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AIRROC matters

LEVERAGING LEGACY LIABILITY

International Insurance Diplomacy

BREXIT: RUN OFF NIGHTMARE? · YOU'RE "COVERED" · ELENI ON LEGACY • REG. 68 REDUX
HAIL ALDRIDGE · TRAINING TEAMWORK · 50 SHADES OF AIRROC • RITES OF SPRING

A Touch of Spring

Peter A. Scarpato

It's probably no coincidence that I sat down to pen my notes on the first gorgeous spring day in Philadelphia. Like AIRROC version 2017, the day is full of warm promise and renewed energy, a renewal that arrived just in time to address seismic shifts in U.S. politics and regulations, EU and UK relations and the threat of armed conflict in the Far East. Let others worry about geopolitics and war while we tackle the other themes.

The first "mini-section" contains two articles which cover the impact on run off of the UK's historic 2016 decision to exit the European Union ("Brexit") and the surprise announcement of a joint agreement between the EU and U.S. to govern insurance and reinsurance transactions, issued under the auspices of the Dodd Frank Act ("Covered Agreement"). Frank Schmid's *Brexit Implications for the Run Off Business* is an in-depth analysis of financial, industrial and regulatory changes resulting from the UK vote and what they hold for the future of our beloved industry. Next, Fran Semaya presents *Does Covered Mean Equal?*, a fascinating look at how coordination among the U.S. Treasury, the U.S. Trade Representative and European Union produced the Covered Agreement, which works to achieve several objectives related to reinsurance and "prudential group supervision." It may not, however, grant U.S. reinsurers "equivalence," subjecting them to the regulatory rigors of Solvency II.

Everyone enjoys a good miniseries, and at AIRROC we aim to please. In her first of three articles, *The Legacy Market*, Eleni Iacovides gives us a historical perspective of the early days of run off in Continental Europe. Her next two articles will compare European and U.S. run off methods and culminate with an examination of where we are two years out from Rhode Island's IBT. With that theme in mind, we present another miniseries of sorts with two pieces reminding us once more of the workings and potential impacts of New England's now two-year old foray into the world of novel run off legislation. Al Bottalico and Jonathan Bank's *Rhode Island Regulation 68* gives us the statute's nuts and bolts and Connie O'Mara and Al Bottalico interview regulators Jack Broccoli, Elizabeth Dwyer and Christopher Brennan in *Is Reg. 68 Good for the Industry?*, exploring the law's impact on business and policyholders both inside and outside the state.

Yes, it's still a people business. And one of the best and most interesting is Susan Aldridge, AIRROC's counsel and the feature of this issue's "Spotlight." See how Susan's work in white collar defense, child custody law and legal academia led her to her current position. And we're always *Learning About Legacy,* the aptly named article presenting Barbara Hadley's discussion with Ben Baker, Head of the IRLA Academy and our own ED Carolyn Fahey. Carolyn picks a unique choice from her menagerie in *An AIRROC Chameleon?*, illustrating the changing palette of events from NJ October 2016 through early spring and beyond.

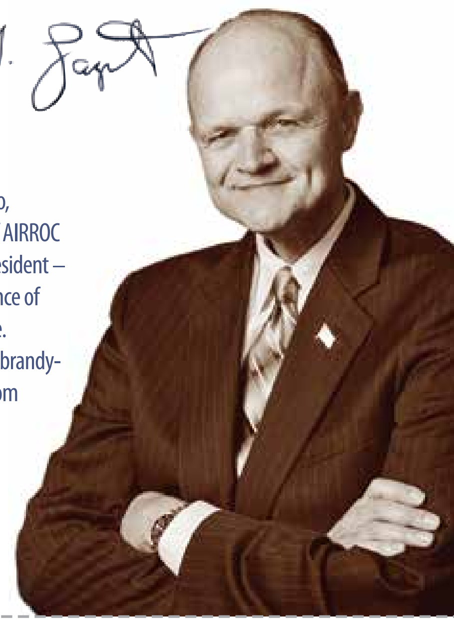
Finally, we finish up with a trio of treats: a summary of presentations at our rescheduled *2017 Spring Meeting,* Connie O'Mara's book review on *The Iskaboo Guide to Part VII Transfers,* and of course Present Value.

Whew! So much has happened and will continue as AIRROC remains vital and vibrant in the run off arena.

Let us hear from you. •

ERRORS AND OMISSIONS

In the Index of the Winter 2016-2017 AIRROC Matters, Bill Flaherty was referred to as, "AIRROC Person of the Year 2015" when it should have been for the year 2016. It appeared elsewhere in the magazine with the correct year.



Peter A. Scarpato, Editor & Chair of AIRROC Matters, Vice President – Ceded Reinsurance of ACE Brandywine.
peter.scarpato@brandywineholdings.com

AIRROC matters

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illustration / Rafael Edwards

Brexit Implications for the Runoff Business

A Macroeconomic Perspective

On June 23, 2016, the United Kingdom held a referendum on membership in the European Union (EU), which the country had joined in 1973. As a surprise to many, the referendum resulted in a majority favoring an exit. The Brexit vote prompted a change in political leadership in the following month, with Theresa May being appointed Prime Minister. On March 29, 2017, the United Kingdom triggered Article 50 of the Treaty of Lisbon, which offers the UK two years to negotiate the terms of the exit and the ground rules for future cooperation before the country leaves the EU.

The pending departure of the UK from the European Union affects the run-off industry in multiple ways. For one, the new steady state of the UK regulatory environment and the path toward it are unknown, generating uncertainty around the business model of the UK financial services industry, in particular as it pertains to cross-border transactions. Further, more than four decades of EU membership have given rise to an industrial structure that will have to adjust to a material realignment in exchange rates, increased uncertainty regarding terms and conditions of access to world markets for goods and services, and reduced access to foreign labor. Finally, there are questions around the unity of the United Kingdom, considering that Scotland and Northern Ireland (unlike England and Wales) voted to remain in the EU.

Chart 1 depicts the movement of the effective exchange rate of the pound sterling around the Brexit vote (vertical line). The effective exchange rate is an index comprised of the currencies of major UK trading partners, weighted by trading volume. Starting with an initial drop of 6.7 percent, the UK currency has lost 12.4 percent (as of March 1st, 2017) of its value since the referendum. All else being equal, the depreciation of the pound sterling improves the UK price competitiveness in world markets, although the effect may not be as strong as in the past due to a generally increased foreign share in the production chain of exports. The currency depreciation also generates inflationary pressure, which contributes to the inflation risk premium.

The change in the UK industrial structure in response to an exit from the EU is likely to be both profound and protracted. Most importantly, the UK economy will have to adjust to new ground-rules for international commerce. Upon exiting, the UK may not qualify as a member of the European Economic Area (EEA), a status currently enjoyed by non-EU members Iceland, Liechtenstein, and Norway. EEA membership would not only provide the UK with continued access to the Internal Market, it would also allow the country to continue to benefit from trade deals that the EU has struck (and will strike) with the rest of the world. Fundamental to EEA membership are the principals of (1) the free movement of goods, (2) the free movement of services and freedom of establishment, (3) the free movement of persons (and citizenship), including free movement of workers, and (4) the free movement of capital. Restricting access to the UK labor market was a major Brexit campaign item and ranks high on Theresa May's agenda (*The United Kingdom's exit from and new partnership with the European Union*, Presented to Parliament by the Prime Minister by Command of Her Majesty, February 2017) — controlling immigration ranks fifth out of twelve goals. It is thus unlikely that the UK will be granted EEA status. Without EEA membership, the UK is destined to resort to WTO (World Trade Organization) rules, which establish the most-favored nation (MFN) principle for the exchange of goods and services and for trade-related protection of intellectual property rights. The UK will have to supplement the WTO framework by an array of bilateral trade deals that may take decades to negotiate. As pointed out by the Lords Select Committee (*European Union Committee Brexit: the options for trade*, December 17, 2016) in regards to Switzerland, which is not an EEA member country, "[o]ver the last *two decades*, Switzerland and the EU have negotiated

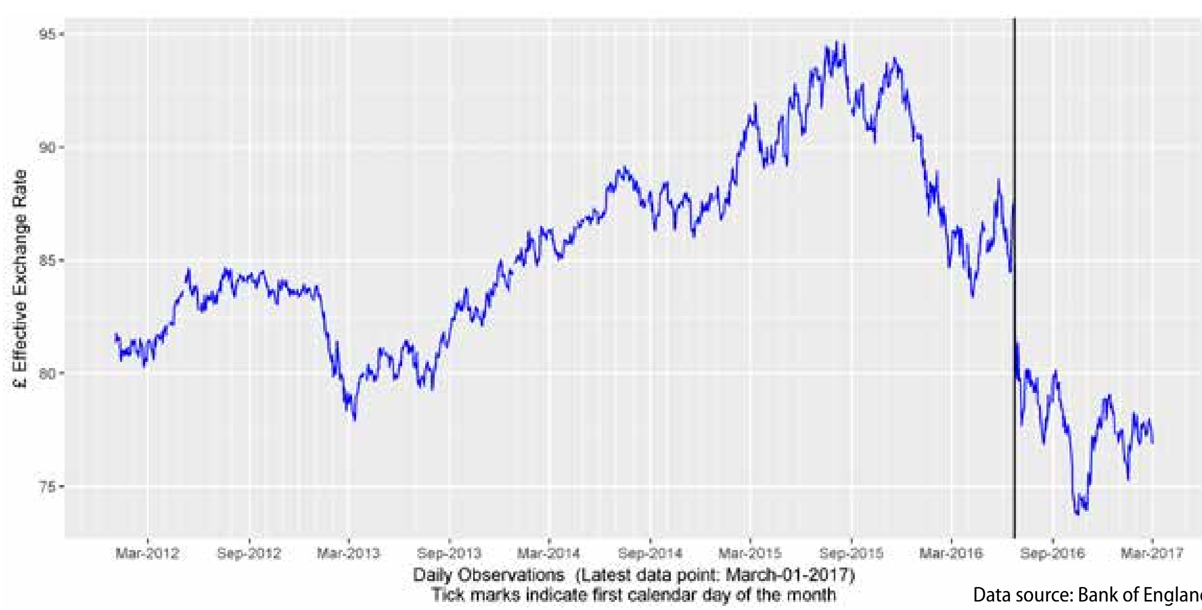
The change in the UK industrial structure in response to an exit from the EU is likely to be both profound and protracted.

a bespoke bilateral arrangement which encompasses over 100 individual agreements." (italics added).

