[INSIGHT] By Peter H. Bickford

Gone But Not Forgotten!

Peter H. Bickford

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You may have heard the huge sigh of relief coming from Downtown Manhattan in early August, particularly from the William Street offices of the New York Liquidation Bureau. On August 8th the decades long failed rehabilitation of Executive Life Insurance Company of New York (ELNY) finally ended and it was officially liquidated. Not only was it liquidated, its remnants, including its restructured contracts, were shipped out of town (to, of all things, a District of Columbia captive). Gone! Goodbye! Good riddance!

Before too much congratulatory backslapping, however, a sober post mortem is in order.

First, it is important to remember that ELNY was placed in rehabilitation in 1991 to "protect it" and not because it was insolvent. After 20+ years under management of the Liquidation Bureau, ELNY ended up insolvent to the tune of almost $2 billion. It is also important to understand that ELNY has been seriously insolvent for many years. According to testimony of the rehabilitator's own witnesses during the March 2012 hearing on the rehabilitator's plan to liquidate ELNY, serious efforts by the rehabilitator, the life guaranty associations and the life industry to address ELNY's insolvency began in 2006. Those efforts ultimately led to a plan approved by the court in April 2012 and implemented this August after court rejection of all appeals.

To briefly recap, the plan utilized the remaining ELNY assets and guaranty fund commitments to provide for continued full payment on roughly 84% of ELNY contracts. The remaining 16% — about 1500 contracts – have benefits reduced by as much as 50% or more to cover the roughly $900 million remaining shortfall. Almost all of these reduced benefits were to structured settlement annuities used as funding mechanisms for settlements with people with severe bodily injuries. The rehabilitator justified the plan as being the fairest plan possible under the circumstances and in view of the statutory limitations on each state's guaranty fund coverage. The objectors – a group of annuitants whose benefits were cut substantially under the plan – argued unsuccessfully that the plan was discriminatory and that they should be afforded the opportunity to explore fairer alternatives. The courts disagreed.

With court support for the plan and rejection of all arguments against it, together with sweeping immunity granted to anyone associated with the rehabilitation effort, shouldn't the book on the ELNY saga be closed once and for all? Quite the contrary! *Now is the time to put legal posturing aside and to make objective, constructive assessments of the ELNY circumstances, including its troubled history, and to pursue a serious discussion of appropriate and necessary changes to the liquidation process and the guaranty fund structure, not just in New York, but nationwide.*

To ensure that the participants in those discussions are not misdirected by past litigation rhetoric, and to enable them to correctly understand the defects in the insolvency process exposed by ELNY, the air needs to be cleared regarding a few myths that pervaded the proceedings.

First is the myth that the final court approved plan is not discriminatory. It is! The reduction in benefits under the restructured ELNY contracts falls almost exclusively on one class of beneficiaries – structured settlement annuitants. The rehabilitator and the guaranty associations argued throughout the proceedings that the plan was not discriminatory because the ELNY assets were applied uniformly to all contract. The reduction in benefits to structured settlement annuitants resulted from the statutory limitations on guaranty fund coverage, not because of any discriminatory application. That legal posture was successful with the courts, but with the reductions applying almost exclusively to one category of annuitant the plan is *de facto* discriminatory. If the current process allows for such obvious discrimination (which it does) then the structure needs to be radically reconsidered. There is no justification for a system that permits

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such blatant discrimination.

But the discrimination against structured settlement annuitants is not the only discrimination occurring under the ELNY rehabilitation. A less discussed but equally significant form of discrimination was the discrimination – or preference – caused by the long delay from the time ELNY was known to be seriously insolvent up until the implementation of the restructuring plan. This delay in addressing the insolvency created a preference in favor of short-term annuities or annuities that simply matured while ELNY was insolvent over long term or deferred payment annuities. Every state's insolvency or bankruptcy statutes include provisions for voiding preferential transactions occurring prior to actual filing for bankruptcy or liquidation, and allow receivers or trustees in bankruptcy to recover preferential payments (see, for instance, NY Insurance Law Section 7425). Since at least 2006, and probably longer, the rehabilitator and his agents allowed payments in full (including contractual enhancements such as cost of living adjustments) to continue to annuitants even though ELNY was known by them to be significantly insolvent, thus creating a preference in favor of some annuitants over others. If ELNY had continued in private hands, its management would likely have been held financially responsible for allowing such preferential treatment. In the ELNY proceeding, however, the rehabilitator and his agents received blanket immunity from responsibility instead.

