

WHAT EVER HAPPENED TO THE
NEW YORK INSURANCE
EXCHANGE (AND WHY DO WE
CARE)?

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Introduction

In 1980 the New York Insurance Exchange opened to great fanfare and expectations as a Lloyd's type market to help stem the flow of capital and premiums out of the U.S. Seven years later the Exchange ceased to operate, and many of its underwriting syndicates were insolvent and facing liquidation. The experiences of these syndicates after the closing of the Exchange helped plant the seeds for many of the commutation, run-off and similar schemes used today to strengthen the balance sheets of reinsurers or to avoid formal, time consuming, costly and inefficient liquidation. This article will discuss the history of these efforts by the Exchange and its underwriting syndicates, the current status of some of these efforts, and the lessons learned or not learned by the market and the regulators from the Exchange experience.

I. WHAT WAS THE NEW YORK INSURANCE EXCHANGE?

The New York Insurance Law devotes a whole article to a currently non-existent entity: The New York Insurance Exchange.¹ Additionally, the New York Insurance Department has promulgated and continues in force three regulations dealing with the operations of this non-existent entity.² So what was this entity that required so much attention by the regulators? What happened to this entity? And how is it important to us today? First, a little history.³

A. A BRIEF HISTORY OF INSURANCE REGULATION IN THE U.S.

In the Mid-1970's, there was a capacity crisis in the property/casualty insurance marketplace. Unable to obtain adequate coverage in the traditional markets, insurance buyers began demanding solutions to their immediate requirements and long-term answers to persistent market cycles. (This was before the boom of offshore excess facilities, captives, risk retention vehicles and other alternative insurance and risk spreading devices.)

One answer to the capacity crisis was the insurance exchange concept. Proponents of the exchange concept pointed to the tremendous success of Lloyd's of London in the U.S. market, particularly the flexibility of the Lloyd's system in meeting new and developing insurance needs. But there was a serious roadblock to the establishment of a Lloyd's type market in the U.S. – the U.S. insurance regulatory system.

The U.S. system of state-based regulation of insurance dates back to the mid-19th century. The two signal events in this period were the 1869 Supreme Court decision in *Paul v. Virginia*⁴ upholding the constitutionality of a state's

regulation of foreign insurers operating within its boundaries, and the founding in 1871 of the National Convention of Insurance Commissioners (now known as the National Association of Insurance Commissioners, or the NAIC) establishing an effective means for state regulators to exchange data and develop model laws, regulations and forms.

There were numerous attempts to contest the state regulatory scheme, all of which were unsuccessful until 1944, when in *U.S. v. Southeastern Underwriters Association*⁵ the Supreme Court held that the business of insurance was interstate commerce and therefore subject to federal antitrust laws. This unexpected decision (at least to the insurance industry) prompted the passage in 1945 of the McCarran-Ferguson Act, specifically making the business of insurance (i) a matter for state regulation, and (ii) exempt from federal antitrust laws except in cases involving boycott, coercion or intimidation, or where state regulation is not effective.

With this background and tradition of state regulation of the business of insurance, state regulators focused on two areas in particular: rates and forms. To address regulatory concerns over the drastic rate-cutting practices of thinly-capitalized companies that could result in bankruptcies and unprotected customers, many states adopted statutes requiring prior approval of rates. In addition to significantly controlling the rates charged by insurers, state regulators also developed standard policy forms to protect customers against confusing and inadequate contracts, and unscrupulous, quick-dollar peddlers, particularly in the field of fire insurance.⁶

The focus of regulatory efforts on rates and forms made the development of a viable, self-regulated, centralized insurance market in the U.S. impractical at best. Brokers could not submit risks directly to an underwriter or underwriters, negotiate terms and conditions of coverage, and expect to bind coverage. The need to obtain rate and form

approval before completing the contract in many cases left innovation and leadership in new coverages to the overseas exchange – Lloyd’s of London. Lloyd’s thrived in the U.S. domestic market, building a reputation as the “insurer of the world” on the inability of the U.S. insurance industry to provide the unusual but necessary coverages American businesses sought.

