The INSURANCE RECEIVER

Promoting professionalism and ethics in the administration of insurance receiverships.

Volume 12, Number 2 **Summer 2003**

President's Message

by Robert L. Greer, CIR-ML

I am pleased to be completing my first quarter as President of IAIR in these very exciting times as we continue to develop and mature as an organization. We have some particularly significant opportunities:

- IAIR was invited to participate in the NAIC Working Group of the Insolvency Task Force,
- IAIR's professional designation program may be incorporated into the NAIC accreditation standards and
- The IAIR Board has begun a strategic planning effort to define the future of the organization

During the March NAIC in Atlanta, IAIR was invited to participate in a Working Group of the Insolvency Task Force charged with addressing ways to improve the receivership process within the United States. As IAIR president, I was privileged to represent you and offer our organization as a resource to this working group. IAIR can be, and is, an international think tank offering a global intellectual laboratory. As I advised the NAIC "we stand ready and willing to canvas our members, which include some of the very members of the working group, and bring to your (NAIC) consideration the positive examples of success in the current system both domestically and internationally as well as those areas where our experience and training teach us that further improvements are needed."

In addition, in this issue in the interview with Arkansas Commissioner Mike Pickens, President of the NAIC, we discuss incorporating the IAIR designation program into the NAIC accreditation standard. We know that a new charge to the NAIC Accreditation Task Force, chaired by Commissioner Donna Lee Williams of Delaware, is to examine the CIR program of IAIR for consideration as an NAIC accreditation standard. We will cooperate and work with this NAIC Committee to present the criteria of our program and the successes of our designated professionals.

We have completed a decade as an organization - it is time to review our successes and identify areas that require refinement. The Board began that process at the March NAIC meeting with a full-day planning session on Friday. In the morning we captured each person's impressions of the organization and in the afternoon worked in two groups to address: Long Term Vision and Short Term Changes. The Board is reviewing the minutes of those meetings now and will reconvene again on Friday, June 20, before the NAIC meeting in New York City to agree on a plan of action.

We look forward to sharing our vision with you in the coming months. We believe we will be recommending a number of improvements or modifications to the operation of IAIR. One may be the by-laws associated with the election of officers. Board member Vivien Tyrell is chairing a group that is reviewing the process.

I am proud of IAIR's recognition and accomplishments. As an organization we are moving beyond childhood to adolescence - a period of life that presents joys and challenges. It is a privilege to be working with the Board and members to move our organization to a higher level.

The ***I****NSURANCE* ***R****ECEIVER*
Volume 12, Number 2
Summer 2003

In this Issue

Feature Articles. . . . . .

Pages 8 - 14:
An Interview with Arkansas Insurance Commissioner Mike Pickens
by Trish Getty, AIR-Reinsurance

Pages 15 - 17:
Run-Off Sci-Fact
by Paul Evans and Julian Turner

Pages 24 - 27:
Ancillary Proceedings Under Section 304 of the Bankruptcy Code and Reinsurance Collateralization Devices
by John F. Finston and Dennis R. Wheeler

Departments. . . . . .

Page 2:
Message from the President
by Robert L, Greer, CIR-ML

Page 4:
View From Washington
by Charlie Richardson

Pages 5:
News From Headquarters
by Paula Keyes, AIR

Page 5:
IAIR Roundtable Schedule

Pages 6 - 7:
Atlanta NAIC Meeting Recap
by Mary Cannon Veed

Pages 18 - 19:
Meet Your Colleagues
by Joe DeVito

Pages 20 - 23:
Receivers' Achievement Report
by Ellen Fickinger

Thank You To The Sponsors Of The March 2003 Roundtable

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Correction: In the Spring issue of *The Receiver*, the firm name of one of the IAIR 2003 Insolvency Workshop sponsors was incorrectly listed on page 3. It should have been Colodny, Fass, Talenfeld, Karlinsky & Abate, P.A.

View From Washington

by Charlie Richardson

Opening a Can of Worms? Congressional Re-Examination of Fair Credit Reporting Act

A storm is hovering over Congress as the January 1, 2004 expiration of the federal preemption by the Fair Credit Reporting Act nears. That law allows insurance companies to share customer information, including credit report data, used in the underwriting process. Insurance firms are currently required to comply with state insurance laws when using credit information in the underwriting process and this compliance is becoming increasingly tricky. Numerous state legislatures are clamping down on personal auto and homeowners insurance companies' long-held practice of looking at consumer credit information in determining whether to issue or renew policies, or what premiums to charge for those policies. Examination of the FCRA could lead to a new discussion in Congress over how insurance companies use credit scoring, as well as opening several other sticky issues relating to privacy. But it is legislation which the Congress will have to act upon this year.

House Financial Services Committee Announces Aggressive Insurance Industry Agenda

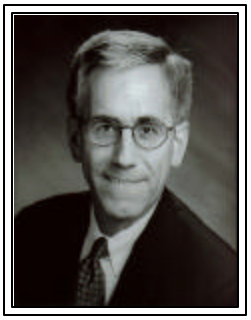
As part of its Oversight Plan for the 108th Congress, the House Financial Services Committee has announced a laundry list of 20 insurance industry issues it intends to address over the next two years. Among them are: Insurance Solvency Regulation, National Insurance Uniformity (including optional federal charter proposals), Terrorism Insurance, Workers Compensation Insurance, and several others.

The complete list, almost breathtaking in its depth and breadth, can be found on the web at http://financialservices.house.gov/media/pdf/01-31-03%20Oversight%20Plan.pdf. The House Financial Services Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, Chaired by Congressman Richard Baker (R-LA), is expected to examine many of these issues this Congress. Congressman Baker told us in a March meeting that he was particularly interested in speed to market issues.

Calling in the Doctor – House Republicans Reintroduce Medical Liability Reform Bill

Striking doctors from New Jersey to Nevada protesting rising malpractice insurance premiums have focused renewed Bush Administration and Congressional attention on medical malpractice conditions. Rep. Jim Greenwood (R-PA) reintroduced his bill, the "HEALTH Act of 2003" (H.R. 5). H.R. 5 limits punitive damages to two times the amount of economic damages awarded or $250,000, whichever is greater, establishes a cap on non-economic damages at $250,000, and limits the number of years a plaintiff has to file a healthcare liability action. The bill got quick action in the House, by passing on March 13 by a vote of 229-196, largely along party lines. The Senate will be tougher. Majority Leader (and Dr.) Bill Frist (R-TN), a key backer of medical liability legislation is negotiating with Senator Diane Feinstein (D-CA) for a more moderate bill, but bucking the trial lawyers' alliance with the Democrats is hard. Senator Edward Kennedy (D-MA) and Patrick Leahy (D-VT) have suggested reining in malpractice premiums through eliminating malpractice insurers' exemption from antitrust laws. If the Congress does not act, reform pressures will continue in certain states. After all, few legislators are going to be able to avoid some kind of action in the face of striking emergency room doctors.

Much of the discussion implicitly conceded that the current state system was not as efficient or flexible as it needs to be



Department of the Treasury Interim Final Rule Under the Terrorism Risk Insurance Program

In late February, the Department of the Treasury issued an interim final rule as part of its implementation of Title I of the "Terrorism Risk Insurance Act of 2002" (P.L. 107-297). The Act established the "Terrorism Risk Insurance Program" to provide a temporary reinsurance backstop for commercial property and casualty insurers in the event of future terrorist acts. The Program will remain in effect until December 31, 2005.

The interim final rule outlines the purpose and scope of the Program and key definitions that Treasury will use to implement it. See 68 FR 9803-9814. The interim final rule incorporates, with some modifications, guidance previously issued by Treasury [December 11, 2002 (67 FR 76206-76208, 67 FR 76208-76209); December 2, 2002 (67 FR 78864-78869); January 29, 2003 (68 FR 4644-4545)]. The rule is the first in a series of regulations Treasury will issue to implement the Program.

In mid-March, Treasury also announced the appointment of Jeff Bragg, former administrator of the Federal Insurance Administration during the Reagan administration, to head the federal program.

News From Headquarters

New York IAIR Meetings Schedule

Please note the IAIR schedule for the New York meetings has been revised to accomodate changes to the NAIC schedule. The IAIR reception will be held on Sunday evening rather than our usual Saturday evening.

In addition, IAIR is holding a strategic planning Board Meeting all day Friday in advance of the regular Board Meeting on Saturday morning. The Friday Board Meeting is open to all IAIR members.

The following is the schedule of IAIR meetings, which are being held at the New York Hilton and Towers located at 1335 Avenue of the America, New York, NY 10019 (Tel: 212-586-7000):

Friday, June 20th	Board Meeting	9 a.m - 5 p.m.	East Suite, 4th Floor
Saturday, June 21st	Board Meeting	9 a.m. - noon	Clinton Suite, 2nd Floor
	Roundtable	1 - 4:30 p.m.	Clinton Suite, 2nd Floor
Sunday, June 22nd	Committee Meetings	8 a.m. - 5 p.m.	Hilton Board Room, 4th Floor
	Reception	5:30 - 7:30 p.m.	Harlem Suite, 4th Floor

These meetings are open to all IAIR members. We encourage you to get involved in a committee. Please contact any of the chairs listed below to find out how you can assist. The schedule of committee meetings will be available on the IAIR website at www.iair.org under the Events & Schedule section.

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IAIR Roundtables 2003 Schedule

NAIC Meeting - June 21 - 24, 2003
New York City, NY
Roundtable: June 21, 1:00 - 4:00 p.m.

NAIC Meeting - September 13 - 16, 2003
Chicago, IL
Roundtable: September 13, 1:00 - 4:00 p.m.

NAIC Meeting - December 6 - 9, 2003
Anaheim, CA
Roundtable: December 6, 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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Legal Counsel: William Latza and Martin Minkowitz of Stroock Stroock & Laven LLP.

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Atlanta NAIC Meeting Recap

by Mary Cannon Veed

After playing hooky from my role as meeting recapper for a few months, I am hopefully back on the straight and narrow path that will produce reasonably timely meeting reports for the newsletter.

The agenda for the Atlanta Roundtable has to have been the most enticing I've seen in many a meeting. It had new faces, new issues, hints of controversy and plenty of variety. The actual event wasn't quite as good as the advance billing, but it was still a blockbuster presentation. It led off with a presentation on the EU's insurance solvency work. The hoped-for European Commissioner didn't materialize, but Morgan Fullilove did. What was disappointing is that she stuck to the procedural facts, and although there was a wealth of information about websites and white papers, she didn't really explain why any of us should want to read them. The difficulty is that she couldn't very well do that without lending some credence to the idea that all is not well in European insurance regulation, and she wasn't inclined to go there. In fact, the EU is in the puzzling position of having adopted a set of mandatory, Community-wide laws, which are taking effect just about now, when it hasn't gotten around to developing enough regulations to flesh them out. There is a real risk that hastily-constructed and superficial gap-fillers will create loopholes and entitlements that will be disruptive to solvency regulation everywhere. For some reason, it's much easier to adopt EU rules than to un-adopt them, so bad rules need to be headed off early.

