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Coverages and Strategies

- **The Coming of Age of Cyber Insurance**
  Richard G. Clarke
- **D&O Insurance Market Today**
  Susanne Mast Murray and Fred T. Podolsky
- **Product Liability Claims Alleging Property Damage**
  Kevin Dreher
- **"Auto" vs. "Mobile Equipment"**
  Arthur L. Flitner
- **Turning "Silver" Into "Gold": The Aging Work Force**
  Jeff Chilcott, Renee Mattaliano, Lance Perry, A. V. Riswadkar, and Clayton Shoup
- **Contingent Workers: Panacea or Pandora's Box?**
  Tacita A. Mikel Scott and E. Abena Antwi

- ISO on Enterprise Risk Management — *Product Quality and ERM*
- Insurance Strategies — *The Claim Game*
- Insurer Solvency — *Maximizing Recovery*
- Insurance Law — *Lloyd's of Hollywood*

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Insolvent does not necessarily mean without money.

How to Maximize Coverage When Your Insurer Is Declared Insolvent

KIMBERLY WINTER

Given the current economic climate, with stories of bankruptcy and bail-outs filling the news, it is understandable for all types of policyholders to be concerned about what might happen if their insurers are declared insolvent. It has been said that needing insurance is like needing a parachute — if it isn't there the first time, chances are, you will not be needing it again. That is why it can be crucial for policyholders to understand how to handle a claim, particularly in the event of insolvency, when the process becomes even more complicated.

This article provides practical tips that may assist policyholders to maximize recovery in the event of a claim involving coverage intended to be provided by an insolvent insurer.

A Brief Background: Why Do Insurers Become Insolvent?

Unfortunately, even when one has taken precautions to procure the best coverage available through a highly rated insurer, insolvency remains a risk. Insolvency may occur for various reasons, including a simple failure to compete (losing business to other companies with a better product or lower prices), unsustainable growth, or a sudden influx of catastrophic losses for which the insurer did not have adequate

reserves or reinsurance.

Unlike most noninsurance companies, which are subject to the federal bankruptcy code, the regulation of insurance company financial stability and solvency is a function of state government.[1] Each state's department of insurance tracks the financial well-being of the insurance companies that are licensed to do business in that state. Insurers must submit financial data periodically and are subject to audits.

When an insurer appears to be suffering financially, there are various steps the state regulators can take to help resolve the impairment, including rehabilitation. Unfortunately, liquidation is sometimes the only feasible resolution.

Although the number of insurers declared insolvent has been declining since 2000, it is very likely that more insolvencies are on the horizon. The present financial difficulties facing many insurers (caused in part by their recent lowering of premiums and broadening of coverage terms in order to stay competitive), coupled with heightened scrutiny from regulators, make the continuation of this declining trend seem impossible.

What If My Insurer Is Declared Insolvent?

When a domestic insurer is declared insolvent, it ceases operating. The liquidator takes control of all the financial activity, marshaling assets (such as reinsurance) and handling claims, so that the insurer may be completely and permanently dissolved.

Most states follow one of two liquidation model acts, the Uniform Insurers Liquidation Act or the Insurers Rehabilitation and Liquidation Model Act. However, each state has its own set of insolvency statutes and regulations governing the insurers domiciled in that state.

Payments from an insolvent insurer's estate are made based upon the priority statutes of the state in which the company was domiciled. Typically, the administrative claims are paid first, followed by policyholder claims, then general creditor claims, and so on, to the extent that the estate has sufficient funds to pay each successive class of claims.

Typically, the state director or commissioner of insurance is appointed the receiver of insolvent insurers in that state, although the director or commissioner often appoints outside professionals to act as special deputy liquidators. While the director of insurance is the statutory receiver, the court overseeing the insolvency proceeding will generally have the final say regarding whether any particular claim will be allowed. In other words, if the receiver denies a claim, that is not necessarily the end of the process. All states' laws on insolvency allow for due process, including a hearing before the receivership court.

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Why Bother With an Insolvent Insurer?

Simply because an insurer has been declared insolvent does not mean that there will be no funds to pay policyholders' claims. It is important not to disregard these insurers, as pursuing an insolvent insurer may be the only viable means of recovery for certain claims.

When faced with a claim against an insolvent insurer, the claimant should also make a claim against the appropriate state guaranty funds. However, these funds are often little help for large claims or companies. Many states' guaranty funds have caps on the amounts they will pay (often, $300,000 per claim) and net worth exclusions (often, insureds with a net worth of $25 million or more will be precluded from recovery, but the figure varies).

Moreover, excess insurers might not drop down to provide coverage in the event the underlying insurer becomes insolvent. Usually, it is not possible to pursue a direct claim against your insolvent insurer's reinsurers (although there are a few exceptions). All of these factors show the reasons why the successful recovery of a claim directly against an insolvent insurer may be important.

What Steps Should a Claimant Take?

