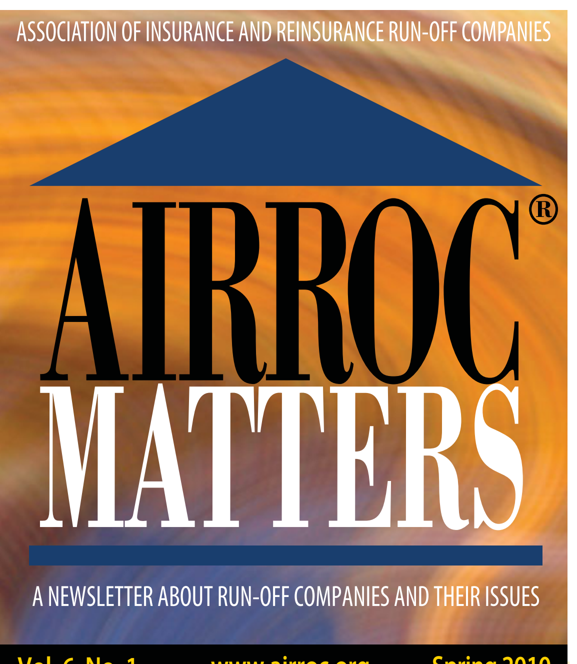


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*Message from CEO and Executive Director*

# A Leap of Faith

Trish Getty

A lesson learned, an attitude acquired.

Approximately thirty years ago while diving in the Virgin Islands, I was awarded the PADI certification of Certified Open Water Diver. A few years later while diving in the Cayman Islands, I was challenged by a fellow diver from Chicago to take the ultimate dive. Always open to challenge, I accepted. One afternoon, under proper surveillance, we dove and dropped to 60 ft. below surface, and positioned ourselves on similar level stone pinnacles that grew from the ocean's floor. At 60 ft. from the surface, light disappears. We allowed a certain amount of air out of our vests, then back dived into an abyss of black water. I trusted my training, capabilities, equipment and diving buddy. The experience was one of the most exhilarating moments of my life.

I took a similar dive six years ago when I agreed to build AIRROC. When I met with the interested parties in August of 2004, it became clear that there was a need and this was the time to establish this run-off association. I continue to believe that our mission statement is on track as we further define our objectives. Before the release of this newsletter, your board of directors will meet (May 10-11) to consider our accomplishments and to further define our future objectives because AIRROC matters.™

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*Think Tank*

# Shedding Liabilities

*By Nick Pearson*

Nick Pearson

Insurers in run-off have two powerful tools for de-risking their book – novation and assumption transactions, and loss portfolio transfers. The only way for a company to truly legally and statutorily eliminate the liabilities associated with books of business is through a novation and assumption transaction (often referred to as "assumption reinsurance"). This entails substituting another insurer for the issuing carrier and in almost all circumstances requires consent of the insureds. The other option for companies seeking to transfer the liabilities associated with discontinued operations are loss portfolio transfers ("LPT"s), which are a form of reinsurance and, therefore, do not legally cut off the issuing carrier's liability to the insureds, but can result in transfer of the past liabilities for statutory accounting purposes.

*Insurers in run-off have two powerful tools for de-risking their book - novation and assumption transactions, and loss portfolio transfers.*

*The only way for a company to truly legally and statutorily eliminate the liabilities associated with books of business is through a novation and assumption transaction…*

## Assumption Reinsurance

An assumption reinsurance transaction is one in which the original contract of insurance between Insurer A and the Insured is extinguished and replaced by a new contract between Insurer B and the Insured, typically granting the Insured the same rights against Insurer B as it had against Insurer A, with Insurer A having no further obligation to the Insured. A novation and assumption contract therefore operates as a release between Insurer A and the Insured with respect to all rights, duties and obligations under the novated policy.

Many states have adopted a version of the National Association of Insurance Commissioners Model Assumption Reinsurance Law, which generally requires insured consent to the novation and assumption. In addition, in those states that have not adopted the Model Act, there is often

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*Notes from Editor and Vice Chair*

# Spring has Sprung...and so has AIRROC

Peter A. Scarpato

Stated "PC" with apologies to Lord Tennyson, "In the spring a young person's fancy lightly turns to thoughts of love…" and, I submit, AIRROC's continuing success. The emergence of green buds on dour branches stirs within us a zest for life and energizes the soul, as does AIRROC's repeated gatherings of comrades in run-off. This newsletter captures some of that zest, and more, starting first with Trish's *Leap of Faith*, presenting the fitting analogy of Trish's scuba diving challenges and the genesis and development of AIRROC.

In *Shedding Liabilities,* Nick Pearson outlines novation/assumption transactions and loss portfolio transfers, powerful tools in the run-off "de-risking" arsenal. Next, Kathy Billingham and I remind the run-off community of mediation, a formidable yet underused settlement tool, in *Mediation in Reinsurance and Insurance Run-off – An Introduction.*

In our section on *Summaries of March 4, 2010, Special Education Sessions*, Publication Committee members Bina Dagar, James Veach, and I, and, in two cases, the speakers themselves–Pollyanna Deane and Efstathios Michael–summarize the many pointed and helpful educational sessions. Included are *Update on the AIRROC Dispute Resolution Procedure, Equitas v R&Q: Exxon Valdez and Kuwait Update, Financial Statement Analysis* and *Legislative Update and Developing Impact of EU Legislation on the Insurance Sector–Effect of Solvency II with Particular Reference to Run-off.* We were particularly honored to have NY Superintendent James Wrynn, as summarized in *NY Superintendent James Wrynn Reports on Efforts to Revive the New York Insurance Exchange,* address a topic of both past historical and future entrepreneurial interest and respond to questions from the membership. Thank you Superintendent!

We next move to John West's *Policyholders' Response to Proposed US-Based Schemes of Arrangement,* where John comments on an article from our last newsletter *(Alternatives to Receivership Require Increased Attention from the US Insurance Market),* noting and aptly discussing the objections of a policyholder's group to application of "UK-like" Schemes of Arrangement. Our Legalese section contains *Cedant's Sharing of Privileged Documents with Reinsurers Waived Attorney-Client Privilege: Significant Oregon Federal District Court Decision,* in which Patricia St. Peter and Wilbert V. Farrell, IV summarize a case of extreme import to cedants, where the judge ruled that sharing privileged documents with reinsurers waived the attorney-client privilege and work product doctrine, even where the interests of the cedant and its reinsurers were not adverse when some privileged documents were shared.

We would be woefully incomplete without Nigel Curtis' *Present Value* and *KPMG's Policyholder Support Update,* the former containing a photo of Board member Mike Palmer and R&Q colleague Collin Johnson at the peak of Mt. Kilimanjaro, Africa's highest mountain – like AIRROC, ever climbing, ever growing, looking upwards.

Let us hear from you. ■

*Mr. Scarpato is an arbitrator, mediator, run-off specialist, attorney-at-law and President of Conflict Resolved, LLC, based in Yardley, PA. He can be reached at peter@conflictresolved.com.*

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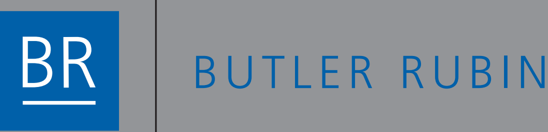


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**Shedding Liabilities** *continued from page 1*

case law establishing that a novation requires the consent of the insured. The law of the state in which the insured is found will determine whether and by what means the insured's consent is required. The consent requirement can make assumption reinsurance transactions difficult and costly to implement, particularly for large books of personal lines business. This has acted as a deterrent to their more widespread implementation.

*The consent requirement can make assumption reinsurance transactions difficult and costly to implement…*

Typically, in an assumption reinsurance transaction the assuming insurer will be licensed in the jurisdiction where the insured is located, as the new insurer will be deemed to be transacting insurance in that jurisdiction. However, in some commercial transactions if the insured is willing and the placement satisfies the requirements, the replacement insurer could be a surplus lines writer, or even an unauthorized insurer if the insured was willing to travel to the jurisdiction where the insured is licensed so that the policy could be written as a direct placement. Alternatively, there are some states that have industrial insured exemptions to their insurer licensing laws, which could be applicable depending upon the location of the insured and whether it qualifies as an "industrial insured" under the statute.

These possible alternatives to a licensed assuming insurer may make it easier for the issuing carrier to find a replacement insurer willing to assume these risks at a more favorable price. However, it should be kept in mind that the insureds must be willing partners and may be adverse to insuring with an unlicensed carrier.

