Navigating Insurer Insolvency

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I. Domestic Insurer Insolvency

Insurance companies are like any other private business in many ways, with periods of increased profitability and serious financial hardship. But unlike many businesses, an insurance company's financial impairment affects not only its policyholders but also creditors, agents, other insurers, reinsurers, and even the public at large. As a result, extensive insurance regulation has been enacted to protect policyholders and other interested parties from the risk of an insurer's financial distress and mitigate the effects of insurer insolvency.

Insurer insolvency is governed by state law rather than the Federal Bankruptcy Code. *See, e.g.*, *Clark v. Fitzgibbons*, 105 F.3d 1049, 1051 (5th Cir. 1997); *Cohen v. State ex rel. Stewart*, 89 A.3d 65, 72 (Del. 2014); *Viacom, Inc. v. Transit Cas. Co.*, 138 S.W.3d 723, 725 (Mo. 2004). While insurer receivership is akin to federal bankruptcy proceedings in a number of ways, it has its own unique rules and statutory schemes. And unlike bankruptcy, insurance insolvency can vary drastically from state-to-state. Receivership proceedings are governed by the law of the state in which the insurer is domiciled. However, because insurance companies today rarely operate in a single state, the laws of the various states in which the insolvent insurer conducted business may also be implicated.

Many states have sought to reduce this uncertainty by adopting statutes patterned after either the Uniform Insurers Liquidation Act ("UILA") or the Insurers Rehabilitation and Liquidation Model Act ("Model Act").[1] *Compare* Okla. Stat. 36 §§ 1921-1938 (year) and La. Stat. Ann. § 2038 *et seq.* (2012) (adopting versions of UILA) *with* Mich. Comp. and 40 Pa. Stat. and Cons. State. Ann. §§ 221.01 – 221.6.3 (adopting versions of Model Act). Much like the Full Faith

[1] The National Association of Insurance Commissioners (NAIC) has been actively involved in the state regulatory process to creating a more uniform scheme regarding insurer liquidations and receiverships by developing three model acts, including the Uniform Insurers Liquidation Act, the Insurers Rehabilitation and Liquidation Model Act, and the Insurer Receivership Model Act.

and Credit clause of the Constitution, these model acts require states to recognize and enforce orders of a reciprocal sister state concerning liquidation of an insolvent insurance company. *See All Star Advertising Agency, Inc. v. Reliance Ins. Co.*, 898 So.2d 369, 373-74 (La. 2005); *Twin City Bank v. Mut. Fire Marine & Inland Ins. Co.*, 646 F. Supp. 1139, 1141 (S.D.N.Y. 1986). Any other actions against the defunct insurer must be stayed. *G. C. Murphy Co. v. Reserve Ins. Co.*, 429 N.E.2d 111, 115 (N.Y. Ct. App. 1981). Under these schemes of interrelated insolvency laws, the insurer insolvency is achieved through multiple receivership proceedings. A primary "domiciliary" proceeding is initiated in the state where the insurer is domiciled and one or more "ancillary" proceedings in other interested states. Nonetheless, disputes still arise regarding the applicability of these model acts and, consequently, courts may refuse to stay concurrent insolvency proceedings. *Groves v. Mut. Benefit Life Ins. Co.*, 1996 WL 35069826, at *8 (Kan. Ct. App. Feb. 16, 1996) (affirming that stay of ancillary liquidation proceeding was not required); *Ala. Nat'l Life Ins. Co. v. Gammill*, 504 P.2d 516, 520 (Ariz. Ct. App. 1972) (declining to stay ancillary proceedings because there were "material differences" regarding whether states were reciprocal despite both having adopted versions of the UILA). Therefore, it is important to understand not only the laws where the insurer is domiciled but also the laws of any jurisdiction where insolvency proceedings are pending.

