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President's Message

Joseph J. DeVito, MBA, CPA, AIR – Accounting/Financial Reporting, Reinsurance and Claims/Guaranty Funds

We delayed publishing this edition of The Insurance Receiver so that we could address some of the details regarding the upcoming IAIR program "Emerging Investment Opportunities - Bridging The Gap Between The Capital Markets and Troubled Insurers" to be held at the Ritz Carlton Battery Park in New York City, on October 24, 2007. This one day program is being limited to approximately 200 attendees. We expect a strong draw based on an agenda which includes some very prestigious regulators and capital markets representatives involved in this area. The program is designed to be dialog-intensive to allow the attendees an intimate, open forum with our esteemed guests. The idea to host such a program came from the Spring 2007 roundtable when the Superintendent of Insurance for New York State, Eric Dinallo, discussed his desire to explore the roles that the capital markets should or could play for troubled insurers. Since then, the Education Committee and the IAIR Board have been busy planning this upcoming session and we are excited at the prospects and opportunities.

Joseph J. DeVito

We are looking to make this Capital Markets program an annual event and expect that future programs will allow for larger attendance. We understand that the limited attendance along with a higher registration fee for this first program may not allow all interested parties to participate in October 2007. But, by making Capital Markets an annual event, we hope to share the experience with everyone!

Now, to the Spring and Summer 2007 meetings:

At the Spring 2007 Board meeting, it was decided that Holly Bakke and Barry Wells will be the new vice-chairs to assist Pam Woldow during her final year as the Education Committee chairperson. This will be a collaboration that will not only work to make the 2007 education programs bigger and better than before, but also will provide a stronger foundation for the years to come.

During the Spring meeting in NYC a very dynamic roundtable was opened by the then Acting Superintendent of Insurance for New York State, Eric Dinallo followed by an introduction from Mark Peters, the new Special Deputy Superintendent of the New York Liquidation Bureau. Their enthusiasm contributed to the electricity of the meeting and, on behalf of all the members of IAIR, we wish them much success in their new ventures and welcome them to participate in future IAIR events.

Regulation 141 was addressed by Jim Veach of Mound, Cotton, Wollan & Greengrass together with Larry Levine of the New York State Department of Insurance. A panel discussion followed. The panel included many notable and highly distinguished insurance professionals including Pam Woldow of Altman Weil, as moderator; Andrew Maneval of the Hartford Group and the current chairperson of AIRROC; David Brietling, deputy receiver of Reliance; and Robert Lewin of Stroock & Stroock & Lavan covering reinsurance collateral and collections. Finally, a spirited exchange on novation and policy buyouts was spearheaded by James Owen of McCarthy, Leonard et al and Tom Kober of the Home Insurance Company. Overall, the discussions were riveting and informative and a job well done by Barry Wells of RSM McGladrey who chaired the event.

Just when we thought the roundtable couldn't get much better, Paige Waters of Sonnenschein assembled a discussion panel during the Summer 2007 meeting in San Francisco that combined topics affecting the US and London. In particular, Paige's partner at Sonnenschein, Darry Sragow, presented an Overview of Insurance Initiatives on Capitol Hill that was followed by a Market Analyst's View of the Insurance and Reinsurance Industry given by Bill Bergman of Morningstar. Across the pond, the afternoon session kicked off with David Kendall's (Kendall Freeman), The London Market: How It Works Legally. John Halls of RLI Global introduced Collecting Claims From the London Market, a topic that looked at London from the outside in. Ambereen Salamat of Kendall Freeman closed the roundtable with The Impact and Issues of Part VII Transfers in the Run-Off Sector.

Our Think Tanks have continued to be examples of the tremendous energy that exists among the members of IAIR. The 2 hour sessions fly by as the current major topics facing the insurance industry are volleyed back and forth. These Think Tank sessions have become even more popular since our Marketing Committee suggested we have a continental breakfast available to the attendees.

As promised, the Marketing Committee, chaired by Mary Jo Lopez of RSM McGladrey has provided IAIR Hospitality Suites during the Spring and Summer meetings. The suites allow for more intimate, ad-hoc discussions. Refreshments, snacks, and a little TV provide a comfortable respite from a very hectic schedule. Anyone interested in sponsoring the Hospitality Suite, please contact Paula Keyes.

We are looking forward to an exciting second half of 2007…a special thanks to everyone for the tremendous contributions.

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BOARD TALK-Meet Kenneth M. Weine, AIR-Claims/Guaranty Funds

By Jamie Saylor and Michelle Bolter

Just recently, we were able to visit with one of IAIR's newest Board members, Ken Weine. Ken has been a member of IAIR since 2001 and has previously served on IAIR's Publications and Standards Committees and currently sits on its Education Committee. Ken was elected to the Board in December 2006 and his term runs through the end of 2008.

Ken lives and works in Chicago even though he hails from Indianapolis. When asked if he had any divided loyalties in this past Super Bowl match up between Chicago and Indianapolis, Ken said he had no hesitation in supporting his hometown Bears against the Colts. Ken's nine year old son, Eric, made sure dad was supporting "da Bears." While not the football outcome he was pulling for, Ken takes solace in the fact that his real sports passion, the White Sox, took home the 2005 World Series crown after their 88-year championship drought. Although he lives on the north side of Chicago, Ken is a season ticket holder and long time fan of the south side Sox. As a matter of fact, he and fellow IAIR Board member, Mary Veed, share White Sox season tickets. Though not expressly offered, we're thinking we might know who to ask for tickets to a game the next time we meet in Chicago.

