LEVERAGING LEGACY LIABILITY

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2014 Commutations & Networking Forum

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When Experience Counts

Yearend Yearnings

Peter A. Scarpato

As 2014 ends, we step back, breathe deep and consider problems of the past and promises of the future. AIRROC's breath is particularly deep and satisfying, in the glow of a decade of creativity, growth and success. With this background, we proudly present another issue, filled with information relevant and topical to our readers.

First, Barbara Murray's piece on *Predictive Analytics*, what companies now envision as the model-based substitution for a predicted "claims brain drain" as seasoned claims professionals leave the business. Next, Steve McElhiney, CEO and Chairman of EWI Re, offers *LIMA in the Limelight*, our continuing journey into the run-off advantages of Vermont's Legacy Insurance Management Act, which contains currently available investment opportunities and, with future legislative changes, the potential for captives to achieve finality through capital-market investments.

Jumping from legislatures to center stage, Connie O'Mara shows how DRP meets Hollywood in *That's Entertainment*, a summary of AIRROC's innovative educational session on dispute resolution. This session combined live and videotaped action to illustrate differences in traditional arbitration and the DRP. And, in our search for interesting published materials, we include a reprint from Best's Review, *The Czech Connection* by Fred Eslami, Senior Financial Analyst at A.M. Best's. Unbeknownst to many, author Franz Kafka started out as a lawyer and insurance company employee, which influenced his works and ultimately helped to establish workers' compensation.

AIRROC updates include a testament to our *Decade of Success,* our Executive Director's summary of AIRROC's many achievements to these past 10 years, and *AIRROC Announces Changes to its Board of Directors*, thanking departing directors Keith Kaplan and Glenn Frankel for their dedicated service and welcoming "yours truly" – me - and Marcus Doran as the board's newest members.

Continuing our theme, AIRROC Matters's cover displays the collegiality of penguins for this year's successful October Commutation and Networking Forum. Most agreed that the location and facilities were second to none, topped off by the wine-tasting dinner located steps from the hotel. The Forum also featured excellent educational programs on pools, financial reporting, LPTs and LIMA, summarized by Publication Committee members Randi Ellias, Connie O'Mara and Michael Goldstein. The Forum also formally recognized Anna Petropoulos, President of Apetrop USA, Inc., as AIRROC's 2014 Person of the Year and Abigayle Claflin, an Actuarial Science major at St. John's University, recipient of the 2014 Trish Getty Scholarship.

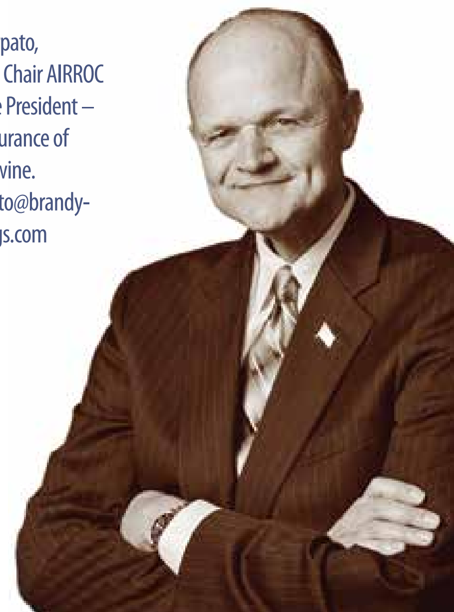
Last, our own Leah Spivey submits *The Legacy of Pink/ Komen Fundraiser*. To celebrate its 10th anniversary, AIRROC replaced its women's luncheon with a fundraising activity sponsored by Carroll McNulty & Kull. Fran Semaya and Peter Bickford's Present Value provide the perfect icing on the cake.

On behalf of the Publication Committee, I wish you all a joyous holiday season and happy, healthy and bountiful New Year!

Let us hear from you. ●

Errors and Omissions

In the last issue, the email addresses were incorrect for Larry Schiffer and Alex Chopin of the law firm Squire Patton Boggs. The correct emails are Larry.Schiffer@squirepb.com and alexandra.chopin@squirepb.com. AIRROC Matters regrets the errors.



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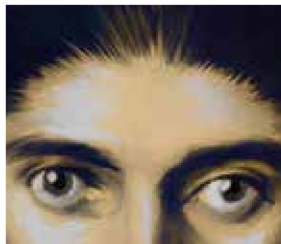

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Predictive Analytics

The Future of Claims Management

Many insurance staffing agencies predict that the insurance industry will have experienced a significant decrease in the number of claims professionals by 2022. The majority of current insurance claims operations staff are experienced professionals with retirement looming over the next decade, as a result claims departments will lose significant historical organizational, operational and industry expertise. These evolving dynamics present a variety of issues, primarily of which is the claims leaders ability to manage available resources effectively while attaining organizational objectives.

In anticipation of the impending change in the workforce, some larger claims operations are already making improvements to their claims systems and implementing a more refined approach to segmentation for early identification of high risk claims and routing of work to appropriate claims handling workstreams. However, predictive analytics, an as yet underutilized tool, has promise to be a more effective solution to the impending shortage of experienced claims personnel dilemma.

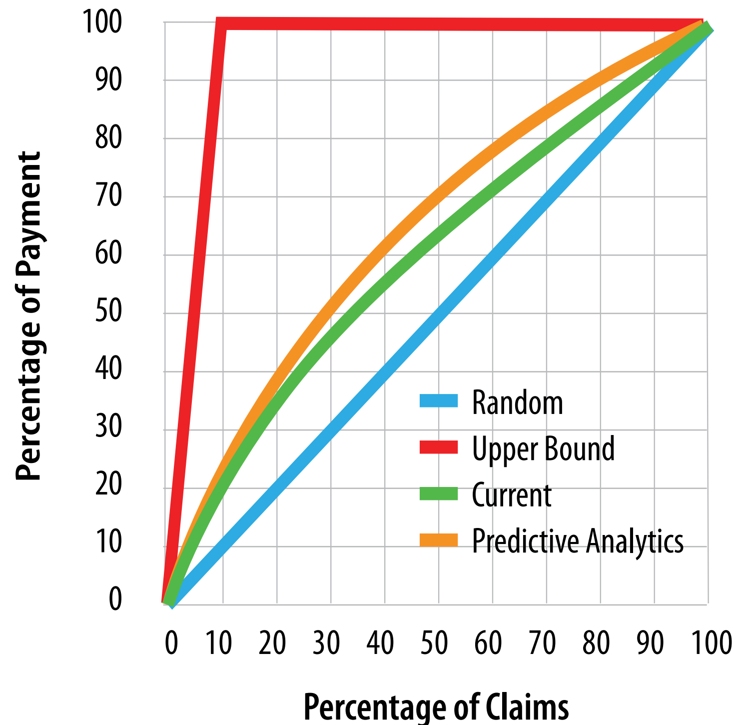
Insurers already utilize predictive analytics to enhance analytical processes and improve underwriting results, but from a claims standpoint, predictive analytics is still in its infancy. The incorporation of predictive analytics into a claims organizations operations can improve profitability by identifying key areas for enhancing efficiencies, and achieving greater consistency around triage and case strategies. In light of the ever-changing nature of claims, driven in large part by external forces (e.g., legislative and judicial changes) combined with the anticipated and significant demographic shift in future claims staff, claims organizations should begin planning now to identify solutions to address these challenges.

An Industry Perspective on Predictive Analytics

By definition, predictive analytics is a process that transforms raw data into signals that can help predict future actionable outcomes. Organizations may use predictive analytics across the entire insurance life-cycle, from identifying target markets to optimizing claims adjudication processes to overall risk management. In fact, market leaders take an enterprise view of predictive modelling, and focus not only on efficiency, but also on strong internal analytical resources and state-of-the art technology.

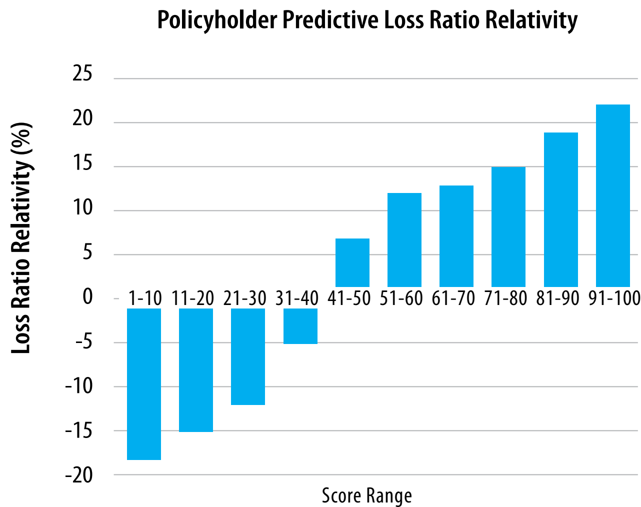
The number of carriers that use predictive modeling to support underwriting, claims and distribution has increased significantly over the past five years, and industry trends suggest this reliance on predictive analytics will continue to increase. As organizations incorporate related tools and techniques into their core processes and decision making process, they should consider the state of the market and other key considerations.

