized</u> throughout all of the states.[vi]

On the above, saying that the "preservation of the state-based national system is paramount" is not inconsistent with saying "each state must be able to look after the best interests of its constituents." The laws and regulations that each state adopts (based on the NAIC model laws and regulations) have to work in balance and in harmony with the unique regulatory framework, insurance market and other socioeconomic systems in each state.

Efforts to bring the early detection of trouble in insurers and early action on the same continue to evolve. An area where we have recently been applying some consideration is in regard to the risk focused processes of financial analysis. This is an Accreditation Standard as set out below (with the deletions ~~struck-through~~ and additions <u>underlined</u> from 2017 to 2018).

e) Documented Analysis Procedures
The department should generally follow the risk-focused financial analysis process outlined in the NAIC Financial Analysis Handbook to ensure that appropriate analysis

procedures are performed on each domestic insurer and insurance holding company system, as applicable to either the domestic regulator or lead state depending on the filing.[vii]

The above reflects a significant amount of change, but it does not require absolute uniformity among the states. Note the use of the terms "generally follow" and "outlined" in the above. Where this is notable by those in involved with resolutions of trouble in insurers is where some states are trying to detect risks through continuous risk-focused market and financial analysis. Some are also employing the idea of communicating any risks detected as soon as practicable to the insurer. On the range of possible early actions, this is very early but it also very light. If the insurer also sees the potential risks, then they can begin to address it. If they do not, then if the risk arises to bite the insurer, them the regulator can say, "We tried to get you to address this."

Because there are many areas where uniformity is needed, the world developed an international standards organization (ISO). In the group's own words, "The ISO story began in 1946 when delegates from 25 countries met … to create a new international organization 'to facilitate the international coordination and unification of industrial standards'"[viii] Uniformity of definitions and measures in science and accounting makes things comparable. But, this becomes ever less critical as we move to a more ubiquitous use of AI where divergence in these can be computed out of the comparisons. Note that here also not everything is required to be uniform and that ISO is aimed only at facilitating coordination and unification (bringing into one place or area of thought versus making all the same) as opposed to global uniformity. One concept recently emerging is that AI will generate such a degree of abundance that complete opposite socioeconomic systems will be able to easily coexist with minimal friction between them.[ix]

But, in closing, in insurance this diversity has to be actively managed. A fracture, uncontrolled breakup of insurers into inharmonious units with no coordination is not managed divergence. It is just cost reduction run amok. We see, too often, everything that used to be in an insurer now outsourced to dozens of third-party administrators. They each have no coordinated idea of how risks are being transferred. But, they are cheaper. That is not the idea in asking all to think before calling for anything and everything to be uniform. Does it really need to be?

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[i] By Douglas Hartz - with my usual disclaimer that these are not necessarily the thoughts of anyone I have ever worked for or with, am working for or with, or may ever work for or with. These may not even be my own ideas, as much as they may be proposals only (just to see what may or may not stick). Don't pen me in.

[ii] The first question of the first standard, Exam Authority, of Part A: Laws and Regulations – Excluding Risk Retention Groups. See, page 129, Accreditation Program Manual As Of January 1, 2018. While the Manual is a regulator only publication, the Self-Evaluation Guide / Interim Annual Review Form is marked as public information in the table showing which publications in the Manual are confidential, at page 5 of the Manual.

[iii] *Supra*, Manual, pages 154 and 155.

[iv] See, for example, https://www.forbes.com/sites/janetstemwedel/2015/08/20/the-philosophy-of-star-trek-is-the-prime-directive-ethical/#133237942177, last viewed 07-12-2018.

[v] The AI reference here comes from Max Tegmark, TED2018, https://www.ted.com/talks/max_tegmark_how_to_get_empowered_not_overpowered_by_ai?utm_campaign=tedspread&utm_medium=referral&utm_source=tedcomshare (last viewed 07-12-2018).

[vi] http://www.naic.org/cipr_topics/topic_naic_model_laws.htm (updated 04-30-2018, last viewed 07-12-2018).

[vii] *Supra*, Manual, page 18.