Ken has been working in the insurance industry his entire career. Ken's first job out of college was with State Farm. Throughout his career, Ken has worked with both receivers and guaranty funds and has over 18 years experience counseling regulators, insurers and corporate management on insurance and risk-related matters. He founded Joint Venture Partners (JVP) in 2006 as a consulting firm to the insurance industry. Among other areas of expertise, Ken and JVP specialize in risk-based financial examinations. At JVP, Ken is able to take a more hands-on approach with his clients. His increased level of client involvement has allowed Ken to focus on providing high-quality, value-added services to his clients.

Ken feels that one of the more pressing issues facing IAIR during his tenure will be the continued development of the IAIR accreditation process. One of the driving forces behind his decision to join IAIR, Ken feels that improving the value and importance of IAIR's AIR and CIR designations is a key to IAIR's longer term success. To that end, he believes that a move toward an IAIR curriculum that will bestow such designations on IAIR members who have completed IAIR coursework and passed exams will help those members seeking industry work to be recognized as qualified providers by virtue of completing IAIR's rigorous accreditation requirements.

When asked what professional accomplishment he was most proud of, Ken responded that in addition to starting his own company and receiving IAIR's Accredited Insurance Receiver (AIR) designation, he is most proud of the Insurance Forum that he founded. This almost unprecedented free annual symposium tackles the latest insurance trends from federal, state and market viewpoints. Ken founded this forum, which is dedicated to bringing together respected insurance professionals countrywide, in order to discuss current issues facing the industry. As a free event, it is a testament to Ken's dedication that the 2007 Insurance Forum is now entering its 11th year.

While there is much more to learn about Ken's professional background, we thought we'd let readers check out his curriculum vitae on their own. We wanted to get the scoop on the man behind the man. So we asked Ken several hard-hitting questions.

Q: If you could have dinner with any three people in the world, dead or alive, fictional or non-fictional, who would they be and why?

A: Alfred Hitchcock, Honus Wagner and Sigmund Freud. Alfred Hitchcock was the father of the thriller movie. His films not only created a genre, but they remain timely and suspenseful today. Ken's sure Mr. Hitchcock would have some incredible dinner stories to share. Honus Wagner was one of the greatest baseball players of all time and was among the first five inductees into Baseball's Hall of Fame. Ken would love to get an autographed baseball card from "The Flying Dutchman." Incidentally, in a February 26, 2007 auction, Honus Wagner's baseball card auctioned for $2.35 million. So we think Ken's motivations might not be strictly from a human interest slant on this one. Ken feels Sigmund Freud, the father of psychoanalysis, would help him better understand the interplay between his guaranty fund clients and his receiver clients.

Q: What is your favorite NAIC/IAIR conference location?

A: San Diego, California. After talking with Ken, we really found that any IAIR location where the temperature hits 75 degrees is a favorite.

Q: hat is your favorite leisure activity?

A: Attending baseball games. Ken and his son are currently trying to attend a baseball game in every Major League Baseball ball park. Thusfar, they've been to 10 parks, with the Metrodome in Minneapolis and Comerica Park in Detroit next up on the list.

Q: Give us one piece of personal information that even your good friends don't know about you?

A: Ken had a mullet in college. Even though we pushed for it, we couldn't get that picture from him for inclusion in this article.

Board Talk is a new feature designed to introduce IAIR membership to its outstanding Board representatives. Thanks to Ken for his cooperationon this article.

News of AIRROC Spreading

By Trish Getty, CEO & Executive Director AIRROC

In May of 2004, Debra Hall (then general counsel of the RAA), introduced me to a handful of industry leaders after the RAA had decided not to form a run-off association. Since the idea was her brainchild, Debra hoped to identify someone to drive the formation of the run-off association. There were a few meetings of interested parties, then seed money committed. With the guidance of Jeff Mace of LeBoeuf Lamb (who became our general counsel), our bylaws, mission statement, etc. were established and AIRROC (Association of Insurance & Reinsurance Run-Off Companies) was incorporated in the State of New York on December 14, 2004. Our website (www.airroc.org) was created and logo designed thanks to the tremendous help of many from Navigant.

Many talented non-members volunteered to sit on our Publication Committee and in a very short time created a stellar publication, "AIRROC Matters." The current IAIR President, Joe DeVito, is AIRROC's Treasurer.

Committees were formed and met for the first time in January of 2005 to help understand and address the myriad interests of our member participants who come from all walks of life. Members include ongoing writers with significant books of discontinued lines, companies in run-off and others in rehabilitation or liquidation. Many didn't know one another; but after rolling up their sleeves and working together, they have become friends. Receivers are getting to know their reinsurers face-to-face, something I had hoped to achieve after witnessing a huge communications gap between these parties over the years.

Since there are common issues among most companies in run-off, the need for a worldwide run-off association was obvious. Our founding members were quite clear: they wanted AIRROC to be a principal-to-principal association, therefore our bylaws state that our members must be risk bearing entities. Participants represent their member company. We meet four times a year to further committee objectives and educate our members on cutting edge issues. Our meeting venue provides a place where many can meet to resolve issues, discuss reinsurance collections or further commutation efforts. While our Early Closure Committee has worked on a number of projects, the best early closure solution is commutation. It is rewarding to see many "side meetings" occurring during the membership meetings.

