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## AIG: TIME TO EVALUATE, NOT PANIC

By Robert D. Chesler and Michael David Lichtenstein

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**Many of our clients wonder if, and how, the meltdown of AIG will affect them. The situation with AIG is unprecedented, and answers for many questions simply do not yet exist.**

**We address here some of the most common concerns.**

AIG is a highly complex business organism. Most clients do not deal with the parent company, which is the entity that has the current problems, but rather with the individual insurance company subsidiaries, such as National Union, American Home and Commerce & Industry. We have seen no reports that the individual AIG insurers are under-reserved or have other problems. As far as we know, they are operating in "business as usual" mode.

We do not know if the potential bankruptcy, or actual future bankruptcy, of the parent would affect the status of the individual insurance companies. However, state regulations make the assets of the individual insurance companies all but untouchable, regardless of the parent company's financial needs.

Insurance companies do not enter bankruptcy. When a state department of insurance determines that insolvency exists, an insurance commissioner has two options. First, the commissioner can place the insurance company in rehabilitation. For example, this can happen if the insurer's problem is cash flow instead of net worth. Under rehabilitation, the insurer does not write new business and is protected from litigation so that it can marshal its assets in the hope that it can come out of the insolvency and resume operations. This seldom happens. The other option is liquidation. In that situation, the insurance commissioner appoints a liquidator to wind down the insurer's business. That winding down can take 20 to 30 years and can result in payments over time on claims to policyholders. The ultimate amount received by the policyholders is dependent on numerous factors, including whether the company adequately reserved its liabilities and can access reinsurance.

Every state has a guaranty fund to protect policyholders from insurer insolvency. Many of these funds (not in New Jersey) limit recovery to

individuals and to corporations whose net worth does not exceed a statutorily set maximum. Our general experience is that guaranty funds are more interested in protecting their resources than in paying claims. Moreover, the AIG companies provide such a huge amount of insurance that their insolvency could hinder the ability of guaranty funds to cope.

Many contracts of all sorts require that a party to the contract have insurance with an insurer that has a certain rating, for example, 'A' or better. Several companies, such as A.M. Best and Fitch, rate insurance companies. As of now, all the AIG insurance companies are highly rated 'A' or better. Our impression is that the rating agencies tend to lower ratings promptly upon receipt of bad news, since they have been sued in the past for changing ratings too late, resulting in losses by policyholders. We have begun monitoring these ratings on a daily basis.

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Reportedly, many companies are considering switching their insurance from an AIG company to another insurer. Companies can change insurers at the end of the policy period, and can also try to cancel insurance in the middle of the policy period and seek a replacement. Such cancellation may be controlled by the terms of the insurance policy or by state regulation. However, as AIG is the dominant insurer in many lines of business, finding replacement coverage may be difficult. If changing insurers, a company should work with its insurance broker or consultant to avoid gaps in coverage.

Finally, there could be the equivalent of a bank run on AIG, with numerous policyholders either canceling or non-renewing. Such a run could diminish the AIG insurers' capital flow sufficiently that it could produce action by rating companies or the state regulators. Although this risk is real, there is no evidence that a "run" is actually occurring at this time.

In sum, there are many issues to be addressed and we are available to help you work through your questions and concerns.

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