Upon separation from the EU, the UK may seek to maintain Solvency II equivalence and the right to passport into the EU. What is more, the UK may aspire to have passporting privileges expanded to other industries and have these privileges made hard to revoke. Although such enhanced equivalence may ultimately preserve unencumbered Internal Market access for UK-domiciled insurers (and for non-UK-domiciled insurers that access the EU through the London market), the current state of uncertainty may encourage insurers, including run-off carriers, to act proactively and establish subsidiaries in the EU. Notably, in March 2017, AIG declared its intent to write EU business out of Luxembourg, and Lloyds of London announced to set up a European Union subsidiary in Brussels, Belgium. In the event of the UK forgoing Solvency II equivalence status (and thus losing its passporting privileges), the UK insurance industry may experience significant restructuring as it adjusts to a new (and yet unknown) regulatory regime. According to the *Financial Times* (February 26, 2017, "Brussels sets out tough new line on equivalence") the European Commission, in a "staff working document," has laid out strict conditions for countries seeking and maintaining Solvency II equivalence, including the right of the EU to "on-site" inspections of foreign companies and "effective access to data."

In the near term, the run-off industry deals with a high degree of uncertainty regarding the future regulatory environment and the prospective structure of the UK economy. This uncertainty, to the extent that it cannot be eliminated by means of diversification, manifests itself in risk premiums. Although such risk premiums may add to the supply of run-off portfolios as insurers adjust the business, these premiums may also contribute to the costs of run-off transactions. Further, uncertainty

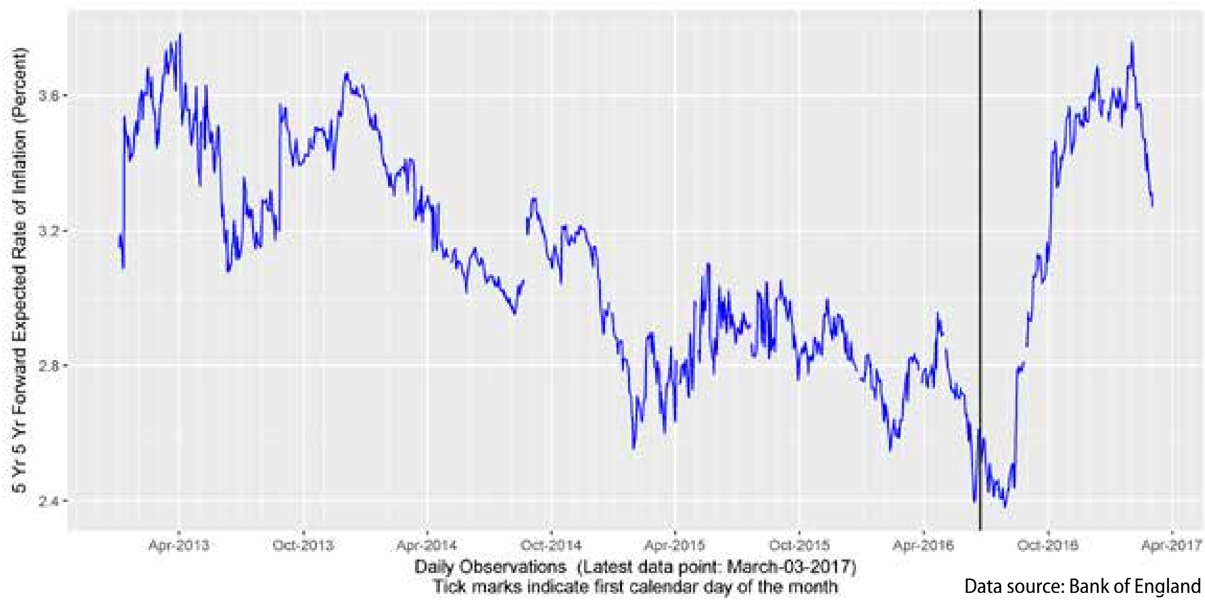
Chart 1: Brexit Vote and Pound Sterling Effective Exchange Rate



Data source: Bank of England

Brexit (continued)

Chart 2: UK Long-term Inflation Expectations



Data source: Bank of England

creates value to waiting in investment decisions where such decisions create irreversibilities and knowledge about the future state of nature arrives over time. This value of waiting is the result of a real option as uncertainty accords value to optionality. The value of waiting subtracts from the net present value of run-off transactions that can be deferred to a future point in time where some (or all) of the uncertainty has been resolved.

Among possible risk premiums are interest rate and inflation risk premiums. Run-off portfolios are long-tail in nature and thus greatly affected by uncertainty about future rates of interest and inflation. Inflation, due to its high degree of persistence, has a highly-leveraged effect on the payout of long-tail portfolios. If the run-off carrier has less ability to eliminate inflation risk than the original writer, then run-off transaction become less attractive, all else being equal.

Chart 2 depicts the five-year forward expected rate of inflation for the UK—this is the rate of inflation that is embedded in nominal and inflation-indexed UK sovereign bond yields and is expected to prevail (on average) during the five years starting five years from the present time. Initially, long-term inflation expectations dropped following the Brexit vote (vertical line), as the bond market anticipated an economic slowdown in response to increased economic uncertainty. Then, when in early October Theresa May criticized the Bank of England for policy actions it had taken during the Global Financial Crisis, concerns about central bank independence became predominant and, as a result, inflation expectations rose sharply. Although long-term inflation expectations have stabilized more recently, the gauge remains well above the Bank's stated 2 percent inflation target.

In the long haul, the run-off industry is likely to benefit from a change in industrial structure and the concomitant reallocation of capital across the financial and non-financial sectors.

In the long haul, the run-off industry is likely to benefit from a change in industrial structure and the concomitant reallocation of capital across the financial and non-financial sectors. However, the high degree of uncertainty about the future structure of the UK economy, the terms and conditions of access to world markets and foreign labor, and the regulatory regime that will govern the insurance industry generates value to waiting in the present time. This way, uncertainty subtracts from the economic value of run-off transactions as irreversible investment decisions that can be postponed to future points in time at which some of the current uncertainty has been resolved. ●

Frank Schmid,
Head of P&C Inforce Management, Commercial and Legacy, AIG.
frank.schmid@aig.com

Does Covered Mean Equal?

EU and U.S. Bilateral Agreement on Insurance and Reinsurance

Francine L. Semaya

On January 13, 2017, the Secretary of the Treasury ("Treasury"), the U.S. Trade Representative ("USTR") and the European Union ("EU") took the industry and regulators alike by surprise when they issued a press release announcing the completion of negotiations and the finalization of the "Bilateral Agreement Between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance (the 'Covered Agreement')."

Background

When the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") was adopted in 2010, it created a new office, the Federal Insurance Office ("FIO"), within the U.S. Treasury Department. The FIO does not have general supervisory or regulatory authority over the business of insurance, clearly leaving the regulation of the business of insurance to state regulation. In addition to the specific roles FIO is authorized to play under Dodd-Frank, FIO is specifically authorized, along with the USTR, to negotiate and enter into Covered Agreements, a term created under Dodd Frank.

The Dodd-Frank Act provides that "The Secretary and the United States Trade Representative are authorized, jointly, to negotiate and enter into covered agreements on behalf of the United States." (31 U.S.C. § 314). The Act then states that a "Covered Agreement" is a written agreement between the U.S., a foreign government(s), or regulatory entity(ies), concerning "prudential measures" with regard to the business of insurance and reinsurance and protects insurance and reinsurance consumers to a level that would be "substantially equivalent" to the protection afforded under state insurance regulation. (See, U.S.C. §313(r)).

Covered Agreements are not considered to be treaties and therefore technically do not need the approval of Congress. They are, however, required to be submitted to certain Congressional committees and cannot become effective until after 90 days from the date on which the final version is submitted to Congress. Although a Covered Agreement does not need Senate confirmation as does an international Treaty, Congress can amend or reject the Covered Agreement within the 90-day period, otherwise the Covered Agreement becomes effective on the 91st day. Likewise, the EU must file the Covered Agreement with the Council of the European Union and the European Parliament and it must be formally signed to make the Covered Agreement effective.

Why the need for a Covered Agreement and the urgency to get the agreement finalized as soon as possible following the November 2015 announcement? The U.S. insurance industry feared the implementation of Solvency II, which

Covered Agreement (continued)

was to become effective January 1, 2016. The EU had not, as of the date of the announcement of the intent to enter into negotiations, granted "equivalence" to the U.S. and therefore U.S. insurers and reinsurers doing business in the EU would be subject to additional strict regulatory requirements under Solvency II. The NAIC and state regulators insisted that the capital and reinsurance requirements under the current state regulatory scheme should be enough to grant "equivalence" to the U.S. and therefore concluded that a Covered Agreement was unnecessary.

One of the major concerns preventing the EU from granting equivalence was the reinsurance collateral requirements mandated by state insurance laws. Following over 10 years of negotiation and drafting, in 2012 the National Association of Insurance Commissioners ("NAIC") amended the Credit for Reinsurance Model Law and Model Regulation to reduce collateral required by certified reinsurers to be posted for U.S. assumed risks. As of today, 35 states have statutes that incorporate the language of the NAIC Amended Credit for Reinsurance Model Law or wording that is substantially similar and 29 states have adopted the Regulation. These states represent 69% of the direct written premium in the U.S. for all lines of business. These amendments provide that certified reinsurers do not have to post 100% collateral as in previous years, but depending on certain factors, some collateral is still required to be posted by non-U.S. reinsurers. Because of the U.S. collateral requirements and certain governance differences, which exist because of the U.S.'s state-based regulatory system, the EU refused to consider the U.S. as a jurisdiction that had an "equivalent" insurance regulatory scheme as the countries in the EU. As a result, after Solvency II became effective, U.S. insurers and reinsurers became subject to restrictions impacting their business in EU countries. Reinsurers were required to meet local presence requirements, post collateral, and face other restrictive measures. Despite the cries of the state regulators, the Covered Agreement was to become the vehicle to allow the U.S. insurance regulatory system to be considered "equivalent" to the insurance regulatory system in EU countries. The question remains whether the Covered Agreement in fact "grants" equivalency to the U.S. insurance regulatory system.

Why the need for a Covered Agreement and the urgency to get the agreement finalized as soon as possible following the November 2015 announcement?

Negotiating the Covered Agreement

The FIO, acting under the direction of the Treasury, and the USTR jointly advised Congress, in a written letter dated November 20, 2015, that negotiations were to begin to enter into a covered agreement between the U.S. and EU. The discussions began in February 2016 and meetings were held in July, May, September, and December of that year. Following the December 2016 meeting, the industry was left with the impression that little progress had been made. Imagine the surprise of the industry and the state regulators when on January 13, 2017, the Treasury and the USTR announced that an agreement had been reached between the U.S. and the EU and the final Covered Agreement had been forwarded that day to the Congressional committees as required under 31 U.S.C. § 313(c)(1). Additionally, the U.S. and EU issued a joint statement that provided that the Covered Agreement "will ensure ongoing robust insurance consumer protection and provide enhanced regulatory certainty for insurers and reinsurers operating in both the U.S. and the EU."