If it becomes apparent that an insurer is at risk of insolvency, either resulting from its own actions indicating an inability to pay or arising from an outside audit of the company's finances, nearly all states authorize the insurance commissioner or superintendent to initiate receivership proceedings to rehabilitate and, if necessary, liquidate the insurer's assets. The standard for determining whether an insurer is insolvent is whether its assets are exceeded by claims or other liabilities. *Sheppard v. Old Heritage Mut. Ins. Co.*, 425 A.2d 304, 307 (Pa. 1980); *Lindsay v. Main*

Ins. Co., 315 S.E.2d 166, 168 (S.C. Ct. App. 1984). Rehabilitation occurs when an insurance company is suffering from financial distress, but the court believes that the receivership can rehabilitate or preserve the business of the insolvent insurer. In the alternative, the commissioner may instead decide to liquidate the insurance company if a domestic insurer is in a financial condition that allowing further business would be hazardous to its policyholders, creditors or the public. *Fortunato v. N.J. Life Ins. Co.*, 603 A.2d 964, 966-67 (N.J. Sup. Ct. 1991); *People ex rel. Palmer v. Nat'l Bankers Ins. Co. of Lincoln*, 17 N.E.2d 579, 610 (Ill. 1938). A distressed insurance company does not systematically move from one type of receivership to another. Rather, at the time the receivership proceedings are commenced, the commissioner will decide the type of receivership most appropriate under the circumstances.

II. Policyholders' Rights and Liabilities on Insurer Insolvency and Liquidation

With regard to policyholders, the institution of the receivership in connection with liquidation proceedings can result in several adverse effects.

First, the rights and liabilities of all parties interested in the estate (*e.g.*, policyholders, credits, shareholders) are fixed as of the date the order of liquidation is entered. *In re Ambassador Ins. Co., Inc.*, 114 A.3d 492, 504 (Vt. 2015); *Hundson v. Am. Chambers Life Ins. Co.*, 950 N.E.2d 978, 981-82 (Ohio Ct. App. 2011). All insurance policies and bonds issued by the insurer are automatically terminated within a certain number of days (usually 30) after entry of the court-approved order of liquidation. *In re Penn Treaty Network Am. Ins. Co.*, 259 A.3d 1028, 1036 (Pa. Commw. Ct. 2021). As a result, after an insurer is placed into receivership, a policyholder can only recover against the insurance company's estate for covered losses that occur on or before the policy is cancelled and coverage is extinguished. Notably, however, certain types of policies, such

as life insurance and health insurance policies, are exempt from termination and generally remain in force despite the pending liquidation.

Additionally, the initiation of insolvency receivership proceedings triggers the establishment of insurance guaranty associations or insolvency funds to pay claims in the event the insurer becomes insolvent and unable to pay its outstanding liabilities. Each state has created a guaranty association or insolvency fund which takes over the insolvent insurer's claims payment responsibilities. Guaranty associations or funds are comprised of money from an assessment placed on all insurers licensed to do business within the state. *See Seehaus v. Bor-Son Constr. Inc.*, 783 N.W.2d 144, 151 (Minn. 2010); *Parkwoods Comm. Ass'n v. Cal. Ins. Guar. Ass'n*, 141 Cal. App. 4th 1362, 1365-66 (1st Dist. 2006). Upon insurer insolvency, guaranty associations essentially "step into the insolvent insurer's shoes to the extent of its obligation on all covered claims." *Gallagher v. Sidhu*, 109 P.3d 840, 842 (Wash. Ct. App. 2005). To that end, guaranty associations pay claims, defend policyholders where appropriate, and can be involved in coverage litigation. They can also seek contribution claims or subrogation. However, there are a number of significant obstacles upon the availability of guaranty associations and insolvency fund resources that may preclude or severely limit recovery. For example, many state statutes concerning eligibility to guaranty association proceeds contain their own definitions of "covered claims," oftentimes which cover starkly different losses than the original policy issued by the insolvent insurer. Additionally, many of these guaranty associations impose residency or property location restrictions, limit recovery to only certain types of policies, and include per-claim limits of recovery. *Rogers v. Imeri*, 999 N.E.2d 340, 344 (Ill. 2013). Because of these various restrictions, substantial litigation has arisen from policyholders seeking recovery from guaranty

associations. Therefore, policyholders should not assume that a state-sponsored guaranty association or fund will provide appropriate coverage for a claim.