Most of us would appear to be unaffected by the shenanigans of insurance regulation in continental Europe, but watch out! Having finally gotten permission to tackle insurance regulation, the EU machinery has already begun pressing the US to "remove barriers" to free trade in insurance. The barriers in question are US state-based rules that don't give reciprocal recognition to European insurance regulation (as we do to other states). Deb

Hall's presentation on reinsurance security rules last meeting was the tip of a pretty good-sized iceberg in that area. There's a great deal to be said in favor of the concept that when a "civilized" country applies a "plausible" system of insurance regulation, its conclusion that a given company is solvent and functional should be reciprocally recognized here, if our own companies get the same treatment there, especially given that insureds really do benefit from access to a wide range of insurers. ("Civilized" and "plausible," of course, are elastic terms.) It is very likely that the US will have its own free trade gospel quoted back at it, and we will end up with some form of treaty-based mutual recognition of insurance regulation. In theory, it's even a good idea. To make a long story short, those solvency rules they're building in Brussels stand an excellent chance of governing companies who will do business in your backyard in a few years.

Among the websites she referred to was the excellent site put up by the EU itself, http://europa.eu.int/comm/internal_market/insurance/. If the bright idea from the Board has come to pass and you're reading this newsletter by email, click on that link and download yourself some bedtime reading. Even if it hasn't, I understand IAIR will post the Powerpoint presentations on line; if they can do that it should provide a great resource for anyone who might have dozed off or otherwise failed to listen attentively to the excellent presentations.

For those who haven't encountered 304 orders, John Finston's presentation was a good primer on a little-known, but potentially important, complication to a US liquidation with foreign entanglements.

On a more general note, Bob Greer's nice letter notwithstanding, I am still not convinced IAIR has recovered from the nasty bout of xenophobia that surfaced during the election of officers. Periodically, the organization wonders why it is called "International." Generally it doesn't wonder very long. International members were instrumental in the formation of IAIR and they have provided invaluable perspective and breadth to the organization ever since. There is absolutely no good reason why non-US members should be relegated to the role of second-class members, yet we sometimes behave as though that is where we are headed. IAIR needs to strongly reaffirm its commitment to international membership, or it is apt to lose those members and not a few Americans as well.

It's been a while since we saw Ian Nasatir at an IAIR meeting, but his presentation on holding company bankruptcy as a complication to the insolvency of the insurer showed insolvency proceedings from a whole new angle. Time was, when an insurer failed, even though it inevitably had a holding company, nobody paid it much attention. More recently though, owners have realized that exploiting the bankruptcy system and the myriad overlaps between its jurisdiction and that of the receivership creates many opportunities to salvage value from what would otherwise be a lost cause. But it also made me wonder why receivers, often the representative of the holding company's single largest creditor, and clothed with all the powers of the Holding Company Acts to boot, don't insist on a greater role in bankruptcy proceedings, to prevent them from becoming the exclusive playground of management and the bankers, and to nip at the bud any incipient conflicts of jurisdiction. Come to think of it, the same probably goes for

304 hearings.

The remainder of the NAIC meeting was, frankly, a disappointment. The most striking thing about it was what wasn't there. Dozens of insurance commissioners, some of long standing, have left office. While it is true that the same number of newcomers have arrived, they weren't making much of an impact yet. The result was a sort of a vague and disoriented meeting, reflecting, I am afraid, a vague and disoriented NAIC. It's perfectly understandable that it should be preoccupied with assimilating its new members, and that they should be concerned more with their homestate budget crises than NAIC matters. But if the NAIC cannot regain its focus and direction, we could be in for a frustrating year, and they are going to find themselves blindsided by national insurance issues. Emblematic of the situation was the accidental "endorsement," by one of Commissioner Pickens' deputies, of association health plans in testimony to Congress. The original confusion, while unfortunate, was no disgrace – foot-in-mouth disease affects everyone sooner or later.

The fact that, by the time the NAIC assembled, its real position, while stated, was still largely uncommunicated, and that it looked as though the issue had gotten ahead of the NAIC and not the other way around – now that was a problem that would have been easier to prevent than it turned out to be to cure.

Of course, from the receivers' point of view, association health plans are a terrific idea. Why, they are a positive treasure trove of employment opportunities for both receivers and lawyers, almost as good as METS and MEWA's. The IAIR Board chose to preoccupy itself with internal issues, and passed up a chance to issue a ringing endorsement to Mr. Hartnedy – well, they plainly aren't looking out for our best interests here!

Hopefully it's a temporary artifact of all the new arrivals combined with a host of evil state budget problems, but government attendance was way down, and those who came seemed short on marching orders. Crowning the problem was the inability of the MARG task force to command a quorum for more than a few minutes, notwithstanding hours and hours of work that should have been within striking distance of a conclusion. The truth is there are only a handful of issues that are really controversial in the whole MARG, and even those controversies are mild ones. If the Task Force allows itself to get high-centered when it encounters a genuine issue, there is little hope it will ever report out a useful statute.

I completely missed, until Business Insurance reported it, the curious events surrounding reinsurance collateralization. The Reinsurance Task Force has been fiddling with the concept of reducing the requirement of 100%-of-gross-reserves collateralization, in the name of creating a more level playing field between foreign reinsurers and US companies, who may not require collateral at all. The Insolvency Task Force thinks that's a terrible idea; they worry that reinsurance collection overseas against insolvent markets is chancy and difficult. The foreign reinsurers tend to grumble that the ITF never tried to collect reinsurance from an insolvent US reinsurer, and there's the implicit threat that super-collateralization simply forecloses US insurers from access to sound, responsible reinsurers overseas who can find more attractive ways to tie up their scarce capital than in an NAIC trust fund.

It seems the RTF worked its way around to deciding to recommend a reduction in collateral requirements. Initially the proposal was to have been for prospective application only. At least, that's what Commissioner Csiszar says he thought when he voted for it. But in the minutes, lately published (but not, of course, adopted by the Task Force yet) the motion seems to have gained a little extra wording: that ceding companies could agree with their reinsurers to apply the new rules to old business, too. That was the substance of a colloquy between Commissioner Oxendine and Bill Marcoux, representing the IUA. But was it part of the motion to approve? Whether it was or not, should it have been?

Although I tend to agree that the current requirements are excessive, for the life of me I can't decide if the addendum enhances solvency or impairs it. On the one hand, it gives the ceding company a tempting "chip" to use against a reinsurer that is threatening non-renewal. On the other hand, how many ceding companies, pursuing renewal, would turn down the demand of retroactive reduced collateral if it were possible? More to the point, if the reduced collateral is really hazardous applied retroactively, why allow it going forward? Conversely, if it's a safe tactic, why not OK it retroactively, too, if the parties agree? The parliamentary fuss has had the curious effect of drawing attention to the general issue of collateralization and need for a level playing field, but also highlighting a lack of consensus among the commissioners that, for some reason, is more visible between task forces than between states. Curiouser and curiouser.

On the other hand, somebody forgot to tell Holly Bakke that her fellows had left their determination home. She had a busy meeting, starting off with a rousing presentation (in the best former-schoolteacher audience participation tradition) to IAIR, and going on to announce an initiative to educate potential receivership judges, a white paper and thinly disguised wakeup call toward more effectiveness for guaranty funds, and participating in a parallel session on "improvements" to the receivership system. What she hasn't done (yet), is make the organization finish what it has already started. Our receivership system would be considerably improved if the NAIC actually finished, and convinced their members to implement, the reforms that have already been proposed. The NAIC is in a mode where it is good at starting things, bad at finishing them, and abysmal at selling the finished product. The last couple of years it has seemed to be shaking off its malaise, but this meeting looked very much like a relapse. Hopefully it's temporary.

An Interview with Arkansas Insurance Commissioner Mike Pickens

by Trish Getty, AIR-Reinsurance

BACKGROUND

Education

I have been Arkansas Insurance Commissioner now for six (6) years, since January 1997. Prior to becoming commissioner I was a litigation attorney and partner in the Little Rock law firm Friday, Eldredge & Clark, the largest law firm in Arkansas. I represented policyholders who were being sued in personal injury and workers' compensation litigation. I also handled some family law cases and performed pro bono legal work. Please see attached biography

Yes, I attended college on a baseball scholarship to the University of Mississippi ("Ole Miss"). If I may say so myself, I was an excellent high school baseball player but a mediocre major college pitcher. After a bout with mononucleosis and some arm trouble my freshman year, my primary claim to fame was giving up back-to-back home runs to Raphael Palmeiro and Will Clark one cold night in Starkville, Mississippi. In fact, I was the second pitcher to do so that night. We lost that game something like 24 to 16. Former New York Yankee's catcher Jake Gibbs was a great friend and coach. Coach Gibbs kept me on the team and allowed me to get my education. I think he kept me on the team just to hold up the team GPA since I was in pre-med and made good grades.

Playing major college athletics has helped me understand the importance of hard work, teamwork and never giving up no matter what the odds are against you. Something my dad told me when I was a little boy has served me well in both athletics and life: "When the going gets tough, the tough get going."

Family

My wife, Melissa, is a high school science teacher. My daughter, Mary Catherine, is ten (10). She is an excellent student and good little athlete. Basketball is her sport and she plays on a little all-star team that travels to tournaments in Arkansas, Missouri, Tennessee and other surrounding states. My son, Rob, is seven (7). He is very thoughtful, inquisitive and wants to be a scientist. He is just now beginning to get into baseball and other team sports.

Zero, a Boston Terrier, is the family dog. But don't tell him, Melissa or the kids that. He is a real character and an integral member of the family. When he was a puppy, he bit an insurance adjuster. I don't know if there is significance to that or not...

I have sat down with Melissa and the kids and gotten their permission to be somewhat of an "absentee father" for the year 2003. Seriously, though, ever since I have been a NAIC officer I have made it a point to be home as much as possible, particularly for important events, and on weekends. I have been Mary Catherine's assistant basketball coach now for the past four (4) years, and I take Melissa and the kids with me as much as possible when traveling on NAIC business. Our work at the NAIC is important, certainly. However, God and family come first.

The reforms are also affecting the terms of private contractual arrangements.

Arkansas Insurance Commissioner

1. Why did you want to become the Arkansas Insurance Commissioner?

Honestly, I did not seek appointment as Arkansas insurance commissioner. I was a partner in the Friday law firm, had a good law practice and was staying busy with work and family commitments. I was surprised when Governor Mike Huckabee contacted me about the position. The more I looked into the job, the more intriguing it became to me. I thought the job would be an enjoyable challenge and a chance to learn more about insurance regulation. As an attorney, I knew and dealt with insurance law and the claims process but really did not have a great deal of experience on the regulatory side. I still believe my best qualification as Arkansas insurance commissioner is that I am a well informed insurance consumer, first and foremost.

2. What is your greatest achievement as Arkansas Insurance Commissioner?

I believe our (not my) greatest achievements here at the Arkansas Insurance Department since 1997 have been our reorganization of the Department, particularly the Finance Division, which is responsible for monitoring insurer solvency and market conduct; achieving NAIC accreditation with one of the top five (5) scores ever awarded in financial analysis; implementing necessary technology initiatives which have made this Department more efficient and effective (Arkansas won the NAIC Technology of

the Year award two (2) years in a row, and was the very first state to implement all the Regulation 2000 initiatives); obtaining full law enforcement authority for our Fraud Division; and being very successful in passing good, necessary consumer protection legislation (we have successfully passed over one-hundred (100) pieces of legislation since 1997).

3. What is your greatest individual achievement?

I believe our greatest achievements here at the Department have been the improvements we have made to the financial solvency division and passage of a number of pieces of good consumer protection legislation. See attached annual report messages.

4. From your prior professional experience, what single experience or person has proven to be the most helpful in your current position?