The Covered Agreement

The Covered Agreement addresses three areas of reinsurance and prudential group supervision issues. One key issue that the Covered Agreement does not address is "equivalence." Nowhere in the Covered Agreement does it state that U.S. compliance with the provisions of the Covered Agreement will be equivalent to granting "equivalence" to the U.S. under Solvency II. It is clear, however, that if either party to the Covered Agreement fails to comply with the terms of the Agreement, then the other party is not required to comply—which would leave both parties in the same place as they are now. The Treasury describes it as follows:

> [T]he United States would not be required to implement the Reinsurance collateral elimination provisions…if the EU fails to comply with the terms of Agreement on group supervision and local presence. Similarly, the EU could re-apply Solvency II group supervision

requirements to U.S. insurers worldwide operations if the United States does not complete the necessary reinsurance reform within five years.

Reinsurance

1. Reinsurers will not have to establish local presence in either jurisdiction;

2. EU reinsurers will not have to post any collateral in the U.S. and U.S. reinsurers will not have to post collateral in EU countries, provided the reinsurers meet requisite capital and surplus ($250 million US; €225 million);

3. Reinsurers must: consent to jurisdiction in the cedent's home jurisdiction; provide financial reports for the prior two years; demonstrate prompt claim payments practices; and confirm they are not in any solvent scheme of arrangement, receivership, or winding up proceedings;

4. The Collateral provision applies to reinsurance agreements that are entered into, amended, or renewed after the state law becomes effective. It should also be noted that the Covered Agreement allows the parties to a reinsurance agreement to negotiate for collateral.

The Covered Agreement provides that the U.S. has 5 years (60 months) to comply with the terms regarding changes to collateral requirements. If, after 42 months, states have not amended their statutes to be in conformity with the requirements of the Covered Agreement, the FIO will take the necessary steps for preemption in accordance with the rules provided in Dodd-Frank.

It also provides that the EU countries have 24 months from the time the EU signs the Covered Agreement to revise their laws so that U.S. insurers and reinsurers can operate in the EU without having to establish a branch office or a local subsidiary.

Group Supervision

Generally, U.S. insurance groups will be subject to "worldwide" group-level insurance prudential supervision (which includes governance, solvency, capital and reporting requirements) by the state insurance department where the ultimate parent company is domiciled. Likewise, EU insurers doing business in the U.S. will be supervised on a worldwide group level by the insurance supervisor in the country where the ultimate parent is domiciled. It is unclear whether the location of the ultimate parent in either jurisdiction would be the most logical to supervise the entire insurance group. U.S. insurers doing business in the EU will not have to comply with Solvency II worldwide group capital, reporting, or governance standards. The U.S. and EU will still be able to request information about worldwide activities of group insurers that might be harmful to their policyholders or financial stability and take appropriate action, as required. There are certain exceptions whereby the "host supervisors" may exert some level of group supervision. These include the worldwide group Own Risk and Solvency Assessment ("ORSA") and other reporting requirements that relate to a risk that may have a serious or negative impact on policyholders or affect financial stability. Further, if the insurance group is not subject to group capital assessments, then the host supervisor may impose such requirements.

The Covered Agreement provides that the U.S. has 5 years (60 months) to comply with the terms regarding changes to collateral requirements.

Currently Solvency II requires a group-level capital assessment whereas the NAIC is in the process of developing a group capital assessment that would be applicable to U.S. insurance groups doing international business.

The EU member states will comply with the group supervision mandates under the Covered Agreement once the Covered Agreement is signed and the internal approvals for "provisional application" are finalized. This is estimated to take 3 months.

Exchange of Information

The Covered Agreement encourages U.S. and EU insurance supervisory authorities to exchange supervisory information. Attached to the Covered Agreement is an Annex that provides a draft Memorandum of Understanding to be used as a model for supervisory authorities to formalize the procedure for exchange of such information.

Next Steps/Congressional Review

On February 16, 2017, the Congressional Subcommittee on Housing and Insurance held a Hearing on "Assessing the U.S.-EU Covered Agreement," during which a panel of four witnesses provided testimony. The witnesses were: The Hon. Ted Nickel, the current President of the NAIC and

Insurance Commissioner of Wisconsin; Mr. Charles Chamness, President & CEO of the National Association of Mutual Insurance Companies; Ms. Leigh Ann Pusey, President & CEO of the American Insurance Association; and Mr. Michael T. McRaith, Former Director of the Federal Insurance Office.

As expected, there were vastly different views expressed by the witnesses. Whereas Mr. McRaith, in his written testimony, expressed what an important role the U.S. regulators played in the negotiating process, Commissioner Nickels expressed concern over the lack of transparency in the negotiating process. On specific provisions, Mr. Chamness explained that elimination of collateral is a concern to ceding insurers, especially smaller insurers that rely heavily on reinsurance and do not have to ability to negotiate for collateral. Ms. Pusey acknowledged the work done by the NAIC and that the Covered Agreement likewise recognizes the efforts of the NAIC in its amendment to the Credit for Reinsurance Model Act. With 35 states having adopted laws or regulations reducing reinsurance collateral requirements, the states are well on their way to compliance as the NAIC will require the adoption of the model act as an accreditation standard by January 1, 2019. Most notable was the lack of discussion on whether the Covered Agreement is the vehicle to replace the regulatory requirements under Solvency II to grant equivalence to the U.S. regulatory system.

On March 15, 2017, the NAIC sent a letter to Steven Mnunchin, the new Secretary of the Treasury, asking him to review and clarify the terms of the Covered Agreement. The letter advised the Treasury Secretary that the greatest concern to state regulators is that the Covered Agreement does not explicitly provide that the EU recognizes the U.S. as an "equivalent" jurisdiction as required under Solvency II. Furthermore, the regulators asked him to seek clarification of the terms and intent of the provisions of the Covered Agreement to allow the state regulators to properly implement the provisions, and to ensure that the terms are in the best interest of the U.S. insurance industry.

From the divergence of opinion, it seems clear that the Covered Agreement is not explicit and its terms are subject to numerous interpretations.

In response to the NAIC's letter, industry associations sent a joint letter reciting that the Covered Agreement "affirms" state regulators role as the "primary regulators" of U.S. business of insurance. The Covered Agreement does not state that specifically, but the sentiment was expressed by witnesses at the February hearing. The trades are also concerned that, if the Covered Agreement is not executed, U.S. reinsurers not only have to create and maintain branch operations in the EU member states, which requires capital costs and the placement of personnel in such branch offices, but also would be subject to EU regulatory requirements.

From the divergence of opinion, it seems clear that the Covered Agreement is not explicit and its terms are subject to numerous interpretations. For the initial intent of the Agreement to be effective, this author believes that amendments or redrafting is required to satisfy the conflicting and somewhat confusing terms.

Open Questions

The author has identified a number of unanswered questions stemming from the Covered Agreement or issues that require further clarification or answers, including:

1. Does the Covered Agreement need to be amended to clarify that, once the U.S. complies with the requirements under the Covered Agreement, it be deemed "equivalent" under Solvency II?
2. Do states that comply with the elimination of collateral prior to the 60-month deadline have to wait for all states to comply before the insurers domiciled in such states be granted reciprocity in the EU?
3. What impact will the current administration have on the implementation of the Covered Agreement? Will changes to Dodd-Frank, including the possible elimination of the FIO, negatively impact the implementation of the Covered Agreement?
4. Do "material" changes or amendments to a reinsurance agreement trigger compliance for elimination of all collateral requirements under the agreement?
5. If and when the Agreement becomes effective, how long will U.S. insurers and reinsurers have to wait before such insurers no longer have to establish local operations in EU member states in order to do business there?

It remains to be seen whether the Covered Agreement will become effective and what changes, if any, will be made to respond to the concerns noted by industry and regulators alike, or whether it will be tossed aside by the current administration, as other international trade agreements have been. ●

Francine L. Semaya is a legal consultant in insurance regulation, reinsurance, insurance insolvency and transactional matters. Ms. Semaya is a member of the AIRROC Publication Committee. flsemaya@gmail.com

The Legacy Market

Innovation. Flexibility. Creativity. Capital Appeal. That Order.

Eleni Iacovides

The insurance industry has shown through the years that it has a remarkable ability to respond to challenges, and to adopt and adapt, whether this relates to a new financial or regulatory framework or to respond to demands for new products and solutions. One of the biggest challenges that the European industry faced in recent years was the implementation of Solvency II, the European legislation that codifies and harmonizes insurance legislation across the European Union.

In this first of three articles, we will consider the transfer mechanisms used widely for decades now across Europe; we will then compare the European and U.S. frameworks, especially in light of the relatively new framework in Rhode Island. In the final article, we will examine where the U.S. market finds itself two years on from the enactment of the Rhode Island IBT framework and discuss what may have influenced the way in which the market and other states reacted to this development.