The following tips should help your company

maximize its potential recovery against any insolvent insurers.

1. Do your homework first: Is the claim worth pursuing?

   a. Is the receivership still open?

      For older estates, it is important to determine whether the receivership remains open. There are various Web sites that provide information on the status of receivership estates. However, be cautious of Web sites that purport to list the status of all receiverships, because these may be inaccurate. Often, an ancillary receivership estate may be closed in one state, but the main estate remains open in another state. You may believe an estate has been closed; in order to be certain, the best practice is to contact the receiver and ask for a copy of the order closing the estate.

In the end, many estates that looked nearly worthless in the beginning wind up paying a significant portion of the claims.

   b. What is the financial status of the estate?

      For newer estates, it may take years before anyone knows what the ultimate payout to claimants will be, but some estates eventually have paid 100 percent of approved policyholder claims. Generally, the receivers will make several interim distributions as they get a better understanding of what the ultimate assets and liabilities of the estate will be.

      If it is too early to know how much the liquidator might pay to approved claimants, do not assume the situation is hopeless. When insurers are first placed into liquidation, their balance sheets look grim. The insurer may have massive liabilities and estimated future liabilities and not much on the asset side. However, the liquidators take whatever funds are available and invest them — at the same time collecting reinsurance and any other assets that are available. Over the years, these invested funds and other assets can build up substantially. On the other side of the balance sheet, the company's actual and estimated liabilities may diminish significantly as a result of the insolvency itself, due to such events as bar dates and simple attrition — not all claimants want to leap through these hoops, or they may not think it worthwhile to do so. In the end, many estates that looked nearly worthless in the beginning wind up paying a significant portion of the claims that are eventually allowed.

   c. What types of known and future claims do you have?

      Do you have several small claims, one large claim, or perhaps no current claims at all, but the nature of your business makes it plausible that you will incur significant future liabilities? If the current or expected future liabilities seem likely to reach the insolvent layer of coverage or are too uncertain to predict, then making the effort to file a proof of claim is often worthwhile, rather than taking the risk of being barred later.

   d. For known claims, how strong is your coverage position? Are there any applicable exclusions?

      If you are pursuing one small claim and the only applicable policy with the insurer contains a seemingly applicable exclusion, you may not want to spend much time pursuing the claim. On the other hand, depending upon the language of the exclusion and the type and cause of alleged damages, the exclusion may not necessarily bar coverage. You should check with coverage counsel before making a final determination.

2. Gather basic information before you file a proof of claim.

   Once you determine that your company has claims worth pursuing, it is often best to contact the receiver for some general information. Rather than a for-profit insurance company, the receiver is a neutral party, trying to treat similarly situated claimants fairly and equally. Accordingly, the receiver is often quite helpful in assisting claimants.

   a. Have any claims already been filed on your behalf? If so, have they been determined?

      For receiverships that began several years or even decades ago, you might be surprised to discover previous claim filings made on behalf of your company (or its predecessors) long before you became involved. This can become a problem if you are attempting to assert a new claim after a bar date.

      If the receiver informs you that a proof of claim was previously filed, request a copy. You may be able to add to or amend it to include more recent claims, depending upon how cleverly drafted the original proof of claim was and whether a "policyholder protection" claim was filed.

   b. Has a claim-filing bar date been set? If not, does the receiver expect one to be set soon?

      Inquire about any bar dates that may be approaching, and make certain you file your claim before the deadline, if possible. Request that the receiver place you on the notice list for any future bar dates or other significant events in the estate. Ask if the receiver has a Web site that you can check for updates.

   c. If you missed the bar date, is the receiver still accepting late-filed claims?

      Sometimes, the receiver has discretion to accept late-filed claims after the bar date, and sometimes, a bar date is firm; it depends on the estate. If you did not receive a proof of claim form and otherwise did not have notice of the liquidation, you may be allowed to file a claim after the bar date.

Complete the forms carefully. All estates and proofs of claim are different.

      The receiver will often have a list of policyholders to whom notice of the liquidation was sent. If your company is not on that list, you may be allowed to file a late claim without providing additional proof that you lacked notice of the liquidation. If you are on the receiver's list but the receiver has your address listed incorrectly, for example, you may be allowed to file a late claim after signing an affidavit that you did not have notice of the liquidation due to the incorrect address.

3. File adequate proofs of claim and supporting documentation.

   a. Complete the forms carefully. All estates and proofs of claim are different.

      Just as states' insolvency laws differ, so do their proof of claim forms. Be careful to fill out the forms as completely and accurately as possible, and make certain the proper party signs the form, or it may be rejected. This can be especially problematic if you are submitting the form close to the bar date, when there may be no time to fix errors.

   b. Must your claim be liquidated, or can the value be left undetermined?

      In certain states and at particular stages in the procedure for different estates, you may be able to submit a "contingent" or "unliquidated" claim. Generally, these contingent or undetermined proofs of claim are accepted at the beginning of the receivership, and claimants are asked to submit an amended, liquidated proof of claim at a later date.

