International Association of Insurance Receivers

Volume 5, Number 1 | The Newsletter | Spring 1996

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President's Message

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

I would be deeply remiss if I did not start off my first message to the membership by taking the time to publicly thank the former president and board member, Jeanne Bryant, for all of her dedicated work through two terms as board member and one term as president. I would also like to thank John Massengale, former board member and treasurer, for all of his efforts on behalf of the Association. Both Jeanne's and John's terms expired at the last annual meeting in December.

On behalf of the whole Association, I would like to welcome Bob Craig as a new board member, and Chairman of your Ethics & Accreditation Committee, as well as Nelson Burnett (Pari Passu), back to the board. Bob's and Nelsons three year term on the board began at the last annual meeting.

> "The Board continues to strive for ways to involve anyone in the membership interested in full participation... ."

As you read this, we should be in the throes of spring. A time for a new beginning and rejuvenation from the ravages of winter. I am pleased to report to you that the 1996 Insolvency Workshop co-sponsored by the NAIC and IAIR, January 25-26 in Albuquerque, New Mexico was a rousing success. The program provided a discussion of current issues which arise in insolvency proceedings from the state regulators perspective. The Thursday schedule consisted of four concurrent sessions on topics such as Effective Use of Administrative Supervision, Tax Issues, Closure Strategies, HMO's and Fraud. Friday covered recent developments in insolvency law creditors committees and long-tail claims. Moderators and panelists included state insurance regulators and others experienced in insurer insolvency. The workshop received an outstanding overall score of 4.5 (5.0 being the top score), from evaluations. All of the scores from the various segments are in the very good to excellent range, indicating that participants believed the program's goals were clear and the materials were very helpful. We were able to garner a very strong turnout of 186, up from 145 in 1995. I would like to thank all IAIR members who graciously donated their time to assist in the various presentations.

Please mark your calendars for November 7-8, 1996, the current scheduled dates for the IAIR/NCIGF Seminar/ Workshop to be presented in Tamp, Florida at the Hyatt West-Shore Hotel. Information regarding this educational opportunity will be mailed in early fall. Anyone interested in active participation on the workshop faculty should contact Kristine Bean (Education Chair) at (312) 347-6942.

I was pleased to meet many of our fellow members at the IAIR Reception a the Detroit NAIC. You board has established a new policy, as respects these receptions to make them more of a highlight of your NAIC experience than in the past. The June national meeting will continue to be co-hosted by the IAIR and NCIGF,

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Is there a Financial Simulation Model in Your Future?

by Michael E. Mateja, FSA, MAAA, Managing Director & Chief Actuary, CHALKE

I have heard on good authority that the first weeks of a new receivership are the toughest. A receiver is in hostile territory, and survival is perhaps the only objective that matters in the first week or two. At some point, however, when the beachhead is secure, the receiver starts to formulate a long range plan and all the intermediate objectives that must be achieved to make the plan a reality. Following is a partial list of questions that the receiver's plan must address.

- What is the real value of the assets and the liabilities? Is there a material difference between book and market value?
- What does the current balance sheet really look like? What's it going to look like a year or two out?
- What, if any, exposures exist on the product portfolio? Are interest crediting rates appropriate on interest sensitive products?
- What is the current investment program/policy? Is it appropriate? If not, why not?
- What is the current and projected liquidity situation? How will it change if interest rates increase or decrease?
- Is there real value in the property? If so, how much is there, and how can it be realized? If not, how much funding from the Guaranty Associations likely will be required?

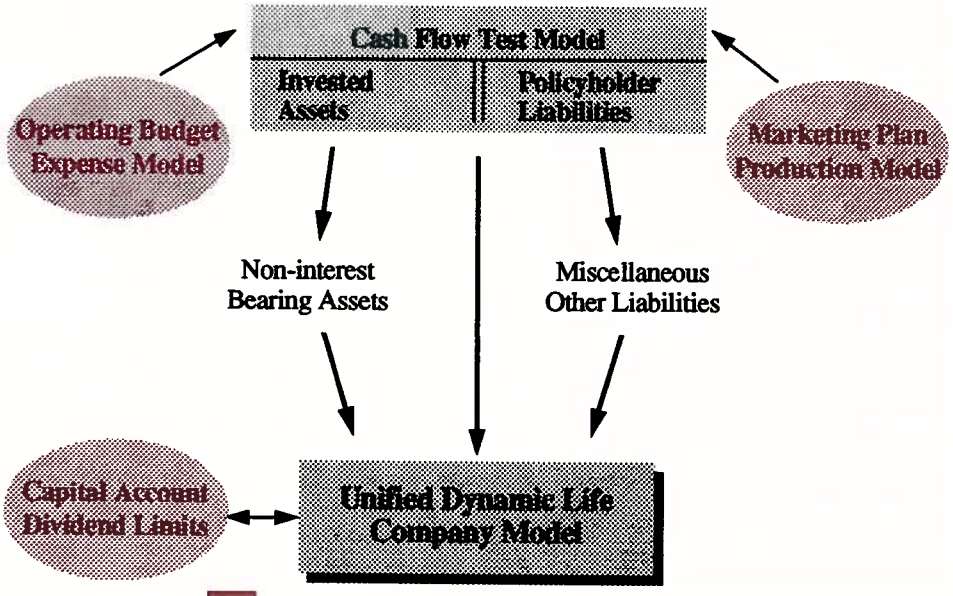
Superimpose upon this list the typical collection of tax, legal, reinsurance, employee, creditor, and administrative issues, and it's no wonder that answers to these and other financial questions are slow to emerge. Any effort to get the necessary answers is likely to be frustrated by the failure of management of the company to develop a reliable financial planning tool. Effective planning is synonymous with a sound understanding of the business, and a management that has just lost control of its company probably never really understood the business sufficiently to run it successfully.

The receiver, thus, is put in the demanding position of fundamentally understanding the business to successfully answer the questions that are the focus of his/her plan. Now, it's clear that a competent receiver will ultimately get the job done. But in this high technology era, the question that must be asked is whether there may be a better way. As explained subsequently, there indeed is a better way, one that seamlessly integrates all the financial dynamics associated with the operation of an insurance company. That better way is a financial simulation model.

Financial Simulation Models of Life Insurance Companies

Models of life insurance companies have been used in one form or another for generations. The term "granularity" has been used to characterize the level of detail reflected in a model. Historically, most models were "coarse," and were based typically on an extrapolation of prior financial results. These early models worked reasonably well, largely because of relatively simple products and the benign economic environment within which they operated. Given the complex products and the volatile economic environment of recent years, a reliable model of a life insurance company must be capable of reflecting the underlying financial fundamentals of the business. Thus, it is only recently that attempts have been made to build what may be characterized as "fine" models, where the objective is to reflect actual assets and

Unified Balance Sheet Model



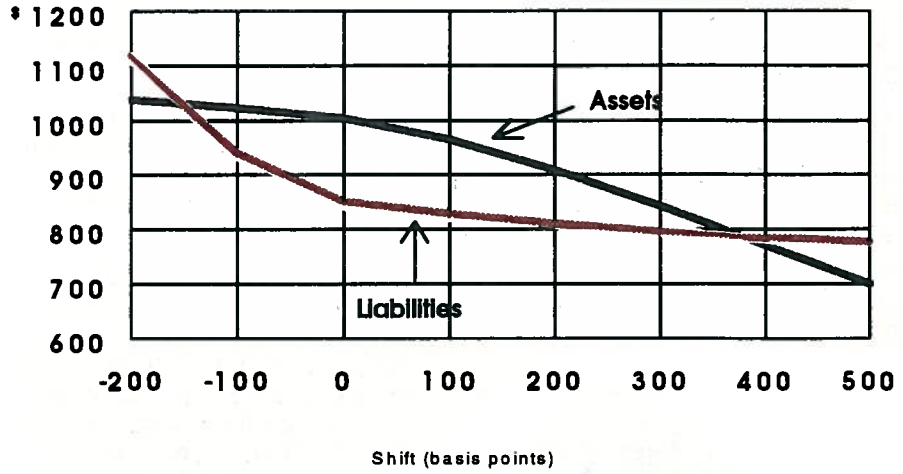
liabilities and the behavior characteristics of each. The impetus for these recent modeling efforts is found in the cash flow testing requirements now associated with actuarial certification requirements of valuation laws and regulations.

The life insurance business clearly is recognized now as a cash flow business, and only by understanding the underlying cash flows can one really understand the financial characteristics of the business. Cash flow analysis is now widely recognized as fundamental to valuation of insurance liabilities, but few have made the connection between cash flow analysis and effective financial management of an insurance company. In fact, cash flow testing models, with suitable refinements, are capable of providing both management as well as receivers with an enduring and effective planning tool that can address every conceivable question or issue related to the financial dynamics of an insurance company.

Building comprehensive financial simulation models of life insurance companies is leading-edge actuarial work. It requires commercial software designed for this purpose and competent model builders, who have in-depth knowledge of both the assets and the liabilities found in an insurance company. A good financial model reflects each individual asset in the portfolio, and each asset record is carefully crafted to reflect all options associated with the future performance of the asset. One of the most troublesome classes of assets currently found in insurer's portfolios is

CMOs, but a good asset model will be capable of reliably forecasting expected cash flows from these assets under a range of future economic assumptions. Real estate and commercial mortgages, where there is often considerable uncertainty associated with future cash flows, can be accurately modeled, but development of the cash flows from these assets generally requires help from real estate professionals. For the liabilities, the commercial software provides the platform to model the unique options associated with the products, which yields a projection of the expected cash flows from the liabilities. The financial simulation model is completed by adding non-invested assets and those liabilities unrelated to policyholder obligations. It is sometimes appropriate to add refinements to reflect the expected impact of the receivership on expenses, which is possible through a careful analysis of fixed and marginal expense rates. When the model is finally validated and tested, the result is a tool that can respond to any financial issue that a receiver may present.