The way we were

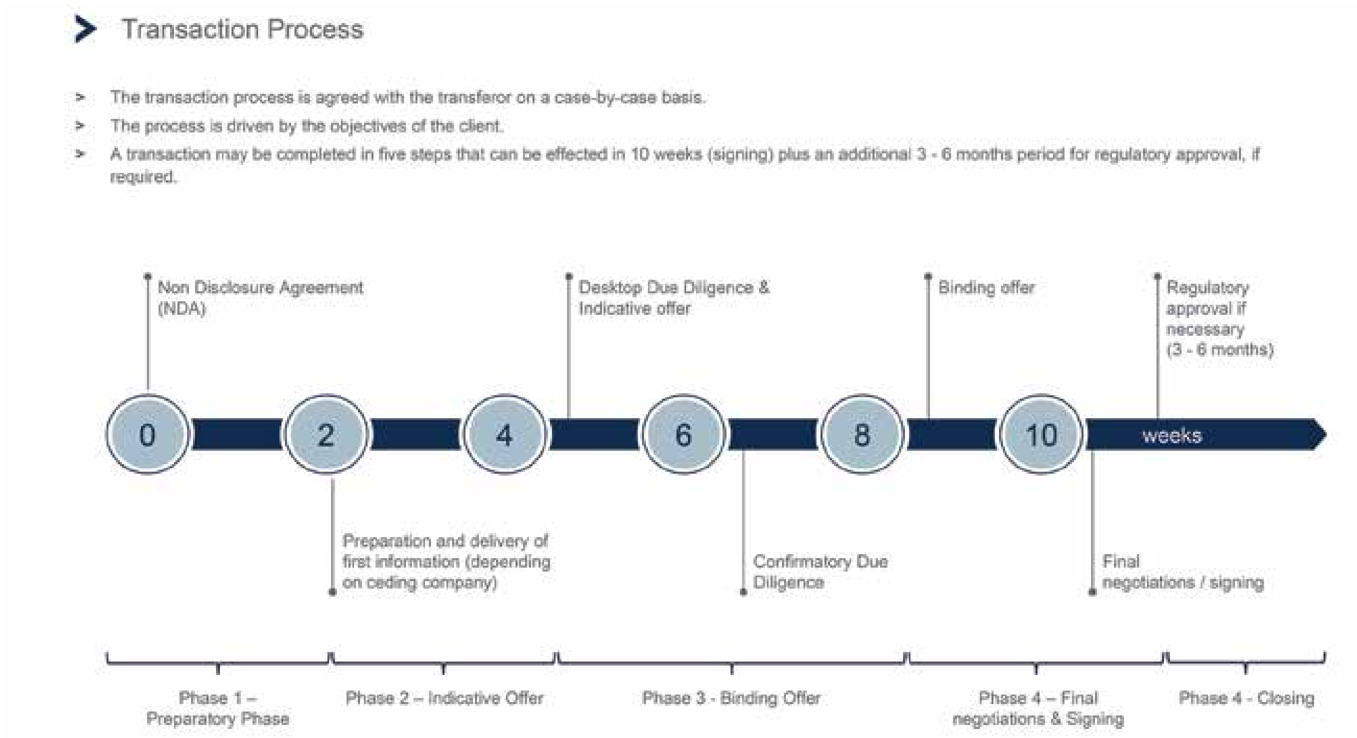
When I started my career as a lawyer in the early 1990s, insurance litigation was seen as the poor relation of insolvency litigation. For those who were around at the time, this was the era of Asil Nadir and Robert Maxwell, to name a couple of non-insurance colourful characters. I had the pleasure and honour to work on both insolvencies. The first insurance "novel" I had to read when I qualified was the Department of Trade and Industry report on the collapse of the Weavers Pool. It was fascinating and had all the ingredients of a good novel: money, men with power and authority, a business empire, allure and a twist at the end. We then had Pacific and General and Pine Top. Then came the Independent and HIH. Life for contentious lawyers was great, the issues were untouched, it all went to litigation and the settled legal principles that we all take for granted today were made then. Still, run off was seen as second class and perhaps so were we! And today? Run off is an integral part of the insurance industry and specialist acquiring vehicles operate alongside insurers offering them additional tools with which to profitably and efficiently manage their business. The recent impressive investment into new vehicles and growth of existing vehicles is evidence of the market's profitability and therefore, appeal to investors.

Twenty plus years on, judging from the new players and capital invested in it, I and quite a few others, find our market more appealing than ever…

Our world today

Solvency II, the relatively new European regulatory framework, along with the low investment returns, soft market and pressure on underwriting profit has forced insurers to focus, more than ever, on the cost of capital and consequently on capital efficiency, in addition to the need for optimization of internal resources and cost reduction. Reserves held for old, discontinued or non-core business have become more capital intensive, therefore restricting insurers' ability to deploy capital elsewhere such as new products, digitalization or a strategy to increase one's market share in core business or a new jurisdiction. The disposal of such portfolios to specialist acquiring vehicles has long been used in the United Kingdom and

The Legacy Market (continued)



more recently in Continental Europe as a way in which insurers deal with portfolios they no longer wish to keep on their balance sheet. The harmonised regulatory framework makes this process predictable and efficient, both key advantages in any business transaction.

Capital release solutions through retrospective reinsurance, the assumption of insurance portfolios or the acquisition of entire legal entities provide insurers with much needed additional tools in their tool kit when considering how to manage demands on capital and resource efficiency.

Our tool kit

Different business needs and priorities require different solutions and here, we will examine four key structures which are being widely used to provide finality or exit.

Sale / Acquisition of a legal entity

If a legal entity (e.g., a subsidiary) is in run off, this can be disposed of in its entirety and of course, the technical reserves are automatically transferred. This is a well-known process and subject to the legal requirements in the relevant jurisdiction, a relatively straight forward process, particularly for small entities.

Retrospective Reinsurance and Adverse Development Cover

A loss portfolio transfer (LPT) is a financial reinsurance transaction, typically offered by leading reinsurers through the usual broking route; this solution has been used much more widely than a statutory portfolio transfer (below), perhaps because it is quicker to achieve and it does not require regulatory or judicial approval. In such a transaction, the gross reserves of the ceding insurer are fully reinsured retrospectively. In order to obtain full cover for the covered reserves in the event that there is deterioration, the cedent may additionally obtain an adverse development cover, which would cover all risk in excess of the reserves covered by the LPT. The combination of these two instruments gives the cedent full economic, but not legal, finality, as it is conceivable that reserves may deteriorate to the extent that the ADC is blown and therefore, the risk reverts to the cedent.

Twenty plus years on, judging from the new players and capital invested in it, I and quite a few others, find our market more appealing than ever…

Statutory Portfolio Transfer

This is the only instrument (apart from an outright sale of a legal entity) that delivers full economic and legal finality to the cedent. In Europe, the legal and regulatory framework is harmonized across the Union and apart from Great Britain, (soon to submit its own exit solution) where a transfer needs to be approved by the court, all EU member states proceed on this with very few and not significant differences. In this case, the ceding insurer transfers all policies including outstanding expected claims and IBNR to the acquirer together with the assets that cover the entire book of business being transferred. Once the transfer is approved by the home regulator (the regulator of

The need to be more operationally efficient and to deliver higher returns to shareholders drives us all to transform, innovate and perhaps disrupt.

the jurisdiction in which the policies were issued) having been engaged in a consultation process with the acquirer's regulator, then the transfer is binding on all policyholders. There is of course a period of publication of the intended transfer during which policyholders may object to the transfer on the basis that their interests would be materially jeopardised by the transfer. Such a transaction need not be lengthy but it does need to take into account the regulatory process which has rigid time frames. In transactions where time is of the essence, parties typically combine an LPT/ADC solution, which can quickly deliver economic finality followed by a legal process, which will then deliver the legal finality. In this case, the LPT and ADC covers fall away and are replaced by the transfer; the premium under the two covers becomes the risk premium for the SPT.

Why do it?

The need to be more operationally efficient and to deliver higher returns to shareholders drives us all to transform, innovate and perhaps disrupt. The solutions described above release capital, allow the cedent to achieve higher ROE by investing released capital in more profitable and/or core business, reduce the insurer's exposure to potentially long-tail and volatile business and reduce operational overheads. Employing these solutions also often receives support from the cedent's regulator as regulators are now more than ever, keen to support any steps taken by insurers which are likely to avoid failure. Our niche market is perfectly positioned with capital, knowledge, expertise and creativity to face any challenge. We look forward to seeing more states in the U.S. adopting legislation that will allow statutory portfolio transfers across a market with huge potential. ●

Eleni Iacovides, Group Chief Client Officer at DARAG Group Ltd.
e.iacovides@darag.eu

Is Reg. 68 Good for the Industry?

A Chat with Dwyer, Broccoli and Brennan



Jack Broccoli, Elizabeth Dwyer, Christopher Brennan

At the Commutation & Networking Forum in October, 2016, the authors sat down with Elizabeth Dwyer, Jack Broccoli and Christopher Brennan to talk about the Rhode Island statute. Ms. Dwyer is the Rhode Island Superintendent of Banking and Insurance in the Department of Business Regulation. Jack Broccoli is in the Rhode Island Department of Banking and Insurance and Christopher Brennan is at the New Jersey Department of Banking and Insurance. Here is what transpired.

Connie: *First of all, thank you for participating in the AIRROC Education Day; your panel discussion was very informative. While you did mention that the Rhode Island statute was an effort to promote business in Rhode Island, what caused you to focus on a run-off process for insurance companies?*

Elizabeth: Well, in looking at Part VII transfers in the UK and similar schemes in Bermuda, we realized that there was no comparative process available to companies in the U.S. who wanted to run-off a book of business and achieve finality. We started with a statute in 2002 that was focused on supporting a commutation plan process and then, after various intervening revisions in the statute, we amended it in 2015 to permit a commercial insurer to transfer its legacy closed blocks of business to an assuming Rhode Island insurer. I must emphasize that this is for solvent companies and not for insolvencies.

Connie: *Why is Rhode Island a good place for this?*

Elizabeth: We have a court system that has a specialized "business calendar" and we have a small group of people that can work with you to move the process along. Rhode Island staff will talk to other state regulators to understand other states' concerns and assist in resolving them.

Connie: *Chris, do you see any concerns for New Jersey policyholders that may be involved in one of the Rhode Island Regulation 68 transfers?*

Christopher: We will want to know why this is good for our policyholders and we will be looking at reserve/capital driven reviews to assure the financial adequacy of any such plan. I think any state looking at a plan to transfer will go through something equivalent to or very similar to a Form A review. [If a New Jersey company is sold to another entity it would go through the Form A review process].

Connie: *Beth, you mentioned that this regulation was intended to improve the economy in Rhode Island, but how does it* *do that? Does a company have to move to or start up operations in Rhode Island?*

Elizabeth: There is no such requirement in the statute but it does create work for lawyers and accountants in Rhode Island and a company could decide to staff offices there; we hope they do that.

Connie: *I believe a company might have some concerns if they are planning to move a book of business to a Rhode Island entity either from a staff perspective or from a public relations perspective. If a company wishes to file a plan with the department, how much information is going to be subject to Rhode Island's "Freedom of Information Act"and thus available to the public?*

Elizabeth: The initial filing is exempt from public access. When it is approved, the Transfer Plan will be public, but some information in the process may still be proprietary and protected from disclosure. No individual case reserves would be specified. What needs to be confidential should be discussed with the department; a filing company cannot simply stamp everything confidential, but we are very sensitive to protecting proprietary information.

Connie: *Chris, how will New Jersey participate in the process for one of its domestic insurers?*

Christopher: A company or its lawyers should contact us in advance and we will work with them to facilitate the process, bearing in mind that our goal is to protect our policyholders. But, I cannot emphasize enough that it is better to set up lines of communication with the Department so that all state regulators are hearing the same plan and getting consistent supporting information. People do not realize the extent to which state insurance departments communicate with one another and it is important to provide consistent information to all interested regulators. A process can be worked through more efficiently if you talk to us first rather than simply filing materials with no advance warning. Whether it is New Jersey as the domestic regulator that needs to approve such a transaction, or some other state as the domestic regulator, the process would likely be similar. A company should reach out to their regulator and communicate their plans.

