

MEALEY'S LITIGATION REPORTS

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The Proof Is In The Pudding: Acceleration Of Reinsurance Recoveries

By

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[Editor's Note: Ms. Hall is Vice President and General Counsel for the Reinsurance Association of America (the RAA). Based in Washington, D.C., the RAA represents reinsurers who assume the vast majority of U.S. business ceded to U.S. reinsurers. Prior to joining the RAA, Ms. Hall was Chief General Counsel of the Office of the Special Deputy Receiver in Chicago, Illinois. The RAA, along with others, is appealing the Mission Final Liquidation Dividend Plan (the FLDP). Responses to this commentary are welcome.]

I read with interest Richard White's article concerning his approach to the earlier closure of insurance receiverships. (See 4/3/96, Page 23). Implicit in his article are the "twin objectives" he begins with: the need to achieve expediency in truncating the business of an insolvent insurer, and the need to safeguard the rights of both creditors and debtors.

It was not a surprise to read Karl Rubinstein's response to Mr. White's article in which he claims that Mr. White is advocating what California already has underway in the Mission insolvency. (See 5/1/96, Page 15). However, Mr. Rubinstein has focused on Mr. White's first objective while overlooking the second. Similarly, Mr. Rubinstein's plan in the Mission proceeding is long on creativity but very short on the recognition of parties' rights. Mr. Rubinstein's claim that the FLDP "seems to be the approach which [Mr. White] advocates" works a disservice to Mr. White's commentary and presumes that those knowledgeable about the issue are incapable of discerning the difference.

COMMENTARY

While Mr. Rubinstein describes himself and others involved in Mission as "trailblazers," he fails to note that others (e.g., Illinois and various schemes of arrangement adopted in the U.K. and Bermuda) have cleared the path before him. The difference — they travelled the path within the confines of their legal authority.

As many of the receiverships initiated in the '70's and the '80's are nearing the point where there is an end in sight, receivers are faced with the need to plan an exit strategy. In many cases, substantial numbers of claims have been evaluated and liquidated, guaranty fund claims have been paid, litigation has been pursued or even completed, and commutations with reinsurers have been successfully negotiated.

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The Mission liquidator is often heard to remark that reinsurers wish to avoid — or delay — their obligations to an insolvent estate. Mr. Rubinstein repeats that claim in his commentary and notes that it is not surprising that the “only energetic opposition to our FLDP has come from reinsurers.” (I agree with Mr. Rubinstein here — it is not surprising that the group whose rights are being trampled upon are the ones who will vigorously respond.)

Before addressing what it is that reinsurers prefer or not — let's make sure that we have the facts straight — using some receivers' statistics. According to a sworn declaration submitted in the Mission proceedings, the Mission liquidator has entered into 313 commutation agreements, leaving only 54 reinsurers of Mission's direct business.¹ In the transcript of those proceedings, Mr. Rubenstein stated “Almost all of our reinsurers have settled with us, and either have commuted or have keep-current agreements, and there's no litigation with them whatsoever, none, over 300 reinsurers.”²

Similarly, in a report issued concerning the Transit Casualty Company the liquidator reported that for each of the 4 consecutive years prior to the report, 1990-1994, the estate had collected over \$100 million in assets which totaled \$640.9 million in collections during the previous nine years.³ Most of that figure represents reinsurance recoveries.⁴ According to its own account, for the five years prior to its insolvency in December 1985, Transit engaged in “massive reinsurance transactions” by agents operating in all 50 states involving over 900 reinsurers in some 30 foreign countries on 5 continents.⁵ Of those 900 reinsurers, approximately 550 have settled their obligations with the liquidator.⁶

Although some have attempted to paint reinsurers generally with a broad brush as recalcitrant, the majority of reinsurers meet their legitimate obligations to an insolvent estate, and in the Mission estate in particular, the vast majority of reinsurers have, according to the liquidator, commuted and thereby accelerated their obligations to even one of the most controversial insolvencies in recent U.S. history.

Notwithstanding the general business-like approach of reputable reinsurers, there is little dispute that some reinsurers prefer to delay payment or avoid their obligations altogether. I ran into such reinsurers and retrocessionaires in the Illinois receiver's office and, no doubt, anyone in the solvent or insolvent end of the business has encountered them as well.

At the same time, however, there are reinsurers and receivers who have legitimate disagreements over notice, coverage, evaluation and other issues. For example, not all of Mission's reinsurers who have elected thus far not to commute have acted out of ill will or evil motives — some reinsurers legitimately take issue with the amounts that Mission has billed them or the amounts of IBNR that Mission claims it ceded to them. Clearly, there is ample support for seriously questioning Mission's IBNR figures. A three-judge panel appointed by the liquidation court found that Mission's actuarial figures were not credible.⁷ Although the liquidation court summarily rejected the panel's award of rescission, the California Court of Appeal ordered the liquidation court to enter judgment in favor of the reinsurers or show cause why the court should not be ordered to do so.⁸

In any event, the liquidator — like any other ceding insurer or reinsurer — does not have the corner on the market with respect to IBNR or any other valuation. Reinsurers, who are in the business of paying claims and of estimating IBNR regularly for a variety of financial reporting

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purposes, are just as capable of producing fair and reasonable estimates of what they owe and what others owe them. In fact, they are probably more qualified considering that they are in the business, that insolvent insurer's records are notoriously poor and the fact that the ceding insurer's lack of expertise in this and other areas may well have contributed to its insolvency. It is Mission's purported right to treat IBNR as paid loss that is the problem, not the concept of valuing IBNR for other, unrelated purposes.

