2011 Runoff Symposium

Welcome and Opening Remarks by Larry Schiffer and John S. Pruitt

Left: Dewey & LeBoeuf's Larry Schiffer and John S. Pruitt, Insurance Regulatory Department

Transferring Legacy Liabilities – New Methodologies and Techniques

By Bina T. Dagar

Speakers: *Evan D. Bennett*, Director, Reinsurance Consulting, Blackman Kallick LLP, *Brian Fannin,* Senior Vice President, Swiss Reinsurance America Corp., *W. Michael Flaharty,* Managing Director, FTI Consulting.

At the Runoff Symposium hosted by Dewey LeBoeuf, an impressive panel of experts discussed four areas of retroactive reinsurance:

1. What is retroactive reinsurance?
2. What are the statutory accounting considerations of retroactive reinsurance?
3. What other options are there to address legacy?
4. When should one think about legacy?

Following is a brief summary of the salient points discussed by the panelists.

- Retroactive reinsurance protects an entity from financial loss from claims which have *already occurred* but which have not yet been resolved. This typically covers for loss reserves on multiple historical accident or underwriting years. There is latitude in structuring the cover with a horizontal or vertical split of risks.
- In its earliest incarnation, retroactive reinsurance was used to discount loss reserves. No underwriting risk transfer was present, and losses were known with virtual certainty. This benefited the transferring party that released its "trapped" reserves and bolstered its policyholder's surplus. The NAIC responded with the introduction of a new accounting treatment (SSAP 62), whereby the reinsurer must assume significant insurance risk and must understand that a significant loss may be realized from the transaction in order for it to qualify as an insurance contract.
- Other options available are as follows:

  a. *Adverse Development Cover,* which indemnifies loss reserves above a certain threshold; cover may attach below the company's carried reserves.

  b. *Novation*, whereby the company may effect a full release of liability without having to conduct retroactive accounting.

  c. *Portfolio Transfer* is Part VII mechanism in the U.K. Its analogous option in the U.S. is SSAP 62R. Effective January 1, 2010, the NAIC permits companies to book certain retroactive transactions using the same rules that apply for prospective accounting.

  d. *Entity Purchase*, which allows a full release of liability and the assumption of all administrative function by the acquiring party.
- Legacy matters when a company is seeking a *strategic reorientation* such as the desire to exit a business line or market; to suspend operation through either closure with legal finality or hibernation of an alternative risk retaining entity such as a captive; or to attain economic finality in an M&A context.

An entity may consider legacy to achieve *operational*

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Left: Evan D. Bennett, Blackman Kallick LLP, W. Michael Flaharty, FTI Consulting, Brian Fannin, Swiss Reinsurance America Corp.

efficiency through a reduction in administrative expenses, compliance costs and claims handling costs; a replacement of its internal retrocession agreement; a consolidation of its multiple operating entities; or a relief from collateral costs.

Legacy allows an entity to *manage capital* by protecting it against adverse developments; by making risk capital available for growth or acquisitions; by managing rating agencies' pressure especially when the outlook is negative; and by stabilizing earnings against volatility from reserves.

The panel discussed captive runoff considerations. Everyone knows the popular domiciles of Bermuda and the Cayman Islands, however, more than half the states in the U.S. allow captive domiciles now. In the past, captives were mostly used for basic needs to front specific lines of business. Today, they have evolved into more developed and complex vehicles. A variety of reasons exists for a company to exit the captive market. As with the non-captive business, an entity may wish to strategically reorient itself or to recover capital. The entity may want to repatriate elsewhere, either offshore or in another state. Or it may exit to gain finality.■

Rhode Island's Voluntary Restructuring of Solvent Insurers Law: An Insider's View

By Frederick J. Pomerantz, Wilson Elser Moskowitz Edelman & Dicker LLP

On April 25, 2011, the Rhode Island Superior Court granted a motion by GTE REinsurnace Company Limited ("GTE RE") to implement a commutation plan for an accelerated closing of the business of the still-solvent U.S. reinsurance company without a lengthy runoff or liquidation. GTE RE is the first Rhode Island company to use the 2002 Voluntary Restructuring of Solvent Insurers law, codified as Rhode Island Chapter 27-14.5-1 *et. seq*. (the "Statute").

In a joint presentation before the Runoff Symposium, Andrew Rothseid, principal of RunOff Re.Solve LLC, the commutation plan advisor for GTE RE and Gary S. Lee, a partner of Morrison & Foerster LLP, counsel for the Rhode Island Department of Business Regulation ("DBR") in connection with the GTE RE runoff plan (the "Plan"), offered an insider's view of how Rhode Island's Voluntary Restructuring of Solvent Insurers law works. Mr. Rothseid and Mr. Lee discussed the background, purpose and benefits of the Statute, the steps that were involved in preparing the Plan for filing, the respective roles of the Superior Court and the DBR, the lessons learned from the Plan and developments in solvent scheme practice. [*See also,* Andrew Rothseid's article entitled *The Rhode Island Solution,* page 18].

The Rhode Island statute is unique in that no other state statute expressly and transparently permits solvent runoff. It closely models the Companies Act in effect in the United Kingdom and Bermuda, which permits closure through a "scheme of arrangement." Under U.K. and Bermuda law, a deal is agreed between an insurer and its creditors in which the insurer pays 100 percent of the net present

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