At present, it appears that estates in only Missouri, Illinois, and Utah may allow claims for estimated future liabilities (in addition to past costs), as long as you provide proper documentation of these anticipated liabilities. However, even where estimated liabilities are allowed, the receiver will likely require that you provide a liquidated amount for these contingent claims at some point in the liquidation.

Do not make the mistake of simply waiting for payment once you file the proofs of claim.

c. File a separate proof of claim for contingent or "policyholder protection" claims that may arise later.

If you file a proof of claim only for known claims, then the bar date passes and another liability arises, you may be precluded from making a claim on that new liability. The receiver will likely assert that you cannot be excused from the bar date because you had previously filed other claims and, therefore, knew of the bar date. Unless you have an argument to include the new claim under a previously submitted proof of claim, you will be without recourse. The best practice is always to file a separate proof of claim for contingent liabilities that may arise.

d. Send a cover letter with your proofs of claim, and attach detailed descriptions and supporting documentation for your claims.

Make it as simple as possible for the receiver to understand your claim. Include in the cover letter policy numbers, insured's name, claimant's name, and any other information that might help the receiver process your proof of claim.

To the extent that your company has undergone mergers, acquisitions, or name changes, you may need to explain the corporate history leading to the transfer of liability (and/or insurance rights) from the insured entity to the present company.

e. Treat the proof of claim as you would notice to an insurer.

Attach relevant demand letters; pleadings, such as the petition or complaint; and any other supporting documentation that you would normally send to an operating insurer.

4. Do not make the mistake of simply waiting for payment once you file the proofs of claim.

a. Follow up on the initial proof of claim filing.

Make sure the receiver received the proof of claim. Request the claim number assigned, and ask for a date-stamped copy of your proof of claim for your records.

b. Request that the receiver provide information on the status of your claim in writing.

If you wait for the receiver to take action on your claim, you may be waiting a long time. The typical receivership involves several thousand claims, and you want yours to be processed sooner rather than later. Phone calls are often effective, but written correspondence gives you documentation of when and how often you have contacted the receiver. The more often you contact the receiver's office, the more likely the receiver will want to resolve your claim.

c. Send additional information about your claim as it develops.

If a new claim arises, submit the information to the receiver immediately. New claims will likely fall under a policyholder protection proof of claim you previously filed, or you may be allowed to file an additional, separate proof of claim for the new claim. When you submit new information, ask the receiver if a new proof of claim form should be submitted as well.

d. Be responsive to requests from the receiver.

If the receiver requires additional information to process a claim, provide that information in a timely manner and present it in an easy-to-understand format. If your company has significant potential future liabilities (environmental, asbestos, silica, or other products liability claims, for example), it may be worth hiring a third-party actuary or similar service to estimate those liabilities for estates that allow for estimation of contingent claims.

e. Make the receiver's job as easy as possible. Consider sending a settlement proposal.

If there is a dispute with the receiver regarding coverage or damages, you may want to provide a settlement proposal. Such proposal might include a summary of the pertinent policy provisions, a summary of the claim, and applicable law. You also may want to provide calculations of damages based upon pro-rata or all-sums-allocation methods for long-tail claims.

Color-coded charts and graphs are often helpful to show a rise in damages over the years or problems with other years of coverage. These types of supporting documents not only make it easier for the receiver to review your claim, but they show the receiver that you are serious about pursuing the claim.

f. Offer to meet the receiver face-to-face.

Offering to discuss and negotiate a significant claim face-to-face shows the receiver that you are serious about the claim and that you are not going to go away without a fight. If there is any indication that the receiver is willing to negotiate the claim, an in-person meeting will likely prove to be worth the cost of the trip.

g. Object to a claim denial.

Follow through with the claims process; do not simply give up. Many claimants are intimidated by the judicial process and often feel that when the receiver denies their claim, nothing more can be done. That is really just the beginning of the claims resolution process. If the receiver and the claimant cannot resolve the claim, then the claimant may begin the formal judicial proceeding by filing a brief, attending a hearing, and presenting evidence of its claim to the receivership court.

Concluding Thoughts

Obviously, it is never a good day when you find out that the insurer with which you have had coverage for several years has just been declared insolvent. However, it is not necessarily time to panic, either. It may take a while to receive payment from insurers newly declared insolvent, but if the recommendations in this article are followed, a claim may yield value that greatly exceeds expectations.

Endnotes

1. There has been much debate recently regarding the benefits of state versus federal regulation of insurance companies. The recent $85 billion bridge loan to American International Group (AIG) has spurred even more debate, with advocates of federal regulation asserting that AIG's situation proves that the job of overseeing insurers has become too complex for states to handle on their own. Others have argued that the AIG case illustrates the value of state regulation, since AIG's property and casualty subdivisions are evidently still solvent, even as the financial services side of the business is foundering.

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