While Cavell in the UK had been holding a commutation rendezvous in Norwich for six years, there was need for this venue in the U.S. to attract more U.S. companies. In October of 2005, we held our first AIRROC/Cavell Commutation & Networking Event in the Meadowlands, NJ, a smashing success with delegates from all over the world in attendance. In October of 2006, the kick off of the event, the gala dinner, was attended by 360 registrants. Business Insurance covered the event.

Given the positive comments received from delegates about the progress made in October, 2006, AIRROC decided to give back to their members and hold a one-day commutation event on February 21, 2007 in New York, totally funded by AIRROC. The need was obvious since we had well over 100 delegates. We will again hold a one-day commutation event on February 27, 2008, the day before our February 28 membership meeting.

This October 15-17, 2007, the commutation event will occur again in the Meadowlands, with 400 registrants expected. The events include an education program, presented this year by Mealey's, whereby attendees can gain seven CLE credits including one hour of ethics.

Our Legislative/Amicus Committee carefully monitors legislation that may affect companies in run-off, that is, those with books of discontinued lines or in liquidation.

We are happy to report that we have passed the infancy stage and are standing strong with fifty members at June 1, 2007. Our board of directors is a dedicated group of senior managers who each represent a member company. We encourage you to visit our website, where you can find our bylaws, mission statement, board members, member companies, executive committees, career opportunities, meeting details, commutation event details and a host of other items of interest. Perhaps you will consider AIRROC membership because ***we seek solutions***.

Ms. Getty has been active in the insurance and reinsurance industry for forty-two years, specializing in reinsurance claims. She has significant experience evaluating liability and reserve adequacy plus planning and implementing claims and operational audits. In 1996, Trish expanded her focus to include sales and marketing of reinsurance services. In addition to active business, Trish has provided consulting services to regulators for the reinsuance administration of troubled and liquidated companies. In 2004, she became founding CEO & Executive Director of the Association of Insurance & ReinsuranceRun-Off Companies (AIRROC).

The View From Washington

By Charlie Richardson

The 4th Annual Insurance Summit presented by Networks Financial Institute in Washington, D.C., and supported by Baker & Daniels, was held on March 7, the same day that the Senate Judiciary Committee held a hearing on legislation to repeal the insurance industry's antitrust exemption! (More on that issue at the end of this article.) Major federal and state policymakers, academics, and industry representatives participated. Here are some of the highlights - this is a good summary of where things now stand in Washington as this article was being written and what lies ahead for all of us in this Congress and beyond.

Walter A. Bell, Alabama Insurance Commissioner, and President of the National Association of Insurance Commissioners

- Commissioner Bell said state insurance regulators would be vastly more responsive to the needs of consumers and businesses than a new untested federal insurance regulator, including during natural disasters. "Just look at the federal reaction to Katrina?" the Commissioner asked rhetorically.
- He said that the NAIC has been retooling and streamlining state regulation for several years. Commissioner Bell said it is ironic that some insurers who now favor an OFC were originally resistant to the NAIC's SERFF system for rate and form filing. Commissioner Bell also cited the Interstate Insurance Compact, which has been enacted by 29 states (containing about 50% of the national premium volume) and will serve as a central point of filing for life, annuity, disability, and long-term care insurance.
- Commissioner Bell said that while the state-based regulatory model must be kept and reformed, federal regulation is appropriate in some areas, such as the recently introduced reinsurance/surplus lines insurance bill (H.R. 1065), which the NAIC has endorsed.

Rep. Barney Frank (D-MA), Chairman, House Financial Services Committee

- Chairman Frank stated that he is open to considering some form of federal involvement in insurance regulation, but only if it will not diminish consumer protection.
- In addition to consumer protection, Frank said that the OFC debate would turn on the extent to which state law is preempted and what type of insurance should be federally regulated.
- Frank noted that preemption is an open question as the Supreme Court determines whether OCC and OTS broad preemption of state law is permissible.
- Frank said that these issues have become more complicated by the question of how to deal with catastrophes, such as Hurricane Katrina or the 9/11 terrorist attacks.
- Frank said the House intends to pass legislation next month to extend TRIA for more than five years and expand it to cover group life insurance and chemical, nuclear, and biological attacks.
- He also expressed hope of repeating last year's passage of legislation to overhaul the National Flood Insurance Program to discourage rebuilding in flood-prone areas and creating a higher premium for coverage of second homes.

Sen. John Sununu (R-NH), member of the Senate Banking Committee

- Senator Sununu stated that he and Senator Johnson planned to reintroduce a revised version of their optional federal charter bill. Sununu said he had not pursued another Senate co-sponsor (Sen. Johnson is still recovering from brain surgery from late last year), adding that he and Johnson had planned to educate Senate colleagues about their OFC proposal through hearings.
- Sununu cited the success that the banking industry has achieved with a dual-chartering structure, saying that it has ample regulation and consumer protection. An ombudsman position will be created in his legislation to provide consumer protection at the federal level.
- Sununu noted that rate regulation would not happen at the federal level under his bill because there is no interest in that policy from Republicans and some Democrats.
- The Senator added that the White House has not endorsed OFC but is expressing more interest in the issue.
- He added that repealing the insurance industry's exemption from federal antitrust law should be debated in the context of broader insurance reform.

Rep. Ed Royce (R-CA), member of the House Financial Services Committee

- Rep. Royce was critical of some aspects of the state-based regulatory system and said that he thought an optional federal charter was the way to go.
- Rep. Royce said that he wants Congress to legislate a "world-class federal regulator" so that insurance companies can compete nationally. Rep. Royce, who introduced an OFC bill (H.R. 6225) in September 2006, said he would reintroduce his legislation in this Congress and push it vigorously.
- Royce said that the Bush Administration is "warming to the idea" of an OFC, based upon remarks from last year by Administration officials.

