NEBRASKA DEPARTMENT OF INSURANCE

SOLVENCY MONITORING AND INSOLVENCY PROCESS

NEBRASKA

THIS PRESENTATION

- Two insolvency proceedings used to illustrate today's topics:
  - Martin Frankel
  - CoOportunity
- Cases and statutes that create the state-based regulatory system
- Typical causes of insurer insolvencies
- Solvency Monitoring
  - Risk-Based Capital and triggers for regulatory action
- Receivership Proceedings
  - Steps involved in supervision, rehabilitation, and insolvency
  - Groups creditors into classes and assigns priorities to classes so that lower classes of creditors only get paid if there is still money in the estate.
- Guaranty Associations
  - Mechanism for other insurers writing the same business to contribute money so that losses covered by the insolvent insurer's policies will get paid
  - Payment right away instead of waiting for the estate to close to get claimants their money.

"If you've seen one receivership, you've seen one." Here are two.

CASE STUDIES

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MARTIN FRANKEL – AN EXAMPLE

- Frankel was a former securities broker who was barred by the SEC as part of a settlement in 1992, then migrated to the insurance industry.
- Anonymously acquired and controlled insurance companies in several states.
- Embezzled over $200M in insurance company assets over nearly an 8-year period.
- Scam was exposed in May 1999 when Mississippi insurance regulators noticed three insurers had invested all their assets in the same trust.
- Mississippi put three Frankel-connected insurers into regulatory supervision.
- Several states put Frankel's insurance companies into receivership when it was discovered the companies' primary assets were investments in Frankel's own shell company.
- Among the states affected were Arkansas, Mississippi, Missouri, Oklahoma, Tennessee, and Virginia.
- Of the $200M stolen from insurance companies, $150M was recovered from entities that allowed the scam to occur.
- The recovered $150M lessened the obligation for Guaranty Associations that otherwise would have needed to pay policyholders' claims.

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What Happened: The Scam

- Frankel gains secret control of a small securities firm and creates a phony trust to purchase an insurer.
- He converts insurer assets to cash--supposedly in custody of the securities firm for T-bond trading.
- Instead, he steals cash and launders through secret accounts.
- Hides theft with false trading records, a stream of trading "profits," and complicity of co-conspirators controlling the insurance firm.

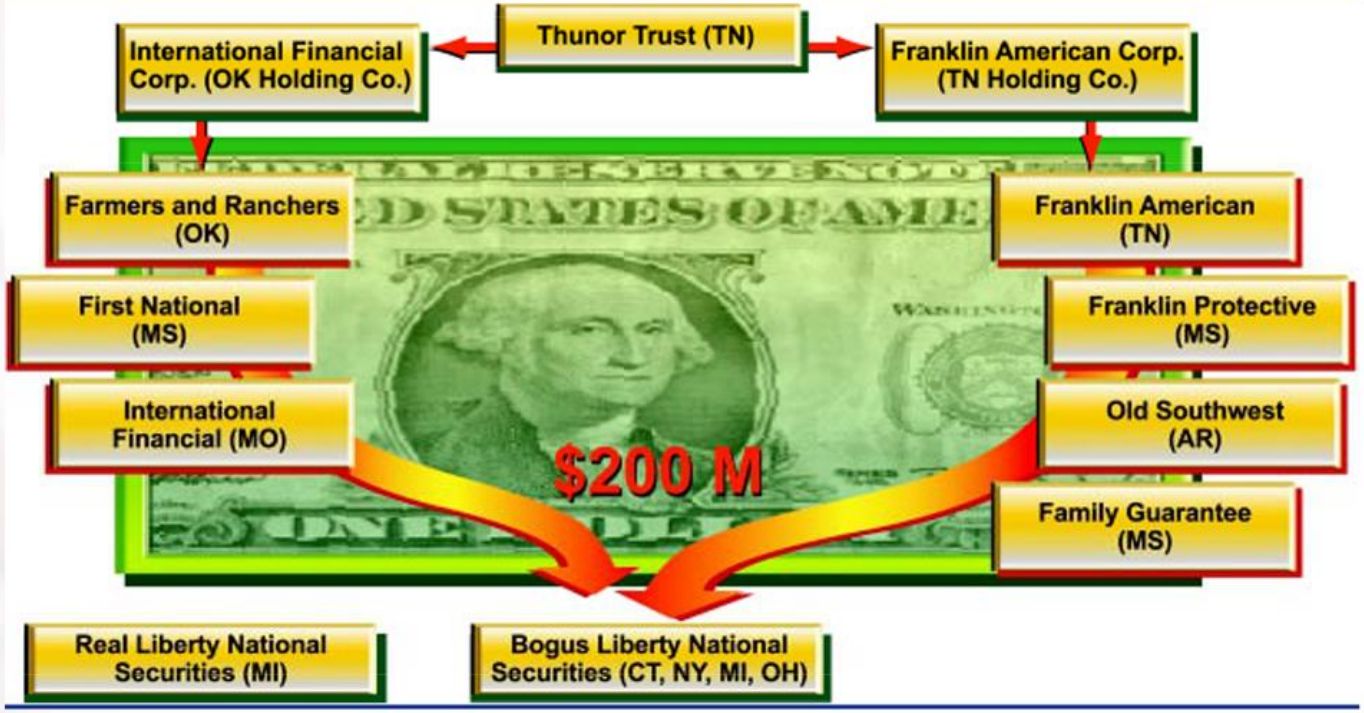
(continued)

What Happened: The Scam

- Ultimately, Frankel buys six more insurers and steals their assets, each time using previously stolen cash to buy the insurers, maintain the scheme, and support his lavish lifestyle.