B. THE CREATION OF THE NEW YORK INSURANCE EXCHANGE

The capacity crisis of the mid-70’s intensified the pressures for more open competition, and also contributed to a significant growth in the reinsurance industry – unfettered by the rate and form requirements placed on primary companies by state regulators. The impact of these two trends was reflected in New York with the adoption in June 1978 of the “Free Trade Zone” and insurance exchange legislation.

The Free Trade Zone⁷ was New York’s response to the perceived need for greater market flexibility by allowing licensed insurers in New York to write large or hard-to-place commercial risks free from rate and form restrictions. The insurance exchange legislation – originally conceived (and for the most part operated) as a reinsurance exchange – was a direct result of the concern over shrinking capacity and the flow of premium dollars overseas. Neither concept was able to obtain the necessary legislative and regulatory backing on its own; together, however, they were able to muster the necessary acceptance.

The 1978 insurance exchange legislation authorized the drafting of a constitution, which was adopted by statute in February 1979. The New York Insurance Exchange finally opened its doors on March 31, 1980. Ominously, the following day – April 1, 1980 – was the first day of an infamous 10-day transit strike in New York City.

The Exchange was set up to operate similar to Lloyd's as a centralized marketplace for the brokering and underwriting of insurable risks. Its two categories of members were the underwriting members (or syndicates), and the broker members. Only brokers approved by the Exchange as members or associates could place business with the syndicates, and all business was to be processed through the Exchange facility. The basic elements of the Exchange were:

1. A centralized trading floor;
2. Exclusively a brokers market;
3. Underwriting syndicates that were severally (not jointly) liable on their insurance or reinsurance underwritings;
4. All transactions were centrally processed through the Exchange facility;
5. Self-regulated through
 - i. common rules for the conduct of business; and
 - ii. maintaining the financial integrity of Exchange syndicates; and
6. The maintenance of a security fund funded by the Exchange syndicates.

Under §6201(b) of the New York Insurance Law, the Underwriting syndicates could write reinsurance, direct insurance on risks located outside the U.S., surplus lines from other states (where qualified), and risks rejected by Free Trade Zone insurers.⁸ For a number of reasons, including competitive disadvantages and regulatory hurdles in the other states, the Exchange was essentially a reinsurance market.

II. THE BRIEF BUT SPECTACULAR LIFE OF THE EXCHANGE

A. THE RISE

From its opening on March 31 through the end of 1980, a total of only \$17 million was written on the New York Insurance Exchange. Nearly all this business was reinsurance, and much of it was “directed” business from related organizations. Activity increased significantly by year-end, however, as brokers came to realize the relative ease of placement on an exchange market, and ceding companies began to accept the Exchange syndicates as reinsurers.

A 1982 study by the Diebold Group, Inc., commissioned by the Exchange’s Board of Governors, predicted that the Exchange would be a major world-wide reinsurer with premium writings of \$1.2 billion by 1986, and \$5 billion by 1991,⁹ and the first few years of operation seemed to confirm this optimism.

The next several years witnessed extraordinary growth on the Exchange, so that by the end of 1984, it ranked in the aggregate as the eighth largest U.S. reinsurer by premium (\$345.6 million) and fifth largest by policyholder surplus (\$182.6 million). The number of syndicates grew from sixteen on opening day to thirty-five active syndicates by December 31, 1984, and the number of participating brokers exceeded one hundred, including most of the major national brokers and reinsurance intermediaries.

It seemed as though the predictions of the Diebold Report might not have been so pie-in-the-sky after all!

B. AND THE FALL

However, it was not to be.

The tight market that helped launch the Exchange legislation in the late 70’s had disappeared by the time the

Exchange opened in 1980. The rapid growth in premium volume coupled with the extreme soft market conditions of the early 1980's helped spark a growing impression in the industry that the Exchange was really the market of last resort, the "dumping ground" for the submissions from the bottom drawer that could not be placed anywhere else.