A closer look at the insurance industry reveals that market leaders have better internal modeling capabilities by virtue of faster IT development, greater alignment of strategic processes, and buy-in at the highest levels of the organization. They focus on improving predictive analytics capabilities, while struggling to overcome technological challenges and limitations in process alignments. Prior to detailing the specific areas in which predictive analytics can add value to a claims organization, the organization should identify measures, such as gain charts and lift curves, to demonstrate the benefits, or "predictive power," of applying these advanced modeling and analytical techniques. Gain and lift values are especially useful when an organization uses decision trees to prioritize its efforts.



Line of Business	State of the Market	Key Considerations
Personal Lines	• Majority of carriers incorporate credit scoring, motor vehicle records and prior claims experience in pricing, marketing and underwriting to reduce the potential for claims/fraud. • Carriers use analytics to promote self-service at the point of sale and improve policyholder retention.	• How do carriers differentiate when most use the same external data? • Cross-selling and up-selling has not caught up to the analytics. • High level of regulation places limits on the data that can be used.
Small Commercial	• Significant growth in the use of predictive analytics in underwriting and claims applications. • Less regulation facilitates greater use of internal and external data. • Predictive analytics drives straight-through claims processing and automated underwriting in certain segments.	• Not all carriers have enough data to build class or state specific predictive analytics solutions. • Underwriters and agents are beginning to support automated decision making. • Predictive analytics can incorporate policyholder behaviors to improve loss control, reduce fraud and facilitate premium audits.
Middle Market/ Specialty	• Risks are more heterogenous than in other lines. • Emerging application of predictive analytics in professional liabilty lines over last three years. • Less regulation facilitates greater use of internal and external data. • Limited use of straight-through claims processing.	• Low frequency/high severity lines result in a small volume of quality data, which poses modelling challenges. • More difficult to get buy-in from underwriters and agents.

Predictive Analytics (continued)



Lift Curve

A lift curve measures the degree of segmentation, or the predictive power, of a predictive analytics solution relative to the average. In the absence of predictive analytics or other segmentation tools and techniques, an organization can expect, at best, to achieve the average (e.g., loss ratio). With predictive analytics, an organization can segment the entire population of risks it has accepted on the basis of which risks the organization expects to perform better or worse than average. In the example below, an organization expects policyholders with a score between one and ten to have a loss ratio which is 18 percentage points lower than the average, while predicting a loss ratio 22 points higher than the average for those policyholders with a score between 91 and 100. The difference in relativities between the best and worst segments is the degree of segmentation power, or 'lift'.

Current Use of Predictive Analytics in Insurance Organizations

Applying predictive modelling techniques within the claims function can help an organization reduce claims costs and improve operational efficiency. These analytics give organizations the tools they need to better prepare for the future, utilize resources more appropriately, and ultimately optimize results. Within the claims function, predictive analytics has potential benefits in claim segmentation, fraud detection, recovery, counsel and vendor management, and operations and controls. Historically, more volatile claims were not assigned to skilled claims analysts until case reserves had already deteriorated, which often was too late for the adjuster to impact costs significantly. With predictive modeling and establishing a claim segmentation process, an organization can improve efficiency and costs by identifying potentially volatile claims earlier based on specific claim criteria and directing these claims to the most appropriate claims professional. This process also allows an organization to establish a fast track claims processing unit for the management of a homogenous group of relatively large volume of low severity claims. A company also can use analytics and segmentation to determine optimum settlement authority limits while streamlining operations.

The current approach to detecting fraud for most organizations is largely reactive. Predictive modeling offers near real time analytics to identify cases with a high propensity for fraud at each stage of the claim. The model can capture data elements to address both policy holder and third-party fraud. The effectiveness of fraud detection increases when combined with text mining, which allows for searching within claims adjuster notes. These notes often are the only source of internal information that can be incorporated into the model.

Under certain circumstances, an insurance company can recover a portion of its claims costs from a third party; for example, an insurer may be able to recover a portion of costs of a workers' compensation claim from an equipment manufacturer if the workers' injury resulted from an equipment malfunction or faulty design. The insurer often can recover a

Functional Area	Enhancements from Application of Predictive Analytics
Rating and Pricing	• Developing/modifying rating plans • Optimizing layers of attachment • Improving reinsurance placement • Strengthening pricing accuracy
Underwriting	• Selecting lines of business • Predicting policyholder profitability • Identifying geographical targets • Applying exclusions
Claims	• Improving segmentation • Expediting recovery • Improving fraud detection • Enhancing Counsel and vendor appointment/ management • Optimizing loss control processes and controls • Gaining efficiencies
Distribution	• Strengthening Agency and Broker appointment • Optimizing commission • Improving expansion • Improving oversight
Customer	• Expanding cross-sell and up-sell • Increasing renewals • Improving Policyholder experience • Decreasing costs

Claims Function	Benefits from the Application of Predictive Analytics
Segmentation	• Earlier detection of potentially volatile claims for better claim management • Fast track claim processing for a large volume of low severity claims • Determination of optimum settlement authority • Streamlining of operations
Fraud	• Identification of claims with a high propensity for fraudulent activity by the claimant or a third party • Most effective when combining analytics with text mining
Recovery	• Assessing the cost /benefit of recovery efforts • Early identification of claims with potential recovery opportunities • Determination of staff assignment for claims with highest recovery potential
Counsel and Vendor Management	• Leverage buying power at the enterprise, as well as adjuster or regional level • Measure counsel and vendor performance for better segmentation, identification of problems, and cost savings • Detailed cost analysis to lower costs, monitor contract compliance and identify alternative vendors
Operations and Control	• Identification of operational /control triggers allowing for earlier management intervention • Positively impact areas such as average settlement costs and time to settlement

larger amount more quickly if an experienced adjuster handles it. Not only can predictive modelling measure the cost/benefit of recovery efforts, but early on also can identify for segmentation to the appropriate resource those claims with the greatest recovery opportunity. For example, predictive analytics can help an insurer determine thresholds or criteria for collection risk levels, which can enable it to pursue recovery effectively and efficiently by quickly assigning these claims to the corresponding internal or external resource.

Current methods of evaluating counsel and vendor performance reside at the adjuster or regional management desk. As a result, buying power is not fully leveraged at the enterprise level, where invoice reduction affords the only real opportunity for costs savings. With predictive analytics, an organization can measure relative and absolute counsel and vendor performance, which allows for early segmentation, identification of red flags, and reduction of overall costs. A model can evaluate costs by service type, location, frequency, industry and policyholder, as well as determine the impact on ancillary benefits. As a result, management can better quantify expected costs/savings resulting from enhanced vendor oversight, more accurately measure contract compliance, and target alternative vendors better suited to address a specific need.

The ability to identify triggers and red flags independently of desk-driven upward communication improves opportunities for management to provide appropriate oversight and timely intervention, as well as to enhance processes and controls. Predictive modeling enables organizations to combine their reliance on the individual claims professionals and claims management staff with a variety of tools, including:

- Segmentation of individual claims and claims professionals' responsibilities;
- Improvement in the effectiveness of claims procedures;
- Measurement of claims staff, outside counsel and other service provider performance;
- Facilitation of reinsurance reporting; and
- Improvement in overall claims management.

The use of predictive modeling coupled with traditional upward communication to improve claim management can favorably impact average settlement costs, average number of days open by exposure type, impact of litigation on the number of days open or settlement value, and the impact of socioeconomic and comorbidity factors on claim costs.

Conclusion

Organizations planning for long term success should incorporate predictive analytics in their routine claims operations. Several factors, including the predicted decline in the number of claims professionals, as well as ongoing pressures to maximize efficiencies, stay competitive and operate with top tier performance, make use of predictive analytics not just a luxury, but a bare necessity. ●

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LIMA in the Limelight

Opportunitites Created by the Vermont LIMA Act

Often times, insurance professionals at large, mistakenly view the world of insurance and reinsurance run-off from the exclusive perspective of poorly performing, environmental liability-oriented business that is financially impaired. While clearly much of the run-off of the past has encompassed this variety of insurance and reinsurance business from legacy operations, there is a much broader strategic opportunity around run-off that is emerging. Such opportunities constitute the future of run-off.

Going forward, organizations will increasingly utilize the concepts of run-off and novations as a strategic tool to allow global insurance groups, captive insurance companies, and others to exit certain lines, or portfolios of business to unleash capital for better emerging opportunities, and to free management attention and oversight to more core activities. As such a strategic tool, this theme is only nascent and is just beginning to come to full fruition.

Additionally it bears mention, that our industry is heavily focused on mass tort exposures arising from the pre-1986 environmental crisis – EIL and Asbestosis liabilities that have had such a profound impact upon the industry for decades now and are not abating. However, to only view mass tort from the perspective of these well understood legacy issues is a limited view.

There are a variety of emerging mass tort issues that will, invariably, impact the insurance industry over time as the plaintiff's bar examines potential claim opportunity areas to exploit. Such themes include:

- Obesity claims from fast food and consumer food products companies;
- Global warming suits;
- Food additives;
- EMF claims arising to utility companies; and
- Shale development and related issues around "fracking".

These emerging nascent mass tort areas could have as profound an impact to the global industry, over time, as EIL and Asbestos have in recent decades – if not more. In my view, it is not a matter of "if"; it is a matter of "when".

Thus, from the prism of emerging tort issues, very proactive global insurance groups may begin to evaluate such current liabilities for strategic "culling" efforts – to "laser them out" today of a broader liability portfolio, to avoid future claim actions.

Some of these applications are probably best illustrated by hypothetical examples.