I have been fortunate to have some great mentors in my life. Buddy Sutton, the Managing Partner of the Friday law firm, is the best litigator in Arkansas and one of the most prestigious defense attorneys in the country, representing clients like Union Pacific Railroad and Browning Arms Company. It was an honor to practice law with and learn from Mr. Sutton. Undoubtedly, though, the two (2) most important influences on my life have been my dad, Jim Pickens (who recently retired from a 35-year career as an executive with a large public utility and now is serving as the Economic Development Director for the State of Arkansas) and my grandfather, O.C. Pickens, Jr. Both my dad and my grandfather have taught me the importance of hard work, character and integrity, perseverance, honesty, God and family. If I become just half the man these men are, I will have had a successful life.

5. As an appointed Commissioner, do you think this system is preferable to electing a Commissioner?

I have served with some excellent elected commissioners, folks who are willing to put good regulation above politics. However, it is my personal opinion the best regulatory system is one where the chief insurance regulator is appointed for a term of years. This gives the commissioner a degree of independence from both the person who appointed him and the legislature. This system allows the regulator to do the right thing, but it still makes him or her accountable to both the state's chief executive, legislature and, most importantly, the people.

6. After 9/11, what was the single largest challenge you have faced in office?

After 9/11 I think the single biggest challenge regulators have faced has been the hardening of the property and casualty insurance market and issues related to terrorism insurance. Although the market was hardening before 9/11, this tragedy seemed to help create a "perfect storm" of events that have rocked the property and casualty industry, in particular. Insurers are having to deal with a number of adverse market factors, and consumers have been directly impacted in the form of rate increases, cancellations, nonrenewals and other concerns. While I believe regulators have handled this situation well and have worked in the very best interest of consumers, this has been a tough time for consumers, insurers and regulators.

NAIC Officer

1. How have you enjoyed your prior experience as an NAIC Officer?

I have enjoyed my two (2) years as an NAIC officer and look forward to this year as president. We have many experienced, energetic and hard-working NAIC members. I see my job as NAIC president as being to involve and motivate our membership and to provide them all the tools they need to meet our goals for 2003. I believe you can accomplish a great deal when you don't care who gets credit for it. All the credit for our success will go to our NAIC members.

2. What was your most memorable experience to date?

The most memorable part of being an NAIC member is working with some of the most intelligent, hard-working, dedicated public servants in the country. I really can't think of a single "most memorable" experience. However, my involvement in the NAIC's international work, particularly our technical assistance to developing nations, has been both a unique and enjoyable learning experience. I have been fortunate to travel to Warsaw, Cairo, Geneva, London, Dublin and other places around the world. This year, we're in the process of planning trips to China and Russia. This international work gives us a chance to help ensure there exists a level legal and regulatory playing field for United States insurers doing business in these new, emerging markets; and gives us the chance to help our foreign colleagues as they work to protect consumers and facilitate the development of their marketplaces. It is exciting work. If we can help improve the financial service markets and prosperity of these countries, just maybe the world will be a little better place in which to live. Prosperous people -- those who can feed, clothe, and house their families and live in relative comfort -- tend to be happy and peaceful people.

3. What is the single most significant benefit to state regulation that you have seen?

It is difficult to cite the single most significant benefit to state regulation I have seen. I will say I believe the Gramm-Leach-Bliley Act ("GLBA"), the Congressional scrutiny of state insurance regulation that has accompanied it, and the unprecedented progress we have made in modernizing state regulation have been very positive developments for state insurance regulation. There now is enormous consensus that the state-based insurance regulatory system must be modernized, that it must become more efficient, more effective, less costly and less burdensome, and that all this must happen in a way that improves consumer protection. I strongly believe the very best days for state insurance regulation lay ahead.

4. After 9/11, what has been the single largest challenge the NAIC has faced?

After 9/11 the single largest challenge the NAIC has faced has been dealing with the myriad issues related to the hard property and casualty market and implementation of the Terrorism Risk

Interview with Mike Pickens (cont.)

Insurance Act of 2002. State insurance regulators are closely monitoring both the solvency and market conduct of the property and casualty industry. We want to make sure we allow companies to adjust to the changing marketplace in a way that does not displace or harm insurance consumers. We are closely scrutinizing rate increases, particularly those related to the terrorism risk. Many state legislatures are focusing on insurance issues, and state regulators have been working hard to educate lawmakers about the effects of their decisions on consumers. The NAIC has been and will continue to work closely with the United States Treasury Department to implement TRIA, and to enforce the anti-money laundering rules of the U.S.A. Patriot Act. There are many issues on the table, and we have our work cut out for us.

NAIC President

1. What initiative do you anticipate to be the signature of your tenure as NAIC President?

In addition to the ongoing technical work of the NAIC, in 2003 I have some goals I believe we must achieve for the good of our organization. First, I believe it is important we make good progress in developing the national product standards for the products covered under the Interstate Compact. We have created the National Product Standards Working Group, which will report directly to the Executive Committee. If we can make good progress on these national product standards, I believe we can earn the support of key law and policymakers for the Compact. In 2003 we also have created a Governmental Affairs Committee, the purpose of which is to educate interested parties, especially state and federal law and policymakers, about the benefits of state insurance regulation and the concerns we have about the federal charter proposals being discussed around Washington, D.C. It is vitally important for regulators to "get in the game" as far as this federal charter debate is concerned. We need to engage all the friends of state insurance regulation, particularly our Governors and key state and federal lawmakers to partner with us in our educational and modernization efforts.

Another key initiative this year will be the Global Receivership Database. Data is the lifeblood of smart regulatory and marketplace decisions. By centralizing and sharing information through this global receivership database, we can eliminate the need for antiquated state-specific differences, and allow states to more easily communicate concerning receivership information and information regarding potentially distressed insurers.

Along these same lines, we have created a new Information Resources Management Committee that will ensure the states have available to them state-of-the-art, Web-based technology, and that our business processes drive the use of our technology, not the other way around. Technology is a vital component of all our regulatory modernization efforts.

State regulators have made a significant impact on international issues. In 2003 I would like to see us make significant progress on our work to ensure fair, effective International Accounting Standards. I would also like to see us sign Memoranda of Understanding with Vietnam, India, and perhaps Russia and Latin American countries like Chile. We will also work closely with insurance regulators in China to provide some substance and technical assistance based upon the Memoranda of Understanding we signed with them in 2002. I would like to see regulators weigh-in on the asbestos litigation issue, and study the effect of class action litigation on consumers, company solvency, and state regulation, in general.

Finally, the number one complaint we receive in the states is "My health insurance costs too much and I can't afford it." This is one of the most important consumer issues in the country. In 2003 I would like to see state insurance regulators put this issue front-and-center and to focus the health insurance debate on the problem of COST; work to determine what is driving the cost of health insurance, and then offer some reasonable, market-based solutions and more individual choices for consumers. There is not a one-size-fits-all solution to this problem. To date state insurance regulators have not contributed as much to this important consumer issue as we need to. I believe we will do so in 2003.

2. Aside from being an organization that meets in conjunction with the NAIC, and as well as conducting education workshops, what do you know about IAIR?

Steve Uhrynowycz, the Deputy Receiver for Arkansas, and I have participated in IAIR meetings.

3. What can IAIR do to help the NAIC understand its structure and role?

I believe it is important for IAIR members and the NAIC to work together and attend each others meetings so we each will understand our respective roles in helping insurance consumers in a time of dire need. I am not sure how much other commissioners, particularly some of our new members, may know about IAIR.

4. What can IAIR do to help individual Commissioners and/or Superintendents of Insurance?

I would encourage IAIR to send each commissioner information about your organization and invite as many commissioners as possible to participate in IAIR functions, meetings and educational events.

5. What do you think of a professional organization doing a per employment certification of persons qualified to act as Receivers?

I like the idea of professional organizations doing a per employment of certification of persons qualified as Receivers. This is an interesting concept, one I believe has some value, and I would like to hear more about it. This could very well be a valuable service to Departments charged with retaining insurance and solvency professionals.

6. Would you support a change in the NAIC accreditation requirement that each department must employ an IAIR Certified receiver to supervise a multi-state insolvency?

I would have to learn more about the issue and visit with NAIC members before I would support a change in the NAIC accreditation requirement that each Department must employ an IAIR certified receiver to supervise a multi-state insolvency. It is important to have full NAIC membership support before adding accreditation standards. If this initiative is something IAIR would like to pursue, I would encourage you to contact Donna Lee Williams, the Chair of the NAIC's Accreditation Committee, so the issue could be thoroughly discussed and vetted with the entire membership.

7. Do you think that it is important that there is a flow of communication between the regulators and the receivers?

I strongly believe it is important that there is a good flow of confidential information and communication between regulators and the receivers.

8. If so, who would you suggest act as a liaison between the individual state regulators and the receivers?

I am not sure I believe there is a need for a liaison between individual state regulators and receivers. I believe it is very important for commissioners, directors and superintendents to, as much as possible, work directly with their receivers and to meet with them about important insolvencies on a regular basis. Personally, I believe direct, regular contact under these circumstances is preferable to having anyone act as a liaison.

9. Since the NAIC seems supportive of an interstate compact for uniformity and efficiency in certain areas, why is there not more support for the compact with regard to receiverships?

See Question 11 below.

10. What is your view of federal regulation of insurance?

a. As to Health Insurance?

b. As to Property and Casualty?

c. As to Life and Annuity

At this time, I am opposed to federal regulation of insurance in any form. Encroaching federal jurisdiction into the area of health insurance is one of the factors that has resulted in the demise of the small group health insurance market, the politicization of health insurance, and the increasing cost and bureaucracy associated with health insurance. Generally speaking, federal regulation is more distant, less accountable and less responsive than state regulation. When insurance consumers need to call 911, they want and need that call to be a local call, not a long distance call. State insurance regulators are much more responsive and accountable to their insurance consumers than any federal regulator could every be. Also, governors and state law and policymakers are concerned about the loss of premium tax and other revenue that would inevitably result from the creation of a large new, distant federal bureaucracy in Washington, D.C. That being said, I do believe it is important for the state-based insurance regulatory system to modernize, to become more coordinated and less burdensome. The NAIC has made a great deal of progress in its uniformity/reciprocity efforts since the passage of GLBA in November 1999.

11. Do you think that insurance regulators should look to bankruptcy law as a model for handling insurance insolvencies?

Undoubtedly, the way state regulators handle multi-state insolvencies is vitally important to insurance consumers. When a multi-state insurance company becomes insolvent, it is imperative that state insurance regulators cooperate and communicate effectively, coordinate their regulatory and consumer protection activities, and work together with one another and the various guaranty funds in order to ensure consumers' claims are handled in the most efficient, expeditious way. I do believe we can learn some things from looking to bankruptcy law as a model for handling insurer insolvencies in some ways. I particularly like the federal bankruptcy database, and would like to see the NAIC create a "Global Receivership Database" in 2003. The Model Act Receivership Working Group is currently reviewing the NAIC Insurers Rehabilitation and Liquidation Model Act and considering incorporating provisions of the Uniform Receivership Law which is more bankruptcy oriented than the NAIC Model Act. At the end of the day, the most important goal is to ensure that consumers' claims are paid in as seamless a manner as possible.

