The INSURANCE RECEIVER

Promoting professionalism and ethics in the administration of insurance receiverships.

Volume 11, Number 2 **Summer 2002**

Philadelphia, PA

Reinsurance And Assumption Agreements: Does Insolvency Support A Novation?

The Global Impact of The Enron Insolvency

"Standard" Provisions In Reinsurance Contracts: Whose Standard And In Whose Best Interests?

Insurance and Reinsurance Litigation – A Liquidator's Perspective

President's Message

by Elizabeth A. Lovette, CIR-ML

There is something about Spring that gets me jazzed! Tulips and daffodils are pushing their way up through the chilled earth, birds' song drift in through my bedroom window that I dared crack open the night before, college kids everywhere are traveling on Spring Break, shirt sleeves are rolled up, walkers and runners are pounding the pavement en masse, and everyone's step seems just a little lighter. Perhaps I so enjoy Spring for its symbolic representations: emergence from dormancy, birth, growth, renewal, life, vitality. Of late when I think of IAIR similar connotations come to mind, and I feel a sense of resurgence similar to the onset of Spring and the new growth it beholds. Though perhaps obscure, I draw this comparison for many reasons.

At the most recent Board meeting in Reno, new member applications were approved that pushed our membership to a record high of 403 surpassing the previous high reached at the December meeting. Not only has membership reached a pinnacle, but new member applications continue to roll in. Also at the Reno Board meeting, a record number of non-Board IAIR members were present for the duration of the meeting despite an extended Executive session that left members waiting in the hall for a prolonged period of time. My apologies! As a result, the Board has now adopted the policy that any matters requiring Executive attention be held at the very onset of meetings and accordingly reflected on the agenda. Board agendas are posted in advance of meetings on IAIR's website, so I urge members to check the agendas for notice of Executive matters that would slightly delay the start of the public meeting. I speak on behalf of your Board when I say what a refreshing and welcomed change to see our members vocal and interested in the workings of the Board. With the exception of Executive session, Board meetings are open and public to all IAIR members as well as any other interested party, and I encourage your continued participation and input.

More welcomed surprises came at the Saturday afternoon Roundtable hosted by fellow board member and chair of IAIR's Marketing Committee, Trish Getty, AIR-Reinsurance. A milestone was achieved in that two commissioners graciously participated in our Roundtable presentation: Georgia's Commissioner

The Insurance Receiver Has Changed!

You may notice that *The Insurance Receiver* looks a little different this issue then in past issues. In our effort to improve the publication, IAIR has made a slight formatting change and added information to the newsletter. We have added a new column, *Meeting Update*, by Bob Loiseau of Jack Webb & Associates, Austin, Texas. Bob will keep us informed about what happened at the prior roundtable, board meeting and committee meetings. This will keep you up to date on how IAIR is working for you.

We are also running articles in their entirety before starting the next article. Therefore, you will not have to flip throughout the publication to read one article.

Finally, we are changing the timing of the publication to be available to members several weeks before the quarterly meeting rather than a month after it.

We appreciate your patience during this transition and hope you will enjoy these improvements.

The INSURANCE RECEIVER
Volume 11, Number 2
Summer 2002

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John Oxendine opened with a candid discussion of Lloyds followed by a thought-provoking Question and Answer session with the audience. In the mock mediation that followed, Commissioner Jose Montemayor of Texas also made a guest appearance where he portrayed himself in the role as Receiver of Big Top Insurance Company and made it clear to his Special Deputy Receiver, portrayed by Bob Loiseau, that he wanted Big Top closed! I think those of us in attendance were glad that Bob was in the hot seat and not us! My warmest thanks to both Commissioners Oxendine and Montemayor for lending their valued time and expertise to our Roundtable. The Commissioners' Roundtable presence coupled with the participation of Commissioners Terri Vaughan, Mike Pickens, and Diane Koken at the recent Insolvency Workshop is certainly a positive reflection of IAIR's increasing recognition within the regulatory community.

More on the Roundtable. What a hit!! For those of you fortunate to attend this standing-room only event, a mock mediation unfolded that was without a doubt educational and certainly entertaining. Kudos to Mike Cass; Chris Fuller; Bob Loiseau, CIR-P&C; Stephen Schwab; and David Spector for their spectacular performance in the roles of Receiver, Reinsurer, and respective counsel, and to Jonathan Bank whose stellar performance as Mediator added levity while encouraging the audience to identify the issues in resolving the dispute at hand. Like the 2002 Insolvency Workshop, attendees stayed rapt until the end signifying yet another successful IAIR educational event.

I am also thrilled to report that my pleas to membership for participation on IAIR's various committees did not fall on deaf ears. Every committee meeting I attended sported new faces eager to become involved in IAIR activities. The energy in those meetings was palpable and inspiring, and I thank those members new and old to the committees for your interest and support. I also welcome anyone with thoughts or ideas for promoting IAIR, to contact me and share your suggestions. As I have said before, the lifeblood of this organization is a strong, diverse and active membership base. If IAIR is to continue to grow, thrive and advance its mission of promoting professionalism and ethics in the administration of insurance receiverships, your support is vital. As former President, Bob Craig is fond of saying, "the IAIR train's on a roll!" Come on, get on board!

I look forward to seeing everyone in Philadelphia, but in the meantime, enjoy Spring!

Thank You To The Sponsors of The IAIR Reno Meeting

IAIR would like to express its sincere appreciation to the following organizations for their generous support of the IAIR Meeting held March 16 - 19, 2002 in Reno, Nevada. It is only with the assistance of these firms that we are able to provide quality educational programs to the insurance insolvency industry. Thank you.

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Phoenix, Arizona

View From Washington

By Charlie Richardson

Terrorism Reinsurance Update

The number one legislative priority of the property/casualty trades in Congress since September 11 has been terrorism reinsurance. And they came pretty close to getting a bill passed last December, although ultimately the proposal got hung up in the Senate over tort reform. The insurance industry, business groups, the NAIC, and even the White House have tried to keep the heat on Congress to do something, and a report issued by the GAO in February helped their cause, at least for a short time after its release. But, right now, the motivation to act quickly on terrorism reinsurance seems lacking. Bottom line, the political fire has gone out of the belly of the terrorism reinsurance advocates in Congress, as everyone's attention shifts to passing a budget. Obviously, some members of Congress have concluded that the lack of insurance coverage for terrorism is no longer a pressing issue, because of the lack of a "dramatic disruption" in economic activity as a result of the failure to pass a reinsurance measure last year and, documenting the extent of the problem has been difficult, because many businesses hesitate to highlight their insurance situation. Some consumer advocates have pulled away completely from the concept of a federal terrorism insurance backstop.

So, unless there is another terrorist scare, it now looks like Congress will do on this issue, what it does best -- nothing-- and leave to the states the whole question of terrorism exclusions.

Money, Money, Money

President Bush signed on March 27 the McCain-Feingold/Shays-Meehan Campaign Finance Reform Bill, the first significant changes in federal campaign laws since Watergate. Fueled by the Enron scandal, the final landmark vote in the Senate (60-40) a week earlier ended a fight that had stretched over years and hundreds of votes. Opponents, led by Republican Senator Mitch McConnell of Kentucky, promise to fight on in court. Lawyers and political operatives already have laid out strategies for keeping the contributions flowing under the new rules of campaign fundraising, which include a ban on unregulated "soft money" contributions to national political parties. Both parties are rushing to raise as much soft money as possible before the measure takes effect after the Congressional elections this year.

The legislation is complex, and parts of it may not pass Constitutional muster. But, here are the key elements:

- Soft Money: Soft money fundraising and spending for national parties is banned. National parties can only raise and spend hard dollars for any activity. Soft money will still be permitted for applicable state and local parties.
- Issue Ads: Corporations, associations and unions cannot make targeted electioneering communications, except as express advocacy through their PAC, using hard dollars. "Issue ads" that refer to a candidate and run within 60 days of a general election or 30 days of a primary are barred.
- Disclosure: Monthly disclosure would be required for candidates and parties. FEC will set software standards for disclosure. There will be expanded disclosure requirements for political advertisements.
- Fundraising: Full ban on fundraising on federal property.
- Limits:

Individual limits: $2000 per election from individuals (up from $1,000) to federal candidates; $25,000 per year (up from $20,000) per party committee.

Aggregate limits: $95,000 total per cycle, (up from $25,000) broken down as follows: $37,500 aggregate to all committees other than national parties (includes PACs and state hard money committees). Remainder of $57,500 (depending on money spent on PACs) to all national party committees.

PAC limits: No change

Some members of Congress have concluded that the lack of insurance coverage for terrorism is no longer a pressing issue

Privacy Battles Continue

President Bush's decision in late March to roll back key aspects of the Clinton Administration's medical privacy rules has sparked renewed interest in privacy legislation that could well reignite the debate over financial privacy protection. Sen. Kennedy (D-MA) promptly announced that he — probably along with Sens. Dodd (D-CT) and Shelby (R-AL) — will introduce legislation to reverse the Bush medical privacy policy. Expect this legislation also to include Sen. Shelby's long-pending bill to overturn the opt-out approach to financial privacy protection, as well as to give consumers additional protections related to telemarketing and use of behavioral profiling on- and off-line. After taking control of Senate Banking last year, Sen. Sarbanes (D-MD) said he would introduce privacy legislation and push it, although he has yet to take any follow-up action in this area. A move in the Senate Health, Education, Labor and Pensions Committee, however, could lead Sen. Sarbanes to re-engage, assuming the post-Enron legislation that has so far completely tied up the Banking Committee does not continue to preoccupy him.

Reno NAIC Meeting Recap

By Mary Cannon Veed

A Two-Piece Meeting Recap

We began to divide the "meeting recap" report in the Insurance Receiver into two pieces because, among other things, it was looking increasingly schizophrenic anyway. As the "normal" industry gets increasingly preoccupied with issues like regulatory modernization, new products, and the social impacts of our product, they spend less and less time thinking about solvency and its alternatives. But, even as the spotlight flits away from genuine insolvency work, that work remains important, not only to the insureds and insurers directly affected by past insolvencies, but also to be prepared for the incoming ones, and once in a while to influence regulatory approaches to solvent companies to try to prevent the preventable failures and mitigate the unpreventable ones.

We've been down this road before, and any veteran of Garn St Germain and the MEWA wars knows that even well-conceived efforts to remove barriers and economic disincentives often create solvency issues that don't become obvious for years, at least to those who don't, out of professional habit, see the cloud in every silver lining. That's why we've split the NAIC report into two sections, one reporting directly on the IAIR activities and EX5, (courtesy of Bob Loiseau) while the other one ranges more widely around the meeting and discusses the influences that will shape how your next customer will look.

Slot Machines, Re-Engineering, and Terrorism

This time, the NAIC meeting was dominated by three things: terrorism, regulatory reengineering, and slot machines. The latter produced the memorable image of David Spector, who professed to know nothing about them, catching a cascade of quarters and wearing a foolish grin, after a 50¢ investment made expressly to demonstrate their futility to your humble reporter. I cannot report whether he went back to that particular well, but it was a moment at least as good as anything he generated in the Roundtable, and that, to poach on Bob's turf, was pretty memorable all by itself.

Terrorism

I am not sure why or how it happened, but the NAIC sponsored a "Symposium" called "The View From The Trenches" that considerably exceeded its usual standards of timeliness, frankness, and range. I meant to drop by and ended up staying the afternoon, because of the very pointed and expert exchanges I got to watch. The thing was so unstructured that, having missed the first few minutes I couldn't identify the speakers until I read somebody else's report on it. Apparently, anonymity loosened tongues. The program began with a discussion of terrorism coverage which was not, as the NAIC's report might let you think, limited to the clichés about the magnitude of the risk and the impossibility of addressing it in the private sector, but ventured to question the mixed signals the industry is giving. It began with "we can't handle this" and moved to mesmerization with the potential premiums if it could. An observation I had not heard before, but which made good sense, came from a federal official in the audience. He commented that the reason the idea of a terrorism pool stalled in Congress was the industry's insistence that the problem was temporary, combined with arguments in support of a pool that logically supported permanent relief if they supported anything at all.

I notice that in the time since, NAIC leadership has gone on the bandwagon for a "narrowly tailored and time-limited" federal solution along with President Bush, but simultaneously the cashier window is opening up on coverage again. Have a look at the NAIC's press release www.naic.org/1news/releases/rel02/040902_naic_pres_whitehouse.htm, and then look at all the coverage announcements on businessinsurance.com. At the same time, commissioners in various states

are denying approval of retail policy endorsements excluding terrorism, and denying approval by the back door for commercial policies by insisting on "fire following" clauses. In spite of which, as Terry Vaughn noted, "the sky did not fall" on January 1. Maybe the best terrorism insurance solution is no terrorism insurance solution. Whether or no, it seems that's what we're going to get.

