Masthead Logo

DePaul Law Review

Volume 15
Issue 1 *Fall-Winter 1965*

Article 11

Insurance - Insurance Company Insolvencies: Relief for Victims in Illinois

Michael Jordan

can usually find some method, legal or illegal, to evade them. But the criminal cannot acquire his type of firearm when there is no effective, cheap, and general source of supply.

Some firearms control legislation will likely be passed by this Congress, but it will not present, even in theory, a final solution to the diverse problem of firearms proliferation. But whatever step is taken will be a step in the right direction.

John Peterson

INSURANCE–INSURANCE COMPANY INSOLVENCIES: RELIEF FOR VICTIMS IN ILLINOIS

Every year throughout the United States, there are companies dealing in casualty insurance which are unable to meet their current obligations and are found to be insolvent. As a result the policyholder and others making claims against the insurance company have no remedy for reimbursement of their losses. These persons must utilize their own resources in spite of the fact that they relied upon the insurer to pay all valid claims. In essence, the policyholder has no assurance that his company will be in a position to pay a valid claim when and if it arises. The problems of insolvency and relieving those financially affected by the insolvency are the major topics of discussion in this note.

There is a significantly large number of insurance companies doing business in Illinois that become insolvent each year so as to merit new or at least increased governmental regulation in our state. The magnitude of the problem is apparent when one considers the pertinent statistics. As of September 14, 1965, twenty of approximately 782 companies doing business in Illinois were in conservation or liquidation.[1] Although this represents less than five percent of all casualty insurance companies in Illinois, the twenty companies represent over 500,000 policyholders.[2]

---

[1] William J. Dorf, deputy director of Insurance in charge of liquidations, supplied the information regarding the companies. For the number of companies doing business in Illinois, see THE NATIONAL UNDERWRITER 4 (1965). Companies in liquidation: Adams Mutual Ins., Amer. Bowlers Mut., Amer. City Life, Bedford Mutual, Blackhawk Mutual, Central Casualty, Commerce Ins. Co., Cosmopolitan Ins., Crown Ins., W.Va., Gen. Union Mut., Mid-Union Indem., Monroe Mutual, Multi-State Ins., Oxford Gen. Ins., Pioneer Ins., Du Page, Whitehall Mut., Lincoln Cas. Co., Sang. Co., Banner Mutual, Bell Casualty.

[2] This conclusion is based upon testimony in proceedings conducted by Jerome H. Torshen, as special counsel for John F. Bolton Jr., Illinois Insurance Director, in his capacity as liquidator of Multi-State Inter-Insurance Exchange against Multi-State's former president, Charles Hoffman Jr., (Docket No. 65CH 4823). Multi-State had 2060 claims filed by the deadline of the claim date and there are 32,000 assessable policy-

When so many people are involved, there is reason for concern. However, from these statistics it cannot be said that Illinois is an isolated island where financial difficulties occur as a result of fate or luck. On May 11 and 12, 1965, the report of the Antitrust & Monopoly Subcommittee of the Senate Judiciary Committee indicated that approximately fifty insolvencies have occurred in the last six years throughout the United States.[3] While insolvency is a universal problem in the United States, it is one to which the states must direct themselves, since federal legislation has placed control of insurance companies under the domain of the states.[4]

POSSIBLE CAUSES OF INSOLVENCY

In order to effect a solution to the problem of insolvency, it is first necessary to understand the possible causes of the problem. There are basically four; (1) an ineffectual code of legislative regulation, (2) inadequate enforcement of the code due to an inept or insincere regulatory department, (3) insufficient appropriations to the regulatory department to assure comprehensive regulation, and (4) fraudulent practices by companies evading the regulations.

The purpose of an insurance code is twofold:[5] to maintain the companies in a sound and solvent position and to make sure that the contracts and obligations of the companies are strictly performed. If either purpose is not achieved, the regulatory laws are not adequate. Any deficiencies appearing in a code are not necessarily indicative of a need for greatly broadened controls, but may only require minor changes in the code which increase fixed standards for compliance.