[viii] (https://www.iso.org/about-us.html, last viewed 07-12-2018). Also see, https://www.iso.org/iso-31000-risk-management.html, for material that may have more correlation to insurance.

[ix] *Supra*, Tegmark, at about 15:50 in. Do you want, "a pious society with strict moral rules, or do you a hedonistic free-for-all …" with AI all could coexist.

CONGRATULATIONS TO MICHAEL MARCHMAN

Each year during the NCIGF Annual Conference, a deserving recipient receives the Gates-Marchman Service Award selected from nominations submitted by NCIGF members. This year's honoree is Michael Marchman. Mike is the Executive Director of the Georgia Guaranty Association. CIR-ML and former director and officer of IAIR.

The award honors John Gates and Percy Marchman, pioneers of the P/C guaranty fund system. They epitomized the very best personal and professional qualities. Both were gentlemen, highly principled and professional. Most of all, they put protection of policyholders above all else and were willing to do whatever it took to deliver on that mission. Congratulations Mike on recognition of service above and beyond the call. Thank you.

Criteria: To qualify for the Gates-Marchman Award, nominees must:

- Exemplify the qualities and characteristics of Mr. Gates and Mr. Marchman that made them such distinguished members of the guaranty fund community, including:
    - Personal integrity;
    - Love of the guaranty fund system for its assistance to policyholders;
    - Vision.
- Be guaranty fund managers (presently or retired), guaranty fund staff members (presently or retired), industry representatives working with the guaranty fund community (presently or retired), and others serving "in the trenches" of guaranty fund work;
- Have devoted at least 10 years of service to the P&C guaranty fund system;
- Served as a mentor to others in the system;
- Embrace the Vision and Mission statements of the State Property and Casualty Guaranty Fund System:
    - Vision. To be the trusted, effective and reliable payer of claims to policyholders and claimants of insolvent property and casualty insurance carriers.
    - Mission. To work cooperatively to pay covered claims to policyholders and claimants of insolvent property and casualty carriers according to state statutory protections.

THE PERFECT RECIEVER NO 18: BROTHER CAN YOU SPARE A DIME? (ALL ABOUT ASSETS)

By Patrick Cantilo, Cantilo & Bennett

Although this is the eighteenth number of this column, amazingly I have not yet devoted one to the left side of the balance sheet. I will rectify this oversight forthwith! First, standard disclaimers. I am not an accountant, investment manager, or otherwise more qualified than your favorite cartoon character to address this topic. Second, any views expressed herein are strictly my own and certainly not those of someone who actually understands the subject. Third, this discussion is necessarily limited and only general principles, not the numerous and important exceptions, are addressed. Finally, before following any recommendations contained in this article consult your own expert. Any forward-looking statements are blatant uneducated guesses while those glancing backwards are simply the product of defective memory and mis-perception. **Here is the best thing about this article: you will learn many cool new terms that you can sprinkle about in cocktail conversation to make you sound like a Wall Street powerhouse**. Buckle-up; here we go!

Most insurers have assets and liabilities. If you are reading this, the ones placed in your charge have more of the latter than the former. It is widely understood that problems with assets OR with liabilities can cause insolvency. Too little of the first or too much of the second and there you are: broke! Occasionally, a management team achieves the double-whammy: problems with BOTH, assets AND liabilities. In this short article, we will strive to gain a basic understanding of assets without regard to whether they are no part, a small part, or most of the problem leading to insolvency.

MONETARY VS. NON-MONETARY ASSETS

For our purposes (avoiding a prolonged headache), we can think of assets as falling into two major categories: monetary and non-monetary. It is important to note, however, that non-monetary assets can almost always be reduced to monetary assets and vice versa. The rub always consists of how much of one do you get for the other. Common examples of non-monetary assets are the company's home office, the president's Rolls Royce, the luxury apartment assigned to the President's Executive Assistant, and the professional sports stadium luxury sky-box used by the President to entertain other presidents and their Executive Assistants. Less common but often important examples are intellectual property (i.e., patents and copyrights), royalties, and other contractual rights. Monetary assets generally include cash, stocks, bonds and other financial instruments.