First, let's assume the case of a London-based Lloyd's syndicate and global underwriting group is merging with a major Asian insurance group. From an over-arching perspective, such a hypothetical merger is highly complementary as London and Asian-focused operations are combined for a more global risk platform and a more diverse insurance portfolio with lower overall risk is created (under the tenet of portfolio theory that risk diversification tends to reduce overall volatility of results as well as to mitigate the impact of regional pricing trends).

However, let's also assume that, over time, both of these organizations have also created North American underwriting facilities, though not highly core to either organization, and have been profitable and well controlled. But in this case, they are redundant and duplicative as they operate in similar lines of business and market niches. There is no compelling strategic rationale to keeping both segments post-merger, as they compete against each other and, thus, would only serve to destroy owner capital through channel conflict. Thus, a strategic exit from one platform would be a logical next step to pursue, thus freeing capital for a higher and better use.

These emerging nascent mass tort areas could have as profound an impact to the global industry, over time, as EIL and Asbestos have in recent decades – if not more. In my view, it is not a matter of "if"; it is a matter of "when".

Second, let's examine the hypothetical case of a captive of a major Fortune 500 company in the food business. Let's assume this longstanding captive (say, 25 years in business) has been providing an excess casualty program to the parent of, say, $250MM in limits over this period. Further, let's assume the captive has been assuming one layer of this program (say, the $25MM excess of $25MM layer) for this entire period under review.

As a result, the captive has accumulated a significant degree of capital from favorable underwriting results from this program; the parent has well controlled commercial auto, products, and general liability risks; the related loss experience over time has been favorable due to its stellar risk management and safety culture. These exposures are further reviewed annually by a major actuarial firm that fully develops the IBNR reserves based on overall industry factors. The business has produced an assumed 35% loss ratio over this period on this basis. Taken together, this case is a text book case of a captive "success story".

Management, however, is increasingly concerned about emerging mass tort exposures and is beginning to become nervous about the potential for mass tort suits across the United States related to obesity issues. Some of the concepts advanced by the plaintiff's bar in this context include the deleterious mass marketing of such food product to children, and other creative tort concepts.

The stacking of $25MM limits across 20 years is starting to make management concerned; while there is a very real possibility that such a threat will never really manifest itself to the point of creating a financial issue, the potential "worst case" scenario over time could eventually threaten the financial viability of the captive.

Thus, a "lasering" solution might be in order that would allow this captive to transfer some degree of its assumed exposures to a different capital provider base with a higher tolerance for volatility and downside risk. In other words, such a move would align an upwards shift in the relative risk profile of the insurance liabilities to a new capital provider with a higher risk tolerance and appetite (such as a hedge fund).

This final point is a natural segue into the concept of risk adjusted insurance capital and the varying degree of appetites for risk and volatility that it naturally presents.

The traditional insurance platform is organized for risk adjusted returns in the 7 to 10% rate, normalized for any potential volatility over time due to shock type severity losses. Such platforms are not seeking out-sized financial returns; rather, they are looking for more orderly returns that do not present the insurance policyholders, claimants, or capital providers to undue solvency risks or

LIMA in the Limelight (continued)

shock events that might give rise to either regulatory concerns (i.e. adverse RBC ratio changes) or rating agency downgrades, or negative outlooks. In this traditional insurance model, no undue asset or liability risk is sought and the investments, counterparty risks, and liabilities (through reinsurance) are monitored over time accordingly for conservatism.

The "hedge fund" backed insurance capital model is one where out-sized ("alpha") returns are sought both on the asset side and on the underwriting side. Superior investment results allow for more competitive insurance pricing and when that model is coupled with unusual underwriting risks with opportunistic returns, or ones exposed to undue volatility, very potentially compelling economic returns can be achieved (ROE).

With all of this as a back-drop, the Vermont Legacy Insurance Management Act (LIMA), enacted by Governor Peter Shumlin in February, 2014 creates opportunities to address these sorts of issues with innovative platform solutions. LIMA is the first U.S legislation that allows the formation of specialized, Vermont-based companies to acquire and manage closed blocks of non-admitted commercial insurance policies and reinsurance agreement. A 'Closed Block' requires no more business written in the future, policies must have expired for a period of at least 60 months, and there must be no active premiums to be paid. LIMA enables a non-admitted insurer from any jurisdiction to transfer closed blocks of business to a special-purpose corporate entity domiciled in Vermont. LIMA transfers are limited to commercial insurance policies and/or reinsurance agreements protecting underlying American liability that have continued exposure to claims. No personal insurance, such as life, health, auto or homeowner, or workers' compensation, is involved. LIMA requires the assuming company to establish a new entity domiciled in Vermont, which will be subject to the continuing authority of the Vermont Department of Financial Regulation (DFR)[1].

LIMA creates new investment opportunities. Since the blocks of policies involved are closed, the investors need not be active as an insurance company, thereby expanding possibilities for increased investment. A lot of investment companies are expected to be formed in Vermont.

How LIMA Works

The transferring company will want to relieve itself of contingent liabilities that may never amount to a claim, but are sitting on its books as liabilities. Policyholders and reinsurance counterparties are allowed to opt out of the transfer transactions since acquiring companies must provide 'direct written notices' to them prior to any transfer. Under LIMA, the commissioner of the Vermont DFR would review the acquiring company's solvency before and after the implementation of the proposed transfer of the closed blocks of business. Once a transfer is approved by the Vermont Insurance Commissioner, it acts as a statutory novation. LIMA creates new investment opportunities. Since the blocks of policies involved are closed, the investors need not be active as an insurance company, thereby expanding possibilities for increased investment. A lot of investment companies are expected to be formed in Vermont.

As respects captive insurance companies, the application of LIMA currently is limited to the ability for such a captive to novate reinsurance agreements into LIMA compliant SPVs in accordance with the statute above.

That said, the hypothetical captive situation outlined above would be permissible and, thus, appears to have a ready opportunity for transactions to evolve as Fortune 500-type captives seek to "fine tune" their assumed reinsurance exposures to date, in the face of potential emerging tort exposures. While no such deals have been formalized, it is assumed there will be several under review shortly.

As LIMA potentially evolves in future Vermont legislative sessions, it is conceivable the statute will be broadened to allow dormant captives to move their exposures in total into capital market backed insurance SPVs (again, with capital provided by external providers) to achieve a complete finality to the captive and wind-up. Theoretically, a capital markets-backed vehicle could achieve superior investment returns applied to a base of assets acquired in this manner, to achieve sufficient size and scale to pursue a global alternate risk investment mandate and, in turn, utilize an established claims management and run-off organization to aggressively run-off this portfolio of liabilities over time. In other words, hope to achieve superior claims results over time through a dedicated run-off structure.

From the perspective of Vermont, such an expansion of LIMA would increase captive assets in the state; presumably dormant captives in various other domiciles would be consolidated into

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this "Vermont only" exit option. The assets under management, the service provider requirements, and needs for scale would be a good fit with the existing Vermont captive infrastructure network – developed over 30-plus years. Frankly, the existence of a turn-key "exit" tool should serve to aid Vermont captive formations, as new parent organizations would have a well defined "exit strategy", should the business case for the captive change over time. It is hoped the Vermont legislature will contemplate such an expansion of LIMA in this regard.

In sum, insurance run-off as a strategic tool is expanding – and will continue to do so with the consolidation of global platforms and other strategic considerations. LIMA provides a new platform tool to allow such exits from these, and other potential "lasering" of risk considerations. ●

Endnotes

1. No. 34. An act relating to a transportation policy that considers all users. It is hereby enacted by the General Assembly of the State of Vermont.

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That's Entertainment

The AIRROC Dispute Resolution Process Seminar

Summary by Connie D. O'Mara

Drama, Comedy, Action! The White & Williams sponsored comparative workshop on the AIRROC DRP versus traditional Arbitration had it all.

Drama unfolded through both live performances and video clips giving the audience an opportunity to experience key excerpts in the interplay between parties, counsel and arbitrators in a fairly routine dispute arising from the cession of asbestos losses as a single "event". White & Williams' partner Michael Olsan, director and co-star as Attorney for the ceding company in the DRP process faced off against Jeanne Kohler, Chair of Edwards Wildman Palmer's Insurance and Reinsurance Department, representing the Reinsurer. In the mock arbitration segments, Justin Fortescue of White & Wiliams represented the cedant and the reinsurer was represented by Isla Long, Partner, Pepper Hamilton LLP. A cast of company representatives and arbitrators lent street credibility to the production. Daryn Rush, (co-chair Reinsurance at White & Williams) the producer, stressed the point that the exercise was not designed to make one process shine in contrast to the other, but to contrast them, so the audience was able to compare how they fit into a menu of dispute resolution alternatives. (The materials from the workshop are available on the website and they include a chart that succinctly contrasts the two). The presentation dramatized critical differences in rhythm and timing.

A post-show panel discussion (Ben Gonson, Frank Kehrwald, William Littel, Marianne Petillo, Peter Scarpato and Andrew Maneval) noted operational differences in using the DRP. A single arbitrator costs less time and money and works best when parties can agree on its use, can resolve document exchange issues, and can narrow the issues to a focused IOPF (Initiation of Proceedings Form). Since this all precedes selection of the single arbitrator, parties have a greater role in designing the process, and need not rely on the traditional arbitration panel to manage the process. In addition, the panel discussed how choosing the single arbitrator under the DRP process provided some degree of control and resulted in a much quicker arbitrator selection than umpire selection in a traditional arbitration. Thus, the DRP is especially effective where parties have a degree of cooperation and a clear dispute they cannot resolve through negotiation or mediation. The panel also stressed that the DRP process can be flexible to accommodate the parties' needs.