A danger to which insurance regulation is subject is that the industry may ultimately control or, at least, greatly influence the regulator. This is a natural result of the fact that many of the individuals within a regu-

---

holders according to the testimony admitted in the above case. The total number of persons involved by the companies in receivership or liquidation exceeds a half-million, based on a projection of the number of claims filed against this company.

[3] *Hearings on Substandard Insurance Business before the Subcommittee on Anti-Trusts and Monopoly of the Senate Judiciary Committee*, 89th Cong., 1st Sess. (1965). The chairman of the Insurance subcommittee, Thomas J. Dodd (D-Conn.), called the list of insolvencies evidence of a serious failure on the part of state regulation and the industry to protect the public. In an address by Senator Dodd before the National Association of Casualty and Surety Agents and the National Association of Casualty and Surety Executives Annual Convention at White Sulphur Springs, W.Va., October 5, 1965, he said: "If state regulation proves inadequate to the task of protecting the public, how long can the federal government be expected to stay its hand?"

[4] McCarran-Ferguson Act, 15 U.S.C. §§ 1011-1015 (1963).

[5] A letter From John F. Bolton Jr., Director of Insurance, State of Illinois, to Michael Jordan, August 24, 1965, on file with the *De Paul Law Review*.

latory department were at one time or another a part of the insurance industry, especially those in the policy-making positions in a department. Furthermore, the committees and boards appointed to assist an Insurance Director are usually over-represented by members of the industry.[6] The appointment of a board is a step in the right direction, but will not of itself accomplish the purpose if it does not represent the entire public.

According to Richard G. Hershey, one of the major causes of insolvency is a misuse of funds, as well as other fradulent practices.[7] It is doubtful that this cause will ever be eliminated entirely, but it can be substantially diminished by imposing penalties for fraud and deceit. That such fraud is prevalent is substantiated by criminal and civil suits pending against officials involved in several companies that have failed due to fraud.[8] These suits may serve as a partial deterrent for future evils, but they will never be a total bar to such misconduct.

In comparison with other states, Illinois seemingly has been able to cope with these causes of insolvency. The Illinois Insurance Code "is as modern as perhaps any other state in the union," according to J. F. Bolton, Jr.[9] Enforcement is administered by a staff of professionals who have been commended by members of the industry as well as spokesmen for the public. The amount of money appropriated for the department ($2,132,395 for the period July 1, 1963 to June 30, 1965) is insufficient when considering the number of companies the department must regulate each year, but is greater than the amount spent in most states.[10]

In view of the data supplied by F. A. Holderman,[11] the expenditures by the State of Illinois for insurance regulation are fairly commensurate with those of other states. Illinois ranks fifth among the States in the number of examiners hired to aid in regulation, while it ranks among

[6] The 19 members appointed to the advisory committee to the Director of Insurance in Illinois on June 23, 1965, included 12 from the insurance industry, 4 from government, 1 educator, an attorney, and a certified public accountant.

[7] Richard G. Hershey, former director of insurance for the State of Illinois, predecessor to Mr. Bolton, the current director, as reported to Dave Pauly, staff writer for the CHICAGO DAILY NEWS. Mr. Pauly was interviewed by the author.

[8] Suits reported by the Insurance Department as follows: four officers of one of the companies in liquidation, Central Casualty Co., now face trial in Criminal Court on charges of embezzlement. Two officers of another of the troubled firms, Mid-Union Indemnity Co., were indicted in 1963 for fraudulent stock sales. A civil suit was filed in Circuit Court, December, 1964, against officials of Cosmopolitan Insurance Co., the largest of those now being liquidated.

[9] John F. Bolton, Jr. is the current Illinois Insurance Director. This statement was made July 14, 1965, in an address to the Insurance Advisory Committee.

[10] The amount of the appropriation was supplied by the Department of Insurance.