Al: *Regarding reserve levels in your panel discussion, you went over the requirement of an independent third party review initiated by Rhode Island. I think you indicated that under a Reg. 68 runoff plan, the reserve levels are going to need to be at the higher end of the range and at a high confidence level. I believe this is how the UK transfers are accounted for and Rhode Island has indicated they have modeled their requirements after reviewing the UK requirements. So, how does this free up capital?*

Jack: Initially there may not appear to be financial benefits to a company wishing to transfer legacy liabilities, especially at higher reserve levels. However, it does bring finality to the company transferring the business (or various books of business) and they won't have to worry about adverse development in the future which could impact capital levels, RBC, Rating Agencies, et cetera. Also management does not need to worry about managing legacy liabilities and therefore it frees up resources from an administrative perspective.

Elizabeth: If the sole purpose is to free up capital then it may not make sense but for some companies but there are a lot of other benefits that may make it beneficial, particulary if you are consolidating portfolios. In addition, "alien" insurers or reinsurers could use the statute to transfer books of business to the U.S. that may involve U.S. policyholders. We cannot anticipate all the ways the industry could use this process to support their business goals, but we know it is used frequently in the UK and we wanted to provide a level playing field in our state.

Connie: *So it is a "if you build it, they will come" sort of situation?*

Elizabeth: We think so.

Note: For additional background reading please see: *AIRROC Summary Rhode Island Regulation 68,* by Joseph C. Monahan, Saul Ewing LLP, AIRROC Matters, Winter 2016–2017, Vol. 12, No. 4 p. 20; *Welcome to the New World of Runoff*, by Luann Petrellis, Ernst & Young, LLP, at https://tinyurl.com/kwh5ucr, and *Rhode Island Adopts Regulatory Amendments to Facilitate Transfers of Closed Blocks of Business by Non-Rhode Island Insurers*, Mayer Brown Newsletter, 7 August 2015, at https://tinyurl.com/l24k2ty ●

Connie D. O'Mara, an assistant editor of AIRROC Matters, is an ARIAS-certified arbitrator who serves as an expert witness on claims handling issues. connie@cdomaraconsulting.com.

Al Bottalico is an insurance specialist in the Los Angeles office of Locke Lord LLP and the former Deputy Commissioner for the Financial Surveillance Branch of the California Department of Insurance. al.bottalico@lockelord.com

Rhode Island Regulation 68

Voluntary Restructuring of Solvent Insurers Act

Recently Rhode Island revised its Voluntary Restructuring of Solvent Insurers Act as implemented by DBR Regulation 68. This is, in many respects, modeled after the UK's Part VII Transaction, which, subject to court approval, enables companies to transfer/novate a book of business (and divest itself of all residual liability), to another unrelated insurer that assumes all liabilities associated with that business. Reg. 68 is not as broad as the UK's Part VII legislation, but nevertheless creates an option in the United States that had not heretofore been available.

Once the transferor identifies the book (or books) of business to be transferred, the first step is obtaining the consent of the domiciliary regulator of the insurer seeking to transfer/novate business to a Rhode Island domestic. Without knowing which other state(s) may be involved, it is impossible to know the applicable regulator's predisposition to such a transaction. Both Elizabeth Dwyer, Superintendent of Insurance, and Jack Broccoli, Associate Director -Financial Regulation, have indicated that Rhode Island will work with other regulators to address any regulatory concerns. Assuming no objections at this stage, the next step is to either establish a newly-licensed Rhode Island domestic, or to identify one that is prepared to assume the business pursuant to the requirements of the statute and regulation.

While utilizing an existing Rhode Island domestic may be an easier process, the regulatory process to form and license a Rhode Island domestic to take advantage of Reg. 68 is relatively simple, and requires a minimum combined capital and surplus of $3mm. An advantage of Reg. 68 is that it permits a Rhode Island company to set up individual protected cells, thus allowing that company to assume disparate books of business, and then to either retain or reinsure the business as part of the business transfer plan.

An advantage of Reg. 68 is that it permits a Rhode Island company to set up individual protected cells, thus allowing that company to assume disparate books of business...

Pursuant to the statute, the business to be transferred to the Rhode Island domestic is limited to commercial property & casualty run-off liabilities, so not all lines of business would qualify for a business transfer plan, (for example workers' compensation would not qualify).[1] Additionally, to qualify under Reg. 68, the business to be transferred must have a natural expiration that occurred more than sixty (60) months prior to the filing of the Insurance Business Transfer Plan and be in a closed book of business or a reasonably-specified groups of policies. The Rhode Island domestic* would then manage the run-off of the business, but the business could be reinsured from the Rhode Island company, or from each protected cell within the company, to a third-party reinsurer. This structure would add another layer of separation by giving it separate reinsurance protections.

There are a number of factors that should be kept in mind in planning for the utilization of a Rhode Island domestic for run-off purposes including, but not limited to:

- Consent must be obtained from the domiciliary regulator of the insurer seeking to transfer/novate business;
- The new (or existing) Rhode Island insurer to which the book of business is transferred/novated may reinsure the business as part of the business transfer plan, but this would require review of the reinsurance agreement any potential collateral requirement;
- The independent actuarial review (commissioned by the Rhode Island Department) must consider all

interested parties and will be an important aspect to gaining approval from all the regulators involved;

- Communication with non-domestic regulators should occur so they do not raise objections, although their express approval may not be required. For example, review of the business transfer plan to fully understand what blocks of business and why these blocks are being transferred will be necessary in order to communicate with the regulators and gain their support. Although, as noted above, explicit approval may not be required from non-domiciliary states, it is likely Rhode Island will listen to concerns from other states and seek to gain their support;
- Credit for reinsurance of transferred book—business ceded or retroceded by the Rhode Island domestic to a non-admitted (including offshore) reinsurer may require collateral in the form of so-called Reg 114 trusts, letters of credit, other trusts, or funds withheld.

As previously noted, there are some potential roadblocks/pitfalls that may confront the transferor, including, but not limited to:

- Some states may be hostile and/or express concerns regarding a voluntary restructuring and transfers under the Rhode Island statute and regulation;
- Some insurers, insureds, reinsurers, and industry groups may oppose them;
- Whether the business transfer plan and commutation plan are respected by other states has not been tested in court. There is a good argument to be made that states should give proper deference (comity) to Rhode Island Reg. 68;
- The Rhode Island insurer assuming business may be required to provide collateral such as Reg 114 trusts, letters of credit, etc. so that transferring insurer may claim full reserve credit for any transfer because;
- The Rhode Island insurer (particularly if a new domestic) likely cannot be widely licensed due to seasoning requirements, and may not have ratings or a significant amount of surplus.

For additional information please contact the authors of this article.

1. Rhode Island has also indicated there is nothing in Reg. 68 that would preclude alien business from being transferred to Rhode Island under such a plan and there are various ways this could be accomplished. Many books of alien business have a substantial amount of U.S. policyholders and therefore regulators may view this favorably as policyholders would gain from the oversight provided by U.S. regulators.

** One company has now been incorporated in Rhode Island, ProTucket Insurance Company, to take advantage of Reg. 68.*

Al Bottalico is an insurance specialist at Locke Lord LLP and the former Deputy Commissioner/ Financial Surveillance Branch of the CA Department of Insurance. abottalico@lockelord.com

Jonathan Bank is Of Counsel at Locke Lord LLP whose practice focuses on reinsurance/insurance dispute resolution, insurance company restructuring and regulatory related matters. jbank@lockelord.com

SPOTLIGHT

Susan Aldridge

Counsel at Chadbourne & Parke and General Counsel of AIRROC

What is not readily discernable about Susan Aldridge is her rich and varied legal career.

She began in the white collar criminal group at Fulbright & Jaworski (now Norton Rose Fulbright), and also did *pro bono* work, principally on child custody cases. When her one-year *pro bono* sabbatical ended, she was relieved to return to representing large insurance companies fighting over dollars! In addition to these two experiences, Susan's career has run the gamut from working internally in a client's office for several months and gaining useful perspective on her clients' focus on transactions, to teaching legal research and writing full-time at American University's Washington College of Law and teaching Alternative Dispute Resolution as an adjunct professor for several years. But if she could have a second career, it would involve educational neuroscience research. Having taught secondary school French and English for three years before she went to law school, Susan is credentialed in education. She is interested in recent advancements by educators and researchers to discover how children learn, and what can be done to optimize education for all students, including those with learning disabilities.

Chadbourne & Parke is now about to enter a new phase, as it will be merging with Norton Rose Fulbright this year. Susan feels like her career is coming full circle as she looks forward to working again with some of the people who mentored her in the early years of her career. As a litigator, she says she truly enjoys analyzing documents created years ago and piecing together the history of what actually happened, and why companies made the decisions they did. The process of putting together that story for an arbitration panel—from the client's perspective—is always rewarding. She also enjoys working with witnesses and finds that no matter how many times a witness has given testimony at a deposition or trial, he or she usually still needs to be guided through the process at some level.

… success, especially in these times, depends on a willingness to be flexible and move away from "how we've always done it"…

Susan's favorite book is *The Power and the Glory* by Graham Greene, which is a novel about a priest running from the police during the persecution of the Catholic Church by the Mexican government in the 1930s. In the non-fiction category, she highly recommends *The River of Doubt* by Candice Millard, a compelling account of Theodore Roosevelt's journey through an uncharted tributary of the Amazon River following his unsuccessful 1912 campaign for the presidency.

When we asked Susan about her first involvement with AIRROC and her opinion on AIRROC's educational sessions/conferences, she reflected on her invitation by Art Coleman to speak at a membership meeting in 2008. After that first meeting, she attended the October conference and membership meetings regularly. Susan found that the educational presentations are thoughtful and often involve something topical that she is working on. When Dewey LeBoeuf (which had hosted the membership meetings) closed its doors, Art invited Chadbourne & Parke to host the meetings at their offices and serve as AIRROC's general counsel. Susan considers it an honor to serve in this capacity and to work with such a great group of people. She has appreciated the opportunity to become familiar with the laws affecting trade associations and to work on by-laws and other documents for the organization.