As the premium volume grew, so did the loss ratios, eventually leading the Exchange to request certain syndicates to stop underwriting new and renewal business, but these actions proved to be too little and too late. Many of the Exchange syndicates were well over their guideline capacity even before they were asked to cease writing. The syndicates also had written large volumes of business at a time of over-capacity and extremely soft pricing, with no "good times" to fall back on. Thus the seeds of financial trouble were present in the first few years of the Exchange, and by the end of 1985 the decline was in full swing.

Volume dropped in 1985 for the first time in the Exchange's short history (from \$345.6 to \$309.5 million); additional syndicates ceased writing business or sought to withdraw from the exchange; capital contributions were used to bolster sagging surplus rather than fund new syndicates; and several syndicates were placed under joint control with the Exchange to allow even closer monitoring of their financial activity by the Exchange. These actions were still inadequate, and in August 1986, five syndicates were declared insolvent by the Exchange Board of Governors and the New York Superintendent of Insurance was petitioned to liquidate four of them. By September 1987, the Exchange had petitioned the Superintendent of Insurance to liquidate three more syndicates, and many of the remaining syndicates, fearing the worst, petitioned for withdrawal from the Exchange by year-end 1987.

Although plagued by the adverse publicity of these insolvencies and the withdrawal of many of its major industry participants, as well as by a back-office operation

that had not kept pace with its growth, the final straw appears to have been an action by the separate Board of Directors of the Exchange's security fund. On September 2, 1987 the security fund's board of directors called down the \$500,000 deposits of each of the underwriting members on the Exchange – a total of \$25 million – to meet the potential claims against the security fund resulting from the declared syndicate insolvencies.¹⁰ This action, which was totally unexpected by the underwriting members, sent a shockwave through the Exchange market resulting in all but ten of the syndicates petitioning to withdraw. On November 23, 1987, the remaining Exchange members, on the recommendation of the Board of Governors, voted to temporarily suspend the writing of new and renewal business on the Exchange. The Exchange never opened its doors again.

C. AFTER THE FALL – WHAT HAPPENED TO THE SYNDICATES?

A total of fifty syndicates wrote more than \$1 billion in business on the Exchange. Although it is impossible to track, some estimates of the ultimate liabilities of the Exchange syndicates will reach in excess of \$3 billion. Where did these liabilities go after the Exchange closed?

Ultimately ten of the fifty syndicates were declared insolvent by the Exchange and the Superintendent of Insurance was petitioned to liquidate them. Of these ten, seven were ultimately liquidated, and three were successfully “rehabilitated” under court approved plans. The seven syndicates ultimately liquidated were:

- KCC New York Corp.
- Heartland Group, Inc.
- Pan Atlantic Investors, Ltd.
- Pine Top Syndicate Inc.
- Realex Group N.V.
- U.S. Risk Inc.

The three successfully “rehabilitated” were:

- Burt Syndicate Inc.
- Candon Syndicate N.V.
- First New York Syndicate Corp.

The remaining syndicates withdrew from the Exchange over the next several years with their obligations being assumed by other insurance entities. Most of these syndicates, particularly those sponsored by major insurance entities, had their insurance obligations assumed by affiliated entities. Those without substantial insurance affiliates had to scramble to find acceptable assuming entities. The Exchange was anxious to shed all its members so that it could also be dissolved. Therefore, “acceptable” often included alien entities, particularly Bermuda or Cayman domiciled entities created specifically for this purpose.

Because of the substantial assumption upstream and offshore, it is impossible to track the ultimate liability for the business written on the Exchange. What we do know, however, is that many of these assuming entities followed the lead of several of the insolvent syndicates by pursuing aggressive commutation strategies to reduce their ultimate liabilities and to avoid their own insolvency. While today these “run-off” or “winding-up” operations are commonplace, in the mid-80s the concept was still developing and subject to regulatory suspicion and resistance.

Several of the syndicates that were declared insolvent by the Exchange and faced liquidation by the Superintendent of Insurance were pioneers in seeking to use commutations to increase surplus to minimally acceptable levels, and to allow the orderly run-off of liabilities without liquidation. These syndicates, although limited in resources, were uniquely situated to push the envelope in this area.