[11] Mr. Holderman is the manager of the *Legislative Bureau of the American Mutual Insurance Alliance*, a trade Association of mutual insurance companies. He was interviewed by the author.

the most active when measured by the number of companies doing business in the state. Moreover, Illinois ranks in the top five states in premium volume. While these factors create a favorable position for Illinois in comparison with other states, the fact that insolvencies are nation-wide cannot be overlooked. It is suggested that perhaps no state is doing enough to guard against the problem of insolvency.

Further complications of this problem are caused by the mounting backlog of cases pending in our courts. The period during which claims are pending extends the time during which a company may go insolvent without having to pay valid claims. The longer it takes to reach judgment, the greater the chance a claim will not be paid, since the company may have become insolvent during the intervening time. This additional complication is a further hazard to the policyholder and can be alleviated only by current court calendars. In Illinois, a backlog exists in many of the counties, with Cook County leading the list. Fifteen courts have delays of more than thirty months before a case is heard.[12]

The recent Illinois judicial reform may aid in the diminution of the backlog, but it is doubtful that it will ever be eliminated entirely. Admittedly, the number of valid claims that must reach judgment before being paid is slight, but these claims for the most part are against the potentially insolvent insurance company, for it is the failing company that gains the most by stalling the payment of claims against it. Therefore, it appears that improved judicial administration will never decrease the number of insolvencies, since the company approaching insolvency will still be able to stall until insolvency is reached, whether the backlog is reduced or remains the same. However, the number of persons affected by insolvency will decrease if fewer claims are pending in court at the time the insolvency occurs.

PUBLIC POLICY

Whether or not a problem will be acted on, and the procedure for such action, depends upon the public policy of the state. In the matter of insolvencies, the insurance industry's views have been made apparent by their trade alliances,[13] lobbyists, and individual company spokesmen.

[12] In the Law Division, Circuit Court of Cook County, Illinois, the waiting period is 60.2 months. In the Municipal Division of the same court, the period is 49.0 months. INSTITUTE OF JUDICIAL ADMINISTRATION, 13TH ANNUAL SURVEY OF STATE COURT CALENDARS (1965).

[13] There are several alliances or associations, each of which is composed of companies doing similar business, such as life, casualty, fire, etc. The primary purpose of these groups is legislative lobbying in the various states, although they fulfill other functions as well by offering educational programs and seminars for the industry, and general research for the member companies. The major associations are the following: American Mutual Ins. All., 20 N. Wacker Dr., Chicago, Ill., Assoc. of Cas. & Surety

They have pat answers to the two basic questions of concern to the public; should not the policyholder be protected against the possibility of an insolvency, and is further legislative regulation necessary to avoid insolvencies.

The insurance industry spokesmen feel no action is necessary to relieve those affected by insolvencies. They hold the belief that it is an unfortunate circumstance, but if one chooses to take the risk of being insured by a faltering company, one must bear the burden of that risk should the company fail. Likewise, they feel the burden of insolvency should fall on the policyholder rather than the taxpayer through increased taxes, because such a shift of the burden of insolvency would be "unjust." Finally, they state that energy should not be directed at relieving the policyholder of his burden, but that the basic causes of insolvency should be the target. If too much relief is given those persons affected by insolvency, little reason will exist to guard against further insolvencies.[14] The insurance company spokesmen feel that their industry is faced with enough regulation at this time in regard to safeguards against the possibility of insolvency, and that any further control would constitute excessive governmental regulation. They further state that the percentage of failures is too small to cause concern.

On the other hand, an opposite view is expressed by the policyholding public.[15] They favor legislative action to prevent insolvencies and seek means to relieve those persons who are financially affected. They feel that if one buys insurance, there is a presumption that the company is able to assume the risk and will continue to be financially responsible when a valid claim is to be paid. There is no reason why the burden of the risk of insolvency should fall on the policyholder rather than on any

---

Companies, 110 Williams St. N.Y., N.Y., American Insurance Assoc. 120 S. La Salle St., Chicago, Ill., Institute of Life Insurers, 488 Madison Ave., N.Y., N.Y. Representatives from these groups are the primary spokesmen in legislative matters. Other important spokesmen include various legislators in the General Assembly who are sympathetic toward the industry viewpoint.