Susan feels that success, especially in these times, depends on a willingness to be flexible and move away from "how we've always done it" in order to accommodate an industry's changing needs. She has watched with interest AIRROC's expansion and engagement in new enterprises. She finds that offering new categories of memberships and partnerships, expanding the locations and types of educational offerings, and surveying companies regarding their challenges and needs are examples of the many creative things the organization has done to stay vibrant in a changing environment. Developing the AIRROC Dispute Resolution Procedure to offer companies a way to resolve their differences on an expedited and cost effective basis was a great move in her opinion.

Her last thoughts? She just hopes AIRROC doesn't decide it needs a new General Counsel! ●

Bina Dagar, bdagar@ameyaconsulting.com and
Connie D. O'Mara, connie@cdomaraconsulting.com

Learning about Legacy

Legacy education and training is a growing market. Barbara Hadley of Iskaboo asked Ben Baker of IRLA and Carolyn Fahey of AIRROC how they define 'training' and 'education' in the context of their respective associations.

'To the IRLA Academy, training and education go hand in hand depending on what needs to be achieved,' says Baker. 'Training is aimed at developing a new, or existing skill. Therefore, in IRLA terms, it is important that any training provided is relevant and of high quality.

'Education has a wider remit. It is a process of building upon existing knowledge and experience,' he adds. 'For example, IRLA has arranged a presentation on cyber risk. This is designed to bring members up to date with current thinking, how this emerging risk is approached and what the future might bring.'

For Fahey, 'education is about conveying knowledge. Providing opportunities to learn about areas that you might not know anything about or deepening understanding of an issue that you might have heard about but aren't expert in. Training, to me, is providing skills to DO something. Negotiate a commutation, settle a dispute, conduct an effective audit, interpret a balance sheet, or understand an actuarial projection.

'One of AIRROC's goals is to provide a balance of both education and training to our industry,' says Fahey. 'Nearly every event we offer will have a mixture of current topics, issues, and challenges that our industry faces each day, coupled with sessions designed to offer concrete takeaways for our audiences. Knowledge that they can "tuck away" for later, and skills that they can utilise to implement change in their daily work right away.'

So how do they identify and select those topics and issues which are important and of value to prospective attendees?

Nearly every event we offer will have a mixture of current topics, issues, and challenges that our industry faces each day.

Carolyn Fahey

And what are the key learning objectives?

'The Academy identifies topics from the requests and needs of the membership,' Baker stresses. 'It is fundamental that IRLA provides topics on relevant matters, be they regulatory, technical or legacy related issues, or on a current subject, for example, cyber risk or M&A.

'The key learning objective is that whatever we deliver from the Academy, it must add to the members' knowledge and they must be able to use this new knowledge when they return to their offices.'

Fahey also sees her members' input as crucial: 'AIRROC has a very active Education Committee made up of representatives from AIRROC member companies. They do a fantastic job of generating ideas for session topics and identifying speakers of interest. I view them as one of AIRROC's greatest resources for formulating terrific and engaging conferences.'

How about the rising number of young, highly educated professionals who are now streaming into the industry?

IRLA has a very active Young Professionals Group, Baker points out, whose membership is growing. YPG and the Academy both provide opportunities to network and benefit from the programmes provided.

'AIRROC is consistently working to raise awareness of how important the legacy sector is to insurance and dispel the myth that if you work in run-off that means you are unemployed in a few years,' says Fahey. 'We also have a focus to broaden our contacts within our member companies to invite the next generation of insurance professionals to come to AIRROC.

'AIRROC also offers a professional designation—the Certified Legacy Insurance Professional (CLIP).'

I asked whether they felt there was an 'attitude gap' between these young professionals and those company employees who worked their way up in a more traditional 'learning on the job' approach? And if so how that gap should be addressed?

Baker admits there is often a reluctance on the part of some people to attend training and educational events, 'because they feel that those around them may think that they should already know the subject. But that is really as far as it goes. The way to reduce the "attitude gap" is to design programmes that are open to all irrespective of where they are in their career.

'The IRLA Academy works on the basis that you never stop learning and, with this in mind, we approach everything we do on the basis that those who are at the beginning of their careers need to be equipped with the relevant skills to be successful, and those who have "learned on the job" can give the benefit of their experience. It should be a two-way flow and we encourage this.'

Although Fahey hasn't personally seen an attitude gap she does hear a lot about the upcoming 'talent gap' in the insurance industry: 'AIRROC has been supportive of the groups that are providing opportunities for younger professionals to meet each other as well as more experienced industry practitioners to address this need.'

Both Baker and Fahey stress the importance and benefits of associations and groups engaging with one another when it comes to help with training and education initiatives.

For Baker 'the insurance business is built on face to face contact and, to coin an old phrase "the sum is greater than the individual parts". The IRLA Academy has begun the process of building closer relationships with key associations, initially in the London market, and has already developed a good working relationship with the CII and the Insurance Institute of London:

'The mutual benefits are exciting, particularly in the case of education where a sharing of knowledge and the ability to participate in each other's educational events can only be of benefit to all,' says Baker. 'There is no point in being in competition with each other. If one organisation runs a good programme that is relevant, why not ask for a place on it?'

Fahey agrees wholeheartedly: 'I think that it is extremely important and valuable for AIRROC to engage with and work with other industry associations.

The key learning objective is that whatever we deliver from the Academy, it must add to the members' knowledge.

Ben Baker irla

Our commitment to this is very evident in that we openly support and collaborate with several groups including IRLA, IAIR (International Association of Insurance Receivers), EECMA (Emerging Environmental Claims Managers Association) and the SOA (Society of Actuaries)—just to name a few. We have launched very successful collaborative efforts with all these and you will see more to come!

'As non-profit associations, we all have our challenges with remaining relevant and serving the industry effectively,' she adds. 'We often have strict budgetary constraints and few staff to support what we do so, we need to be creative and efficient to make an impact. Working together not only makes the most of the resources we have but also allows us to share expertise across our memberships.'

Finally, how can the industry itself help associations like IRLA and AIRROC to respond to education needs appropriately and ensure that the right information goes to the right people at the right time?

'This relies on the ability of IRLA and its members to clearly communicate to the industry as a whole, through contributing to articles and a willingness to speak at public events,' says Baker. 'It is only by explaining what the organisation does in a clearly focused way that a two-way dialogue will develop. This is our plan.'

Says Fahey: 'The AIRROC Education Committee is always seeking ideas and assistance! My door is always open to anyone that would like to share an idea, contribute to a committee, speak at an event, or provide constructive commentary. We are only effective with the input and feedback of those we serve. Let me know your thoughts!' ●

This article first appeared in Run Off & Restructuring Yearbook & Directory 2017. Reprinted with permission from Iskaboo Publishing.

Ben Baker is head of the IRLA Academy and chair of the IRLA Learning and Development working party.

Carolyn Fahey is the Executive Director of AIRROC.

Barbara Hadley is a director of Iskaboo Publishing Ltd which produces in-depth reports on topical issues.
barbara.hadley@iskaboo.com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An AIRROC Chameleon? Message from the Executive Director

For each issue of AIRROC Matters I choose an animal in which to base my article. It keeps me creative and thinking about my messages for each issue. Luckily for me the kingdom of animals is as diverse and interesting as my job with AIRROC!

A chameleon's skin changes colors in response to its emotions, such as anger, fear, or changes in light, temperature, and humidity. Since my last article, I have experienced at least all of these emotions and environmental changes (and I am working on my color changing skills…).

I haven't had the chance to write about AIRROC NJ 2016. While there are many months of preparations that lead to the event, the hard work is all worth it as I have the time to see the education sessions unfold, hearing the "hum" in the ballroom as discussions are unfolding and observing the rotation to different tables as companies move to their next meeting.

"Productive" was the word I heard most often when asking our attendees about their experience. Business gets done at AIRROC NJ. In 2016, delegates reported that they met with at least 7–10 companies over two days. You can't get more efficient than that. Imagine the time and expense if those delegates had to travel to each of those meetings separately!!

That alone is part of the reason that AIRROC exists—come to AIRROC and meet with the people you need to see. Move your business to the next level. Agree on the next steps toward resolving your dispute. Calculate the figures to get a few steps closer to finishing that deal you have been working on for months—or maybe years. All in one place—all at AIRROC—all in a few days.

After NJ is behind me, the work doesn't stop. It is now time to look at the following year. Budget, plan, schedule, market, renew, refresh. It seems at first that I have so much time to get all of the pieces in place, then all of a sudden the holidays are upon us and the new year begins!

A chameleon's eyes can move independently of each other, enabling them to look in two different directions at once. It would be beneficial to me as the Executive Director of AIRROC to have that talent because we have so many initiatives we work on at once.

Between October and March there were many new and notable happenings for AIRROC:

- The inaugural meeting of the AIRROC Advisory Council;
- Plans for a collaborative event with the Emerging Environmental Claims Managers Association (EECMA);
- AIRROC presented on an ARIAS US Webinar on "The Rising Relevance of Runoff";
- A new committee to focus on AIRROC's Governance;
- An upgrade to the Association Management System (MemberClicks) is in progress, which will help streamline back end operations;
- AIRROC/E&Y Survey published;
- The creation of an AIRROC Media Kit for marketing to potential sponsors, partners and advertisers;
- New format for the Chicago Regional to involve multiple firms;
- The launch of AIRROC's first on-demand training module on the DRP is expected in the next few months;
- A new location for the Monday dinner event at AIRROC NJ 2017.

As we all do, we have also had our challenges. AIRROC underwent an IRS audit. To anyone the words "IRS" and "audit" in the same sentence spark concern, even panic! While it was a random selection, the findings required some restructuring of our agreements and contracts. Just about the time that we were finishing that, we found ourselves staring into an expected Nor'easter the week of the March Membership Meeting. The Executive Committee and I had to make a difficult decision to postpone without even knowing if we would be able to reschedule. It proved to be a

Carolyn Fahey

good decision as NYC was virtually shut down on the day, which was to be the networking day. Thankfully, we were able to find new dates and move ahead only a few weeks later. AIRROC is nimble and determined to provide our members with forums to meet and opportunities for education.

We have our full schedule set for the year. Let's hope that Mother Nature leaves us alone.