GAO
Accountability • Integrity • Reliability

The $200 Million Multi-State Scam



In 2002, Frankel was sentenced to 200 months (16 years 8 months) in federal prison.

A state court in Tennessee also sentenced Frankel to 16 years, which was allowed to run concurrently on the condition that he assist officials in recovering lost assets looted from his Tennessee insurance companies.

Over 10 years after Frankel's sentencing, the estates were still being settled.

For Immediate Release
April 23, 2015

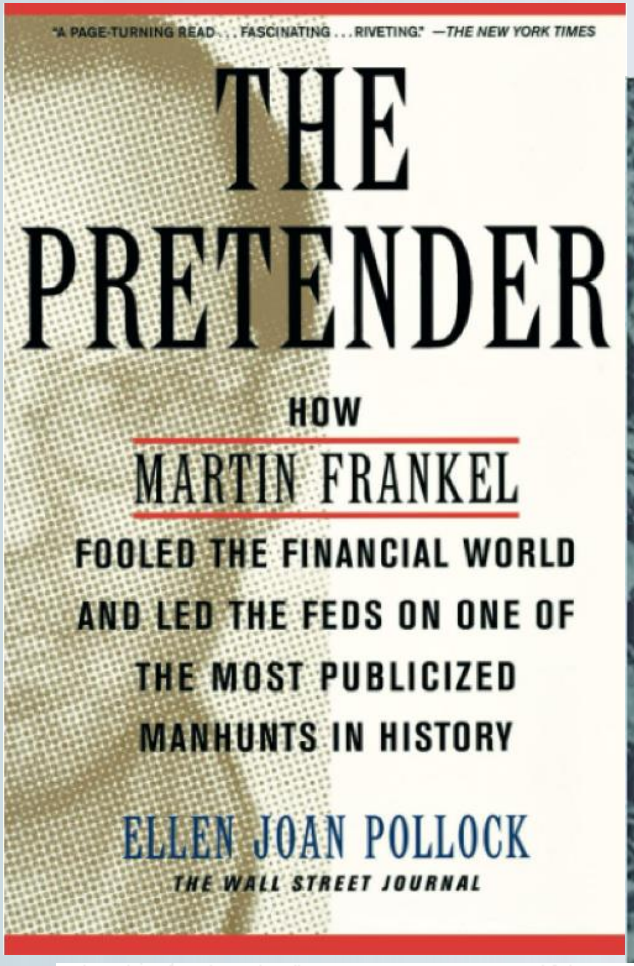
Commissioner Mike Chaney Announces Distributions To Guaranty Association in Wake of Frankel Scandal

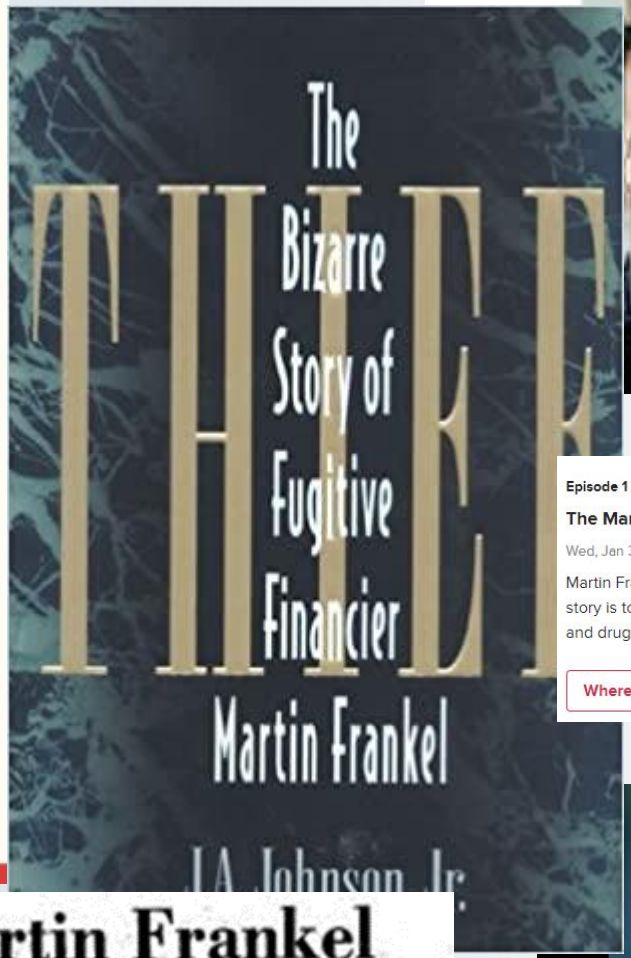
Jackson Mississippi –The liquidation estates of three former Mississippi-domiciled life insurance companies that were looted by Martin Frankel in the 1990's made additional distributions in December 2014, totaling over $10,500,000.00 to the Mississippi Life & Health Insurance Guaranty Association, according to Mississippi Insurance Commissioner Mike Chaney. The Guaranty Association pays benefits for policyholders of insurance companies that become insolvent.

The reimbursements to the Guaranty Association were made possible by successful recovery efforts directed by Chaney in his role as liquidator of the three Mississippi-domiciled companies. In cooperation with other insurance commissioners, the recovery effort by Chaney has recouped over $150 million, largely from entities that allowed the scheme to occur.

The three Mississippi companies – First National Life Insurance Company of America, Family Guaranty Life Insurance Company, and Franklin Protective Life Insurance Company – along with life insurance companies domiciled in four other states, were forced into liquidation after their assets were looted under a criminal scheme masterminded by Frankel. Frankel and his co-conspirators, who stole over $200 million from these companies, were convicted of numerous crimes.