Whether or not insurance department approval will be required for an assumption reinsurance transaction will typically depend upon its size. Many states regulate bulk reinsurance transactions, which require approval if certain thresholds are tripped. For example, New York requires approval if, during any consecutive 12 month period, a domestic P&C insurer were to cede an amount of insurance for which the total gross reinsurance premiums are greater than 50% of the company's unearned premium on the net amount of its in-force book at the beginning of the period. New York exempts reinsurance "made in the ordinary course of business reinsuring specified individual risks under reinsurance agreements relating to current business" from this calculation. The law of the domiciliary jurisdiction of the issuing carrier should always be consulted to determine whether regulatory approval is required. Of course, a company in solvent run-off under regulatory oversight will probably have more stringent approval requirements imposed upon it.

## Loss Portfolio Transfers

Under LPT agreements, the issuing carrier remains legally liable to its insureds, but would transfer to the assuming reinsurer(s) 100% of the liabilities associated with known losses and IBNR. LPTs are always retrospective in nature, which differentiates them from contracts for new business. New York's definition of a loss portfolio transfer is illustrative:

> *Loss portfolio transfer* means an agreement: (1) by which a transferer increases its surplus to policyholders as a result of payment of consideration to a transferee for undertaking any loss obligation already incurred in excess of the consideration paid; or (2) where the consideration paid by the transferer, in connection with transferring any loss obligation already incurred, is derived from present value or discounting concepts based upon anticipated investment income. See *New York Regulation 108.*

*Under LPT agreements, the issuing carrier remains legally liable to its insureds, but would transfer to the assuming reinsurer(s) 100% of the liabilities associated with known losses and IBNR.*

In order to realize the economic benefit of LPT agreements to transfer the liabilities relating to the insureds' reserves, the issuing carrier would need to be able to take statutory statement credit for the liabilities ceded, or obtain qualifying collateral to set off against those liabilities. The same premium volume criteria as discussed in connection with novation and assumption agreements will apply to LPTs in determining whether departmental approval is required.

In addition, depending upon the domiciliary jurisdiction of the cedent ("transferer") LPT contracts generally need to meet some or all of the following criteria in order to obtain statutory statement credit:

(a) The agreement shall provide that the obligations of

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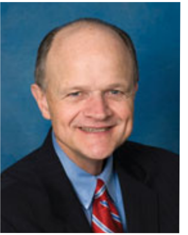
*Feature Article*

# Mediation in Reinsurance and Insurance Run-off – An Introduction

Katherine Billingham



Peter A. Scarpato

*By Katherine Billingham and Peter A. Scarpato*

Members of AIRROC are all too familiar with this perpetual dilemma. Everyday, run-off managers face the eternal challenge of covering the costs to run a business while paying claims and allocating precious little resources to managing disputes. Run-off companies handle at least as many claim disputes as ongoing carriers. But, in many cases, the "one-size-fits-all" arbitration clause in most reinsurance contracts does not provide a commercially sound avenue for resolution, especially given the current prohibitive cost of arbitrations.

Let's face it, arbitration costs have skyrocketed and the outcome is always uncertain. On the other hand, mediation offers a streamlined alternative for run-off cedants and reinsurers, and it shifts to them the power and opportunity to control the process of negotiating their dispute and to decide the terms of their outcome. Mediation is specifically designed to assist parties in reaching commercially reasonable solutions that best serve their interests.

*Katherine Billingham is an ARIAS-certified reinsurance arbitrator and mediator, an attorney and consultant. She is a former executive officer of a reinsurance company who in 1990 went into private practice in the reinsurance and insurance industry. She is the Chair and CEO of ReMedi, the non-profit Re/Insurance Mediation Institute and can be reached at kathy@kbillingham.com.*

*Peter A. Scarpato is an ARIAS-certified umpire and arbitrator, mediator, insurance/reinsurance consultant and Editor of AIRROC Matters. He has nearly 30 years experience in dispute resolution as outside and in-house counsel, senior insurance executive and full time ADR professional. He is Vice Chair and President of ReMedi, the Re/Insurance Mediation Institute, Inc. and can be reached at peter@conflictresolved.com.*

And you've probably noticed that most parties want to settle, and usually do settle, their disputes. The number of legal disputes resolved by trial (and by extrapolation, arbitration hearing) has declined steadily over the past 30 years. In 2002, despite the increase in new case filings, only approximately 2% of lawsuits were resolved by trial.[1] Meanwhile, the use of mediation has grown exponentially. Nearly 90% of Fortune 500 companies now use mediation, which typically enjoys a settlement rate from 85-90%.

Out of necessity, run-off managers optimize the sensible allocation of resources by taking the most commercially reasonable approach. They maintain a keen eye on the developing evidentiary, tangible and intangible merits of disputes and prefer to settle and move on when a fair and timely opportunity arises.

Nevertheless, until recently mediation has been underutilized in the reinsurance arena largely because, unlike lawsuits, there is typically no tribunal or other mechanism that requires these matters to be mediated. Additionally, since reinsurance is an arcane area, parties usually prefer to have their disputes reviewed by peers familiar with its nuances, customs and practices. Until recently[2], there were few mediators in the U.S. who specialized in this area.

With recent accelerated frequency, parties to reinsurance disputes are turning to mediation. We have seen a substantial increase in the use of mediation in the last 18 months. Possible reasons for this change include the state of the economy and, more likely, parties' successful exposure to mediations in other types of legal disputes.

> *Recently we faced this issue: Where do two run-off entities, both cost conscious in nature who are usually able to resolve their differences amicably, principal to principal, go when they reach an impasse? We decided to retain a mediator and, within weeks, were able to achieve a satisfactory result through a single day mediation, costing a fraction of projected arbitration costs and enabling us to retain our good working relationship.*
>
> **—Karen Amos**
> Joint Head of Claims, Resolute Management Services Limited

*continued on page 11*

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**Mediation in Reinsurance and Insurance Run-off – An Introduction** *continued from page 8*

Mediation is facilitated negotiation. Typically, a mediator will hold an initial joint session to explain the process, verify that the decision-makers are present, and will then hear the relative positions from each party. Thereafter, the mediator will usually meet with each party individually and shift between parties until an agreement has been reached. The mediator will share only information that a party authorizes. The mediator's principal mission is to enhance communication, clarify issues and identify interests to assist the parties in developing options to achieve the goals. Mediation provides commercial results for commercial problems.

## Benefits of Mediation

**Client control over negotiations:** Negotiations are the stock-in-trade of effective run-off managers, but the less control one has over the actual process, the less predictable the outcome. Sometimes the manager is more open to settlement while the lawyer prefers to press on with the case. A mediator ensures that all parties not only have a voice in the negotiations, but that they have the final say in whether a settlement should be negotiated and on what terms.

**Decision-makers focus on the case:** Business people managing active or discontinued operations are busy with business. How many times have you walked into a business meeting only to realize that you are sitting across the table from a lower level person with limited authority? Given the time and cost-constraints of their business, run-off managers want to ensure that the time and money devoted to prepare for and attend a negotiation with the other side is well-spent. Mediation requires the participation of the decision-makers with authority to settle. Mediation brings authorized decision-makers together to negotiate and requires that they are fully prepared and focused on the current dispute.

**Persistence is not a sign of weakness:** As we have all experienced in arbitration or litigation, especially just before hearing or trial, if a party attempts to negotiate, is unsuccessful and later tries again, the other side might view this approach as a sign of weakness. In mediation, however, the parties expect several rounds of negotiations as the mediator respectfully and persistently encourages them to develop areas of agreement. Being relentless and optimistic, even while at an impasse, is the gift of a skilled mediator, and the sense of weakness is out of play.

**Outlet for moral indignation:** Bitter arbitrations and lawsuits are often brought, not because of substantive issues, but because powerful people, who might not have even spoken to each other, have gotten mad. As the differences escalate, the dispute becomes personalized, preventing parties from separating their subjective selves from the objective problem. In this environment, some prefer their "day in court" before they can be open to settlement. Allowing parties to air their grievances before a mediator with an empathetic ear, and also in the presence of the opposing party, provides an outlet for such emotions and once accomplished, opens the door to productive negotiations.

> *I recently participated in two reinsurance mediations which both resulted in resolution of the disputes. I believe this type of dispute resolution process in very specific situations is very effective and saves both time and costs*
>
> **—Diane Ferro**
> Vice President -Claims
> CNA Insurance Companies

## Dimensions of the Mediator

**Foster candid discussions:** Many people come to the negotiating table using posturing as a default strategy. During negotiations, lawyers will tend to exhort the strengths of the client's case, usually for the benefit of the client. This leaves little room for a frank discussion about the true merits of one's case. A mediator can bypass posturing and guide the parties to more meaningful progress in negotiations.

