

**IBNR value in US insolvencies: IN RE: INTEGRITY INSURANCE COMPANY, Superior Court of New Jersey Appellate Division, United States, 2 October 2006**

The State of New Jersey Appellate Court ruled that the final dividend plan (“FDP”) proposed by the liquidator for Integrity Insurance Company (“Integrity”) was invalid in part because incurred but not reported (“IBNR”) claims were improperly included in the valuation of claims by its policyholders.

As background, Integrity wrote umbrella and excess liability insurance policies which covered long-tail liabilities prone to significant IBNR. These underlying policies were reinsured by various companies. In 1987, Integrity was placed into liquidation with over 26,000 policyholder claims filed. The liquidator allowed US\$598,000,000 in paid claims and an estimated liability of US\$2,055,335,000 in respect of claimants who had not presented specific losses. Under the FDP, the Liquidation Court could approve claims for IBNR which were deemed to be absolute and which had been determined by qualified personnel employing certain standard practices and procedures. The liquidator for Integrity successfully obtained the lower court’s permission to approve the FDP.

The Reinsurance Association of America (“RAA”) challenged the lower court’s holding which permitted the liquidator for Integrity 1) to estimate IBNR claims for policyholders on an actuarial basis and 2) to compel Integrity’s reinsurers to pay the computed IBNR sums in accordance with the FDP.

The RAA argued 1) that IBNR losses did not constitute a “claim” within the meaning of the relevant insurance and reinsurance policies nor within the Insurer Liquidation Act (“ILA”) (which governs the liquidation of insolvent insurance companies in New Jersey), and 2) that IBNR losses can never meet the conditions precedent to payment imposed by the ILA.

Under section 17:30C-28A of the ILA, a claimant making a contingent claim can only share in the distribution of the assets of an insolvent estate if it is deemed to be an “absolute” claim against the insolvent company. The court considered the dictionary definition of the term “absolute”

which is defined as, “free from restriction, qualification, or condition; conclusive and not liable to revision”. It held that IBNR claims are actuarial estimates and are, therefore, not absolute. Thus, the statute prohibits IBNR claims from sharing in the estate.

The exception under section 17:30C-28b of the ILA provides that a contingent claim may be admitted into the estate if the claimant would be able to obtain a judgment in respect of the claim against the estate. However, the court held that IBNR could not fall within this exception since, by its very nature; IBNR represents bulk claims of all potential claimants and demonstrates only that historical experience suggests the insurers might have to pay an amount approximated actuarially. Therefore, the court refused to admit IBNR claims as an established claim in an insolvent estate where the losses were not capable of being sufficiently ascertained to reduce to a judgment.

Lastly, the court considered testimony from industry experts which unanimously confirmed that the IBNR estimates would not achieve “100 percent accuracy”. It observed that: “IBNR estimates in the industry are limited to voluntary agreements relating to matters such as mergers and acquisitions, extensions of credit, selling reserves, and filing tax returns.”

Accordingly, the court held that IBNR claims could not share in any final distribution from the Integrity estate. While the liquidator has substantial discretion in choosing a mechanism for closing the estate (ie, the FDP), the court held that she could not select one which contravened the plain language of the ILA. The court determined that the provisions of the FDP permitting the use of IBNR losses were invalid.

### **Comment**

The New Jersey Court’s decision in this case is contrary to the movement in the UK to promote the closure of solvent and insolvent estates. For example in the UK, companies in a scheme will often receive a court sanctioned crystallization of the creditors’ claims. In particular, this

valuation process by the scheme administrator will include case reserve and IBNR totals where appropriate. In this case, it is suggested that US courts are not sympathetic to creditors of an estate carrying balances attributable to IBNR. A practitioner in this industry would be wise to negotiate a commutation with insolvent estates in the US before a court or liquidator decides that a final dividend will include no value for IBNR claims.

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