[INSIGHT] By Peter H. Bickford

State of Inflexability

It is right there in the New York insurance law: if an insurer "ceases to do any insurance business for more than one year continuously," it is subject to, among other things, forfeiting its charter and being liquidated. There is no counterpart to this provision in the NAIC receivership model act's long list of reasons for liquidation, and it appears to be singular to New York's statute (another 49 and 1 example?). In the not so distant past, the NY regulators strictly interpreted this provision to mean that if an insurer stopped issuing new policies, went into run-off or sought to commute its business, it was "self-liquidating" and no longer engaged in the business of insurance. No matter that the company may continue to process and pay claims, issue endorsements, or otherwise maintain books of business – actions that are generally considered to be part of the business of insurance. And no matter that the company's attempts, whether commuting or running off its business, were in the best interest of the financial condition of the company and the security of its policyholders.

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Over time, of course, the NY department had to retreat from its strict interpretation, particularly with solvent companies running off or commuting discontinued books of business. From its infancy in the late 1980s-early 1990s, the run-off business has grown into a substantial and recognized business with its own trade groups and recognized expertise, and is now a mature, universally recognized stratagem even by New York's regulators. It has been more difficult, however, for New York's regulators to accept the use of these tools to restore or maintain financial solvency. For example, the NY insurance law provision allowing the use of commutations as part of a company's attempt to "prevent impairment or insolvency," was actually a reaction to courts approving the implementation of company-initiated plans over the objection of the regulators rather than a regulatory recognition of a useful tool to help protect companies and their policyholders.

These courts recognized that in some instances it was more beneficial to policyholders and creditors for financially troubled insurers to find economic solutions short of formal receivership – like debtor in possession plans in bankruptcy law. The NY regulators, however, aggressively cling to their premise that they and they alone are the exclusive statutory voice for policyholders, claimants and creditors, even if such voice proves hugely detrimental (See Executive Life Insurance Company of New York).

Part of the NY regulators' argument is that the law provides very narrow parameters for dealing with financially stressed insurers. The only options are formal rehabilitation or liquidation. New York law does not provide for conservation as an option to rehabilitation or liquidation, as is provided in the NAIC receivership model act, and certainly does not provide for a less formal regulatory supervision outside of court ordered receivership.

New York's argument that the existing statute lacks flexibility ignores the scope of the rehabilitation option, which directs the rehabilitator to "take possession of the property of such insurer and to conduct the business thereof" with broad authority to carry out this charge. Also, the lack of a statutory conservation option is largely a distinction without a difference. The stated objectives and purposes of conservation versus rehabilitation in the NAIC receivership model act and other state statutes are basically the same – run the business, eliminate the problems and restore the company to the marketplace. It is unfortunate that over the decades the existing broad statutory authority stagnated into a rigid, inflexible view where rehabilitation predominantly is purgatory before liquidation.

From time to time over the last few decades New York insurance regulators (distinguished from its receivers) have argued that the real problem is the lack of statutory authority for regulatory supervision or control over the operations of a financially troubled company without having to place it in formal court ordered rehabilitation or liquidation. Other states have this statutory authority, which allows them to act on a company well before the need for formal receivership is required. Texas, for instance (yes, Texas!) provides its insurance regulators with such authority, correctly recognizing that "[p]lacing an insurer in receivership often destroys or diminishes, or is likely to destroy or diminish, the value of the insurer's assets . . ."

There are many insurance executives and professionals, however, who have consistently opposed providing the New York regulators with even more authority over them, pointing out that the regulators already have far too many existing tools at their disposal to identify and act upon troubled companies. The problem, they point out, is not the lack of statutory authority but a lack of business acumen on the part of regulators resulting in formulaic and inflexible decisions rather than adapting to or solving specific problems and needs.

Ironically, perhaps the best argument in favor of pre-receivership supervision in New York is its stubborn, inflexible, unaccountable receivership process. Compare New York's receivership process, with its rigid interpretation of the statute and lack of accountability, to Texas's system of using fully accountable outside independent insurance professionals. Some examples are shown in the chart on the next page.

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Given the grim reality of the receivership process in New York, it is no wonder that companies facing financial difficulty may seek any kind of deal with the regulators to avoid boarding Charon's boat to cross the river Styx to the receivership afterlife. Harsh as this analogy seems, so long as the State executive or legislative leaders continue to be unwilling to make the receivership process more flexible and accountable the likelihood of a company's recovery once its keys are turned over to the receiver remain quite slim. The alternative of providing regulators with expanded supervisory authority, or "debtor in possession" type of receivership, bears its own substantial risks and concerns.

TEXAS	NEW YORK
• Outside professionals	• Full-time liquidation bureau employees
• Bonded	• Broad immunity
• Accountable to insurance regulators and the courts	• *De facto* accountable to no one
• Required to prepare, file and follow business plan	• No plan required
• Required to file monthly or quarterly reports with regulators and the court on status and progress of plan	• No periodic reports required
• Most proceedings before judge/court appointed master familiar with insurance receiverships	• Randomly selected judges/no centralized receivership expertise

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Unfortunately, the industry's well-founded fear of expanding regulatory authority coupled with the state's failure to make the receivership process more flexible and accountable will result in the worst possible option: perpetuating the status quo.

Hobson had it easy![IA]