[INSIGHT] By Peter H. Bickford

Rehab the Rehabilitator!

There was a time not so long ago when the New York Insurance Department took the view that if an insurance company stopped writing new business and tried to simply run-off its business, it was engaging in a prohibited activity—self-liquidation. The failure to "do the business of insurance for a period of one year" was—and still is—grounds for liquidation of an insurer, and the Department's position was that if a company was not writing new business it was not doing the business of insurance.

This position, of course, pre-dated the international growth of the run-off and legacy management business, whether used for the protection and expansion of ongoing business, to manage financial stress, or simply to refocus on core or preferred business. You may recall Equitas, which was created by the Lloyd's market in the early 1990s to wall off its troublesome old asbestos and spiral obligations, thus helping to restore financial stability to the market and enabling Lloyd's to attract new capital for new business. Equitas may not have been the first use of a run-off vehicle to wall off old business from ongoing operations, but it certainly was the most significant up to then and helped establish the legitimacy of such use.

Today the run-off and legacy business is a significant part of the business of insurance. The industry has developed expertise in all elements and levels of run-off and legacy business, including underwriting, claims, accounting, actuarial, legal and any other professional aspect of the business. A number of trade groups have also developed over the past two decades devoted in whole or in part to legacy business, such as AIRROC (Association of Insurance and Reinsurance Run Off Companies) and IAIR (International Association of Insurance Receivers). *The regulators, of course, were slow to recognize that the management of outstanding contracts was as much a part of the business of insurance as writing new business. Which may also explain why regulators have been slow to understand the concept of rehabilitation.*

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It is a stale old joke that to insurance regulators rehabilitation is the state of purgatory of a financially stressed company before it is liquidated. By first placing a company into rehabilitation, the insurance commissioner as receiver can give lip service to attempts to revive a troubled company. However, as history shows, actual efforts to revive companies in rehab are few and far between and actual successes exceedingly rare. I have often been asked whether there has ever been a successful rehabilitation of an insurance company in NY. My answer is it depends on your definition of rehabilitation. The infamous NY Liquidation Bureau would argue affirmatively, and probably would point to its most recent success, Interboro Insurance Company. In my view, however, Interboro is the exception—if it is even that—that proves the rule. The Executive Life disaster – over 20 years in "rehabilitation" at a cost to policyholders and the industry of almost $2 billion to date – is a more accurate example of the failure of the rehabilitation process.

Under NY Insurance Law, the basic direction to the superintendent as liquidator is to "take possession of the property of such insurer and to <u>*liquidate the business*</u> of the same . . ." This is in contrast with the basic direction to the rehabilitator "to take possession of the property of such insurer and to <u>*conduct the business thereof*</u>, . . ." The rehabilitation statute also provides that: "The rehabilitator or any interested person . . . at any time, may apply for an order terminating any rehabilitation proceeding and permitting such insurer to resume possession of its property and the conduct of its business, . . ."

In other words, a liquidator's job is to marshal and distribute assets in accordance with strict statutory distribution rules, while a rehabilitator's job is to manage the business of the company—keeping it alive—until the cause or causes of the need for rehabilitation have been addressed, and then restoring the company to the marketplace. These are not hard concepts to understand, but in practice state agencies appointed as rehabilitators (like the aptly named Liquidation Bureau in NY) have not caught on to the difference between liquidating and running an insurance company. The number of instances where companies in rehabilitation have been deconstructed as if in liquidation far outnumber those few instances where the business has been saved in some form or another and returned to the marketplace. Unfortunately, even if regulators—acting as rehabilitators—understand the difference between liquidation and rehabilitation, more often than not they do not have the expertise required to manage the business.

This failure of understanding and expertise is one more reason why permanent insurance receivership bureaus are a waste of estate and public assets and should be eliminated. The independent expert resources are plentiful in the private market, and even more so since the growth and development of legacy and run-off businesses.

In response to the criticism that rehabilitation is simply an interim step before liquidation, many states point to their authority to place troubled companies into supervision, where the company's manage-

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ment stays in place but operates under the strict supervision of the regulators without having to be placed into formal liquidation or rehabilitation. The NY Department, which does not have statutory authority for formal supervision, has sought such authority in the past as a way of addressing the concerns of companies wary of the consequences of consenting to formal liquidation or rehabilitation. However, there is no reason that a properly run rehabilitation could not provide the same benefits as a formal supervision, but with the added protection of appropriate court injunctive relief that is often missing under a regulator's order of supervision. There is nothing in the rehabilitation statute to prevent the court appointed rehabilitator from keeping management of a distressed but savable company in place as his or her designated agents until the company is rehabilitated – like a debtor in possession bankruptcy.

Even if State insurance commissioners continue to serve as statutory receiver, their role should be limited to overseeing the liquidation or rehabilitation process and not assuming the role as manager of insurance entities — a role they are generally not equipped to handle.

The Bottom line is that State insurance commissioners should stick to their regulatory and oversight roles and get out of the business of trying to run insurance companies without proper expertise! [IA]