The efforts directed by Chaney have resulted in the recovery of millions of dollars to repay the Guaranty Associations for the money they have spent in protecting the thousands of policyholders affected by Frankel's criminal activity.





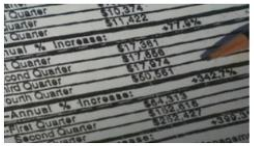
Episode 1

The Martin Frankel Case

Wed, Jan 30, 2008 · 60 mins

Martin Frankel swindled investors out of $200 million. A story is told of money laundering, prostitution, bizarre sex, and drug abuse.

Where To Watch



FBI captures Martin Frankel

By Bridgette Greenberg
Associated Press

NEW HAVEN — Missing money manager Martin Frankel, accused of embezzling millions of dollars to fund his reclusive yet luxurious lifestyle, was arrested Saturday in Germany, the FBI said.

Frankel told authorities as they took him into custody "You got me," FBI Special Agent Michael Wolf said Saturday.

Authorities found Frankel in the Hotel Prinz in Hamburg, Wolf said. He was apprehended without incident and charged with money laundering and wire fraud. It could be several months before Frankel can be extradited for trial in Connecticut.

Seized from his room were a computer and its contents and an undetermined amount of cash and diamonds, Wolf said. He could not say whether Frankel had been trading from his room.

Also taken into custody was a 35-year-old U.S. citizen, Cynthia Allison, who was using the alias Susan Kelly, Wolf said. He did not elaborate on Allison's relationship to Frankel. She was detained for questioning, but has not been charged.

The arrest ends an international manhunt which began when Frankel, 44, disappeared more than four months ago.

Authorities found piles of documents burning in Frankel's high-security mansion in Greenwich on May 5. An arrest warrant was issued later that month. Insurance company regulators said Frankel's unlicensed brokerage — apparently run out of the $3 million Greenwich mansion — had siphoned money several insurance companies.

Six were in the South — three in Mississippi, and one each in Arkansas, Tennessee and Oklahoma — and one was in a Southern border state, Missouri. Regulators ally Frankel stole at least $218 million from the insurers, but a lawsuit filed by some of the companies puts the loss at $915 million. Frankel allegedly controlled Thorner Trust, set up in 1991 by Franklin businessman John Hackney to buy small, struggling insurance companies.

COOPORTUNITY – AN EXAMPLE

- Formed under the ACA, domiciled in Iowa and licensed in Nebraska.
- Coverage began on January 1, 2014.
- Projected 10,000 members – instead got 110,000.
- Underpriced, claims worse than expected, did not receive expected funding.
- Placed in rehabilitation on December 23, 2014.
- Placed in liquidation on February 28, 2015.
- Enrollment reduced from 110,000 to 16,000 by March 1, 2015.
- Remaining policyholders cancelled by August 31, 2015.
- Liquidator filed several lawsuits – audit/accounting firm, actuarial firm, federal government.
- Nebraska Life and Health Insurance Guaranty Association had potential claims liability of $100M, paid total claims just over $81M.
- The two affected guaranty associations have recovered approximately 98% of their combined policyholder- and administrative expense-level claims against the CoOportunity estate.

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NEWS RELEASE - CoOportunity Health Policyholders Encouraged to Act Quickly

February 10, 2015

The Nebraska Department of Insurance encourages CoOportunity Health policyholder
immediately in securing new coverage. February 15, 2015 is the last day for open enro
may be inconvenient and, in some cases, a financial burden because some policyhold
deductible. However, there are compelling reasons to act before the end of the Februa

CoOportunity will be liquidated on February 28, 2015. Liquidation is essentially bankru
individual policies may be cancelled 180 days after liquidation and group policies will

The special enrollment period lasts for 60 days after the liquidation order is signed by
options for the purchase of individual health insurance may be limited. It is questionab
required to sell a policy to an individual outside of an open or special enrollment perio
subject to tax penalties as determined by the Internal Revenue Service.

Individuals who receive an advance premium tax credit (APTC) and/or cost sharing re
effective on the date that liquidation takes place. A policyholder who has paid $50 per
insurance policy, which may run into the hundreds of dollars per month depending upo
qualify for CSR, which can significantly lower deductibles and copayments, will lose th
CSR for the co-pay for prescription medication will no longer receive that discount. Th
liquidation goes into effect, CoOportunity Health plans will no longer be considered as

Once a health plan goes into liquidation, its policyholders are protected by the Nebrask
$500,000 cap exists for each individual under the policy. While this sounds like a lot of
stay could easily cost $500,000. For any amount over $500,000, policyholders and the
care. This could lead to significant amounts of medical debt.

The liquidator will do all that is possible to protect the interests of policyholders, howe
available and remaining to assist policyholders.

"Individuals and businesses should move quickly to get new coverage since there are
of the Nebraska Department of Insurance. "While I sympathize with those who have m
licensed insurance agent immediately." Policyholders who are in the special enrollmen
2596 if they have an individual plan. If they have a small business plan through the SH

NEWS

CoOportunity liquidation approved by judge

Tony Leys tleys@dmreg.com

Published 12:36 p.m. CT Feb. 24, 2015 | **Updated 12:39 p.m. CT Feb. 24, 2015**

View Comments

The end is near for CoOportunity Health.

Polk County District Judge Arthur Gamble agreed Tuesday to sign an order putting the troubled Iowa-based health-insurer into liquidation as of midnight Saturday.

The order, similar to a bankruptcy, will seal the fate of CoOportunity, which was formed with more than $100 million in federal loans and grants under the Affordable Care Act. The health-insurance co-op collapsed late last year after attracting about 120,000 members in Iowa and Nebraska.