**Identify interests and discreet impediments:** Whether the parties in dispute are active or run-off companies, there are often hidden interests in their positions that they cannot share with the other side. Examples include as yet undisclosed weaknesses in the case, budget or staff limitations, unstated other business relationships, impending liquidation, distaste for their management or lawyers, etc. Mediators are trained to listen carefully and to gain an understanding of the party's underlying issues, motivations and impediments to a settlement, especially during individual caucuses. Sometimes these interests were not even disclosed previously to their attorney. Mediators can and will assist in folding these interests into a workable agreement and exploring ways to overcome impediments.

**Assist in exploring options without bidding against self:** One of the most common frustrations experienced in

*continued on page 24*

## Welcome and Opening Remarks

*Left:* Dewey & LeBoeuf's Jeff Mace and Larry Schiffer, AIRROC Chair Jonathan Rosen and Board member/Education Committee Co-Chair Karen Amos

## Update on the AIRROC Dispute Resolution Procedure

*Left:* Michael Zeller, Marianne Petillo, and audience member Steven Schwartz

*By Peter A. Scarpato,* Conflict Resolved

Board member Michael Zeller updated the status of AIRROC's Dispute Resolution Procedure ("DRP"). Currently the arbitrator list contains 45 names, including 34 ARIAS-certified – a strong list. In Mike's view, more parties must actually use the DRP. Although unaware of how many parties are using the DRP without selecting an AIRROC arbiter, Mike noted one confirmed usage and asked fellow board member, Marianne Petillo of ROM, who works with one of the parties, to discuss her experience.

> *Currently the arbitrator list contains 45 names, including 34 ARIAS-certified – a strong list.*

Since she had permission, Marianne revealed that Transport Insurance Company, another AIRROC member, was the other party. The parties chose the DRP because their dispute involved a minor amount (less than $150,000), much less than the cost of a full-blown arbitration, and they were able to waive discovery and live witnesses at hearing. Also, in Marianne's view, the parties were comfortable using the DRP given the quality of the arbitrator list.

The case has moved along quickly, easily and uneventfully. The parties submitted their initial claim form in December 2009. Once the arbiter was selected (a matching name on both parties' nominee lists) the Organizational Meeting took place, the parties filed their initial and responsive briefs, and obtained a decision before the April 7, 2010 deadline. Total cost for ROM, was less than $25,000. ■

# Equitas v R&Q: Exxon Valdez and Kuwait Update

*Left*: Paul Brockman, Efstathios Michael

*By Efstathios Michael,* Slaughter and May (who acted for Equitas)

In a first ruling of its kind, the English Court in *Equitas v R&Q* has decided that reinsurance claims can be proved with the assistance of actuarial models. Excess of loss spiral reinsurance claims arising out of the Exxon Valdez disaster in 1989, and out of the loss of Kuwait Airlines Corporation ("KAC") and British Airways ("BA") aircraft during the first Gulf War in 1990-1991, ground to a halt some years ago. Earlier English Court decisions had determined that some Exxon losses which had passed into the reinsurance spiral did not fall within the policy terms, and that the KAC and BA losses, which had been paid on an aggregated basis, should never have been aggregated. As a result, some reinsurers adopted the position that UNLs for these claims were contaminated and so further reinsurance claims could not be made in respect of them.

*…the English Court in Equitas v R&Q has decided that reinsurance claims can be proved with the assistance of actuarial models.*

Although it was accepted that the reinsurance spiral could not be unwound or reconstructed, Equitas in this case endeavoured through the use of actuarial models to identify with reasonable certainty the effect of the incorrectly aggregated Kuwait/BA and irrecoverable Exxon Valdez elements so the relevant UNLs could be discounted to strip out any contamination. R&Q's response was that, as a matter of principle, Equitas could not prove its losses using a generalised actuarial model; moreover, it contended that the models were flawed.

In summary, the Court accepted Equitas' position: as a matter of principle the models could be used; and these particular models were able to sustain the claims. After many years of uncertainty, this decision provides important clarification for the reinsurance sector, and should allow claims which had stagnated for over a decade to be processed again. ■

*…this decision provides important clarification for the reinsurance sector, and should allow claims which had stagnated for over a decade to be processed again.*

# Financial Statement Analysis

*By Bina T. Dagar,* Ameya Consulting

KPMG experts, Mark Allitt and Leslie Fenton, discussed the use of the Financial Statement data, its limitations, and ways to make it transparent; and they suggested initiatives to improve the reporting of run-off business. They affirmed that there is no transparency in the NAIC Blank. Adding to that complication is the fact that each state's rules are different, rendering a national benchmarking difficult. In spite of this, it is worth noting that, compared to other jurisdictions, U.S. data for run-off and insolvent companies is not only more transparent but it has a framework for reporting and a streamlined approach to data filing. Nonetheless, the question of how statistics are manipulated remains, leading to the importance of analyzing the basis from which the numbers are derived.

Financial Statements can benefit run-off companies' efforts to benchmark data via the review of Schedule F. However, as a caveat, this information may not be used as a tool to negotiate for the reason that the data may contain underreported or inaccurate numbers. They recommend that companies:

- Determine why some numbers are not reflected;
- Scrutinize the reliability of the data relative to

*continued on next page*

competition in the market and to the thoroughness of the information;

- Interpret the data between active and run-off business of the entity; and
- Evaluate how proactive companies are about cutting off a run-off piece of business. This also relates to the ability of companies to act swiftly to reallocate assets towards core business and not have capital stuck in limbo.

*Left*: Mark Alitt, Leslie Fenton

*Financial Statements can benefit run-off companies' efforts to benchmark data via the review of Schedule F. However, as a caveat, this information may not be used as a tool to negotiate for the reason that the data may contain underreported or inaccurate numbers.*

The two experts encouraged companies to strongly consider selling their run-off business to professionals and concentrating on running their active business. In their view, this segregation will allow for better use of statutory capital.

They suggested that companies establish market initiatives to drive the transparency and analysis of available data. For this to work, enlist the help of a state or a regulator who is knowledgeable and forward-thinking and has the presence of mind to take a leadership role to push for transparency and to have NAIC focus on data gathering to make the industry more efficient.

Finally, the key message from Ms. Fenton and Mr. Alitt was that market information affects, even drives, the way companies' results get reported. Transparency is key to administrative savings, accelerated closure of market losses; it benefits all parties. ■

*…this decision provides important clarification for the reinsurance sector, and should allow claims which had stagnated for over a decade to be processed again.*

# NY Superintendent James Wrynn Reports on Efforts to Revive the New York Insurance Exchange

*By James Veach,* Mound Cotton Wollan & Greengrass

The New York Insurance Exchange ("Exchange") closed its doors in November 1987, but left behind a statutory framework—New York Insurance Law Ch. 62. New York Superintendent James Wrynn now oversees a joint industry-regulatory effort to revive the Exchange. In his remarks at AIRROC's March 4th Membership Meeting, the Superintendent outlined the steps he has taken to build a new (and different) Exchange.

*In his remarks at AIRROC's March 4th Membership Meeting, the Superintendent outlined the steps he has taken to build a new (and different) Exchange.*

## An Industry-supported Exchange

Mr. Wrynn's predecessor, Eric Dinallo, had come across Chapter 62 shortly after Governor Eliot Spitzer appointed him Superintendent of Insurance. Mr. Dinallo explored whether the Exchange could be revived, but the monoline

*continued on next page*

meltdown and AIG pushed this project off Superintendent Dinallo's agenda.

Shortly after Governor David Paterson appointed Mr. Wrynn to succeed Mr. Dinallo, Superintendent Wrynn met with industry representatives to "get a sense of whether they felt there was a real need for this type of facility." Responses varied, but the Superintendent found enough support to warrant further exploration.

Mr. Wrynn emphasized that he did not intend to "sell" the Exchange, but rather to determine if the industry needed this type of investor/insurer-driven vehicle. To that end, the Department met with hundreds of industry representatives. Those discussions led to a three-staged process to determine whether a reconstituted Exchange had enough support to operate successfully.

First, Mr. Wrynn and his staff reached out to the industry and gathered comments and suggestions. The Superintendent concluded that a revived Exchange would not be just another "platform," but rather would operate in North America as Lloyd's now operates in London.