[14] See Holderman, *supra* note 11.

[15] Spokesmen for the policyholders include certain legislators sympathetic toward their plight. Included in this group of legislators is Rep. Anthony Scariano (D-Park Forest), an advocate of tighter controls over the industry, and one who is actively seeking means to prevent insolvency. Another interested legislator, who sits on the House Insurance Committee is Rep. Cecil A. Partee (D-Chicago), who intends to introduce legislation establishing an insolvency fund. Still another state assemblyman, Rep. Philip C. Goldstick (D-Skokie), pointed out the possibility of a reinsurance fund. He added, however, that much research and investigation is necessary to examine the advantages of such a plan. Other legislators in both houses are concerned as well, but mention cannot be made of all of them. Another spokesman for the public (in general) is the Better Government Association, which is concerned with the government's part in regulation of the industry.

other group. Laws should be enacted to protect the policy buying public from their current plight. Moreover, the current number of insolvencies is serious enough to require action now.

AUTHORITATIVE RECOGNITION OF THE PROBLEM

Curative steps have already been taken to aid in the prevention of insolvencies. However, no method of relief has been established to aid the victims of this problem.[16] Illinois has moved to correct this oversight. On June 23, 1965 the Illinois Director of Insurance, J. F. Bolton Jr., announced the appointment of a committee to serve as an advisory board to the Department of Insurance.[17] Secondly, the Department of Insurance sponsored a legislative program during the recent session of the General Assembly which had as its purpose the strengthening of the insurance laws, particularly in the problem areas mentioned above, and the correcting of discrepancies which had come to the Department's attention. The 74th Illinois General Assembly passed many of these bills, thus tightening regulation of the industry and furthering the public policy of protecting the policyholders.

The most significant addition is a new provision which establishes rigid standards in the formation of new companies. A sound plan of operation must be presented in advance to the Director of Insurance who must be satisfied that the experience and background of the people involved in the company is such that a reasonable promise for a successful operation can be predicted. Failure to comply would result in the suspension or revocation of the company's existing certificate of authority.[18]

Another important change in the law is an increase in capital requirements. To start a new life insurance company which is also authorized for accident and health business, a $900,000 capital and surplus reserve will be required as opposed to the former amount of $450,000. The statute further provides that a multiple line company for fire and casualty must

[16] Improved regulations, and legislation now being enforced in most of the United States, aid in the prevention of insolvencies. Each state has minimum reserve requirements, and procedures to examine financial statements and to license agents and brokers. It would be groundless to cite all of the fifty insurance codes in as much as each state has the same basic controls that vary only in the mechanics of accomodating the individual states. However, no state, so far as can be ascertained, has specific legislation providing for relief to insolvency victims. Such legislation would be an innovation.

[17] *Illinois Information Service News Release* (June 23, 1965). For a list of the members' association or affiliation, see *supra* note 6.

[18] ILL. REV. STAT. ch. 73, § 767.4 (1965). It is unlawful for any company to engage or to continue in the business of issuing insurance without first procuring from the Director of Insurance, a certificate stating that such company has complied with the requirements of the Insurance Act.

have a capital and surplus reserve of $1,500,000, as opposed to the former amount of $900,000. At the same time, the rather complicated sections of the statute formerly dealing with minimum capitalization have been greatly simplified.[19]

It is suggested that other important changes which will strengthen the regulatory program include the following: revocation or suspension of the certificate of authority of a foreign company without advance notice if it is in bad financial condition or is insolvent;[20] more serious penalties for failure to keep books properly posted or to comply with the orders of the Insurance Director.[21]

Finally, the Director may occasionally require supplemental summary statements which are certified by independent certified public accountants whose services may be retained by the Director.[22]

POSSIBLE REMEDIES

To eliminate some of the major causes of insolvency, the possible remedies include more realistic reserve and surplus requirements on the part of companies having casualty risks;[23] more stringent reporting to the state auditors in order to receive more accurate financial reports; more audits with increased auditing staffs to accomplish this; greater penalties for the purpose of deterring fraud; and greater authority in the Insurance Director to enjoin companies from doing business when it appears that the company is not sound.[24]

To relieve those affected by the insolvencies that will not be eliminated, a new safeguard must be established to assure the payment of all valid claims. This safeguard can be either a policyholder-funded insolvency

[19] ILL. REV. STAT. ch. 73, §§ 625, 655, 678, 711 (1965).