CONTINUED FROM PAGE 5:

- He pointed to the failure of the "SMART" proposal to advance in the 109th Congress because it was too narrow in scope. He believes an OFC bill will only succeed if it has as many industry players in the debate and on the same team as possible.

Allan B. Hubbard, Assistant to the President for Economic Policy and Director of the National Economic Council

- Director Hubbard said insurers should be very careful about allowing the federal government to get involved in the business of insurance, which leads to insurance providers behaving not rationally but politically.
- "In every situation that I'm aware of," Hubbard said (he listed the Pension Benefit Guaranty Corporation, the Federal Crop Insurance Corporation, and the National Flood Insurance Program), the presence of a federal insurance backstop leads to premium levels or caps being set by Congress that are not actuarially sound, often creating a "moral hazard."
- Hubbard said he wanted to "punt" on the question of whether Congress should pass OFC legislation. He insisted that the Administration will work with Congress this year on reauthorizing TRIA, but policymakers need eventually to phase it out in order for the private market to provide terrorism insurance. He added that the creation of a national catastrophic insurance fund would be inappropriate and that negative episodes like coastal flooding are best handled at the state level.

I moderated a hard-hitting panel of industry leaders. The panel discussed state v. federal regulation, Congress' appetite for dealing with insurance issues, consumer protection and national trends. The panelists were:

- **William H. McCartney**, Senior Vice President of Insurance Regulatory Policy, USAA
- Coalition Opposed to a Federal Insurance Regulator**, Greg Wren**, Executive Director,
- **John H. Brown**, Vice President Government Relations, Jackson National Life Insurance Company
- Optional Federal Charter Coalition, **J. Stephen Zielezienski**, Senior Vice President & General Counsel, American Insurance Association, and **Wendy E. Cooper**, Senior Vice President & Associate General Counsel, AXA Equitable Life Insurance Company

Prof. Sharon Tennyson, Cornell University

- A large body of academic research demonstrates that insurance markets function competitively in the absence of rate regulation. By contrast, a growing body of empirical evidence suggests that rate regulation leads to higher average insurance costs.
- Current proposals for an OFC, which would eliminate state (and federal) regulation of insurance rates, are one way to achieve rating reforms.

(Paper available at http://isunetworks.org/policy-brief.asp)

Prof. Hal Scott, Harvard University

- Prof. Scott tackled a wide range of issues surrounding the organizational structure of a possible federal role in insurance regulation.
- He compared and contrasted various models, including the current state-based insurance system, the bank model, the OFC proposal from last Congress, and others.

(Paper available at http://isunetworks.org/policy-brief.asp)

* * *

Fight Over The Insurance Industry's Antitrust Exemption

On February 15, controversial legislation was introduced in the House and Senate to repeal the antitrust exemption that the insurance industry got in the McCarran Ferguson Act of 1945. H.R.1081 and S.618 have heavy-duty Congressional sponsors and represent a threat to the industry of potentially significant proportions. On March 7, the Senate Judiciary Committee had a hearing on the legislation. To take a look at some of the witness statements, go to http://judiciary.senate.gov/hearing.cfm?id=2581.

Then on April 3, the 12-member, bipartisan Antitrust Modernization Commission released its 500-plus page report to the President and Congress. The Commission dealt with McCarran Ferguson and encouraged lawmakers to take a close look at the insurance industry's antitrust exemptions. You can find the report at http://www.amc.gov/report_recommendation/amc_final_report.pdf.

The insurance industry is largely united in fighting this assault, and there are certain to be many skirmishes the rest of this year and into the 2008 Presidential election cycle. Stay tuned.

Federal Competition

By Bill Goddard

There has been a great deal of thunder in Washington lately about the regulation of insurance. In the wake of Hurricane Katrina, Senator Trent Lott of Mississippi and others have called for modification of the McCarran Ferguson Act that provides exemption from federal laws for state laws regulating the business of insurance. The rhetoric has been strong, as Senator Leahy said on the Senate floor:

Antitrust laws are the beacon of good competition policy. Insurers may object to being subject to the same antitrust laws as everyone else, but why shouldn't they be subject to the same laws as every other company in this country? If they are operating in an honest and appropriate and open way, they have nothing to fear. Cong. Rec. S2045 (Daily ed. Feb. 15, 2007).

Senator Lott added: I also found, to my absolute horror, something I should have known, which is that the insurance industry is not covered by antitrust laws. They have a waiver. I said: How could that be? I remember hearing discussion over the years about the McCarran-Ferguson Act, but I never focused on it. When I realized that rate setting and actually policy actions by the industry were not covered by antitrust laws, I was stunned. I understand you need a lot of information to decide on rates, but that information can be used back and forth to in effect set rates as an industry without making sure that it is not done in an anticompetitive way. Do you mean that under this exemption, that companies could collude on what actions they take or, even worse, what actions they don't take, which is what we got into after Hurricane Katrina? We had companies basically saying: Oh, no, no, you are covered by Federal flood insurance. We don't have to pay under the household policies for wind damage. Cong. Rec. S2047 (Daily ed. Feb. 15, 2007).