III. THE EXCHANGE SYNDICATE INSOLVENCIES

A. THE EXCHANGE ACTIONS AND INACTIONS

When the Exchange petitioned the New York Superintendent of Insurance to liquidate the first four syndicates in August 1986, many believed that it lost a golden opportunity to demonstrate to the industry that it could succeed as a self-regulated marketplace. Its constitution and by-laws, approved by the Insurance Department and the Legislature, provided the Exchange with significant powers over its underwriting syndicates. These powers included the types of authority generally granted to insurance regulators over insurers, such as the authority to:

- restrict writings;
- require an increase in surplus or capital requirements;
- issue cease and desist orders;
- suspend authority;
- place a syndicate under its supervision; or
- declare a syndicate insolvent and seek liquidation.¹¹

In addition, however, the Exchange had certain advantages that the state regulators do not enjoy. In particular, the Exchange had almost immediate access to information on the business of its syndicates. Syndicates could only write business through the Exchange facility, and all business written by the syndicates was processed by the Exchange. Therefore, in theory, the Exchange should have had much more timely and accurate information about the extent and character of the writings of each syndicate member. In fact, however, the Exchange did not take advantage of this access to information, as evidenced by its failure to stop the insolvent syndicates from continuing to

write business long after they had overextended their capital resources.

The reasons for this failure were complex, including the blurring of the line between the Exchange as promoter of the market as well as its regulator (an issue that Lloyd's was also forced to address many years later), and the processing backlog at the Exchange facility that prevented it from having any significant control of the information available to it. The syndicates that were the subject of the Exchange's belated efforts to control their writings also suggested that the Exchange's backlog prevented them from knowing the true extent of their writings until it was too late.

Once they realized that the Exchange management was determined to rid itself of these troubled entities by petitioning the Superintendent of Insurance to liquidate them,¹² many of the members, both underwriting syndicates and brokers, urged that the Exchange find a market solution to the problem rather than simply turning them over to the State. They argued that for the Exchange to be accepted as a viable market, it had to deal with the adversity of financially troubled syndicates to show the industry that it had the ability and the resources to address difficult situations. The Exchange, it was argued, should use its unique self-regulatory authority to work with the syndicate managers, the broker community and the Exchange's security fund to find a way keep the troubled syndicates out of the liquidation process.

Because these syndicates were almost exclusively a reinsurance market, it was argued, there was much more leeway in negotiating commutations and other arrangements with ceding companies and retrocessionaires. Furthermore, funds were available to assist in bolstering these syndicates through the Exchange's security fund, in which all syndicate members had contributed substantial funds, both through initial deposits upon joining the exchange and through assessments on the premiums written through the facility.

One of the proposed market solutions was for the creation of a new syndicate that would be the reinsurer of or assuming entity for the insolvent syndicate liabilities. This new syndicate -- which had the working name Syndicate 101 -- would be capitalized by the existing members, take control of the remaining assets of the insolvent syndicates, and look for additional financial support from the Security Fund. This proposal was presented long before the Lloyd's market "invented" Equitas.

For whatever reasons, however, the Exchange took no extraordinary steps to attempt to prevent the liquidation of these syndicates, including Syndicate 101, and petitioned the Superintendent of Insurance to liquidate four syndicates in August 1986, and three more by September 1987 when the NYIE Security Fund drew down the \$500,000 initial deposits of each of the 50 member syndicates.

Soon after the Exchange petitioned for the liquidation of the first four syndicates in August 1986, the New York Superintendent of Insurance commenced liquidation proceedings against them. These proceedings, however, did not stop the attempts to avoid liquidation. The efforts of several of these syndicates and their owners helped lay a foundation for the use of commutations and other financial arrangements to avoid formal liquidation of professional reinsurance companies. A review of these efforts is helpful to understand the regulatory, legal and market issues at the time, some of which continue to be applicable to today's market.

B. THE SYNDICATE LIQUIDATION PROCEEDINGS

After the formal liquidation proceedings were commenced by the Superintendent of Insurance, the owners and managers of several of these syndicates continued to press for plans to avoid liquidation, but now the case was being presented to the New York Insurance Department, not

the Exchange. The Insurance Department was not any more sympathetic to the syndicates' urgings, however, than the Exchange had been. If anything, the Insurance Department was even more adamant in its refusal to consider the use of commutations and other agreements with syndicate creditors to avoid liquidation.