It is a common misconception that excess insurers drop down and are required to assume the responsibility of an insolvent primary insurer. The insolvency of the original insurer does not change the nature of the excess insurer's contractual obligations. Absent a specific drop-down provision, it is unlikely that an excess insurer will take the place of the insolvent insurer to pay covered claims. *Waste Mgmt. of Minn., Inc. v. Transcontinental Ins. Co.*, 502 F.3d 769, 773 (8th Cir. 2007); *Radiator Specialty Co. v. First State Ins. Co.*, 651 F. Supp. 439, 443 (W.D.N.C. 1987); *but cf. Lechner v. Scharrer*, 429 N.W.2d 491, (Wis. Ct. App. 1988) (concluding excess insurer's policy was ambiguous as to whether it assumed insolvent insurer's liabilities). Similarly, because the policyholder lacks privity of contract, a reinsurer is generally not required to pay a claim filed by a policyholder when the original insurer is declared insolvent. *In re Bennett Funding Grp. Inc. Sec. Litig.*, 270 B.R. 126, 131 (S.D.N.Y. 2001); *Allemannia Fire Ins. Co. v. Fireman's Ins. Co. of Baltimore*, 209 U.S 326, 332 (1908) (stating that "[t]he liability of the [reinsurer] is not affected by the insolvency of the [reinsured] or by the [reinsured's] inability to fulfill its own contract with the original insured."). Some reinsurance contracts, however, include "cut through" clauses which provide policyholders with a direct right of action against the reinsurer under certain limited circumstances, such as the event of insurer insolvency. *Jurupa Valley Spectrum, LLC v. Nat'l Indem. Co.*, 555 F.3d 87, 89 (2nd Cir. 2009). Cut-through provisions alter the reinsurer's obligations in the event of insurer insolvency. In exchange for inclusion of cut-through provisions, reinsurers are able to charge additional premiums and more appropriately gauge potential risk.

In addition to cut-through provisions, courts in a few states have allowed policyholders under certain conditions to file actions directly against reinsurers in the event of insolvency of the

underlying insurer. *See, e.g.*, *Koken v. Legion Ins. Co.*, 831 A.2d 1196, 1236-37 (Pa. Commw. Ct. 2003) (allowing policyholder to pursue direct action against reinsurer on theory of third-party beneficiary status); *Venetsanos v. Zucker, Facher & Zucker*, 638 A.2d 1333, 1339 (N.J. Super. Ct. 1994) (finding reinsurer's conduct may change the nature of the relationship such that direct action is permissible). But these cases are predominantly outliers and rarely invoked. States have also held that direct action statutes do not give the policyholder a cause of action against a reinsurer. *Arrow Trucking Co. v. Continental Ins. Co.*, 465 So.2d 691, 693 (La. 1985). It is therefore unlikely that excess insurers or reinsurers will provide any source of recovery in the wake of insolvency of an underlying carrier.

III. Notice and Filing Proof of Claims

After a court enters an order of liquidation, the liquidator and, ultimately, the court must distribute the insolvent insurer's assets in a timely fashion. However, the court must also consider the policyholders' strong interest in bringing covered claims against the insurer. To balance these interests, the liquidator must give notice of the order to all persons or entities known or reasonably expected to have a claim against the insolvent insurer. Even so, the best practice for most insureds is to check their insurance records during the relevant timeframes for possible coverage. Coverage may be found under the estate's name, or under one of potentially many former subsidiaries and company names.

The notice of liquidation will typically include a bar date on which claims must be filed. It may also advise that coverage may be available through a state guaranty association or insolvency fund. Failure by the receiver to provide proper notice regarding the bar date or forms necessary to file a claim may provide a basis to seek distribution, even if the proof of claim is untimely. *State ex rel. Wagner v. Amwest Sur. Ins. Co.*, 738 N.W.2d 813, 817-18 (Neb. 2007).