The bill introduced by Sen. Leahy and co-sponsored by Sen. Lott, which was under discussion when the above quotations were made, is S. 618, which carries the grand title of "the Insurance Industry Competition Act of 2007." A companion bill, H.R. 1081, has been introduced in the House of Representatives. Yet, this bill is far from a "repeal" of McCarran Ferguson. The operative language of S. 618 reads:

(a) IN GENERAL.—The Act of March 9, 1945 (59 Stat. 33; 15 U.S.C. 1011 et seq.) (commonly known as the McCarran-Ferguson Act) is amended—(1) in section 2(b) (15 U.S.C. 1012(b)), by—(A) inserting ''as it relates to unfair methods of competition,'' after ''Commission Act, as amended,''; and (B) striking ''to the extent that such business is not regulated by State law'' and inserting ''The Federal Trade Commission Act, as it relates to areas other than unfair methods of competition, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.''; and (2) by striking section 3 (15 U.S.C. 1013). (b) FEDERAL TRADE COMMISSION ACT.—Section 6 of the Federal Trade Commission Act (15 U.S.C. 46) is amended by striking the third undesignated paragraph following subsection (i). Insurance Industry Competition Act of 2007, S. 618, 110th Cong. (1st Sess. 2007)

If this proposed legislation were to be enacted, § 1012 would be amended to read:

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, as it relates to unfair methods of competition shall be applicable to the business of insurance to the extent that such business is not regulated by State law. The Federal Trade Commission Act, as it relates to areas other than unfair methods of competition, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

In addition, the act would delete 15 U.S.C. § 1013(b), the provision famously interpreted by Justice Souter and then bracketed by Justice Scalia in *Hartford Fire Ins. Co. v. California*, 509 U.S. 764 (1993), "Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation." Theoretically, the Sherman Act could not now extend to boycotts and these other difficult to define scenarios if state law regulates the business of insurance in this area.

Finally, the Act would strike the "third undesignated paragraph following subsection (i)" of 15 U.S.C. 46. However, this statute does not contain undesignated paragraphs after subsection (i). It is likely that this is a drafting mistake and that the drafters intended to strike the fourth undesignated paragraph following subsection (l) which reads:

Nothing in this section (other than the provisions of clause (c) and clause (d)) shall apply to the business of insurance, except that the Commission shall have authority to conduct studies and prepare reports relating to the business of insurance. The Commission may exercise such authority only upon receiving a request which is agreed to by a majority of the members of the Committee on Commerce, Science, and Transportation of the Senate or the Committee on Energy and Commerce of the House of Representatives. The authority to conduct any such study shall expire at the end of the Congress during which the request for such study was made.

Most of the traditional McCarran-Ferguson law would remain untouched. The exemption from the Federal Priority Statute, 31 U.S.C. 3713, would remain as the Supreme Court interpreted it in United States Department of the Treasury v. Fabe, 508 U.S. 491 (1993). Securities activi-

CONTINUED FROM PAGE 8

ties of insurance holding companies would remain subject to federal regulation as the Supreme Court found in *S.E.C. v. National Securities, 393 U.S. 453 (1969)*. Activities outside the "business of insurance" would remain subject to federal regulation, See *Union Labor Life Ins. Co. v. Pireno, 458 U.S. 119 (1982)*. Those places where states have not regulated the business of insurance would continue to be subject to federal regulation. See *Federal Trade Commission v. Ticor Title Ins. Co., 504 U.S. 621 (1992)*.

It is also interesting to note that the bill as drafted does not seem to affect the reverse preemption of either the Sherman or the Clayton Act. Note that the bill says "as it relates" not "as they relate," implying that only the treatment of the FTC Act is changed.

So what is different? Essentially the line of cases typified by *Federal Trade Commission v. Travelers Health, 362 U.S. 293 (1960)*, and Federal Trade Commission, 357 U.S. 560 (1958), in which the Supreme Court ruled that the Federal Trade Commission was not permitted to interfere with state regulation of insurance companies would now be subject to a new test. If the activities of the FTC were designed to root out "unfair methods of competition" then the FTC would be able to join state regulators to take enforcement action, or, if the FTC's authority conflicted with state statute, to pre-empt state regulation and take action. Would use of collective rate-making loss data be viewed as "unfair methods of competition"? The Act invites, but does not require, the Department of Justice and the FTC to "issue joint statements of their antitrust enforcement policies regarding joint activities in the business of insurance." Presumably, if the federal regulators take up the invitation to issue guidelines, the courts would give deference to those guidelines in interpreting the statute. In the meantime, it is safe to conclude that authority of the FTC would be expanded by this bill, but the other traditional areas of state regulation, from rate and form regulation to insolvency, would remain intact and continue to pre-empt any federal regulation not specifically directed to the business of insurance.

Bill Goddard is an associate in the Financial Restructuring Group of Bingham McCutchen's Hartford office. His practice concentrates on insurance, reinsurance and insurance insolvency matters. Prior to attending law school, he was an investment banker at JP Morgan & Co. and at Marsh & McLennan Securities Corporation, focusing on mergers and acquisitions within the insurance industry and advice to companies experiencing financial distress. He is the author of three law journal articles on insurance regulation and insolvency. Prior to joining Bingham McCutchen, Bill served as law clerk to the Hon. Jon O. Newman, United States Court of Appeals for the Second Circuit. Bill received his A.B and M.B.A. degrees from Dartmouth College and his J.D. from the University of Connecticut.