The full-length feature is currently in negotiations; the word on the street is that George Clooney is being considered to play Howard Denbin (party arbitrator for the reinsurer) and Benedict Cumberbatch has signed to play Jonathan Rosen (party arbitrator for the ceding company). It is hard to imagine they could match the repartee and zeal of the originals.

Over lunch, a panel discussed their views on mediation of reinsurance disputes. This included Peter Scarpato's presentation of "The Counterintuitive Mediator" and commentary by Glenn Frankel and Daryn Rush describing how mediation can provide significant benefits. Not only can it resolve disputes, but if a settlement is not reached, it can narrow the issues and make subsequent arbitration more cost-effective. ●

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Photos/Jon Kuntz

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FEATURE

The Czech Connection

Author Franz Kafka's insurance career influenced his fiction and led directly to the world's first workers' compensation program.

illustration / Rafael Edwards

Key Points

- **The Story:** Renowned author Franz Kafka used his experiences in the insurance business to frame scenes in his masterworks.
- **The Background:** The writer drew heavily on his liability knowledge to help establish what today is known as workers' compensation.
- **The What-If:** Kafka's influential insurance writings and his famous novels had to be saved by his biographer from destruction.

Author Franz Kafka's insurance career influenced his fiction and led directly to the world's first workers' compensation program.

Franz Kafka was born in 1883 in Prague, a city then under Austro-Hungarian rule. He and his work were relatively unknown during his short life (he died in 1924 at age 40 of laryngeal tuberculosis) and most of his great work was published posthumously, thanks to the efforts of his friend and biographer, Max Brod.

Works like *The Metamorphosis*, *The Trial*, and *The Castle* express strange transformations, ruthless characters and bureaucratic complexities. However, the general reader of these works, not to mention some educated attorneys and insurance professionals, are for the most part unaware that behind these complexities lies a solid educational and professional background in law and insurance.

After completing his elementary and secondary studies, Kafka studied law in 1901 and obtained his doctoral degree in 1906. He spent a year as a law clerk for civil and criminal courts and in 1907 was hired by an Italian insurance company, Imperial Regia Privilegiata Compagnia di Assicurazioni Generali Austro-Italiche.

Unhappy at this job, he resigned after only eight-and-a-half months, but was able to secure another job in less than two weeks at Prague Workmen's Accident Insurance Institute for the Kingdom of Bohemia in Prague, which was part of a network of similar institutes having been established by the Austro-Hungarian Empire.

The institute set and collected insurance premiums from employers based on the risk of accidents their operations presented. It also processed, reviewed and paid claims received from injured workers.

Kafka spent from 1908 to 1922 at various positions with the institute. He wrote in his diaries: "Aside from my family relationships, I could not live by literature if only, to begin with, because of the slow maturing of my work and its special character; besides, I am prevented also by my health and my character from devoting myself to what is, in the most favorable case, an uncertain life. I have therefore become an official in a social insurance agency."

His three previously mentioned major works were written while he was an employee of the institute—*The Metamorphosis* in 1913; *The Trial* in 1915; and 1921's *The Castle.* Arguably, Kafka's best works are somewhat related to his work at the institute.

For example, he visited a castle in Friedland in January or February 1911. Judging from an entry in his diary of this trip, it seems probable that Kafka visited this place while on official business for the institute. This castle may have influenced Kafka's conception of the castle that he describes in his 1921 novel.

According to Kafka's biographer, Max Brod, the institute exposed Kafka to a "vortex of contentious economic interests and forces." During Kafka's first years there, he rotated among its three main departments—actuarial, accidents, and appeals—familiarizing himself with different aspects of the institute's operations.

Additionally, Kafka was the special assistant to the institute's director, Dr. Robert Marschner, and to the head of the actuarial department, Eugen Pfohl. Kafka himself served as vice legal secretary (1913), legal secretary (1919) and chief legal secretary (1922). He wrote speeches for both men and authored detailed and comprehensive analytical evaluations for the institute's annual reports.

Inspiration at the Institute

With his legal education and background, Kafka also served as a litigation attorney for the institute. He prepared the institute's legal responses to various appeals, including one for Christian Geipel & Sohn, which owned a weaving mill, on its risk classification; and served as general counsel in the criminal prosecution of a quarry owner who was very uncooperative about paying the necessary premiums to insure his workers. (It has been suggested that this case may be the source for the final scene of *The Trial*, where Josef K. meets his end atop a square block of stone near the wall of a quarry.)

Thanks to Klaus Hermsdorf and Benno Wagner, whose monumental collection *Amtliche Schriften* (2004) contains more than a 1,000 pages of Kafka's office writings; and Stanley Corngold, Jack Greenberg and Benno Wagner's *Franz Kafka: The Office Writings* (2008), we now know that he also authored various articles and studies dealing with accident prevention, risk classifications, premium analysis and so on.

The editors of these two collections view these articles and reports as "an integral part of his literary oeuvre," whose impact on his stories and novels should not be underestimated. It is true that Kafka's professional writings, as the profession dictates, are dry and, to the uninitiated, even boring. But the issues discussed in them appear to have created in Kafka the basis and framework of his literary writings.

Kafka also authored various articles and studies dealing with accident prevention, risk classifications and premium analysis.

Kafka derived a great amount of his knowledge of the world and of life, as well as his skepticism and pessimism, from his experiences in the office—from coming into contact with men who had suffered injustice, to having to deal with the long, drawn-out process of official work, to the stagnating life of files.

The Austro-Hungarian's Worker's Accident Insurance Law came into effect in 1889, and served as a basic model for the social insurance programs of various countries, including the United States. Kafka was a key contributor, whose understanding of accidents and the ways to mitigate them helped to expand and spread a rather universal approach to workers' compensation.

Several of his reports are worth mentioning. The first is *On the Examination of Firms by Trade Inspectors*, which he wrote in 1911 and addressed to the Ministry of the Interior.

In it, he expressed the institute's opinion that it should be allowed to inspect factories rather than relying on the ministry's useless and meaningless reports prepared by ignorant officials who had no experience in understanding risks.

Kafka was frustrated by the red tape that the ministry had imposed on the institute, and which forbid it to inspect the factories. He believed that any risk classification and premium pricing should be done by professionals—actuaries and knowledgeable insurance experts.

He argued that the lack of standardization in the interpretation of rules and regulations, and the ministry inspectors' lack of knowledge, often presenting uncorroborated conclusions instead of the facts that the insurer needed, impaired the institute's ability to properly evaluate the factories for their true risks and premium pricing. A simple change in the law to allow the insurer to inspect these firms and deal with them in a standard fashion would eliminate thousands of appeals from factory owners and speed up the resolution process, Kafka noted.

Frustrated by Inaction

In two articles published in the daily newspaper *Tetschen-Bodenbacher Zeitung* in 1911, Kafka takes on the topic of workman's insurance and employers and discusses the original and intended ideal of workmen's accident insurance at a time when it had become the object of conflict between the vested interests of the state, employers and workers.

After a brief historical comparison between the experience of Germany's pay-as-you-go system and Austria's fully funded system, Kafka contends that the Austrian system placed greater demands on the involved groups, causing painful surprises. He explained the premium contribution, which is graduated

according to the firm's risk level so the most dangerous receive the highest risk classification with the highest premium rates.

Initially, such classification was based on statistical data provided by the interior ministry. But the data was so defective and inadequate that it did not represent the actuality and resulted in an unjustified distribution of charges among the firms. After this attack on the government, Kafka blames the institute as well as industrialists for the system's problems. He accused the institute of having its hands tied up by both the government and employers. "The institute seemed simply to be a corpse," he wrote, "whose only living element was its growing deficit. The last hope was for a general reform of social insurance." Kafka added that employers did not fulfill their obligations to the institute, either.

He pleaded for legal reforms to deal with the issues he had raised. "We forget that the current law is, in fact, in place and that a long time will have to pass before it is replaced by a new and better one, and that therefore we need to arrange our affairs with the current law as best as we can."

Answering Appeals

Some of Kafka's time was spent responding to the appeals of companies over various issues and actions the institute had taken.

One such response appears in his Risk Classification Appeal by Norbert Hoschsieder, Boarding House Owner in Marienbad. Hoschsieder was a rather rude businessman who used all kinds of reasoning to avoid paying for compulsory insurance. Hoschsieder owned hotels that had mechanical elevators; as such he was liable for insuring his employees against accidents.

He contended that the motor for his power-operated elevators was not located on the premises but in a local power station, from which he simply received the electrical energy that operated it.

Then, recognizing his blunder, he argued that while in fact there was a motor on the premises, it was locked in a black box in the cellar and only accessible to the elevator technician, and forbidden to anyone else.

After several responses by the institute between June 1912 and November 2013, an administrative court finally dismissed Hoschsieder's claims and determined that elevators were legally considered worker-operated machines, and thus required insurance for work-related accidents.

In his first novel, the unfinished *Amerika* (also known as *The Man Who Disappeared*) Kafka includes several passages about the technical functioning of an elevator.