12. How do you think the Reliance insolvency has affected the industry?

The Reliance insolvency has given all state regulators a wake-up-call as far as insurance insolvencies are concerned. I believe as we do a post-mortem on all aspects of the Reliance insolvency we will learn many things about improving our monitoring of insurer solvency and handling large insolvencies, the latter particularly with regard to the interaction between state regulators and the state court system. One thing that definitely has come out of the Reliance situation is that we now understand the importance of educating state court judges about the possible adverse effects of ongoing litigation on insurance consumers in these cases.

13. What are your thoughts on the challenges of regulating commercial property casualty business and minimizing the impact of insolvencies in a market which appears to be trending away from state regulation, e.g. more business in captives not licensed in many states, greater involvement of offshore entities (whether reinsurers or affiliates), policies which increasingly feature high deductibles or other arrangements that simulate self-insurance, etc.?

Certainly there are challenges in regulating commercial property casualty business and minimizing the impact of insolvencies in a market which at times appears to be trending away from state regulation, with more business in captives which are not licensed in some states, greater involvement of offshore entities

Interview with Mike Pickens (cont.)

and other arrangements that simulate self-insurance. State law and policymakers have taken steps to attract insurers back into their markets. For example, many states now have passed, or are in the process of passing, captive insurance laws. I believe it is important for state regulators to demonstrate the value of good regulation to regulated entities. Good, reasonable, fair regulation is not only good for we insurance consumers, it can and should be good for the regulated entity, as well. Regulation need not always be an adversarial process. Regulated insurance companies can learn a great deal and keep themselves out of trouble, if they will develop an open, honest relationship with their regulators. I firmly believe good, reasonable regulation is better than no regulation, and I believe most insurance entities believe that as well. The rub is, how do we create a regulatory environment that will protect consumers and work well for the industry?

14. Assuming that insolvencies are on the radar screen of the insurance commissioners, what can we do as receivers and guaranty fund administrators to assist the regulators in doing their job better?

Insolvencies are always on the radar screens of insurance commissioners. IAIR, the guaranty associations and state insurance regulators need to maintain a constant dialogue and work to find ways by which we can, on a routine basis, confidentially share information and expertise that can help prevent insolvencies or, if and when they occur, ensure they are handled in as smooth a manner as possible.

15. Many receivers feel that better post-mortems could be done on insolvencies. Is there statistical data that could be compiled that might be useful for regulators or IAIR?

I agree that better post-mortems must be done on insolvencies. Under the leadership of Commissioners Holly Bakke and Chuck Cohen, the Insolvency Committee at the NAIC will be working not only to create the Global Receivership Database, but also to identify ways that guaranty associations and regulators can work more closely together both before, during and after insolvencies and conduct better post-mortems on insolvencies. The NAIC would be interested in any specific recommendations IAIR might have in this regard.

16. The NAIC seems to be moving in the direction of uniformity of laws (at least as it affects business development issues of the marketplace). Insolvency and guaranty fund laws although similar in many respects still result in disparate treatment for policyholders and third party claimants depending upon their state of residence. Does the NAIC foresee the uniformity of guaranty fund and insolvency laws as a priority?

Many commissioners have expressed concerns about the disparate treatment for policyholders and third party claimants that exists because of minor, irritating deviations among various state insolvency and guaranty fund laws. I do believe it is about time the NAIC made the uniformity of guaranty fund and insolvency laws a priority. I am hopeful that, under the leadership of Commissioners Bakke and Cohen, this reprioritization will be one of the positive effects of the development of the Global Receivership Database project.

17. How do you think Unicover affected the industry? Do you believe that the aftershocks have finally subsided or are there other potential "Unicovers" out there?

Again, situations like Reliance and Unicover tend to serve as wake-up calls and learning experiences for all of us. I would not want to speculate about whether there are any other situations like these lurking out there. However, I will say these situations remind us regulators to remain always vigilant in our consumer protection activities.

18. Do you think states should take a more active role in policing foreign reinsurers who take a predominant position relative to the underwritten liability on a surplus lines basis? If so, will the NAIC work with the states to coordinate efforts so that more states can afford to monitor these reinsurers?

I do believe states should remain ever-vigilant in policing foreign reinsurers who take a predominant position related to the underwritten liability on a surplus lines basis. In fact, state insurance regulators, working through the Surplus Lines Task Force, have already begun to step-up our efforts in this regard. The NAIC also is developing good relationships with the United Kingdom's Financial Services Authority and other international and foreign regulatory bodies so we can do a more effective, efficient job of protecting consumers in this area.

19. With the tenuous nature of the stock market adversely affecting investing income, to what extent should regulators consider regulating the rates insurers charge?

As far as rate regulation is concerned, I am a proponent of a competitive rating system where the regulators' job is to determine whether rates are "excessive, inadequate, or unfairly discriminatory." I believe a competitive rating model works best for consumers and for the industry. Where laws allow for over-regulation of rates, there is a tendency to suppress rates, which leads to price unpredictability and instability for consumers and solvency concerns for the industry. I do not believe we consumers are well-served by over-regulation of rates. I believe a competitive rating model strikes a good balance between allowing the market to regulate rates and allowing regulators to intervene to protect consumers as necessary and appropriate.

20. Guaranty Associations -

a. Should GA's be limited to the role of guarantor in receiverships or should they be viewed as preferred creditors?

Concerning the role of guaranty funds in receiverships, we know there is disagreement as to what priority the guaranty funds' expenses should have in the receivership. As a compromise, the NAIC model law creates a class for guaranty fund expenses between receiver's administrative expenses and

policyholders. In Arkansas, our law places guaranty fund expenses in the same class as receiver's administrative expenses. I tend to favor the Arkansas approach.

b. Should all states consider forming Life and Health guaranty funds?

I do believe that all states should consider forming life and health guaranty funds. It is very important for consumers to have available to them the safety net of a guaranty fund. This is just good consumer protection.

c. Similarly, and considering the extensive number of health maintenance organization insolvencies, should states consider forming HMO guaranty funds? Or would it be better to expand the role and responsibilities of life and health guaranty funds?

In many states, because of the very small size of their HMO marketplaces (for example, in Arkansas we have four (4) licensed HMOs), it would be difficult or impossible to pass a guaranty fund law for HMOs. The simple reason is that where there are only three (3) or four (4) HMOs in the marketplace, one of those HMOs generally has a disproportionate share of the market, and thus its consumers would bear a disproportionate share of the guaranty fund liability. If a state has a large, competitive HMO marketplace, an HMO guaranty fund may be much more feasible. For purposes of consumer protection, I would argue it is generally better to expand the role and responsibilities of life and health guaranty funds to include HMOs rather than to create HMO-specific guaranty funds. Of course, there are political hurdles to overcome in both scenarios.

21. What do you anticipate to be the long term impact of the numerous corporate failures of the past 12 months? (e.g., Enron, Worldcom, etc.)

I anticipate the long term impact of corporate failures like Enron, Worldcom and others will be increased legal and professional and ethical standards for accountancy, an increased level of accountability for corporate executives, as well as a healthy degree of increased cynicism on the part of stockholders and investors. I believe all of us will be much more critical and questioning of the balance sheet than we have been in the past, and I believe that ultimately, this is a good thing for consumers, companies and our economy. Stock prices must reflect true, not phantom, value in order for our system of capitalism to thrive, prosper and serve us well.

22. With substantial premium increases virtually industry wide after 9/11, do you think there is a capacity problem with the industry?

I have not seen any evidence of a serious capacity problem at this time except there are affordability problems in some stressed lines like medical malpractice and nursing home liability in some states.

23. How do you propose that the NAIC position itself to deal with the burgeoning development of offshore and alternative insurance devices to which domestic industry looks whenever the economy starts to slide?

I believe state insurance regulators need to work to make our regulatory environments as seamless and reasonable as we possibly can without giving away anything in the way of consumer protection. I also believe we need to learn to get a handle on the burgeoning development of offshore and alternative insurance devices so we can ensure a necessary and appropriate level of consumer protection regardless of the status of our domestic economy.

24. What more can the NAIC do to address the utilization of alternative health financing mechanisms?

As I mentioned before, I believe it is vitally important the NAIC focus more this year on our number one (1) consumer complaint: "My health insurance costs too much and I can't afford it." From listening to consumers from my state and all across the country, I am convinced consumers do not want or need a one-size-fits-all solution for financing their healthcare needs. And that really is the issue. Increasing health insurance costs is not really an insurance issue at all; it is a healthcare financing issue. Insurance is one way to finance healthcare, but certainly there are others. Unfortunately, to date the federal government has not allowed any of the other possible financing solutions to work. Such as medical care savings accounts, medical IRA accounts, tax credits for health insurance, and a number of other possible market-oriented solutions. Consumers want more choices tailored to fit their individual needs, not a one-size-fits-all solution. And if the federal government will "get out of the way," I believe state law and policymakers can provide some leadership and excellent alternatives. Undoubtedly, this question of how to finance the very best healthcare system in the world is one of the most important issues facing all of us in the 21st Century.

25. London --

a. How do you view the role of London and other overseas markets?

The role of the London market is important to many of our states. Traditionally, the London market has been willing to underwrite risks that other insurers either can not or will not underwrite. The London market plays an important role in our insurance system in this country.

b. What is your opinion on corporate (thereby limited liability) investments in Lloyd's?

From what I have heard, the corporate changes at Lloyd's have been positive developments for the London market. As I understand these changes as currently structured the corporate investment in Lloyd's will in no way adversely affect consumer protection. Certainly American regulators intend to be vigilant in working with the Financial Services Authority to ensure American consumers of the Lloyd's market are protected. I believe it is fair to say all of us want to see the Lloyd's market survive and thrive in the years to come.

c. How closely should the NAIC monitor the affairs of these other markets?

I believe it is vitally important for American regulators to closely monitor the affairs of the Lloyd's and other

Interview with Mike Pickens (cont.)

markets, and to work closely with regulators in other countries to ensure the highest level of consumer protection possible for American consumers.

d. Are current efforts to monitor these other markets effective?

I believe current efforts to monitor the Lloyd's and other markets are becoming more and more effective every day. We can always improve and are working to do so.

e. What other means of improving communication between other markets and the NAIC do you think should be implemented to enhance, if not simply to protect, the interests of domestic insureds adversely impacted by foreign insolvencies?

State insurance regulators are working through the NAIC to exchange important information and coordinate our regulatory activities of these markets. We also are working with key regulatory agencies in other countries to monitor the solvency of these markets. A key component here is the development of an agreed-upon set of international accounting standards. Also, working through the Surplus Lines Task Force and the IID Task Force at the NAIC, we will continue to improve and coordinate our regulatory communications and activities with regard to these important markets.

Closing

I believe the future is bright for state insurance regulations and the NAIC. Working through the NAIC, state insurance regulators have made remarkable progress in regulatory modernization and consumer protection since the passage of GLBA in 1999. And, after 9/11, state insurance regulators demonstrated the strength and importance of the state-based insurance regulatory system to everyone, particularly federal law and policymakers. If we as state regulators are responsible and accountable to, and take good care of, our fellow insurance consumers, we will prove that functional insurance regulation at the state level is the very best insurance regulatory system for all of us. And in turn, we will build upon our legacy of consistency, efficiency and trust and continue to serve state regulation well throughout the 21st Century. It is vitally important state regulators working through the NAIC engage in the federal charter debate. If we don't do it, who will?

Run-Off Sci-Fact

By Paul Evans and Julian Turner

Paul Evans and Julian Turner examine the arrival of the e-scheme for North Atlantic Insurance Co and look at its potential impact on insolvent run-offs.