Iowa Insurance Commissioner Nick Gerhart said after the hearing that most CoOportunity members have taken his advice and switched to other carriers. But 28,677 still have CoOportunity policies, including about 1,800 Iowans who purchased individual policies that qualify for subsidies under the Affordable Care Act. To keep those subsidies intact, such customers must switch plans by midnight Saturday. "If those 1,800 Iowans want to keep their tax credits, they need to move quickly," Gerhart said.

The reasons federal law does not control insurer insolvencies

STATES AS INSURANCE REGULATORS

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Paul v. Virginia, 75 U.S. 168 (1869)

- In the 19th century, the insurance business was exclusively regulated by the states individually.
- Insurers in New York, wishing to have uniform federal regulation of insurance companies, orchestrated a test case to invalidate state regulation.
  - Samuel Paul, an insurance agent, did everything necessary to be licensed in Virginia except depositing a bond. Paul was refused a Virginia insurance license then proceeded to sell New York insurers' policies without a license. Paul was then convicted and sentenced to pay a $50 fine. He challenged the license requirement statute as invalid.
- "Issuing a policy of insurance is not a transaction of commerce."
  - "These are not part of the commerce between the States any more than the sale of goods in Virginia by a citizen of New York whilst in Virginia would constitute a portion of such commerce."
  - Effectively removed the business of insurance beyond the U.S. Congress's legislative reach.
- For the next 80 or 90 years, insurance was regulated by the states. Courts just kept saying, "Insurance is not commerce."

BANKRUPTCY CODE EXEMPTION (1898)

- Federal Bankruptcy Act of 1898
- 11 U.S.C. § 109.
- From later commentary to section 109:
  - “Banking institutions and insurance companies engaged in business in this country are excluded from liquidation under the bankruptcy laws because they are bodies for which alternate provision is made for their liquidation under various State or Federal regulatory laws.”

U.S. v. South-Eastern Underwriters, 322 U.S. 533 (1944)

- Overturned *Paul v. Virginia.*
- An association of several fire insurance companies was indicted for alleged violations of the Sherman Antitrust Act (price fixing, noncompetitive premium rates).
- The issue was whether the Commerce Clause grants Congress the power to regulate insurance transactions that involve parties in more than one state.
- Really, the question was whether federal laws like the Sherman Act would apply to insurance companies, even when those laws did not specifically reference insurance.
- Supreme Court held that an insurance sale is not merely a contract, it is a starting point for a complex series of transactional operations. This flow of money and documents is commerce.

MCCARRAN-FERGUSON ACT (1945)

- Enacted in 1945 remove any uncertainty over states' regulatory authority over insurance created by *South-Eastern Underwriters.*
- Contains a basic delegation of authority from the U.S. Congress to the states regarding the regulation and taxation of the business of insurance.
  - "Silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several states."
  - "No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance."
- Two contingencies:
  - Congress can enact legislation applicable to the business of insurance by mentioning insurance in the law.
  - When states do not enact or maintain insurance laws, that regulation is left to Congress under the Sherman Act, the Clayton Act and the FTC Act.
- Confirmed as the law of the land in the Gramm-Leach-Bliley Act and the Dodd-Frank Wall Street Reform and Consumer Protection Act.
- Anti-trust exemption for health and dental insurers eliminated in 2021 in the Comprehensive Health Insurance Reform Act of 2021.
  - States opposed as redundant.

U.S. Dep't of the Treasury v. Fabe, 508 US 491 (1993)

- George Fabe, Superintendent of Insurance of Ohio, argued that the statutory preferences for distribution of an insolvent insurer's remaining assets apply.
- The U.S. Treasury argued that 31 U.S.C. § 3713(a)(1)(A), which gives the federal government first priority, applied instead of the state statutory preferences.
- Issue: was the Ohio liquidation priority statute "regulating the business of insurance" so that the federal priority statute was preempted under McCarran Ferguson.
- Holding: to the extent the Ohio statute placed policyholders' claims and administrative expenses ahead of federal claims, the Ohio statute was protecting or regulating the relationship between the insurer and insured, and therefore not preempted. General claims were not the business of insurance.
- Effect: created a new category for federal claims after administrative and policyholder claims.

Mistakes were made…

REASONS INSURANCE COMPANIES FAIL

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101st Congress
2d Session

COMMITTEE PRINT

Committee
Print 101-P

FAILED PROMISES

Insurance Company Insolvencies

A REPORT

BY THE

SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATIONS

OF THE

COMMITTEE ON ENERGY AND COMMERCE

U.S. HOUSE OF REPRESENTATIVES

FEBRUARY 1990

U.S. GOVERNMENT PRINTING OFFICE

26-370

WASHINGTON : 1990

For sale by the Superintendent of Documents, U.S. Government Printing Office
Washington, DC 20402

DINGELL REPORT (1990)

- “The regulatory system must anticipate and deal effectively with the activities of the pirates and dolts who inevitably will plague an attractive industry such as insurance, where customers hand over large sums of cash in return for a promise of future benefits.”
- “An insurer’s ability to pay – its solvency – must be subjected to proper regulation on a continuing basis, from the time premium payments are accepted until the time all anticipated insured events have occurred. The policyholder must rely on the competence of the regulatory system, as well as the skill and integrity of the insurer, for protection from insolvency.”
- “The simplicity of the insurance concept is matched by extreme complexity in its implementation. Pricing the promise properly, managing funds, sharing risks through reinsurance, establishing adequate reserves, and handling claims all require sound judgment, good organization, and personal talent. When these are lacking due to wrongdoing or incompetence, insurance can be a very easy business to leave.