Some of the aspects of what we nowadays call "risk management" or "risk mitigation" are presented in his *Accident Prevention in Quarries* (1914). This report, which is full of impressive pictures of quarry accidents, deals with the working conditions of Austrian quarrymen.

> *Some of the aspects of what we nowadays call "risk management" or "risk mitigation" are presented in* Kafka's Accident Prevention in Quarries (1914).

In the section *Alcohol Abuse in Quarries*, he mentioned a quarry owner who also ran a pub and had brandy brought in for his workers daily. The owner kept thinly masked accounts of how much each worker drank and subtracted the amount from the worker's pay.

Kafka's plea in this report is that all pubs close to and near quarries should be shut down, not only because of the dangers they impose on quarrymen but also because of workers being "demoralized." Over time, Kafka increasingly focused on accident prevention measures and analyzing work-related safety issues.

In his biography of Kafka, Max Brod wrote that, "when it came to the point of choosing a profession, [Kafka] postulated his job should have nothing to do with literature. That he would have regarded as a debasing of literary creation. Breadwinning and the art of writing must be kept absolutely apart."

Brod also indicated that, for Kafka, the institute's principal attraction was that it was one of the few offices in Prague that allowed him to work a "single shift" from 8 a.m. until 2 p.m.

He worked six days a week, with no break for lunch, thereby affording him more uninterrupted time each day for writing.

And, although Kafka valued the fact that his work at the institute "doesn't demand all my strength," he complained constantly about his work to his friends and fiancée, and in his diary.

Author's Note

This essay is materially based on *Franz Kafka: The Office Writings* (2008) by Stanley Corngold, Jack Greenberg and Benno Wagner, and on a number of reviews of the book.

Kafka's other reports, letters and articles include: *The Scope of Compulsory Insurance for the Building Trades* (1908); *Speech on the Occasion of the Inauguration of the Institute's New Director* (1909); *Fixed-Rate Insurance Premiums for Small Farms Using Machinery* (1909); *Inclusion of Private Automobile "Firms" in the Compulsory Insurance Program* (1909); *Measures for Preventing Accidents from Wood-Planing Machines* (1910); *Petition of the Toy Producers' Association in Katharinaberg, Erzgebirge* (1912); *Letters to the Workmen's Accident Insurance Institute in Prague* (1912-15); *Criminal Charge Against Josef Renelt for the Illegal Withholding of Insurance Fees* (1913); *Second International Congress on Accident Prevention and First Aid in Vienna* (1913); *Jubilee Report: Twenty-Five Years of the Workmen's Accident Insurance Institute* (1914); *Risk Classification and Accident Prevention in Wartime* (1915); *A Public Psychiatric Hospital for German-Bohemia* (1916); and *Help Disabled Veterans! An Urgent Appeal to the Public* (1916/1917). ●

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News & Events

Francine L. Semaya & Peter Bickford

Liberty Mutual CEO Appointed as Presidential Advisor on Trade

David Long, chief executive officer of Liberty Mutual Insurance, was named to a group advising President Obama on Trade policy and negotiations. He joins a group that will include representatives from technology and entertainment companies, as well as, union representatives, and will advise the administration on financial services issues.

National Association of Insurance Commissioners

Election of Officers: On November 19, 2014, at the conclusion of the NAIC Fall National Meeting held in Washington, DC, the NAIC elected new officers who assume their roles on January 1, 2015:

President: Monica J. Lindeen, Montana State-Auditor and Commissioner of Securities and Insurance

President-Elect: Michael F. Consedine, Pennsylvania Insurance Commissioner

Vice President: Sharon P. Clark – Kentucky Insurance Commissioner

Secretary-Treasurer: Ted Nickel- Wisconsin Insurance Commissioner

Key Issues for 2015

1. Global Capital Standards proposed by the International Association of Insurance Supervisors (IAIS): Key to the NAIC is working with the Federal Insurance Office and the Federal Reserve to present a unified US position to the IAIS and to ensure protection to US consumers.

2. Principles-Based Reserving: Because of the slow pace of states adopting the NAIC proposed National Standard, the NAIC task force has adopted Actuarial Guideline B to permit companies to use XXX and AXXX captives until principles-based reserving is ratified. Forty-two states, comprising 75% of national premium is required to meet the national accreditation standards. To date, only 18 states, with 28% of the national premium have adopted principles-based reserving legislation.

3. Cybersecurity Task Force: Although incoming President Lindeen has not appointed any members to this new task force, its goals include monitoring cybersecurity developments, and then to be responsible to advise, report on, and make recommendations to the NAIC Executive Committee on cybersecurity issues. This task force is also charged with assisting states in protecting information housed in the insurance departments and the NAIC.

4. Qualified Jurisdictions for Reinsurance Collateral Reductions: The NAIC announced its recommendation of qualified jurisdictions from which reinsurers will be able to post reduced collateral. The five jurisdictions are: The Bermuda Monetary Authority; The German Federal Financial Supervisory Authority; The French Autorite de Controle Prudentiel et de Resolution; the Central Bank of Ireland; and the United Kingdom's Prudential Regulation Authority of the Bank of England. Visibly missing from the approved jurisdictions were Japan and Switzerland, but the NAIC Reinsurance Task Force assured the attendees that their approval is due shortly.

5. Corporate Governance: The NAIC adopted the "Corporate Governance Annual Disclosure Model Act" and corresponding Regulations. Compliance begins in 2016 and insurers will have to provide the required documentation in four key areas: governance framework and structure; policies and practices of the Board of Directors and its Committees; policies and practices of senior management; and oversight of critical risk areas. The detail required for the reporting by insurers is extensive and must include the rationale and suitability of each of the above for the insurer/insurer group's needs. The new requirements are applicable to all US insurers, with no exemption for small insurers and fraternals. More information will be provided in a future edition of AIRROC Matters.

Industry News

M&A activity in fall of 2014 was shaping up to be relatively slow on the company front, although more active on the brokerage side. There were only a spattering of small company transactions, until **RenaissanceRe Holdings Ltd. ("RenRe")** announced in late November that it was acquiring **Platinum Underwriters Holdings, Ltd. ("Platinum")** for $1.9 billion. Under the agreement, the common shareholders of Platinum will receive $76.00 per share in stock and cash, a 24% premium to the November 21st closing price of Platinum's common shares. Interestingly, part of the cash being paid to Platinum's shareholders will come from a special Platinum dividend. According to RenRe's president Kevin J. O'Donnell, the acquisition will "accelerate the growth of our U.S. specialty and casualty reinsurance platform and as a result, create enhanced value for our shareholders." Speculation is that this transaction is a precursor of more major acquisitions in light of the soft market.

Other than the RenRe-Platinum transaction, the company activity was relatively quiet. In October, the Bermuda-based reinsurer **Till Capital, Ltd.** completed its acquisition of the Canadian insurer, **Omega General Insurance,** including its two subsidiaries, **Omega General Insurance** and **Focus Group, Inc**. Also, the sale by **Zurich Insurance Group** of its general retail business in Russia to **OLMA Investment Group,** a Moscow-based investment company, was completed in November.

Present Value (continued)

In addition, there were two significant insurance law firm mergers announced this past fall. On October 1st, California-based **Barger & Wolen LLP,** merged with Chicago-based **Hinshaw & Culbertson LLP.** The combined firm will continue under the **Hinshaw & Culbertson** name with 120 attorneys in its insurance and financial services practice. On December 1st, two other prominent insurance firms, Dallas-based **Locke Lord LLP** and Boston-based **Edwards Wildman Palmer LLP,** announced approval of a merger to be effective January 10, 2015, creating a 1000-lawyer firm with 23 offices operating under the name **Locke Lord Edwards LLP.**

New AIRROC Members

Welcome to AIRROC's newest corporate members, **Southland National Insurance Corp. ("Southland")** and **QBE North America ("QBE").**

Southland is a legal reserve life insurance company based in Tuscaloosa, Alabama, and is currently active in two lines of business, Advance Funeral Planning, marketing preneed and final expense products, and Supplemental Benefits, the administration of insured and employer funded dental and supplemental benefits plans.

QBE is part of QBE Insurance Group, with its roots in Australia 127 years ago. Today QBE Insurance Group is one of the world's top 20 general insurance and reinsurance companies with gross written premium of $17.9 (US) billion in 2013 and employing more than 17,000 people in 43 countries.

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 on the Move

Thomas B. Leonardi, who has been the Connecticut Insurance Commissioner since February 2011, will be leaving that post to join Evercore, a New York based global investment banking advisory firm as a senior advisor with a focus on the insurance industry sector. While Connecticut Insurance Commissioner, Leonardi has been a member of the Executive Committee of both the National Association of Insurance Commissioners (NAIC) and the International Association of Insurance Supervisors. He also served as a member of the U.S. Treasury's inaugural Federal Advisory Committee on Insurance and was selected to serve on the World Economic Forum's Global Council on Insurance and Asset Management.

Michael Fitzgerald, formerly with Aon's Inpoint, has joined new AIRROC member QBE North America as Senior Vice President, Discontinued Programs. Mike, who is an AIRROC board member, brings over 30 years global and domestic experience to this newly created role, where he will be responsible for oversight of all QBE's current and future runoff business. Mike can be reached at Michael.Fitzgerald@us.qbe.com.