The Symposium was chock full of other fascinating insights, into things like credit scoring, toxic mold, workers' compensation capacity, and the disappearance of nursing home liability coverage (Rob Graham commented, pungently, that in that case insurance is the "canary in the coal mine". The problem's not the canary, it's the coal mine, which is true of several of our other liability coverage "crises" where conditions in the industry make it more feasible to buy insurance against malpractice than to do the job right, and then to blame the insurer when the rates get steep.)

Re-Engineering

As I've said before, sometimes the NAIC accomplishes a lot by just milling around, and terrorism may be an example. Once in a great while, however, it accomplishes things by actually doing them, and the financial services modernization push is the most spectacular one I've seen. Consider some statistics, all involving initiatives that were at best somebody's crazy idea two years ago:

Reno NAIC Meeting Recap

• 39 states have passed the Producer Licensing Model, or something close to it. 11 states are pending; that leaves maybe two holdouts?

•44 states use SERFF (electronic filing of rates and forms). The sales challenge now is to the companies.

•50 states have published rate and form filing checklists side-by-side, where their more idiotic constraints look so silly they should gradually evaporate. And the Rate and Form model, in a new "condensed" version, is launched. The NAIC got behind the curve on rate and form re-engineering, but now it seems to have caught up a bit.

•52 jurisdictions (including PR and DC) accept the UCAA (file once, start 52 applications for certificates of authority, although local additions to the filing may still be needed.) Gloria Glover of Alaska, may be emboldened by distance, distributed a devastating table showing how many of those supposedly critical local rules are really just form over substance. Another place where sunshine, even midnight sunshine, is the best medicine. The price of C of A's is dropping, as their acquisition through channels gets more rational.

To have so many states adopt measures of such complexity in a reasonably uniform fashion in this kind of time is remarkable. And there's no sign, yet, of a letup.

Long Term Care May Be a Growth Area

Lately I've been trying to educate myself about the business of long-term-care insurance. The industry claims that, as baby boomers reach senescence, as Social Security becomes less comprehensive, and as acute illness (accidents, infectious disease, and so on) becomes less likely to kill you than chronic things like high blood pressure and Alzheimer's, the need for assisted living services will grow and the market for coverage to pay for it will, too. Long-term care insurance has accumulated value like life insurance, but case management issues like health insurance. Its very existence is changing the usage patterns for the services it covers. And it is the quintessential political football. The picture of a frail, but independent, grandmother forced to choose between paying her LTC premium or her light bill is guaranteed to get you on 60 Minutes. The Life and Health Actuarial people have engineered a fascinating reversal of regulatory attitudes, from a philosophy that rates should be affordable in the first instance and open to increase if necessary in the future, to one which opines that rates which are stable over the long term are essential to buyers getting value for their money, even if that means they start out higher and rely on actuarial data containing a large element of pessimism. The concern, though, is two-fold: first that these policies can be oversold to people who will expect more from them than they can reasonably deliver, and second that regulators will pick and choose between the two rating philosophies, especially where older policies are involved, and end up demanding that insurers offer rates that start low and remain stable.

Another aspect of long-term care insurance is the development of "definition creep." These policies often contain restrictions that made sense when they were written, but got overtaken by events before they were called upon to pay claims. The growth in home health care has created demands that policies that would pay for nursing home care also pay for the same services provided at home or in a hospice. Utilization review practices that point patients directly to nursing facilities instead of hospitals play havoc with policies that require a prior three-day hospital stay as a bright line substitute for a decision whether the insured's condition is serious enough to warrant care. Pressure to expand benefits, both in newly written policies and retroactively in old ones, ignores the hydraulic connection between scope of coverage and cost. And how much underwriting is enough?

In an indication that reality may be rearing its ugly head, the last item on the agenda for the Senior Issues Task Force was to discuss how policies would be handled in insolvency. Must the estate continue coverage if the policies are "guaranteed renewable?" Do GA's cover them? For how long? As health insurance or life insurance? One hopes the Task Force takes advantage of the accumulated experience of the guaranty funds, IAIR members and EX5 on this one, but in the few minutes of discussion on this topic, the group looked very much like starting from scratch with all the wrong assumptions.

The Compact Lives To Fight Another Day

And the meeting did produce one substantial surprise: the Interstate Compact announced a public hearing to discuss whether it should dissolve. The fact is that a compact with three members, no matter how well motivated, just won't cut it, and nobody was beating a path to their door. But at the hearing, legislators from several states, including New York, Texas, New Jersey, and Missouri, showed up and avowed the intent to introduce the legislation in their states this year. Not only that, but the compact concept got another shot in the arm as an NAIC working group undertook to try to regulate life and annuity rates and forms via an interstate compact. The problem with compacts, as we have discovered, is that when they are powerful enough to make a difference the states won't have them, and the compacts the state bureaucracies will accept aren't powerful enough.

Can NCOIL and the legislators generate critical mass for the Receivership Compact? Can Commissioners Fitzgerald, O'Connell, and Montemayor navigate a useable Filing Compact between Scylla and Charbydis by the announced deadline of this summer? Stay tuned.

News From Headquarters

The IAIR Board of Directors Needs You!!

The Nominations Committee is now accepting applications for the IAIR Board of Directors. If you are interested (or you know an IAIR member interested) in serving a three-year term, please let us know. If you are nominating someone other than yourself, you must also submit a written statement from that person that if elected, they are willing to serve. The Nominating committee does not process any nominations without this statement from the nominee.

To serve on the Board of Directors you must be a current IAIR member, you must be willing to attend all Board meetings (which are generally held at the quarterly NAIC meetings). The election will be held at the December 2002 IAIR annual meeting in San Diego.

This year there are five positions expiring and one of those parties is not eligible to run again because they have served two full terms. We need at least two, but attempt to have three, candidates for each open position. We also try to have representation from all disciplines within the IAIR membership (i.e. receivership, guaranty fund, industry, etc.) as well as international and individuals with the AIR/CIR designations.

Nominees will be required to provide a brief paragraph describing their qualifications or why they would like to be elected, as well as a recent photograph, for the proxy mailing to the membership. The deadline for nominations is October 1, 2002.

If you want to submit a candidate's name, please e-mail Dick Darling, Chair of the Nominations Committee at ddarling@osdchi.com or contact Paula Keyes, Executive Director, at IAIRhq@aol.com.

The OSD Has A Website

The Office of the Special Deputy Receiver in Illinois has a website at www.osdchi.com. Check out the latest news about Illinois insolvencies.

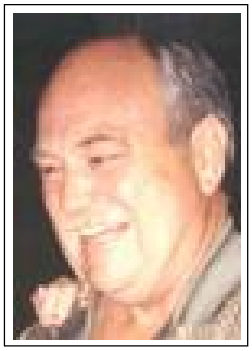
NAIC Receivership Contact Person Report

The NAIC Receivership Contact Person Report is now online at www.naic.org. Using the Regulators link, you will see two links to Contact List Regarding Insurers That Went Into Receivership Prior to 2001 and Contact List Regarding Insurers That Went Into Receivership in 2001.

Save This Date!!

On November 7 - 8, 2002 IAIR is co-sponsoring with the NCIGF a Joint Seminar to be held at the Hyatt in Henderson, Nevada. As more information becomes available, it will be provided both in this publication and on the IAIR website at www.iair.org under the Events & Schedule page.

In Memorium



David S. Baggett of Ft. Worth, Texas passed away after a valiant fight with lung cancer on Thursday, April 11, 2002 at his home with his family by his side. David was the owner of Regulatory Resources, Inc. and served as a Special Deputy Receiver for the Texas Commissioner of Insurance in several receivership estates. A member of IAIR, David was a CPA and previously, an insurance examiner in his home state, North Carolina. More importantly, he was a man of integrity who epitomized the definition of professionalism. He will be missed by his colleagues as well as his family. David was buried on his family lot in Jacksonville, North Carolina.

IAIR Roundtable Schedule

NAIC Meeting - June 8 - 12, 2002
Philadelphia, PA
IAIR Roundtable
June 8, 1:00 - 4:00 p.m.

NAIC Meeting - September 7 - 11, 2002
New Orleans, NA
IAIR Roundtable
September 8, 1:00 -4:00 p.m.
(Roundtable will be on Sunday)

NAIC Meeting - December 7 - 11, 2002
San Diego, CA
IAIR Roundtable
December 8, 1:00 - 4:00 p.m.

The ***INSURANCE RECEIVER***

is intended to provide readers with information on and provide a forum for opinion and discussion of insurance insolvency topics. The views expressed by the authors in *The Insurance Receiver* are their own and not necessarily those of the IAIR Board, Publications Committee or IAIR Executive Director. No article or other feature should be considered as legal advice.

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Accountant: Stephen Phillips, CPA, FLMI, AIR of Cunningham, Porter & Phillips

Reno IAIR Meeting Recap

by Robert Loiseau, CIR- P&C & Tom Clark

Board Of Directors Meeting

Members of IAIR's Board discussed a number of interesting matters along with business items such as approval of minutes and financial statements. Foremost among them was the announcement that IAIR now has more than 400 active members. While this is welcome news, it raised an interesting but unexpected issue: the per member per month administrative costs of running IAIR in some cases exceed the membership dues paid by organizations eligible for group discounts. Although discussed, no formal action was taken on this issue, but an increase in the group membership dues is likely to be needed.

The Annual Insurance Insolvency Workshop sponsored by IAIR turned a modest profit; a good result for IAIR's first formal education program without the imprimatur of the NAIC. The presence of Commissioners Mike Pickens (AR), Diane Koken (PA) and Terry Vaughn (IA) on the program contributed immensely to its value and undoubtedly served as a major draw as well. Other senior regulators responsible for insolvency oversight in their respective states included Betty Patterson (TX), Norris Clark (CA) and Belinda Miller (FL). Because this annual January program follows so closely after the holidays, the Board is considering moving it to early February in 2003 to allow more time for preparation, and facilitate even better attendance.

The Board also reviewed preparations that are under way for the NCIGF/IAIR training seminar. This program, which is held bi-annually, will be presented on November 7 and 8, 2002 in Henderson, NV. Interestingly, the host hotel is a waterfront resort approximately 20 miles from Las Vegas. The program, which is still under development, will focus on issues within the property and casualty segment of the industry and will involve an interactive format. Attendees will be heavily involved in insolvency related problems in hypothetical receiverships and rehabilitation plans.

Committee chairs gave their reports to the Board, summaries of which appear in the following section. IAIR's next Board meeting will be June 8, 2002 in Philadelphia between 9:00 AM and noon. Items requiring the Board's attention in executive session will be addressed between 8:00 AM and 9:00 AM so that IAIR members attending the Board meeting will not have to leave the meeting room and return after completion of the executive session. Attendance at these Board meetings is an excellent way for members to learn about and stay abreast of IAIR's activities; the meeting is open to all members, and attendance and participation is encouraged.

Roundtable Recap

The involvement of not one but two Commissioners in the afternoon's presentation signaled a change from years past where IAIR operated in virtual anonymity in relation to NAIC.

Kicking off the afternoon in typically lively style with a presentation on the state of the NAIC's recent meetings with Lloyd's, London representatives by Georgia Insurance Commissioner John Oxendine, who chairs the NAIC Surplus Lines Task Force. Commissioner Oxendine outlined for the participants several of the options proposed by Lloyd's in relation to concerns regarding its continued solvency in the aftermath of September 11 and worldwide economic downturns.

After a brief presentation from the various committee chairs to the assembled participants, the focus of the afternoon began. Under the creative direction of Trish Getty and Stephen Schwab - Bob Loiseau, Jonathan Bank, Mike Cass, Chris Fuller, and David Spector accomplished the near impossible – making a reinsurance mediation both informative and entertaining. The interests of the insolvent estate, Big Top Insurance Company in Liquidation, were represented by Messrs. Loiseau (Receiver) and Fuller (Estate Counsel), while the interests of the "solvent" reinsurer, Axis of Evil Reinsurance Company, were represented by Messrs. Cass (the Insurance Executive) and Spector (Company Counsel). Mr. Bank mediated. In a short span of two and one-half hours, interspersed with substantial input from the attendees, the players navigated a scenario in which Big Top's interest in resolving a substantial outstanding reinsurance recoverable to facilitate closure were counterbalanced by Axis' efforts to rescind the contract as a result of substantial MGA impropriety, not to mention Axis' own Reliance-related ailments. While the Receiver and Counsel did their able best to keep the issues simple and straightforward, Axis of Evil's Executive Office and Counsel provided parries sufficient enough to show how resolution had evaded the parties to the point. Adding a dose of political reality (there's such a thing?) to the discussions was Commissioner Jose Montemayor, who instructed his Receiver to settle it now due to substantial concerns about the continued longevity of Big Top as a result of its business practices while supplying the all too familiar gig – "I'm disappointed that this hasn't settled already." With reinvigorated perspective, the parties saw through their own legal arguments, faced the reality of the situation, and reached settlement. While the nature of the dispute was well known to the majority of the attendees, the presentation served as perfect illustration of how mediation can provide a forum more suited to resolving disputes between entrenched parties whose legal positions are relatively equal.