Guaranty Associations and Reinsurance & Assumption Agreements

By Robert Hall

I. Introduction

In the parlance of the insurance industry, a reinsurance and assumption agreement is the contractual vehicle by which a primary book of insurance business is moved from one primary insurer to another. Such an agreement may or may not affect a novation, i.e. a substitution of one insurer for another with the express or implied agreement of the insureds.1

If the transferee's insurer becomes insolvent, guaranty associations may be called upon to pay the claims of the transferee's insureds. The purpose of this article is to explore case law concerning guaranty associations obligations under these circumstances.

II. Case Law Finding the Guaranty Association Liable

In *Mississippi Ins. Guaranty Assoc. v. MS Casualty Ins. Co. and American Reliable Ins. Co., 947 S.2d 865 (Miss. 2006)*, MS Casualty and American Reliable sought to exit the workers compensation business through reinsurance and assumption agreements with Legion. The insurance department approved the transaction and reinsurance proceeds on the business were assigned to Legion. Insureds were informed that Legion: (1) was their new insurer; (2) was the proper recipient of premiums; and (3) would pay their claims. However, the insureds were not asked to agree expressly to the substitution of insurers.

When Legion became insolvent, insureds made claims against the Mississippi Insurance Guaranty Association (hereinafter MIGA). The MIGA resisted, arguing that these were not covered claims since Legion was a reinsurer.

The case turned on whether or not a novation had taken place. While there was no express assent by insureds to the substitution, the certificate of assumption sent to insureds described the transaction clearly and the insureds acted accordingly, i.e. sending premiums and claim notices to Legion. The court ruled that this affected an implied assent which resulted in a novation.

An insurance department approved transfer of workers compensation business via assumption and reinsurance agreement from Selective to Reliance National provided the backdrop for *Bowles v. BCJ Trucking Services, Inc. et al., 615 S.E.2d 724 (N.C. Ct. App. 2005)*. When Reliance National became insolvent, the North Carolina Insurance Guaranty Association (hereinafter NCIGA) resisted claims on the basis that they were not covered claims under the guaranty association law. However, North Carolina Industrial Commission, which had original jurisdiction over the matter, ruled as a matter of fact that the transaction affected a novation and the NCIGA failed to take exception to this ruling. The court ruled against the NCIGA:

As noted above, IGA failed to make exceptions to the Commission's findings of fact and they are binding on appeal. The Commission found as fact the assumption reinsurance agreement was a novation. It held the novation extinguished the contract between Selective and BCJ and that Reliance expressly assumed 100 percent of Selective's obligations. The agreement did not create a new contract for insurance coverage but solely substituted a new party, Reliance for Selective, to the contract. Through novation, Reliance is deemed to have replaced Selective as if Reliance had issued the original contract of insurance to BCJ.2

III. Some Other Relevant Case Law3

A happier result, from the standpoint of guaranty associations, took place in *Hemisphere National Bank v. Dist. of Columbia Ins. Guaranty Assoc., 412 A.2d 31 (D.C. Ct. App. 1980)*. A borrower obtained a loan secured by a surety bond. When the borrower defaulted on the loan, the bank negotiated for additional security in the form of deed of trust on land owned by the borrower. In subsequent litigation, the president of the lender admitted that the deed of trust was intended to replace the surety bond as security. The surety subsequently became insolvent and the lender filed a claim with the guaranty association. The court ruled against the lender on the basis that the deed of trust affected a novation which terminated the surety's obligation and therefore, that of the guaranty association.

Security Benefit Life Ins. Co. v. FDIC, 804 F. Supp. 217 (D. Kan. 1992) involved a single premium deferred annuity issued to Hansen, which assigned it to Savings Life which was liquidated by the FDIC. The obligation to pay the annuity was transferred several times through assumption and reinsurance agreements. Notice of the transfer was issued eventually to Hansen but did not make its way to the FDIC until long after the period stated in the notice to object to the transfer had passed. The FDIC sought to collect from the original issuer of the annuity. The court stated the applicable rule as follows:

The assumption agreement was not effective as to Life Savings successors in interest absent proof that at least one of them consented to the substitution. Unless [the original issuer of the annuity] can establish that . . . FDIC agreed to the substitution of [the successor insurer], the agreement between [the original issuer] and [the successor] cannot be construed as relieving [the original issuer] from its obligation on the Savings Life annuity.[4]

Since there was no evidence of consent, the court ruled that the original issuer remained liable to pay the annuity.

The original issuer, IAD, issued group annuity contracts to a trustee and then transferred the business to its subsidiary, IAI, pursuant to a reinsurance and assumption agreement in *Vetter v. Security Continental Ins.*

Continued from page 10:

Co., 567 N.W. 2d 516 (Minn. 1997). The trustee received an assumption certificate describing the transaction and providing an opportunity to object, but the certificate did not state that the trustee would lose its rights against IAD if it did not object. The trustee took no action at that time but when IAI became insolvent, sought to collect from IAD.

The court found that there had been no consent to the termination of the trustee's rights against IAD under either Minnesota or Illinois law. A Minnesota statute provides that an insured retains rights against the original insurer that engages in a reinsurance and assumption agreement, absent written release signed by the insured. The court found that Illinois law has equally high standards on point.

IV. Conclusion

The upshot from the case law above is that an assumption and reinsurance transaction is not reinsurance but a transfer of book of business from one primary insurer to another. Therefore, the defense that reinsurance is not covered by guaranty associations is inapplicable. However, not all reinsurance and assumption transactions result in a novation which cuts off the rights of the insured against the original insurer. Many states require high standards of proof to support a novation. When these issues arise, the efforts of guaranty associations could better be directed to proving a lack of novation so that the original insurer must pay the claims rather than the guaranty associations.