Mindy S. Kipness was recently appointed as AIG's Global Head of Reinsurance Operations with oversight of global P&C reinsurance operational functions including Reinsurance Account Services, Reinsurance Collections, and Reinsurance Claims. She has 28 years of reinsurance experience and has been with AIG since 1996. Mindy, who is also an AIRROC board member, can be reached at Mindy.Kipness@AIG.com.

WINTER 2015 MARK YOUR CALENDAR

February 3, 2015
AIRROC Workshop: "The Future of the Duty of Utmost Good Faith"
Princeton, NJ
www.airroc.org

February 25-27, 2015
IAIR Insurance Insolvency Workshop
San Antonio, TX
www.iair.org

March 18-19, 2015
AIRROC Spring Membership meeting
New York, NY
www.airroc.org

March 28-31, 2015
National Association of Insurance Commissioners (NAIC)
Spring National Meeting
Phoenix, AZ
www.naic.org

April 21-22, 1015
ACI Run-Off and Commutations Forum
New York, NY
www.americanconference.com

May 6-8, 2015
IRLA Annual Congress
Brighton, UK
www.irla-international.com

After 24 years as an insurance regulator, including service as Assistant Commissioner for the Office of Solvency Regulation, New Jersey Department of Banking and Insurance, **Robert "Bob" Kasinow** has joined the regulatory team at Alvarez & Marsal Insurance and Risk Advisory Services. ●

A Decade of Success

Carolyn Fahey

Message from the Executive Director

It's been a great 2014 for AIRROC! We celebrated our 10th "birthday" with an established history of success behind us and we continue to build momentum. Not only are more companies realizing that AIRROC offers its members terrific value for their investment in membership, they see the positive impact that attendance at our meetings has on their bottom line.

Just a few numbers worth sharing related to AIRROC's accomplishments in 2014:

- AIRROC hosted eight events: Two in New York, two in Chicago, and one each in Boston, Philadelphia, New Jersey and Washington, DC.
- Attendee surveys have been extremely favorable: 96.5% of the attendees rated our programming Excellent or Very Good.
- 793 individuals attended AIRROC events in 2014 – 79% of these were from AIRROC members or Corporate Partners.
- Four new members: QBE, PennTreaty, Southland National, Fifth Avenue Claims Services.

These items are all indicative of AIRROC's continued relevance to our members and the legacy industry. Looking ahead into 2015 the Board and I have new initiatives planned including an updated Dispute Resolution Procedure (DRP), a Mediation version of the DRP, and our own designation for Legacy Professionals.

Mark your calendar for the upcoming 2015 AIRROC events on the facing page.

We are also planning programs in Boston, Chicago, and London. Watch for the dates to be announced!

See you soon…

Carolyn Fahey joined AIRROC as Executive Director in May 2012. She brings more than 20 years of re/insurance industry and association experience to the organization.
carolyn@airroc.org

AIRROC Board of Directors & Officers 2015

Back Row – left to right: Sylvain Villeroy de Galhau (AXA Liabilities Managers UK); Michael Fitzgerald (QBE North America); J. Marcus Doran (The Hartford/First State); Frank Kehrwald (Swiss Re); Marianne Petillo (Co-Chair), ROM Re; William Littel (Secretary), Allstate; Karen Amos (Resolute Management Services), Michael Baschwitz (Zurich); Peter Scarpato (Brandywine). **Front Row – left to right:** Art Coleman (Immediate Past Chairman), Citadel Re; Ed Gibney (Vice Chair), R&Q; Mindy Kipness (AIG), Carolyn Fahey (Executive Director); Katherine Barker (Co-Chair), Excalibur Re; Ann Weikers (RiverStone ReSources LLC); Leah Spivey (Munich Re America). **Not Pictured:** Sheila Chapman (CNA); Joseph J. DeVito (Treasurer), DeVito Consulting.

Pass the Torch

AIRROC Announces Changes to its Board of Directors

AIRROC is pleased to announce the appointment of two new members to its Board of Directors:

Peter Scarpato, Vice President Ceded Reinsurance, Brandywine

J. Marcus Doran, Assistant Vice President – Commutations, The Hartford

Mr. Scarpato was elected by AIRROC members and will serve a three-year term expiring in 2018. Mr. Doran was confirmed to finish out the term of Glenn Frankel, who resigned from the board due to a change in responsibilities. AIRROC has a 15-person board which all serve three year staggered terms.

AIRROC Executive Director, Carolyn Fahey, commented that she is pleased to welcome Peter and Marcus. They are both already very involved with supporting the organization. Peter serves as the Editor-in-Chief for AIRROC Matters, and Marcus has been the Vice Chair of AIRROC's Education Committee. "It is only fitting that they now have the chance to influence the success of the organization on a larger scale by serving as directors", said Fahey.

The AIRROC Board would also like to acknowledge the contributions of directors **Glenn Frankel**, The Hartford and **Keith Kaplan,** Reliance in Liquidation, who are leaving the board at the end of 2014. Keith has been on the board for 10 years – and is one of the founding directors of the organization. He has been extremely active in his support of AIRROC's initiatives most recently acting as the Vice Chair of the Publication Committee. Glenn's focus for AIRROC has been on the recent changes to AIRROC's Dispute Resolution Procedure and Mediation Procedure, and assisting with developing the DRP Workshops in New York and Philadelphia. AIRROC Co-Chair Marianne Petillo, ROM Re, thanks them for their contributions and most of all for the time they have given AIRROC, "Working with Keith and Glenn has been an honor and a privilege, and the impact that they have made in the organization will carry forward for many years." ●

AIRROC's mission is to promote and represent the common interests of insurance and reinsurance companies with legacy business. The Association's objectives include improving professional and managerial standards and practices and enhancing knowledge and communications within and outside of the run-off industry.

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AIRROC 2014
COMMUTATIONS & NETWORKING FORUM

NEWS FROM NEW BRUNSWICK

AIRROC does it again! Members gave high praise to the Commutations & Networking Forum in New Brunswick and the quality of programming and the novel dinner events, culminating in the selection of Anna Petropoulos as the Person of the Year.

photos / Jean-Marc Grambert

Everyone Into the Pool? You Be the Judge

Summary by Randi Ellias

Part I: Everyone Into the Pool?

The morning started with an introduction to the characteristics of pools, the complexities of managing a pool, and various strategies for exiting a pool. The session was moderated by John West of Devonshire and included panel members Richard Dupree of Travelers, Edward Gibney of R&Q Solutions, Dea Rocano of Riverstone Resources, and Anna Wszalek of R&Q Solutions. There are three types of pools: (1) involuntary pools, which provide coverage to otherwise uninsurable risks and in which participation is state-mandated; (2) voluntary pools, in which the participant's main motivation for participation is likely to increase capacity; and (3) intercompany pools, in which all the participants are affiliated entities. All pool members share the costs associated with participation and bear the risk of insolvency of other pool members, with each pool member becoming responsible for its share of otherwise unrecoverable expenses. The NAIC currently recognizes 500 existing pools.

Ms. Rocano and Ms. Wszalek discussed the complexities of managing a pool, which can be affected by the type of business insured or reinsured, the types of claims at issue, the age of the pool, which affects the availability of historical records, and the diversity of the pool members. Tracking and collecting retrocessional coverage also adds to the complexity. Pool managers also must cope with two different levels of reporting requirements being: to the pool members and to the retrocessionaires. Finally, the pool managers must be mindful of any audit provisions in the pool's constitution and must be prepared for pool members to request audits on a regular basis. Ms. Rocano and Ms. Wszalek stressed the need for pool managers to proactively provide information to both pool members and retrocessionaires, particularly with respect to large claims, reserves, and denied claims.

There are a number of methods for exiting a pool, including (1) commutation of particular pool years: (2) commutation of pool shares; (3) sale of pool shares. All pools are not created equal, and the best method for winding up the affairs of one pool may not be the same as the best method for winding up the affairs of a different pool. In order to effectively wind up a pool, pool members must be aligned in their respective desires to do so and must buy into the process. Indeed, the importance of pool member buy-in is underscored by the fact that 64% of the audience attending the session preferred an exit plan developed by a committee of pool members, rather than an exit plan developed by a third party or the pool manager. The panel noted that an exit plan managed by a third party or a pool manager ultimately may allow for better project management. Finally, pool members should be prepared for the fact the process of exiting a pool can be a lengthy one – Messrs. Dupree and Gibney noted that the recent wrap-up of the WCRB took approximately eighteen years.

Part II: You Be the Judge

Robin Dusek of Freeborn & Peters then emceed a mock arbitration. The hypothetical involved a reinsurance pool in which a financially-distressed pool member, who held a 2% share in the pool and fronted a large number of risks for the pool, entered into a commutation with one of its cedents to whom it had provided quota share reinsurance. The financially-distressed pool member had retroceded 100% of that reinsurance into the pool and assigned its rights to collect from the pool to its cedent. The pool had been invited to participate in commutation discussions, but declined to do so, although the pool advised the financially-distressed member that it would support a $20M commutation value, as the pool believed there was $10 million in offset available. The financially-distressed member ultimately commuted for $30M – $5M in excess of the cedent's $25M reserves and $10M in excess of the amount recommended by the pool. The ceding company, who purported to step into the shoes of the financially-distressed pool member by virtue of the assignment, then sought to collect from the other pool members. The other pool members refused to pay, arguing that a commutation, which included IBNR, was *not* a settle-

ment as contemplated in the follow-the-settlements provision of the quota share treaty governing the pool. The dispute involved issues of assignment, follow-the-settlements, and bad faith, alleged by both the cedent (standing in the shoes of the financially-distressed pool member) and the pool.