Many people in the international insurance market will be familiar with the thump of a several hundred page document landing on their desk as yet another scheme of arrangement is presented to policyholders and brokers. In the case of North Atlantic Insurance Co (formerly British National Insurance Co), no such document has been circulated and yet the scheme has been supported by the policyholders and the Court, and is now effective. As a result, an estimated two million pages of print never reached it to the press, and yet the scheme is operating.

A scheme of arrangement is now acknowledged as the most likely vehicle for dealing with the resolution of an insurance company's insolvent run-off (and increasingly as a means of bringing solvent run-offs to finality), and scheme contents have continued to develop over the ten years or so since they were first introduced to the insurance market. This scheme for North Atlantic takes a step into the cyberage and also introduces other innovations.

The North Atlantic scheme has, for the first time:

- distributed a scheme document electronically;
- proposed a large estimation and cut-off of a direct insurance book;
- used a web-based approach for the submission of claims; and
- obtained the support of the Financial Services Compensation Scheme for a cut-off scheme.

E-scheme

Up until now, it has been normal practice in all types of schemes to circulate the proposed details and the Notice of the relevant meetings using a mass mailing to all known policyholders, as well as advertising the Notice of

meetings in appropriate journals and newspapers. Generally, this results in policyholders receiving a large package of documents and voting papers. In North Atlantic's case, if this approach had been taken, more than 9,000 separately identified individuals would have received such a circular. At the same time, recent security concerns in the US, where the majority of North Atlantic policyholders are based, have led to delays and difficulties in sending large packages through the mail service. So a different route was taken.

An initial application was made to the UK Court to seek approval for the proposal that North Atlantic place the scheme document on public areas of a dedicated website. This proposal was based on the widespread availability of internet access, particularly among commercial business policyholders. The proposal also set out the intention of mailing each policyholder a one-page summary of the Explanatory Statement, together with voting forms and details of how to access the website, ensuring strict compliance with the requirements of the Companies Act.

The application was approved and the Court made positive comments about the approach, in particular about the substantial savings in printing and postage costs. Access to the scheme documents is immediate for policyholders, as well as access to any other notices or market circulars. The documents are placed on the website in a format that cannot be amended by any third party but, of course, anyone who wants a hard copy can simply download the document and print it in the usual way. The scheme administrators can also add notes about the scheme and its operation, further reports to the market and, in due course, announcements about anticipated dividends without incurring additional distribution costs. At the same time, copies of the documents can also be transmitted electronically within large policyholder groups. In practice, the ease of posting news items on the website means that communication with creditors is likely to be more frequent than is realistically possible by using conventional paper-based distribution.

Estimation and cut-off

The insolvencies of most London market carriers that wrote a mixture of insurance and reinsurance have been handled through a scheme of arrangement which permits a period in which claims have been agreed in the ordinary course and a 'payment percentage' applied to those agreed claims. Well-known examples include Trinity, KWELM, English & American, and Orion. A number of other reinsurers went straight into an estimation or cut-off scheme, which place a present value on all future claims, crystallise a company's liabilities, declare a final dividend and close the estate. Examples of this technique include ICS Re, RMCA Re, Charter Re and Hawk.

Earlier run-off schemes are now being converted into estimation schemes, either using a special resolution of policyholders already provided for in the original scheme, for example the Andrew Weir run-off, or after an amending (i.e. a second) scheme to bring about the same result. Whereas the necessary actuarial techniques for estimating and allocating the liabilities of a reinsurer have been in use for many

Run-Off Sci-Fact (cont.)

years, the new challenge is to extend the techniques to direct insurance, in particular where there is substantial reserving for asbestos, pollution and health hazard risks (APH).

The Andrew Weir scheme has been converted to a final cut-off with total liabilities around $500m, substantially with APH exposures. North Atlantic's liabilities are estimated in excess of $800m, with more than half in respect of direct business and over 80% of the whole in respect of APH. With over 9,000 potential principals which might submit claims, the need was to provide an estimation methodology that was seen to be fair in allocating a limited pot of assets. North Atlantic also believed that it was important to produce a methodology that would assist those policyholders which do not have access to market data or to appropriate expertise to value their own claims, especially for APH.

As a result, policyholders are invited to submit data and information, preferably electronically, to support their claims for additional paid claims, outstandings or claims incurred but not reported ('IBNR'). This information supplements data held by North Atlantic. Policyholders can accept the information on the website detailing paid losses and outstanding loss reserves, discounted to a net present value, as a commercial offer, without taking any further action. It is anticipated that this offer will be attractive to various types of policyholders including those who have settled claims with solvent London market insurers, those with de minimis claims where it is not worth the effort to substantiate a case for a modest IBNR, and those whose claims are substantially mature and where North Atlantic's records reasonably accurately reflect the outstanding loss position. Alternatively, policyholders can make a fuller submission where North Atlantic's records do not accurately reflect the paid loss or outstanding loss reserve position, or where they wish to substantiate a claim for IBNR. In the latter case, a scheme feature is that policyholders do not advise a figure for IBNR. Instead, they provide data, for example statistics on asbestos claim filings, so that the scheme actuary can estimate the policyholder's ultimate claims. Only if data or information submitted by policyholders is disputed by North Atlantic will there be reference to an independent scheme adjudicator whose decision is binding on all parties. The estimation of ultimate liabilities and the allocation of those amounts cannot be the subject of dispute.

This approach avoids the possibility of negotiations with every policyholder, which could be time-consuming and costly given the number of policyholders, and also provides a uniform estimation methodology which applies to all. The North Atlantic scheme has received overwhelming support from policyholders, and in particular US policyholders have accepted estimation as a means of bringing older run-offs to a close.

Web-based submissions

The North Atlantic website (www.northatlanticinsurance.co.uk) contains both public areas and a series of secure areas, each one accessible only to a specified policyholder with appropriate user identity and password. These latter areas contain a series of screens allowing policyholders to add to North Atlantic's data and to submit claims in sufficient detail to assist the scheme actuary's estimation.

The exercise of circulating policy and some claim information to policyholders is key to an estimation scheme. In previous cases this exercise has been undertaken manually on paper forms, resulting in highly labour intensive new data inputting and results analysis. In contrast, the North Atlantic web-based system is demonstrably more efficient and less costly than any paper equivalent.

The advantages for policyholders include a user-friendly environment that enables multiple submissions for business placed through different agents.

For North Atlantic and its scheme administrators there is a unified format for responses which, with a direct link to core systems, avoids inputting new information with the inevitable risk of transcription errors. It also avoids having to interpret handwritten comments or amendments on paper forms. Control of claims verification is improved, as is the flow of management information as the responses of policyholders are received.

As ever, the proof of the pudding is in the eating. North Atlantic is awaiting 30 April 2003, the final date for policyholders to submit information and claims.

FSCS support for a cut-off scheme

Within North Atlantic's agreed claims and reserves are amounts in respect of policies that may be protected under the Policyholders Protection Act 1975 (PPA), in particular arising from professional indemnity and employers' liability business. Operation of the PPA and its interaction with schemes of arrangement was in the hands of the Policyholders Protection Board (PPB) until 1 December 2001 when these responsibilities passed to the newly formed Financial Services Compensation Scheme Manager (FSCS).

Whereas an established method involving the PPB in reserving schemes has been developed over the years, prior to the North Atlantic scheme there had not been a cut-off scheme for an insolvent run-off involving FSCS protected policyholders. For some time a clash of objectives has been identified – the scheme administrators are looking to crystallise all the company's liabilities, collect the remaining assets and pay a final dividend so that the run-off can be completed and the company dissolved. This process necessarily must include putting a present value on future claims from protected policyholders. For professional indemnity policyholders that may not be too difficult as, with older run-offs such as that for North Atlantic, policies have not only expired but are often well beyond the normal period of extended discovery for new claims to be notified. Given that the original policies

are usually written on a claims-made basis, there cannot therefore be any new claims in the future and reserves are for determining any deterioration in known claims ('Incurred But Not Enough'). However for employers' liability business, written on an occurrence basis, there will inevitably be a genuine reserve for IBNR, although this is likely to be calculated on a class basis as it is impossible to determine in advance which policyholder will actually incur the loss in the future.

A further difficulty is that the Financial Services Authority has indicated strongly its concern about the legality of any employer agreeing to commute an employer's liability policy, inter alia because of the potential impact on third parties which might benefit from claims under the policy. This issue above all had created a block on the ability to crystallise a direct book of business including protected policies.

The solution developed for North Atlantic, and likely to be the precedent for all subsequent relevant cut-off schemes, is to separate the cut-off of the estate from the run-off of the policies. As part of the actuarial valuation of all liabilities, North Atlantic's scheme actuary will place a present value on all outstandings and IBNR in respect of protected policies as a class, using information from North Atlantic's records and from policyholders as submitted as part of the scheme process. Dividends in the scheme will be paid on this class valuation to the FSCS and protected policyholders whose claims are finally agreed at a later date within the scheme period will be paid directly by the FSCS at the appropriate protected percentage (100% or 90%). Protected policyholders' claims that are finally agreed after the scheme period in a subsequent liquidation will be paid directly by the FSCS whose obligations will be triggered by the liquidation in accordance with the PPA. Claims under protected policies that have been agreed before the start of the scheme will be paid by the FSCS in the scheme as soon as practical.

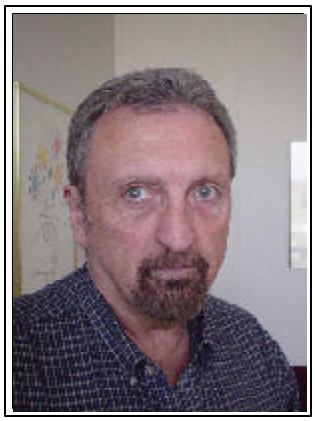
This process ensures that: protected policyholders receive the protected percentage whenever their actual claims are agreed without having to be subject to an actuarial valuation; the FSCS continues to make payment in accordance with the PPA on claims under a policy (policies will continue to exist until the company is dissolved); the FSA is content with the solution; and North Atlantic can, in due course, complete its run-off.

The development of these new features for a scheme of arrangement dealing with a run-off demonstrates yet again the generally flexibility of such schemes, allowing solutions to be tailored to the specific circumstances of any case. In this way a commercial deal that attracts sufficient support from those affected can be contained within an appropriate legal envelope which, once approved, will lead to that ultimate goal of finality.

Paul Evans is a partner in PricewaterhouseCoopers' discontinued insurance practice and Julian Turner is a solicitor with London law firm Richards Butler.

Meet Your Colleagues

By Joe DeVito



Don Aimar

Don Aimar is a staff counsel for the Nevada Division of Insurance and resides in Henderson, Nevada. He is a graduate of the University of Nevada Las Vegas and Loyola University School of Law in Los Angeles, California. He was admitted to practice law in Nevada in 1971. He is also admitted in California and the District of Columbia. He has been a member of IAIR since late 2001.

Aimar's work at the DOI includes appearing as counsel in receivership matters statewide, in addition to enforcement, legislative and supervisory responsibilities. He has been involved in every receivership action taken by the Nevada Commissioner since 1989 as a deputy attorney general, outside counsel and as staff counsel. His previous legal experience has been in civil and criminal law, private practice as well as government service as a public defender and general counsel to the state workers' compensation insurance fund.