ENDNOTES

[1]See generally Robert M. Hall, Reinsurance and Assumption Agreements: How Does the Novation Take Place? XI Mealey's Reins. Rpt. No. 24 at 20 (2001) (hereinafter Hall). This article may also be accessed at the author's website: robertmhall.com.

[2]615 S.E.2d 724, 728 (internal citations omitted).

[3]See generally Hall for an extensive treatment of case law concerning the facts under which a novation exists.

[4]804 F. Supp. 217, 227.

Mr. Hall is a former law firm partner, a former insurance and reinsurance company executive and acts as an insurance consultant as well as an arbitrator and mediator of insurance disputes. The views expressed in this article are those of the author and do not reflect the views of his clients. Copyright 2007 by the author. Questions or comments may be addressed to Mr. Hall at bob@robertmhall.com.]

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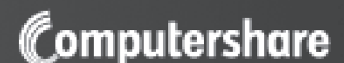

Insolvencies In-Depth Series, Part 4

By James W. Schacht, CIR-ML & Lynn Prescott Helper

RECEIVING REFORM

The way insolvencies are done just doesn't work in today's complex insurance universe. While the "how" of reform can be debated, the "why" is all too apparent.

The time has passed to put a few Band-Aids on the property/casualty insurance insolvency system. It's time to fix this relic that is inefficient, expensive, slow and unfair. Property/casualty insurers, risk managers and insurance buyers deserve far better.

The states must fix it or the U.S. Congress will. But what should be done? Fundamentally, as this series has shown, there are structural problems in the status quo. The business paradigm for the existing insolvency laws and the state guaranty system no longer works. Today's insolvencies have far-reaching, even international implications, and increasingly involve complex reinsurance arrangements and liability products. The unforeseen havoc created for receivers and guaranty funds as the result of recent failures and the systemic shortcomings of the current system cannot continue. The system does not address insurers that might find it necessary or desirable to run off its insurance business and related losses. A dramatic transformation of the insolvency system for property/casualty insurers is required.

Several important principles underpin reform recommendations. First, and most importantly, "going out of business" is still a business. Stakeholders expect and deserve it to be conducted within the context of certain necessary rules. To the extent possible, the reform should be within the current state-based system. Next, creditors should be given an opportunity to fashion a dissolution plan before an insurer is placed in liquidation. Surely the claimant deserves an important role in the process and not one that, at best, is on the outside looking in. A statutory framework for allowing this to happen must be created. If that does not succeed, the receivership system must make provisions for creditors to act in a meaningful role during the liquidation proceedings.

In addition, insurance companies, through the guaranty-fund system, are called upon to pay many of the loss claims of competitors, but without their significant input. Insurers must have authority and a formal role in the insolvency system that are commensurate with this redistribution of wealth and extraordinary requirements imposed upon them. The guaranty-fund system needs to be less fragmented and linked closer to the receiver to improve efficiencies. It must have lower costs, and have the flow of information within it enhanced to allow assets to be marshaled effectively.

Further, changes in receivership law are needed to improve transparency and accountability. Incentives and other procedures must be established to improve the speed at which receivership estates are resolved. Also, the government's role in receiverships should be altered from an administrator to an overseer and regulator. Receivership management can then be assumed by professionals who are skilled and experienced in running off insurers, as well as knowledgeable about the specific receiverships requirements. A state insurance commissioner's hegemony over insurance receivership business was never preordained, and there are compelling reasons to reconsider and change it.

Finally, the public is entitled to know what caused an insurer, particularly, a significant one, to fail. What did the regulators do to detect and regulate it before bankruptcy happened? How well did the insolvency system perform after the failure?

In order to encourage the development of creative alternatives to traditional receivership, data and information will be needed. A central data repository must be created consisting of key statistical and financial information for all insolvencies.

Based upon these principles, here are specific recommendations to improve transparency, accountability and efficiency in the system.

RECOMMENDATIONS

A major statutory structural change should be made to create a "window" for an insolvent insurer. This would give regulators time to develop, with creditors, a plan of finalization or dissolution, perhaps making it possible to avoid liquidation. Guaranty funds should be a part of this new process. The objective is to fashion a plan that speeds resolution though voluntary agreements among a majority of creditors, thus saving significant dollars. In itself, that would make the process much fairer for everyone.

In this process, creditors and reinsurers would agree to a methodology for resolving long-tail claims, the claims that typically impede and prolong the settlement of an insolvency. Certain legal protections would have to exist, such as "stays and injunctions," to allow the development of an appropriate plan that preserves values for claimholders. Unlike today, government would oversee the process but would not be responsible for its creation. That solution would come from the parties that hold the biggest stake in the resolution of the insolvency.

This structural change would include procedures for insurers for which solvency is unknown or problematic, and where solvency is presumed but not a certainty. In this case, creditors and claimants could accelerate finality through an arrangement approved by a majority of the insurer's creditors. Again, this avoids lengthy receivership proceedings in the event the insurer is found to be insolvent.

While no one desires to disturb the principle underlying the purchase of insurance--exchanging uncertainty and risk of loss for certainty--this is a fair compromise. Because under the current system, unless risk is transferred, uncertainty persists that creates a situation that delays, if not blocks, the resolution of the issues. These situations happen, for example, when there is a ratings agency downgrade, a deterioration in risk-based capital or a variety of other unforeseen adversities. The purpose of such a new statute would be to establish a creditor-driven process that would seek to make

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prompt payments to creditors and to look for effective ways to maximize assets for claimholders.