It was the Department's position that such agreements would be tantamount to self liquidation, which was specifically prohibited by the Insurance Law.¹³ The syndicates argued that it was not self-liquidation if it was part of a court approved plan. Furthermore, an overwhelming percentage of the ceding companies were in favor of a settlement of their claims without waiting through a lengthy and costly liquidation process. Because the ceding companies as the creditors of the syndicates were in favor of these plans, who was the Department protecting by refusing to allow the plans to proceed?

These arguments fell on deaf ears at the Department until the court made them listen!

1. The KCC New York Syndicate Corp. Proceeding

Under the New York Insurance law, an order of liquidation cannot be entered without providing for a hearing on the merits of the application.¹⁴ The first such hearing for an Exchange syndicate occurred in December 1987 with respect to the KCC New York Syndicate Corp. (KCC), one of the first syndicates that the Superintendent of Insurance sought to liquidate.¹⁵

Prior to the hearing, KCC presented to the Court and the Department a plan of rehabilitation. Under the plan, KCC would pay a varying percentage of paid, case reserves and IBNR that, if accepted by the Court, would restore its surplus to positive. Included with the plan were signed agreements from ceding companies representing over 80% of outstanding claims accepting the terms of the plan, subject to Court

approval. The Department strongly objected to the plan on several grounds, the most significant being its objection to self-liquidation. In addition, however, the Department also objected on the grounds that it could only be effective if 100% of ceding companies approved, that each claimant received exactly the same percentage distribution (so there would be no ‘Preferential’ treatment), and the plan must result in the syndicate’s surplus being restored to at least \$2.2 million – the minimum capital level for a syndicate to actively write on the Exchange.

With no agreement being reached between KCC and the Insurance Department, an evidentiary hearing was scheduled before Justice Irving Kirschenbaum of the New York Supreme Court in Manhattan. The hearing, however, never got past the Department’s first witness, its internal examiner. After setting forth the Department’s case for a determination of insolvency, the examiner was presented on cross examination with the following definition of insolvency in the Exchange’s Constitution and By-Laws:

“Insolvent” means a financial condition in which the conduct of business by a Member or Associate Broker on the Exchange may jeopardize the interests of other Members, Associate Brokers or of policyholders due to a finding, based upon a financial statement made by, or a report on examination of, such a Member or Associate Broker, *that the Member or Associate Broker is unable to pay its outstanding lawful obligations as they mature in the regular course of business.*¹⁶
(Italics added)

For some unknown reason, the Exchange Constitution – which was codified as part of the Insurance Law -- used a bankruptcy rather than insurance definition of insolvency. In other words, as long as you could pay your claims as they matured, regardless of whether or not you did not have the

assets currently to pay your ultimate losses, you were not insolvent! Furthermore, Justice Kirschenbaum had a bankruptcy background and understood the distinction presented to him.

Rather than facing a decision determining that KCC was NOT insolvent, the Department reluctantly agreed to accept KCC's plan of rehabilitation, which was then approved by the Court.

The KCC proceeding also paved the way for other syndicate plans to be negotiated with the Department and approved by the Court.

2. Other Syndicate Plans

The success of obtaining approval of the KCC plan opened the door for other syndicate plans to be negotiated with the Department and approved by the Court. Additionally, with the Court's involvement the Security Fund took an interest in these plans, apparently realizing that spending some funds now to support these plans could remove far greater sums from its potential obligations down the road.