Mr. Aimar has been counsel in receiverships of property & casualty companies, HMOs, home warranty and pre-need insurers. He was lead counsel in most of those cases. Currently he is lead counsel in the liquidation of First Nevada Insurance Company, a Nevada domestic property & casualty insurer.

He is currently a member of the By-Laws Committee of IAIR. He also has served for over 5 years as president of the Board of Directors of a local non-profit community based counseling agency located in Las Vegas. Mr. Aimar has made Nevada his home since return to the state after completing law school in 1970.

Michael P. Fleck

Michael P. Fleck is Managing Director and owner of The ROME Group, LLC, where Results Oriented Management Effort is applied to the management and turnaround of troubled HMO and related medical delivery companies in the USA since 1995.

Personally, Mr. Fleck has over twenty years of successful leadership experience in managed healthcare delivery, finance and operations with increasing levels of responsibility. He spent five years as CEO responsible for the turnaround and growth of a non-profit IPA model HMO and its sale of all assets to a national HMO at fair market value. He provided joint venture management services to the Alternative Care Technologies (ACT) Division of Lincoln National Insurance in California. He has had numerous consulting assignments as interim CEO and/or CFO in troubled provider owned HMO and PHO organizations. He is the project director providing management services to the receiver in a 165,000 member mixed model HMO liquidation. He served as Receiver of a California dental HMO and arranged its successful sale to new owners. He provided interim CEO services for a Medicaid HMO in crisis, where he restored employee confidence, corrected financial and MIS problems, obtained insurance commission approval, and a 3 year contract renewal from the state Medicaid authority.

The ROME Group LLC maintains sub-contract arrangements with numerous professionals representing medical, operational, information system and financial management disciplines as needed in the operation of managed care delivery organizations in the USA. More information on the ROME Group is available at their web site www.romegroupresults.com.

Mr. Fleck joined the International Association of Insurance Receivers in 2000 as a result of his emerging involvement with receivership and liquidation situations. He has attended the Insolvency Workshop to expand his skills in this area of business operations.

Mr. Fleck served as a Director of the Washington State Health Insurance Pool for three years. He is an active supporter of the March of Dimes having served as a Director of the Western Washington Chapter for four years.

He is a member of Beta Gamma Sigma National Accounting Honor Society, and received his MBA and Bachelor of Science degrees from Bowling Green State University in Ohio.

Joseph Termini

Joe Termini is an attorney and insurance insolvency consultant who recently retired after 29 years of distinguished service with the State of New York Insurance Department Liquidation Bureau. His tenure culminated as Special Deputy Superintendent of Insurance in charge of the Liquidation Bureau. He also served as the Bureau's General Counsel, among other posts.

He has been a prominent participant in shaping the law and practice of insurer insolvency as we know it today. In the course of his career he had full managerial resonsibility for the Insurance Superintendent's receivership of sixty-three (63) insolvent insurance companies with an aggregate asset base of over $3 billion. He also had adminitrative resonsibility for all New York Security Fund claims and claims outside of New York. His work included litigating and supervising litigation against former officers and directors and accountants of insolvent insurers and collecting reinsurance on behalf of the insolvent insurer.

Joe Termini's work in liquidation and rehabilitation proceedings has produced a legacy of cutting edge decisions that are cited by jurists and legal practitioners in jurisdictions throughout the United States. His knowledge and experience in this important aspect of the insurance industry is recognized both here and abroad.

He received his undergraduate degree from The Citadel in Charleston, South Carolina and his law degree from St. John's University School of Law. He is admitted to practice law in the Eastern and Southern districts of New York, the Court of Military Appeals and the United States Supreme Court. A lecturer before the National Association of Insurance Commissioners and other industry groups, he currently serves as Of Counsel to Wilker & Lenci, LLP and as consultant to Subrogation Capitol Group and Creative Capitol Incorporated.

Michael Warren

Michael Warren is the sole proprietor of The Warren Group, a CPA practice specializing in two areas: litigation support to Receivers and their legal counsel in D&O, E&O, accountants' professional liability, and fraud cases; and federal income taxation of receivership estates. This work has included obtaining policyholder rulings for tax-free exchanges of policies from the Internal Revenue Service and obtaining recognition from the IRS of the tax-exempt status of receivership estates. He has also litigated against officers and directors and accountants of insolvent insurers, prepared expert witness reports and testimony in arbitration cases, and qualified as an expert witness on numerous occasions in state and federal Court cases. Michael resides in Nashville, Tennessee and is a graduate of The University of North Carolina-Chapel Hill. He is licensed to practice public accounting by the states of North Carolina and Texas.

Michael was previously the partner in charge of the insurance tax practice for the Southwest Region of Ernst & Young,LLP located in Dallas, Texas. Over the last twenty years, Michael has been engaged on some of the largest insurance insolvencies in the United States, including Baldwin-United, Executive Life, Kentucky Central, Mutual Benefit Life, Texas Employers Insurance Association, and National County Mutual Fire Insurance. Michael has also been engaged extensively on HMO/ Managed Healthcare company insolvencies in Georgia, Texas and Louisiana.

Mr. Warren has served as an officer and director of several solvent insurance companies domiciled in various states. In addition to his practice in insolvencies, Mr. Warren is engaged as a tax consultant on many healthy reinsurance companies- both onshore and offshore, owned by automobile dealers in connection with their credit insurance and warranty business.

Michael's wife, Denise, is a partner in an investment banking firm in Nashville that specializes in the healthcare industry, among others. Together they are the proud parents of a two-year old daughter and enjoy traveling, scuba diving, and snow skiing.

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); Evelyn Jenkins (TX)
International - Jean Akers (England)

Mark D. Tharp (AZ) provided an update on **Diamond Benefits Life Insurance Company**. On September 5, 2002, the United States District Court, for the District of Arizona, in MDL Docket No.972 C.A. No. 2:89-1473 granted Summary Judgment in favor of the Adventist Defendants and the FDIC as Receiver for HomeFed Bank, F.S.B., a federally chartered bank in receivership, and staying consideration of claims against Bank of America National Trust and Savings Association, a federally chartered bank (successor to Continental Illinois Bank and Trust Company of Chicago). The Receiver is pursuing the defendants under a variety of theories (including conversion, fraudulent conveyance, breach of fiduciary duty, fraud, aiding and abetting fraud) in conjunction with the sale of **Diamond** and misuse of its assets. The Receiver is considering an appeal.

Mike Rauwolf (IL) continued to report on the reinsurance run-off of **American Mutual Reinsurance in Rehabilitation (AMRECO)** currently under OSD supervision. Total claims paid inception to date for Loss and Loss Adjustment Expense total $30,449, Reinsurance payments $156,429,899 and LOC Drawdown disbursements $9,613,386. For the run-off of the **Centaur Insurance Company, in Rehabilitation** business, total claims paid inception to date for Loss and Loss Adjustment Expense total $53,294,714, Reinsurance Payments $4,945,493 and LOC Drawdown disbursements $13,876,555.

We continue to receive updates on the collections for **Grangers Mutual Insurance Company** from **James A. Gordon (MD)**. Collections during the third quarter of 2002 totaled $1,310.78.

An update was received from **W. Franklin Martin Jr. (PA)** regarding **The Fidelity Mutual Life Insurance Company (FML) in Rehabilitation**. As of 9-30-02 **FML** showed a statutory surplus in excess of $107,000,000 after reserving for all policyholder liabilities and paying most creditors. They were unable to resolve certain issues with the Policyholder Committee concerning the calculation of non-guaranteed elements after Closing. Actuarial affidavits have been filed with the Commonwealth Court explaining their respective positions and it is anticipated that the Court will require a hearing. Consequently the bid process for implementing the Third Amended Plan for Rehabilitation will be further delayed.

Evelyn Jenkins (TX) Texas receiverships reporting distributions include **Employers Casualty Company**, which made its ninth early access distribution to 45 participating guaranty associations in January 2003, raising the total to date to $178 million. ECC continues to pay 50% distributions on approved policyholder claims, and projects a partial distribution to general creditors. **Statesman National Life Insurance Company** made a third early access distribution of $500,000, bringing total distributions to over $2.7 million. **American Guardian Insurance Underwriters Lloyds** made a final distribution of $13,887,229 to guaranty associations and policyholders. **Gulf Atlantic Life Insurance Company** was also closed, with a stockholder distribution to the Equity Life Insurance Company of Hawaii receivership. Finally, the Texas Department of Insurance continues efforts to locate the owners of approximately $7 million in unclaimed equity distributions from **Members Mutual Insurance Company**. Members had $13.8 million dollars in funds remaining after the payment of all claims, which was distributed to the mutual company's 66,000 former policyholders.

In the area of legal activities, the

American Eagle receivership's litigation against former officers and directors was settled for $1.7 million, which came from the defendants' personal assets due to the insolvency of Reliance, their D&O liability carrier. Commutations on American Eagle's aviation reinsurance program have produced reinsurance recoveries of $3.8 million in the past year. **Comprehensive Health Services of Texas, Inc.** recovered $105, 000 in a partial settlement against one of three former auditors. And **American Benefit Plans**, an unauthorized health insurer, obtained court approval of a health claim processing procedure designed to accelerate claims adjudication and reduce costs.

New Texas receiverships include **Colonial Casualty Insurance Company**, which was placed in permanent receivership on October 7, 2002. Craig Koenig was appointed as the Special Deputy Receiver. **Amcorp Insurance Company** was placed in permanent receivership on November 6, 2002, and Hubert Bell was appointed as the Special Deputy Receiver. **AmCare Health Plans of Texas, Inc. and AmCare Management, Inc.** were placed in permanent receivership on January 21, 2003, and Jean Johnson was appointed Special Deputy Receiver for both companies. **Empire Lloyds Insurance Company** was placed in permanent receivership on February 11, 2003, and Margo Kirkpatrick was appointed Special Deputy Receiver. **The Millers Insurance Company** was placed in permanent receivership on March 24, 2003; its special deputy receiver had not been appointed at press time.