DINGELL'S LIST OF SIMILARITIES AMONG INSOLVENT AND PROBLEM COMPANIES

- Rapid expansion
- Overreliance on managing general agents
- Extensive and complex reinsurance arrangements
- Excessive underpricing
- Reserve problems
- False reports
- Reckless management
- Gross incompetence
- Fraudulent activity
- Greed
- Self-dealing

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THE MOST DISTURBING SIMILARITY AMONG PROBLEM COMPANIES

- Deplorable management attitudes.
- Driving force was quick profits in the short run, with no apparent concern for the long-term well-being of the company, its policyholders, its employees, its reinsurers, or the public.
- Senior managers abdicated their responsibility to set sound policies and control the activities of their subordinates and agents, and instead actively promoted and participated in the reckless mismanagement that caused the demise of the companies they were entrusted to safeguard.
- Treated reinsurance as a way to pass loss problems to somebody else in exchange for easy premium dollars, rather than a prudent method to share risks with other companies.
- When the fatal results of these outrageous attitudes reached the breaking point, the officers and directors running these companies simply disclaimed responsibility and walked away.
- Some of them have been involved in multiple insolvencies.

INSURANCE IS UNIQUELY VULNERABLE TO MISMANAGEMENT AND FRAUD

- “Making believable promises is a stock item in every con man’s bag of tricks. The prepayment of large, often vast, sums of money with few restrictions lends itself naturally to monumental wasting of assets through greed, incompetence, and dereliction of duty. This combination of easy money based on easy promises makes the insurance industry an irresistible target for financial knaves and buccaneers.”

INSOLVENCY'S EFFECT ON OTHER INSURANCE COMPANIES

- "A true irony of the whole situation is that well-managed insurance companies are hit twice by the acts of the unscrupulous and inept. The good companies first lose business to the artificially low prices of unsound companies. When the results of mismanagement lead to insolvency, the healthy companies must then pay the costs of the bailout. As one industry official observed, 'Every time they write a bad policy, my company is involuntarily placed on the underwriter's slip, where they get the premiums and we pay the losses.'"

Financial surveillance of potentially troubled companies

SOLVENCY MONITORING

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IMPROVED STATE REGULATORY SYSTEM

- Strengthened capital requirements
- Aggregated and streamlined data collection
- Coordinated monitoring and early warning
- Peer accreditation program
  - Accredited states' assessment of their domestics is given credit in other states.
  - This is the reason insurers want to domicile in a state that is accredited and has a good reputation with other states.
- Greater risk-based approach
  - RBC is the minimum capital needed to support a company's overall business operations in consideration of its size and risk profile. Requiring companies to hold a higher amount of capital provides a cushion against insolvency.
  - RBC takes into account the lines an insurer is writing. RBC is keyed to a formula, so it's not perfect – RBC is an indicator, not a stand-alone tool.
- Coupled with market regulation

STATE OVERSIGHT ACTIVITIES

- Financial reporting
  - Insurers file annual and quarterly financial statements using NAIC Blanks and Instructions
  - Accounting for insurers uses Statutory Accounting Principles (SAP)
    - Unique to insurance
    - Key is ability to satisfy all obligations at all times
    - Versus GAAP, which gives a period-to-period picture
    - Codified into the NAIC Accounting Practices & Procedures Manual
- Financial analysis
  - Desk audits of quarterly and annual statements, RBC reports, actuarial opinions (adequacy of reserves), management discussion and analysis
  - NAIC financial data repository is able to analyze ratios, industry comparisons and indicators
- Financial examinations
  - On-site examinations and interviews

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SOLVENCY RISKS

- Areas of solvency risk include:
  - Surplus – decreases, commitments, need for additional
  - Liquidity
  - Investments – ratings, ownership, value
  - Reserves
  - Reinsurance – program and recoverables
  - Affiliate transactions – arm's length, fair and reasonable, outside influences
  - Expenses – administrative, commissions, off-balance sheet, fraud
  - Underwriting – new line of business, new product, new state, change in standards
  - Claim management
  - Governance and controls – these are nonquantifiable, judgment calls so hard to document.
    - Considerations include expertise, culture, IT systems, management turnover
- Financial analysts and examiners look for changes and seek to understand why the changes are happening.

WHEN EXAMINERS IDENTIFY A CONCERN

- Confidentiality is important. See § 44-5906(8)(a), examination workpapers and documents obtained by or disclosed to the DOI "shall be given confidential treatment and shall not be subject to subpoena and may not be made public by the director or any other person, except to the extent provided in subsection (7) of this section, and shall not be public records subject to disclosure pursuant to sections 84-712 to 84-712.09."
  - Sometimes, reporters will comment that regulators "should take action," not knowing that the regulators are already taking serious action.
- Actions to consider at this early stage:
  - Follow-up analysis inquiry, targeted examination
  - Business plan, projections, strategic plan
  - Limit writings, investments, expenses
  - Capital infusion

SOLVENCY RESOURCES

- NAIC Center for Insurance Policy and Research https://content.naic.org/cipr-topics/troubled-companies
- NAIC white paper, Alternative Mechanisms for Troubled Insurance Companies https://content.naic.org/sites/default/files/alternative-mechanisms-troubled-companies.pdf
- NAIC Troubled Insurance Company Handbook
- NAIC Financial Analysis Handbook
- NAIC Financial Analysis (E) Working Group https://content.naic.org/cmte_e_fawg.htm
- NAIC Accounting Practices and Procedures Manual
- NAIC Annual and Quarterly Statement Instructions
- NAIC Accounting Practices and Procedures (E) Task Force https://content.naic.org/cmte_e_app.htm