Due to space limitations in this newsletter and in my brain, we will not get into an exquisitely detailed inventory of all the kinds of assets in each category. These illustrations should suffice for our high-level (no, not simple-minded, thank you!) discussion of the topic.

There is a special category of non-monetary assets referred to as commodities. They include such things as oil, gold and soybeans and are generally divided between "hard" (typically natural resources that have to be mined) and "soft" (typically agricultural products) commodities. There are special markets for the purchase and sale of commodities, including "futures" (obtaining the right today to buy a specified quantity of a given commodity at a specified price on a specified future date), the best known being the Chicago Board of Trade. This article will not address the commodities markets because I just told you everything I know about them.

For purposes of rehabilitation or liquidation, the analysis as to non-monetary assets is relatively straightforward. Will there come a time at which we will want to convert them to monetary assets? If so, when and how much can we get for them? I will spend the rest of our time together talking about monetary assets, recognizing as we do so that they may earlier have been non-monetary in form.

First, the goal of any receiver is to have as much in monetary assets as is necessary to pay all of the company's debts (liabilities) in full. Although there are exceptions, such payments are almost always made in monetary assets, typically cash. Unfortunately, most receivers will never have enough money to pay off all debts and the aim therefore becomes to get as close as possible. There are ways of managing the liabilities, but we will not bother ourselves with those here. Today it's all about the assets. Generally, most of an insurer's assets are "invested" in stocks or bonds. Many of you know all about stocks and bonds and should probably use your time more wisely than to see how far off the mark I can take the rest of our readers. For the rest of you, let me begin with some fundamentals.

WHAT ARE STOCKS?

Stocks (also called "equities" in an effort to confuse you) are simply partial ownerships in an enterprise. For example, the ownership of Apple, Inc., is diffused among approximately 4.83 billion shares of equal value (around $207 each as of this writing).[1] If you own one of those shares you own 1/4.83 billion (2.070393374741201e-12 for those insisting on precision) of the company. Clearly that doesn't give you a whole lot of say over its affairs. So why would you spend your $207 to buy that? Two main reasons: first, Apple will pay dividends on each of those shares. In 2017, Apple paid approximately $2.40 per share in dividends. That is a little over 1%, which beats most bank accounts and CDs. Second, you can sell that stock at any time, including when it goes up in value. Apple's stock traded at around $155 a year ago. If you had bought your share then and sold it now for $207 you would have made $52, or about 34% profit on your investment. Along the way, you might also have collected a couple of bucks in dividends. Of course, stocks depreciate just as often as they appreciate, and your $155 Apple stock share would have been worth $150 about six weeks after you bought it. At the time you would have been faced with the choice of holding on hoping it would regain some or all of that value or even becoming more valuable (as it did in fact) or selling it then and cutting your losses, thereby avoiding further loss if it continued to decline. This precise prospect is what makes stocks or equities risky investments. Most insurers invest little or none of their money in equities.

"SHAKEN, NOT STIRRED!" - WHAT ARE BONDS?

Bonds (also called fixed-income securities to keep you off-balance) are fundamentally loans. Apple obtains some of the money for its projects (about $100 million as of last year) by borrowing from sophisticated lenders. It does so by issuing into the bond market its promises to pay a sum certain on a date certain with interest accruing and being paid at a defined rate. These are typical corporate bonds. Investors that believe Apple is good for the money will buy these bonds, the proceeds of the transaction going to Apple for its purposes. Apple will make annual interest payments (sometimes called "coupons" to further confuse you) to the holders of these bonds and, on the day they are due (the "maturity date"), Apple will pay back the full purchase price. The investor will have gained the interest as a reward for her investment. How high that interest rate is depends on the market and how risky investors perceive the bond to be. If there is some doubt that Apple will be able to repay the loan, the interest rate is higher in order induce investors to take the chance.