All policyholder claims filed within the prescribed bar date share equally in the distribution of the insurer's assets. Claims filed after the bar date are considered late-filed claims and, depending on the jurisdiction, may not be allowed to share in the distribution of the insurer's assets. Where there are multiple receiverships in more than one state, all claimants—even those from ancillary proceedings—must file their claims on or before the bar date set in the domiciliary liquidation proceeding.

Insureds are usually permitted to file "protective" proof of claim forms if the specifics of their claims have not yet developed. An insured who has not triggered the insolvent insurer's policies in a tower or whose claim is in the nascent stages may be unable to prepare a full claims submission. The protective proof of claim allows the insured to preserve the right to bolster the claim if and when additional information becomes available at a later date. Again, a best practice is to file the proof of claim even if the likelihood of triggering the insolvent policy is slim. Emerging torts such as PFAS, talc, sex abuse, and coal ash may lead to losses for an insured where they previously believed none existed.

Although filing the claim is of the utmost importance, the content of the proof of claim is equally as paramount. For example, every proof of claim must include information such as the particulars of the claim including the consideration given for it, whether the claim is liquidated or undetermined, the identify and amount of security on the claim, whether there is any setoff, counterclaims or defenses to the claim, the name and address of the claimant and attorney representing the claimant, and the social security number or federal employer identification number of the claimant. The liquidator may also request certain information or documents in support of a claim. This should be clearly indicated in the claim notice. Failure to include the

requisite information precludes any entitlement by the claimant to share in the distribution of the insurer's assets.

IV. Guaranty Funds and the Exhaustion Obligation: Implications for Other Insurers

There are four potential parties that could end up bearing some or all responsibility for an insolvent insurer's obligations: guaranty funds, insureds, other primary insurers and excess insurers. To what extent are other primary and excess insurers required to absorb some or all of the insolvent insurer's liability?

Insurer insolvency directly implicates co-primary insurers providing concurrent coverage for the same insured and risk at issue, and other primary insurers in long-tail cases. Co-primary insurers generally share defense costs and indemnity obligations on a pro-rata basis, depending on the limits of coverage in each policy. However, whenever one co-primary insurer becomes insolvent and a guaranty fund steps in, the solvent co-primary insurer typically loses its right to contribution for defense and indemnity costs. Practically all guaranty fund statutes limit access to guaranty funds for only "covered claims", usually defined as those that would have been covered under the insolvent insurer's policy. These statutes also provide that "covered claim" does not include any amount that would be due to another insurer, such as by way of contribution vis a vis an "other insurance" clause. *See generally, Isaacson v. California Ins. Guar. Ass'n*, 750 P.2d 297 (1988); "When Insurers Go Belly Up: Implications for Insurers, Policyholders, and Guaranty Funds", M. Aylward and P. Hummer, 70 Def. Couns. J. 448, 458-59. Secondly, guaranty fund statutes require claimants to exhaust all other available sources of recovery before seeking guaranty fund relief. This includes the insured's (or claimant's) obligation to first exhaust all rights against any other solvent primary insurer providing concurrent coverage for the same risk. *See generally,* NAIC

Model Act, sec. 12(A) ("Any person having a claim against an insurer whether or not the insurer is a member insurer under any provision in an insurance policy other than a policy of an insolvent insurer which is also a covered claim, shall be required to exhaust first his or her right under the policy."); *Connecticut Ins. Guar. Ass'n v. Union Carbide Corp*., 585 A.2d 1216, 1224-25 (Conn. 1991). A concurrent primary co-insurer, therefore, essentially becomes the equivalent of a single primary insurer.