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Supervision, Rehabilitation, and Liquidation

RECEIVERSHIPS

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REGULATORY INTERVENTION

- Goal is to prevent insolvencies, or if that is not possible, administer severely impaired or insolvent insurers.
- Range of remedies before a delinquency:
  - Exams, conferences, corrective action plans, restrictions on activities, and formal cease and desist orders.
- Delinquency/Receivership proceedings:
  - Supervision
  - Rehabilitation
  - Liquidation

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RISK-BASED CAPITAL TRIGGERS FOR REGULATORY ACTION

- Company action level event, § 44-6016
  - Insurer needs to prepare an RBC plan to identify the conditions contributing to the event, propose corrective actions, provide projections both in the absence of the plan and with the plan, identify key assumptions impacting the insurer's projections and sensitivity of the projections to the assumptions, and identify the quality of and problems with the insurer's business (assets, anticipated business growth and associated surplus strain, mix of business, use of reinsurance…)
- Regulatory action level event, § 44-6017
  - Can happen if the RBC plan is rejected by the Director and is more serious. A regulatory action level event means the insurer must submit or revise its RBC plan, the DOI will examine assets, liabilities, and operations of the insurer, and after the exam, a corrective order will be issued.

RISK-BASED CAPITAL TRIGGERS FOR REGULATORY ACTION

- Authorized control level event, § 44-6018
  - Regulatory action level event corrections can happen, and, in the alternative, the Director is authorized to place the insurer under regulatory control under the Insurers Supervision, Rehabilitation, and Liquidation Act if the Director deems it to be in the best interests of the policyholders and creditors of the insurer.
- Mandatory control level event, § 44-6019
  - The insurer's total adjusted capital is less than its mandatory control level RBC. The Director "shall" place the insurer under regulatory control under the Insurers Supervision, Rehabilitation, and Liquidation Act if the Director deems it to be in the best interests of the policyholders and creditors of the insurer.

INSURERS SUPERVISION, REHABILITATION, AND LIQUIDATION ACT

- § 44-4809(2)(a)
- The Director “shall” by order notify the insurer and list requirements for corrective action when:
  - (i) the insurer's condition renders the continuance of its business hazardous to the public or to its insureds,
  - (ii) the insurer has or appears to have exceeded its powers granted under its certificate of authority and applicable law,
  - (iii) the insurer has failed to comply with the applicable provisions of the insurance laws of this state,
  - (iv) the insurer's business is being conducted fraudulently, or
  - (v) the insurer gives its consent, the director shall by order notify the insurer of his or her determination and furnish to the insurer a written list of the requirements to abate the determination.

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SUPERVISION ORDER

- Can be public or confidential, depending on whether it is advantageous for policyholders to be aware and whether doing so would unduly harm the company.
- Order can be entered into voluntarily or the company has the right to appeal to a hearing officer or courts.
- “Supervisor” is named in the Order. Officers and board continue to manage the company but various items need prior approval by or notification to the Supervisor.
- Order lists reasons the company is being placed into Supervision, usually reference to the Hazardous Condition Regulation in the findings of fact.
  - 210 NAC 55, Rule to Define Standards and Director’s Authority for Companies Deemed to be in Hazardous Financial Condition
- Order lists items that need prior approval or notification, examples are in the NAIC Troubled Insurance Company Handbook.
- Order lists conditions to abate supervision.

SEIZURE OF INSURER

- Seizure order authority under § 44-4810, for Director to ascertain the condition of the insurer.
- Director petitions the Lancaster County District Court to take possession and control of all or a part of the property, books, accounts, documents, and other records of an insurer and of the premises it occupies for transacting business, enjoining the insurer from disposition of its property and transaction of business except by written consent of the Director.
- Petition alleges:
  - Grounds to justify a court order for a formal delinquency proceeding under the Insurers Supervision, Rehabilitation, and Liquidation Act;
  - The interests of insureds, creditors, or the public will be endangered by delay; and
  - Contents of an order deemed necessary by the Director.
- Court records, documents, DOI files, etc. remain confidential unless the court orders otherwise, § 44-4811.

INSURERS SUPERVISION, REHABILITATION, AND LIQUIDATION ACT

- Grounds for rehabilitation at § 44-4812(1)-(12).
  - (1) The insurer is in such condition that the further transaction of business would be hazardous financially to its insureds or creditors or the public;
  - (2) Embezzlement from the insurer, wrongful sequestration or diversion of the insurer's assets, forgery or fraud affecting the insurer, or other illegal conduct in, by, or with respect to the insurer that if established would endanger assets in an amount threatening the solvency of the insurer;
  - (4) Control of the insurer is in a person or persons found after notice and hearing to be untrustworthy;
  - (7) Without Director consent, insurer has entered into any transaction the effect of which is to merge, consolidate, or reinsure substantially its entire property or business in or with the property or business of any other person;
  - (12) The board of directors or the holders of a majority of the shares entitled to vote or a majority of those individuals entitled to the control of those entities listed in section 44-4802 requests or consents to rehabilitation under the act.

REHABILITATOR'S POWERS AND DUTIES

- Court-appointed rehabilitator takes possession of insurer's assets and administers them under the general supervision of the court. (Lancaster County District Court)
- Accounting to the court no less than semiannually.
  - Each accounting includes a report of the rehabilitator's opinion as to whether the insurer needs to be reorganized, consolidated, converted, reinsured, merged or another transformation of the insurer is appropriate.
- Rehabilitator takes actions to reform and revitalize the insurer.
- Can take legal action if it appears that company management, employees, or other people have committed criminal or tortious conduct or breach of any contractual or fiduciary obligation detrimental to the insurer.