Committee Activities

Liz Lovette's opening remarks at the Roundtable, in which she solicited greater committee involvement by members generated an immediate response; every

committee meeting attended by this reporter had new faces present. Some came to see what particular committees were doing, while others signed up for committee membership and went right to work. The influx of new blood was welcomed by each committee chair, and in some cases, new committee members immediately took on responsibilities and began making substantive contributions to the committees' activities. The following is a brief summary of the various committees' activities, and their status at the Reno meeting.

Accreditation And Ethics Committee

This continues to be one of IAIR's most active committees. It has ongoing responsibility for conferring CIR and AIR accreditations, monitoring continuing education credits of those designees and addressing ethical issues that arise from time to time. One of this committee's highest priorities is updating IAIR's Code of Ethics that was adopted shortly after the association's organization and then largely neglected. Committee member Dan Orth agreed to be the principal draftsman of a new Code of Ethics, which will be considered at the committee's June meeting in Philadelphia. Although subject to change, modification and adoption by the Board of Directors, the goal is to articulate the ethical standards applicable to IAIR's members generally, along with the higher standards applicable to holders of the CIR and AIR designations. The committee also addressed separate issues with respect to those designations. The CIR designation is in the process of being trademarked with the United States Patent Office, and, not surprisingly, the examiner (being largely unfamiliar with insurance receivership) requested additional documentation and information concerning receivership activities and the Certified Insurance Receiver (CIR) designation itself. Committee members also began reviewing the AIR designation to consider whether it should be renamed in a manner reflecting its current status as a specialization certificate, compared to an overall receiver's accreditation. This will also be addressed at the June meeting, and members' views and opinions on the AIR title and function are invited. Please convey comments to any committee member for discussion at the next meeting, or make it a point to attend and participate.

Membership Committee

As noted in the President's Message, the Membership Committee must be doing something right, because membership in IAIR has reached an all time high. With membership applications being timely approved by the committee after processing by IAIR's executive director, Paula Keyes, the committee focused its attention on whether IAIR has now reached a critical mass where it can provide membership benefits to its members. Such benefits could take many forms, from discounted office supplies to reduced room rates and travel expenses for IAIR members, similar to benefits afforded regulators who attend quarterly NAIC meetings. As with the Accreditation and Ethics Committee, member input on this topic is both welcome and actively solicited.

The involvement of not one but two Commissioners in the afternoon's presentation signaled a change from years past where IAIR operated in virtual anonymity in relation to NAIC

Publications Committee

Having now attended many Publications Committee meetings, this reporter can personally attest to the committee's greatest need and recurring theme: finding topical articles for the Insurance Receiver which are relevant to IAIR's membership and which bring fresh perspectives and new information to them. While there are always plenty of articles "in the pipeline" the Editorial Board is sometimes hard pressed for articles as deadlines are looming. While one of the duties entailed in membership on this committee is twisting colleagues' arms to write articles for the newsletter, unsolicited articles are always welcome, and usually make their way into print. The Publications Committee continues to change and improve this newsletter; in the next issue readers are encouraged to note the new format of the Receivers' Achievement Report. The table of information about receivers' achievements from around the country will be changed to present achievements in a more consistent and user-friendly format. The committee also needs new volunteers to serve as Zone Reporters and State Contact Persons. Specifically, reporters are needed for the following zones: Southeastern Zone – Florida, Midwestern Zone – Kentucky and Western Zone – California.

Marketing Committee

The Marketing Committee is charged with heightening IAIR's profile within the industry and among members of the regulatory community. In this case, "marketing" takes many forms. Preparation of IAIR's Resource Directory, and its complimentary distribution to insurance commissioners and their senior staff responsible for receivership activities is one example. Another is the series of presentations about IAIR activities made to regulators at their periodic NAIC conferences. These presentations have now been made to each NAIC zone and the results are already manifesting themselves; insurance commissioners and their top insolvency staffers have become frequent speakers, attendees and participants at IAIR's Roundtables and formal educational programs. Heightened familiarity with IAIR by regulators and members of the judiciary is among the most important activities in which IAIR's Marketing Committee engages.

Managed Health Care Task Force

This group took a well-deserved break from more than two years of quarterly meetings and did not convene in Reno. The Task Force will meet again during the June conference to consider where its efforts can be best utilized going forward.

Reinsurance And Assumption Agreements: Does Insolvency Support A Novation?

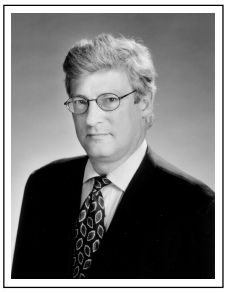
by Robert M. Hall

I. Introduction

In the parlance of the insurance industry a "reinsurance and assumption agreement" is the contractual vehicle by which a book of primary insurance business is moved from one primary insurer to another primary insurer. In fact, this transaction is a novation rather than a reinsurance transaction. As of a particular date, the insurer which takes over the book of business (the "assuming insurer") is substituted for the insurer which issued the policies (the "original insurer"). Typically, the original insurer pays the assuming insurer the unearned premiums as of the effective date of the transfer and the assuming insurer is responsible for claims occurring after such date. The original insurer retains the premium earned prior to the effective date as well as reinsurance, salvage and subrogation recoveries on losses which occurred prior to such date. New and renewal business is the responsibility of the assuming insurer. In effect, one primary insurer replaces another.

There are a number of reasons why reinsurance and assumption transactions take place. Sometimes insurers make a corporate decision to exit a line of business and this is one of the faster ways of doing so. The transactions also occur when an insurer, typically a life insurer, has encountered financial difficulties and the insurer, or its receiver, wishes to sell the book of business in order to raise liquid assets and preserve the value of the insured's accrued value in the policy. The specter of insolvency highlights the issue of policyholder consent to the novation. As the court observed in Vetter v. Security Continental Insurance Co., 567 N.W. 516 at 521 (Min. 1997):

Insurance policies are contracts and unless there are statutory provisions to the contrary, general principles of contract law apply. (Citation omitted) As a general rule, and in the absence of a contractual provision to the contrary, an obligor on a contract may assign all beneficial rights to another, or may delegate his or her duty to perform under the contract to another, without the consent of the obligee. (Citation omitted) Notwithstanding the assignment, however, the original obligor remains responsible for performance on the contract and if performance is substantially different from that required of the original obligor, the original obligor may be liable. (Citations omitted) In substance, [sic] original obligor may not divest itself of liability without the consent of the obligee. (Citations omitted) If the obligee consents to the delegation of duties, and agrees to release the original obligor from its responsibilities under the contract, a substitution of one party for another – or novation – occurs. (Citations omitted) [1]



The purpose of this article is to examine case law relating to reinsurance and assumption transactions to determine the circumstances under which an enforceable novation has taken place between the policyholder and the assuming insurer.

II. Novations When the Original Insurer is in Receivership

Most case law dealing with a novation as a result of a reinsurance and assumption transaction arises in the context of the original insurer being in receivership or subject to disciplinary action. In this context, approval of the assumption and reinsurance transaction by a court and/or the insurance department is a very significant factor in supporting the finding of a novation..

A. Cases Finding a Novation

A common fact situation in litigation over reinsurance and assumption agreements is an insured or beneficiary whose benefits under the coverage provided by the assuming insurer are less favorable, in one fashion or another, than the coverage provided by the original insurer. An example is Kuhl v. General American Life Ins. Co., 192 S.E. 831 (Ga.1937) in which a life insurance policy lapsed but the value of the policy was used to purchase term insurance. Pursuant to court order, and with insurance department approval, this business was reinsured and assumed by an insurer whose coverage granted term insurance for a lesser period. The insured died before the expiration of the original period but after the assuming insurer's period. The assuming reinsurer had sent the insured a certificate to attach to the policy noting the lesser period but the beneficiary claimed that the certificate was insufficient notice without the reinsurance and assumption agreement itself and that it should not be binding on her. The court disagreed stating:

"The insured could not accept part of the certificate and reject others, and must be deemed to have accepted it according to its terms. The acceptance of this certificate by the insured bound him to the terms of the purchase agreement referred to therein, whether a copy was mailed to him or not. There is no allegation that any effort was made to obtain a copy of the agreement and the insured was at liberty to refuse to accept the certificate if a copy of the purchase agreement was withheld from him. The insured having retained the certificate in silence, his beneficiary will not now be heard to contend that the certificate and

the purchase agreement did not constitute the agreement between the insured and the defendant."[2]

A case purporting to state the general rule in such matters is Jeffett v. American Ins. Co. of Texas, 280 S.W.2d 395 (Ark.1955). The insured was receiving disability payments when his insurer became insolvent and the book of business was reinsured by another insurer with insurance department approval. The insured received a certificate notifying him of the transfer and giving him the option of proceeding against the estate or receiving fewer monthly disability payments but did nothing until the disability payments ran out. The court ruled that a novation had taken place stating:

"The general rule as to reinsurance contracts is that the reinsurer is to be held liable either under its reinsurance contract or upon a subsequent agreement made between it and the assured, and that [sic] assured has the right to accept the reinsurance offered him, or to sue the original company for damages. If he accepts the reinsurance contract and pays premiums to the reinsurance company, he is bound by the terms of the reinsurance contract, and cannot recover from the reinsurance company on the old policy unless the reinsurance contract in terms, or by necessary implication, contains an agreement to assume or be responsible on the policy reinsured."[3]

Kriss v. Bankers Life and Casualty Company, 335 P.2d 90 (Ok.1959) involved a benefit certificate issued by a mutual benefit association wherein the beneficiary paid an assessment on the death of other members. The benefit association became insolvent and with the approval of the insurance commissioner, the business was assumed by another insurer who billed on a monthly basis and which provided a certificate of assumption which contained notice of the assumption and sufficient information for the insured to calculate the limits available for the premiums paid. The book of business went through several additional reinsurance and assumption transactions before the insured died. The beneficiary sought the limits offered by the mutual benefit association which were higher than those offered by the assuming insurer. The court rejected the beneficiary's arguments ruling:

"Plaintiff further concludes that the named companies did not advise the insured of the terms of the reinsurance agreement and that therefore she is not bound thereby. As has been seen, the Commissioner of Insurance in 1937, under the provisions of (citation omitted) approved the sale of the defunct Damon Co. to the Santa Fe Co. That approval validated the reinsuring contract without more, under the record before us. The failure of the purchasing company to mail copies of the agreement to Damon policyholders did not invalidate that contract."[4]

There are a number of reasons why reinsurance and assumption transactions take place

Two much traveled policies were involved in Garretson v. Western Life Indemnity Co., 157 N.W. 160 (Iowa1916). One policy was reinsured and assumed six times after it was issued by a company that was placed in receivership and other was reinsured and assumed three time. At least the original transfers were approved by a court and the relevant insurance department. The insured received various riders to his policies and certificates subjecting coverage to the reinsurance and assumption agreement executed by the assuming reinsurers and the insured paid premiums to the assuming insurers. When one policy lapsed, he reinstated it with one of the assuming insurers. Under the circumstances, the court found that the original policies had been terminated, that the insured had accepted coverage from the assuming insurers and that the assuming insurers were not required to provide the level of benefits contained in the policy issued by the original insurer.

