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Banning "Bad Actors"

Cuomo calls it curtains for crooks on financial stage

Peter Bickford Looks at the "Bad Actor" Playbill PAGE 13

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Bad Laws/Bad Actors
PART I

Peter Bickford has over four decades of experience in the insurance and reinsurance business, with particular focus on regulatory, solvency, agency, alternative market and dispute resolution issues. In addition to his experience as a practicing attorney, he has been an executive officer of both a life insurance company and of a property/casualty insurance and reinsurance facility. A complete biography for Mr. Bickford may be accessed at www.pbnylaw.com.

New York's new Superintendent of Financial Services, Maria Vullo, was confirmed less than a year ago, but has already put her own mark on the position. She was on the job adding staff and implementing policy even before confirmation—an unprecedented move in the annals of the DFS and its predecessor Insurance Department. She has appeared to be attentive to the insurance industry and its needs, available to speak to industry groups, and has voiced support for the DFS role as industry supporter as well as enforcer. Most importantly—perhaps—she has already shown some flexibility by addressing industry and professional concerns and comments on the DFS proposed cybersecurity regulations, resulting in significant changes to the original proposal. This is in stark contrast to her predecessor, the "Sheriff of Wall Street" Benjamin Lawsky, who was far more focused on the banking business than the insurance business, shunned insurance industry functions and forums, and zealously embraced enforcement over the regulatory and support functions called for by law.

Considerable skepticism remains, however, on whether Superintendent Vullo's early actions mark an actual mellowing of the administration's mandate, and it will take more than a few speeches and one amended proposed regulation to allay this skepticism. The recent "bad actor" edict from Albany will not help.

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One of the cornerstones of Governor Cuomo's 2017 State-of-the-State pronouncements was his proposal to ban "bad actors from the financial services industry for egregious conduct." Aside from the legal challenges in defining such general concepts as "bad actors" and "egregious conduct," it is hard to argue against the basic premise that bad people should not be allowed to operate in financial services business, or any business for that matter. Once again, however, the major new administration mandate aimed at the financial services sector echoes the former superintendent's enforcement-centric bent, not the current superintendent's more conciliatory words. The press release announcing the bad actor proposal sets the tone by citing as the singular major achievement of the DFS since its 2011 creation as having "established itself as a leading financial regulator by bringing in billions of dollars through enforcement actions to protect consumers."

Another problem with the new attack on bad actors is that existing law—at least on the insurance side—would already seem to be more than adequate to cleanse the industry of questionable characters. Anyone who has ever been involved with the statutory and regulatory vetting process for participation in a licensed insurance entity would wonder what more need be added to the Department's arsenal against weeding out bad actors. The Governor's proposal specifically cites the Wells Fargo scandal (setting up fraudulent accounts and the selling of products to consumers without their consent) as evidence of the need for greater enforcement authority, and this may well be another example of insurance being swept into unnecessary regulatory attention because of banking industry issues.

But accepting the premise that more needs to be done to rid the insurance industry of bad actors, here's a challenge for the new superintendent: commit to establishing and applying the same bad actor standards to entities under your direct management and supervision. If this challenge were to be accepted, a good starting point would be to address the seriously flawed structure and accountability of New York's insolvency process and its current lynchpin, the Liquidation Bureau.

The Poster Child for bad actors in the insolvency process remains the $2 billion shortfall of Executive Life Insurance Company of New York (ELNY) while under the Liquidation Bureau's watch, and the herculean effort of the liquidator to ensure there was no investigation into potential wrongdoing or to apply common standards of accountability to the management of the estate. If ELNY—or any licensed insurer—had suffered a $2 billion loss under its own management, management would have had the proverbial book thrown at them, and rightfully so. But despite the evidence of massive mismanagement while in receivership, no effort was made to hold anyone accountable, which led me to pose the following questions to the outgoing superintendent in the May 25, 2015 issue of *Insurance Advocate*:

> *Why, with all your emphasis on pursuing the wrongdoers in the name of protecting the consumer, didn't you pursue the wrongdoers under your own roof in connection with the failed stewardship by the Liquidation Bureau of Executive Life Insurance Company?*

Why did you fail to protect the most seriously injured Executive Life annuitants whose interests you professed to represent? And when you failed to protect them, why did you go to extreme measures to prevent those same consumers from doing so themselves?
Why don't your rules of conduct for the industry, so exquisitely spelled out in your annual report, apply to your own house?

