[INSIGHT] By Peter H. Bickford

Past is Prologue

Peter H. Bickford

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The new Spielberg/Hanks movie "*Bridge of Spies*" is by all accounts a relatively factual telling of a 1950s Cold War drama played out on the front pages of the press with little public knowledge of the real drama occurring behind the scenes. The movie's hero is an insurance lawyer from Brooklyn, James B. Donovan, who was asked to defend a Soviet spy living underground in New York, Colonel Rudolf Abel. Because of his independent negotiating skills, Donovan, played by Tom Hanks in the movie, was drawn into the high-stakes behind-the-scenes negotiations for the exchange of Abel for two Americans, including the U-2 spy plane pilot, Francis Gary Powers.

I never knew James B. Donovan, who died at age 53 in 1970, but recently learned of a connection to him that brought back memories of another, far less dramatic, story wrought with misinformation or misconceptions – the aftermath of the old New York Insurance Exchange.

The connection is that James Donovan's law partner, Tom Parry, was the lawyer for the exchange's security fund. Although Tom was the only contemporary partner in the firm of Donovan Maloof Walsh & Kennedy (later Donovan Parry McDermott & Radzik) to have actually practiced law with James B. Donovan, Tom seldom discussed his former partner's exploits and I only became aware of the connection recently. But upon learning of the connection, it made a lot of sense. Tom, who retired a number of years ago, was a hard-nosed negotiator and staunch defender of the security fund and its role in the long drawn out process of resolving the many financial issues facing exchange syndicates following the close of the Lloyd's-style facility in the late 1980s. And like the Cold War events of the 50s and 60s, the factual story seems to elude common knowledge.

Even today when I mention efforts to consider the establishment of a modern US-based syndicated market, eyes role with ingrained but incorrect perceptions about the old exchange. I have written about these misperceptions many times in the past, but for the moment – in honor of James B. Donovan and his partner Tom Parry – I am focused on the role of the exchange's security fund.

The security fund was created under the original exchange legislation as a separate entity from the exchange with its own board of directors and officers. Many observers, however, considered it to be nothing more than an arm of the big insurers that controlled the exchange, with a board made up of representatives of the same major insurers running the exchange's board. In fact the security fund board was fiercely independent and took many actions opposed by the exchange board – independence exemplified by its counsel, James B. Donovan's partner Tom Parry.

In the mid-1980s the exchange syndicates ran into the same underwriting and financial problems that also plagued and almost destroyed the Lloyd's facility and bankrupted many of its individual investors. However, while the Lloyd's market worked together to address its financial and market problems, the New York exchange leadership failed to take steps to protect its market, resulting in its closing after a short seven years. The exchange failed to use its unique self-regulatory authority to work with syndicate managers, the broker community and the security fund to find ways to address the syndicates' financial problems to keep the market active and viable. Instead, eight of the exchange's 35 active syndicates became financially over-extended and were turned over to the State for liquidation without any serious attempt to resolve these problems within the exchange framework.

The security fund, on the other hand, worked with representatives of the financially troubled syndicates, their policyholders and other creditors and the courts to seek broad market solutions, including the first use of commutations to restore solvency (leading to the enactment of §1321 of the New York Insurance Law). Another proposed market solution was for the creation of a new syndicate that would be the reinsurer of or assuming entity for the old liabilities of the impaired or insolvent syndicate. Sound familiar? The proposal, which was presented long before Lloyd's created Equitas as its own run-off facility, was supported by policyholders, syndicates, brokers, the security fund, and the liquidation courts, but flatly rejected by the exchange leadership. While the exchange leadership was washing its hands of the troubled syndicates and forcing the closure

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of the market, the security fund was working with syndicates, their policyholders and creditors, regulators and the courts by supporting court-approved commutation plans and other efforts to resolve the financial problems short of liquidation. And when liquidation was a certainty, the security fund worked with policyholders and other creditors to push for resolution of the estates and payment of claims.

Even though the security fund actively worked to achieve market solutions and to maximize distributions to creditors, its legacy has been wrought with misconceptions about its role, including a perception by many today that the actions of the security fund were designed to and helped precipitate the closing of the exchange, and that it did little or nothing to help resolve the financial difficulties facing the exchange and its financially troubled syndicates.

Why is it important today to address these misconceptions? Despite the eye-rolling, knee-jerk reaction of some at the mention of a modern platform for syndication of capital in the US, many others see the growing value of such a facility to stem the flow of capital offshore and to provide a meaningful mid-market risk-spreading alternative. Although pushed to the background following the merger of banking and insurance in New York, the effort started by insurance superintendent Eric Dinallo in 2007 and expanded by his successor James Wrynn has never disappeared and continues to percolate. An exchange working group of industry, investor and regulatory representatives created by Superintendent Wrynn produced a significant and credible road map for the construction of a modern, effective facility. One of the central themes to that road map is the importance of a strong central financial control unit backed by a security fund providing sound security assurances to the marketplace.

While the old exchange failed to provide the committed central management necessary for a successful market, the security fund – under the leadership of its board and counsel, Tom Parry - demonstrated the value of a strong but flexible security fund. Policyholders and other creditors of the financially strained syndicates of the old exchange – thrown under the bus by the exchange's leadership – had their positions substantially enhanced by the active, creative roll of the security fund.

It took nearly a half-century for the efforts of James B. Donovan to be fully appreciated. It is my hope that it will not take that long for the efforts of the leadership of the old exchange's security fund – including Mr. Donovan's partner Tom Parry - to be recognized and appreciated.[IA]

Peter Bickford has over four decades of experience in the insurance and reinsurance business, with particular focus on regulatory, solvency, agency, alternative market and dispute resolution issues. In addition to his experience as a practicing attorney, he has been an executive officer of both a life insurance company and of a property/casualty insurance and reinsurance facility. A complete biography for Mr. Bickford may be accessed at www.pbnylaw.com.