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Section 46(cont.)

F. A trade association expressed concern that counterparties not be placed in a better position as against the insurer than the counterparty would enjoy under comparable provisions of bankruptcy law. A second concern was that claims of counterparties, after any netting agreements or setoffs are considered, should be assigned the same priority as general creditor claims. A technical resource advisor responded that under the proposed amendments the counterparties would not be better situated than under applicable provisions of federal law. The working group decided to add a drafting note to make clear that the priority of claims would not be changed by the amendments, but would be controlled by the general provisions pertaining to the priority of distribution. **1997 Proc. 2nd Quarter 536**

Section 47. Priority of Distribution

When the first drafting committee met to decide on a list of important items to include in the model, one of the most essential was establishing the order of priority of claims against the estate of the insolvent insurer. They considered it most appropriate to place policyholders, beneficiaries and claimants ahead of general creditors. **1976 Proc. II 363** The scheme adopted in 1977 remains essentially the same today. **1978 Proc. I 269**

In December of 1985 a study group submitted a report to the task force on the issue of federal priority, which was currently being litigated in the courts. The arguments against federal priority are based on the exemption from federal regulation allowed to the business of insurance by the McCarran Ferguson Act. **1986 Proc. I 436-438**

A suggested federal bill was drafted to clarify the priority of federal claims in insurance insolvencies. **1986 Proc. II 500-501**

Advisors suggested amendments to this section in 1986. They would have created two new classes of claims, dividing claims filed late into two classes, and creating a new class of claims for expenses of the guaranty association. The amendments were not adopted. **1987 Proc. I 420, 424**

A working group recommended technical changes to this section for clarification, **(1989 Proc. I 450-451)** which were adopted without comment. **1989 Proc. II 339, 381**

The opening paragraph was amended in 1989 in response to a situation where defrauded stockholders attempted to make their claim a super-priority claim. The change expressly disallows the circumvention of the priority system. It was the opinion of the majority of members that certain classes of creditors (*e.g.,* policyholders) are intended to receive a higher priority than other classes of creditors (*e.g.,* stockholders) in the general assets of the insurer, and to allow a lower class creditor to receive a preference over a higher class creditor based on equitable remedies is inconsistent with the priority scheme. **1990 Proc. IA 410**

A. The wording for Subsection A(6) was revised in 1989. The change was made because the majority believed that the guaranty association's claims for allocated loss adjustment expenses should receive the same treatment as claims from non-covered claimants for loss adjustment

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Section 47A(cont.)

expenses. Therefore it should fall under Class 3. Class 1 would be reserved for unallocated loss adjustment expenses of a guaranty association (*i.e.,* their administrative expenses). The original language had provided a Class 1 priority for expenses in handling claims. **1990 Proc. IA 410.**

B. The first draft of the 1994 revisions, which was released in the summer of 1993, placed guaranty fund administrative expenses in Class 3, the same priority class as other guaranty fund claims and policyholder claims. What had been Subsection A(6) on unallocated loss adjustment expenses was deleted. **1993 Proc. 2d Quarter 634, 669-670**

After release of the first draft of revisions to the model, numerous comments were received on the priority section. Comments were related primarily to two issues: changes necessary as a result of the decision of the U.S. Supreme Court in *U.S. Dept. of Treasury v. Fabe* and the priority to be assigned to the unallocated loss adjustment expenses of guaranty funds. The working group voted to revise the draft to place the unallocated loss adjustment expenses of guaranty funds in Class 2. **1993 Proc. 3d Quarter 358**

Later the working group, the drafters agreed that only the expenses that the receiver would have incurred should be afforded a higher priority. **1993 Proc. 4th Quarter 583**

At its next meeting the working group agreed to revise Section 47B to describe in detail the administrative expenses of guaranty association to be included in Class 2. The working group also agreed to add a provision allowing the receiver to pay expenses currently, so long as there were sufficient assets to pay all Class 1 claims in full, and the guaranty association agreed to repay any amounts needed to pay Class 1 clams against the estate. **1994 Proc. 1st Quarter 305, 310**

C. In an effort to revise the model to be consistent with the *Fabe* decision, the working group moved employee claims from Class 2 to Class 5. Class 3 now includes all policyholder claims including those of federal, state or local governments. Claims of the federal government other than policyholder claims were placed in Class 4. **1993 Proc. 3d Quarter 358**

At a later meeting of the working group, it was suggested that a drafting note be added calling attention to the fact that in some jurisdictions the courts have held that punitive damages may not be excluded from insurance policies. The drafters also agreed to add language to Paragraph (5), "unless expressly covered under the terms of the policy." **1994 Proc. 1st Quarter 309**

In September 1996 a working group began consideration of technical amendments to the model. One suggestion was to delete a sentence at the end of Subsection C(2) that read "Notwithstanding this subsection, earned premium claims on policies (other than reinsurance agreements) shall not be excluded." **1996 Proc. 3d Quarter 849**

The technical amendments were adopted by the working group and subcommittee. **1996 Proc 4th Quarter 938, 945**

I. Included in the technical amendments first considered in September 1996 was deletion of several words in this subsection and the reference to "Class 3 or 4" was changed to "Class 3." **1996 Proc. 3d Quarter 849**

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Before adopted the reference was changed to "Class 3 or 6." **1996 Proc. 4th Quarter 945**

Section 48. Liquidator's Recommendations to the Court

C. This subsection was added during the extensive 1994 revision. **1994 Proc. 4th Quarter 629**

D. Subsection D was added during the 1994 revision. It was added to allow the liquidator to avoid the expenses of processing claims that could not possibly receive a distribution of assets. There was some concern that the added language could allow criticism of the liquidator if claims were processed for a reason other than a potential distribution, *e.g.,* to collect reinsurance on retroceded business. **1993 Proc. 2d Quarter 671**

Section 49. Distribution of Assets

Section 50. Unclaimed and Withheld Funds

A. When preparing model revisions in 1993, the working group agreed to add a provision allowing the receiver to ask the supervising court for authority to use unclaimed funds for the administration of low or no asset estates. **1993 Proc. 4th Quarter 582**

In 1995 a working group discussed methods of funding the administration of estates with few or no assets. One regulator suggested development of a provision similar to one in his state's law that provided for a Closed Estate Fund. **1995 Proc. 2d Quarter 514**

The individuals drafting language to accomplish this identified two issues to be addressed: the first was long-term funding through an existing receivership division; the second was funding of a short-term or immediate need. The subgroup suggested that Section 50A be amended to allow for the creation of an account to fund low or no asset estates. The group considered possible sources of funding. One suggestion was to assess each insurer an amount not to exceed $100 per year. A second proposal was that the guaranty associations be authorized to make assessments and turn over the funds generated to the insurance department. An objection to the second proposal was that most insolvent insurers without sufficient assets to fund administration expenses are unlicensed insurers that are not members of the guaranty associations so the association should not have any obligation with respect to these insurers. **1995 Proc. 3d Quarter 599**

A regulator asked how the working group arrived at the suggested $100 assessment, and whether the money would be used for payment of claims. A staff member responded that the opinion of the working group was that this amount might be acceptable to the insurance industry. He also said that funds generated by the assessment would only be available to defray the expenses of administration and could not be used for the payment of claims. **1995 Proc. 3d Quarter 583**