Green v. American Life and Accident Ins. Co., 112 S.W.2d 924 (Mo.Ct.App. 1938) involved two life policies which were issued by a company which became insolvent, were assuming by another company which became insolvent and then were assumed by the defendant. The transfers were pursuant to court order and with the assent of the relevant insurance departments. The insured understood that the policies were assumed and paid premiums to the assuming insurers. The insured received a notice from an assuming insurer that reduced the duration of term insurance that would be purchased should the insured default on his premium payments. The insured defaulted on premiums and then died after the term insurance purchased by the assuming insurer expired but before the date that the term insurance provided by the original insurer would have expired. The court ruled that the insured had elected to be insured with the assuming insurer and was bound by the terms and conditions of the coverage provided. The court went on to comment on the receivership context:

"This is no case of a private reinsurance agreement entered into between two companies where the assent of the policyholders to any change would be required, but here the reinsurance agreement was entered into by virtue of a court order which was made in the course of the receivership proceeding in which all the policyholders were represented by the superintendent of the insurance department and by the result of which they were no less bound than if their names had appeared as actual parties to that suit. Once a policyholder elected to pay his premiums to defendant, the latter became liable to such policyholder, not, however, to the extent originally provided in the policy, but only to the extent of the liability it had assumed under the reinsurance contact."[5]

Johnson v. American Life and Accident Ins. Co., 145 S.W. 2d 444 (Mo.Ct.App. 1941) re-examined the same reinsurance and assumption agreement as in the previous case. The agreement contained a provision placing a lien on the reserve value of the policy so that if the policy lapsed, the amount of term insurance that could be

(Continued on page 12)

Reinsurance And Assumption Agreements

purchased was shortened in duration. The insured never received a copy of the reinsurance and assumption agreement but did pay premiums to the assuming insurer and reinstated the policy after it lapsed once. When the policy lapsed again, the insured died after the term insurance provided by the assuming insurer expired but before the term insurance under the original policy would have expired. In addition, there was a failure to comply with a state statute which required the assuming company to provide the insurance department with each insured's benefits pursuant to the reinsurance and assumption transaction and for the department to provide this to each insured. The court ruled that the statute was directory and not mandatory. In addition, the court ruled for the assuming insurer noting that the original policy was terminated by court order and that the insurance department had approved the assumption of business. Going further, the court stated:

"[T]he rights of the policyholders, if they elected to continue their insurance with the reinsuring company instead of making a claim to their proportionate share of any assets of the insolvent company, were to be measured by the terms and provisions of such reinsurance agreement; and that the limitations upon the reinsuring company's liability, as fixed by the reinsurance agreement, did not depend upon proof of actual notice to the policyholders, whose election and consent to accept the same were to be taken as evidence by the fact of their payment of premiums to the reinsuring company." [6]

The insured received a new policy form, and paid premiums to, the assuming insurer after the insolvency of the original insurer in Western Life Indemnity Co., 145 N.E. 786 (Ind.Ct.App.1924). However, the new policy lapsed and the reinstatement rights were more liberal in the original policy than in the new one. The insured died after the interval to reinstate under the new policy expired. The court ruled: "When the appellee and her husband accepted the provisions of a new policy from appellant, the rights and liabilities of appellant and appellee were measured by the provisions of that contract and of the policy issued by appellant . . ." [7]

Two cases on a related subject involve objections by shareholders and policyholders in the receivership court to proposed reinsurance and assumption transactions. Neblett v. Carpenter, 305 U.S. 297 (1939); Ballou v. Davis, 75 F2d 138 (7th Cir.1935). In both cases, the recommended agreements were upheld. With respect to certain objecting policyholders, the Supreme Court noted: "The alternative open to all is to dissent from the plan and to prove their claims for breach of their policy contracts against the liquidator of the old company." [8]

There are a few cases in which the courts have found there to be no novation despite the approval of the transactions by a court and/or insurance department

B. Cases Finding No Novation

There are a few cases in which courts have found there to be no novation despite the approval of the transaction by a court and / or insurance department. One is Baer v. Associated Life Ins. Co., 248 Cal.Rptr. 236 (Ct.App.2nd Dist. 1988) in which the original insurer was given a cease and desist in California and entered into a reinsurance and assumption transaction with the assuming insurer pursuant to insurance department approval. The assuming insurer subsequently was placed in receivership. An insured of the original insurer received disability benefits from assuming insurer after the reinsurance and assumption transaction. When the assuming insurer was placed in receivership, the insurer sought to collect from the original insurer. The court ruled there was no consent to the novation on the part of the insured:

"(The original insurer) contends that appellants submission of their claims to (the assuming insurer) is evidence of their approval of the Reinsurance and Assumption Agreement. However, it is clear that appellants were given no meaningful or effective alternative. They had no opportunity to object to the agreement before it was executed and approved by the insurance commissioner. Faced with the need for continuing and extensive medical treatment, appellants had no choice but to submit their claims for payment of medical benefit to (the assuming insurer). Their doing so does not reach the level of approval needed for us to find a novation." [9]

Another receivership case in which no novation was found is Protective Life Ins. Co v. Tibbs, 91 S.W.2d 593 (Ark.1936). When the original insurer was placed in receivership, the book of business was reinsured and assumed pursuant to court and insurance department approval. The reinsurance and assumption agreement granted the assuming reinsurer a lien against the reserve of the life policy subject to the lien being removed by payment of premium. The assuming insurer issued to the insured a rider to the policy which attached a copy of the reinsurance and assumption agreement. The insured declined to pay any further premium and when he died, his estate sought the face value of the policy. The court ruled in favor of the assuming insurer:

"From construction of the contract of assumption it follows that appellee is not entitled to recover the face value of the policy of insurance from (the assuming insurer) because neither he nor the insured accepted the re-insurance plan by actually paying future premiums to appellant, but, on the contrary, repudiated the plan by refusing to pay such premiums." [10]

C. Comments on Novations When the Original Insurer is in Receivership

It is evident from the case law that courts examining the impact of a reinsurance and assumption transaction after the fact give considerable deference to an insurance department or receivership court which approves the

transaction as the best means of salvaging for policyholders the value of their policies. Nonetheless, it would be wise for those effecting the transfer of a book of business from an original insurer which is in receivership to give insureds an explicit choice of: (a) making a claim in the estate for damages for breach of contract; or (b) accepting substitute coverage from the assuming insurer, with the coverage described in considerable detail. In addition, it is advisable to inform insureds that payment of premium to the assuming reinsurer or reinstatement or alteration of the coverage provided by the assuming insurer will be deemed acceptance of the transfer.

III. Novations Unrelated to Receivership of the Original Insurer

A. Cases Finding a Novation

The issue in Northwestern Nat. Life Ins. Co. v. Gray, 161 F. 488 (D.Neb.1908) was whether the insured could collect the face amount of the original policy from the assuming insurer. When the assuming insurer entered the assumption and reinsurance transaction, it provided the insured with notice of the transaction as well as notice that the face amount of his policy would be reduced. The insured continued to pay premiums until the policy matured. The court ruled in favor of novation holding:

"Without hesitation, so far as this record discloses, and presumably with full knowledge of the provision made for him in the event he concluded not to accept the proposition, and with like full knowledge of the remedies available to him for the breach of his contract, (the insured) elected to accept and did accept the terms offered to him by the new company. He entered upon the performance and continued in the performance of the terms agreed upon for a period of 4.5 years until his certificate matured. This amounted to a novation, a new contract voluntarily entered into by (the insured), and he cannot now repudiate it. His election was final and conclusive." [11]

The assumption and reinsurance agreement did not allocate responsibility for deaths prior to the effective date of the agreement in American Public Life Ins. Co. v. Stambaugh, 456 S.W.2d 953 (Ct.Civ.App.Texas 1970). It appears, however, that the reserve liability for an individual who died prior to the effective date was part of the consideration paid to the assuming insurer. The court held that the assuming insurer was liable to the beneficiary stating:

"Where . . . an insurer unqualifiedly assumes all obligations and liabilities of policies of insurance of another insuring company in exchange for a valuable consideration, then the insured may hold the assuming insurer liable under the terms and conditions of the policy so assumed. Where one company acquires funds from another for the specified purpose and agreement of payment of claims of designated policyholders, then no justification or reason exists for the assuming company to refuse payment to policyholders who had no knowledge of nor consented to the intercompany agreement." [12]

B. Cases Finding No Novation

Vetter v. Security Continental Ins. Co., 567 N.W.2d 516 (Min.1997) involved group annuity contracts issued to employee pension plans. Two related companies wished to transfer the book of business. After the transaction occurred, notice was given to the trustee of the pension plan that the transfer would be effected on payment of premium to the assuming insurer or within 20 days unless the contract holder objected. The trustee was not told that by not objecting, the original insurer would be released. The assuming insurer became insolvent and the trustee sought to collect from the original insurer. The court ruled that there was no novation since a state statute required that the original insurer remain liable for the default of the assuming insurer absent a written instrument, signed by the insured, releasing the original insurer.

The trustee was not told that by not objecting, the original insurer would be released

In Barnes v. Helka Fire Ins. Co., 57 N..W. 314 (Min.1893) a policy was assumed by an insurer which later became insolvent after the insured suffered a fire loss. It does not appear that there was any agreement between the insurers or with the insured that the assuming insurer would be substituted for the original insurer. The court ruled that the insured could recover from the original insurer stating:

"Unless there was a substitution of debtors, in the nature of a novation, between the three parties, upon the (insured's) consent to the new agreement, the (insured) has not waived or lost her right of action against the (original insurer). A creditor . . . may prosecute as many (remedies) as he has, as in the case of several debtors. And so, if, in this instance, the remedy against the insolvent company, as respects the plaintiff, was merely cumulative, there is no reason why she might not pursue both." [13]

The insured in Clair v American Bankers Ins. Co., 137 S.W.2d 969 (Ct.App.Mo.1940) received notice of the reinsurance and assumption and paid premiums to the assuming reinsurer before the policy lapsed for nonpayment of premium. While the court seemed skeptical that a novation had taken place, its consideration of this issue was pre-empted by its finding that the reinsurance and assumption agreement was not in compliance with state statute requiring advice to the insurance department which would provide an opportunity for objection by interested parties. Therefore, the agreement was ruled a nullity.

In Epland v. Meade Insurance Agency, 545 N.W.2d 401 (Ct.App.Min.1996), the court left to the jury the issue of whether a novation took place but the court's dicta suggests a high standard to prove a novation. The insureds had a hospital liability policy which was reinsured and assumed twice. After the first transaction, the insureds received notice of the transaction which contained a statement that payment of premium to the assuming insurer would release the original insurer. The insureds

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paid premium to the assuming insurer until the policy was reinsured and assumed again. The second assuming insurer gave notice of the transaction and directed the insureds to pay premiums to it. The insured failed to so pay premiums, since it was seeking another insurer, and the policy lapsed. When a loss occurred, the insureds tried to collect from the original insurer. Finding that novation was a matter of intent, the court found that this was an issue for the jury. However, the court commented:

"Respondent insurance companies never sought or allowed for the (insureds') consent. They completed the sale of the policies and then informed the (insureds) they had new insurers. As far as the (insureds) knew, they had only one choice - pay the premiums or lose coverage." [14]

C. Comments on Novations Unrelated to Receivership of the Original Insurer

Without the supporting aura of an insurance department or receivership court approval of an assumption and reinsurance transaction, it is even more important to assure that insureds are informed consumers. They should be informed explicitly that they can: (a) reject the transfer (but be non-renewed at anniversary); or (b) accept the substitution of the assuming insurer which will provide the coverage described in some detail in the notice. In addition, insureds should be: (c) given a fixed amount of time to reject the transfer; and (d) informed that in the absence of explicit rejection of the transfer, that payment of premium to the assuming insurer or reinstatement or alternation of the assuming insurer's coverage will be deemed to constitute acceptance of the transfer.

IV. The Frankel Factor

While not dealing specifically with novations, there are several recent decisions involving insurers controlled by Martin Frankel entering into reinsurance and assumption agreements. They demonstrate the need to finalize the agreement and obtain all necessary regulatory approvals before assets are transferred.

In Peoples Benefit Life Ins. Co. v. Dale, 1999 U.S. Dist 22253 (S.D. Miss), the plaintiff insurers contracted to transfer a book of business to First National Life Insurance Company along with $14 million to cover liabilities. These funds were placed in a depository controlled by Martin Frankel who also controlled First National. The transaction allegedly was conditioned on the approval of First National's domiciliary insurance commissioner. Instead, the commissioner placed First National in receivership. Plaintiff insurers sued for a return of the $14 million fund bu the federal district court abstained, deferring to the liquidation court:

"The Court finds that Burford abstention is appropriate in this case to the extent Plaintiffs ask this Court to determine who owns the $14 million fund. By declining the opportunity make this determination, the Court avoids interfering with "state efforts to establish a coherent policy with respect to a matter of substantial public concern," which in this case is the administration of the liquidation estates of [First National and an affiliate]. (Citation omitted) This is especially true in light of the fact that the rehabilitation and liquidation statutes of Mississippi and Tennessee provide procedures for litigating disputed claims, which provide an "opportunity for ventilation of the claim Plaintiffs make to the $14 million fund. (Citation omitted) " [15]

The result is the possibility that the plaintiff insurers will be held to be general creditors of First National. If this occurs, the plaintiff insurers will have to pay claims on policies they sought to transfer to First National plus $14 million to First National's policyholders.