Reinsurers do not necessarily prefer the long-term runoff of claims. Often, reinsurers find that dealing with insolvent estates is an administrative burden and a nuisance that diverts them from their ongoing business needs and goals. It is for this, and other reasons, that many reinsurers prefer to commute in the early stages of a liquidation. In fact, many receivers have encountered situations where reinsurers approach them with an attempt to initiate commutation negotiations long before the receiver is prepared to pursue such negotiations.

What reinsurers *do* support — at least many if not all of those who are members of the RAA — is the voluntary resolution of a reinsurance relationship where both sides are on an equal bargaining level. Notwithstanding this, reinsurers generally recognize that a voluntary resolution is not always possible.

The answer, however, is not the Mission approach. Contrary to Mr. Rubinstein's claims of fairness and his attempts to blame his current troubles on recalcitrant reinsurers — the FLDP violates statutory and contractual rights to due process and attempts to create out of whole cloth the authority to estimate claims that the legislature has never granted the Commissioner.⁹ The Mission plan would allow the liquidator to estimate reinsurance recoveries based on the IBNR projections of his actuaries (already held to be lacking in credibility, as discussed earlier) or, if he prefers, to disregard the estimates of his own actuaries and supplant them with his own views of what the recoveries ought to be. In response to the RAA's objections¹⁰ — the liquidator says "trust me." Neither liquidators, nor their actuaries, are magically granted upon appointment, any special omniscient powers that make their numbers right — or, that make their numbers any *more* right than the other party to the business transaction. Having entered into even-handed negotiations for years that have proved unsuccessful with respect to certain reinsurers, the FLDP allows the liquidator to abandon those negotiations and *force* his view of what is right — like a child with a temper tantrum who picks up not only his toys, but his friend's toys, and goes home.

So, if Mission isn't the answer — then what is? A good starting point is Mr. White's two prong approach: striking the balance between the need for expediency while safeguarding the rights of *both* creditors and debtors.

Earlier this year, the Utah Department of Insurance proposed legislation aimed at meeting Mr. White's articulated objectives. The RAA did not oppose the legislation, which was recently passed and signed into law.

In Utah, a liquidator will have the ability to estimate the claims of policyholders and ceding insurers, and accelerate the recovery of reinsurance obligations. The statute will allow the liquidator to engage in these activities only after a certain number of years, to allow sufficient time for claims development and to motivate the parties during that period to resolve their dispute through a voluntary negotiation process. Reinsurers' rights to notice and participate in the underlying adjudication process are preserved.

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While acceleration of reinsurance recoveries is permitted, it is not done through the dictatorial, one-sided approach crafted in Mission — rather, it provides for a fair and even-handed resolution. If unable to agree on a voluntary commutation over the course of time, an arbitration panel is appointed for the purpose of determining the proper commutation amount. Each party appoints an arbitrator and the liquidation court appoints the umpire. Both sides submit their commutation proposals, along with supporting documentation. This process results in the acceleration of reinsurance recoveries from those reinsurers with whom the liquidator has been unable to reach an agreement, including the acceleration of IBNR. While the Utah approach is not without flaws and provisions objectionable to reinsurers, it is a long way from Mr. Rubinstein's suggestion that reinsurers want to delay payment and otherwise create obstacles to the earlier closure of insolvent estates.

As my grandmother used to say, the proof is in the pudding. Presented with fair and commercially reasonable options, reinsurers act in a reasonable and responsible manner. On the other hand, when presented with the unilateral, overreaching approach that has characterized the Mission insolvency proceedings — reinsurers will respond in an "energetic" manner to protect their rights as both creditors and debtors to an insolvent insurer. The RAA looks forward to hearing more from Mr. White and his anticipated approach to the closure of Integrity.

ENDNOTES

1. *Garamendi v. Mission Insurance Company*, Dkt. No. C572 724 (Cal. Sup. Ct.), Declaration of John G. Horner in Support of Insurance Commissioner's Reply to Objections to Final Dividend Plan, February 16, 1995.
2. *Garamendi v. Mission Insurance Company*, Dkt. No. C572 724 (Cal. Sup. Ct.), Transcript of Proceedings of February 16, 1995, at p. 56.
3. Transit Casualty Company, *Insolvency and Liquidation Report*, pp. 1 and 3 (March 1995).
4. *Ibid*, at p. 3.
5. *Ibid*, at p. 1.
6. *Ibid*, at p. 3. "The Receivership still has a significant task ahead in collecting reinsurance assets since of the company's 900 original reinsurers there still remain about 350 reinsurance companies to settle with."
7. On February 2, 1995, the panel issued a unanimous decision allowing rescission, rejecting the Mission liquidator's claim for \$2 billion in reinsurance recoveries and damages and awarded the retrocessionaires recovery of their cost of suit. *Garamendi, etc. v. Abeille-Paix Reassurances, et al.*, Case No. C 683 233 (Cal. Sup. Ct.).
8. *Copenhagen Reinsurance Company, Ltd. v. Superior Court of Los Angeles*, Dkt. No. B099422 (Cal. Ct. App.), Alternative Writ of Mandate, February 22, 1996.

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9. In fact, the Commissioner recognized this lack of authority and through Assembly Bill 1274, the Department attempted, during the pendency of these proceedings, to seek legislative authority to estimate claims.

10. Also objecting are the Illinois Director as Rehabilitator of Centaur, its parent Borg-Warner and Lloyd's of London. ■

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