*The Superintendent concluded that a revived Exchange would not be just another "platform," but rather would operate in North America as Lloyd's now operates in London.*

Second, the Department focused on the operational aspects of a new Exchange. Specifically, those studying the Exchange are concentrating on:

1. rebuilding the Exchange from the technological ground-up to make it the most advanced institution of its kind in the world;
2. instituting common claims protocols, agreed in-advance per loss/per occurrence definitions, and in-house arbitration procedures to resolve disputed claims so that "any claim that should be paid, will be paid"; and

*Left*: NY Insurance Superintendent James Wrynn and Zack Phillips of *Business Insurance*

3. using financial and underwriting expertise in the New York City area to capitalizes Exchange members and underwrite risks such as reputational damage, climate-change-related losses, and cyber-security breaches that were not being underwritten when the old Exchange operated.

Third, in order to measure industry support for a new Exchange, the Superintendent arranged a January meeting with seventy-five leaders from more than fifty companies to hear what the Department has learned and what the Department proposes to do. These industry representatives then signed up for working groups that now include: Capitalization, Markets, Regulatory Oversight, Operations and Technology, and Multi-State issues. (Mr. Wrynn also brought in Peter Bickford, former General Counsel for the old Exchange as an advisor to the working groups.)

The first working group meeting focused on taxes and met the same day Mr. Wrynn addressed AIRROC's Membership meeting. Although the first working group to meet focused on taxes, Superintendent Wrynn does not see a revived Exchange as a pure tax play, regardless of where tax rates move in the U.S. and abroad over the next few months or years. "I don't want (the Exchange) to be just tax driven; I want to provide a real benefit to the industry from a business point of view." ■

## Legislative Update

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

A panel, including Frank Kehrwald, Swiss Reinsurance America Holding Corp. and Janet Kloenhamer, Fireman's Fund Insurance Company, provided a Regulatory and Legislative Update, covering numerous legislative initiatives that hold potentially serious consequences for the insurance industry. Of greatest interest is the United States House of Representative's passage of HR 4626, a bill to repeal the health insurance industry's McCarran Ferguson antitrust exemption, by the margin of 406 to 19, which if

*continued on next page*

*Left:* Frank Kehrwald, Janet Kloenhamer

enacted would immediately chill, if not actually impact, the health insurance industry. With news of Anthem Blue Cross' California rate increase of up to 39% affecting 700,000 individual policyholders, and a recent meeting among President Obama, HHS Secretary Sebelius and current NAIC President Jane Cline to discuss this and other health insurer rate increases as background, federal legislators are expectedly feeding on perceived collusive rating practices, split markets and price fixing with resulting higher premiums. Practically speaking, a McCarran Ferguson repeal, while politically expedient, would minimally impact health insurance premium increases since states retain the right to approve rate increases and remain bound by mandatory renewal mechanisms while other states mandate health insurance coverage.

*…federal legislators are expectedly feeding on perceived collusive rating practices, split markets and price fixing with resulting higher premiums.*

*Practically speaking, a McCarran Ferguson repeal, while politically expedient, would minimally impact health insurance premium increases since states retain the right to approve rate increases and remain bound by mandatory renewal mechanisms while other states mandate health insurance coverage.*

The panel also covered global solvency issues including Solvency II's additional tests: consideration of systemic risks, economic capital and risk based capital tests, principle-based capital requirements including verifiable business testing, uniform global accounting standards for reinsurers with flexibility of application and new solvency intervention standards.

Further, the panel covered recent amendments to SSAP 62, adding an additional exception to retroactive accounting property and casualty reinsurance run-off agreements meeting qualifying conditions and recent federal initiatives including the Senate Banking Committee's draft proposal for comprehensive financial regulatory reform. ■

## Developing Impact of EU Legislation on the Insurance Sector — Effect of Solvency II with Particular Reference to Run-off

*By Pollyanna Deane,* Berwin Leighton Paisner LLP

Solvency II is the new set of regulatory requirements for insurance firms operating in the EU. The measures are anticipated to be implemented in October 2012.

Solvency II aims to facilitate the Single Market across the EU, to protect policyholders through better risk management and to strengthen competitiveness by encouraging more efficient capital management. It adopts the three pillar approach which the Basel banking reforms used:

Pillar I: Quantitative Requirements

Pillar II: Supervisory Review

Pillar III: Public Disclosure

*Solvency II aims to facilitate the Single Market across the EU, to protect policyholders through better risk management and to strengthen competitiveness by encouraging more efficient capital management.*

*continued on next page*

Pollyanna Deane

- Supervisors want Pillar II to provide a Total Balance Sheet approach, aiming:
- to reduce the risk that an insurer would be unable to meet its claims;
- to reduce the losses suffered by policyholders if a firm is unable to meet its claims fully;
- to provide supervisors with early warning so that they can intervene promptly if capital falls below the required level;
- to promote confidence in the financial stability of the insurance sector; and
- to recognise diversification and risk mitigation. The capital allocation requirements are designed to reward diversity.

Preparation for Solvency II is underway. As they stand, the requirements of Solvency II, if implemented today, would mean possibly 25% of Europe's insurers would need to take strategic action to meet those requirements. Companies are looking to adopt the most capital efficient approach, adopting group structures with branches not subsidiaries. Further, they are looking to raise capital rather than deploy it, leading to increased reinsurance. Finally, companies are likely to identify business which requires increased capital and potentially they will leave certain markets. Duplicated, unprofitable, non-core operations are likely to be discontinued and, therefore, in effect put into run-off.

Run-off is clearly part of the business cycle, and provides an opportunity to release capital or achieve a profit, but business in run-off still requires capital, it becomes a drag on operations and finally is likely to become increasingly less attractive to keep because of the requirements of Solvency II which pushed it into run-off in the first place.

Run-off companies face the challenges of meeting the capital requirements, diversification, buying reinsurance and raised costs of compliance. However, the run-off sector is taking steps to bring their particular concerns to the table, while seeing Solvency II as offering further opportunities.

Run-off is increasingly likely to be outsourced to specialists, although Solvency II is seeking to impose tighter data quality and operational risk controls for outsourcing. There are to be stricter disciplines in the management of operations, with more thorough scrutiny of claims and contracts leading to increased litigation and delays.

*Run-off is increasingly likely to be outsourced to specialists, although Solvency II is seeking to impose tighter data quality and operational risk controls for outsourcing.*

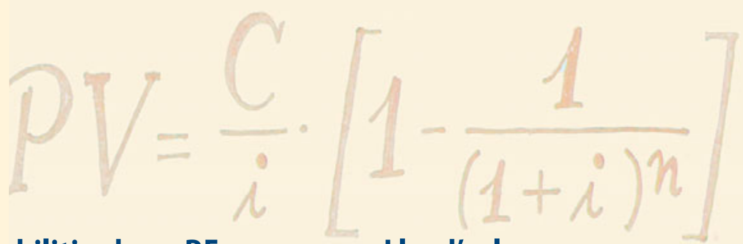
For companies based outside the EU, the EU will assess their home states for third country equivalence - see Consultation Paper No.78. In essence, the EU will want to see matching requirements as to reinsurance, group solvency and group supervision in the home state before allowing that company to operate freely within the EU. Countries such as Switzerland are already looking to meet the Solvency II requirements and hence gain third country equivalence status, ahead of time.

*For companies based outside the EU, the EU will assess their home states for third country equivalence… the EU will want to see matching requirements as to reinsurance, group solvency and group supervision in the home state before allowing that company to operate freely within the EU.*

The EU is certainly hoping to spread its influence more widely and using Solvency II to create a level playing field not just in Europe but across the globe. The advantages offered by the Single Market and the advances in exit solutions to achieve finality mean that in embracing the challenges and opportunities offered by Solvency II, the EU is hoping that its insurers lead the field. ■

# Present Value

By Nigel Curtis



## Run-Off News

### White Mountains Re acquires Central National

White Mountains Re Limited has entered into a definitive agreement to acquire Central National Insurance Company of Omaha from Drum Financial Corporation. In run-off since 1989, Central National has been operated under an order of Rehabilitation in the State of Nebraska since 1990. The transaction, expected to be completed during the first quarter of 2010, is subject to regulatory approval and other customary closing conditions. Under the terms of the agreement, White Mountains Re will pay approximately $5 million. Central National's statutory surplus as of September 30, 2009 was $13.3 million. See www.whitemountains.com.

### Axa Liabilities buys BF Rückversicherung

AXA Liabilities Managers has entered into a definitive agreement with the German states of Berlin and Brandenburg to acquire non-life run-off company BF Rückversicherung.

