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LEGAL UPDATES

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Personal Liability Risks for Insurance Liquidators: Navigating Federal Super Priority in Insolvency Proceedings

Insurance commissioners serving as liquidators of insolvent insurance companies should be mindful of the potential for personal liability arising under the Federal Priority Act (FPA) and potential solutions through model legislation under development by the National Association of Insurance Commissioners (NAIC).

Background

Specialized state insurance supervision, rehabilitation, and liquidation statutes apply to insurance company insolvencies as opposed to federal bankruptcy law. Under state law, the head insurance regulator in the state serves as the liquidator and is responsible for the liquidation process, which includes collecting and distributing the insurer's assets to policyholders and creditors. The court overseeing the liquidation sets a deadline for claims against the liquidation estate. Once the claim period closes, the liquidator pays claims according to claim priority established under state law. Most states give priority to payment of administrative expenses and policy claims over other claims. Higher priority claims are paid in full before lower priority claims may be paid.

FPA: risk of personal liability and lack of deadline

Under the FPA, 31 U.S.C. § 3713, claims of the United States have priority over all other claims. Thus, the FPA conflicts with state insurance liquidation priority statutes, which prioritize administrative expenses and policy claims over federal government claims.

Additionally, the FPA creates *personal liability* for a representative of an estate who makes payments for other claims while the government's claims go

unpaid. Thus, insurance liquidators face a risk of personal liability for estate payments made to other creditors.

Further uncertainty arises from unclear deadlines for federal claims. In a federal bankruptcy proceeding, Fed. R. Bankr. P. 3002 gives the federal government 180 days to file a claim. However, there is no federal statutory deadline applicable to state insurance insolvency proceedings. The government may contend it is not subject to the deadline set by the supervising state court. As a result, liquidators could have personal liability even after the completion of liquidation. The risk of personal liability and uncertainty of whether the federal government will file a claim can cause significant delays in the liquidation process.

Conflict between state priority statutes and the FPA

The U.S. Supreme Court addressed the conflict between a state insurance liquidation priority statute and the FPA in *U.S. Dept. of Treasury v. Fabe*, 508 U.S. 491 (1993). The court held that the FPA did not preempt the Ohio insurance liquidation priority statute to the extent that the state statute protected policyholders. The court relied on the McCarran-Ferguson Act, which allows state laws governing the business of insurance to “reverse preempt” federal laws of general application, such as the FPA.

Mitigating the risk of personal liability

Some state laws grant immunity to liquidators for claims. Still, the FPA might preempt state immunity statutes. In addition, some state laws indemnify officials for acts done in their official capacity, but it is uncertain whether liquidator conduct (as opposed to commissioner conduct) falls within the indemnity statutes.

Because of this uncertainty and the risk of personal exposure, liquidators often obtain a release of federal claims from the Department of Justice (DOJ), but that process can be time-consuming and document intensive. According to the NAIC, liquidators have had requests for at least 29 releases pending with the DOJ, some for as long as 17 years.

Potential federal legislation to mitigate liquidator risk and to expedite the liquidation process

The State Insurance Receivership Priority Act (SIRP) is a model act under development by the NAIC. The SIRP proposes a two-year deadline for the United States to file claims against an insolvent insurance company and narrows liquidator personal liability. The SIRP would help expedite the liquidation process, allowing consumers to recover more quickly and addressing liquidator concerns about personal liability arising from the FPA’s lack of a claim deadline.

What this means to you

Insurance commissioners serving as liquidators for insolvent insurance companies should be aware of the FPA and the risk of personal liability. Liquidators should obtain a federal waiver or release prior to making payments (or make payments subject to clawback rights). Federal adoption of the SIRP would bring clarity and reduce liquidator concerns by imposing a deadline for the federal government to make claims and narrowing liquidator personal liability.

Contact us

If you have questions regarding the FPA or insurer receiverships, please contact Kirsten Byrd, Emily Waters, or your Husch Blackwell attorney.

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