Investors also buy and sell previously issued bonds on the exchanges. A bond's value will depend on its duration (when it will be repaid), credit-worthiness (the risk that it will not pay in full at maturity), and its interest rate. A bond that matures in ten years and pays 5% interest will have lower value than one that matures in five years and pays 5% interest because investors don't have to wait as long to get their money. One issued by a solid company will have higher value than a similar bond issued by a weaker company due to the risk that the latter may not pay in full at maturity. And obviously, one that pays a higher interest rate will have a higher value than one with a lower coupon rate. In addition, bond values fluctuate due to changes in the capital markets. As interest rates rise, bond values tend to fall because, all other things being equal, newer bonds must pay a higher interest rate and therefore are more attractive to investors. Conversely, falling interest rates generally cause bond values to rise.

PSST, WANNA BUY SOME GREAT STOCK AND BONDS?

So now that you are an expert, you want to run out and buy three or four shares of stock so you can get rich. But where do you go? The kind of stock we are talking about is bought and sold on public exchanges, today high-tech devices for matching buyers and sellers and keeping the cardiology industry vibrant and prosperous. The largest such exchange is the New York Stock Exchange

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[1] I will confine my discussion to typical, publicly-traded common stock and bonds. Companies can issue many kinds of stock, including "preferred" stock that often behaves more like subordinated bonds. There are also many different types of debt instruments, including municipal bonds, high-yield bonds, swaps, collateralized obligations and government securities. In addition, there are many ways to trade fixed income and equity securities, including devices based on anticipated future events, such as options, puts, and derivatives. I don't know anything about that stuff, so I won't talk about it. I have noticed that in my public library, behind the Marvel graphic novel collection, there is a dusty shelf full of great books about these things. They must be great because they have colorful covers. They are also available online.

(sometimes called "The Big Board") but there are many others such as the NASDAQ exchange (formerly an acronym for National Associations of Securities Dealers Automated Quotations), the London Stock Exchange, the Frankfurt Stock Exchange and the Shanghai Stock Exchange. Today, individual investors place buy and sell orders on the exchanges through computer trading platforms like Schwab, TD Ameritrade, E*Trade and the like. Institutional investors have dedicated direct channels for doing so. The major public stock exchanges are generally highly reliable and not easily manipulated, inspiring great and indispensable investor confidence. These exchanges also serve as the market for publicly traded bonds.

MARKET VARIABLES

Stock and bond price fluctuations are driven by what investors are willing to pay for the particular stock or bond at a given point in time, in turn governed by investors' perception of how that stock or bond is likely to do in the future compared to other stocks or bonds the investor could buy. Put another way, the price of a given stock or bond is influenced by how the issuing company itself is doing (company factors) and how other stocks and bonds are doing (market factors).

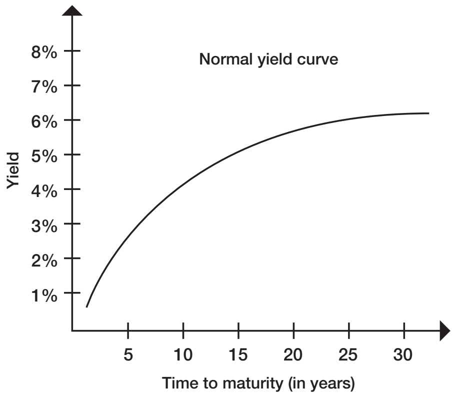
In evaluating existing or potential monetary assets, there are several interactive key variables that should be considered. First and foremost, of course is PRICE, the amount at which it can be bought or sold at a given time. The remaining factors are important because they affect current and future prices. These are the factors that determine for how much I can sell a given asset in the future. The VOLUME of a publicly-traded security (how many shares are trading in the market) is important because it determines how quickly it can be sold. If few shares are being traded, there are likely to be few buyers, making a quick sale difficult. How quickly a stock or bond can be sold for (or converted to) cash is generally referred to as its LIQUIDITY. That is affected by many factors (such as VOLUME) some related to the issuing company (relative confidence about its future) and some to the market (are better opportunities likely to be available to buyers when you want to sell your stock or bond). Also important is DURATION, particularly for bonds. When the bond must be redeemed (repurchased) by the issuer at face value (the original issue price) is critical because it affects buyers' perception of the underlying risk. The longer a bond must be held before it will be redeemed, the more risk there is that bad things may happen to reduce the issuer's ability to redeem it at maturity for full value. Thus, bonds that mature far off in the future are deemed less liquid than those that mature soon. Liquidity is also affected by volume as we have just discussed. If there is a very active market in the particular bond, its holder need not wait until it matures to sell it for cash. Whether a bond trades "at par" (it can be sold for its full face-value) or above or below par depends on how the market views it in comparison to other potential investments. A bond with a coupon rate above market will generally trade above par and vice versa. This is because a high-interest bond will pay more than is available in the market until maturity. On the other hand, CREDIT RISK can erode that additional value. If there is material doubt that the issuer will be able to redeem the bond at full value at maturity investors will discount its value. There are several Nationally Recognized Rating Organizations ("NSRO"s - like Moody's and Standard and Poor's) that analyze the credit worthiness of issuers of publicly-traded securities and publish relative ratings for each. These ratings, enable investors to compare securities at a glance.