The syndicate plans focused on two elements: commutations with ceding companies representing at least 90% of liabilities, including IBNR; and reinsurance to cover the uncommuted liabilities. The Security Fund participated in three of these plans as shown by the following schedule, prepared by the Security Fund, showing the name of the syndicate, the date the approval by a judge of the Supreme Court, New York County of each plan was entered, and the payment by the Security Fund for reinsurance premium to cover the uncommuted liabilities for each syndicate:¹⁷

<u>NAME</u>	<u>DATE OF ENTRY</u>	<u>AMOUNT OF PREMIUM PAID BY THE SECURITY FUND</u>
BURT SYND.	0/25/88	\$2,640,500
CANDON SYND.	12/20/88	2,320,000
FIRST NY SYND.	12/29/88	<u>500,000</u>
	TOTAL	<u>\$5,460,500</u>

Ironically, the syndicate that forced the issue with the Department through the Court, KCC, eventually lost its fight to avoid liquidation. In 1991 KCC returned to the Court for approval of an amendment to its plan. By this time all but approximately 10% of its liabilities had been successfully commuted and paid. However, the remaining surplus did not exceed the Department's call for a minimum of \$2.2 million, the minimum surplus required to write on the Exchange (which was no longer operating!). Because the bulk of the syndicate's obligations had been met, its ownership decided it no longer made economic sense fighting the Department on this requirement, and did not contest the renewed petition to liquidate.

Months after the order of liquidation was entered against KCC, the Appellate Division of the New York Supreme Court overturned a lower court ruling in the First New York proceeding, unanimously holding that the \$2.2 million surplus of the Department was not necessary because the Exchange was no longer operating and there was no possibility for the syndicate to write any further business.¹⁸ Unfortunately, this decision came too late for KCC.

IV. POSTSCRIPTS AND LEGACIES

The relative success of the rehabilitation efforts of the Exchange syndicates broke new ground for the winding-up of professional reinsurance companies. These efforts opened the door for other reinsurance entities facing financial difficulty to explore new ways to address these concerns, and to work with regulators, ceding companies and the Courts to develop solutions that benefited everyone without the prospect of decades of unproductive liquidation proceedings.

A. RUN-OFF/WINDING-UP PLANS FOR PROFESSIONAL REINSURERS

The challenge to the insurance definition of insolvency led reinsurers and regulators to consider allowing entities to run-off their obligations by current valuing liabilities rather than adhering to strict insurance accounting.

Unfortunately, New York was late to the table in this regard, although some instances of achieving similar results can be found, usually through the use of reinsurance rather than obliquely allowing discounting.

B. §1231 OF THE NEW YORK INSURANCE LAW

A good example of New York appearing to embrace the new ground advanced by the Exchange syndicate insolvencies is §1231 of the New York Insurance Law. This statute appears to be a liberalization of the use of commutations in New York. In fact, it was a reaction to the Court approved plans of the Exchange syndicates designed to remove the review and approval of these plans from the Courts and place that review and approval solely with the Insurance Department. This end is accomplished by the statute requiring that any plan to use commutations to restore the surplus of a licensed insurer must be approved by the Superintendent of Insurance, and that any such plan does not remove the Superintendent's prerogative to pursue

rehabilitation or liquidation under Article 74 of the Insurance Law.¹⁹

Quite simply, f §1231 and the regulation promulgated pursuant to that section²⁰ had been in place before the Exchange syndicates presented their plans to the Court, the Court would have been compelled to reject the plans because the Department had not approved them.

C. EQUITAS (YES, EQUITAS!)

To say that the insolvent syndicates invented Equitas may be a stretch. There can be no denying, however, that the central proposition of Equitas – establishing a separate entity within the Lloyd’s market to assume the old obligations of its syndicates – were similar indeed to the Syndicate 101 concept presented to the Exchange and the Court in the late-1980s, well before the Equitas solution was raised at Lloyd’s.

V. THE NYIE SECURITY FUND, INC.

No review of the aftermath of the Exchange would be complete without a discussion of the Security Fund. In fact, such a discussion is particularly appropriate at this time because of its Court approved but as of yet unfulfilled plan to distribute its assets.

The Exchange legislation and its Constitution and By-Laws called for the establishment of a security fund to protect the policyholders of Exchange syndicates.²¹ It was to be a separate entity from the Exchange, with its own board of directors. The NYIE Security Fund, Inc. was therefore established under the New York Not-For-Profit Corporation law, with its own charter and by-laws. Funding for the security fund was to come from the syndicates, but in return the syndicates were exempt from contributing to the State Guaranty Funds (nor were its policyholders covered by the State funds).