EFFECT ON PENDING LITIGATION (STAY)

- If the insurer is a party or obligated to defend a party in any action pending in any court in this state, the court “shall stay the action or proceeding for **ninety days** and such additional time as is necessary for the rehabilitator to obtain proper representation and prepare for further proceedings.
- Rehabilitator shall immediately consider all litigation pending outside this state and petition the courts with jurisdiction over that litigation for stays whenever necessary to protect the estate of the insurer.

INSURERS SUPERVISION, REHABILITATION, AND LIQUIDATION ACT

- Whenever the director believes further attempts to rehabilitate an insurer would substantially increase the risk of loss to insureds, creditors, or the public or would be futile, the director may petition the district court of Lancaster County for an order of liquidation. § 44-4816.
- § 44-4817 The director may petition the district court of Lancaster County for an order directing him or her to liquidate a domestic insurer or an alien insurer domiciled in this state on the basis:
  - (1) Of any ground for an order of rehabilitation as specified in section 44-4812 whether or not there has been a prior order directing the rehabilitation of the insurer;
  - (2) That the insurer is insolvent; or
  - (3) That the insurer is in such condition that the further transaction of business would be hazardous, financially or otherwise, to its insureds or creditors or the public.

LIQUIDATOR'S POWERS AND DUTIES

- Court-appointed liquidator takes possession of insurer's assets and administers them under the general supervision of the court. (Lancaster County District Court)
- Vested by operation of law with title to all property, contracts, and rights of action and all of the books and records of the insurer, as of the entry of the final order of liquidation.
- Financial reports to the court including the assets and liabilities of the insurer and all funds received or disbursed by the liquidator during the current period.
  - Filed within one year of the liquidation order and at least annually thereafter.
- § 44-4821 lists liquidator's additional powers.

TERMINATION OF COVERAGE

- For policies other than life, health, and annuities, policies continue in force for 30 days.
- Life, health, and annuities continue in force for the period and under the terms provided for by any applicable guaranty association.
  - If there is no guaranty association (including foreign) coverage for life, health, or annuities, policies terminate in 30 days from the liquidation order.

NOTICE TO CREDITORS

- Liquidator gives notice as soon as possible.
  - By mail, email, fax, or telephone to the insurance commissioner of each jurisdiction where the insurer does business.
  - By mail to any guaranty association or foreign guaranty association that may become obligated as a result of the liquidation.
  - To all agents.
  - To all policyholders and all other people known or reasonably expected to have claims against the insurer.
  - By publication in a newspaper of general circulation where the insurer has its principal place of business and wherever else the liquidator deems appropriate.
- **Notice to potential claimants shall require that claims be filed with the liquidator on or before a date the liquidator specifies in the notice, no later than 18 months after the liquidation order.**
- Notices to agents and policyholders includes, when applicable, notice that coverage by a guaranty association may be available for all or part of policy benefits.

INJUNCTIONS AND INTERVENTION

- § 44-4824 “The courts of this state shall give full faith and credit to injunctions against the liquidator or the company or the continuation of existing actions against the liquidator or the company when such injunctions are included in an order to liquidate an insurer issued pursuant to corresponding provisions in other states.
- “Whenever, in the liquidator's judgment, protection of the estate of the insurer necessitates intervention in an action against the insurer that is pending outside this state, he or she may intervene in the action.
- “The liquidator may defend any action in which he or she intervenes under this section at the expense of the estate of the insurer.”

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STAYS ON PENDING LITIGATION

- § 44-2419. Order of liquidation; stay.
- “All proceedings arising out of a claim under a policy of insurance written by an insolvent insurer shall be stayed for **one hundred twenty days** from the date of entry of the order of liquidation to permit proper defense by the association of all such pending causes of action.”
- Same as rehabilitation, liquidator can petition courts in other jurisdictions for a stay.

ASSET RECOVERY

- § 44-4825 no later than 120 days after the liquidation order, liquidator prepares a list of the insurer's assets.
- Liquidator shall reduce assets to a degree of liquidity consistent with effective execution of the liquidation.
- Fraudulent transfers are prohibited. §§ 44-4926 and 44-4927.
- Transfer is fraudulent if made or incurred without fair consideration or with actual intent to hinder, delay, or defraud either existing or future creditors.
  - A fraudulent transfer may be avoided by the receiver, except as to a person who is a good faith purchaser, lienor, or oblige for present fair equivalent value.
  - A person who has given in good faith a consideration less than fair value may retain the property as security for repayment.

LAWSUITS AS ASSET RECOVERY

- Typically, the largest asset to recover is reinsurance. An additional source of money is litigation against those that contributed to the insolvency.
- The liquidator will undertake an investigation to identify any cause of the insurer's insolvency that may lead to a financial recovery by the estate.
  - Typical causes to consider include undercapitalization, uncollectible or inflated assets, insufficient loss reserves, problems with reinsurance, negligent underwriting, risky investments, fraudulent transactions, failure to monitor agents, and mismanagement by directors and officers.
  - Typical defendants are former directors, officers, and consultants, as well as certain debtors of the estate.
- Money owed under the Affordable Care Act's "3Rs" program was part of the CoOportunity liquidation, as were claims against directors and officers, actuaries, auditors, and accountants.

CLAIM PAYMENTS

- In rehabilitation, claims can be paid in the normal course of business as they become due or as part of a rehabilitation plan.
- In liquidation, the insurer's assets must be distributed to creditors in the order set forth in the priority of distribution statute.
- Claims in the higher priority class must be paid in full or funds reserved to pay them in full before any payment may be made to lower priority claims.
- All claims in a class must receive substantially the same pro rata distribution.
- No subclasses can be established within any class.
- It is possible for one claimant to hold several claims, not all of which have the same priority.