Illinois (Mike Rauwolf, State Contact Person)
Receivership Estates Closed

Name of Insured	Category	Licensed	Year Action Commenced	Payout Percentage	Amount
Equity General In Liquidation Closed 12/12/2002	P&C	Yes	1989	Class A - 100% Class D - 100% Class E - 100% Class F - 100% Class G - 57.16%	$4,175,049.00 $7,077,147.00 $51,057.00 $16,871.00 $1,679,376.00
Resure Inc. In Liq. Closed 12/19/2002	P&C	Syndicate	1997	Class D - 70.25%	$13,030,138.00

Distributions
Early Access and other Funds paid to Guaranty Funds or Associations and disbursements to policy/contract creditors

ESTATE	LOSS AND LOSS ADJUSTMENT EXPENSE	EARLY ACCESS DISTRIBUTION	RETURN PREMIUM	REINSURANCE PAYMENTS
Alliance General Insurance Co.	0	$72,359.00	0	0
American Mutual Reinsurance Co.	0	$0.00	0	1,103,559
Associated Physicians Insurance Co.	0	$80,585.00	0	0
Centaur Insurance Company	(26)	$0.00	0	0
Coronet	398	$0.00	0	0
Delta Casualty Company	440	$38,967.00	0	0
First Oakbrook Corporation Syndicate	150	$412.00	0	0
Gallant Insurance Company	64,331	$0.00	113,368	0
Illinois Earth Care Workers Comp	114,706	$0.00	0	0
Illinois Health Care Insurance Co.	0	$0.00	383	0
Illinois Insurance Co.	(1,050)	$32,560.00	0	0
InterAmerican Insurance Co. of IL	0	$0.00	(3,596)	0
Oak Casualty Insurance Co.	468	$0.00	0	0
Prestige Casualty Company	0	$4,430.00	0	0
United Capitol Insurance Co.	17,642	$15,501.00	0	0
Valor Insurance Co.	22,884	$0.00	168,468	0

Texas (Jean C. Sustaita, State Contact Person)

Early Access Distributions

Estate	Amount Distributed	Guaranty Funds	Percentage	Total Distribution
Employers Casualty Company - 9th	$8,386,000.00	45	95%	$179,127,623.00
Statesman National Life Ins. Co. - 1st	$1,248,958.75	24		$2,726,125.00
- 2nd	$997,167.00			
- 3rd	$500,000.00			

Estate Closings

Estate	Amount Distributed	Guaranty Funds	Other	Percentage	Total Distribution
Amer. Guardian Ins. U/W Lloyds	$13,817,229.29	TX - Class 1		100%	$2,561,813.81
		TX - Class 2		37.69%	$11,011,746.54
			Class 2 - Policy Claims	37.69%	$150,264.31
			Class 2 (UEP)	37.69%	$93,404.63
					$13,723,824.66
Gulf Atlantic Life Ins.	$422,225.00	None	Class 1		$1,500.00
			Class 4	100%	$372,969.00
			Class 5		$47,756.00
					$422,225.00

Maryland (James A. Gordon, State Contact Person)

Early Access and other Funds paid to Guaranty Funds or Associations and disbursements to policy/contract creditors

Distributions	Estate	Amount		
Guaranty Funds	Grangers Mutual Ins. Co.	$696.52	(GA)	Administrative
		$29,595.83	(MD)	
		$2,363.25	(TN)	
		$337,083.58	(DC)	
		$556,076.00	(GA)	Policy Claims
		$1,736,566.00	(MD)	
		$100,390.33	(TN)	
Policy/Contract Creditors	Grangers Mutual Ins. Co.	$297,407.00	(MD)	
		$49,262.00	(DC)	
		$24,195.00	(GA)	
		$8,621.00	(VA)	
		$55,177.00	(TN)	
General Creditors		$339,614.00		

New Jersey (John Kerr, State Contact Person)

Receivership Estates Closed

Name of Insured	Category	Licensed	Year Action Commenced	Payout Percentage	
Health Plans of America	HMO	Yes	1999	Class 1	100%
				Class 3	100%
				Class 4	100%
				Class 5	50.02%
Sussex Mutual Ins. Co.	P&C	Yes	1992	Class 1	100%
				Class 4	100%
				Class 5	5%
HIP Health Plan of NJ	HMO	Yes	1999		

Early Access and other Funds paid to Guaranty Funds or Associations and disbursements to policy/contract creditors

Receivership	Disbursements to Guaranty Funds	Date	Disbursements to Policy/Contract Holders	Total Assets Disbursed
Health Plan of America (HMO)	N/A	N/A	$850,150.00	$850,150
Home State Insurance Co.	$10,283,046.00 NJPLIGA	3/8/2001	$33,300.00	$10,316,346
			$156,926.00	$10,473,272 Cumulative
Sussex Mutual Ins. Co.	$1,567,468.00 NJPLIGA	1/3/2002	$171,980.00	$1,739,428
Warwick Insurance Co.	$9,100,431.00 NJPLIGA	Var	$485,292.00	$9,585,723
			$299,880.00	$9,685,603 Cumulative
HIP Health Plan of NJ	N/A	1st Qtr	$4,996,549.00	
Class I		2nd Qtr	$51,530.00	
		3rd Qtr	$341,645.00	$5,460,969
		4th Qtr	$71,245.00	$62,179,176 Cumulative
			$2,007,400.00	$2,007,400
				$30,668,498 Cumulative

Pennsylvania (W. Franklin Martin, Jr., State Contact Person)
Early Access and other Funds paid to Guaranty Funds

Estate	Guaranty Funds
PHICO Insurance Co.	$23.8 million

Minnesota (Jacqueline L. Gardner, State Contact Person)
Receivership Estates Closed

Name of Insured	Category	Licensed	Year Action Commenced	Payout Percentage
National Family Insurance Co.	P&C	Yes	1996	32.94%

Early Access and other Funds paid to Guaranty Funds or Associations and disbursements to policy/contract creditors
Approved Distribution per Minn, St., § 60B.44 as follows:

Estate	Claimant	Recommended and Allowed	Amount Distributable	Total Distributable by § 60B.44 "class"
National Family Insurance Co.	Class 2 MN Ins. GA	$433,753.15	$433,753.15	
	Special Deputy Liquidators	$30,000.00	$30,000.00	
	Total: § 60B.44, subd.2	$463,753.15	$463,753.15	$463,753.15
	Class 4 MN Insurance GA	$1,591,511.14	$524,218.53	
	Farmers Alliance Mutual	$31,225.33	$10,285.13	
	Grinnell Mutual R/I Co.	$8,751.37	$2,882.56	
	Walter H. Rucinski	$50.00	$16.47	
	56 "deductible" claimants as listed in Recommended Claims	$5,600.00 (@ 100.00 each)	$1,844.64 (@32.94 each)	
	Total: §60B.44, subd. 4	$1,637,137.84	$539,247.33	$539,247.33
	Class 4a (or "5"): MN IGA	$15,214.11	$0.00	$0.00
	Class 6: 58 claimants	$205,513.84	$0.00	$0.00
	Class 8: 3 claimants	$129.82	$0.00	$0.00
	Total: 124 Claims	**$2,321,748.76**	**$1,003,000.48**	**$1,003,000.48**

New York (F.G. Bliss, State Contact Person)

Early Access and other Funds paid to Guaranty Funds or Associations and disbursements to policy/contract creditors

RECEIVERSHIP	SECURITY/GUARANTY FUNDS	POLICY/CONTRACT CREDITORS	TOTAL
Consolidated Mutual	$16,525,684.00	$620,879.00	$17,146,563.00
Cosmopolitan Mutual	$6,016.00	$0.00	$6,016.00
First Central	$22,960,144.00	$397,554.00	$23,357,698.00
Galaxy	$3,706,794.00	$0.00	$3,706,794.00
Horizon	$6,116.00	$0.00	$6,116.00
Ideal Mutual	$16,980,697.00	$629,054.00	$17,609,751.00
Long Island	$5,559.00	$0.00	$5,559.00
Pan Atlantic	$0.00	$2,129,954.00	$2,129,954.00
Whiting	$3,423.00	$0.00	$3,423.00
TOTAL	**$60,194,433.00**	**$3,777,441.00**	**$63,971.874.00**

Ancillary Proceedings Under Section 304 of the Bankruptcy Code and Reinsurance Collateralization Devices

By John F. Finston and Dennis R. Wheeler

Alien reinsurance companies are frequently required, by state law, to provide collateral in the U.S. as a prerequisite to doing business in this country. When these companies become insolvent, bankruptcy or similar proceedings are generally commenced in the company's country of domicile under the laws of that country. The foreign proceeding has no jurisdiction over the company's U.S. assets, and the U.S. Bankruptcy Code does not permit alien reinsurance companies to file a plenary bankruptcy petition. However, section 304 of the Bankruptcy Code does permit the foreign bankrupt to file a petition for ancillary bankruptcy proceedings in the U.S. which are designed to assist the main proceeding in the foreign country. Under these ancillary proceedings, the U.S. bankruptcy court can issue preliminary injunctions with nationwide reach which mimic the automatic stay. These injunctions prevent U.S. claimants from suing in the U.S. to collect under the reinsurance collateral agreements, leaving them with no alternative but to pursue their claim in the foreign proceeding.

Some argue that this result is wrong because the purpose of the collateral requirement is to protect or insulate U.S. insurers from having to go abroad to collect when their foreign reinsurance company becomes insolvent. Section 304 intervenes to force them to do just that, and, it is argued, this exposes U.S. companies and policyholders to the vagaries of the foreign bankruptcy law and could result in trust proceeds being made available to the company's general creditors instead of U.S. claimants.

This article reviews the cases decided by various bankruptcy courts and federal courts addressing this issue and discusses the seriousness of these concerns in light of the decisions and trends of the federal courts.

Reinsurance Collateralization Devices

Unlicensed alien reinsurers are generally not subject to the state insurance laws and regulations applicable to licensed insurers and reinsurers. Considering this lack of regulation, and to protect U.S. insurance companies that cede business to alien reinsurers and therefore depend upon the solvency of the reinsurers, states have adopted laws requiring unlicensed alien reinsurers to establish either multiple-beneficiary or single-beneficiary collateral devices. These collateral devices typically take the form of either a trust account or a standby letter of credit. The trust or letter of credit serves as collateral to secure the alien reinsurer's ability to meet its obligations to U.S. insurance companies and policyholders.

Alien reinsurance companies that become accredited reinsurers are permitted to post a single trust fund for the benefit of all U.S. ceding insurance companies and policyholders. These trusts are known as multiple-beneficiary trusts. The form of the trust, as well as the amount and other trust characteristics are regulated by state insurance laws and regulations. Alien reinsurance companies also are permitted to meet state collateral requirements through the use of trusts or letters of credit designed to collateralize obligations to a single U.S. insurance company and its policyholders. These trusts or letters of credit are known as single-beneficiary collateral devices.

Section 304 of the Bankruptcy Code

Section 304 of the U.S. Bankruptcy Code permits a representative of a foreign estate in liquidation to petition a U.S. bankruptcy court for the commencement of a case ancillary to the foreign proceeding. The overall goal of an ancillary proceeding is to prevent the piecemeal distribution of assets in the U.S. through legal proceedings initiated in domestic courts by local creditors, and to accommodate the foreign proceeding to the extent that its insolvency laws are similar to those of the U.S. The filing of a section 304 petition does not result in the imposition of an automatic stay. All relief under section 304 must be expressly requested and granted by the court.

There are two essential predicates for initiating a section 304 case. First, there must be a foreign proceeding pending, and second, the party petitioning for section 304 relief must be a "foreign representative." The term "foreign representative" is defined to mean "a duly selected trustee, administrator, or other representative of an estate in a foreign proceeding." This predicate is normally established as long as the representative has been appointed pursuant to the other country's bankruptcy laws. The phrase "foreign proceeding" is defined as "[a] proceeding, whether judicial or administrative and whether or not under the bankruptcy law, in a foreign country in which the debtor's domicile, residence, principal place of business, or principal assets were located at the commencement of such proceeding, for the purpose of liquidating an estate, adjusting debts by composition, extension or discharge, or affecting reorganization." Both formal judicial proceedings and less formal arrangements or schemes qualify as foreign proceedings provided the arrangement is subject to judicial supervision.

Section 304(b) permits the

bankruptcy court to grant three types of relief: (1) injunctive relief; (2) a turnover of assets; and (3) other appropriate relief. Injunctive relief is the most common form of relief requested. Foreign representatives frequently request a broadly drafted preliminary injunction, which, if granted, mimics the automatic stay. Before granting relief, courts are to "be guided by what will best assure an economical and expeditious administration of [the] estate, consistent with:

1. Just treatment of all holders of claims against or interests in such estate;
2. Protection of claim holders in the United States against prejudice and inconvenience of processing of claims in such foreign proceeding;
3. Prevention of preferential or fraudulent dispositions of property of such estate;
4. Distribution of proceeds of such estate substantially in accordance with the order prescribed by this title;
5. Comity; and
6. If appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns."