Funding was from two sources: a \$500,000 Initial Deposit by each underwriting member upon acceptance as a member (the "Deposit Fund"), and through an assessment on premiums written on the Exchange (the "Surcharge Fund"). At the time of the call down of the Deposit Fund in September 1987 (discussed above in Section II.B.), the Security Fund controlled assets of approximately \$39 million, the \$25 million in deposits and approximately \$14 million accumulated in the Surcharge Fund, including the investment income on those funds.

Under Article XIII of the Exchange Constitution and By-Laws, the Security Fund was obligated to pay only those "unpaid contractual obligations" that are certified as unpaid by the Superintendent of Insurance to the Security Fund upon the completion of the liquidation of a syndicate. In other words, after a syndicate is placed into liquidation under Article 74 of the Insurance law, the Superintendent acts as liquidator as he would with any insolvent domestic insurer. Only upon distribution of all the assets of the syndicate in liquidation would the Superintendent be in a position to certify the unpaid claims to the Security Fund, and only then would the Security Fund have any obligation to pay policyholder claims of an insolvent syndicate.

In the seventeen plus years since the first order of liquidation was entered in respect of an Exchange syndicate in 1987, the Security Fund has not paid out any funds in payment or for the benefit of syndicate policyholders aside from the roughly \$5.5 million in assets used by the Security Fund to purchase reinsurance back in 1988. This is in part due to the fact that the Superintendent did not certify any "unpaid contractual obligations" to the Security Fund until September 1996 when it issued a certification for U.S. Risk Inc.

Even upon receiving that certification, however, the Security Fund made no distribution, determining instead to wait until the Superintendent completed the liquidation of all

the syndicates in liquidation. In this way, the Security Fund would be able to deal with a finite amount of claims. By the time of the first certification, all Exchange syndicates were either in liquidation or withdrawn with their obligations assumed by other insurance entities not covered by the Security Fund. Therefore, once the pending syndicate liquidation proceedings were completed, there could be no further syndicate liquidations and hence no further claims against the Security Fund.

The last syndicate liquidation proceeding was completed in late 2002. In November 2003, the Security Fund petitioned the New York Supreme Court, New York County, for an order pursuant to sections 510 and 511 of the Not-For-Profit Corporation Law approving a plan under which the Security Fund would distribute substantially all of its assets (less a reserve for expenses) on a pro-rata basis to the holders of unpaid contractual obligations certified to the Security Fund by the Superintendent of Insurance.²² According to the Plan of Distribution filed with the Petition, the Security Fund had certifications from the Superintendent of Insurance for all liquidated syndicates, showing a total of “unpaid contractual obligations” of \$112,553,457.81, and “gross amounts available on June 30, 2003” of \$81,759,812, or a little more than 72% of the certified claims.²³

The Security Fund’s Petition and Plan of Distribution were approved by an order of Justice Herman Cahn filed on February 24, 2004. As of this time, no funds have yet been distributed by the Security Fund in accordance with this order.

VI. CONCLUSION

In February 1996 an order of liquidation was entered in the New York Supreme Court for the Exchange entity itself. Although its life was brief, the consequences of the Exchange – both good and bad – continued to be felt in the industry some seventeen years after it closed its doors. Some of these

consequences are obvious to any ceding company “stuck” with an Insurance Exchange certificate participated on by insolvent or untraceable syndicates. More importantly, however, may be the developments arising from the ashes of the insolvent syndicates and the contributions of those syndicates to the development of better ways to address the run-off or winding up of professional reinsurance entities, and the increase in flexibility of the regulators in addressing the problems of financially troubled insurers and reinsurers.

VII. ENDNOTES

¹ New York Insurance Law, Articles 62, §§6201 – 6203.

² New York Insurance Department Regulations No. 89, 89-A and 89-B (NYCRR, Part 18).

³ This section and other parts of this paper are derived from this author’s book on insurance exchanges in the U.S., “Exchange: A Guide to an Alternative Insurance Market” (NILS Publishing Co., 1987).