BF Rückversicherung is the former reinsurance arm of German-based and state-owned Feuersozietät. After the sale and the transfer of the direct insurance business at the end of 2003, BF Rückversicherung continued to be a public-law institution owned by the states of Berlin and Brandenburg. BF Rückversicherung then ceased writing new business and was put in run-off. The company wrote reinsurance of aviation, property and satellite risks. Its gross reserves total close to 70 million Euros. See www.axa-lm.com.

### Lloyd's closes more Open Years

Lloyd's of London has reported that the 2007 calendar year saw a low level of catastrophe losses and a strong performance across all major classes of business, helping it achieve a profit of £2,773m (US$4,239m) at closure. The result includes a surplus of £964m (US$1,474m) on the 2006 and prior reinsurance to close (RITC) received as at December 31, 2008.

In aggregate, run-off years reported an overall profit of £117m (US$179m) including investment income and syndicates backed by insolvent members supported by the Central Fund reported an overall surplus for the second successive year. By the end of 2009, a further seven syndicates with a total of 18 years of account were closed. However, three syndicates were unable to close their 2007 year of account at year end so the net reduction in open years was 15. The aggregate net reserves on run-off years of account have now fallen to £1bn (US$1.52bn). Lloyd's Annual Report 2009. See www.lloyds.com.

*Left to right:* Collin Johnson, Mike Palmer, Callum Licence and Alistair Conner

**Reach for the Sky** AIRROC Board member Mike Palmer and Collin Johnson, both of Randall & Quilter, reached the summit of Mount Kilimanjaro in Tanzania on February 27, 2010. At 19,341 feet (5,895 meters) it is the highest mountain in Africa. You can find out more about their exploits on their trip blog at www.phrenetech.com.

## People

**Martin Membery** and **Matthew Griffith** have joined Sidley Austin's London insurance practice as partners. They will help to develop the firm's transactional and regulatory insurance and corporate practices. Both join from Pinsent Masons, where Martin was the head of its insurance sector practice, and Matthew had been a partner since 2004.

**If you are aware of any items that may qualify for inclusion in the next "Present Value"; upcoming events, comments or developments that have, or could impact our membership; please email them to Nigel Curtis of the Publications Committee at n.curtis@fastmail.us.■**

## AIRROC 2010 Board of Directors

*Left to right:* Ali Rifai (Zurich, Co-Vice Chair), Jonathan Rosen (The Home, Chairman), Janet Kloenhamer (Fireman's Fund), Joe DeVito (Treasurer), Ed Gibney (Secretary, Global Resource Mgrs.), Michael Zeller (AIG), Art Coleman (Citadel Re, Co-Vice Chair), Frank Kehrwald (Swiss Re), Marianne Petillo (ROM), Keith Kaplan (Reliance), Trish Getty (CEO & Executive Director), Michael Fitzgerald, Kathy Barker (Excalibur Re), Karen Amos (Resolute Mgmt. Services), Mike Palmer (R & Q Re). *Not pictured*: John Parker (TIG), Jeff Mace (Dewey & LeBoeuf, Legal Counsel)

*Message from CEO and Executive Director* **A Leap of Faith** *continued from page 1*

Our members have taken a leap of faith in AIRROC as we continue to support our foundation ever focusing on the industry's needs. We strive to make a difference in this run-off industry.

Remember to send your challenges to us so that we can consider run-off education and report on related news. Suggested topics as well as articles for "AIRROC Matters" are quite welcome.

The AIRROC Dispute Resolution Procedure (DRP) has been used by the first parties who are pleased with our process and will use it again. From beginning to end, the entire AIRROC DRP process took less than four months to complete. Fantastic! We hope to have the hard copy of procedures in booklet form completed and in your hands before the end of May, 2010.

We will keep our positive attitude and hard work going to remain a valuable association! When you encounter a writer who would benefit from AIRROC membership, simply convince them to take the leap of faith to join AIRROC where Solutions Matter™! ■

*Ms. Getty has been active in the insurance/reinsurance industry for over forty years, her keen experience in reinsurance claims, both inwards and outwards, harking back to 1972 when she began her experience in that sector of the industry with Berkshire Hathaway/National Indemnity Re. Trish has been employed in most fashions of the reinsurance industry, the majority as reinsurance claims manager, which led her to AIRROC and understanding its members' histories and today's needs. Trish readily recognizes the great value that AIRROC brings to its members at such a crucial time in the worldwide run-off industry. She can be reached at trish-getty@bellsouth.net.*

# Policyholders' Response to Proposed US-Based Schemes of Arrangement

John West

*By John West*

I read with great interest an article which had been published in the Winter issue of AIRROC Matters. It was entitled, "Alternatives to Receivership Require Increased Attention from the US Insurance Market" and was co-written by Fran Semaya and Michael Kurtis. In essence, they summarized the basic elements of a White Paper which had been published by the NAIC's Financial Condition (E) Committee in December of 2009. The Paper was entitled, "Alternative Mechanisms for Troubled Companies." What the Committee attempted to do was provide descriptions of current methods of handling insolvent insurance companies as well as provide some possible alternatives which would provide some relief to those current models.

*What the Committee attempted to do was provide descriptions of current methods of handling insolvent insurance companies as well as provide some possible alternatives which would provide some relief to those current models.*

One of the alternatives proposed in the Paper was "U.K.-Like Schemes of Arrangement." To a rough draft of that Paper, there was a response sent back to the NAIC in November of 2009 by "Certain Policyholders" ("The Group" listed as Exxon Mobil Corporation, Goodrich Corporation, Textron Corporation and ITT Corporation). In their response to the concept of schemes, the Group stipulated many arguments against utilization of this mechanism. It seems as though their comments may reflect the overall attitude of the US market to the concept of solvent or insolvent schemes.

*John West is a Senior Vice President for Helix UK, a London based service provider with offices in New York, Mexico and Europe. He can be reached at john.west@helixuk.com.*

To begin with, the Group felt that the White Paper did not address a clear definition or categorization of "troubled insurers." They mentioned that "at one point, the draft refers to a 'troubled' insurer as one that is in a "financially troubled condition which could potentially lead to an insolvency in the foreseeable future.'" The NAIC supplemented that by saying that the Paper will not consider situations where the insurer is merely inconvenienced by a particular book of business. However, the Group suggested that the White Paper amend the definition of a "troubled" insurer to include only those insurance companies that have been downgraded to a Best's "D" rating or below (or comparable rating) *and* are in *imminent* danger of insolvency in the *immediate* future. Indeed, the Group feels that the White Paper's lack of specificity regarding "troubled" but still solvent companies creates a dangerous slippery slope that could allow solvent companies to behave like insolvent companies. This would enable them to "wind up their business and cut off their obligations to policyholders prematurely, without judicial review or other safeguards to achieve consumer protection and satisfaction of policyholder obligations."

Secondly, the Group urged the NAIC to "strongly oppose" UK-style cut-off schemes of arrangement for solvent insurer, regardless of whether they are troubled. Solvent Schemes, they say, "do not honor contractual obligations, do not ensure policyholder claim priority, do not allow dissenting policyholders to opt out of the scheme, do not ensure continuation of coverage, do not include a safety net of guaranty association protection, and do not allow a policyholder to seek judicial review of its claims against the insurer." The Group states that even though there have been a large number of solvent schemes in the UK, in every instance when policyholders have mounted serious opposition, the UK courts have ruled in the policyholders' favor. In particular, objecting policyholders (including those listed in this article as the "Group"), have successfully challenged the BAIC, WFUM and Scottish Lion solvent schemes in the UK courts. Just as a side note, Rhode Island Statute Title 27 Chapter 14.5-4 states that "any commercial run-off insurer may apply to the court

*continued on page 22*

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## Policyholders' Response to Proposed US-Based Schemes of Arrangement *continued from page 20*

for an order implementing a commutation plan. Point 4 states that the approval of a commutation plan requires consent of (i) 50% of each class of creditors; and the holders of 75% in value of the liabilities owed to each class of creditors. The court shall enter an implementation order if…the court determines that implementation of the commutation plan would not materially adversely affect either the interests of objecting creditors or the interests of assumption policyholders."

> *…the Group [of certain policyholders] urged the NAIC to "strongly oppose" UK-style cut-off schemes of arrangement for solvent insurer, regardless of whether they are troubled.*

The Group feels that since solvent schemes "go against the core principles and values that the NAIC supports", they believe the White Paper should expressly recommend that regulators not adopt solvent schemes, or any other similar plans (like Rhode Island's) as an alternative mechanism for handling troubled but solvent insurance companies. They state that the Rhode Island statute is a domestic version of the UK's solvent schemes and presents substantially similar problems.