Courts have held that where the insured of an insolvent insurer is jointly and severally liable with another co-defendant, a guaranty fund claimant first must exhaust the co-defendant's coverage before turning to the fund. *See, Parkwoods Community Ass'n v. California Ins. Guar. Ass'n,* 141 Cal. App. 4th 1362 (1st Dist. 2006). However, a guaranty fund claimant is not required to exhaust available excess insurance coverage. *See generally*, Washington Ins. Guar. Ass'n v. Letter, 847 F.2d 761 (11th Cir. 1988). *But see Ross v. Canadian Indemnity Ins. Co.*, 142 Cal. App. 3d 396 (2d Dist. 1983) (California guaranty statute requires a claimant to exhaust all available secondary insurance before looking to the guaranty fund).

With long-tail cases, the scope of a primary insurer's obligation to absorb an insolvent insurer's responsibility depends on whether the given jurisdiction adopts the "all sums" or allocation approach. States adopting the all sums approach apply joint and several liability to all primary insurers providing coverage for the insured over a period of time, so long as coverage was triggered during a given policy period. In these states, a guaranty fund claimant must exhaust the limits of insurers in the timeline, up to the limits ("all sums") of each policy in the chain that are exposed. Whereas, in states that allocate coverage based upon time on the risk, a primary insurer may prorate its number of years on the risk against the total number of years of coverage provided by other insurers, at times resulting in a percentage of policy limits. Under this scenario, the

insured might bear its proportional responsibility for the gap in coverage caused by the insolvent insurer. *Aylward, supra,* at 455-57.

V. Guaranty Fund Associations and Bad Faith

With few exceptions, model guaranty fund acts adopted by practically all states grant bad faith immunity to state guaranty fund associations arising out of claims handling practices. For example, the NAIC Model Act provides, "There shall be no liability . . . for any action taken . . . in the performance [of a Fund's] . . . powers and duties." This immunity extends to vicarious liability for the insolvent insurer's bad faith conduct, even though the guaranty fund steps into the shoes of the insolvent insurer. Immunity also includes tortious claims handling practices by a guaranty fund, and violations of unfair claims practices acts. *See, e.g., Bentley v. North Carolina Ins. Guar. Ass'n*, 418 S.E.2d 705 (N.C. App. 1992); *Fernandez v. Florida Ins. Guar. Ass'n*, 383 So.2d 974 (Fla. App. 1980); *Bills v. Arizona Property and Cas. Ins. Guar. Fund*, 984 P.2d 574 (Ariz. App. 1999). States shielding guaranty fund associations from bad faith liability generally hold that extracontractual claims are not "covered claims" as defined by the guaranty fund statute. *See Vaughn v. Vaughn*, 597 P.2d 932 (Wash. App. 1979).

A few states, however, extend guaranty fund bad faith immunity only to common law bad faith causes of action, not to bad faith settlement conduct in violation of statutory duties. *See Isaacson v. California Ins. Guar. Ass'n*, 750 P.2d 297 (1988) (comparing bad faith failure to settle within statutory limits to violating guaranty fund's statutory duty to pay and discharge "covered claims"); *T & N PLC v. Pennsylvania Ins. Guar. Ass'n*, 800 F. Supp. 1259 (E.D. Pa. 1992) (breach of statutory duty to timely pay might trigger loss of immunity); *Washington Ins. Guar. Ass'n v. Ramsey,* 922 P.2d 237 (Alaska 1996) (guaranty fund has no immunity for bad faith failure to enforce its statutory duties). In addition, guaranty fund immunity does not extend

to breaches of the duty to defend the insured of an insolvent insurer. *See generally, Jones v. Florida Ins. Guar. Ass'n, Inc.*, 908 So.2d 435 (Fla. 2005) (guaranty fund immunity does not bar an action for attorneys' fees when the duty to defend is breached).

VI. Liability of Agents and Brokers

The courts generally are split over whether - and the degree to which - insurance agents and brokers[2] may be held liable for placing coverage with an an insurer in bad financial condition that later becomes insolvent. Claimants usually fall into two categories, the agent's clients and third-party claimants. Clients may base an action against an agent in breach of contract or professional negligence, whereas actions filed by third parties sound in tort and third-party beneficiary status.

