



INTERNATIONAL ASSOCIATION OF INSURANCE RECEIVERS

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The following is submitted on behalf of the International Association of Insurance Receivers (IAIR). IAIR was founded in 1991 in order to provide individuals who were involved with insurance receiverships an organization through which they would receive education, exchange information, and enhance the standards followed by those who work in this professional area. The following is submitted as an initial response to the Task Force's request for

specific examples of the types of routine issues or delays that can arise in the collection of reinsurance recoverables held by insurers in receivership, as well as whether there are possible related solutions to address timing and collection concerns.

IAIR's membership is diverse, and includes insurance receivers and their staff, insurer and reinsurer representatives, and many individuals and entities who provide legal, accounting, actuarial and consulting services to insurance receivers, or have other interests in receivership. This submission is meant for informative purposes only, and does not purport to represent the views of any individual member or group of members.

No two failed insurers are quite alike, and no two receiverships confront quite the same challenges and opportunities, particularly when dealing with reinsurance recoverables. This means two things for a review such as the Task Force is undertaking: first, that there is no "one-size-fits-all" program for optimizing receivership reinsurance operations, and second, that as much attention must be paid to predicting how new challenges might arise from today's operations as to how to avoid the pitfalls experienced in yesterday's. Nevertheless, some common patterns can be observed.

Learning curve: Fortunately, insurance failures are relatively rare events. Unfortunately, because of this fact, not all insurance departments or their receivership bureaus, and few reinsurers, have had much experience dealing with the complex issues that emerge from an insolvent insurer. Even departments and reinsurers with significant experience can be surprised when they encounter a or and different issues from an insurer or cause of insolvency. Strategies and skill sets necessary for dealing with large, sophisticated property/casualty insurers with multi-line businesses are very different, for example from those used to handle smaller or personal lines insurers. Insurers who fail because of downgrades in their asset portfolio need different handling than those whose downfall are

basically faulty or cash flow underwritings. And the mechanics and even the vocabulary of health and life insurance receivership are something else again.

Receivers and reinsurers not infrequently consume valuable resources reinventing the wheel, unaware that other parties in other states or even countries may have had experience, or even established precedent, which could shorten the new estate's learning curve. To minimize time and money spent on unnecessary conflict and changes of plan, both receivers and reinsurers should take full advantage of the formal and informal training and referral network that now links many states and several countries by way of IAIR. In selecting Special Deputy Receivers, hiring executive staff, or locating specialist expertise, receivers should look for IAIR designations, and should invest in IAIR training for their operating staff.

The same should be said for reinsurers and brokers personnel. The receiver, no less than the reinsurer or cedant, is bound by an obligation to conduct the reinsurance affairs of the insolvent company in utmost good faith. While his primary concern is the protection of creditors, he may find it difficult to collect reinsurance if he has not honored that obligation. While there are plenty of legitimate reasons for tension to arise between reinsurers and receivers, some of the stumbling blocks result from misunderstanding and unjustified distrust of the receivership process. Well-informed reinsurers can make useful contributions to the success of the receivership, and protect their own positions at the same time, but ill-informed and confrontational tactics rarely pay off.

Many receivers misunderstand reinsurance, and many reinsurers misunderstand the receivership process. The time to learn better is not in the chaotic aftermath of a failure. Regulators, potential receivers, and potentially affected reinsurers should identify sources of receivership expertise in advance of need, and cultivate the development of that expertise in their own staff.

Communications

Communication between the receiver and the reinsurer are critical. One can not be successful without keeping reinsurers informed and developing a pattern of transparency.

Bad or absent information makes bad decisions. One of the early consequences of an insurance failure, often commencing well before the actual receivership proceeding, is the collapse of information exchange between the company and its reinsurance partners. When reporting does occur, its quality may not be sufficient. When receivers do attempt reinsurance collections, they often have to play catchup. Sometimes it simply can't be done because the company's accounting mechanisms were not maintained, and receivership systems do not capture the information required under the reinsurance contracts. In other cases, expensive systems must be built-and defended- in order to demonstrate the estate's entitlement to the funds demanded. Determining how many of the estate's scarce resources should be allocated to correcting and maintaining reserves, reconciling accounts, and responding to inquiries is one of a receiver's trickiest decisions. This decision often must be made beginning within the first few weeks of the receivership proceeding, but will have a continuing direct impact on reinsurance collection throughout the life of the estate. When an insolvent company possesses significant reinsurance recoverable assets, time and money invested in maintaining the information and communication systems that support realization

of those assets is well spent, and any notion of “best practices” should reflect that fact.

Another form of communication, to which reinsurers are entitled by their contracts, is information regarding the receiver’s plans to allow claims affecting the reinsurance, and the reinsurer’s right to participate in that process provided by statutes and the reinsurance agreements. But these rights co-exist uneasily with the real world. See below under “Structural Issues” for a discussion of this point.

On a more general note, receivers in recent years have considerably improved their communications with policyholders and guaranty funds. But less thought has gone into ways of giving reinsurers the vital information affecting their interests. Keeping reinsurers informed, not only of the state of their own accounts, but of the receiver’s priorities and hoped-for timetable, can build a base of credibility for the receiver’s processes which will pave the way for collections.