June 6–7 – AIRROC Regional Networking and Education Days, Chicago, IL

June 13 – AIRROC Regional Education Day, Hartford, CT

July 18-19 – AIRROC Summer Membership Meeting, BOD Meeting and Education Day, New York, NY

August 5 – AIRROC/IAIR Issues Forum at the NAIC, Philadelphia, PA

September 7 – AIRROC/EECMA present Contaminated Sediment Sites and Insurance Implications, Philadelphia, PA

October 15–18 – AIRROC NJ 2017 Commutations & Networking Forum, New Brunswick, NJ

November 15 – AIRROC Regional Education Day, New York, NY

In closing from the desk of the AIRROC Chameleon – the next time you see me remind me what color you see that day. I will always be there doing my best to serve the board, our members and partners, and the industry. Let me know how we are doing. ●

Carolyn Fahey joined AIRROC as Executive Director in May 2012. She brings more than 22 years of re/insurance industry and association experience to the organization.
carolyn@airroc.org

AIRROC Announcement

First Members of New Advisory Council

AIRROC is pleased to announce the first members of the new AIRROC Advisory Council. The Board of Directors established the council in late 2016. The council will serve as a critical community and industry champion for and with the AIRROC Board. After a several month application process, the Board ratified the members in February 2017. The members were selected based on their diversity of roles and experiences in the industry.

The members are:

- **David Alberts,** Partner, Mayer Brown LLP
- **Debra Hall,** Hall Arbitrations and SagePoint Solutions Group LLC
- **Stephen Johnson**, Insurance Financial and Regulatory Specialist, Stradley Ronan Stevens & Young LLP
- **Steve McElhiney**, President, EWI Re, Inc.
- **Connie D. O'Mara,** O'Mara Consulting LLC
- **Sandra Santomenno,** Senior Consultant, Towers Watson

The council's role will be to work with the AIRROC Board on strategy and initiatives and help broaden AIRROC's perspective on ways to service the insurance and reinsurance industries. Council members will serve two-year terms.

Marianne Petillo, the AIRROC Board Liaison to the newly formed Advisory Council, stated: "I am pleased with the broad range of senior professionals that we have on the Council, and I look forward to working with them as we continue to find ways to serve our members and the industry as a whole." ●

AIRROC Confirms

Board Leadership and New Directors

AIRROC announces the 2017 board leadership. The officers are: Chair, **Leah Spivey** (Munich Re), and two Co-Vice Chairs, **Michael Fitzgerald** (QBE) and **William Teich** (The Hartford).

Collectively serving as AIRROC's Executive Committee, they bring many years of experience and insights with them. Spivey is the Head of Business Runoff for Munich Re America. Fitzgerald is Senior Vice President Discontinued Programs at QBE and Teich is Vice President of Claims at The Hartford. They all have a long history of dedicated service to AIRROC, both on the Board of Directors and in leadership positions on key committees within the organization.

AIRROC also welcomes three new Directors:

- **André Lefebvre**, Arrowpoint Capital
- **Andrew Hill,** Zurich Legacy Solutions
- **Betsy Mitchell,** Armour Risk Management

Lefebvre was elected by the AIRROC membership for a three-year term. He is Arrowpoint Capital's Chief Financial Risk Officer. In that role, he is responsible for reinsurance, reinsurance accounting, actuarial, and statistical and data management.

Hill was appointed by Zurich Legacy Solutions to complete the term left vacant by Michael Baschwitz who left Zurich in November. In his role as Head of Restructuring, North America for Zurich Legacy Solutions, Andrew is responsible for designing and implementing strategic solutions for Zurich's non-core life and non-life insurance liabilities within North America and Bermuda.

Betsy Mitchell is finishing the term left vacant by Kathy Barker who after eight years on the Board, stepped down to go part time at Armour. Mitchell is a Vice President, Reinsurance and is responsible for Reinsurance / Asset Management including Claims, Collections and Commutations.

AIRROC has a 15-person board which all serve three-year staggered terms.

"I look forward to working with the full board and the leadership as we steer AIRROC in the most effective ways to serve the insurance and reinsurance industries," said AIRROC's Executive Director, Carolyn Fahey. ●

2017 Spring Meeting – New York City

AIRROC Regroups and Reschedules in a Whirlwind

AIRROC's Spring Membership Meeting was cancelled due to the winter storm that roared into many northeast cities on March 13–14. For AIRROC's Executive Director, it was emergency response time. Thanks to the Chadbourne & Parke staff, the AIRROC Board, and our loyal members, we were able to offer our members a day and a half for meetings, as well as an abbreviated education session, attended by nearly 100 individuals.

This is how events unfolded as told by Carolyn Fahey…

Friday March 10: The AIRROC Executive Committee had a call scheduled to prepare for the Board meeting to be held March 14. One key topic was the pending storm. We decided that the forecast was too uncertain and we should wait and see what the forecast was over the weekend. From the logistics end, all of the food was ordered, documents printed, and speaker materials were loaded on the AIRROC APP. The attendee informational email had been deployed. We were expecting 155 attendees – AIRROC's largest turnout ever for a Spring Meeting.

Saturday March 11: Over the course of the day, I received several emails from members either cancelling their attendance or asking if AIRROC had a weather contingency plan. I contacted the Chadbourne & Parke meeting planning staff to find out if we could still cancel the food order (the answer was yes!) and what the firm policy was for closing due to weather.

Sunday March 12: I woke up to even more emails about the impending storm. A call was scheduled with the AIRROC Executive Committee to make a final decision. Once we decided to cancel, notices were sent to all attendees, the Chadbourne & Parke staff and the AIRROC website was updated. Many emails went out that day cancelling travel, dinners, and letting committees know that we would hold meetings via conference call.

Monday, March 13: An inquiry was sent to the Chadbourne & Parke staff about possible dates that their conference space would be available. New date options were received and vetted with the AIRROC Executive Committee. Speakers were contacted about their availability on the new date. As the storm moved in, I was informed at about 11 pm that the Chadbourne & Parke offices were closed on Tuesday. Good thing we moved it!

Tuesday March 14: Based on my list of speaker availability, we held a discussion with the Education Committee leadership on our options. Only two of the five panels could be available for the new date so we needed to identify one more session so that we had a half-day of content. I made a call to Locke Lord to see if they could






photos / Jean-Marc Grambert

work with me on a session – the answer was absolutely yes!! The AIRROC Board held our scheduled meeting via conference call. Board approval to proceed with the new dates was confirmed.

Wednesday March 15: April 3 and 4 it would be. Since it was a Monday to Tuesday timeframe, the AIRROC Executive Committee agreed with my recommendation to start at Noon on Monday the 3rd with meeting time, and offer a morning of education on Tuesday the 4th with meeting time in the afternoon. An announcement was sent to those that were registered about the new dates.

Thursday March 16: Registration was opened for the new dates. Within hours, we had more than 40 registrants.

------ Over the next two weeks, the registrations continued to come in for the new dates. Details were put in place to change all of the materials, the APP, and the new agenda was released. ------

Sunday April 2: I traveled to New York City.

Monday April 3: I arrived at the Chadbourne & Parke offices at 9 am for set up. All went as expected, except being nearly driven off-track by a NJ Transit derailment. Many of the attendees that had planned to come on Monday were not able to get in to the city.

Tuesday April 4: AIRROC featured three education sessions:

– The Runoff Market in 2017: An Update on Size, Recent Transactions and Insolvencies

–Sports and CTE: A Real Headache for Insurers?

–Ethical Issues in Social Media and Metadata

Due to the transit derailment the day before, we had to juggle the timing as some of the panelists for the first session were not able to get there on time. In the end, all went well and the audience had nothing but praise for the speakers and the fact that AIRROC was able to reschedule in a short period of time.

Wednesday April 12: I am writing this article to share with our members and supporters all that went into making this meeting happen for you. AIRROC strives to be nimble and responsive to the needs of our constituents. You wanted a Spring Membership Meeting—we made it happen!

A shout out to our speakers, the Chadbourne & Parke staff, the AIRROC Board, and our attendees. Mountains were moved to make this happen. It was truly a joint effort.

For the July Summer Membership Meeting (July 18–19) the agenda will include the sessions on Talc, the Covered Agreement, and Climate Change that were moved from March. The Education Committee is also working to add some new speakers to round out the day.

Let's hope that the Summer Meeting doesn't bring a plague of locusts… ●

Part VII Transfers

Connie D. O'Mara

The Iskaboo Guide

The Iskaboo Guide to Part VII Transfers*. By Dewi James and Barbara Hadley. 145 pp. Iskaboo.*

While Brexit brings challenging uncertainty for the future, currently, it is business as usual for the UK insurance industry. One feature of the current holding pattern is that companies still enjoy "passporting rights" available to countries in the EEA [the EEA comprises all European Union Member States plus Liechtenstein, Norway, and Iceland].

From the standpoint of companies who may wish to avail themselves of the UK's popular insurance business transfer mechanism, a "Part VII Transfer," acting to bring a Part VII plan to fruition sooner, rather than after the exit is negotiated, may make the difference between a relatively straightforward process that has been employed to-date and one that is complicated, lengthy, and potentially unachievable if an applicant needs to make application to each EEA state court and regulator involved. While there is considerable uncertainty at present on the terms of the exit to be negotiated by the British government (who, how, and over what period of time), the triggering of Article 50, a clause of The Lisbon Treaty, will give the UK two years to negotiate the terms of departure from the EEA. As of the writing of this article, Prime Minister May has targeted March 2017 for triggering Article 50, but as of February 23, 2017, the Brexit bill enabling her to do that has not yet cleared the House of Lords. In the meantime, whether you are

an insurance company looking to restructure operations, exit unprofitable business, or sell run-off portfolios, it is clear that a Part VII transfer could be an extremely useful tool.

The Iskaboo Guide to this process puts the procedure in the context of similar but distinct methods of dealing with run-off business. It describes the Part VII Transfer as:

> An insurance business transfer scheme relocates legal liability in respect of a contract or group of contracts of insurance without the consent of policyholders. With the transfer of legal liability, naturally, go economic, operational and credit risks inherent in the contracts….a transfer scheme may also encompass associated contracts, rights and liabilities; but its greatest value derives from its potential to relieve conclusively the transferor of its policy obligations, and vest these in the transferee.

The implementation of Solvency II regulations at the beginning of 2016 has caused both increased interest in Part VII transfers as well as heightened regulatory scrutiny. Thus, any company, policyholder, or reinsurer that is involved in a potential Part VII transfer may want to consult the Iskaboo guide to understand the process, the issues, and the implications of the end result.

The guide not only contains a detailed background on how Part VII of the Financial Services and Markets Act 2000 (FSMA) – The Control of Business Transfers, sections 104 to 117, applies, but also details the issues that can arise at each step of the process. Further, the Appendices provide case studies to illustrate a range of prior transfers.

Iskaboo has granted AIRROC Matters permission to print its Executive Summary of this useful treatise can be found at this link. http://www.airroc.org/iskaboo-guide-to-part-vii-transfers ●

Connie D. O'Mara, an ARIAS-certified arbitrator, serves as an expert witness on claims handling issues and is the Assistant Editor of AIRROC Matters. connie@cdomaraconsulting.com or www.cdomaraconsulting.com

News & Events

Francine L. Semaya & Peter H. Bickford

Regulatory News

NAIC

The NAIC has created the Innovation and Technology (EX) Task Force to assist regulators in keeping up-to-date on key developments, new products and services from both "start-up" and established companies, to be chaired by the Michigan Insurance Director.