The financially-distressed pool member, played by Marianne Petillo of Rom Re, was represented by Nick DiGiovanni of Locke Lord, LLP. Diane Myers of Munich Re played the role of the spokesperson for the other pool members with John O'Bryan of Freeborn and Peters as her counsel. The audience witnessed the pre-mediation meetings between the clients and their lawyers and the parties' respective presentations at an ultimately-unsuccessful mediation. After deliberations by party-appointed arbitrators Sylvia Kaminsky on behalf of the cedent and Susan Mack on behalf of the pool, the audience served as umpire for the dispute.

The audience was polled after recitation of the hypothetical and before any argument, after listening to the meetings between the clients and their attorneys, after the mediation presentations, and after deliberations by the party-appointed arbitrators. The poll consisted of the same question each time: "Do you think the [ ] Pool should be obligated to pay their 98% share of the $30 million commutation between [the cedent and the financially-distressed pool member]?" The audience was presented with four choices: (1) Yes; (2) No, but the [] Pool should pay some amount between $20 million and $30 million; (3) No, but the [] Pool should pay some amount $20M or less; (4) No." At the outset, prior to any argument or deliberation, the audience was just about evenly-divided among those four responses. At the conclusion of the exercise, only 2% of the audience felt that the cedent should make no recovery from the pool, with 45% of the audience ruling that the pool should pay some amount $20 million or less.

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Financial Reporting Requirements

An Evolution from EZ Reader to World Almanac

Summary by Michael Goldstein

J. Marcus Doran, Assistant Vice President of Commutations at The Hartford (and Vice Chair of the AIRROC Education Committee), moderated this panel of regulatory professionals regarding the increase in financial reporting and regulatory oversight that has occurred over the last twenty five years, and whether the costs have outweighed the benefits to insurers and regulators alike. Audience participation was solicited during the panel through the use of thought-provoking survey questions.

Norris W. Clark of Locke Lord, LLP, began the discussion with an overview of the NAIC Solvency Agenda developed in 1989 ("Agenda"), and amended in the years following. The Agenda was national in scope, adopted uniformly by state, and created in response to the Dingell Report, a federal study criticizing state oversight of the solvency of P&C insurers. The major initiatives of the Agenda were, among others things, the codification of comprehensive statutory accounting principles; revisions to the NAIC Financial Condition Examiners Handbook; development of risk-based capital; and certain other steps to improve regulatory oversight.

Internal assessments have developed subsequent to the Agenda, such as the "Own Risk and Solvency Assessment" (or "ORSA"), which assesses the risks associated with an insurer's business plan and the sufficiency of capital to support those risks. In September 2012, the NAIC adopted the "Risk Management and ORSA Model Act" (effective January 1, 2015), which imposes core requirements on a state's domestic insurers — twelve states have so far passed the legislation. Mr. Clark concluded with a brief overview of additional solvency modernization plans that are being developed, including, "principles based reserving."

Page 24 (from left): Rick Dupree, Travelers; Ed Gibney, R&Q; Dea Rocano, Riverstone; Anna Wszalek, R&Q.

Page 25 (from left): Robin Dusek, Freeborn Peters; Sylvia Kaminsky; Nick DiGiovanni, Locke Lord; Marianne Petillo, ROM Re; Susan Mack, Portia Consulting; John O'Bryan, Freeborn Peters; Diane Myers, Munich Re.

Educational Panels (continued)

John Bator (CFO, RiverStone Resources, LLC), proceeded to discuss the increased cost of financial compliance and reporting that has occurred since the late 1990s; including, the implementation of Sarbanes-Oxley, ORSA requirements, enterprise risk management, COSO requirements, insurance contracts standards, new revenue recognition standards, and more comprehensive disclosure requirements under both statutory and GAAP reporting. All of these increased reporting demands have resulted not only in foreseeable costs, such as, (a) those associated with an increased regulatory/compliance staff, and (b) higher standards and scrutiny for the accounting profession, in general — but also indirect costs associated with activities like the increase of encryption of devices in order to reduce the risk of cyber-attack targeting the sensitive data created in response to new regulatory requirements. Mr. Bator concluded with a brief comparison of U.S. GAAP and the International Financial Reporting Standards (or "IFRS").

Lynn Bachstetter (Associate Director of Insurance, SNL Financial), concluded the panel with additional insights into the significance of data reporting as relates to the acquisition of books of business and other investment opportunities.

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What's on the Horizon?

Relevant Issues to be Aware of . . .

Summary by Randi Ellias

Karen Amos of Resolute Management Services Limited moderated a session in which John Finnegan of Chadbourne & Parke, Lloyd Gura of Mound Cotton Wollan & Greengrass, and Andrew Lewner of Stroock & Stroock & Lavan provided snapshots of the current state of play on three industry issues.

1. Follow the Fortunes: New Developments

Mr. Finnegan reviewed the state of the law on the "follow-the-settlements" doctrine. Mr. Finnegan noted that recent court decisions have put some parameters around the follow-the-settlements doctrine, particularly in the case of settlement allocations. Those recent decisions have established that a reinsurer is not required to follow a cedent's settlements where the cedent's claims-handling and/or analysis is subpar. Further, according to the New York Court of Appeals, in order for the follow-the-settlements doctrine to apply to an allocation decision, that decision must be "objectively reasonable," meaning that the parties to the underlying settlement would have arrived at that allocation at arms'-length as though the reinsurance did not exist. Finally, a recent federal district court decision from the Federal District Court of Connecticut rejected the idea that a reinsurer is not entitled to discovery in an allocation case, recognizing that per New York law, the determination whether the allocation was "objectively reasonable" warranted inquiry into – and discovery of – underlying facts.

2. Supply Chain Disruptions/ Contingent Time Element Losses

Mr. Gura then discussed various coverages applicable to supply chain disruptions, which are usually written as reinsurance of a captive insurer. First, Mr. Gura explained that contingent time element coverage differed from traditional business interruption coverage in that traditional business interruption coverage required physical damage to the insured's own property, whereas, contingent time element coverage encompassed physical damage to any *dependent* property, including that of suppliers or customers, that causes loss to the insured. In the case of contingent element coverage, the loss also covers expense in addition to lost income. Depending upon policy language, contingent element coverage may indemnify for losses that occur on the customer's premises, at the supplier's premises, or any losses that prevent delivery, no matter where sustained.

Mr. Gura also discussed supply chain insurance, which provides coverage in the event of the total or partial reduction of supply. Supply chain insurance differs from both business interruption coverage and contingent time element coverage in that there is no requirement of physical damage. The areas of dispute for supply chain coverage often involve questions of how far down the chain of suppliers the coverage will reach.

3. Asbestos/Asbestosis Exclusions

Finally, Mr. Lewner discussed asbestosis exclusions in CGL policies, noting that in the 70s and 80s, ISO had no asbestosis exclusion, and the term "asbestosis" had two different meanings. First, asbestosis was used to refer to a specific disease. Second, asbestosis was also used to refer to all asbestos-related diseases. Courts who have addressed this issue have split on the question whether the term "asbestosis" is ambiguous such that it is appropriate to consider extrinsic evidence to resolve the ambiguity. Many of the courts that have considered extrinsic evidence have concluded that the term encompasses all asbestos-related diseases.

Page 26 (from left): Marcus Doran, The Hartford; Lynn Bachstetter, SNL Insurance; John Bator, Riverstone; Norris Clark, Locke Lord; Marcus Doran, The Hartford.

Page 27 (starting with third photo left to right): John Finnegan, Chadbourne; Andrew Lewner, Stroock; Lloyd Gura, Mound Cotton.

LPT's: Goals and Considerations

Taming the Volatile Beast

Summary by Connie D. O'Mara

The panel discussion moderated by Andre Lefebvre, Senior Vice President at Arrowpoint Capital, provided a thorough overview on how to analyze whether a Loss Portfolio Transfer or Adverse Development Cover could advance your company's financial strategy.

Todd Cheema, Head of ERO Retrospective Solutions and Senior Vice President of Swiss Re, presented on LPT/ADC options for balance sheet relief, capital optimization, and operational efficiencies. Cheema illustrated, with examples, how different approaches can protect against timing risk and reserve risk when dealing with volatility in run-off portfolios. Cheema also explained how the analysis that is necessary to determine the optimal strategy is key to achieving the financial objectives of managing these risks and in deciding whether to support a merger, capital management requirements, or a realignment for operational efficiency.

Of course, one's appetite for doing an ADC or LPT depends on pricing. Pricing depends not just on actuarial analysis but also on a detailed dialogue with your actuaries concerning your goals and the factual underpinnings of what the actuaries analyze. Jason Russ, Principal & Consulting Actuary at Milliman, laid out a framework for actuarial analysis. Russ described how understanding the nature of the portfolio and the causes of the run-off leads to a better understanding of where to start the analysis. Further, the period of time in which the book has been in run-off determines the focus. Earlier years tend to be more driven by the financial pressures that led to the run-off, whereas later years tend to be more driven by large claim development. In analyzing the middle stage of a portfolio run-off, an actuary needs to understand the impacts on payment patterns from a claims management perspective, including an appreciation for claims reporting, reserving, settlement amounts, and reinsurance performance. All of these considerations necessitate a continued dialogue with actuaries as both the buyer and the seller work through the variables of pricing.

