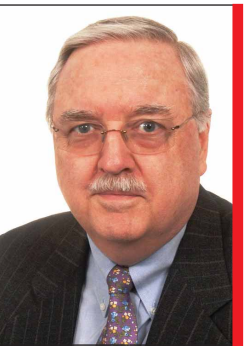
[INSIGHT] By Peter H. Bickford

Warning Shots

Don't you just love the flexibility of the English language? Although annoying to many purists (and often to the sensitivity of our ears) English is always adapting and moving with current times. Even the Oxford English Dictionary has accepted this flexibility by adding current usage into its venerable pages, often the result of modern technology. In 2013, for instance, the OED added "bitcoin," "phablet" and "selfie" to its pages. In addition to new words, English also has the flexibility of changing the nuance of words and phrases with changing times. We also use the vast English vocabulary in an attempt to alter perception — think of Orwell's four ministries in "1984" Truth, Love, Plenty and Peace – or to soften what some may consider unpleasant or harsh, such as the euphemisms "downsizing" for firing, "passed" for died or "adult entertainment" for pornography.



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So it is with some amusement that I have observed a new trend among those involved with the liquidation of insurance companies – receivers and guaranty associations – who now seem intent on referring to their disassembling of insolvent insurers as "resolving" estates. A former head of the NY Liquidation Bureau candidly referred to his job as that of an undertaker disposing of the body of the insolvent company. There was no subtlety to his perception or conduct of the role of the liquidator: aggressively pursue assets and distribute them – eventually – on some pro-rata basis. It was not necessary, in his view, to saccharin-coat the role of the liquidator ("rehabilitation" was not part of his vocabulary!).

But apparently today's insurance undertakers want to soften their image and be perceived as problem solvers rather than demolition experts. And who can blame them? The insurance insolvency process in the US is disjointed, inconsistent and highly inefficient. Describing their role as problem "resolvers" hides the rough edges of the current process and tries to emphasize the positive aspects of marshalling assets and settling claims.

It was initially disappointing, therefore, to see the Federal Insurance Office (FIO), in its long anticipated report on modernizing and improving the system of insurance regulation in the US, mimic this new liquidation process language by calling its section on the insolvency process "Resolution of Insolvent Insurers." In addition to adopting the receivership community's "resolution" mantra, the FIO Report also seemed focused on large, internationally important insurers and the international regulatory agenda rather than the flaws in the existing state process.

At first blush, by adopting the liquidators' newspeak and the international regulatory agenda, the FIO seemed to have missed an opportunity to focus attention on one area of state-regulation of insurance ripe for close scrutiny and national attention. Surprisingly, despite this tepid start, and while it may not have been as direct and critical a commentary as it could have been, the FIO Report makes a couple of spot-on observations and recommendations regarding the "resolution" process.

The section on the resolution of insolvent insurers is a very small part of the FIO Modernization and Improvement Report. Industry trade groups, state regulators and others wasted little time issuing commentary that parsed, studied, scrutinized and analyzed almost all corners of the Report, and their conclusions have been extensively recorded and published. The "resolution" process, however, has not received the kind of in-depth analysis as most of the rest of the Report. While not pretending to be "in-depth," here's a start to the conversation.

The FIO Report makes two recommendations for the receivership process: more uniformity, and transparent financial reporting. On the uniformity side, with all the inconsistencies from state to state on the processing of insurance and other claims, reinsurance collections and distributions, the FIO chooses to focus on the uneven treatment of derivatives and qualified financial contracts. This attention to financial rather than traditional insurance products seems to support the premise that FIO is merely an extension of Treasury's efforts to impose banking regulations on the insurance business. However, although the FIO could have used a much broader brush in presenting this need, the main premise of inconsistent treatment from state to state is definitely on target.

More aptly presented was the second recommendation: the need for greater transparency in the financial reporting by receivers. As correctly noted by the FIO:

> "The status and cost of a receivership estate are issues in which policyholders and other creditors have a keen interest, but too often there is a lack of sufficient, clear and timely information."

The FIO Report discusses the unsuccessful attempts by the NAIC through its Global Receivership Information Database (GRID) to provide meaningful, consistent information about estates in receivership. It also correctly identifies inconsistencies

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in reporting methods, scope of disclosures, and of cost of administration, among other issues. Interestingly, this criticism is well focused and drops the newspeak "resolution" wording. The FIO got this one right.

On guaranty funds, the Report recommends that States adopt uniform policyholder recovery rules "so that policyholders, irrespective of where they reside, receive the same maximum benefits" from the funds. To support this recommendation the Report cites the inconsistencies in the maximum coverage from state to state on the same contract.

Furthermore, the FIO Report sets the stage for some serious reconsideration of insurance guaranty fund effectiveness, particularly in the event of the failure of a large insurance group in the US. It cites figures and information provided by the two national associates representing p/c funds (NCIGF) and life and health funds (NOLHGA) without actually agreeing with the numbers. The FIO conclusion is telling and should send a warning shot across the bow of the state funds and their supporters:

> "Just as insurers perform stress tests under adverse scenarios, NCIGF and NOLHGA should periodically model the potential adverse impacts of such scenarios on the guaranty fund system for review by the FIO."

The last sentence of the "Resolution of Insolvent Insurers" section of the FIO Report, although not presented as a specific recommendation, expresses unequivocally that if the states fail to achieve uniformity of guaranty fund benefits, "then federal involvement may be necessary to ensure fair treatment of all policyholders." It would seem imperative for the receivership and guaranty fund communities across the US to heed these warnings and to clean up the inconsistencies or the Feds will. Good stuff!

Given the extent to which regulators are focused on the front end of the solvency issue, i.e. the establishment of uniform solvency standards, It is only fitting that the back end of the process – the "resolution" of insolvent insurers – should also be of concern to and receive the attention of insurance regulators. Or is it their prevailing view that if the solvency standards are made high enough there is little need to be concerned with the insolvency side? That would definitely be a dangerous assumption.[IA]

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