Receivers’ tactical decisions:

Receivers make a number of tactical decisions about the direction of the receivership that have important effects, deliberate or otherwise, on the success of later reinsurance collection. There is nothing wrong with a decision that limits or forfeits potential reinsurance collections if it is deliberate and fully informed. Reinsurance is often the largest asset of a receivership estate. Best practices of receivers should strive to avoid unintentional negative effects on these crucial resources. For instance,

- Receivers sometimes err by accepting, without sufficient investigation, outgoing management’s claims that reinsurers are treating the company unfairly or dishonestly. If these claims are merely a means of offloading responsibility or diverting attention from management’s own lapses, the receiver is apt to become entangled in unnecessary disputes and give the reinsurer avoidable defenses.
- Conversely, receiverships sometimes are launched with a focus on owners’ and management’s extravagant pay scale, private jet or curious business decisions, but receivers may discover that these concerns are either unfounded or immaterial to the company’s failure. Making claims of mismanagement and dishonesty against management and company owners can provide reinsurers with excuses to postpone payment, or avoid it altogether. On the other hand, if management really did act foolishly or dishonestly to the detriment of reinsurers’ interests, reinsurers may be able to avoid payment even if the receiver’s lawsuit does not provide them a roadmap; the receiver might as well collect what he can from management and its insurers.
- Rushing to commute reinsurance before claims have fully developed can have adverse consequences. Conversely, holding off commutations pending full claim development, when reinsurers are undergoing their own financial stress, can be just as fatal to full recovery.
- Imposing early claim liquidation cutoffs can result in dramatically fewer claims, but the disappearance of reinsurance recoverables. Whether this is a good idea depends on how much reinsurance is in question, and how concentrated the pool of claimants is.

- In the interest of prioritizing service to policyholders and keeping administrative costs low, receivers sometimes suspend or neglect reinsurance accounting. This can be a false economy.
- Adopting streamlined or abbreviated claim handling procedures that disenfranchise reinsurers can be a fine idea to save administrative expense where reinsurance is scarce or dubiously collectible; but shortsighted if the reverse is true.

Structural Issues:

Insolvency Clause: Virtually every reinsurance treaty has one, but confusion and disagreement reign concerning its application. Reinsurers rarely exercise the rights the clause literally grants them, nor would they generally benefit from doing so. They would probably have more use, however, for better claim information provided on a regular basis. On the other hand, failure to comply with the clause potentially jeopardizes reinsurance recovery. Receivers are not consistent in applying the clause, and there is not consensus about the quantum or timing of information release to the reinsurer, or the extent to which the receiver may publicly break ranks with a defending reinsurer or actively espouse the policyholder's position. Reinsurers' role in claims handled by guaranty funds is also unclear. Presently this probably introduces avoidable risk into the receivership, and complicates collections. Development of a joint NAIC/Reinsurer protocol for the application of the insolvency clause, while not simple, might afford worthwhile clarity.

Arbitration: Probably no issue in reinsurance collection has been more extensively, and unproductively, litigated than the apparent conflict between a reinsurer's right to demand arbitration of reinsurance disputes and the exclusive jurisdiction of the receivership forum. While these disputes continue, no reinsurance is collected. Recent caselaw and practice may be coalescing around the idea that reinsurance claims against insolvent estates should proceed in the receivership forum, whereas collection of reinsurance due the estate may proceed in arbitration or other courts. The gaping hole in this division of labor is the handling of setoff. As with the insolvency clause, uncertainty on this point arguably does more harm to reinsurance collection than either candidate resolution. The uncertainty cannot be resolved, at least in the short term, by legislation, even if it were widely adopted, because reinsurance contracts and their wordings may continue in force for many years. But a concerted effort to develop "best practices" for receivers could inject a welcome degree of consistency and improve the defensibility of receiver's decisions.

Setoff: Reinsurers' rights to offset certain balances against others are now widely established by statute, caselaw or both. What is less clear is how the set offs should work, and when they should be applied. In particular, reinsurers who expect that they will ultimately have cognizable claims against the estate, or larger such claims than have presently developed, tend to postpone paying inwards claims pending adjudication of their claims against the estate. They may fear that, if they pay more than they ultimately would have owed, after offset, they will receive only dividends from the estate instead of the effective full value they would receive by exercising setoff. Receivers generally do not tackle their own inwards reinsurance until policyholder claims are finalized, and the effect of any reinsurance spiral can be judged. Gridlock ensues. The Task Force may wish to explore the use of clawback

agreements, akin to those used by guaranty funds, permitting a reinsurer who pays a receiver's claim in good faith to recover his money to the extent a claim in his favor is subsequently adjudicated by the receiver. Protected against loss of setoff rights, reinsurers would have fewer legitimate reasons to postpone payment of accounts this are presently due.

Life Reinsurance. There is very little binding precedent for the handling of reinsurance in life receiverships. Clarity, and the protection of policyholders, might be enhanced if there were clear understandings between the reinsurance and receivership communities over issues such as the transferability of reinsurance in guaranty-association assisted assumption transactions, the obligations of assuming carriers to the former company's reinsurers, and the application of recapture provisions in receivership.

Please feel free to contact us to discuss further. We look forward to working with the Task Force on these issues.

Respectfully Submitted,

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