A similar situation is presented by Huff-Cook, Inc. v. Dale, No 1:99CV00109 (W.D. Va. March 29, 2001) Settlers Life agreed to transfer a book of business to First National along with $44.8 in assets. It was alleged that the reinsurance agreement did not meet regulatory standards and that proper regulatory approval was not obtained. Nonetheless, $44.8 million was transferred to First National and Martin Frankel promptly absconded with it. Settlers became insolvent, its shell was sold and Huff-Cook, the former parent of Settlers, was allowed to bring an action to recover the $44.8 million. Huff-Cook sought a constructive trust over any portion of the $44.8 million which could be located. The receiver of First National asked the federal district court to abstain. The court stayed the action pending a resolution of the issue in the Mississippi liquidation court.

V. NAIC Assumption Reinsurance Model Act

Due to concerns about the transfer of books of business without policyholder consent, the National Association of Insurance Commissioners ("NAIC") adopted the Assumption Reinsurance Model Act ("Model Act") in 1993. According to the NAIC, similar legislation has been adopted in nine states and an additional seven states have related legislation in effect.

This Model Act excludes transactions with an insurer in receivership and also excludes those in which a guaranty association is a party, as long as policyholders do not lose rights or coverage.[16] All other transactions can be effected only with the prior insurance department approval which is based on a number of criteria listed in the Model Act, including the requirement that the assuming insurer be licensed in the states in which insureds reside.

All reinsurance and assumption transactions which are subject to the Model Act must meet very stringent standards to effect a novation with insureds. The Model Act requires explicit notice to insureds, such notice to include:

- Identification of the parties, relevant insurance departments supervising the transactions and contact people
- Procedures for accepting or rejecting the novation
- Five years of rating of both

companies from two nationally recognized rating agencies

- Balance sheets for both companies for the last three years and the Management Discussion and Analysis for the previous year
- An explanation of the reasons for the transaction [17]

Policyholders have the right to reject the novation by returning a pre-addressed, postage paid card provided by the insurer. Policyholders have the right to pay premiums to the assuming insurer for 24 months but reserve the right to object to the transfer. At the end of 24 months, the assuming insurer can send a second notice and consent will be deemed unless the insured affirmatively rejects the transfer.

The Model Act is well designed to protect policyholders from being involuntarily transferred to weak insurers. It does this, however, by making a reinsurance and assumption transaction less attractive as a means of moving a book of business between two solvent companies. The purpose of such transactions is to move business as of a particular date, to eliminate (or at least run off) administrative functions, to move unearned premiums reserves off the books and avoid reserving for losses after the transaction's effective date. Since the insurers involved may not know which insureds are transferred and which are not for over two years, accounting statement preparation and administrative functions are complicated and redundant. A sale of renewals becomes a more attractive, less regulated (albeit more attenuated) method to exit a book of business.

VI. Conclusion

There is a surprisingly large number of cases dealing with the esoteric topic of reinsurance and assumption agreements. Most such cases arise when: (1) original insurer is insolvent, the assuming insurer alters coverage to make the product more viable financially and the insured does not understand that his or her coverage has changed: or (2) after the reinsurance and assumption transaction, the assuming insurer becomes insolvent and the insured wishes to collect from the original insurer.

While not dealing with specifically with novations, there are several recent decisions involving insurers controlled by Martin Frankel entering into reinsurance and assumption aggreements

In the first such situation, courts hearing such claims give considerable deference to the insurance department and receivership court in best trying to preserve the value of the insureds' policies. Nonetheless, case law suggests that it is wise, at a minimum, to give the insureds a choice as to whether to make a claim against the estate or accept new coverage and to inform them that accepting new coverage is a substitution of the assuming insurer for the original insurer.

In the second situation above, there is no receivership court approving the transaction and insurance department approval may be unnecessary. As a result, it is wise to be even more explicit concerning the nature and impact of the transaction, to provide a limited period to object and to identify those acts which will be deemed to constitute acceptance of the substitute coverage offered by the assuming insurer.

To the extent that insurers contemplating the transfer of a book of business are subject to the NAIC Assumption Reinsurance Model Act or a close equivalent, they should consider a sale of renewals as a more practical alternative.

Mr. Hall is of counsel in the Washington D.C. office of Piper Marbury Rudnick & Wolfe. He is a former insurance and reinsurance executive and acts as an insurance consultant as well as an arbitrator and mediator of insurance and reinsurance disputes. The views expressed in this article are those of the author and do not reflect the views of Piper Marbury Rudnick & Wolfe or its clients. *Questions or comments may be addressed to the author at bobhall@qsilver.net.*

Endnotes

[1] 567 N.W.2d 516 at 521.
[2] 192 S.E. 831 at 833.
[3] 280 S.W.2d 396 at 397 .
[4] 335 P.2d 90 at 94.
[5] 112 S.W.2d 924 at 928.
[6] 145 S.W.2d 444 at 447.
[7] 145 N.E. 786 at 792 - 3.
[8] 305 U.S. 297 at 303.
[9] 248 Cal.Rptr. 236 at 239.
[10] 91 S.W.2d 593 at 596.
[11] 456 S.W.2d 953 at 955.
[12] 545 N.W.2d 401 at 406.
[13] 57 N.W. 314 at 315.
[14] 545 N.W.2d at 407.
[15] 1999 U.S. Dist. Lexis 22253 at 9.
[16] Model Act Sec. 2 B. (4) and (5).
[17] Model Act Sec. 4.
[18] Model Act Sec. 5.

"Standard" Provisions In Reinsurance Contracts: Whose Standard And In Whose Best Interests?

By Paul Walther, CPCU, ARe

Introduction

As the contract wording contains the terms and conditions which govern the relationship between the parties to a reinsurance agreement, the drafting of that document is, or should be the most important element of the negotiation process, perhaps even more important than the initial determination of coverage and price. In the interest of economy and expedience, the covernote or slip provided by the intermediary or reinsurer will focus primary attention on such important ingredients as premium, commission, retention, and limit, but generally make only passing reference to the "operational" clauses which will appear in the final contract. More specifically, the covernote will likely detail the key coverage and pricing elements of the contract, but merely include a list of "other clauses" deemed to be of the standard or boiler plate variety, and presumed unlikely to give rise to any concern in consummating the reinsurance agreement. In all fairness, a clear and concise summary of the coverage and pricing aspects of a reinsurance contract is generally perceived as the initial evidence of the parties' respective commitments to their future obligations. Said another way, the covernote summary of terms is a snapshot of a skeletal structure which will eventually require a fleshing out in order to evolve into an effectively working organism. Quite often, however, it is the failure and delay of that fleshing out process, as well as the merely incidental attention paid to the operational aspects of the reinsurance contract, which give rise to the acrimonious contentions causing a break-down of relationships and the need for eventual dispute resolution. How and why does such failure come about? In large part, the answer lies in the general nature of the negotiation process itself.

The Negotiating Process

Firstly, it must be acknowledged that negotiation of reinsurance contracts is an important and critical responsibility of a ceding company's corporate management, a process which in fact, may be essential to a company's financial solidity and very survival. It is therefore understandable that senior executives should take a lead role in that process. Unfortunately, however, there may be instances where a company's negotiating team may be limited to only a few senior executives who focus on the macro view of the reinsurance "forest" and who leave the more micro aspects of pruning the contractual "trees" to other members of the operational units. Similarly, the reinsurer's negotiating team will be generally staffed by senior representatives from the intermediary and/or the reinsurers responsible for determining the extent of reinsurers' future loss obligations, as well as the necessary premium required to assume such obligations. Those executives are also more than likely to focus on the macro aspects of their own reinsurance forest, leaving the micro and tree-pruning details of the contract to their administrative staff for subsequent attention. At this point, it is important to emphasize that it not inherently wrong to embark on a reinsurance relationship based on a simple skeletal set of parameters which outline future obligations. What is critical, however, and what causes relationships to come undone and disputes to arise, is the absence of effective communication thereafter, as well as the failure to record and agree to the operational aspects of the relationship which provide flesh to that skeleton. As the saying often goes: "the devil is in the details."

Drafting The Contract

There is also another aspect of the customary negotiating process which exerts considerable influence on the operational aspects of a reinsurance relationship; namely, the contract drafting process.

Quite clearly, the process has to start somewhere, and that responsibility normally falls on the shoulders of "back room" professionals employed by the intermediary, or the reinsurer in a "direct writing" relationship. Those specialists charged with word-smithing the contract will begin the process by analyzing the covernote or slip, including the notes and memoranda supplied by the negotiating executive, and then incorporating the previously agreed terms and conditions within a standardized format.

Where does the standard form come from? Well, that form is likely to have evolved over time, and is the product of many, many negotiations with other cedents in the intermediary's and/or reinsurer's inventory of clients which have preceded the current relationship requiring implementation. Additionally, the wording is likely to include the same or variations of clauses which have been published by the Broker and Reinsurance Market Association (BRMA), and the London Market Wordings Database. However, neither facility has seen fit to actually recommend the use of any particular clauses or wordings to address the various issues involved.

In that regard, the drafting party will most always be a representative of the intermediary or reinsurer who will include those operational provisions which generally reflect that party's own preferences, but which may or may not have been discussed with, or be preferable to the cedent. It is also conceivable that the draft wording may not even include material clauses or provisions of importance to the cedent, nor to certain reinsurers participating through the services of an intermediary.

At this point, it should be mentioned that, when an intermediary is involved in the placement process, such intermediary is deemed to be the agent of the cedent, despite the fact that the intermediary's compensation normally emanates from the reinsurers. As such, the intermediary is charged with representing the cedent's best interests in the negotiating process. Nevertheless, it is probably quite unlikely that the intermediary will have discussed various operational sections of the contract with the cedent prior to the drafting process.

Admittedly, it would also be unrealistic to expect the parties, including the document wording, to cover every single issue which might arise during the contract term; nevertheless, it is important to address those issues considered most likely to arise during the reinsurance relationship.

As a result, it is therefore essential that the ceding company, as well as all participating reinsurers through an intermediary, analyze the draft wordings with great care. Furthermore, that process should include analysts representing such key operating units as Accounting, Claims, Legal, Systems, and Underwriting in order to pinpoint any elements of "standardization" which may be contrary to the company's operating requirements and general interests.

Unfortunately, such involvement probably does not occur nearly as often as it should; nevertheless, it remains extremely important that the final document contain clear and concise wording to properly reflect the true intentions of both parties to the agreement. Furthermore, reinsurance contracts are not written, nor can they be expected to function in a vacuum. Contractual relationships will be subject to various influential developments over time, and it is important that contracts be reviewed and amended to reflect changing circumstances.

One additional issue of considerable importance will be the degree to which a given reinsurance agreement dovetails with other reinsurance contracts in a company's program. Consistency and concurrency of terms among all cedent contacts is of paramount importance in order to avoid coverage and operational gaps which often lead to contentious dialogue among reinsurance participants.

A clear and concise summary of the coverage and pricing aspects of a reinsurance contract is generally perceived as the inital evidence of the parties' respective commitments to their future obligations

Contract Provisions

In considering the desirable level of "standardization" in a reinsurance contract, it may be instructive to touch on the wording of certain clauses which might suggest alternative or manuscripted attention to address certain issues.

Reassured Name

- Does the contract cover the business of just the companies listed in the wording, or all members of a group regardless of whether such companies are listed?
- Does the contract cover a company's quota share reinsurers, and if so, does the reassured name include such reference?

Term and Termination

- Does the provision deal with incoming and outgoing portfolios?
- In addition to the matter of covering new and renewal policies, do the parties intend to cover "in force" exposures?
- Does the contract allow for re-cession of multi-year policies at the anniversary date, even though the original inception of such policies was prior to the inception date of the contract?
- Perhaps more importantly, what about the unearned premium and outstanding loss portfolios at termination? Will the contract be cut off, with return of the unearned premium, or be allowed to run off, and at which party's option?

Quite often, the wording will include a Special Termination clause which gives either or both parties a right of cancellation based on special circumstances, primarily an adverse change in a party's financial condition.

- Are those terminating circumstances reasonable?
- How much notice is required, and in what form?
- Will coverage for the existing portfolio be run off or cut off?
- Does the special termination wording also address the nature and timing of premium and/or commission adjustments?

Territory

- Will the contract cover loss anywhere in the world, regardless where the subject policy is issued?

Exclusions

- Are there any potential conflicts between the "general" and "specific" exclusions?
- How are "incidental" exposures treated with respect to excluded categories? Is there a grace period for coverage, and if so, for how long?
- If primarily designed to cover a cedent's primary exposures, does the contract exclude any and/or all of that company's Assumed Reinsurance, even if incidental?

Limit and Retention

- For excess of loss contracts, are reinstatements limited or unlimited, and at what price?