Cybersecurity

The New York Regulation "Cybersecurity Requirements for Financial Services Companies" (23 NYCRR 500) became effective March 1, 2017. Financial Services entities are required to be in compliance by August 28, 2017, the end of the 180-day transitional period. It is important to note that each financial service entity must annually certify its compliance with the Regulation. Such certification cannot be made by an affiliate. In the meantime, the NAIC, at its April meeting received updates on states enacting legislation or regulations regarding Cybersecurity and discussed and received comments on its third version of the "Insurance Data Security Model Law."

Covered Agreement

On January 13, 2017, the Secretary of the Treasury ("Treasury"), the U.S. Trade Representative ("USTR") and the European Union ("EU") issued a press release announcing the completion of negotiations and the finalization of the "Bilateral Agreement Between the European Union and the United States of America on Prudential Measures Regarding Insurance and Reinsurance (the 'Covered Agreement')." For complete details on the Covered Agreement, please see article entitled "*Does Covered Mean Equal? EU & U.S. Bilateral Agreement on Insurance and Reinsurance,*" found on page 11.

Industry News

On March 29, 2017, the same day that British Prime Minister Theresa May delivered a letter triggering Article 50 of the EU's Lisbon Treaty to formally start the process of exiting from the EU, **Lloyd's of London** announced that it picked Brussels for its planned European Union subsidiary.

The pace of significant merger and acquisition activity in the p/c sector remains relatively slow. The most significant recent transaction was the announcement in December 2016 that Toronto-based **Fairfax Financial Holdings, Ltd.** would acquire all the outstanding shares of the Swiss-based **Allied World Assurance Company Holdings, AG**. Under the agreement, Allied World shareholders would receive a combination of Fairfax subordinate voting shares and cash equal to $54.00 per Allied World Share, for a total equity value of approximately $4.9 billion.

Meanwhile, on the legacy business front, **Randall & Quilter ("R&Q")** continue to pursue the acquisition of run-off books or companies, including the acquisition or proposed acquisitions over the past few months of **Clariant Insurance AG**, which it plans to relocate to Malta where it will be R&Q's second European run-off consolidator; **AstraZeneca Insurance Company Limited**, originally established as the captive insurer for its parent, **AstraZeneca UK Limited** and in run-off since 2004; and **ICDC, Ltd.**, a captive insurer now in run-off owned by Indiana-based engine manufacturer **Cummins, Inc.** It was originally incorporated in Bermuda and re-domesticated to Vermont in 2015.

Speaking of mergers, one of the most significant insurance industry mergers announced recently did not involve insurance companies but insurance trade associations. Earlier this year the boards of the **National Association of Professional Surplus Lines Officers ("NAPSLO")** and the **American Association of Managing General Agents ("AAMGA")** agreed to merge into a new wholesale, specialty and surplus lines insurance trade association, the **Wholesale and Specialty Insurance Association ("WSIA")**, subject to member approval that should occur before this is published. Both associations have agreed that a merger makes sense given their overlapping memberships. Currently, 77 percent of **AAMGA** members also belong to **NAPSLO** and 48 percent of **NAPSLO** voting members also belong to the **AAMGA**.

AAMGA was established in 1926. For most of its history, membership was limited primarily to managing general agents. In 1983, the **AAMGA** opened its management to domestic and foreign insurance companies, underwriters and other organizations that provide insurance-related services to the wholesale insurance system. Then, in 2013, the association opened its membership further, welcoming managing general underwriters, program administrators, aggregators and other wholesale insurance professionals.

NAPSLO was established in 1975 to represent the surplus lines industry. As a national trade association, **NAPSLO** represents surplus lines insurance agents/brokers, surplus lines insurance companies and associate members from more than 1,500 member offices, all comprising the wholesale insurance distribution system.

WSIA is calling itself "an association of insurance professionals working to build profitable business relationships in the wholesale, specialty and surplus lines insurance industry."

Present Value (continued)

Member News

AIRROC Member and run-off specialist, **Pro Global Insurance Solutions P.L.C.**, has announced the formation of **ProTucket Insurance Company** in Rhode Island (**"ProTucket"**) to offer insurers and reinsurers portfolio transfer services that take advantage of the state's expanded run-off law. **ProTucket** will take on portfolios of business from solvent insurers and place them in a protected cell within the Rhode Island-licensed insurer. Currently in the U.S., insurers usually run off discontinued business in-house, but the practice of transferring portfolios of discontinued property/casualty business to a third party is well-established in other jurisdictions.

Rhode Island amended its laws in 2015 (commonly referred to as the Regulation 68 law) to allow any U.S. insurer or reinsurer, including U.S. units of foreign insurers, to transfer closed books of business or any "reasonably specified groups of policies" through novation. "We are honored to be the first company to be granted a license to implement Regulation 68 and are passionate about the benefits it will bring to our clients and the U.S. insurance market," said Mory Katz of **Pro Global U.S.** in New York.

If you are aware of items that may qualify for the next "Present Value," such as upcoming events, comments or developments that have, or could impact our membership, please email Fran Semaya at flsemaya@gmail.com or Peter Bickford at pbickford@pbnylaw.com

People (and firms) on the Move

Frank J. DeAngelis, a Partner at **Mound Cotton Wollan & Greengrass LLP**, has been confirmed as a judge of the Superior Court of New Jersey, Morris County. Frank started his career at Mound Cotton, an AIRROC partner firm, over 20 years ago.

National law firm **Chadbourne & Parke** (an AIRROC partner firm and outside counsel to AIRROC) and international law firm **Norton Rose Fulbright** have agreed to merge into a single entity with more than 4,000 lawyers and expected annual revenue just under $2 billion. The combined firm will be known as **Norton Rose Fulbright**, with about 1,000 lawyers in the United States, including more than 300 in New York and 130 in Washington, and will continue to act as AIRROC's outside counsel.

Another AIRROC partner law firm, Chicago-based **Freeborn & Peters LLP ("Freeborn")**, is combining with the New York City law firm **Hargraves, McConnell & Costigan P.C. ("Hargraves").** The combination establishes **Freeborn's** first office in New York. "In seeking a partner for growth, there were very few other firms that had the same depth of knowledge and experience in insurance/reinsurance as Joe McCullough and his large team at Freeborn & Peters," said Daniel Hargraves, Founder of **Hargraves**. ●

MARK YOUR CALENDAR

May 8 – 10, 2017
Insurance & Reinsurance Legacy Association Ltd. (IRLA)
IRLA Annual Congress
Brighton, UK
www.irla-international.com

June 6 – 7, 2017
AIRROC Regional Networking and Education Days*
Chicago, IL

June 13, 2017
AIRROC Regional Education Day*
Hartford, CT

July 18–19, 2017
AIRROC Summer Membership Meeting*
New York, NY

August 6, 2017
National Association of Insurance Commissioners (NAIC) Summer National Meeting
Philadelphia, PA
www.naic.org

August 10–15, 2017
American Bar Association Annual Meeting
New York, NY
www.americanbar.org

September 7, 2017
AIRROC/EECMA present Contaminated Sediment Sites and Insurance Implications*
Philadelphia, PA

October 15–18, 2017
AIRROC NJ 2017
Commutations & Networking Forum*
New Brunswick, NJ

November 15, 2017
AIRROC Regional Education Day*
New York, NY

*www.airroc.org

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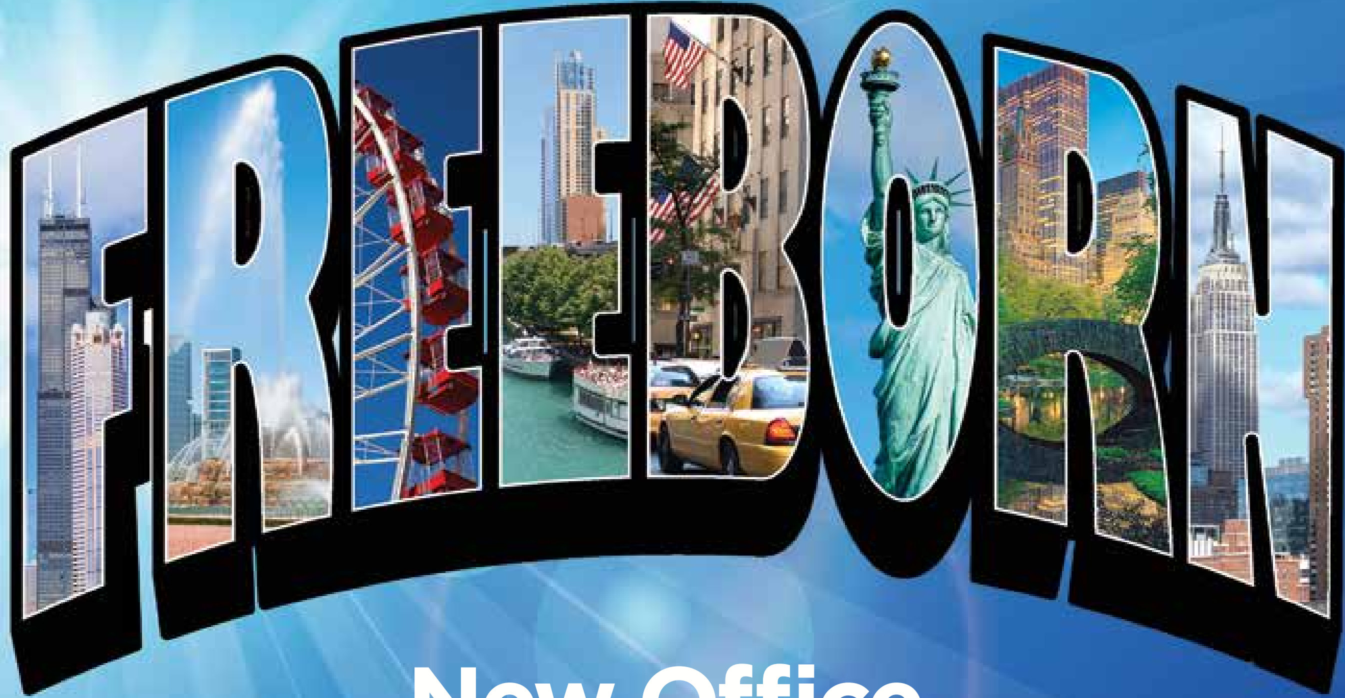
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