ELNY involved mismanagement while in receivership, not before; and the roughly $200 to $250 million owed to Health Republic policyholders or providers pales in comparison to the $2 billion shortfall in ELNY.

Of course, Superintendent Lawsky never answered these questions, nor can we expect Superintendent Vullo to answer for matters that occurred well before her watch. However, Superintendent Vullo has inherited another significant receivership matter that exposes many of the same deficiencies and shortcomings in the insurance insolvency process that allowed the ELNY abuses to go undiscovered for over a decade and ignored when exposed. That current pending matter is the liquidation of Health Republic Insurance Company.

This is not to suggest that Health Republic comes within the same category as ELNY—not even close. ELNY involved mismanagement while in receivership, not before; and the roughly $200 to $250 million owed to Health Republic policyholders or providers pales in comparison to the $2 billion shortfall in ELNY. Health Republic's financial woes were tied intrinsically to the Affordable Care Act, rate approval processes, Federal funding (or lack thereof), and other political and operational issues unique to the health industry today. However, once it was determined that Health Republic should be placed into the receivership process, all the old bugaboos started coming to the surface again. The liquidation of Health Republic strongly suggests that we learned nothing from the ELNY fiasco.

Consider a few fun facts about Health Republic leading up to it actually being placed into liquidation:

- HR was ordered to stop writing new policies on September 15, 2015, but existing policies were to remain in force until the end of their terms.
- By the end of October 2015, a DFS review of HR's finances found the company's financial condition to be "substantially worse than the company previously reported in its filings to NYDFS." Accordingly, it was determined to terminate all policies by November 30, 2015.
- In early November 2015, the DFS reported that it had "opened an official investigation specifically focused on Health Republic's inaccurate financial reporting. ...Among other issues, the investigation will examine the causes of the inaccurate representations to NYDFS regarding the company's financial condition."
- As of mid-January 2017—14 months later—no investigation report has been issued.
- In October 2015, in apparent recognition of HR's financial failure, its board of directors unanimously consented to HR's liquidation. It was six more months, however, before the DFS commenced a liquidation proceeding against HR.
- In the press release announcing the liquidation proceeding in April 2016, the DFS stated: "During the Court-supervised liquidation proceeding, the DFS Superintendent, as the Court-appointed Liquidator of Health Republic, will develop and file with the Court a plan of liquidation that maximizes distributions to claimants in accordance with statutory requirements, while minimizing the duration and cost of the liquidation proceeding, to the extent possible."
- An order of liquidation appointing the DFS superintendent as liquidator was entered on May 11, 2016. As of mid-January 2017—eight months later—no plan of liquidation has been filed with the court.
- The last financial statement prepared for HR before liquidation was as of December 31, 2015. The first statement issued by the liquidator—a one-page summary balance sheet with limited details—was as of September 30, 2016.
- The only other financial information publicly provided is a statement of expenses for HR from the day of entry of the order of liquidation (May 11, 2016) through September 30, 2016.
- There is no publicly available financial information covering the eight-month gap period from October 2015 through May 2016.
- During this eight-month gap period HR continued to engage the services of third party providers for operating, claim, web, legal and other services, apparently with DFS approval, despite the ongoing investigation.

When Health Republic's law firm appeared in the liquidation proceeding representing the Superintendent, it had to make veteran insolvency practitioners wonder, particularly when counsel stated to the court (apparently with a straight face) "our engagement transfers to the superintendent in her capacity as liquidator of Health Republic upon the entry of the liquidation order." Because there was no significant opposition to the petition to liquidate, there were no interested parties present with an incentive to challenge the absurdity of counsel's no-conflict explanation, or of the continuing use of existing service providers in the face of an ongoing investigation. Thus the presiding judge, NY Supreme Court Justice Carol Edmead, was presented with no basis to question or reject the proffered explanation.

Justice Edmead appears to be handling the proceeding as well as can be expected. In fact, she has on her own volition imposed some constructive requirements, like requiring all court documents, transcripts, service contracts and financials to be posted on the Health Republic website. Given the limited tools at her disposal and the systemic obfuscations in her path, however, the odds of her achieving consequential oversight of the Health Republic liquidation are minimal. Yes, she will likely sign orders from time to time approving actions taken on behalf of the Health Republic estate, and may even get the liquidator and her agents to do some things they might not have done if left entirely to their own devices, but those actions will not come close to true oversight.

As will be detailed in Part II, the system simply does not allow it.[IA]