"Standard " Provisions In Reinsurance Contracts)

Ultimate Net Loss

- Are loss adjustment expenses covered, and if so on what basis - in full as part of the loss, or on a proportional basis?
- Are Declaratory Judgement Expenses (DJ's) covered or not, and if so on what basis?
- What about Loss in Excess of Policy Limits (XPL) - covered or not? If covered, for what percentage and for what limit?
- Similarly, is there coverage for Extra Contractual Obligations, and if so, for what percentage and limit? Should such coverage be excess over a company's E&O coverage?
- Are ex-gratia payments covered? If so, on what basis?
- Should the contract include a specific provision pertaining to a company's obligation for punitive damages?
- Is there inuring reinsurance? If so, what is the sequence of loss obligation?
- Is the retention to be kept for the company's pure net account, or can such retention be subject to other reinsurance protection?

Loss Occurrence Definition

- In property contracts, is a "72 hour clause" appropriate? If so, for which type of losses; e.g. windstorm, riot, etc. and does such provision contemplate coverage for multiple occurrences within a single event?
- In workers compensation contracts, is or should an occurrence be defined on a per employee or per event basis?

Reinsurance Premium

- Are the minimum and deposit premiums the same, and if so, do they properly reflect potential volatility in subject premium volume?
- When are the premiums due and payable; i.e., if subject to calculation, is the required deadline reasonable?
- For excess of loss contracts, is the subject premium on a written or an earned basis? If the former, is reinsurance premium considered to be written or earned? Again, if the former, is there provision to return the unearned premium at the end of the contract term?

Premium or Profit Commission Adjustments

- Is the formula overly complicated, and if so, why?
- How are reserves handled for incurred but not reported (IBNR) claims - included, excluded, and calculated by whom?
- When is the first calculation and settlement; e.g., at the immediate end of the first annual period, 12 months thereafter, or at some future date?
- How frequently will calculations be made after contract termination; e.g., no further calculation until all losses settled, or continued on an annual or some other basis?
- Is there provision for credit/deficit carryforwards? If so, on what basis?
- Do the adjustments cover blocks of time; i.e., for more than one year? If so, are there interim calculations and/or settlements and if so, when?

Offset

- Does the offset apply to balances due under the contract at issue or among all contracts between the cedent and a given reinsurer?

Reports and Remittances

- How detailed are the expected reports? Is such detail necessary, and if so, is the filing deadline reasonable?
- When must remittances be paid by reinsurers; e.g., "as soon as possible" or within a more specific time frame? Is there a penalty; e.g. interest, for late payments?

Claims

- When must the company notify reinsurers of a claim and under what circumstances; e.g. serious injuries, percentage of contract retention? Are those conditions reasonable?
- What does the contract say about a reinsurer's obligation to follow the company's fortunes or loss settlements?
- Is there a claim cooperation clause affording reinsurers the opportunity to associate with the company in handling or defending a claim? Is there any provision which deals with a reinsurer's declination of such opportunity?
- Does the contract include "sunrise or sunset clauses" which limit reinsurers' obligations under casualty agreements? Are those clauses appropriate in light of current market conditions?
- Is there a commutation requirement for open claims, particularly under contracts covering workers compensation exposures? Does such requirement include an IBNR allowance, and if so, who determines the IBNR?
- Are punitive damages covered? If so, on what basis and for what limit?

Errors and Omissions

- Does the contract have an errors and omissions clause? If so, what is the penalty and remedy for such error and/or omission?

Arbitration

- Does the contract have an arbitration clause, and if so, what is the procedure for selecting the arbitrators and particularly the umpire?
- What are the requisite credentials of the panelists? Should they be active or inactively involved in the insurance/reinsurance industry?
- Should the panelists and the process be certified by an organization such as ARIAS.US?
- Are there appropriate time limits for the selection process?
- Should there be a provision to consolidate arbitrations with reinsurers involved in the same issue?
- Will the parties expect a "reasoned" (written) opinion?
- Is there a requirement to follow a state's rule of law?
- Should there be a written provision specifying that any arbitration will be confidential?
- Should there be provision to consider mediation as a preliminary requirement before proceeding to arbitration?

Conclusion

The above questions illustrate perhaps just a smattering of issues which suggest more than a cursory review of a great number of provisions considered "standard" among various members of the reinsurance community. Again, it should be emphasized that such provisions are not inherently wrong, nor do the above comments mean to suggest that the provisions are necessarily adverse to the interests of either contracting party.

Rather, the intent is to emphasize the need for each party, particularly the cedent and those reinsurers participating through an intermediary, to carefully review all contract provisions, whether manuscripted or standard, in determining whether such provisions are compatible with a party's interests.

Additionally, both parties must recognize that although they may initially enter into a commercial relationship based on cooperation and fair dealing, such atmosphere may quickly change due to unforeseen circumstances. What initially began as a partnership, can swiftly become a battle of adversaries based on changing interests, especially if one of the parties becomes a discontinued operation with no ability nor inclination to be "commercial" about any aspect of the reinsurance relationship.

It is therefore essential that all provisions (standard and otherwise) of a reinsurance contract accurately convey and express the parties' collective intent with respect not only to the issues of coverage and price, but to the operational elements which will drive the performance of each party. It is additionally important that agreement to such provisions pre-date the inception of the contract, and that revisions be negotiated as and when dictated by circumstances arising during the life of the agreement.

Given all of the issues and concerns outlined in the previous sections of this article, there is a lingering dilemma. What is a cedent to do if the reinsurer is unable or unwilling to change their "standard" wording, or if the suggestion is made to defer any change until next year?" That same question might also apply to the position of a broker market reinsurer. In other words, at what point does a difference of opinion on a contract provision become a "deal breaker?"

All things considered, the need for change boils down to perceptions of materiality and priority in the eye of the beholding party in determining that party's strategic position. Hopefully, the nature of an existing commercial relationship will facilitate implementation of desired changes to thereby preclude possible animosity and contention after the termination of that relationship.

In the final analysis, the combination of a well written wording which accurately conveys the parties' intentions, as well as the diligent implementation of contract requirements, will be the best possible medicine in preventing the emergence of costly reinsurance disputes.

Editor's Note: Paul Walther is CEO and Principal Consultant of Reinsurance Directions, Inc., and is a long time member of IAIR. In addition to his consulting activities which emphasize dispute resolution services, Paul is the editor of the Journal of Reinsurance which is published by the Intermediaries and Reinsurance Underwriters Association.

This article initially appeared in the Summer 2001 issue of the Committee News published by the Tort and Insurance Practice Section of the American Bar Association. Replies to this commentary are welcome.

Meet Your Colleagues

By Joe DeVito

MARK H. FEMAL, CPA, CPCU

Mark Femal is the Executive Director of the Wisconsin Insurance Security Fund. The Fund is located in the capital city of Madison. Mark has held this position since January 1, 1993. Similar to six other state associations the Wisconsin Fund handles claims for both property & casualty and life/health/annuity insolvencies.

Mark began his career in 1976 with the then CPA firm of Houghton, Taplick & Company, also located in Madison. In his 16 years at the CPA firm Mark centered his work in the insurance industry, mainly in the audit of various insurance companies – including financial, operation and claims audits. From 1981 – 1992 the Wisconsin Fund was one of his clients.

Mr. Femal has been active in his professional career speaking at various insurance industry conferences and at civic organizations wanting to learn more about the guaranty fund system. He was on the board of the local CPCU Chapter for 5 years in the middle 1990's.

Mark's accounting/financial background has been a good fit for being on the NOLHGA and NCIGF accounting committees since 1993. He was elected to the IAIR board in 1999, and has served as Treasurer since that time. Mr. Femal is in charge of or a member of 6 NOLHGA/NCIGF Coordinating Committees, which are created to work with the guaranty/funds and Receiver in individual insolvencies.

Mark received his under graduate and masters degrees from the University of Wisconsin-Madison. He earned his CPA certificate in 1979 and CPCU certificate in 1987.

ALAN N. GAMSE

Alan N. Gamse is a Principal in the law firm of Semmes, Bowen & Semmes, a Professional Corporation. He practices in the firm=s offices in Baltimore, Maryland and Washington, D.C. and is Chair of the firm=s Insurance Regulatory and Corporate Practice Area. Mr. Gamse=s practice is concentrated in the areas of insurance, regulatory and corporate law. He represents insurers, agents and rating bureaus with respect to all aspects of regulatory matters including licensure, market conduct examinations, ratemaking, acquisitions, and compliance. He has served as general counsel to residual market entities, guaranty associations and self-insurance programs.

Mr. Gamse has represented clients with respect to insurance insolvency matters since the late 1970's. He presently serves as Outside General Counsel for the District of Columbia Insurance Guaranty Association. Additionally, in the District of Columbia, he has been appointed as Special Deputy Insurance Commissioner and is currently liquidating two small insurers: Atlantic & Pacific International Assurance Company and Capital Casualty Insurance Company.

Mr. Gamse is a member of the Tort and Insurance Practice Section of the American Bar Association. He has served on the Section Council of TIPS and in many other leadership positions. He has served on the TIPS Insurance Insolvency Task Force since its inception in 1995. Mr. Gamse is a member of the International Association of Insurance Receivers and the Federation of Regulatory Counsel, Inc.

A native of Baltimore, Maryland, Mr. Gamse received a B.S. in Industrial Management from the Sloan School of Management of the Massachusetts Institute of Technology, and received a Juris Doctor Degree from the University of Maryland Law School. Mr. Gamse is a member of the Bars of Maryland and the District of Columbia.

WILLIAM H. LEVIT, JR.

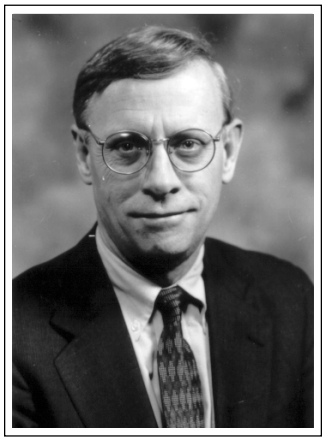
Bill Levit is a senior partner in the Milwaukee office of the Wisconsin-based law firm of Godfrey & Kahn. Since the late 1980's Bill has represented the Wisconsin Commissioner of Insurance in a variety of matters related to the liquidation and rehabilitation of both life and property and casualty companies. Since 1992 he has been lead counsel to the Wisconsin Commissioner in the liquidation of American Star Insurance Company. In 1994 Bill represented a California-based health insurance company in connection with Wisconsin's first pre-packaged insurer rehabilitation.

In addition to Bill's work for the Wisconsin Commissioner, Godfrey & Kahn has a full service insurance practice. For many years the firm's Madison office (LaFollette Godfrey & Kahn) has represented the Wisconsin Insurance Security Fund as well as provided a full range of corporate, regulatory, litigation and arbitration services to both domestic and foreign insurers and reinsurers.

Besides his insurance liquidation and rehabilitation work, Bill has had an active and diverse practice for 35 years as a corporate and commercial litigator. He has spent over 25 years arbitrating and mediating a wide variety of corporate and commercial disputes including insurance coverage, reinsurance and policy allocation issues. He serves as a neutral for the CPR Institute of Dispute Resolution (New York City) and is also on its Insurance Panel. He is on the Commercial and International Panels of the American Arbitration Association, for whom he has arbitrated numerous cases.

Before joining his present firm in 1983, Bill was Secretary and General Counsel of a Fortune 250 manufacturing company, a partner in the Los Angeles office of the New York-based law firm, Hughes Hubbard & Reed, and a U. S. Foreign Service Officer. He is a member of the Bars of New York, California and Wisconsin, is a member of the American Law Institute and a Member of the Chartered Institute for Arbitrators (London). In the 1980's Bill was a Substitute Arbitrator on the Iran-U.S. Claims Tribunal at The Hague. He has acted as counsel for clients before a wide range of international arbitral tribunals in New York, Paris, London, The Hague, Vienna and Zurich.

Bill received his LL.B from the Harvard Law School, has an MA in International Relations from the University of California at Berkeley and a BA, Magna Cum Laude, Phi Beta Kappa from Yale University.



KEAN K. McDONALD

Kean K. McDonald, Esq. is a partner in the law firm of Fox, Rothschild, O'Brien & Frankel in Philadelphia. He has practiced extensively in the areas of professional malpractice - particularly accounting and attorney malpractice - and insurance insolvency. He has been called upon to evaluate third-party liability situations in the insolvency arena, and to prosecute civil actions against potentially culpable outside accountants and lawyers for insurance companies, which he has done successfully. He has also defended accountants and lawyers in failed-bank cases, and is well versed in the law regarding third-party liability in insolvency matters. Kean is Co-chair of the firm's Professional Liability Group, and the senior trial member of the Insurance Insolvency Group.