Another major myth is that participating guaranty associations will have paid out their full caps to annuitants with reduced benefits. The fact is that no participating guaranty association was or will be required to pay out its full statutory cap to any ELNY annuitant! This is because the court approved plan allowed for the statutory subrogation claims of guaranty associations to be offset against their payment caps. In the typical insurance liquidation, the guaranty association pays out up to its statutory cap to claimants, and then has a claim for such amounts against the insolvent estate recoverable pro rata with other claimants if and when the estate makes a distribution in the future. Under the ELNY plan, however, the guaranty fund participations were on a net basis so that cap amounts were simultaneously reduced by subrogation claims. As a result, the guaranty funds were reimbursed their share of ELNY assets before having to pay a dime to any annuitant. Another preference?

The unusual ELNY circumstances highlight the real world limitations of guaranty fund coverage – particularly for annuities — limitations that do not usually appear in the conversation about the protections provided by guaranty funds. They should!

Finally, now that victory is in hand, the restructuring plan implemented, and immunity firmly in place, the liquidator and his minions need to drop the posturing on the financial history of ELNY, particularly concerning its financial status at the time it was taken into rehabilitation, and when it became irreversibly insolvent. ELNY was a successful insurer when taken into rehab to protect it from a possible "run on the bank" because of the failure of its parent company, Executive Life of California. ELNY was NOT insolvent, nor was it deemed to be in a deteriorating financial position. The financial deterioration of ELNY occurred while under the aegis of the NY liquidation bureau. When that deterioration became irreversible is unknown because of the lack of reporting and openness by the rehabilitator and his agents over the years. One thing is certain, though: by 2006 at the latest (and probably much earlier), ELNY was hopelessly insolvent. Any attempts to blame the insolvency or even the depth of the insolvency on subsequent events or conditions, such as the 2008 financial crisis, are misleading and unhelpful. Continuing to hold onto these positions muddies the waters for a serious examination of the insolvency process.

Now that the restructuring plan is implemented, the estate assets transferred to a new assuming entity, objectors suppressed, appeals exhausted and immunity secured, it is time to translate the lessons of the ELNY rehabilitation into meaningful changes in the insurance insolvency process. For changes to be meaningful, however, it its essential for regulators, legislators, guaranty associations, consumers and the industry to understand what really happened with ELNY and not just accept past legal posturing. [IA]

[IN THE NEWS]

MMIP "Second Layer" Not Required

By Katlin Nash

Albany, N.Y.—The statutory clarification that the Medical Malpractice Insurance Pool ("MMIP") is not required to offer a second layer of excess medical malpractice insurance coverage is extended from July 1, 2013 to July 1, 2018. The bill was signed into law as Chapter 80 by Gov. Andrew M. Cuomo on June 30, 2013. The sponsors of the bill were Senator James Seward (R, C, I-Cayuga) (S5704) and Assemblyman Steven Cymbrowitz (D, WF-Kings) (A7388).

"In 1999, legislation was passed to dissolve the Medical Malpractice Insurance Association ('MMIA'), the market of last resort for medical malpractice insurance. Upon MMIA's dissolution, the MMIP was established as a source of medical malpractice insurance for health care providers who were unable to procure such insurance in the voluntary market. Upon initial distribution, i.e., the July 1, 2000 through June 30, 2001 policy year, MMIA insureds were to-receive policies with provisions and at rates which were at least as favorable to the insureds as what they would have received upon renewal has MMIA not been dissolved, including a second layer of excess coverage," said Senator Seward.

"Currently, no authorized medical malpractice insurer offers a second excess layer of coverage to its insured physicians, dentists or podiatrists. It is both unfair and illogical to require MMIP to bear the financial burden associated with providing a second layer of excess malpractice insurance to such health care providers where industry practice does not make such insurance available. Without this extension MMIP will be required to provide a second layer of excess medical malpractice insurance in the involuntary market despite the fact that no MMIP member insurer will provide in the voluntary market such coverage to its own policy holders. This law will continue to correct this inequity by clarifying that MMIP is not required to offer a second layer of excess medical malpractice insurance," said Assemblyman Cymbrowitz. [IA]