Courts have imposed a duty on insurance agents to exercise reasonable skill and diligence in selecting an insurer known to be solvent or financially stable at the time a policy is procured. *See, e.g., Williams-Berryman Ins. Co. v. Morphis*, 461 S.W.2d 577 (Ark. 1971); *Kinder Mortgage Co. v. Celestine,* 635 So.2d 527 (La App 1994); *Nidiffer v. Clinchfield R. Co.,* 600 S.W.2d 242 (Tenn App 1980). Agents have been held liable to the insured for placing coverage with an insolvent insurer at the time of procurance. *See Glenn v. Leaman & Reynolds's, Inc.*, 442 So.2d 1224 (La App 1983). Agents also have been held liable under certain circumstances for failing to notify the insured of the insurer's insolvency occurring after coverage was procured. In one scenario, the insolvent insurer instructed the agent to notify the insured of the insolvency and the agent failed to follow through. *Kinder Mortgage Co. v. Celestine, supra; see also Hlavaty v. Kribs Ford, Inc.,* 622 S.W.2d 328 (Mo App 1981). In another case, the court held that a procuring agent who orally agreed with the client to obtain a "viable" insurance policy, and promptly notify the

[2] Here both referred to as "agent".

insured of changes that could impact the policy, can be liable to the client. *Muncil v. Widmir Inn Restaurant Corp.,* 65 N.Y.S.3d 267 (3d Dept. 2017).

On the other hand, some courts hold that an agent cannot be liable to a client as long as the insurer was solvent at the time the policy was procured, even though the insurer becomes insolvent later. *See, e.g., Sternoff Metals Corp. v. Vertees Corp.,* 693 P.2d 175 (Wash App 1984); *Higgenbotham & Associates, Inc. v. Greer*, 738 S.W.2d 45 (Tex App 1987); *Acadiana Shrimpers v. Phoenix Fire & Marine Ins. Co.*, 640 So.2d 800, cert den 644 So.2d 643 (La App 1994); *Jenkins v. Farmington Cas. Co.,* 979 F.Supp 454 (S.D. Miss. 1997). Other courts go so far as to hold that an agent has no duty to clients to investigate the financial soundness of an insurer before procuring a policy. *See Mark Tanner Construction, Inc. v. HUB International Ins. Services, Inc.,* 2014 WL 906283 (Cal App 2014). However, several courts take the opposite view, holding that an agent has a duty to investigate the financial soundness of an insurer before procuring a policy, even though agent is not a guarantor of the financial condition of the insurer. *Carter Lincoln-Mercury, Leasing Div. v. EMAR Group,* 638 A.2d 1288 (N.J. 1994). In *Nelson, Mullins, Riley & Scarborough, L.L.P. v. Aon Risk Services, Inc. of New York*, 2005 WL 8164993 (D. S.C. 2995), the court held that a law firm stated actionable claims against a broker for failing to adequately investigate the financial condition of the insurer and determine whether the insurer was at risk of failure, before placing coverage with an insurer that later became insolvent. *See also De La Peña, MD v. John Hancock Mut. Life Ins. Co.,* 2010 WL 11601067, *2 (C.D. Cal. 2010) (a broker can have a duty to "advise his client of known changes in conditions that may undermine the suitability of a policy".)

New Jersey permits third parties other than the named insured to assert claims against an agent for placing coverage with an insolvent insurer or for inadequately investigating the financial

soundness of an insurer. *Carter Lincoln-Mercury, Leasing Div. v. EMAR Group, supra*, The *Carter* court's reasoning was based upon a finding that the claimant, a loss payee, was within the zone of foreseeability. Other courts, however, have rejected similar claims, holding that agents owe no such duty to third party claimants. *See West Houston Airport, Inc. v. Millinneum Ins. Agency, Inc.,* 349 S.W. 3d 748 (Tex. App. 2011); *Bustamante v. State Farm Mut. Auto. Ins. Co.,* 517 So.2d 232 (La. App. 1987), cert den 518 So.2d 510 (La. 1988).