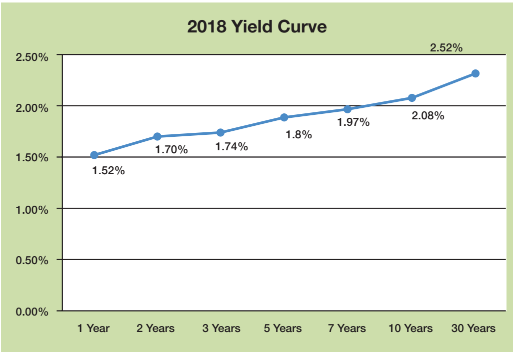
ALM

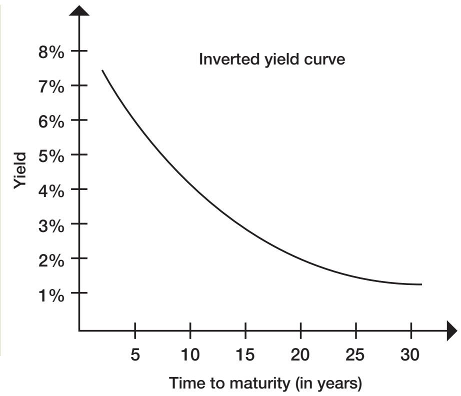
I would be remiss if I did not mention the all-important need to match the duration of assets and liabilities. This "ALM" process aims to assure that cash will be available when needed and does so by targeting investments of duration substantially similar to that of the liabilities they are expected to fund. Put simply, if you expect to pay claims totaling $1.5 billion in two years, you should assure that enough of your investments can be sold at advantageous conditions in time to generate that much cash by the time you will need it. Some companies seek to enhance the "yield" (interest rate) of their investment portfolio by lengthening their duration (buying securities with later maturity dates) in an effort to get higher interest rates. The risk this poses is that they will need to sell those securities before maturity to pay claims and will have to realize substantial losses when they sell them early. In a well-matched portfolio securities will mature as the cash is needed, eliminating that risk. This transitions nicely into our next topic.

YIELD CURVE

As we discussed, fixed-income securities (bonds) of different durations will tend to pay different interest rates. In general, all other things being equal, the longer the duration (the further in the future the maturity date), the higher the interest rate. This makes sense when you think of it as allowing the issuer more time to use your money before it has to repay you (redeem the bond). This relationship is typically depicted in a yield curve that tracks duration and interest rates on opposite axes. In a "normal" yield curve environment there is a







proportionately greater reward (increase in interest rate) for lengthening duration from 0 to 5 years and a lower reward for additional extensions. However how "steep" the yield curve is at a particular point in time is highly dependent on many factors in the broader economy, such as inflation, unemployment, trade deficits, etc. We are today living in an environment of relatively "flat" yield curves. That is to say, there is not much reward for lengthening duration of fixed-income investments. Some economists even suggest that we may see an inverted yield curve in the near future. In such an environment there is an actual cost in sacrificed yield for extending duration. Thus, in making decisions about the length of investments to purchase, ALM is a key consideration but so is the shape of the prevalent yield curve. Even if the company's liabilities are of long duration, it may be better to buy shorter duration assets until the yield curve steepens.