⁴ 75 U.S. [Wall.] 168

⁵ 322 U.S. 533, rehearing den., 323 U.S. 811

⁶ See, e.g., New York Insurance law §3404(e), a recodification of old Insurance law §176, setting forth the precise form of the “standard fire insurance policy of the State of New York.”, also referred to as the “section 176 form.”

⁷ See New York Insurance law Article 63, and Regulation 86 (NYCRR, Part 18B).

⁸ Following is the full text of §6201(b):

(b) The purposes of the exchange shall be:

(1) to provide a facility for the underwriting of:

(A) reinsurance of all kinds of insurance;

(B) direct insurance of all kinds on risks located entirely outside the United States;

(C) direct insurance of all kinds on risks located in the United States other than in this state, provided that such risk qualifies for placement pursuant to the excess and surplus lines requirements of the jurisdiction in which the risk is located; the superintendent may permit the exchange or its syndicates, or both, to take such steps as may be necessary to qualify as an excess and surplus lines insurer in such jurisdiction;

(D) risks which shall have been submitted to and certified as having been rejected by a committee representative of insurers licensed by the superintendent under article sixty-three of this chapter, subject to conditions imposed by the superintendent pursuant to regulation; and

(2) to manage the facility authorized by this article, in accordance with regulations promulgated by the superintendent.

⁹ *An Analysis of the New York Insurance Exchange's Economic Impact*, the Diebold Group, Inc., April 1981, at page 6.

¹⁰ Several syndicates contested the call-down by the security fund. These attempts were rejected by the trial courts and the authority of the Security Fund to make the call-down confirmed on appeal. See *Matter of Senate Syndicate, Inc. v. New York Insurance Exchange, Inc. and NYIE Security Fund, Inc.*, 167 A.D.2d 113, 561 N.Y.S.2d 202 (App. Div., 1st Dept., 1990).

¹¹ New York Insurance Exchange Constitution and By-Laws, Article II, §13.

¹² *Ibid*, §13(f).

¹³ See New York Insurance law §7402(j), which makes self liquidation a grounds for entry of an order of rehabilitation. §7404 incorporates all grounds for rehabilitation as grounds for liquidation.

¹⁴ See New York Insurance Law §7417.

¹⁵ *In the Matter of the Application of James P. Corcoran, as Superintendent of Insurance of the State of New York, for an order to take possession of and liquidate the business of and dissolve KCC New York Syndicate Corporation*, New York Sup. Ct., Index No. 46701/87. The author was counsel to KCC New York Syndicate in this proceeding.

¹⁶ Constitution and By-Laws, Article I, §4(o).

¹⁷ Petition of the NYIE Security Fund, Inc., verified November 10, 2003, to the New York Supreme Court, New

York County, Index No. 119499/03, *In the Matter of the Application of NYIE Security Fund, Inc. for an Order Approving its Plan for the Distribution of Assets and Payment of Unpaid Contractual Obligations Certified to it by the Superintendent of Insurance*, at page 16.

¹⁸ *In Re Corcoran (First New York Syndicate Corporation)*, 171 A.D.2d 431, 567 N.Y.S.2d 13 (App. Div., 1st Dept., 1991).

¹⁹ The full text of §1231 follows:

§1321. Commutation of reinsurance agreements.

(a) If the superintendent finds that a domestic insurer or a United States branch of an alien insurer entered through this state is impaired or insolvent within the meaning of this chapter, the superintendent may permit such insurer to utilize commutations of reinsurance agreements to eliminate the impairment or insolvency, provided that such commutations are approved by the superintendent in accordance with standards prescribed by regulation.

(b) For purposes of this section, commutation of a reinsurance agreement is the elimination of all present and future obligations between the parties, arising from the reinsurance agreement, in exchange for a current consideration.

(c) Nothing herein contained shall preclude the superintendent from proceeding against such insurer under any other provision of this chapter.

²⁰ Part 128 NYCRR, Commutation of Reinsurance Agreements, Regulation 141.

²¹ See New York Insurance Law §6202(b)(4), and Article XIII of the Exchange's Constitution and By-Laws.

²² Petition of the NYIE Security Fund, Inc., *supra*, endnote 16.

²³ Exhibit 7 to the Petition of the NYIE Security Fund, Inc., *supra*.