Option-Adjusted Value of Assets and Liabilities



The foundation for any financial simulation model is complete and accurate data describing the assets and the liabilities of the company. Normally, the required data can be extracted from asset management and valuation systems. The availability of complete and accurate data in electronic form is a critical determinant of both timing and effort associated with construction of a financial simulation model.

Financial Model Output

In the early stages of a receivership, basic financial statements consisting of cash flow, income, and balance sheets are the most useful. Such statements can be produced routinely on a current and projected basis, and they provide the framework for understanding the critical financial management issues that must be addressed. For instance, if cash flow is projected to be negative, it is possible to quickly identify the source, size, and duration of the problem, and to address it on a comprehensive basis. Similarly, surplus trends, and how the trend may be affected by various moratorium provisions, can be quickly and reliably determined.

One of the strengths of financial simulation models is the ability to simultaneously address both immediate and longer term financial management issues. Testing the financial implications of experience variations, for instance, represents an immediate issue that can be addressed in considering appropriate liquidity and investment policy. If a liquidity issue is identified, it frequently requires some restructuring of the asset portfolio. More sophisticated financial simulation models can produce Price Behavior Curves (PBCs) of both the assets and the liabilities, which can be used to assess the overall financial impact of any changes to the asset portfolio. Thus, PBC analysis can assure that solution to one problem, liquidity, doesn't inadvertently create exposure to a more serious future financial problem.

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Financial Simulation Model

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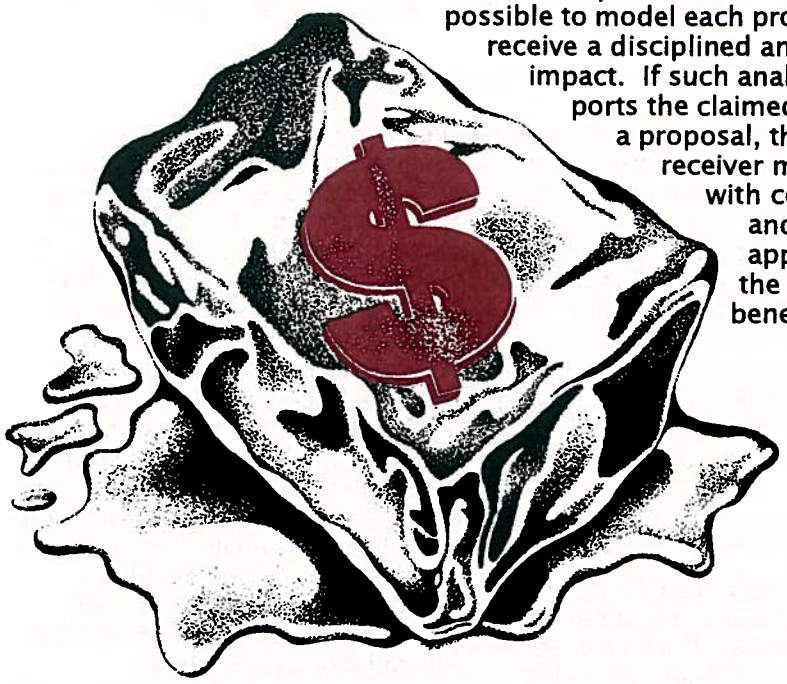
The more important uses of a financial simulation models will generally be related to efforts to establish the potential value of the company. Value of an insurance company, however, is an elusive concept. Whereas "statutory value' is the measure of value that precipitates receivership, it is "economic value" that determines the best option for the receiver to follow. Economic value is defined as the relationship of the "economic value of assets" (EVA), and the "economic value of liabilities" (EVL), and these values can be developed in a straightforward manner from a sophisticated financial model. The options are summarized in the following table:

Relationship of EVA and EVL	Economic Surplus	Options
EVA > EVL	Positive	Rehabilitation or Sale
EVA < EVL	Negative	Insolvency

If there is real value in the company, which is not apparent from the statutory valuation, the receiver may confidently pursue a rehabilitation or sale strategy. Eager buyers can be expected when there is real value, and sale will generally produce maximum advantage for policyholders. On the other hand, buyers will be scarce when there is no real value, unless there is the expectation of financial support from the Guaranty Association system, which practically means a declaration of insolvency. Since Guaranty Associations do not provide full coverage, a financial model can be used to explore options to fill the "uncovered" gaps in coverage.

A disciplined presentation of the financial characteristics of various options is perhaps the most useful information that a receiver can get in the early stages of the receivership. When these options are quantified in terms of their financial and timing dimensions, it is usually possible to quickly establish the most viable alternative.

Perhaps the greatest advantage of a financial simulation model is its practical use as a management tool. A receiver will be flooded with various proposals that will ultimately impact the behavior of future asset or liability cash flows. It should be possible to model each proposal and receive a disciplined analysis of its impact. If such analysis supports the claimed benefits of a proposal, then the receiver may proceed with confidence and some appreciation of the expected benefits.



Maintaining a Financial Simulation Model

Financial simulation models represent a powerful tool that a receiver can call upon to fulfill his/her responsibilities, but the nature of and limits of the tool must be firmly understood. Model results, in reality, are projections or estimates, albeit very sophisticated projections or estimates. Interpretation of results must recognize that the results themselves are dependent upon data quality and the ability of the underlying model to capture the behavior characteristics of the assets and the liabilities. Since the liabilities clearly will be subject to the stresses associated with the receivership, and since the composition of the asset portfolio likely will be changing over time, it is appropriate to think of a financial simulation model as a dynamic rather than a static tool. Both data and assumptions should be reviewed on a periodic basis and should be updated or refreshed as appropriate. Good maintenance of the model will be rewarded with timely and more reliable results.

The foundation of an effective receivership is sound decision making, and a good financial model may be considered a decision making tool. As with any new tool, it takes a bit of practice with a financial model to understand its practical uses and limitations. A skilled financial model builder is really a financial craftsman, who can produce a wealth of useful information that will expedite and focus the work of the receiver. Once you sample the power inherent in a financial model tool, and see how it influences your decision making in practical receivership situations, I am certain that there always will be a financial simulation model in your future.[1]

[1]Michael E. Mateja is Managing Director & Chief Actuary of SS&C/CHALKE, which is the insurance industry's largest supplier of asset/liability management software, PTS®. SS&C/CHALKE specializes in developing comprehensive financial simulation models of life insurance companies to serve as platforms for solving difficult insurance company financial problems for life insurance company management, regulators, and receivers.

Put This Date In Your Diary Now!

March 23, 1997

As you know from previous items which have appeared in *the Newsletter*, IAIR is collaborating in the production of a one day program in New Orleans in conjunction with the Quadrennial meeting of INSOL International, INSOI '97. INSOL International is International Insolvency Practitioners Organization.

We are planning a very exciting program, focusing on problems arising from insurance insolvencies including some of the international aspects which are invariably confronted.

A distinguished panel of presenters, drawn from all over the world, will be in attendance and the program will create a wonderful opportunity to meet and exchange news with friends old and new.

This is the one program you cannot afford to miss and you should ensure that March 23, 1997 is put into your diary now.

This program will form part of IAIR's 1997 educational program and not only are you encouraged to attend, you are encouraged to bring your friends, colleagues and staff as well.

The final cost is yet to be fixed, but there will be discounts for members of IAIR.

INSOL '97—Don't Miss It!

June 1996 • IAIR Roundtable

Date: Saturday, June 1, 1996

Time: 1:00 - 5:00 p.m.

Place: Shereton New York Hotel & Towers

Chair: A. Marc Pellegrino Special Deputy Superintendent, New York Liquidation Bureau

A wide range of current topics are expected to be covered at our June Roundtable which will be held on Saturday afternoon, June 1, in connection with the NAIC meeting.

The Roundtable will be chaired by Marc A. Pellegrino, Special Deputy Superintendent of Insurance who heads New York's Liquidation Bureau.

Recent developments at New York's Liquidation Bureau will be presented as well as some of the unique challenges facing that Liquidation Bureau. Other timely subjects to be updated include the status of Equitas, the Fabe litigation, and the Mission closure plan. Certain practical problems posed by Union Indemnity's litigation will also be examined.

President's Message

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while the December national meeting will be co-hosted by the IAIR and NOLHGA. The board has also agreed to solicit patron sustaining members to assist in some minor way with funding the receptions at the spring and fall meetings. I would like to thank our first patron from Detroit, R.M. Cass & Associates, Chiltington-Omni and Hebb Gitlin. Any members wishing to assist the Association as a patron sponsor of either reception please contact Frank Bistrom at Association Headquarters, (913) 262-2749.

The accreditation process adopted in 1995 by the Association has somewhat slowed since the annual meeting. Unfortunately, we are primarily a volunteer organization and the individuals comprising your Accreditation Committee have been extremely busy in their professional lives, however; we met in Detroit and active solicitation for accreditation by the membership will occur shortly.