Today's environment demands a new and expanded role for the National Conference of Insurance Guaranty Funds ("NCIGF") that draws upon the available skills and resources. The NCIGF was formed in 1971 primarily to help states design appropriate property/casualty guaranty-fund legislation and to serve as a national forum to exchange information and ideas. While its mission has evolved somewhat over the years, dramatic changes are now needed to address the complex situations currently encountered.

By way of example, in today's environment, it is illogical that the guaranty-fund system not be a part of the decision-making process for resolution of a troubled insurer. Would not a cost-effective and creative solution for an insurer's "soft landing" be preferable, if at all possible, to the csts and inefficiencies of receivership?

This is not to suggest the guaranty-fund system has not performed well, because it has performed superbly given the situation. However, structural changes are needed to meet the challenges of today.

All state guaranty funds should be required to be members of the NCIGF. The NCIGF would have clearly defined duties and responsibilities. The members would elect a board of directors of the NCIGF, all of whom must be member insurers. One of the NCIGF's "new" responsibilities would include centralization of the claims administration function and, perhaps, establishing a central claims facility for all guaranty funds to use that could be closely linked with each receivership. The multistate guaranty-fund system could be maintained for funding purposes but not claims administration. Alternatively, the guaranty funds could utilize the failed insurer's claims personnel and systems. NCIGF would also represent the guaranty funds in determining a course of action for a troubled insurer and the selection of a qualified individual to administer a workout plan, or if necessary, the liquidation of an insurer. The NCIGF would also establish standards for guaranty funds to follow in reporting financial and other information to the organization, all of which would be mandatory. This would create a centralized repository for guaranty-fund costs including expenses.

Today, local guaranty funds are accountable to their board of directors, members and regulators through a variety of ways including audited financial reports. However, no one effectively aggregates data from all guaranty funds to determine the cost of an insolvency on a gross or net basis after recoveries. The NCIGF would also be a part of the extremely important postmortem process, allowing all parties to learn how to lessen the impact of future insolvencies or prevent them entirely.

Several reforms are needed to address fundamental concerns with the system for managing insurer insolvencies in the United States. As noted in earlier articles in this series, the present statutory structure is flawed with incentive conflicts, a perceived lack of control and oversight, as well as high costs.

First, the responsibility for administering an insurance receivership would not be in the hands of the state insurance commissioner, but rather, a person experienced in insurer receiverships selected by the commissioner, the state insurance guaranty funds, through the NCIGF, and noncovered creditors. Winding up an insurer is a management function, not a regulator function, and the system should recognize that distinction. For example, whether litigation should be pursued by a receiver should be determined by a cost-benefit analysis and not based upon whether the perceived wrongdoers deserve to be penalized.

Others have noted that the resolution of problems presented by a failed or failing insurer is not best handled by government. Once a company has been found to be in such condition to warrant the cessation of business, it moves from being a governmental concern to one of protecting and finding the best resolution for its creditors. The concern is no longer protecting the general public.

The International Association of Insurance Receivers has professional certification programs for insurance receivers. The association has in process an enhancement of that program to include a course of study and testing before a designation can be granted. This program can be used to create a pool of potential candidates to serve as qualified insurance receivers. As mentioned earlier in this series, in several other countries, only licensed insolvency practitioners can serve as receivers and administrators and the same should occur in the United States.

Previously, we discussed the problems created by insurance products within the liability lines of insurance. These products have dominated the insolvencies of the recent past and likely will be present in future insolvencies. These products create long-tail claims, which have considerably lengthened the closure time for many insolvencies. The system needs to find a solution for this problem. Our suggestion is that the priority of distribution of assets needs to be changed. First, creditors with liquidated claims should be given higher priority over unliquidated and contingent claims. Second, unliquidated claims should be granted priority over contingent claims. Then contingent claims should be allowed if assets remain, and then only if there is an actual insured event or occurrence that can be valued and estimated as to amount. Granted there are complications to be considered; nevertheless, the notion is that known claims should be paid first before more speculative claims are addressed.

Receivers should be accountable for their actions, policies and procedures. This observation is not intended to criticize or question the integrity of receivers; it is just recognition that the current system does not engender accountability. Our prior suggestions to change the insurance commissioner's role to that of an overseer would assist the situation; however, more needs to be done. A rigorous system of standardized reporting requirements, to not only the supervising court and creditors but also a public central repository, needs to be instituted. Such information is necessary to improve transparency and accountability, and such a database will be needed to fashion creative and innovative solutions for companies in financial trouble.

State and public policy-makers must make the redemption of the insurance insolvency system a priority. Unfortunately, one of the system's most glaring deficiencies is the

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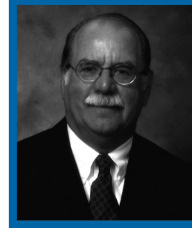
lack of transparency. The lack of a central data repository hides from most public policy-makers the need for systemic change. Nevertheless, it is hoped that this series of articles has demonstrated a need for at least a preliminary inquiry to confirm that the need for reform is real.

Few troubled insurers are evident today as contrasted with prior periods. This relatively tranquil period of time allows for careful study of the system and thoughtful consideration as to how to fix it. The authors readily admit that the reforms suggested in this article do not answer all questions or address all problems of the insolvency system. Similarly, we recognize that our ideas require further development and study; we hope that these articles have at least stimulated the process. As Samuel Johnson stated, "Language is the dress of thought."



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