> *The Group feels that since solvent schemes "go against the core principles and values that the NAIC supports", they believe the White Paper should expressly recommend that regulators not adopt solvent schemes, or any other similar plans…as an alternative mechanism for handling troubled but solvent insurance companies.*

Whether or not the policyholders are correct in their assessment of this mechanism, the point is that since they probably represent enough of a perspective from the policyholder level that this class would be able to successfully contest schemes in the US, thereby reducing the viability of schemes as an option for solvent or insolvent companies. Further, they state that UK-style solvent schemes do not meet the requirements of Chapter 15 of the US Bankruptcy Code. They feel that "such schemes, if contested, would not be enforceable in the U.S." In this regard, they state that with regard to UK Solvent Schemes, "the unstated – but unquestioned – rationale behind solvent schemes is to cut off US policyholders' coverage for liabilities arising from the US tort system." In that effort, it would be crucial to gain US court recognition in order to make those schemes binding in the US. What they feel schemes contribute to are: US policyholders and coverage are targeted, there is an abuse of the US bankruptcy process and there is a lack of policyholder opposition. On that last note, they feel that there are compelling arguments that solvent schemes are not eligible for Chapter 15's protection even though, to date, there has been no meaningful policyholder opposition to solvent schemes in a Chapter 15 recognition process.

> *Further, they state that UK-style solvent schemes do not meet the requirements of Chapter 15 of the US Bankruptcy Code.*

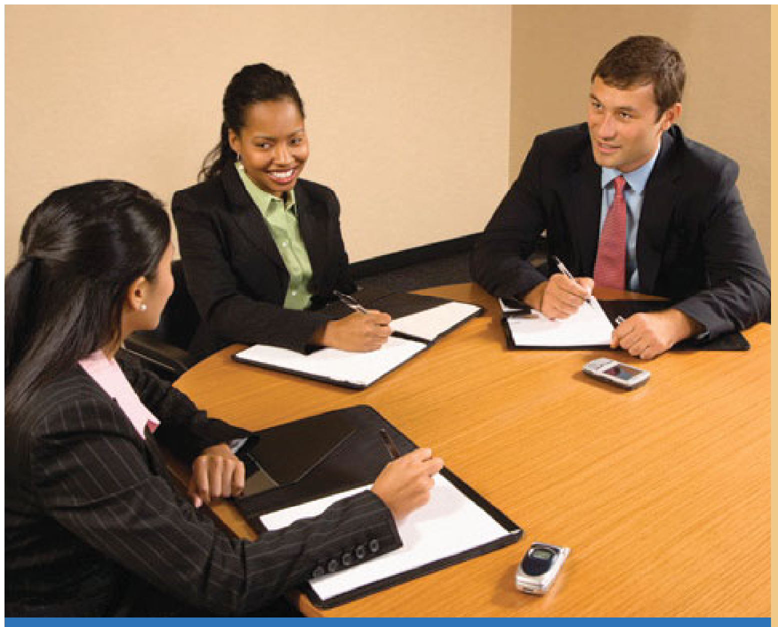
In the NAIC White Paper, the section which lists the advantages and disadvantages of integrating US based schemes of arrangement displays a list of 5 advantages versus 19 disadvantages. The disadvantages seem to show a conflict with what the NAIC has stated as their "core principals." These principals include:

- Honoring contractual obligations
- Policyholder claim priority
- Right to vote and to opt out
- No "cram down" on dissenting policyholders
- Meaningful notice and information sharing
- No compulsory retransfer of risk back to policyholders
- No involuntary loss of coverage
- Guaranty Association coverage
- Court oversight

The White Paper's first disadvantage of US based schemes states that "schemes may undermine the value of insurance contracts by not honoring contractual obligations." That is entirely in opposition to their first core principal. The remaining core principals are almost all discounted by the remaining disadvantages listed in the Paper.

The NAIC is facing a tough hurdle given their desire to develop uniformity, transparency and accountability,

*continued on page 31*



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## Mediation in Reinsurance… continued from page 11

heated, contentious negotiations is the perceived inability to suggest or have your opponent seriously consider reasonable settlement options. The mediator will explore various options without disclosing them to the other side and will assess the likelihood of success of each proposal before any is shared with the other side. In this way, parties can explore options without feeling as though they are bidding against themselves. A mediator can hold an offer as a condition to the other side also improving its offer, a useful tool that is not available to direct negotiators.

**Assist in developing a more realistic analysis:** Having an independent and objective person hear a party's version of the issues is always helpful. More often than not, a party will tend to focus only on the strengths of his case and will discount the weaknesses. A mediator can assist in developing a more realistic analysis and assessing the likelihood of success.

> *"I would recommend the use of mediation in a reinsurance dispute where the facts of a case are relatively well developed, but the parties are unable to bridge the gap in their perception as to the value of the dispute. An effective mediator, experienced in reinsurance custom and practice and the arbitration process, will often be able to manage those expectations to the point where a deal can be reached."*
>
> **—Robert Redpath**
> Senior Vice President and General Counsel
> Clarendon Insurance Group

**Assist in reassessment without losing client confidence in the attorney:** Clients often retain the attorney whom they perceive will fight the most vigorously. This leaves the attorney in the position of reluctance to express less than full confidence in the merits of the case. A mediator can help bring about a more realistic assessment without undermining the client's confidence in the attorney.

Mediation enjoys many benefits over arbitration and in the reinsurance context, mediation's time has come. In mediation, the parties retain control and tailor their own solution, with the benefit of saving precious run-off resources. Rather than a win/lose as in arbitration, mediation can often be a win/win. ■

## Endnotes

1 ABA Journal, The Vanishing Trial, October 2002.

2 The Re/Insurance Mediation Institute ("ReMedi") as well as ARIAS now certify qualified reinsurance mediators.

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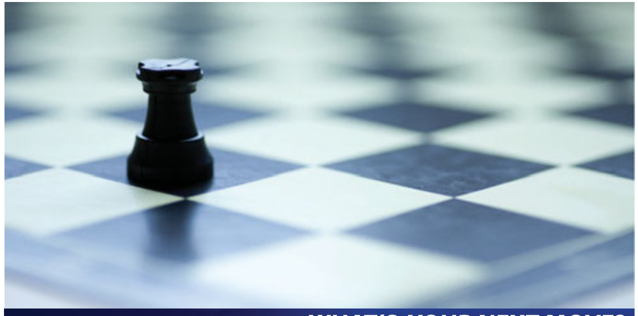

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# Cedant's Sharing of Privileged Documents with Reinsurers Waived Attorney-Client Privilege: Significant Oregon Federal District Court Decision

Patricia St. Peter

Wilbert V. Farrell, IV

*By Patricia St. Peter and Wilbert V. Farrell, IV*

An Oregon federal district court recently sounded a caution alarm for cedants regarding the consequences of a cedant's sharing of privileged documents with its reinsurers. On February 4, 2010, the United States District Court for the District of Oregon ("the Court") issued a decision in the case of *The Regence Group, et al. v. TIG Specialty Insurance Co.*, Civil No. 07-1337-HA, 2010 U.S. Dist. LEXIS 9840 (D.Or. February 4, 2010). In that case, the Court refused to reconsider its earlier denial of the motion for protective order filed by defendant TIG Specialty Insurance Company ("TIG" or "defendant" or "cedant") concerning the scope of subpoenas served by the plaintiffs on TIG's reinsurers, and ruled that TIG's sharing of privileged documents with its reinsurers waived the protections afforded by the attorney-client privilege and the work product doctrine, even where the interests of TIG and its reinsurers were not adverse at the time some of the privileged documents were shared. The prospect of waiver of those protections due to a cedant's sharing of privileged documents with its reinsurers, where the cedant is seeking coverage from its reinsurers for underlying claims, may provide cedants and their counsel with cause for concern regarding whether to share privileged communications with their reinsurers.

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> *…this decision provides important clarification for the reinsurance sector, and should allow claims which had stagnated for over a decade to be processed again.*

In order to more accurately gauge that concern, it is helpful to take a closer look at the significant aspects of the decision.

## Background to TIG's Motion for Reconsideration

Plaintiffs ("Regence") are five corporations headquartered in four different states. Regence brought this action against its insurer TIG alleging claims for breach of contract, declaratory relief, breach of the duty of good faith and fair dealing, fraud, and bad faith. The issues in dispute included TIG's alleged conduct and representations in selling RICO coverage to Regence, TIG's alleged conduct in denying coverage, and TIG's alleged contradictory positions regarding coverage. Regence sought a declaration that TIG was obligated to pay defense and indemnity costs related to three separate underlying lawsuits involving similar claims. During the course of a reinsurance dispute involving a large number of policies, TIG engaged in arbitration proceedings with its reinsurers during which it was compelled to produce privileged and confidential materials to its reinsurers regarding claims and policies involving Regence.