As you know, the Association did not present a roundtable at the Detroit NAIC, deferring to the Federal Preemption Seminar presented on Saturday. I found the information in the seminar to be very useful and hope many of you were also able to attend. The Association will return to its regular scheduled Saturday roundtable at the New York NAIC. Anyone with thoughts of specific topics to be covered is encouraged to contact IAIR Meetings Chair, Michael Miron at (201) 507-6100.

The Board continues to strive for ways to involve anyone in the membership interested in full participation, as well as creating additional benefits for the membership. Additional benefits may include possible seminar discounts. Insurance and other benefits are being considered by your board at this time.

I wish you all a very productive and healthy spring and hope to be able to meet with as many of you as possible in New York.

Meet Your Colleagues

Morton L. Mann • Sustaining Member

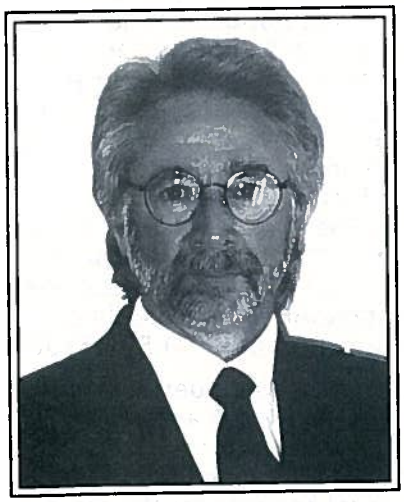
Morton "Morty" Mann is currently Chairman, Executive Advisory Board of Global Financial Insurance Division. Morty spent a considerable part of his career with the Colonial Penn Group from 1959 until 1988, including positions as President of Intamerica Life Insurance Company and Vice President of Colonial Penn Group, Inc. where he was responsible for running off twenty three managing general agency programs.

From 1988 until 1994, when the company closed its U.S. operations, Morty was Senior Vice President of Trinity Square Services, Inc., an insurance consulting practice specializing in run-off administration. In 1995, Mr. Mann became Director of Insurance Marketing for The Outsourcing Partnership, a financial consulting organization with its principal partners being former partners at Coopers & Lybrand.

Morty graduated from City College of New York and has been very active in professional associations., He has served as president of the Mid-Atlantic Chapter of the Insurance Accounting and Systems Association and recently received the 1995 IASA President's Award for exemplary service to that organization. Morty currently serves on the board of directors of the Society of Financial Examiners Endowment Fund and holds the position of Secretary.

Since its inception, Morty has been active with IAIA serving as its initial newsletter publisher and currently the Managing Editor. Morty is also a very visible participant with the NAIC and has served on various NAIC task forces throughout the years, most currently a member of the Advisory Board of the Annual Statement Blanks Task Force.

In addition to industry and local volunteer work, Morty is a character actor in local community theater. Morty enjoys traveling with Hermie, his wife of 42 years, and his three grandchildren. And, according to Hermie, he's always trying to improve his golf game!



Lennard (Len) Stillman • Principal Member

Len is the owner of Stillman Consulting, concentrating in insurance regulatory compliance and liquidation services. Until recently he was the Director of the Rehabilitation and Liquidation Division of the Utah Insurance Department. He also serves as the Insurance Department Administrative Law Judge and as Specialty Deputy Receiver of various liquidations.

Len had been with the Insurance Department since 1987. He has served as Market Conduct counsel, Rates and Forms counsel and Director of the Solvency Surveillance Division. Prior to that he was a partner in his own law firm after having received his law degree from the University of Utah in 1979. Len graduated with a music degree with a theater minor before entering law school ten years later. During the period from his entering college until he graduated from law school, Len was a musician and singer. He still occasionally plays the bass with a group aspiring to garage band status. He claims he doesn't remember much of the sixties and seventies.

As a musician Len found he had a lot of free time and traveled extensively, became an instrument rated pilot, a certified scuba diver, was a professional commercial photographer, a ham radio operator, audiophile, average golfer, poor tennis player and frightened skier. Len also does a bit of painting when he's not discussing the superpowers of various superheros with his four-year-old son. His wife is an attorney, who specializes in family law, in Salt Lake City.

Len serves on various NAIC working groups, does the occasional educational seminar for the IAIR., and serves as president of various corporations owned by sundry receiverships. Len's favorite part of his job is the challenge of never knowing what will happen on any given day. It's much like running a conglomerate, he says, but one that has an ever-diminishing bottom line.

Mark D. Tharp • Principal Member

Mark D. Tharp is President of FitzGibbons, Tharp and Associates, Inc. ("FTA"), a management consulting firm offering a variety of accounting and other professional services to the industry.

Mark began his insurance career in 1981 with the Indiana Department of Insurance as a Field Examiner. Beginning in 1984, he assumed the position of Special Deputy Receiver for the Indiana Department of Insurance, managing some fifteen receiverships over the next several years.

In 1989, Mark left the Indiana Department of Insurance to form what now is FTA, along with his partner Michael J. FitzGibbons.

Currently, FTA acts as Special Deputy Receiver for ten Arizona receiverships, a Nebraska receivership and several entities placed in receivership by the Federal government (Mark currently serves as Special Deputy Receiver for the largest life insurance company insolvency in the history of Arizona). In addition, FTA provides services to several other clients, both auditing and special projects.

Mark has been active in the National Association of Insurance Commissioner for the past ten years, having served on several working groups, including a past chairmanship of the Insurer's Rehabilitation and Liquidation Model Act. Most recently, Mark has been involved in the Receiver's Handbook as a Chapter Editor.

Mark received a Bachelor of Science degree in Business Administration and Accounting from Indiana University, Indianapolis. He is a Certified Public Accountant.

Mark and his wife Malana recently celebrated their 22nd wedding anniversary. They have three children: Emily, 14, Charles, 8 and William, 4.

Mark is an avid runner and enjoys several other outdoor sports as well.

Mary Cannon Veed • Sustaining Member

Marry Cannon Veed has a multifaceted legal career stretching from Holland to the United States, litigating and generally unscrambling everything from dangerous products and fallen down parking garages to collapsed insurance companies and exotic forms of reinsurance—in three languages!

Mary graduated from the University of Nebraska at Lincoln, where she was President of the student union, and met her husband Rich. She attended law school at Creighton University, graduating with honors in 1977. Mary is an avid Cornhusker football fan and maintains her loyalty even in years when they don't win the National Championship.

Following law school, Mary joined her father's trial practice in Omaha. Her best known cases included one of the largest toxic shock syndrome settlements on record and an early reinsurance rescission case, Calver Fire v. Unigard. She is a Certified Civil Trial Advocate.

Mary and Rich traveled to the Netherlands where Mary received a post-graduate degree in the law of the European Union and practiced with a Dutch law firm. Between 1986 and 1989, the Veeds lived in Bermuda, where Mary associated with Milligan-Whyte & Smith. Mary was involved in the Cambridge Insurance plan of claims estimation, and in developing Bermudan reinsurance arbitration.

In 1989, the Veeds settled in Chicago, and Mary joined Robinson, Curley & Clayton. In addition to work on several important suits against accountants, directors and officers of insolvent insurers, she has contributed several sections of the Receiver's Handbook. Just recently Mary has formed her own firm in Chicago, where she will continue to untangle and collect on all manner of reinsurance as well as provide pro active services to insurers and insurance receivers.

Mary and Rich Veed have three children (born in three countries) ages 6 to 13. Mary is still looking for time to use the experience she gained in Bermuda sailing and playing golf.

Detroit Recap

by Mary Cannon Veed, Attorney at Law

The NAIC met for its spring festivities in Detroit March 23 through 27, 1996. It is safe to report that the winds of change were blowing, but, so far at least, haven't moved much of the landscape.

Federal Preemption

Highlight of the meeting, from the receivership perspective, was probably the NAIC's pre-meeting seminar on federal pre-emption. Our preoccupation with *Fabe* and its offspring tends to obscure the multifaceted nature of the relationship between state and federal regulation of insurance-related matters. The seminar was well-attended and marked by interesting presentations (we won't say dynamic, but who can be dynamic discussing ERISA and the Comptroller of the Currency?) and useful papers. A note of controversy was injected by Deb Hall's paper on §304. Her contention that the recognition of foreign receiverships threatens the effectiveness of surplus lines and reinsurance trust funds came as something of a surprise to liquidators who had seen them co-exist relatively amicably for years.

> "Where the ACLI sees 'clarifications', however, some liquidators might see a raid on their assets or prerogatives, and some life insurers may see an abdication of the responsibility of their GA's to delve into and speak up about the causes of specific insolvencies."

Handbook

EX5 and its affiliates pursued mopping-up exercises on a number of projects. The Receivers' Handbook committee submitted the 1995 revisions to EX1, which adopted them. Attention turned to the next generation of revisions, with some new editors and supervisors. A few of the chapters were still looking for contributors. 1996 chapter editors and regulatory liaison are:

Chapter	Editor	Regulator
1. Takeover	E. Biatt	Richard Cecil
2. D.P.	vacent	Doug Hartz
3. Accounting	Billy Bostick	David Lane
4. Investigations*	Steve Schwab	Len Stillman
5. Claims	Steve Schwab	Jean Callahan
6. Guaranty Funds*	Elizabeth Biatt	Richard Cecil
7. Reinsurance	Stuart deHaaf	Jim Dickinson
8. Spec. Rec'ships	Mark Tharp	Richard Darling
9. Legal	Jim Stinson	Peter Gallanis
10. Closing Estates	Mark Tharp	Len Stillman
All Life	Charlie Havens	vacent

** reported they were still short of contributors.*

Guaranty Fund W.G.