VII. Resolving Claims

Insureds (and insurers) who have filed proof of claim forms must exercise continued diligence to preserve their claims, as a number of events may occur over the course of the liquidation that require a timely response. After reviewing the claim, the liquidator will likely request more information and data from the claimant and may set a 30-day deadline to respond. Similarly, once the liquidator has made a determination on the value of a claim, claimants may have only a limited period of time to counter or object. Claimants will also need to abide by any proof of claim or claim documentation deadlines. A late response or filing to any one of these deadlines may jeopardize coverage.

Once the liquidator has adjusted enough claims, they will set an initial payout percentage, which is the percentage of agreed claims they estimate the estate can pay, but it may take several years (or longer) before the initial distributions are made. While some estates end up paying very little even on agreed claims, others may ultimately pay 100% of allowed claims. Parties should bear in mind that U.S. insurance liquidations can take decades to resolve, especially when long-tail (e.g., asbestos and environmental) claims are involved. The Midland Insurance Company (New York) and Mission Insurance Company (California) liquidations opened in the 1980s and continue to deal with closing the estates. More recent insolvencies like The Home Insurance

Company (New Hampshire) and Highlands Insurance Company (New Jersey) do not appear close to resolving anytime soon. Another common concern for insureds is whether the liquidating estate will provide any compensation for so-called "IBNR" claims. IBNR stands for "incurred but not reported" and refers to claims that are projected to be filed and resolved, sometimes with payment, at some point in the future. This is another instance where the answer varies state by state.

Claims are resolved when the liquidator issues a notice of determination to the claimant which is then accepted. There may be various remedies in place to appeal such determination and other opportunities to negotiate, but any final agreement on the value of the claim generally must then be approved by the presiding court. Once the claim value has been approved and if such a payout percentage has been set, the insured will receive an initial distribution. As the liquidator periodically evaluates the financial position of the insolvent estate, smaller, additional distributions may be made to claimants with agreed claims.

VIII. United Kingdom Insolvencies

Because many U.S. companies purchased insurance through the London insurance market, they should also stay abreast of any U.K. insurance company insolvencies. While the options available to liquidate companies in the U.K. vary significantly from the U.S., the preferred way to wind up insolvent insurance companies over the past twenty years has been through schemes of arrangement.

A "scheme of arrangement" is a document proposed by the company or its liquidators that outlines, among other points, how claims will be filed, adjudicated, resolved, and paid. The proposal is voted on by scheme creditors (including insureds) grouped into voting classes and votes for or against the scheme are weighted by the value of the creditor's claims. Typically, direct insureds and reinsurers will be assigned to separate classes. To proceed, the scheme must receive

a majority of the votes in favor and 75% in value. If the scheme passes, it must be sanctioned by the presiding court before becoming effective. Schemes of arrangement often include a final claims bar date, similar to a proof of claim filing deadline – often six months after the scheme becomes effective. In contrast, the final claims bar date requires a full and complete submission, even for IBNR claims, and the resolution of such claims often includes some consideration for IBNR losses. The liquidators will set an initial payout percentage shortly after the final claims bar date, and may make additional distributions (sometimes with interest) as more claims are resolved.

The U.K. company's liquidators have historically sought protection under Chapter 15 of the U.S. bankruptcy code to make the scheme's provisions and deadlines enforceable in the U.S. Consequently, failure to file a timely submission will likely result in a claim being valued at $0. Because each London Market insurer is liable only for their own share of the policy, any amounts allocable to the insolvent U.K. insurer's share going forward are typically borne by the insured.

Solvent companies, including insurance companies, are also permitted to utilize the scheme of arrangement mechanism to achieve finality. They must follow the same steps in the scheme process, and creditors will have the opportunity to vote against the proposal if they so desire.