The six factors set up a tension between a territorial view and a more universal view. The territorial view favors U.S. laws and U.S. interests, and is most clearly expressed by factor number four. The distribution of proceeds under the foreign law should be substantially the same as would occur under U.S. bankruptcy law. The universal view recognizes the efficiency to be gained from permitting the estate's assets, wherever situated, to be handled pursuant to one set of laws in one proceeding. The comity factor most epitomizes this view.

Under the first factor, courts typically examine whether the foreign law comports with due process and provides for the fair treatment of U.S. creditors. With respect to the second factor, courts have consistently stated that the foreign representative must show that U.S. claimants will be treated the same as claimants resident in the foreign country. The mere fact that the U.S. claimants will be inconvenienced by bringing their claims in the foreign country is given little or no weight because U.S. bankruptcy courts impose the same requirement on foreign claimants against U.S. companies in bankruptcy. Under the third factor, courts are to review the foreign law to determine if it has provisions to recapture preferential payments or fraudulent transfers. The fourth factor does not require that the foreign proceeding's distribution priorities be identical with U.S. bankruptcy law, but a comparison will be made. If the foreign state's distribution law differs, and the difference would prejudice a U.S. claimant, the court may not grant the requested relief. Comity generally refers to the cordial recognition of the laws of one country by another.

3. Section 304 and Reinsurance Collateralization Devices

There have been three reported cases in which a foreign representative of an insolvent alien reinsurer has filed a section 304 petition, in part, to enjoin U.S. claimants from collecting under reinsurance collateralization devices.

In re Lines

In re Lines involved The River Plate Reinsurance Co., Ltd. which was undergoing winding up proceedings under the laws of Bermuda. The foreign representative filed a section 304 petition seeking, among other things, to enjoin U.S. claimants from pursuing assets held by a trustee under a trust agreement. The trust was a multiple-beneficiary collateral device. The petition was contested by a U.S. claimant under the trust. The claimant was in the process of establishing its claim under the terms of the trust agreement.

The court determined that although the contesting claimant was extremely close, neither the contesting claimant nor any of the other U.S. claimants had perfected their claim to the trust under the terms of the trust agreement by the time the winding up petition was filed in Bermuda. According to the court, this resulted in the foreign estate retaining a reversionary interest in the entire trust, making the trust part of the foreign estate.

The court then turned to the section 304(c) factors to determine whether it should grant the requested injunction. The court issued the injunction, holding, with little discussion, that Bermuda law provided all of the protections set forth in the factors and that comity to the Bermuda court should be granted. The effect of the injunction was that U.S. claimants to the trust had no alternative but to pursue their claim in the Bermuda proceeding. The court left it to Bermuda law to determine whether the contesting claimant would receive priority over other claimants, but it was clear that the court intended and believed that under Bermuda law, the trust would be distributed first to fully satisfy U.S. claimants before any funds were made available to general creditors.

In re Ocana

In re Ocana involved the Panamanian bankruptcy of Latino Americano de Reaseguros, S.A. (LARSA). The foreign representative filed a section 304 petition seeking to enjoin two actions brought by a U.S. claimant. One action was against the trustee claiming entitlement to a trust, and the second action was against the bank that issued a standby letter of credit in favor of the claimant. The trust was a multiple-beneficiary trust. The letter of credit was issued by a Panamanian bank for the benefit of a single-beneficiary, and was secured by assets of LARSA.

The U.S. claimant contested the section 304 petition. The court declined to enjoin the action against the issuer of the letter of credit. The court held that the letter of credit was not part of the foreign estate since it represented a contract between the bank and the U.S. claimant, and was to be paid using the bank's funds. The court dismissed the fact that the bank held collateral of LARSA to secure the letter of credit as having no bearing on the claimant's right to receive payment from the bank.

The court then addressed ownership of the trust. Unlike Lines, an audit had been conducted pursuant to New York insurance law and the trust agreement to determine the extent of liability to U.S. claimants under the trust. The audit showed that the trust was liable to U.S. claimants for about one third of the $1.5 million trust. The court held that the

portion of the trust withheld by the trustee to compensate U.S. claimants was not part of the foreign estate, but that the estate had a reversionary interest in the remainder. Thus, the court declined to enjoin the U.S. claimant's action with respect to the portion of the trust retained by the trustee for the benefit of the known U.S. claimants. The court let stand the lower court's injunction with respect to the remainder of the trust.

The court did not explicitly address the section 304(c) factors, but presumably, the court considered the factors in deciding to uphold the injunction in part. Thus, the U.S. claimants who had perfected their claims under the trust prior to the entry of the liquidation order and the claimant against the letter of credit were permitted to pursue their claims without interference from the foreign proceeding.

In re Rubin

Next came In re Rubin which involved an Israeli liquidation of The Israel Reinsurance Company Ltd. The foreign representative filed a section 304 petition seeking first to enjoin an action brought against Israel Re by a U.S. claimant to establish rights to a trust, and secondly, the turnover of the trust to the Israeli liquidators. The trust was a multiple-beneficiary trust funded by a letter of credit.

Two U.S. claimants contested the section 304 petition. The first was a claimant who had already taken substantial steps towards perfecting his claim to the trust. This claimant objected to both the injunction and to the turnover order. The second U.S. claimant objected only to the turnover order. This claimant recognized that if the injunction was denied, the other claimant, who was further along in perfecting his claim, would take priority to the trust proceeds. This party reasoned that it stood to collect more under the Israeli liquidation, which would ascertain all valid claims to the trust, and distribute trust proceeds on a pro-rata basis. Other U.S. insurance companies had filed claims to the trust in Israel, but these companies did not contest the section 304 petition.

The Rubin court, following Lines but distinguishing Ocana, determined that the bankrupt estate had a reversionary interest in the entire trust as no claimant had yet perfected its claim. The court then addressed the section 304(c) factors and decided to grant the requested injunction. The court noted that the Israeli court would ascertain the valid claims of the U.S. claimants, and pay the full amount of the trust to these claimants on a pro-rata basis. The court also noted that this distribution priority was similar to the priority under the U.S. Bankruptcy Code. Thus, the injunction required the claimants to pursue their claim in Israel, but all of the trust proceeds were to be used to satisfy U.S. claimants equally on a pro-rata basis.

In each of these three cases, the U.S. claimants under the collateral devices either collected collateral proceeds in full without having to pursue a claim in the foreign proceeding (Ocana), or ended up being required to file a claim in the foreign proceeding, but only after the bankruptcy court had ensured that U.S. claimants would have priority to collateral proceeds (Lines and Rubin). The contesting claimants in Lines and Rubin, who had begun the process but had not yet perfected their claim, may have lost their preferred standing; however, such a result is not unexpected in an insolvency proceeding. Security interests perfected by creditors during the preference period prior to insolvency or bankruptcy are regularly nullified by U.S. courts subsequent to the bankruptcy or insolvency. In the foreign proceeding, all U.S. claimants in both cases were to receive the full amount of their claim if collateral proceeds were sufficient, otherwise each claimant was to receive a pro rata share. This result is fair, and as the Rubin court stated, not unlike what would have occurred under U.S. bankruptcy law.

That bankruptcy courts will take the steps necessary to protect U.S. claimants is even more likely given the Second Circuit Court of Appeal's recent decision in In re Treco. Treco involved the treatment in a section 304 ancillary proceeding of a secured U.S. creditor of an insolvent bank. The bank was undergoing insolvency proceedings in the Bahamas. Both the bankruptcy court and the district court had ordered the collateral turned over to the Bahamian proceeding. The second circuit reversed after applying the fourth section 304(c) factor which requires that distribution of the proceeds of the collateral should be "substantially in accordance with the order prescribed by" the U.S. Bankruptcy Code. The court noted that in a Bahamian proceeding, administrative expenses were entitled to distribution priority ahead of secured creditors. Since administrative expenses in that particular case were expected to be high enough to reduce the secured party's recovery to below the value of his collateral, the court held that this recovery was less than the secured party would have received under the U.S. Bankruptcy Code where administrative expenses do not take priority over secured interests. The court held that before deferring to a foreign jurisdiction, it was incumbent upon the court to ensure, on a case by case basis, that proceeds from the liquidation of U.S. assets distributed pursuant to the foreign scheme would be distributed substantially the same as if the proceeds were distributed under the U.S. Bankruptcy Code. The Treco case did not involve a reinsurance trust agreement or letter of credit, but the analogy with a secured interest is strong and demonstrates that federal courts will protect the interests of U.S. creditors under appropriate circumstances.

Some have argued that since these cases involve the business of insurance, the McCarran-Ferguson Act (Act) requires that state laws regulating insurance should supersede section 304. The Act provides for reverse preemption of federal laws in favor of state insurance laws under certain circumstances. This argument was made to the Rubin court. The court determined that the Act did not prevent it from acting, and that issuing an injunction under section 304 would not invalidate, impair, or supersede the state insurance law or the state statute that required the posting of a pre-answer bond. The court also concluded

that state ancillary liquidation laws did not conflict with section 304, in part because the laws were not being enforced.

Pending Bankruptcy Reform Legislation

Bankruptcy reform legislation is currently pending in the Senate which would replace section 304 with a new Chapter 15 incorporating the Model Law on Cross-Border Insolvency as promulgated by the United Nations Commission for International Trade Law. The pending legislation contains the following provision in the "purpose and scope" section of the legislation:

(d) The court may not grant relief under this chapter with respect to any deposit, escrow, trust fund, or other security required or permitted under any applicable State insurance law or regulation for the benefit of claim holders in the United States.

If this legislation passes, federal bankruptcy courts will no longer be permitted to enjoin actions by U.S. claimants under reinsurance collateralization devices, leaving claimants free to establish and collect their claims without any interference from the foreign proceeding. In the absence of a coordinated approach to evaluating claims against trusteed assets, which is provided by section 304 of the Bankruptcy Code, piecemeal litigation over the corpus of trust assets is likely to occur.

Conclusion

Section 304 has been successfully used by representatives of foreign insolvency proceedings of alien reinsurers to effectively block efforts by U.S. claimants to collect under reinsurance collateralization devices in the U.S. U.S. bankruptcy court injunctions have permitted the foreign proceeding to control the distribution of collateral under the laws of the foreign jurisdiction. However, bankruptcy courts are required to consider the six factors before ceding control to a foreign jurisdiction. In each of the three reported cases involving section 304 and reinsurance collateral devices, it appears that bankruptcy courts, before deferring to the foreign proceeding, took steps to ensure that U.S. claimants would receive no less under the collateral device than they would have received under U.S. bankruptcy law. Particularly in light of the 2nd circuit's recent decision in Treco, these factors provide effective protection to U.S. claimants while at the same time permitting courts to use ancillary proceedings to simplify cross-border insolvencies where appropriate.

Considering the foregoing, if the proposed changes to the Bankruptcy Code are enacted into law, it will be interesting to see if the exemption for reinsurance collateralization devices contained in the proposed new law, and the resulting oversight of claims against those assets by the U.S. bankruptcy court, actually benefits claimants overall, or will merely benefit those claimants that can afford to more aggressively pursue claims against trusteed assets.

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