The Guaranty Fund Issues W.G. gave final consideration to revisions to the GA Model Act. Changes which were approved included various housekeeping clarifications and an optional provision for bond issuance by funds threatened by waves of liquidations induced by natural disasters. A provision to limit guaranty fund liability nationwide after total claims arising under a single policy exceed $10 million (meant to stanch the hemorrhages caused by mass tort claims against policies without aggregate limits) encountered static and was rejected. Discussion centered on the logistical difficulty of handling claims on policies which might, but hadn't yet, hit the aggregate limit. If one fund paid the $10 million, thereby absolving the other 49 states which might otherwise have had liability, was there any means of reimbursing the energetic operator? Barring such a reimbursement obligation (which, from the other states' point of view would amount to paying for claims of people not eligible for coverage in their jurisdiction), could a fund gain an advantage by dilatory claims processing or flimsy claims rejections? Any fund which could hold out long enough against payment stood to gain a windfall release from liability. Another question was who would be responsible to track potential aggregate candidates. Kevin Harris helpfully allocated this task to the Liquidator, a suggestion which attracted no dispute, but no obvious agreement, either, given the uncertain state of data interchange between funds and liquidators.

The aggregate problem is genuine, and having accepted the idea of per-claim limits, the W.G. had no real problem with aggregates in principle. Kevin's assertion that the limit was really only meant to apply to the sort of massive claim problems exemplified by breast implants and asbestos, which tend to get settled in one fell swoop anyway, missed the point that, at $10 million, the aggregate could be invoked

for something as "minor" as a product liability problem with 30 serious claims nationwide. The sense of the meeting seemed to be that an aggregate limit without any practical means to apply it was more trouble than it was worth. one obvious suggestion, to codify the role of NCIGF as a clearinghouse, went unspoken.

The W.G. received a discussion draft for revisions to the Life model act from NOLHGA and the ACLI as well. The proposed changes include efforts to eliminate some of the predicaments the GA's have found themselves in since 1991, and dispose of some well-intentioned but unworkable provisions. Where the ACLI sees "clarifications", however, some liquidators might see a raid on their assets or prerogatives, and some life insurers may see an abdication of the responsibility of their GA's to delve into and speak up about the causes of specific insolvencies. We can probably expect some interesting discussions to result from revisions which, at first glance, appear to be "technical". Provisions generally eliminating the GA's obligation to investigate and report on the causes of liquidation, "clarifying" that the GA's liability is to pay the liquidation shortfall (would this mean that the GA can pay nothing until the amount of that shortfall is determined? The proposed language is completely opaque.), and entitling the GA to assume the insolvent company's reinsurance and take possession of a fair share of special deposit funds are items which the writer suspects will attract some attention.

Model Acts W.G.

The Model Acts W.G. was expected to consider the new section on derivatives, which had been exposed for comment. I can't comment on this one. You can count on one hand the people who understand this revision. I am not one of them, and I was not sure, watching the committee, how many of them were at the head table. The Group shipped the problem out to a new subgroup which will meet with a technical task force and report again in June. Don't know if we'll be any smarter by then, but I can promise we'll be older.

EX5: §§ 49 and 50

EX5 was supposed to adopt new sections 49 (closed estate fund) and 50 (5 year limit on liquidations). Section 49 was adopted; section 50 ran aground. Section 50 made the modest suggestion that a liquidator finish up in seven years or explain to his court why not. It suffered from the same vice that afflicted the guaranty fund aggregate limits: a laud-able objective lacking practical means of implementation. It was even worse hurt, we suspect, by a lack of a real constituency of supporters.

The Compact

The Interstate Insurance Receivership Commission (the Interstate Compact) held its second-ever meeting. It is still enmeshed in administrative detail, and the open portion of the meeting was less than thrilling stuff. It made a regrettable retreat to executive session to discuss offers of volunteer (and not-so-volunteer) assistance, but one gathers that the general idea will be to amass groups of volunteers to address the drafting and organizational projects currently confronting the Commission: writing itself some by-laws, sorting out its funding and its budget, and writing some operative law to govern receiverships under its jurisdiction. As we said, watching the Compact organize itself is sort of like watching grass grow, but it does seem to have the makings of a good crop, someday.

Another meeting is scheduled in San Francisco; date and exact location left open. The Compact is maintaining an "interested parties" list, which you can put yourself on by writing Cathy Travis at the Office of the Special Deputy in Chicago.

> "...I have seen research suggesting that rate *regulation* singlehandedly accounts for more insurance failures than any other cause."

New Matter

On the broader front, the NAIC launched two relatively new ideas which could affect, for good or ill, the supply of new customers for receivership services. One was a task force on "liability based restructurings". This committee is in desperate need of a nickname, and candidates abounded. Someone suggested "liability dumping", which is pretty colorful, but the temptation to call it the "CIGNA/Home Task Force" was almost irresistible. The question is to what extent insurers facing liability overhangs from previous underwriting ought to be able to offload their liability for their youthful excesses to a runoff company while continuing to operate a "clean" company with a nice, simple balance sheet and the goodwill and licenses of the old one. As long as the runoff company (or whatever company ends up with the old risks) remains solvent, of course, the problem is purely administrative. But, notwithstanding the protests of the restructurers, the only reason these plans are attractive is the possibility that the runoff operation will fail, and the hope of being able to salvage at least something from the ongoing business if it does. The short answer is that restructurings like the ones we have seen make sense if the new operation pays a fair price for the goodwill and assets it inherits. The CIGNA

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Receivers' Achievement Report

Jim Dickinson, Chair

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

Our IAIR achievement news received from international and United States reporters covering the third quarter 1995 is as follows:

Receivers' Achievements by State

(Through the Third Quarter, 1995)

Illinois (Mike Rauwolf, State Contact Person)
Disbursements for the Third Quarter 1995

Receiverships	*Amount*
American Mutual Reinsurance Company	$5,151,505
Centaur Insurance Company	51,254
Intercontinental Insurance Company	1,964,187
Merit Casualty Company	632,908
Pine Top Insurance Company	268,234
Security Casualty Company	581,669
Sub-total	$8,649,757
Plus six (6) additional estates where disbursements for each estate were below $15,000	32,498
Total	$8,682,255

Summary by Disbursement Category:

Payments to various guaranty funds/associations (including administrative expenses)	$2,545,766
Payments to policyholders/contractholders (including loss adjustment expenses)	784,984
Payments to ceding companies	5,351,505
Total	$8,682,255

Estates Closed	Year Action Commenced	Insurance Category	Dividend % or Amount
Receivership			
Yorktown Indemnity Company	1988	P&C	89.5% Class A-Guaranty Funds ($2,487,882)
Life Assurance Co of Pennsylvania	1991	Life	N/A (Ancilliary)
Inex Insurance Services, Inc.	1994	Unauthorized	None

Kentucky (Tom Peterson, State Contact Person)

Estate Closed	Year Action Commenced	Insurance Category	Dividend % or Amount
Receivership			
American Insurance & Indemnity Co	1990	P&C	100%-Policyholders & Guaranty Fund claims

Louisiana (Emery Bares, State Contact Person)

Estates Closed	Year Action Commenced	Insurance Category	Dividend % or Amount
Receivership			
Fireside Commercial Life Insurance Co	1987	Life	None
Imperial Lloyds	1991	P&C	100% Guaranty Funds
National Society of Health	1990	Fraternal	12% Policyholders

Maryland (James Gordon, State Contact Person)
Disbursements made to Policyholders/Contractholders

Receivership	*Amount*
Trans-Pacific Insurance Company	$78,792

Pennsylvania (William Taylor, State Contact Person)

Estate Closed	Year Action Commenced	Insurance Category	Dividend % or Amount
Suburban Pennsylvania Business Owners Association	1990	A&H	100.0% Class A&B 67.5% (Class C-Policyholders)

Early Access Disbursements Made to Various State Guaranty Funds/Associations during Third Quarter 1995

Receivership	*Amount*
American Integrity Insurance Company	$ 25,000,000
Corporate Life Insurance Company	15,000,000
Paxton National Insurance Company	6,000,000

Other Developments

Wrigley & Johnson has progressesed Premier Alliance to a point that it has been transferred back to the CLO in California for final operations handling. Contact Harold S. Dunbar, (415) 676-5031.

Philip Singer (England) reported that in December, 1995, the joint liquidators of **Halvanon Insurance Company** (Gerry Weiss and Malcolm London) declared a first interim dividend to creditors of 14 pence to the pound. The sum available for distribution to unsecured creditors, amounted to approximately £5 million.

Halvanon was an Israeli company writing domestic risks in Israel and also international reinsurance risks through its London Branch. A winding up order was made against the London branch in October 1985 and it was wound-up in Israel shortly thereafter. The Israeli liquidation was divorced from the English liquidation by the mechanism of the scheme of arrangement (the first of this type) followed by a second scheme which provided an actuarial methodology for crystallizing the companys tail of business.

Having carried through the provisions of the second scheme which then crystallized the company s liabilities to its creditors, a first distribution became possible. The fact that there has been any sort of distribution is a small miracle in itself, said Mr. Singer. The joint liquidators inherited a set of records which were incomplete and in disarray and required three years concentrated work reconstructing them to the point where collections could begin to be made from reinsurers. To date realizations in excess of £10 million have been made and further distributions to creditors may be anticipated in the future.