He has worked on a number of insurance insolvency cases including the liquidations of two major insurance companies. The investigation uncovered a complex fraud over a five year period orchestrated by the beneficial owner of the two companies with the assistance and complicity of numerous other individuals and entities. Together, the Fox team of attorneys has been instrumental in obtaining for policyholders and creditors the largest recovery achieved on behalf of an insolvent Pennsylvania insurer on either a percentage-of-insolvency or absolute dollar basis.

He frequently writes and speaks on issues concerning professional liability, including a CLE seminar entitled "Avoiding Legal Malpractice: You Be the Judge" and co-authored publication entitled "Litigation Support Consulting Liability Traps for the Unwary."

Kean is a member of the Philadelphia and American Bar Associations, the Philadelphia Association of Defense Counsel and the American Board of Trial Advocates, in addition to the IAIR.

He graduated from Lehigh University with a B.A. in 1967 and an M.A. in 1969, and taught English in college for two years. He graduated from Temple University School of Law with a J.D. in 1974, where he was the Articles Editor of the Temple Law Quarterly and wrote two prize-winning articles.

Insurance and Reinsurance Litigation – A Liquidator's Perspective

by Nigel Rackham

A liquidator has a clear duty to pursue asset realisations and maximise recoveries for creditors. It is not unusual to face difficulties in collecting debts and an appropriately robust approach will be required.

Apart from the existing alleged grounds for non-payment, the insolvency itself sometimes creates additional difficulties. Record keeping is often poor and the loss of key staff can make it difficult to construct a credible claim. Some reinsurers may simply see liquidators as a soft touch – an attitude we are keen to dispel! Amongst legitimate reasons for non-payment are set-off (or potential set-off). After the Charter Re case arguments that reinsurance does not respond until the underlying claim has been paid should no longer cause a problem.

In assessing the position the liquidator will need to reassess the strength of the company's case and, if it is an existing dispute, where it has reached procedurally. He will also need to consider the position of the debtor – the likelihood of reaching a settlement, whether the debtor is good for the money (a "won't pay" rather than a "can't pay") and tactically how to "play his hand".

Other key considerations are the time and cost involved and the consequences of losing! An insolvent company may be required to put up security for costs and if funds are not available from existing resources the creditors may be asked to put up a fighting fund. The opportunity exists for solicitors to act on a contingency fee basis and it is also possible to arrange insurance to cover the costs of an unsuccessful action.

It is important to "flush out" the real issues. Preparation is key and it is usually helpful to reconcile and seek agreement of the data at an early stage. If inspection clauses are invoked it is vital to control the process. It is also important to be mindful of potential legal defences, which may be created by failing to take the proper steps.

A company in a formal insolvency will usually have a committee of creditors. The office holder will work with his committee, will seek their input and get their approval to the intended course of action for material cases. The attitude of the creditors is vital. They have already lost money and if there is no appetite to run the risk of "pouring good money after bad" then a compromise solution may be sought that does not involve further risk.

An interesting case study in how the process works from the perspective of the insolvent company is Aneco Re.

Background to the case

Aneco Reinsurance Underwriting Limited, a Bermudian insurance company, decided to extend its operations into the marine market for the 1989 year. Brokers Johnson & Higgins ("J&H") were aware of Aneco's interest and introduced a treaty from the Bullen syndicate at Lloyd's.

1989 was of course a disastrous year. The losses suffered on the Bullen treaty exceeded $35m. The total retrocessional cover obtained by Aneco on an XL basis was somewhat less.

This was only a part of Aneco's financial difficulties and in April 1992 Peter Mitchell of PricewaterhouseCoopers ("PwC"), Bermuda and Chris Hughes (now of Talbot Hughes LLP) were appointed as liquidators. The liquidators instructed Cameron McKenna who acted for them in all the actions mentioned below.

The liquidators received substantial loss advices on the Bullen treaty and in turn sought reimbursement from the XL reinsurers. The reinsurers disputed their obligations to pay and the liquidators commenced arbitration proceedings in 1993.

In the course of the arbitration it was established that J&H, which had also broked the linked retrocession protection had mis-described the underlying risk to XL reinsurers.

The Proceedings

The arbitrators upheld the reinsurers' complaints in their judgment, given in 1995 and the contracts were found to be void.

The liquidators then sued J&H for damages arising from their negligence in the placing of the reinsurance. The liquidators sought damages on the basis that without satisfactory XL cover Aneco would never have written the Bullen treaty and therefore Aneco's loss was the full $35m. The case eventually came to trial in the summer of 1997. At first instance the Commercial Court found J&H negligent but restricted Aneco's recovery to the reinsurance which has been avoided (at that time some $10m plus interest and costs).

Aneco appealed on the basis of calculating the loss, continuing to argue that the full $35m (plus interest – now over $15m) should be recovered from J&H. There was no cross appeal on the original judgment so Aneco was free to proceed with only the costs of the appeal at stake. The hearing occurred in June 1999 and the Court of Appeal ruled in Aneco's favour in July. J&H then sought and eventually obtained leave to appeal to the House of Lords. Their Lordships heard the appeal in June 2001 and the judgment, in Aneco's favour, was handed down in October.

The rationale

There is nothing particularly controversial about the facts giving rise to a finding of negligence; indeed J&H did not appeal on that basis. The scope of the duty of care is however of interest.

Their Lordships agreed with the

appeal court that J&H had assumed a much broader responsibility than is often the cases with other professionals (J&H sought to rely on certain cases dealing with property valuation for example). Particular factors were that:

- J&H were trying to put a deal together between Bullen, Aneco and the reinsurers (on which incidentally they would earn brokerage twice).
- J&H actually advised Aneco as to how much reinsurance protection to purchase as well as its availability.
- The availability (or otherwise) of reinsurance protection was not only fundamental to the overall deal but it was an indicator to Aneco of the attractiveness of the underlying Bullen business, a factor understood and recognised by the broker.

The implications for Aneco's creditors

The effect of the decision of the House of Lords is that Aneco will benefit to the extent of some $35m (plus interest and costs). This represents a significant proportion of the funds now available for creditors. The timetable - a decade! - is frustrating but the recovery fully justifies the creditors' patience.

The implications for brokers

What should the market make of these decisions? Aneco may be distinguishable on its facts but the situation of a broker introducing business and also placing the related reinsurance is common. The duties to each party are different and the broker needs to be particularly careful to restrict the scope of liability to each party.

Market practices and controls have developed over the last decade but at the same time clients are looking for a more advisory role from brokers. Risk management experts also have to be experts at managing their own risks!

The implications for those dealing with Insolvency Practitioners

Practitioners would rather settle disputes by negotiation than litigate or arbitrate. Nonetheless where there is no other option and the risk/reward balance is appropriate the office holder is quite prepared to use the full weaponry at his disposal even if (as in this case) the timeframe over which the dispute runs is protracted. In many ways reinsurers can find it tougher dealing with insolvent cedants than dealing with the weak solvent company that may need cash at almost any price.

Nigel Rackham is a director in the PricewaterhouseCoopers UK firm. He is a licensed insolvency practitioner and has over 10 years insolvency and restructuring experience, the majority focussing on the insurance sector. PwC is a leading provider of run-off, restructuring and advisory services to the global insurance industry.

PricewaterhouseCoopers Business Recovery Services Insurance Group

The Insurance Corporation of Singapore (UK)
Briefing note

An innovative solution developed by PricewaterhouseCoopers for paying the Creditors of this reinsurer in run-off received unanimous support at a meeting of Creditors in December last year. The distribution of funds to Creditors is due to commence in early April 2002.

The Insurance Corporation of Singapore (UK) Ltd is a UK reinsurance company which, along with other companies, underwrote through a number of agency 'pools'. Incorporated in 1980, it went into run-off in 1991 and Joint Provisional Liquidators from PricewaterhouseCoopers were appointed.

After investigating a number of alternatives, PricewaterhouseCoopers developed an innovative way of achieving an excellent result for the company's Creditors. They applied Section 425 of the Companies Act 1985 to promote a Scheme of Arrangement (a compromise or arrangement between a company and some or all of its Creditors) to enable most Creditors to be paid in full. The Scheme involves a proportion of the Company's assets being set aside to form the Creditors' Fund for the benefit of the majority of the creditors whose claims arise as a result of ICS (UK) participating as an underwriter in the English and American pools.

The Creditors' Fund has been be capitalised on a prudent basis, allowing a margin for potential deterioration.

The company's Creditors also include Oberon Pool Creditors, whose claims arise as a result ofICS(UK)having participated as an underwriter in the Oberon Pool. These creditors will be paid in full by St Paul Re

The Scheme represents a creative use of the legal mechanism, allowing separate classes of creditor to be treated differently, according to their rights and interests. In a liquidation it is likely that all creditors would have had to wait many years for a dividend which may have been less than 70 cents in the dollar

The Scheme of Arrangement was approved by the Creditors in December 2001. It came into effect in January 2002, with an initial distribution of funds to Creditors to commence in early April 2002.

Nigel Rackham, Director at PricewaterhouseCoopers and Joint Scheme Administrator of The Insurance Corporation of Singapore (UK) Ltd, is available for interview or by-lined articles on the Scheme of Arrangement. If you would like to interview him or commission an article, please contact Suzanne Hitchcock or Laura Wallace at Fishburn Hedges on 020 7839 4321.

Receivers' Achievement Report

by Ellen Fickinger

Reporters:
Northeastern Zone - J. David Leslie (MA); W. Franklin Martin, Jr. (PA);
Midwestern Zone - Ellen Fickinger (IL); Brian Shuff (IN)
Southeastern Zone - James Guillot (LA);
Mid-Atlantic Zone - Joe Holloway (NC)
Western Zone - Mark Tharp, CIR (AZ); Bob Loiseau, CIR (TX)
International - Jane Dishman (England); John Milligan-Whyte (Bermuda)

Our achievement news received from reporters for the third quarter of 2001 is as follows:

Gloria Glover (AK) reported that the Life Insurance Company of Alaska was placed into liquidation by the Superior Court of Alaska on February 12, 1999. Assets total approximately $300,000. The period for filing timely claims closed on August 12, 1999. One partial distribution occurred in January 2001 to Class 3 claimants for $56,707.02.

Further collection information was received from James Gordon (MD) for Grangers Mutual Insurance Company. Collections during the fourth quarter of 2001 totaled $23,942.96.

Mike Rauwolf (IL) continued to provide information on the ongoing supervision of the reinsurance run-off for American Mutual Reinsurance, In Rehabilitation (AMRECO). Total claims paid inception to date;

Loss & Loss Adjustment Expense $30,449, Reinsurance Payments $146,459,166, LOC Drawdown disbursements $9,613,386. An additional company under OSD supervision is Centaur Insurance Company, In Rehabilitation. Total claims paid inception to date; Loss & Loss Adjustment Expense $53,294,739, Reinsurance Payments $4,945,493, LOC Drawdown disbursements $132,876,555.

Frank Martin (PA) continues to provide updated information on Fidelity Mutual Life Insurance Company (FML), In Rehabilitation. As of 9-30-01 FML showed a statutory surplus in excess of $124,000,000 after reserving for all policyholders and creditor liabilities. The surplus went down slightly due to the booking of the $65 million policyholder dividend approved by the Commonwealth Court for 2002.

The moratorium on cash surrenders, withdrawals, policy loans and other contractual options which was imposed by the 11-6-92 rehabilitation order was terminated effective 10-1-01. Policyholders are now able to fully access their cash values. Death benefits continued to be paid and policyholder dividends and interest continued to be credited. Because of the high dividends paid in 2001 and planned for 2002, surrenders as a result of the moratorium termination are expected to have minimal financial impact. The moratorium termination order also provides that creditors with allowed claims could be paid immediately with 6% simple interest. All general creditor claims have been paid except for a few where we are awaiting a release to be returned to the Rehabilitator. Settlement of some of the premium tax claims are still pending with state authorities.

On August 14, the Commonwealth Court issued an order approving proposed dividends for 2002 in the approximate amount of $65 million. A petition for approval of crediting rates for non-traditional policies was filed in August and the Policyholder Committee filed objections to the proposed crediting rates as too high in light of recent decreases in the federal funds rates. A negotiated crediting rate amount (total) of $13.5 million was approved by the Court on 12-20-01.

All briefs concerning the Third Amended Plan were completed in December 2001. We are awaiting preliminary approval of the Third Amended Plan as well as approval of the Bid Procedures and our engagement of an investment banker, so that we can begin the investor selection process.

