ALERT
FEBRUARY 2, 2009

INSURANCE CORPORATE AND REGULATORY
News Concerning Recent
Insurance Corporate and Regulatory Issues

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NEW YORK INSURANCE DEPARTMENT ISSUES OPINION ON TREATMENT OF COLLATERAL HELD BY AN INSURER IN LIQUIDATION OR REHABILITATION

Certain insurance programs, particularly workers' compensation programs with large deductibles, require the insured to deposit collateral with the insurer as security for performance by the insured of its payment obligations. The liquidation of Reliance Insurance Company in Pennsylvania brought collateral deposits into the spotlight and led Pennsylvania and Illinois to enact legislation addressing the right to such collateral in the event of the liquidation or insolvency of an insurer. New York does not have an equivalent statute, but an opinion letter issued by the Office of General Counsel of the New York Insurance Department (the "Opinion")[1] on December 31, 2008 provides some guidance.

The Opinion, issued in response to an inquiry to the Department, addresses the issue of whether cash collateral placed with an insurer by a policyholder pursuant to the terms of a payment agreement governing an insurance program would be treated as general assets of the estate of an insurer in liquidation or rehabilitation ("receivership"). The Opinion concludes, with emphasis added, that:

> The view that collateral should not be included in the general assets of an insurer undergoing liquidation or rehabilitation is generally consistent with the practice of the New York Liquidation Bureau, which has indicated to the Department that, *in situations where there is a bona fide agreement between a policyholder and an insurer that specifically characterizes an asset as collateral and not part of the general assets of the insurer, such collateral will not be included in the general assets of the insurer's estate in liquidation or rehabilitation.*
>
> With respect to cash collateral held on an unsegregated basis, it is not possible to state categorically in advance how such collateral would be treated. A decision regarding such assets can be made only after an examination of the particular facts and circumstances of the case. Nevertheless, in cases where such cash collateral does not represent premiums earned by the insurer, and where a policyholder can demonstrate that it has posted an amount of collateral with an insurer for a specific purpose, that policyholder's contractual expectations as to the use, application, and return of its cash collateral will be respected even in the event of the rehabilitation or liquidation of the insurer."

The Opinion notes that existing law, Section 7408 of the New York Insurance Law, excludes from the definition of "general assets" of an insurance company in liquidation, property "…pledged, deposited or otherwise encumbered for the security or benefit of specified persons or a limited class of persons…"[2] If a policyholder provides collateral to secure the payment of workers' compensation benefits to its employees, for example, that collateral would be excluded from the general assets of a company in receivership. If, however, collateral is provided to cover premium payments, that type of collateral deposit would be considered part of the general assets of the company, according to the Opinion.

By contrast, the first subsection of the Pennsylvania statute[3], enacted in 2004, provides, with emphasis added, that:

> (a) Collateral *shall not be considered an asset of the estate* and shall be maintained and administered by the receiver as provided in this section, notwithstanding any other provision of law or contract to the contrary.

"Collateral" and "Deductible Agreement" are defined by the Pennsylvania statute as follows:

> "Collateral" shall mean collateral held by, for the benefit of or assigned to the insurer or subsequently to the receiver in order to secure the obligations of a policyholder under a deductible agreement and also any collateral recovered or held by the receiver that secured the obligations of a policyholder under a deductible reimbursement policy.

> "Deductible agreement" shall include any combination of one or more policies, endorsements, contracts or security agreements which provide for the policyholder to bear the risk of loss within a specified amount per each claim or occurrence covered under a policy of insurance and may be subject to aggregate limit of policyholder reimbursement obligations as set forth in an endorsement to a policy or in a program agreement.[4]

The Pennsylvania statute deals directly with the issues discussed in the Opinion, as does the Illinois statute, 215 ILCS § 5/205.1, entitled Policyholder collateral, deductible reimbursements, and other policyholder obligations. As is the case with the Pennsylvania statute, the Illinois law provides in its first subsection, with emphasis added, that:

> (a) Any collateral held by, for the benefit of, or assigned to the insurer or the Director as rehabilitator or liquidator to secure the obligations of a policyholder under a deductible agreement *shall not be considered an asset of the estate* and shall be maintained and administered by the Director as rehabilitator or liquidator as provided in this Section and notwithstanding any other provision of law or contract to the contrary.

In other jurisdictions, including New York, there is far less statutory clarity concerning the treatment of collateral than is provided by the foregoing Pennsylvania and Illinois statutes. As recommended by the New York Opinion, policyholders would be well-advised to enter into "a bona fide agreement between a policyholder and an insurer that specifically characterizes an asset as collateral and not part of the general assets of the insurer." Otherwise, a New York receiver might take the position that such collateral becomes general assets of an estate in the event of liquidation.

1. OGC Op. No. 08-10-08.
2. New York Insurance Law Section 7408(b)(7).
3. Pennsylvania Insurance Law Section 40-11-405.1, entitled Deductible reimbursement agreements; collateral; obligations of policyholders and receivers.
4. Pennsylvania Insurance Law Section 40-11-405.1(n).

NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS REJECTS CAPITAL CHANGES FOR LIFE INSURERS

The National Association of Insurance Commissioners ("NAIC") has rejected changes in capital and surplus requirements for life insurers proposed by the American Council of Life Insurers ("ACLI"). After considerable media scrutiny and after several weeks of study, the NAIC's Capital and Surplus Relief Working Group ("Working Group") held a public hearing held in Washington, D.C. on January 27, 2009 and voted to accept several of the ACLI proposals, including changes to reserving requirements, reinsurance collateral and accounting procedures.

The NAIC Executive Committee did not, however, concur with the Working Group. As reported in a press release on January 29, 2009 by NAIC President and New Hampshire Insurance Commissioner Roger Sevigny:

> Simply put, the industry has not made a credible case for why we need to make changes on an emergency basis, and why those changes should be limited to the specific proposals made by the industry.

NAIC Vice President and Iowa Insurance Commissioner Susan Voss stated that:

> While the Working Group's proposals have merit, we believe such adjustments would be better implemented through the NAIC's standard protocol. Any future consideration of changes to regulatory requirements will follow the NAIC's open, transparent and deliberative process.

Commissioner Sevigny added that:

> State insurance regulators use time-tested tools to protect consumers and help maintain a solvent and competitive marketplace. Today's vote reflects our belief that it is not appropriate to make emergency, permanent industry-wide changes for which the need has not been demonstrated.

The Working Group, chaired by D.C. Insurance Commissioner Thomas Hampton, voted on each ACLI recommendation separately and approved the following proposals:

- Expanded use of the 2001 Preferred Mortality Tables;
- Elimination of constraints for the use on an adjustment factor, in Regulation XXX;
- Allow greater discretion to state Commissioners to approve collateral for reinsurance;
- Elimination of the stand-alone asset adequacy analysis required by Actuarial Guideline 39;

- Rejection of retroactive application of Section 8C of Actuarial Guideline 38, concerning universal life products with secondary guarantees;
- Use of GAAP rules for accounting for Deferred Tax Assets.

Although the NAIC decided not to adopt these changes on an expedited basis and declined to limit the decision-making process to the ACLI proposals, at a recent seminar sponsored by the Insurance Regulation and Corporate Counsel Committees of the ABA's Tort Trial and Insurance Practice Section, Commissioner Hampton alluded to the fact that the NAIC has been closely studying these issues for some time and will be considering how to implement changes on an expedited timeframe. In the wake of the NAIC decision, life insurers in Illinois, Iowa and Kansas have sought approval of lower capital reserves from their state insurance regulators.

NEW YORK COURT UPHOLDS INSURANCE DEPARTMENT'S DECISION THAT TRADE SECRETS ARE EXEMPT FROM FOIL DISCLOSURE

On January 13, 2009, the New York Supreme Court, the trial level court in New York, denied a challenge to the New York Insurance Department's (the "Department") determination that certain transactional information filed with the Department by a bond insurer as a trade secret was exempt from public disclosure under the Freedom of Information Law ("FOIL").[5] The Court decided in *Aurelius Capital Management LP v. Dinallo,* 108462/08 (January 13, 2009) that the Department's decision to exempt such information on the basis that disclosure of the information filed by MBIA, the bond insurer, would lead to substantial competitive injury to MBIA was reasonable and entitled to judicial deference.

In this case, MBIA filed with the Department information on numerous structured finance transactions it insured, including spreadsheets containing highly detailed information relating to parties involved in each transaction and the details of such transactions. This information was submitted by MBIA with a request that the information be treated as confidential and be exempt from disclosure under FOIL as trade secrets which, if disclosed, would cause substantial injury to the competitive position of the subject enterprise.[6]

Aurelius Capital Management ("Aurelius") brought a proceeding challenging the Department's decision[7] to deny broad FOIL requests submitted by Aurelius "to assess MBIA's financial strength and its ability to meet its obligations."[8] While much of the information sought by Aurelius was disclosed, the Department determined that certain information was exempt from disclosure pursuant to N.Y. Public Officers Law § 87(2)(d) because, *inter alia:* the information at issue was substantially more detailed than that released by MBIA's competitors; the spreadsheets did not lend themselves to selective disclosure, and disclosure would have required the creation of a new record; and that disclosure would lead to competitive harm to MBIA and would likely harm the insurer's relationship with third parties to whom confidentiality had been promised.

In denying Aurelius's petition to challenge the Department's decision to exempt certain requested information from disclosure, the Court found that MBIA and the Department had adequately established MBIA's claim of competitive injury. In addition, the Court found that MBIA and the Department had established that neither MBIA nor its competitors had publicly disclosed most of this information, nor was such information otherwise available elsewhere. Further, the Court affirmed that the Department had no duty to create a record that did not already exist to disclose the information sought by Aurelius in its FOIL request, as the spreadsheets could not easily be redacted or limited.

Although the Court opined that "each case presents a unique set of facts and the ultimate determination of competitive injury is fact specific," the Court found that the Department's conclusion that the private financial data at issue was likely to cause MBIA substantial competitive injury if disclosed was entitled to judicial deference, and therefore the Court denied Aurelius' petition in all respects.

5. N.Y. Public Officers Law §§ 84 et seq.
6. *See,* N.Y. Public Officers Law § 87(2)(d).
7. This action was brought under Article 78 of the New York Civil Practice Laws and Rules.
8. *Matter of Aurelius Capital Management LP v. Dinallo at 2,* available at: http://iapps.courts.state.ny.us/webcivil/FCASDocumentSearch