Linda Chu Takayama (HI) advised that the **Hawaiian Insurance & Guaranty Company (HIG)** has been successfully rehabilitated and was sold in 1995 for $35 million. The company had become insolvent as the result of the Hurricane Iniki catastrophe in 1992. Because HIG sold homeowner insurance, it also became necessary to convince the secondary mortgage market (Fannie Mae and Freddie Mac) to change their nationwide guidelines in accepting policies written by companies in rehabilitation. It also required obtaining from the Standard & Poor and Best rating organizations a market rating for this rehabilitated insurer.

Don Gaskill (KS) reported that the liquidation of **National Colonial Insurance Company** filed a petition in the fourth quarter of 1995 recommending payment of early access funds to guaranty funds.

Tom Peterson (KY) advised that on the closing of the **American Insurance & Indemnity Company** estate, creditors have been paid the following amounts:

	Amount
1) Kentucky Insurance Guaranty Association-Claims & Expenses	$1,476,576
2) Policy and Contract Claims	1,698,237
3) All Other Creditor Classes	1,423,998
Total	$4,598,811

American Insurance & Indemnity Company (AIIC) was licensed only in one state, however wrote business in at least 22 states. The Company operated under the Federal Risk Retention Act and sold business through purchasing groups. The Kentucky Insurance Guaranty Association was the only guaranty fund involved with this insolvency. All guaranty fund expenses have been paid in full by the estate. Through a concerted claims adjudication and litigation management effort, plus stringent controls on maintaining low operating expenses, the AIIC estate was able to pay 100% of approved claims in all priority classes.

Bill Taylor (PA) reported that the Rehabilitator for **National American Life Insurance Company of Pennsylvania (NALICO)** in conjunction with the National Organization of Life and Health Guaranty Association (NOLHGA) solicited bids for the purchase of its approximate 5,000 deferred annuity contracts. After a comprehensive bidding process, a financially strong carrier was selected to assume the policies through an assumption reinsurance agreement. The agreement which is expected to close early in 1996 will include participantion by NOLHGA and provide for 97% of the $130 million reserves of the single premium deferred annuity block. NALICO s remaining assets and liabilities will be subject to a liquidation proceeding at the time of transfer.

Pari Passu

continued from page 7

(Which shall be done only by top line consultants whom they hire!) We are told that this co-management means that they get control of the assets and share in all key phases of each liquidation process, particularly the praiseworthy publicity engendering early accomplishments like Bulk Reinsurance, immediate claims payments for humanitarian and public relations publicity, etc. They are content to let the liquidator handle the day to day, in the trenches administration after they've stripped the estate of prime assets. Anybody experienced anything like that?

Whatever happened to healthcare reform? Did that fall through the cracks as some more of the federal government's non-essential services?

Are we going to throw the baby out with the bathwater? Put Congressman Dingell and "Howlin' Mad" Hunter in charge of the NAIC, and in the process hopefully retain the acronym but instead of the National Association of Insurance Commissioners let it now be the National Association of Insurance Consumers? That's "Consumers" as defined by Nader, plaintiff's lawyers, and the Alabama Supreme Court.

It has been said before in this and similar columns that professional liquidating, insolvency practicing is not a spectator sport. Even if it was, whom are we cheering? And, to whom is our voice individually and collectively directed? Our time, knowledge, expertise is much too valuable to utilize, waste in carving up each other. There are liquidation processes going begging and obvious opportunities in each of our states for policyholder protection where we can readily find operations hazardous to policyholders.

The Loquacious Liquidator could be the mystic William Blake 200 plus years ago uttering these todays truisms for our industry, **"The harlot's cry from street to street shall weave old England's winding sheet."** Then, **"Great things are done when men and mountains meet: this is not done by jostling in the street."** Hey, we ain't harlots but there may be those among us who sometimes for immediate personal gain display those tendencies. And Blake was right, the great things that we need to be about cannot be accomplished by jostling each other on the streets to and fro from IAIR and NAIC meetings! Us mountains and men have to do it on a higher more direct level, right? NCOIL, practice what you preach. Get legislative reform in smaller states to the point where policyholders have pre and post liquidation protection. NCOIL, you legislators have to first fund enforcement of existing laws — Hear our oft repeated dirge, liquidation orders are not self executing. You talk prevention but we can't enforce financial solvency without appropriations for examiners, regulatory and receivership tools and staffing.

"....and then they came for me." Pari Passu.

Detroit Recap

continued from page 11

situation highlighted the fact that it is difficult to determine whether the price is fair if one plays regulatory hide-and-seek with the basic company information. The Home situation suggested that if a bidding war erupts, the company may depreciate while you are trying to sort it out. Quite a conundrum, fully deserving Bob Wilcox's description as the "Issue of the Decade".

The Committee, which is supposed to come up with a white paper on the issue, was first treated (in spite of disclaimers that the committee did not intend to reexamine CIGNA) to a report from Linda Kaiser on CIGNA which said as little as possible about the why's and wherefores of that decision. It also heard comments from Peg Burke of the St. Paul, energetically arguing against restructurings as a breach of the public trust. David Walsh, late of Alaska and now of AIG, who could probably have made the same case, and a CIGNA representative, who would presumably have said the contrary, confined themselves to congenial comment on how much they looked forward to discussing the issue. No doubt.

This committee is also maintaining an interested parties listing, if you fall into that category.

The other germinating idea appeared in the Commercial Lines initiative on "re-engineering" and "deregulation". The writer was asleep at the switch on this one, but it looks as though Adam Smith has arrived at the NAIC. Keep an eye on this one — we may someday thank these folks for supplying us with lots of new grist for the receivership mill. By the same token, I have seen research suggesting that rate *regulation* singlehandedly accounts for more insurance failures than any other cause.

IAIR Meetings

IAIR activities got sort of pre-empted by the Pre-emption Seminar and some Gremlin that prevented much publicity of the reception. People found their way anyway, and a fine time was had by all.

Maybe in New York, the elevators will work.

The Dissolutioin of a Reinsurance Relationship

"New and Imaginative Ways to Collect Reinsurance"

by Francine L. Semaya, Werner & Kennedy

Disclaimer

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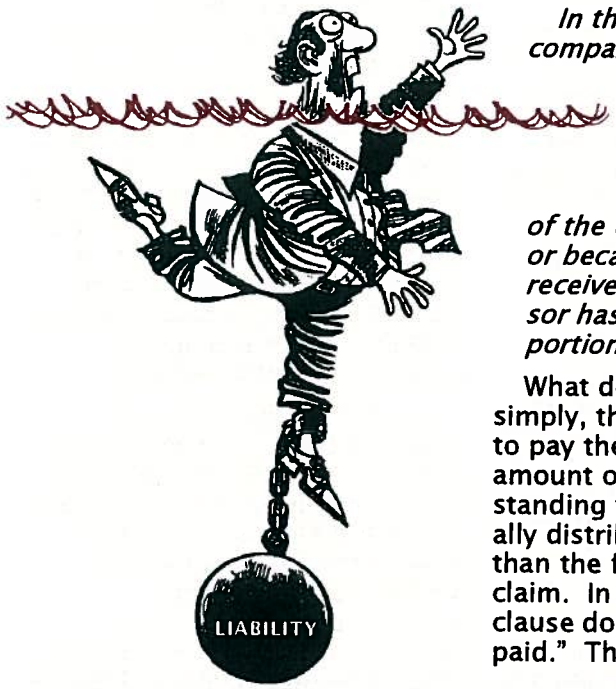
A reinsurance relationship can be compared to a marriage—both are built on trust, understanding and fair dealing, and both can break down when there is a lack of communication, withholding of important information, and an unwillingness by the partners to work out their differences. Often, the result is a severing of the relationship ending either in a divorce - where the parties are released from the marriage, but not necessarily from their obligations, or under the most unusual circumstances, an annulment, which totally unravels the relationship.

Where is it written that an Order of Liquidation is a divorce decree? I have studied both the NAIC Insurers Rehabilitation and Liquidation Model Act and the Uniform Insurers Liquidation Act, and nowhere could I find the provision that permits or grants reinsurers, or receivers for that matter, an automatic right to sever the reinsurance arrangements upon the insolvency of a ceding insurer.



In an ongoing reinsurance relationship, the reinsurance agreement *is* the certificate of marriage. It confirms the relationship and binds the cedent and its reinsurer together. But once one of the parties is declared insolvent, what happens to the relationship? A Liquidation Order does not dissolve all the rights and obligations of the insolvent cedent nor does it provide for the reinsurer to just "walk away" from its obligations. We must look at the insolvency clause, which is found in nearly every reinsurance agreement, and which is triggered upon insolvency, to determine the rights and obligations of the parties involved during a receivership.

A typical insolvency clause provides that:

> *In the event of the [ceding] company's insolvency, the reinsurance is payable on the basis of the company's liability . . . without diminution because of the company's insolvency or because its Liquidator, receiver or statutory successor has failed to pay all or a portion of the claim.*

What does this mean? Very simply, the reinsurer is obligated to pay the Receiver the full amount of its liability, notwithstanding that the Receiver generally distributes to claimants less than the full amount of their claim. In the U.S., the insolvency clause does not mean "pay as paid." Thus, the insolvency clause, much like a prenuptial agreement, predetermines the financial rights and obligations of the parties.