PRIORITY OF DISTRIBUTION

- Class 1: costs and expenses of administration during rehabilitation and liquidation (asset recovery costs, typical fees and expenses, attorney's fees, guaranty association expenses for unallocated loss adjustment expenses)
- Class 2: claims under policies for losses incurred, including third-party claims and guaranty association claims.
- Class 3: claims of the federal government.
- Class 4: compensation to employees for services performed within one year before the filing of the rehabilitation or liquidation petition (two-month limit).
- Class 5: claims for unearned premium or other premium refunds and claims of general creditors.
- Class 6: claims of state or local governments.
- Class 7: claims that were filed late or claims other than Classes 8 and 9.
- Class 8: Surplus or contribution notes.
- Class 9: Shareholder claims.

RECEIVERSHIP RESOURCES

- NAIC Receiver's Handbook for Insurance Company Insolvencies https://content.naic.org/sites/default/files/publication-rec-bu-receivers-handbook-insolvencies.pdf
- NAIC Receivership and Insolvency (E) Task Force https://content.naic.org/cmte_e_receivership.htm

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Limited claim payment protection for an insolvent insurer's policyholders

GUARANTY ASSOCIATIONS

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THE REASON FOR GUARANTY ASSOCIATIONS

- Before the creation of guaranty associations, a typical claimant could have waited for years for payment of a claim and then still receive only a fraction of what was due under the terms of the policy or contract.
- Guaranty associations, subject to statutory limitations, were created to alleviate these problems and ensure the stability of the insurance market.
- Specifically, in the event of a life/health insurer liquidation, the guaranty mechanism provides for the continuation of eligible contracts that would otherwise terminate.

FUNCTIONS OF GUARANTY ASSOCIATIONS

- All states have organizations known as guaranty funds through which the insurance industry covers claims against insolvent insurers.
- Insurers are required to be members of guaranty associations as a condition of licensure.
- Guaranty associations are governed by boards made up of member insurers.
- When there is an insolvency, the member insurers are assessed based on the business they do in that state to cover the insolvent insurer's unpaid claims.
- Guaranty associations and receivers work together to protect policyholders.
  - The guaranty associations and the receiver have different statutory duties to protect policyholders of the insolvent insurer.
  - The duties of the guaranty associations are limited to covered policies or claims as set forth in state guaranty fund statutes.

STATUTORY CAPS PER POLICYHOLDER

- Neb. Rev. Stat. §§ 44-2401 to 44-2419 (Property and Liability); 44-2701 to 44-2720 (Life and Health).
- NLHIGA:
  - Life $300,000, health benefit plans $500,000, disability or long-term care $300,000, other health coverages $100,000, annuities $250,000 (present value)
- NPLIGA:
  - workers' compensation claims have no limit, all other P&C claims are limited to $300,000.

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ASSESSMENTS

- Funding for the guaranty associations comes from assessments on solvent insurers.
- These assessments are not open-ended, but subject to certain annual limitations. Caps are typically based on a percentage of net direct premium written.
- Insurers are allowed to offset a portion of the assessments, over a period of years, against their premium tax liability.
- The guaranty fund also becomes a creditor of the liquidated estate.
- NPLIGA:
  - workers' compensation, auto, other P&C
- NLHIGA:
  - Life, health, annuity

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GA MEMBERSHIP CANNOT BE MENTIONED IN THE SALE OF INSURANCE

- Contrast with banks and FDIC protection – insurers cannot mention guaranty association coverage in advertising.
- **44-2416. Advertisements by member insurers of coverage by association; prohibited.** Advertisements by member insurers which include a reference to the coverage of the insurance guaranty association are specifically prohibited.
- LIFE AND HEALTH INSURANCE GUARANTY ASSOCIATION DISCLAIMER The [insert name of the Life and Health Insurance Guaranty Association] provides coverage of claims under some types of policies or contracts if the insurer or health maintenance organization becomes impaired or insolvent. COVERAGE MAY NOT BE AVAILABLE FOR YOUR POLICY. Even if coverage is provided, there are significant limits and exclusions. Coverage is always conditioned on residence in this State. Other conditions may also preclude coverage. The Life and Health Insurance Guaranty Association will respond to any questions you may have which are not answered by this document. Your insurer or health maintenance organization and agent are prohibited by law from using the existence of the association or its coverage to sell you an insurance policy or health maintenance organization coverage. You should not rely on availability of coverage under the Life and Health Insurance Guaranty Association when selecting an insurer or a health maintenance organization. [Insert addresses of the Association and department.]

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NO GUARANTY ASSOCIATION COVERAGE

- Surplus lines insurers are not part of the guaranty fund system. Their policyholders have little protection against unpaid claims if their insurer becomes insolvent. (New Jersey is the only state to have established a guaranty fund specifically for surplus lines insurers.)
- Risk retention groups are specifically precluded from participating in state guaranty funds under the Liability Risk Retention Act.
- If an insurance company isn't a member of a guaranty association, the policy must state that it isn't covered by a guaranty association.
- If a claim is not covered by a guaranty association, or is only partially paid, the policyholder might be able to file a claim with the company's receiver.

GUARANTY ASSOCIATION RESOURCES

- National Organization of Life & Health Insurance Guaranty Associations (NOLHGA) https://www.nolhga.com/
- National Conference of Insurance Guaranty Funds (NCIGF) https://www.ncigf.org/
- https://doi.nebraska.gov/sites/doi.nebraska.gov/files/doc/GuarantyFunds.pdf

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