

## “A Billion Here, a Billion There, and Pretty Soon You’re Talking Real Money.”

(Attributed to Everett M. Dirksen, US Senator from Illinois, 1950-1969)

**B**ased on a very unscientific two-item sample – the recent J.P. Morgan trading loss and the Executive Life of NY (ELNY) loss – the minimum point for media outrage apparently is \$2 billion. How else can one explain the media attention to the \$2 bil-

lion for all life insurance company failures to \$558 million to cover funding of the ELNY restructuring plan -- but nothing more (The comparable Assembly bill, A9607, was pending before the Assembly Ways and Means Committee as of the preparation of this column). Therefore, once

There is another major difference – the cost to the life versus the p/c companies. As indicated, the maximum that the life companies can be assessed for all life insolvencies under current law is \$550 million – \$50 million under Article 75, and \$500 million under Article 77. Prior to the ELNY liquidation recently approved, there are no publicly known life insolvency events requiring calls on these funds. Contrast this with the record of the p/c funds. Through 2010, NY property/casualty companies have paid into the three p/c funds a net total of almost \$1.9 billion, and those funds, including the interest earned over the years, have been drawn upon by the liquidator to pay claims against insolvent companies totaling \$3.7 billion! That is 6½ times the cost to the life companies, and that does not even count the various invasions of the p/c funds by the State over the years, which is another story altogether.



Peter H. Bickford

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lion J.P. Morgan mess and lack of media attention for the mere \$1.6 billion ELNY insolvency? You would think that a \$1.6 billion loss occurring entirely on the rehabilitator’s watch would warrant more attention. Perhaps when the consequences of the ELNY insolvency are fully understood the attention will follow. In addition to the financial loss to individual annuitants and policy owners, the financial and reputational consequences to regulators and the life insurance and structured settlement industries loom large and potentially long lasting. Consider, for example, the consequences for the NY State life insurance guaranty funds.

The ELNY liquidation will result in the complete exhaustion of New York’s two life guaranty funds. As interpreted by the superintendent of financial services, the old Article 75 fund, covering pre-1984 contracts issued by NY insurers but with only a \$50 million aggregate cap, and the Article 77 fund covering contracts issued to NY residents whenever issued, with a \$500 million aggregate cap, will be tapped out. Senate Bill 6507A, passed by the Senate on March 29, 2012, would increase the Article 77 \$500 million aggregate cap

ELNY is liquidated no funds will be available for any future life insurance company insolvency in New York without an act of the Legislature.

But why is there any cap on these funds? There are no caps on any of the three property/casualty funds -- the Property/Casualty Insurance Security Fund, the Public Motor Vehicle Liability Security Fund and the Workers’ Compensation Security Fund. In addition, there are two other major statutory differences between the life funds and the p/c funds:

- The life funds are post-assessment funds, while the p/c funds are pre-assessment funds. In other words, the life companies only have to cough up funds when needed for an insolvency, while the p/c companies are required to pay in advance and are assessed continuously or whenever a fund dips below a certain level.
- The life funds are managed by independent entities with boards of directors from member life companies. The p/c funds are basically bank accounts controlled by the superintendent as liquidator, with no participation by p/c companies.

So why do the life funds warrant such preferred status? Before ELNY and its problematic book of annuity contracts, the life industry in NY has always managed to have the books of financially troubled life companies assumed by other life companies, thus avoiding the need to call upon the life guaranty funds. When Article 77 was added in 1985 providing a ten-fold increase in the cap from \$50 million to \$500 million, the supporting memoranda briefly referred to the historic need for a cap to protect the solvency of life insurers but acknowledged that the \$50 million cap in Article 75 was too low. There was no discussion of how this number was determined, or why life companies needed this cap protection while p/c companies apparently did not.

But before you p/c-philes conclude that at least the life industry is getting its comeuppance in the ELNY case, consider this: the ultimate cost of the ELNY shortfall may actually be as great or even greater for p/c companies as for life companies! How is that possible? Remember that after taking all the traditional life products out of

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ELNY back in 1992 (see my article on the ELNY insolvency, “Soggy Saga,” in the February 20, 2012 issue of *Insurance Advocate*), the remaining book consisted entirely of annuity contracts, and most of those contracts had been purchased by p/c companies to fund structured settlements of policy claims. In structured settlements, there are two basic kinds of annuity pur-

chasers: so-called “buy and hold” companies that remain obligated for the original settlement even after the purchase of the annuity; and those owners that made a “qualified assignment” of the settlement obligation upon purchase of the annuity, and who are therefore released from further obligation under the original settlement. Because most of the annuities were purchased before qualified assignments were de rigueur, the contract owners – the

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p/c companies – may be obligated to make up the shortfall. Also, even if they had entered into qualified assignments, the ELNY court placed considerable pressure on the companies owning policies to cover any shortfall.

After applying the \$700 million commitment by the various state life guaranty funds (funded by assessments on life companies) and another \$70 million or so from a consortium of life insurance companies for certain enhancements to the ELNY annuitants, a shortfall of more than \$900 million remains unfunded. Although there are no publicly available statistics on the percentage of the remaining ELNY shortfall covered by solvent p/c companies, or how many of them are “buy and hold” owners versus qualified assignments, it is conceivable that p/c companies may end up footing the bill for the bulk of that remaining \$900 million.

Don't get the idea that I am against the life industry and the life guaranty funds. Heck no! If they can continue to get the legislature to limit their exposure for the failure of other life companies, and if they can continue to get the p/c companies to help pay for these failures – I'd say: "I'll have what they're having!" [A]