Western Zone Reporter Bob Loiseau, CIR-P&C (TX) reported an outstanding achievement by Texas Special Deputy Receiver, Derral Parks of the Waco, Texas accounting firm Jaynes, Reitmeier, Boyd & Therral. Members Mutual Insurance Company went into receivership in July 1992, and the SDR succeeded in paying all claims of policyholders, guaranty associations and creditors in full, leaving over $14 million in excess funds. An application to distribute the funds to the equity holders was contested by former affiliates of Members Mutual. A settlement was entered into providing for the distribution of $13.8 million to 64,000 former policyholders, making it the largest distribution of surplus assets in a Texas receivership. The SDR was represented by Catherine Fryer with Bickerstaff, Heath, Smiley, Pollan, Kever & McDaniel, L.L.P, and the Receiver was represented by James Kennedy, Special Counsel to the Receiver at the Texas Department of Insurance. James received an award from the TDI Legal & Compliance Division for his work in leading this effort.

Receivers' Achievement Reports By State

Delaware (George J. Piccoli, State Contact Person)

Receivership Estates Closed	Category	Licensed	Year Action Commenced	Payout Percentage
Union International Ins. Co. Of Delaware	P & C	Yes	1987 Rehabilitation 1990 Liquidation	

District of Columbia (Alan N. Gause, State Contact Person)

Receivership	Loss and Loss Adjustment Expense	
Grangers Mutual Ins. Company	97.06 1416.95	(MD) (DC)
Prime Health	4996962.14	55%

Illinois (Mike Rauwolf, State Contact Person)

Receivership Estates Closed	Category	Licensed	Year Action Commenced	Payout Percentage	
River Forest Ins. Co. Closed 12/26/01	P & C	Yes	1994	1557	Class A - 19.26%

Use and distributions made to policy/contract creditors and Early Access

Receivership	Loss and Loss Adjustment Expense	Early Access Distribution	Reinsurance Payments
Alliance General Ins. Co.	456		
Amreco			
American Unified Life & Health		1,158,433	
Coronet	30		6,921,136
Illinois Earth Care Workers Comp	3,911		
Illinois Environmental Services	810		
Illinois Ins. Co.	4,875		
Inland American Ins. Co.	170		
InterAmerican Ins. Co.	10,245,186	2,907,561	
Merit Casualty Co.	8,240		

Kansas (Daniel L. Watkins, State Contact Person)

Use and distributions made to policy/contract creditors and Early Access

Receivership	State GA	Class 1 GA Admin. Exp.	Class 3 GA Policyholder Claim Payments	Non-GA Policyholder Claim Payments
National Colonial Ins. Co.	Alabama	$3,650.00	$3,650.00	$2,212,815.00
	Arizona	$85,586.00	$440,236.00	
	California	$748,950.00	$12,920,944.00	
	Colorado	$690.00	$13,574.00	
	Florida		$3,245.00	
	Georgia	$16,846.00	$620,267.00	
	Kansas	$2,257.00	$8,887.00	
	Oregon (3)			
	Washington	$4,315.00	$290,679.00	
	Total	**$862,294.00**	**$14,339,091.00**	**$2,212,815.00**

West Virginia (Betty Cordial, State Contact Person)

Use and distributions made to policy/contract creditors and Early Access

Receivership	Amount	
Blue Cross Blue Shield of West Virginia	$10,654,058.38	(50%)
George Washington Life Ins. Co.	$3,109,919.90	(85%)
Intrepid Ins. Co.	$355,964.03	(60.5%)

The Global Impact of The Enron Insolvency

by Charles A. Beckham, Jr. & Mark D. Sherrill

On December 3, 2001, a few days after several of its foreign subsidiaries were placed in administration, Enron Corporation and several of its United States subsidiaries filed for relief under Chapter 11 of the Bankruptcy Code in New York, New York. The number of Enron subsidiaries added to and jointly administered under that case continues to grow, and presently stands at thirty-six (36). In the weeks since the initial filings, the spectacle surrounding the politics and alleged concealment of the Enron collapse has also burgeoned. The media have focused almost exclusively on the American aspects to the Enron story: the lost retirement accounts, the conduct of professionals employed by the company, the Congressional inquiries, and so on. Somewhat obscured by those aspects have been the enormity of the Enron insolvency and the global impact it will have.

Without question, Enron is a mammoth concern. Accounts on the number of Enron subsidiaries have varied, but approximately 3500 appears to be an accurate figure. The insolvency proceedings promise to be particularly difficult because of the interwoven nature of those entities. A participant in the U.K. administration commented, "The Enron group built an extraordinarily complex network of integrated businesses and this will take some time for the administrators s to work through."

Although Enron was regarded as asset-light for a company of its size, it has many assets strewn around the world. Those assets were a part of the company's downfall, thought Dynegy chairman and chief executive Chuck Watson. As Enron now tries to divest itself of holdings, the global assets will continue to play a primary role in the insolvency proceedings. Some assets are held by solvent and some by insolvent entities, but virtually all will affected by the Enron bankruptcy in one way or another.

I. Assets

Enron had particularly heavy holdings in the U.K. As discussed below, many of the U.K. assets are now in administration with Enron Europe, but others continue to operate independently. Among the assets not in administration are a 1,875 megawatt plant in Teesside, a nearby English plant in Wilton, and Wessex Water. Other British assets have already been sold. By December 5, 2001, administrators had already reached an agreement with Centrica Plc, for the sale of the U.K. customer base and operating assets of Enron Direct. Several entities were recently bidding for the European metals trading business.

In addition to the American bankruptcy, administration proceedings concerning Enron entities have occurred in the U.K., Australia, Canada, Japan, Bermuda and Singapore

The company's holdings in India have been subject to great scrutiny, for reasons financial as well as political. In early 1995, Enron entered into an agreement to take a sixty-five percent (65%) stake in the Dabhol Power Company, which sought to develop a power plant and liquefied natural gas ("LNG") terminal approximately 150 miles south of Bombay. General Electric, Bechtel Corp. and the Maharashtra State Electricity Board hold smaller shares. The project, estimated to have cost $2.3 billion, remains the largest foreign investment India has ever received. Soon after the agreement was reached to build the project, however, the support of several Indian political parties eroded, and development of slowed as a result of the ensuing contention. Enron and the other investors halted work on the terminal and plant in June of 2001, even though it is approximately ninety-seven percent (97%) complete.

Another significant element of Enron's ambitions involved Latin American markets. "In 1993, Enron envisioned a single energy market spanning southern South America in which Enron would be the dominant player." The company intended for the central artery to that market to be a 1,870 mile (approximately 3,009 kilometers), $2 billion pipeline to transport natural gas from Bolivia to Brazil. Also in Brazil, Enron owns Enron Commercializadora, several power plants, electricity distributor Electriciadade e Servicos SA, and stakes in Companhia Estadual de Gas and Companhia Estadual de Gas-Rio de Janeiro. In Argentina, it has thirty-five percent (35%) ownership of Transportadora de Gas del Sur and a fifty percent (50%) stake in the Ciesa holding company. Lesser investments in Latin America include several plants and pipelines in Mexico, Colombia, Argentina, Venezuela, Nicaragua and Guatemala. Enron also holds telecommunication subsidiaries, such as Promigas in Colubia, Enron Broadband mexico, Enron Communications do Brasil and Telcosur in Argentia.

Outside of the U.K., Enron has additional assets throughout Europe. Significant properties include power plants in Poland, Turkey and Italy (a one-half stake). Enron also owns pipelines and water projects in Spain.

II. Administration Proceedings and Divestitures

In addition to the American bankruptcy, administration proceedings concerning Enron entities have occurred in the U.K., Australia, Canada, Japan, Bermuda and Singapore. The entities in administration in London include: Enron Europe, Enron Power Operations, Enron Gas and Petrol Chemicals Trading, and Enron Capital and Trade

Resources. Price Waterhouse Coopers was appointed administrator, and dismissed approximately 1,100 employees the following day. It is expected that the European administration will announce an expected recovery at a February 11, 2002 meeting with creditors.

Enron will likely seek to divest many assets that are not in administration as well. "The assets slated for divestiture are mainly international, [although] Enron is also trying to sell its [domestic] pipelines… 'There's not much else in the U.S. of any value,' [stated one] source."

In the U.K., several primary assets have already sold. Other assets are likely to be liquidated in the near future, such as Wessex Water, Teesside Power Elsewhere, BG Group Plc has agreed to purchase Enron Oil and Gas India, Ltd. for $350 million. Prior to its bankruptcy filing, Enron had sold or was in the process of selling approximately $5.5 billion of assets in Brazil, Turkey, Italy, Poland, Columbia, Argentina, Mexico, Venezuela and Nicaragua. Even before considering the domestic turmoil in some of those locations, though, the assets will not be easy to sell. "A lot of them will be given away, just because of their substantial debt loads," commented one observer.

III. An Ancillary Proceeding in the U.S. Bankruptcy

Enron Re Ltd. is a Bermuda insurance company that is in liquidation in Hamilton, Bermuda, pursuant to Section 35 of the Insurance Act, 1978 of Bermuda and the Companies Act, 1981 of Bermuda. The principal assets of that company are its investment accounts, books and records.

On January 18, 2002, the liquidators of Enron Re filed a petition under Section 304 of the U.S. Bankruptcy Code, commencing an ancillary proceeding. The liquidators feared actions against the assets located in the United States but belonging to Enron Re, thereby hindering their ability to marshal the distribute those assets. They therefore instituted the section 304 proceeding, to seek injunction of the commencement or continuation of actions against any property in the U.S. The liquidators' Application for such injunctive relief is pending.

IV. Conclusion

The Enron insolvency is truly a global affair, with ramifications around the world. While many observers focus upon the political consequences in the U.S., the effects are much broader. Banks and other creditors around the world will take substantial losses. Further, many companies will feel indirect effects to their business, from Nigerian gas companies to shipping concerns and end-users of energy. An insolvency with such far-reaching impact should cause all to reflect upon the need to develop improved cross-border insolvency laws, because the future, unfortunately, will likely hold more Enrons.

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IAIR 2002 Committees

Accreditation & Ethics
I. George Gutfreund, CIP, CIR, Chair
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This committee sets the qualifications for the AIR and CIR designations and reviews/interviews all applicants. They also draft IAIR's Code of Ethics. This is a very active, hard-working committee that is always looking for input from new sources.

Amicus
Ellen Robinson, Chair
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This committee comes into action when there is an amicus brief of interest to IAIR. They review the situation and present the Board with a suggested position for IAIR to take.

Bylaws
Bob Greer, CIR, Chair
304-842-8091 or Greerlaw@aol.com
This committee drafts the updates to IAIR's bylaws and periodically they review the long range planning goals of the organization based up a membership survey.

Education
Steve Durish, CIR, Chair
512-345-9335 or sdurish@onr.com
The education committee is responsible for all educational programs sponsored and co-sponsored by IAIR. These include, but are not limited to, the annual Insolvency Workshop, the Staff Training Seminar, the Joint Guaranty Fund workshop and the quarterly Roundtables in conjunction with the NAIC meetings. This is a very active committee which requires a large number of members to present interesting and timely educational programs.

Finance
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The finance committee assists the Executive Director in setting the annual budget and reviews the financial activity of IAIR.

International
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This committee was formed during 2000 to address the needs and concerns of IAIR's growing international membership. Since then the committee has sponsored several educational programs in London and they are working with members from other countries to determine the needs of the membership.

Marketing
Trish Getty, AIR, Chair
678-297-0784 or
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The marketing committee is responsible for developing and implementing a marketing plan for IAIR. They have been instrumental in the creation of the Resource Directory and in bringing awareness of IAIR to the Insurance Commissioners.

Membership
Rheta Beach, FLMI, Chair
801-595-8222 or Rbeach@state.ut.us
The membership committee is responsible for setting recruiting policy, initiating membership drives and handling promotional membership activities of IAIR. They also approve all applications for membership.

Nominations, Elections & Meetings
Dick Darling, CIR, Chair
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This committee is responsible for the annual slate of officers and for handling the voting process together with the Executive Director.

Publications
Tom Clark, Chair
225-343-5290 or tclark@crawford-lewis.com
This committee is responsible for publication of IAIR's quarterly newsletter, *The Insurance Receiver,* and the annual Membership Directory. They obtain the articles from authors, edit, proofread, and advise the Executive Director on publication matters.

Website
Dale Stephenson, CPA, Chair
317-464-8106 or
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The website committee is responsible for the material that is included on IAIR's website as well as establishing an advertising policy for the site that is consistent with the publications of the organization.

If you have any questions about these committees, please feel free to contact the chair person of that committee or IAIR headquarters at 407-682-4513.

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