[20] ILL. REV. STAT. ch. 73, § 674.4 (1965).

[21] ILL. REV. STAT. ch. 73, §§ 744 and 745 (1965).

[22] ILL. REV. STAT. ch. 73, § 748 (1965).

[23] A company organized under Illinois law shall have and at all times maintain a capital amount which shall not be less than the minimum capital requirement applicable to the particular type of business, e.g. life, casualty, or fire, in which it is engaged.

[24] To create greater assurance that a company is, and will continue to be, financially sound, more reserves are necessary. The present amounts should be raised significantly. The annual statements should include more detailed information so that an accurate financial picture can be given the auditors. Information might well include the number of claims filed, disposition of pending claims, the number of court cases pending and the amount of each claim, with the approximate amount expected to be paid on each claim. The Director should not approve any declaration of organization or articles of incorporation or issue a certificate of authority to any company until he has found a sound plan of operation, reliable individuals involved in the operation, and a reasonable expectation of success.

fund to assure payment,[25] a payment from the general state revenue fund,[26] or a trade association reinsurance fund.[27] Each of the safeguards has the advantage of security of payment, but there are disadvantages as well.

Use of a general state revenue fund would be an arbitrary tax on all people in the state, without regard to their participation in the insurance program, and as such, it would not be acceptable. The major objection to the trade association reinsurance fund is the effect of diminished competition within the industry because each participating company would be acting as an insurer for the others.

It is suggested that the most effective safeguard would be the policyholder-funded insolvency fund. This fund would not only assure payment of all valid claims but would also avoid placing any burden on taxpayers in general who have no interest in protecting the insured and who would be unreasonably taxed. This plan would also avoid the effect of diminishing competition in as much as no company would be involved directly by the failure of any other company. Furthermore, adequate controls can be effectively exercised by the Department of Insurance under this plan.

The plan should be established by state legislation and its purpose should be to assure payment of valid claims of faltering insurance companies which have been licensed to do business in Illinois. The fund should be financed by a fee assessed against each policy issued by the companies deemed to come under the plan by the Director of Insurance. A company would come within the funding plan whenever it failed to pay an established percentage of claims filed within a reasonable time. Monies in the fund should be invested for growth by an administrator of the fund, who should be a member of the Insurance Department. Investment should be allowed and regulated exactly as the investment of funds of any insurance company is allowed. The gains would defray the costs of administration and increase the fund, which would provide greater stability and security.

To avoid the burden of higher rates to those policyholders affected, there should be a refund of the fee upon the lapse or termination of a policy, so long as the amount remaining in the fund is adequate and at an estab-

[25] A policyholder-funded insolvency fund is a fund made up of assessments on insurance policies issued by companies doing business in Illinois.

[26] Payment can be made to claimants of insolvent insurance companies directly from the general revenue fund of the State of Illinois. The fund is composed of revenues derived from the general taxes collected by the state that are not earmarked for any particular fund.

[27] A reinsurance fund is composed of monies contributed jointly by companies in the industry taking part in the plan, for the benefit of any failing company.

lished level, and the insurance company is not insolvent. If the company is insolvent, no refunds for its policyholders would be allowed, and if the fund was inadequate to allow a return, a record of the application for rebate would provide a basis for reimbursement when the fund reached the required level. Priority would be given in accordance with the time of application.

CONCLUSION

The prospects for passage of such legislation are remote in view of the industry's organized lobby and fervent opposition to such a measure. Legislators are reluctant to pass legislation without support when the opposition is both strong and vocal. But, when over 500,000 policyholders are in jeopardy of loss due to the insolvency of insurance companies doing business in Illinois, it is suggested that the state must act to protect its policyholder citizens.

Michael Jordan