Finally, Sandra Santomenno, Senior Consultant at Towers Perrin, discussed financial modeling to support a company's strategy for choosing and pricing an LPT/ADC program. The goal is to determine the probability that the run-off portfolio is properly funded across an array of possible economic conditions. She described how Towers Watson's proprietary ESG is an example of modeling to produce future economic scenarios (e.g., interest rates) dealing with asset returns. Assets can then be "rebalanced" to optimize return while meeting projected cash flow.

Educational Panels (continued)

Santomenno explained that financial modeling can also deal with claims volatility in terms of timing and reserves and that the relationship between all of the various risks or dependencies can be modeled to determine an optimum strategy to improve financial performance or to support pricing for LPTs or ADCs.

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Vermont's Legacy Insurance Management Act

How Will it Work?

Summary by Michael Goldstein

Michael Goldstein of Mound Cotton Wollan & Greengrass moderated this panel of regulators and industry professionals who provided an insightful view of the innovative legislation recently passed in Vermont – its Legacy Insurance Management Act ("LIMA" or the "Act"). This constituted the second time this panel was presented – the first time was in June – as it was brought back by popular demand as a "Special Education Feature" at this year's Forum.

Anna Petropoulos (President, Apetrop USA), who was instrumental in getting LIMA passed into law, provided an overview of the Act and described what types of companies and categories of insurance can take advantage of this legislation. She also described how a transfer plan would work under LIMA and concluded with her insights into the benefits of the Act.

Jeffrey Kingsley of Goldberg Segalla – substituting for the Commissioner of Vermont's Department of Financial Regulation, Susan Donegan, who participated in the first iteration of the event – proceeded to walk the audience through a historical perspective on issues involving long-tail liabilities and the impact of Solvency II regarding investment of reserves related thereto. Mr. Kingsley discussed the differences between in-house solutions (commutations) and those solutions involving third-parties (loss portfolio transfers) and the relationship between statutory portfolio transfers in the UK as a basis for LIMA. He also examined the scope of LIMA, the possibilities it provides for U.S. long-tail liabilities issues, and how it contrasts with the UK model. Mr. Kingsley concluded with a brief discussion of how LIMA may alter the regulatory landscape and an examination of its potential expansion.

Daniel Maher (Executive Director, Excess Line Association of New York), then provided his view of LIMA from an excess and specialty lines ("E&S") perspective and indicated that the Act brings some additional protections to E&S transfers, currently a $30 billion a year business in the U.S. From an E&S standpoint, LIMA has the potential of being the new and improved mechanism needed by the industry. However, Mr. Maher added that the reinsurance side of things would be more complex and have additional potential barriers.

Steve McElhiney (CEO, EWI Re), wrapped up with his thoughts on the commercial opportunities created by LIMA, particularly in the realms of run-off related businesses and capital markets firms, as well as, the opportunities created by the Act for the State of Vermont and the synergies associated with this being Vermont legislation. The panel then concluded with a brief discussion regarding LIMA's implications as to (a) how a transferring company will get cedants to follow the portfolio to Vermont given that there is an opt out clause in the Act; and (b) how strong Vermont's case would be if cedants challenge the "statutory novation" portion of the statute. ●

Page 28 (first photo only): Todd Cheema, Swiss Re.

Page 29 (top to bottom, left to right): Sandra Santomenno, Towers Watson; Andre Lefebvre, Arrowpoint Capital; Jason Russ, Milliman; Daniel Maher, ESLNY; Jeffrey Kingsley, Goldberg Segalla; Anna Petropoulos, Apetrop; Daniel Maher, ESLNY; Steve McElhiney, EWI Re; Jeffrey Kingsley, Goldberg Segalla; Michael Goldstein, Mound Cotton; Anna Petropoulos, Apetrop; Steve McElhiney, EWI Re; Michael Goldstein, Mound Cotton.

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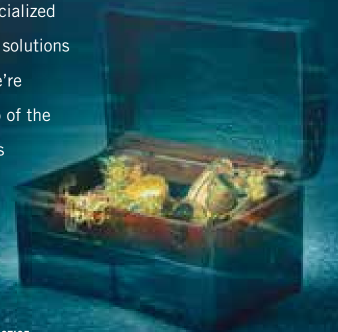

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The Road to LIMA Lands Petropoulos AIRROC's Person of the Year 2014

By Connie D. O'Mara

Anna Petropoulos was named as The AIRROC Person of the Year at this Year's 10th Annual Commutations & Networking Forum. In presenting the award – sponsored by Butler Rubin– Kathy Barker cited Anna as a leader in the Run-off industry and an excellent problem solver. Such leadership came to fruition in Vermont where she spearheaded legislation that facilitates the transfer of "closed blocks" of business. Recognizing Vermont (known as the pioneer and leader in facilitating the creation of captive insurance companies, with more that 1000 such entities currently registered in the state) could be fertile ground for legislation that pulls "all the good bits" out of British Title VII transfers but tailors the process for American sensibilities, Anna was able to get the Legacy Insurance Management Act (LIMA) passed by the Vermont legislature last February. LIMA is the first legislation in the US enabling the transfer of closed blocks of commercial insurance and reinsurance policies, and creates a legal and regulatory framework and marketplace for such transfers.

Anna is President of Apetrop USA, Inc., which offers consulting and advisory services, serving insurers, reinsurers and other investors and prospective investors in the industry that may be considering acquiring or selling blocks of insurance and reinsurance business under the newly-passed LIMA.

Anna has been involved in AIRROC since its beginning and is quite passionate about the organization. She has no patience with treating run-off as a step-child of the industry because she says the business of underwriting is promises, and the business of claims is fulfilling those promises. She feels Run-off is the continued business of fulfilling promises and AIRROC addresses this with professionalism, bringing people together company to company to discuss joint issues and support efficient management of legacy liabilities. Her mantra in spearheading the Vermont statute was "What could possibly go wrong?" and she accepted the challenge of going into unchartered waters on behalf of her clients and the industry. AIRROC is proud to acknowledge that courage with this award. ●

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Above: Kathy Barker, AIRROC Board Co-Chair and Anna Petropoulos.

AIRROC Awards Trish Getty Scholarship

Abigayle Claflin Brings Impressive Academic and Work Experience

For the third straight year, AIRROC awarded a $5,000 scholarship during its annual meeting and conference in New Jersey.

This year's award recipient is Abigayle Claflin. Ms. Claflin is a junior at St. John University's Tobin School of Business majoring in Actuarial Science. In presenting the award, Keith Kaplan said AIRROC's scholarship committee was "… in awe of Abigayle's credentials." Ms. Claflin grew up outside of Nashville and was valedictorian of her high school. She has a 3.92 GPA at St. John's, and is active in the Actuarial Science club and Gamma Iota Sigma, the fraternity for insurance, risk management, and actuarial students. She has already gained real-world experience by interning at Allianz this past summer. In addition to academic pursuits, Ms. Claflin participates in the performing arts as a member of the Chappell Players theatre group, as well as, with Bad Astronauts, a Comedy Improv group.

The scholarship is provided in honor of Trish Getty, the founder and first Executive Director of AIRROC. It is awarded to a student at St. John's studying Insurance, Risk Management or Actuarial Science who is in need of financial aid for tuition. In accepting the award, Ms. Claflin thanked the audience and explained how vital such aid is in helping to develop the next generation of talent for the insurance industry. ●

Above: Abigayle Claflin and AIRROC Board Member Keith Kaplan.

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The Legacy of Pink / Susan G. Komen Fundraiser

By Leah Spivey

Champagne and Cupcakes were served and donations collected for the local branch of Susan G. Komen during AIRROC's Annual Commutations Forum at the Heldrich Hotel in New Brunswick, NJ. As a change of pace and in celebration of AIRROC's 10th year anniversary, it was decided that the usual AIRROC Women's Luncheon would be replaced with a more inclusive and outreaching afternoon fundraising activity sponsored by the law firm of Carroll McNulty & Kull.

AIRROC itself, a non-profit insurance industry organization, matched donations up to $500. In total, a gift of $1,350 was sent to Susan G. Komen Central and South Jersey from this traditionally October-held, AIRROC Event, which coincides nicely with the *Think Pink*, Breast Cancer Awareness month.

This was the first of hopefully many future outreach events which AIRROC will host as it expands its sights outward as a more mature non-profit organization. Carolyn Fahey, Executive Director of AIRROC, was pleased to host the event and is grateful to all of the charitable givers. "I always knew that our membership consisted of professional, thoughtful, caring people and am happy to now know that they are also generous to a worthy cause."

Susan G. Komen Central and South Jersey has 25% of its donations committed to research and the other 75% to local services including education, screening, diagnosis and transportation. Keeping it local is part of the mission of Susan G. Komen. This year alone over 7,000 New Jersey women will be diagnosed with breast cancer and many will benefit from the services provided by Susan G. Komen. ●

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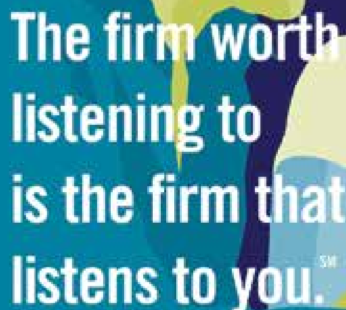

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