Let's take a step back for a moment to briefly examine the relationship between a cedent and its reinsurer. Reinsurance is a contractual arrangement between insurance companies where one insurer insures the risk of another.[1] The purpose of such an arrangement is to spread the risk among insurers in order to prevent any single insurer from having to bear catastrophic loss.[2]

The relationship between the cedent and reinsurer is predominantly governed by the terms of the reinsurance agreement, which sets forth the rights and obligations of each party. However, general customs, standards and practices of the reinsurance industry, developed over centuries, also play a significant role in defining the reinsurance relationship.

The cornerstone of the reinsurance relationship is the doctrine of "utmost good faith." It is a reciprocal duty - a duty owed by each party to the other. It is a duty of "absolute and perfect candor or openness and honesty."[3]

Through its evolution and application, the doctrine of utmost good faith has established certain tenets to the reinsurance relationship. At the outset of the reinsurance relationship, the ceding company must be careful to disclose all facts of which it is aware that materially affect the risk. In turn, the reinsurer with knowledge of facts that may be material to the risk cannot be silent and later object to the

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Dissolution

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sufficiency of the cedent's disclosure. Further, the reinsurer should make its inquiries at the outset of the relationship. Although a reinsurer may be entitled to avoid liability in certain cases, without a legitimate reason for doing so, a court will not readily annul the reinsurance marriage.

In 1883, the United States Supreme Court further developed the doctrine of utmost good faith as a principle of reinsurance by finding that a reinsurance contract may be voided due to the cedent's nondisclosure.[4] The Supreme Court, in *Sun Mutual*, noted that "concealment, whether intentional or inadvertent, . . . avoids the policy."[5]

A small number of courts have departed from the Supreme Court holding by requiring a higher standard than innocent nondisclosure in order to void a reinsurance contract. For example, the Eighth Circuit Court of Appeals held that a reinsurer must establish either "intentional concealment of known, material facts, or bad faith refusal to ascertain such facts" in order to prevail on a rescission defense for breach of the duty of utmost good faith.[6]

> "There are special circumstances, however, which may influence a court in deciding whether to grant or deny rescission based on allegations of fraud and misrepresentation when one of the parties is an insolvent insurer."

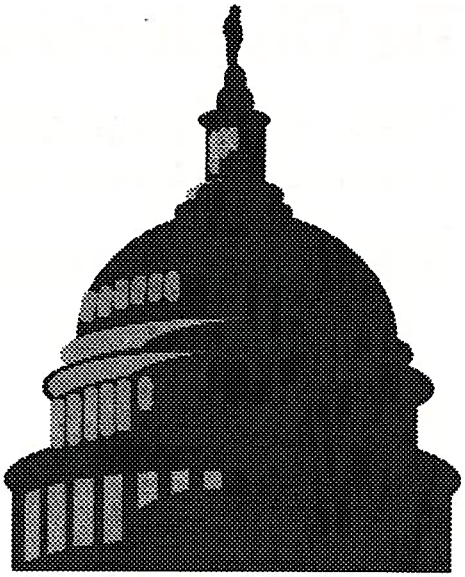
The majority of the courts, however, will allow a reinsurer to rescind the contract where the reinsurer establishes the nondisclosure of a material fact. What constitutes a material fact? Essentially, a fact is material if, had it been revealed, the reinsurer either would not have entered into the contract or would have entered into the contract at a higher premium.[7]

A federal District Court in Massachusetts recently found that a ceding insurer's nondisclosure of its delegation of its underwriting authority to third parties was material to the risk and an intentional act.[8] The Court even noted that "[p]arties to a reinsurance contract . . . have been described as partners in a marriage or in a business relationship, owing to each other the highest degree of fidelity. The relationship is founded on the confidence one party places in the integrity of the other."[9]

The duty to disclose material facts, however, is not absolute. Courts tend to analyze the materiality of the facts at issue together with the circumstances surrounding the non-disclosure or misrepresentation.

The New York Court of Appeals did not allow a reinsurer to void the reinsurance agreement for nondisclosure when the reinsurer had constructive knowledge of the non-disclosed information.[10] The Court found that the obligation to disclose material facts does not apply to protect a reinsurer where the terms upon which the original risk had been insured are generally found in policies of the kind insured because the reinsurer should be aware of those terms. The Court also found that the reinsurer failed to attempt a timely rescission. A Washington District Court went further to suggest that, in addition to acting promptly, a reinsurer must inquire as to a ceding insurer's departure from terms of the reinsurance contract in order to avoid a waiver of its right to rescind.[11]

The Second Circuit Court of Appeals provided further guidance



on the scope of the duty to disclose by indicating that a reinsurer must establish three elements to rescind a contract based upon a material misrepresentation or nondisclosure: first, nondisclosure of facts that materially affected the risk; second, that the facts were known to the ceding insurer at the time the reinsurance was issued; and third, that the ceding insurer was aware that the facts would have been material to the reinsurer.[12]

There are special circumstances, however, which may influence a court in deciding whether to grant or deny rescission based on allegations of fraud and misrepresentation when one of the parties is an insolvent insurer.

Where one of the parties has been declared insolvent the courts may deny rescission based on the concern that third parties may be affected by such a decision. A Montana District Court denied rescission to the reinsurer because of the prejudice against the insolvent cedent's creditors.[13]

In contrast, the New York Appellate Division, in the Union Indemnity matter, unanimously upheld the lower court's decision granting the reinsurers their affirmative defense of fraud, thereby resulting in the reinsurance contracts being voided.[14] The court found that "[the reinsurers'] claim of fraud in

"The courts however are not always clear whether reinsurance premiums must be returned upon the granting of rescission of a reinsurance contract."

the inducement created rights at the time the treaties were entered into, prior to [cedent's] liquidation. Those rights were not altered by the liquidation, and the amounts sought never became assets of the insolvent estate . . ."

The New York Appellate Division also denied a reinsurer's request for the rescission of its contract with an insolvent cedent. Rescission was disallowed, however, because the reinsurer did not return the premiums paid to it by the cedent.[15] The court applied a rule of contract and insurance law dictating that "when a 'contract of insurance ha[s] been rescinded, the law implies an obligation on the part of the insurer to refund the consideration to the insured or his estate.'"

A federal district court in New York held that the defense of fraud and remedy of rescission for fraudulent inducement of retrocession contracts were not rendered unavailable as a matter of New York law by the mere fact of insolvency proceedings.[16] However, in this case, the retrocessionaires were unable to prove that the retrocedent failed to disclose material facts of which it was aware. The failure to disclose insolvency, therefore, did not establish a defense of fraud or the right of rescission under New York law because the retrocessionaires could make no showing that the retrocedent was aware of its own insolvency when it entered into the reinsurance contract.

The object of rescission is to restore the parties to the position they occupied before the transaction was negotiated and partially or completely performed. To accomplish this, the rescinding party must return or offer to return to the other party everything of value received under the contract. In this respect, rescission annuls the reinsurance "marriage" as it returns the cedent and reinsurer to their "pre-marital" or pre-contractual position.

In bankruptcy proceedings, the law generally requires the return of consideration paid before rescission can be granted. In an appeal from a bankruptcy proceeding, for example, the Seventh Circuit Court of Appeals held that the defendant's conduct, regardless of a showing of fraud, did not justify rescission where the Plaintiff failed to return payments received as consideration and did not demand the return of goods it delivered under the contract.[17] The court stated: "[A]n offer to return consideration is a condition precedent to the exercise of the right to rescind an agreement."

The Bankruptcy Court for the Central District of California, while discussing rescission, stated that "the rescinding party must restore everything of value that she received under the contract, or offer to restore upon the condition that the other party does likewise."[18]

Courts, however, do not always strictly require the return of consideration before granting rescission. Thus, we face the question of whether rescission of a reinsurance contract is not more akin to a divorce and settlement than an annulment. In other words, the marriage partners, cedent and reinsurer, separate with the understanding that they will not return what each has received from the other. Instead, they enter into a settlement and then simply walk away from any future obligations.

The Bankruptcy Court for the Northern District of Illinois in applying California law held that to rescind a contract for fraud, the rescinding party does not have to return the consideration it received if the other party is refusing to return the consideration it received.[19]

In non-bankruptcy proceedings, it has also been held that a party rescinding a contract must return the consideration paid under the contract. Similarly, the New York Appellate Division has noted that "when a 'contract of insurance ha[s] been rescinded, the law implies an obligation on the part of the insurer to refund the consideration to the insured or his estate.'"[20]

The courts however are not always clear whether reinsurance premiums must be returned upon the granting of rescission of a reinsurance contract. The First Circuit Court of Appeals in vacating a District Court order for rescission due to fraud under the reinsurance treaties and a judgment for an amount representing the difference between claims paid and premiums received, made no statement as to whether premiums should be returned under rescinded contracts thereby leaving the question yet unanswered.[21]

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WANTED

YOUR ARTICLES FOR *THE NEWSLETTER*

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

Article 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.

Interstate Insurance

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becomes even more obvious when one considers how workouts or rehabilitation plans are instituted under the present systems. Typically, they are fashioned by the domiciliary receiver without input from the other states. The non-domiciliary states not only need the ability to provide input, they should be part of the decision-making process. The states, through the Commission, will have a voice in determining how the problems of a troubled insurance company are handled and resolved. All states should have this ability to participate in plans to protect their residents concerned with a troubled carrier.