In a May 1, 2009 Order, the Court denied TIG's motion for a protective order by which TIG sought to shield from production documents relating to positions TIG took in communications with its reinsurers in the ordinary course of TIG's reinsurance claims submission (and during arbitration proceedings between TIG and its reinsurers) for the purpose of ensuring coverage from the reinsurers. The Court found that TIG failed to meet the burden of establishing that specific prejudice or harm would result if the documents were produced to Regence and, further, TIG failed to make a threshold

*continued on next page*

showing of appropriate circumstances to warrant a protective order. TIG then filed a motion to reconsider and clarify the Court's May 1, 2009 Order.

## The Parties' Positions

Citing authority from the Ninth Circuit Federal Court of Appeals (*Transamerica Computer Co., Inc. v. IBM,* 573 F.2d 646 (9th Cir. 1978), and *Gomez v. Vernon*, 255 F.3d 1118 (9th Cir. 2001)), TIG asserted that disclosure of privileged material constitutes a waiver of the attorney-client privilege only if the disclosure is voluntary and not compelled. In its briefing, TIG argued that there could be no waiver of the privilege because the arbitration panels specifically ordered TIG to produce the attorney-client communications to the reinsurers in the respective reinsurance arbitrations.

Additionally, TIG asserted in its briefing that confidentiality agreements in the arbitration proceedings with the reinsurers effectively prevented TIG's document production in the arbitration proceedings from constituting a waiver of the attorney-client privilege and work product doctrine. TIG took the position that the documents requested by, and provided to, the reinsurers with the expectation of confidentiality maintain their privilege protection because of the "common interest" between a reinsurer and its cedant. Relying upon *AIU Insurance Co. v. TIG Insurance Co.*, No. 07 Civ. 7052, 2008 U.S. Dist. Lexis 96693 (S.D.N.Y. November 25, 2008), TIG argued that the confidentiality agreements precluded waiver as to all parties, and that TIG's non-waiver as to its reinsurers amounts to non-waiver as to Regence and other third parties, even if disclosure of the documents has been made to a party's direct adversary.

Regence, on the other hand, argued in its briefing that the *Transamerica* and *Gomez* decisions were inapposite because both of those cases dealt with the inadvertent disclosure of privileged documents, and not with a cedant's voluntary disclosure to its reinsurers during the ordinary course of business and during arbitration proceedings. Moreover, Regence further argued that to the extent that any documents were previously privileged and protected, such privilege or protection was waived when TIG shared the documents with its reinsurers.

Finally, Regence argued that the *AIU* decision provided no basis for reconsidering the Court's Order because the *AIU* court made clear that a cedant can waive the privilege by sharing documents with its reinsurers. In this case, the cedant and its reinsurers were involved in an adversarial proceeding and, therefore, there was no common legal interest and, accordingly, any shared information was not privileged. In other words, a waiver as to one adversary constitutes a waiver as to all adversaries.

## The Court's Ruling

In its February 4, 2010 decision, the Court denied both TIG's motion for reconsideration of the May 1, 2009 Order, and TIG's alternative request for certification to appeal the May 1, 2009 Order. The Court granted TIG's motion only insofar as it sought clarification of the May 1, 2009 Order.

In denying the motion for reconsideration, the Court found that TIG's reliance upon *Transamerica* and *Gomez* as grounds for reconsideration fell well short of the type of "newly discovered evidence" or reflection of an "intervening change in controlling law" required to grant reconsideration. The Court further found that those decisions did not support TIG's sought-after conclusion – that if a party is compelled to produce documents in another matter, there is no waiver of privilege so long as reasonable steps had been taken to protect confidentiality in that other matter. Instead, the Court reiterated its prior ruling – that even if the reinsurance documents at issue were at some point privileged, TIG expressly or impliedly waived that privilege by its production to its reinsurers during the arbitration.

*…that even if the reinsurance documents at issue were at some point privileged, TIG expressly or impliedly waived that privilege by its production to its reinsurers during the arbitration.*

In its May 1, 2009 Order, the Court acknowledged the *AIU* court's conclusion "that an insurance company can be construed as waiving any privilege if it has shared its counsel's documents with a reinsurer when the parties' interest are not aligned." The Court reaffirmed that conclusion in this decision and reiterated that the scope of Regence's requested discovery was reasonable and proper. Because the interests of Regence and TIG were indeed adverse, the Court stood behind its refusal to invoke the common interest doctrine as a basis for a protective order.

*continued on page 28*

## Significant Oregon Court Decision continued from page 27

> *…the Court acknowledged the AIU court's conclusion "that an insurance company can be construed as waiving any privilege if it has shared its counsel's documents with a reinsurer when the parties' interest are not aligned."*

The Court went on to clarify that its earlier Order compelled – without reservation – production of Regence's requested discovery, including:

1. The reinsurance policies purchased by TIG covering the Regence policy at issue or underlying litigation that is at issue;
2. Documents exchanged between TIG and its reinsurers about the underlying litigation;
3. Documents relating to coverage for the underlying litigation "exchanged with an opposing party or the arbitrators as part of the [arbitration proceedings]…"; and
4. Documents relating to the payments received by TIG from its reinsurers in connection with settlement of claims for coverage for the underlying litigation.

The Court further noted that the scope of this discovery was not restricted to temporal limitations regarding when the disputes arose between TIG and its reinsurers or when those disputes were resolved. The scope of discovery the Court allowed included all documents related to the policy at issue and TIG's reinsurance claims for the Regence matters. In its May 1, 2009 Order, the Court expressly noted that Regence was not seeking reinsurance information regarding claims of other policyholders or TIG's privileged materials from the arbitrations that were not previously shared with the arbitrators or the reinsurers in those arbitration proceedings.

Potential Effect of the Court's Ruling on a Cedant's Sharing of Information With Its Reinsurers

The Court appeared to rely heavily on the fact that even though the interests of TIG and its reinsurers may have been aligned at one time, their interests did not remain aligned and, therefore, the common interest doctrine did not apply under these circumstances. It is anyone's guess as to whether the Court would have compelled production of the privileged documents if TIG had not been engaged in arbitration with its reinsurers and, further, if TIG had not been compelled to produce privileged documents during the course of the reinsurance arbitration proceedings. Nevertheless, caution should be exercised by cedants when deciding whether to share privileged communications with the cedant's reinsurers in the ordinary course of the cedant's claim submission. In the event a dispute should later arise between a cedant and its reinsurer, the cedant may be later compelled to produce the privileged communication in related litigation. ■

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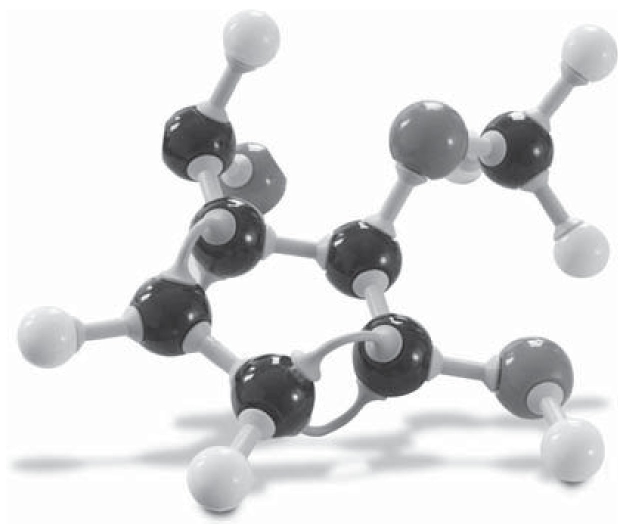

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## Shedding Liabilities *continued from page 7*

the transferee are payable on the basis of the liability of the transferer without diminution because of the insolvency of the transferer.

(b) The agreement shall be noncancellable, except at the discretion of the superintendent acting as rehabilitator, liquidator or receiver of the transferer or transferee.

(c) The agreement shall not contain terms permitting, or operate to permit, the transferee to exercise influence over the claim settlement practices and procedures of the transferer by delay of payment of balances due or otherwise, except that, subject to the ultimate responsibility of the transferer, the transferee may participate in the defense of claims in a manner that shall not constitute unfair claim settlement practices.

(d) Recoveries due the transferer must be available without delay for payment to losses and claim obligations incurred under the agreement, in a manner not inconsistent with orderly payment of incurred policy obligations by the transferer.