BOOK VS MARKET

My final explanation addresses the difference between book and market values. Put simply, book value is the value of an investment as reflected on the company's financial reports. Often that is the value at which it was acquired, sometimes amortized over its duration. Market value is simply the amount for which the security can be sold in the market at any point in time. Because the value of a given stock or bond will vary over time, there will generally be a difference between the book and market value of a company's investments. This difference is sometime referred to as unrealized gain (if market value exceeds book value) or unrealized loss (if book value exceeds market value). They are unrealized because the company will not actually experience the difference unless it sells the security. Over time an unrealized loss may become an unrealized gain as the security appreciates and vice versa. Under certain circumstances (such as when the company does not intend to hold them till maturity) an insurer must mark some of its securities to market and carry them on its financial reports at market value rather than book value. The yield of an investment portfolio is typically expressed as "market yield" (interest rate based on the portfolio's market value) or "book yield" (interest rate based on the portfolio's book value). If a portfolio has appreciated since acquisition market yield will typically be lower than book yield because the same investment income represents a lower percentage of the higher market value. Conversely, in a portfolio of declining value market yield will tend to exceed book yield.

CONCLUSION

I have endeavored ambitiously in these few pages to provide an elementary introduction to basic investment concepts that are important for receivers to grasp. I have not even scratched the surface of this complicated subject but perhaps I have enabled you to understand better some of the comments you hear in such discussions. I close with the observation that if you had given your brother a dime when the song was written (1930) and he had invested it wisely, today he would have about $15.

Patrick Cantilo is a very old Texas receiver who once was president of IAIR and served on its board of directors for ten years until he showed up at a meeting and they promptly booted him out! He practices law with Cantilo & Bennett, L.L.P. in Austin. Over the decades he has represented or worked for about half the states in various insurance solvency or regulatory projects

A VIEW FROM WASHINGTON

By Patrick D. Hughes and Jigar D. Gandhi, Faegre Baker Daniels

Turing of the Tide? Results and Impact from the Midterm Elections

With the country deeply polarized, the most expensive midterm election in history resulted in what many pundits had expected: Democratic control over the House of Representatives and Republican control over the Senate. With some elections still contested, the Democrats will have gained around 35 seats, while in the Senate Republicans appear headed toward picking up three and up to four seats.

The House and Senate will return next week in a lame duck session, with some unfinished government funding business that must be completed before a December 4th deadline. Leadership elections will be upcoming with Sen. Mitch McConnell (R-KY) remaining as Majority leader and Nancy Pelosi (D-CA) reclaiming the gavel as Speaker of the House.

The results of the election will have significant implications for the insurance industry, especially in the House. As Maxine Waters (D-CA) takes the gavel as the Chairwoman of the House Financial Services Committee. Waters has long been a thorn in the side of the financial services industry, but has also proven to be pragmatic and work with the industry. She most recently worked on the "JOBS 3.0" effort. Waters has taken a tough stance on the financial services industry, although she has often focused her ire on the big banks.

While the Senate will retain its Republican majority does not mean there won't be changes. The retirement of current Financial Services Committee Chairman Orrin Hatch (R-UT) leaves that crucial post available. Sen. Chuck Grassley (R-IA) has seniority, but he may choose to remain as chair of the Senate Judiciary Committee. That may prompt Sen. Mike Crapo (R-ID) to leave his role as chair of the Senate Banking Committee, triggering Pat Toomey (R-PA) to become chair of the Banking Committee.