Another important function of the compact is to provide for the collection and analysis of information. Those who have tried to study the U.S. receivership system to develop improvements have been stymied by the lack of data and information on receiverships. While the NAIC has tried to collect such information, the fact is that the state insurance departments report only what they want or may not report at all. The IIRC will correct this situation because the Commission will collect information on all pending receiverships and, presumably, will not only study and analyze this information itself, but also will make non-confidential information and data available to others for review.

> "Another difficulty is the practical inability of a non-domiciliary state to become involved in the domiciliary receivership proceedings in a meaningful way or to consider and comment upon the plans of the domiciliary receiver."

All of the aforedescribed benefits should improve the operation of insurance receiverships and make them more effective and efficient in assuring that all creditors, including state guaranty funds, receive maximum distributions as soon as possible. This is, after all, the ultimate goal and objective of all receiverships proceedings.

While the Compact will produce positive results, it is important to recognize what the Compact will not do. Except for improving interaction and communication between receivers and state insurance guaranty funds, it will not impact the law or operation of guaranty funds. Also, operating control and authority over receiverships still will reside with state insurance commissioners and will not be transferred to a central bureaucracy. The IIRC will not create another layer of regulation for the insurance industry because the Commission will concern itself only with insurance receiverships.

Finally, it is important to remember that state legislatures can terminate their state's participation in the compact at any time. This provision fully protects individual state sovereignty and assures that the Commission's activities will be truly consensus based, reflecting the shared expertise and judgment of its members.

For many years, regulators, the insurance industry and others have been seeking a mechanism to improve the receivership system. The Interstate Insurance Receivership Compact offers a solution which deserves the enthusiastic support of all interested parties.

Dissolution

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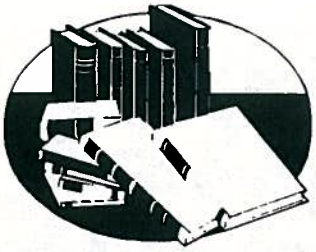
In examining the reinsurance relationship and evaluating its characteristics, we are reminded again and again of its similarity to a "good" stable marriage - utmost good faith, full disclosure, trust and integrity. We are also reminded of the break-up of marriage - the unwinding of the wedding vows, the returning or at least sharing of property that was acquired during the marriage, an attempt to return to the pre-contractual or "pre-marital" position. Yet, we are left with an open question upon the dissolution of the reinsurance relationship or reinsurance marriage especially when one party is in receivership: Is the break-up an annulment or a divorce and settlement? Should the reinsurer return all the premium to the insolvent cedent? Should the reinsurer be held to an ongoing payment - something akin to alimony and child support? Or should the reinsurer keep the premium and walk away from its past and future obligations and allow the estate to be responsible to its policyholders without the means to pay their claims?

1 *Christiania Gen. Ins. Co. of New York v. Great Am. Ins. Co., 979 F.2d 268, 271 (2d Cir. 1991).*
2 *Unigard Sec. Ins. Co. v. North River Ins. Co., 4 F.3d 1049, 1053 (2d Cir. 1993).*
3 *Black's Law Dictionary, 1520 (6th ed. 1990).*
4 *Sun Mutual Ins. Co. v. Ocean Ins. Co. 107 U.S. 485, 509-10, 27 L. Ed. 337, 1 S.Ct. 582 (1883).*
5 *Sun Mutual, 107 U.S. at 510.*
6 *General Reins. Corp. v. Southern Co. of Des Moines, 27 F.2d 265 (8th Cir. 1928), see also Old Reliable Fire Ins. Co. v. Castle Reins. Co., 665 F.2d 239 (8th Cir. 1981).*
7 *Christiania, 979 F.2d at 278-79.*
8 *Compagnie De Reassurance D'Ile de France v. New England Reinsurance Corp., 825 F.Supp. 370 (D. Mass. 1993), rev'd on other grounds, 57 F.3d 56 (1st Cir. 1995).*
9 *Compagnie, 825 F. Supp. at 383.*
10 *Sumitomo Marine & Fire Ins. Co. v. Cologne Reins. Co. of America, 75 N.Y.2d 295, 552 N.E.2d 139, 552 N.Y.S.2d 891 (1990).*
11 *Unigard Security Insurance Co. v. Kansa, Action No. C90-1693 WD (W.D. Wash. 1992).*
12 *Christiania General Ins. Corp. v. Great American Ins. Co., 979 F.2d 268 (2d Cir. 1992).*
13 *Glacier Gen. Assurance Co. v. Casualty Indemnity Co., 435 F. Supp. 855 (D. Mont. 1977).*
14 *Michigan National Bank - Oakland v. American Centennial Ins. Co., 200 A.D.2d 99 (1st Dep't 1994).*
15 *Curiale v. AIG Multi-Line Syndicate, 204 A.D.2d 237 (1st Dep't 1994).*
16 *Stephens v. American Home Assurance Co., 811 F. Supp. 937 (S.D.N.Y. 1993).*
17 *See Peoples Marketing Corp. v. Hackman, 347 F.2d 398 (7th Cir. 1965).*
18 *In re Hathaway Ranch Partnership, 127 B.R. 859 (Bankr. C.D. Cal. 1990).*
19 *In re Amica, Inc., 135 B.R. 534 (Bankr. N.D. Ill. 1992).*
20 *Curiale v. AIG Multi-Line Syndicate, 204 A.D.2d 237 (1st Dep't 1994).*
21 *Compagnie de Reassurance D'Ile de France v. New England Reinsurance Corp., 57 F.3d 56 (1st Cir. 1995).*

Other News & Notes

By Douglas A. Hartz, Missouri Receivership Supervisor



Many of you commented on the absence of our SIR Display in Detroit. I must admit, I lied when I told many of you that it had been, well, lost. In reality, it is being reset with our illustrious new Name, Acronym and Logo and will be proudly unveiled in its new resplendent form in New York. Many also noted not seeing the IAIR Newsletter prior to the Detroit Meeting. Well, I hope it was worth the wait. We have changed the schedule for the Newsletter. It will, from now on, be produced after the NAIC meetings on or about the first day of April, July, August and January. This one is 'off schedule' due to the Detroit meeting being so late in March and because, frankly, change takes more time than we ever allow for it. We changed the schedule to be able to report on the prior meeting. You will also be seeing a Meeting Bulletin, which will be only about a two page foldout, covering the upcoming meeting events and other 'Mark Your Calender' items.

The goals of the Newsletter are to 1) provide a forum for the presentation of ideas, 2) inform us about our colleagues and how we are doing as an industry, and 3) to initiate further discussion. I believe it is an understatement to say that we have some commentary in here that should initiate some further discussion. Please take special note of the IAIR publications disclaimer. However, not wanting to leave well enough alone, there are some notes I want to add.

In relation to Jim Schacht's very

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IAIR UK Workshop

Date: May 29, 1996

Place: Savoy Hotel, The Strand
London, England

The presentation to members will include, among other subjects, Equitas, S304, Pools, pay as Paid, Set-off, Policyholders Protection Act, Contingent Liabilities and a Law Reform session.

Our speakers are drawn from a wide spectrum and included Michael Miron, Alexander & Alexander (past president of IAIR); Nigel Montgomery, Davies Arnold Cooper; Vivien Tyrell, D.J. Freeman; Daryl Ashborne, Touche Ross; Christian Wells, Lovell White Durrant; and, Philip Singer, Coopers & Lybrand.

For more information, please contact Association Headquarters at (913) 262-2749 or Philip Singer, Coopers & Lybrand at (011) 44-171-583-5000.

INSOL International's 5th World Congress

Events of the past decade have heightened attention to the problems of cross-border financing and insolvency. INSOL International's 5th World Congress in New Orleans, March 23-26, 1997, will provide a unique global forum for the exchange of information and ideas among professionals and other constituencies from around the world who have a need to understand the insolvency laws and practices of various countries. INSOL's 1997 World Congress will explore the multinational and multi-cultural aspects of cross-border insolvencies which have affected many business enterprises and have led to a substantial increase in the number and complexity of cross-border insolvency situations. The Congress will provide you with the most current information, in addition to presenting an unparalleled opportunity to meet and form relationships with insolvency professionals, lenders, judges, regulators, academics, insurance professionals, debt traders and swap and derivative experts from around the world.

Conference Theme

The theme of the conference is "Understanding International Insolvency—Rescues, Bankruptcies & Credit Extensions." We will study insolvency systems of many countries throughout the world to better equip us for both initial credit assessment and action if the loan or credit extension becomes a problem. We will do this by a hypothetical discussion of a multinational insolvency, separate sessions on the insolvency laws and rescue cultures of numerous countries and other sessions providing updates on the latest developments in international insolvency. This will develop an understanding of not only the practical rescue systems of individual countries but also the complications of rescues when assets are located in more than one country.

Why You Should Attend

INSOL's World Congresses present a unique opportunity to meet and interact with all of the constituents who must cooperate in any international rescue. Participants include judges, accountants, lawyers, lenders, debt trackers and insurance insolvency experts, who generally must interact successfully to achieve resolution of an international insolvency program.

The Congress will enable delegates to learn about the insolvency laws of other countries and to learn the techniques and complications of dealing with resolving financial difficulties of troubled companies of all sizes. In the break-out sessions delegates will be able to discuss these techniques as they might apply in their own countries.

It is important that anyone involved on a cross-border basis with lending, debt purchasing or restructuring issues understand the practical implications of resolving an insolvency issue if one develops. Whether you are dealing with the largest multinational conglomerates or the local manufacturer with foreign customers and suppliers, it is important to benchmark the insolvency laws of the various countries to the insolvency system that you understand.