(e) The agreement shall constitute the entire contract between the parties, and must provide no guarantees of any kind to the transferee by or on behalf of the transferer, whether directly, by side agreement, or otherwise.

(f) The agreement must provide for quarterly reports by the transferer to the transferee, setting forth the transferer's total loss and loss expenses reserves on the policy obligations subject to the agreement, so that the respective obligations of transferer and transferee will be recorded and reported on a consistent basis in their respective annual and interim statements required to be filed in New York.

(g) The consideration to be paid by the transferer for the loss portfolio transfer must be a certain sum stated in the agreement.

(h) Direct or indirect commissions to the transferer or transferee are prohibited.

(i) Any provision for subsequent adjustment on the basis of actual experience in regard to the policy obligations transferred, or on the basis of any other formula, is prohibited in connection with a loss portfolio transfer, except that provision may be made for the transferer's participation in the transferee's ultimate profit, if any, under the agreement.

Assumption reinsurance and LPTs are powerful tools for insurers to transfer liabilities. However, these transactions require careful attention to detail in order to ensure they achieve the economic benefits desired and do not run afoul of regulatory requirements. ■

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## Policyholders' Response to Proposed US-Based Schemes of Arrangement *continued from page 22*

especially when it comes to receiverships. The current systems of receivership in the US are unique to the states which oversee them. The NAIC distributed a questionnaire in 2009 to various Receivers and professional administrators in the industry to question them about current challenges in their markets and in their experience. 37 states responded with issues that were summarized in six aspects. The following will show what delays are faced by receivers in trying to collect $2.610 Billion in reinsurance, of which $2.237 Billion (or 85.7%) is over 90 days past due. Average number of days overdue is 1,812. The reasons for delay are as follow:

Disputes = 38% this is $994 Million part of $2.610 Billion

Slow Pay = 16% this is $418 Million

Insolvent Insurer = 10% this is $261 Million

Commutations = 4% this is $104 million

Other = 25% this is $653 Million

Not provided = 7% this is $183 Million

The above numbers are *recoverables*. If one applies similar anticipated delays to the amounts which will become recoverable going forward, the implications are profound. In addition, it is not unlikely that the US may see another round of insurance company insolvencies within the next 10 years. Unless there are solid, uniform practices in place, there can be no consistent method of closure. ■

Alert No. 33

# KPMG Policyholder Support Update

*KPMG's Restructuring Insurance Solutions practice has been providing Policyholder Support Alerts to the insurance industry regarding Schemes of Arrangement for a number of years. These alerts act as a reminder of forthcoming bar dates and Scheme creditor meetings. To subscribe to these alerts or access KPMG's online database of solvent and insolvent Schemes of Arrangement, please visit their website at www.kpmg.co.uk/insurancesolutions.*

## Solvent Schemes – Upcoming Key Dates

### MINSTER INSURANCE COMPANY LIMITED, MALVERN INSURANCE COMPANY LIMITED, THE CONTINGENCY INSURANCE COMPANY LIMITED, PROGRESS INSURANCE COMPANY LIMITED, GAN ASSURANCES (FORMERLY GAN ASSURANCES IARD), QBE INSURANCE (EUROPE) LIMITED AND THE RELIANCE FIRE AND ACCIDENT INSURANCE CORPORATION LIMITED

Schemes for the above companies were approved at Meetings of Creditors on 18 January 2010. The Schemes were sanctioned by the Court on 16 March 2010, and the bar date has been set as 21 September 2010. Further information is available at www.minsterins.co.uk.

## Other Recent Developments

### ENGLISH & AMERICAN UNDERWRITING AGENCY ('EAUA') POOLS

A Practice Statement Letter was sent to all known brokers and policyholders on 15 October 2009 indicating that 16 companies which participated in the EAUA Pools intend to propose Schemes of Arrangement in respect of business underwritten for them by the EAUA Pools. The order granting leave to convene Meetings of Creditors was granted by the High Court on 30 November 2009. The meetings were scheduled to be held at 11:00am on 30 April 2010, at Plaisterers' Hall, One London Wall, London, EC2Y 5JU. Further information is available at www.englishandamericanpools.com.

### ALLIANZ GLOBAL CORPORATE & SPECIALTY (FRANCE); AGF MARINE AVIATION TRANSPORT AND COMPAGNIE D'ASSURANCES MARITIMES AERIENNES ET TERRESTRES ("CAMAT"); ALLIANZ IARD; DELVAG LUFTFARHT VERSICHERUNGS AG; NÜRNBERGER ALLGEMEINE VERSICHERUNGS AG (IN RESPECT OF THE CAMOMILE UNDERWRITING AGENCIES LIMITED BUSINESS)

A Practice Statement Letter was sent to all known brokers and policyholders on 30 April 2009 indicating the intention to propose Schemes of Arrangement for each of the above companies' involvements in the business underwritten for them by Camomile Underwriting Agencies Limited ("CUAL"). The order granting leave to convene Meetings of Creditors was granted by the High Court on 17 December 2009. The meetings will be held at 11:00am on 10 June 2010, at the offices of Sidley Austin LLP, Woolgate Exchange, 25 Basinghall Street, London EC2V 5HA. Further information is available at www.CUAL-scheme.co.uk.

### THE SCOTTISH LION INSURANCE COMPANY LIMITED

The Scottish Court of Appeal upheld the Company's appeal against the dismissal of the petition to sanction the proposed Scheme on 29 January 2010. The date for the sanction hearing has not been set. Further information is available at www.scottish-lionsolventscheme.com.

### TOKIO MARINE EUROPE INSURANCE LIMITED ("TOKIO MARINE")

A Practice Statement Letter was sent to all known brokers and policyholders on 28 August 2009 indicating the above company's intention to propose a Scheme of Arrangement. The above company intends to apply to the High Court of Justice of England and Wales for permission to convene

*continued on page 34*

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Meetings of Creditors although no specific date for this application has been announced. Further information is available at www.TMEISCHEME.com.

### TRIMARK 1968 AND PRIOR YEARS POOLS ("TRIMARK")

The bar date for the above company's Scheme of Arrangement passed on 12 April 2010. Further information is available by e-mailing Ben Webber at ben.webber@kpmg.co.uk or Trevor Sage at trevor.sage@ctcaxiom.com.

## Insolvent Estates

### ENGLISH & AMERICAN UNDERWRITING AGENCY ('EAUA') POOLS (ENGLISH & AMERICAN INSURANCE COMPANY LIMITED, THE INSURANCE CORPORATION OF SINGAPORE (UK) LIMITED AND THE HOME INSURANCE COMPANY (IN LIQUIDATION) - INSOLVENT PARTICIPANTS)

See Other Recent Developments above.

### HIGHLANDS INSURANCE COMPANY (UK) LIMITED

The deadline for Scheme Creditors to submit a Final Claim Form passed on 15 February 2010. Further information is available at www.ukhighlands.co.uk.■

*Please contact Mike Walker, Head of KPMG's Restructuring Insurance Solutions practice in the U.K. at mike.s.walker@kpmg.co.uk should you require any further information or guidance in relation to insurance company schemes and insolvencies..*

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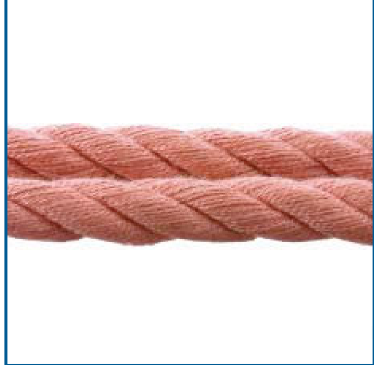

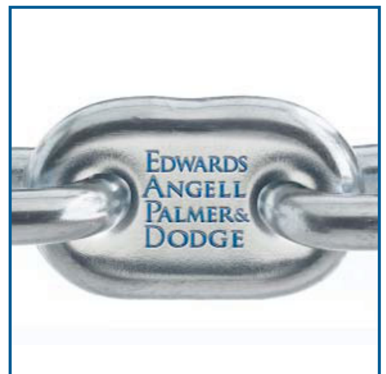


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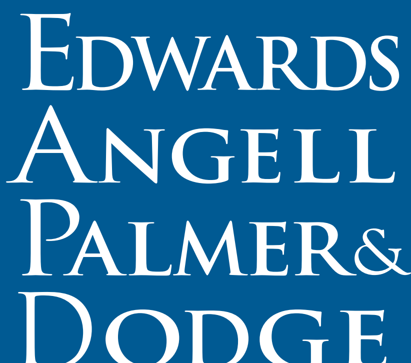


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