Drain the what? An Update on Federal Legislative Activity

On the federal legislative area, in May of this year, President Trump signed into law the *Economic Growth, Regulatory Relief, and Consumer Protection Act*, S.2155. The law was part of Sen. Crapo and Sen. Jon Tester's (D-MT) regulatory relief package. The law established a 23-member Insurance Policy Advisory Committee on International Capital Standards. It further requires members of "Team USA," representatives from the Federal Reserve, Treasury, and FIO to reach a consensus with the NAIC in pending international negotiations before the IAIS, FSB, or other international forum for financial regulators and supervisors. Note that on receivership issues Team USA has been quite active in 2019, with active consultations impacting resolution policy and the prospect for recovery and resolution plans.

The House also passed the *International Insurance Standards Act of 2018, H.R.4537*, sponsored by Rep. Sean Duffy (R-WI) would require both Treasury and the Federal Reserve to have greater consultation with Congress and with state insurance regulators prior to entering into international insurance agreements.

What's Next with FIO and the Fed?

With the Financial Stability Oversight Council's announcement of the de-designation of Prudential's systematically important designation it dropped the number of total non-bank systemically important financial institutions to zero. This may lead to questions as to what is next with the Fed and with FIO on systemic regulation.

Last year, the Treasury Department released a report in which it recommended that FIO consider establishing an advisory committee or other feedback mechanism to provide broad stakeholder input to members of Team USA on international matters. The report further outlined five "pillars" to guide the FIO's mission and to ensure the consistency with the existing state-based regulatory system:

- Promote the U.S. state-based insurance regulatory system and advocate for the U.S. insurance sector in international forums and negotiations, and in foreign markets.
- Provide insurance policy expertise and advice to the federal government, state insurance regulators, and industry through the publication of comprehensive research and analysis, consultation on emerging issues, and evaluation of federal insurance programs.
- Provide coordinated and collaborative leadership on insurance issues that engage the federal government and state insurance regulators, including through enhanced coordination between the federal government and state insurance regulators.

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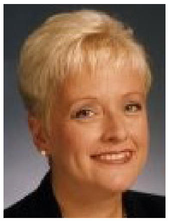
- Protect the U.S. financial system and economy by advising the Secretary and the FSOC on insurance-related matters that may pose a threat to U.S. financial stability.
- Protect America's financial security by promoting access to insurance products and administering the Terrorism Risk Insurance Program

In September, the FIO released its annual report. While the report did not announce any new major initiatives, it did provide a list of its ongoing work, including its work with the IAIS on the ComFrame and its efforts leading coordination among Team USA on the development of the Insurance Capital Standards and the use of an activities-based approach.

Between the flipping of the House, role changes for key leadership positions, and expected new activity from Federal officials, the insurance industry, its stakeholders, and the resolution community of regulators, receivers, and the guaranty system have plenty to keep an eye on.

WELCOME TO OUR NEWEST IAIR MEMBERS

Dennis Haag
Dennis is the Statutory Liquidator with the Pennsylvania Insurance Department. Mr. Haag is the former Agency Director at American Integrity Insurance Company and attended Penn State University.



Debra J. Hall
Debra is the Principal of Hall Arbitrations LLC in Rockport, Maine providing umpire, arbitrator and mediator services in insurance and reinsurance disputes. Ms. Hall is a certified ARIAS-US Arbitrator and has undergone formal mediation training at the Strauss Institute for Dispute Resolution at the Pepperdine School of Law. She also provides consulting services and expert witness testimony.

Ms. Hall's previous experience includes Senior Vice President and Senior Regulatory Counsel for Swiss Re America Holding Corporation and Swiss Re America, Senior Vice President and General Counsel of Reinsurance Association of America and Chief General Counsel and Executive office of the Illinois Office of the Special Deputy Receiver.

Debra is the President of the Penobscot Bay Ringers, a community handball group.

Andrea Lentine
Andrea is the Executive Director of the Alabama Insurance Guaranty Association and a member of the Alabama State Bar. Before becoming the Executive Director, Ms Lentine was a Workers Compensation Claims Examiner, Liability Claims Examiner and Liability Claims Supervisor with the association.

Ms. Lentine's prior experience includes Senior Claims Examiner with Stonewall Insurance Company and as an Associate Attorney with Haynes & Associates in Birmingham, Alabama.

Andrea is a member of Birmingham Chapter of The Daughters of the American Revolution.

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