For further information and full registration materials, please contact:

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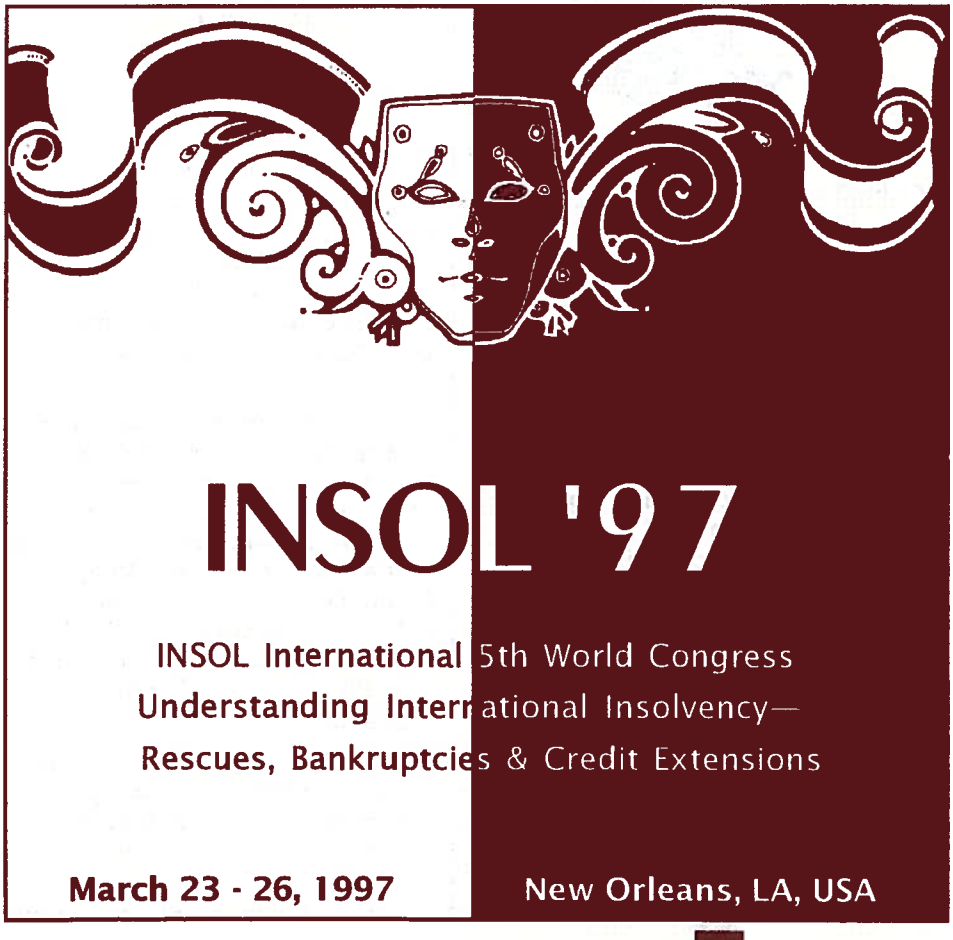

Other News & Notes

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timely update on the IIRC (Eye-irk? At least we are not the only ones with an awkward acronym), has this been, on the part of receivers, nothing to fear, but fear itself? Do you agree that it does *not* now appear to be the creation of the "NOSD" (National Office of the Special Deputy) that was once apprehended? Can we all agree that cenrtralized oversight of dispersed SDR's is desireable? Or, that oversight at all is? Is this a case of, 'get involved with how this is still being formed or get ready to live with the result'? I submit, as I have done before, that there are enough positves to this idea that it is going to continue to gather acceptance among the states and that we had better work out any real negatives and perceived minuses or be ready to live with them.

Could Francine Semaya have found a more appropriate metaphor for what too commonly develops in the reinsurance relationship after the insolvency of a cedent? Kramer v. Kramer? Or better yet, The War of The Roses? If the Union Indemnity affirmative defense of fraud in the inducement were applied by the hapless policyholders who thought they were buying insurance what would we have? Can every one be put back where they started? Or, just a select few? Would there always be enough refund funds to go around? Who is more easily induced?

Mary Cannon Veed's commentary on the Detroit meeting was not biting at all, was it? But, even though we are not elected folks voting on our own pay or perks, does it look just a bit bad when we vote down a "modest suggestion" (that is, the Section 50

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INSOL '97 Conference at a Glance

Saturday, March 22, 1997

Preliminary Meetings:

- United Nations Commission on International Trade Law (UNCITRAL) & INSOL International Multinational Judicial Colloquium
  Coordinator: The Honorable Tina L. Brozman, US Bankruptcy Court

Reception & Dinner

Sunday March 23, 1997

Preliminary Meetings:

- Lenders
  Coordinator: Eddie Theobald, Lending Services Director, Barclays Bank, UK
- Judges
  Coordinator: The Honorable Tina L. Brozman, US Bankruptcy Court
- Insurance Insolvency
  Coordinator: Phillip Singer, Coopers & Lybrand, UK
- Debt Trading
  Coordinator: Marc S. Kirschner, Jones, Day, Reavis & Pogue
- Regulators
  Coordinator: Peter Joyce, Inspector General and Agency Chief Executive, The Insolvency Service, UK
- Global Implications of Swaps and Derivatives—ISDA Presentation
  Coordinator: Ernest C. Goodrich, Jr., Merrill Lynch
- Cross-Border Extension of Credit
  Coordinator: Robert Hertzberg, Hertz, Schram & Saretsky *(on behalf of the Commercial Law League of America)*
- Academics
  Coordinator: Professor Ian F. Fletcher, University of London, UK

Welcome Reception: "A Splash at the Aquarium"
For all delegates and guests

Monday, March 24, 1997

Opening Ceremonies

- World Update
- Report on Preliminary Meetings

Technical Program:

- Hypothetical: A practical cross-border insolvency problem.
- Presentations on the insolvency laws and practices in 10 countries.

Conference Luncheon

Opening Night Dinner: "A Taste of New Orleans"

Tuesday, March 25, 1997

Technical Program:

- Case Study Continued
- Basic Cross-Border Accounting Issues

Concurrent Break-Out Sessions:

- The thrust of these sessions will be cross fertilization of ideas for the solving of practical problems which delegates can relate to circumstances in their own countries.

Free Afternoon

Sponsors' Designated Events

Wednesday, March 26, 1997

Technical Program:

- Practical Realities on Restructuring
- Case Study Conclusion

Conference Luncheon

Closing Ceremonies

Closing Dinner: "The Magic of Mardi Gras"

Other News & Notes

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revision) that a Liquidator should have to "plan for winding up the estate"after five years and after seven show "good cause" why the Liquidation is not ready to be closed? The one sound objection to this section that I have heard could be remedied by adding a sentence to the effect that, "The supervising court shall not use this section to merely clear its docket."

Does the balance of the NAIC Insurers Rehabilitation and Liquidation Model Act envision its subject matter liquidations taking less than seven years? Does the same question apply to the Guaranty Association model acts? Have you read the most excellent treatment "The U.S. Guaranty Association Concept at 25" by Christopher J. Wilcox in the Journal of Insurance Regulation, 14:370, Spring 1996? Would you believe that one of the three "abiding principles" which guided the drafting of the predecessor to our NAIC Model Act focused on "speed of resolution" because the delay in payment commonly experienced by claimants (susally cited as 7 years) was unacceptable?

Does the view that the average insurer insolvency can not be done in less than seven years turn your thoughts to the time value of money? Suppose your guaranty fund ("GF") assesses its members $10,000,000, right after your liquidation date, and that the members take premium tax offsets for $3,333,333 for each of the next three years. Further suppose that ten years after your liquidation date you make a 100% distribution on all of the GF claims (which were exactly one half (50%) of the policyholder class) and the GF returns the $10,000,000 to its member companies. The member companies then have reverse premium tax offsets, right? Is the net effect of this an interest free loan by the state treasury to the GF member companies of $10,000,000 for at least six years? If the member companies never reverse the preium tax offsets would we have to call this a grant?

Suppose, adding to the above example, you make early access advances to the GF, say four months after the liquidation date, of $5,000,000 with interest rates averaging 7% over the ten years. If $1 will approximately double at 7% over 10 years, then you must have started with $10,000,000 on the liquidation date for you to have $20,000,000 ten years later. Did you remember that the GF only got 50% of the 100% distribution? Therefore, when you give $5,000,000 to the GF as an advance on their claim, would not the $5,000,000 left over only grow to $10,000,000 over ten years? Would this then lead to a distribution of 75% on the whole $20,000,000 of claims in the policyholder class (assuming you properly treat the advance as an asset and not as a reduction of the GF gross claim)? So after ten years the GF gets a check for $2,500,000 (to add to their $5,000,000 advance) and the other policyholder class claimants get checks totalling to $7,500,000. Assuming you are one of those other policyholder class claimants, are you happy? Would you be happier if the advance to the GF was deemed to grow to $10,000,000 so the other policyholder class claimants, including you, get checks totalling to $10,000,000? What about the $5,000,000 that the GF has assessed since it had the other $5,000,000 to pay its claims directly from the receiver?

Mark Your Calendar

IAIR Detroit Round Table – June 1, 1996

See page 5 for details

INSOL International '97 – March 23, 19978

New Orleans, Louisiana, USA

"Understanding International Insolvency—Rescues, Bankruptcies & Credit Extensions"

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