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Back in the Saddle Again…

Peter A. Scarpato

For those who have had the unfortunate experience, returning from major back surgery mirrors crawling back from the brink. Notwithstanding the skill and prowess of neurosurgeons, critical body parts are never reassembled quite like they were before, which explains why they don't work quite as they did before. And if you get 50-60% pain relief, you may utter the dreaded phrase "Mission Accomplished," for in my experience, expecting more simply sets you up for failure.

So, it is with a tempered sense of accomplishment that I return to my Editor's Desk to share with you the latest issue of AIRROC Matters. We start with a timely piece by our newly named AIRROC Person of the Year, Stephen Johnson, entitled *Corporate Governance.* In his article, Stephen explains why even the biggest and most successful companies often navigate into troubled waters and, more importantly, how three crucial components of corporate governance, accountability, fairness and transparency, can help them wade it out. Next, Micah Bloomfield, Michelle Jewett and Daniel Martinez give insurers a tax lesson, in *The Impact of the Tax Reform Act on the Insurance Industry.* Their message: the reform law offers both good and bad news for insurers.

They say there's never enough of a good thing, and our returning author and avid AIRROC supporter Eleni Iacovides submits *Anticipation. Excitement. Commitment. Patience. That Order*. In her sobering piece, Eleni begins by stating that the United States cannot pin down a uniform approach to insurance business transfers, not to mention the general feeling that a federal approach is near impossible. But she ends on a high note, predicting that a "fair wind" favoring insurance business transfers will soon "blow" in the U.S.

We're extremely proud to present Andrew Ward and Victor Nelligan's article analyzing the results of the first *PwC Global Insurance Runoff Survey*, co-sponsored by AIRROC. Spoiler alert: the global non-life run-off market is at least US $730 billion, with the U.S. dominating the market and hosting almost half of the world's non-life run-off liabilities. Good news: over the next few years, the U.S. should produce "significant developments," through stakeholders who will explore effective ways to manage legacy in innovative ways.

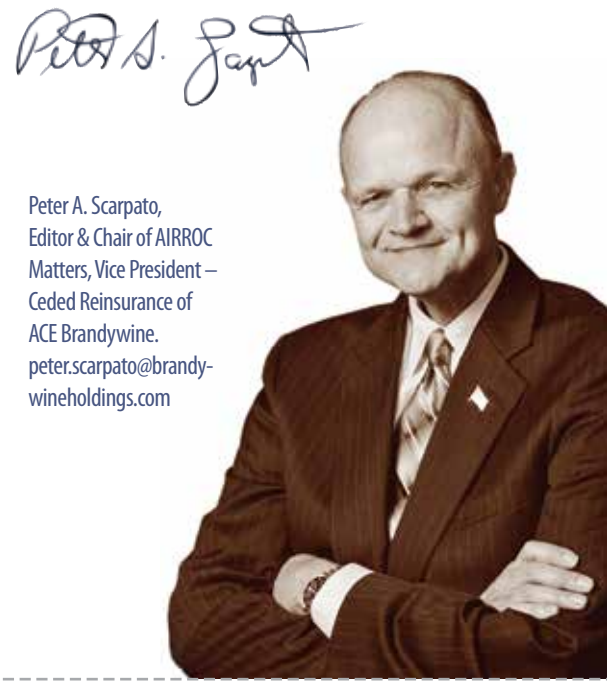
And while everyone likes a good duel to the death, in our business, negotiated settlements are king. Connie O'Mara appreciates this, and offers *Cue the Mediator,* an interview with experienced mediator Bill Hengemihle, who makes the case for mediating complex CERCLA superfund disputes.

Carolyn Fahey continues her animal theme with a rabbit in, *AIRROC is Hopping into Spring,* showcasing a series of announcements and upcoming events for 2018, including our new location for AIRROC's Commutations & Networking Forum at the Westin Jersey City Newport hotel in Jersey City, N.J. Our training programs kicked off in January with a program cosponsored by Stroock Stroock & Lavan in New York City. The sessions included pieces on program managers, claims, bad faith, IBT statutes, and a keynote by former Delaware Insurance Commissioner Karen Weldin Stewart. We also covered AIRROC's Spring Membership meeting, highlighting programs on PwC's insurance runoff survey, September 11th coverage, cumis counsel, E-cigarettes, and ethics for in-house counsel.

One of the best we saved for last is Lisa Simon's *Biometrics: The Next Big Privacy Issue.* Lisa explains that the automated recognition of individuals based on unique characteristics (e.g., facial recognition software) offers promise, but may raise numerous privacy and security concerns.

Enjoy!

Let us hear from you.



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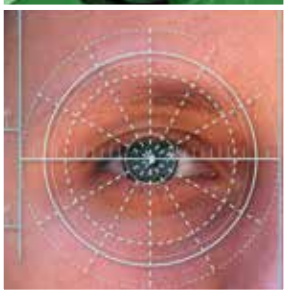

Illustrations / R. Edwards
Photos / Jean-Marc Grambert

AIRROC

Corporate Governance

How many times are we going to learn about another corporate misstep? The list of companies making headlines for the wrong reasons never seems to end —Wells Fargo, Volkswagen, Target, Toshiba, Experian, Yahoo, Weinstein, Wynn, Uber—just to name a few. What do all of these companies have in common? A lack of strong corporate governance.

Corporate governance can simply be defined as a framework of rules and practices by which a Board of Directors ensures accountability, fairness, and transparency in a company's relationships with all of its stakeholders. This is simple and logical, and cannot be seriously challenged as an extremely important, if not mission-critical, objective. Yet, even today, many companies large and small do not walk the walk, or even talk the talk, of strong corporate governance.

It may be trite to say, but it is all so true, that real corporate governance begins with the "Tone at the Top." The Board of Directors of an organization holds the power and has the duty to set this tone and, with that power, establish the culture of an organization. Culture is the true benchmark of what an organization is, what it represents as its values, and how it accomplishes its mission. Culture has now become a recognized asset of a corporate organization or, in far too many cases, a liability.

Great organizations can only be truly great when executing best-in-class governance. This requires mindful leadership from a proactive, intelligent, healthy, responsible, and accountable Board of Directors.

Today, regulators across multiple industries understand the benefits of strong corporate governance. As such, regulators are evaluating the companies within their jurisdictions from the perspective of corporate governance, both in hindsight following scandals and as added components of routine, proactive oversight. While federal regulators are reducing overall regulatory compliance, federal and state regulators are increasing the oversight of good corporate governance practices within the banking and other industries. Additionally, within the insurance marketplace, state regulators have similarly ramped up oversight on this important front.

Following the 2008 financial crisis, the National Association of Insurance Commissioners (NAIC) analyzed existing corporate governance regulatory initiatives and statutory requirements and identified a need to collect additional information from insurers regarding their corporate governance practices. Upon completing its study in 2014,

the NAIC developed a model act and accompanying model regulation, known respectively as the Corporate Governance Annual Disclosure Model Act (#305) and Corporate Governance Annual Disclosure Model Regulation (#306). As of January 2018, nineteen states (California, Connecticut, Delaware, Florida, Idaho, Indiana, Iowa, Kansas, Louisiana, Maine, Montana, Nebraska, Nevada, New Hampshire, Ohio, Oregon, Rhode Island, Virginia, and Vermont) have adopted the Model Act. Eleven states (California, Connecticut, Florida, Indiana, Iowa, Louisiana, Nebraska, Ohio, Rhode Island, Vermont, and Virginia) have adopted the Model Regulation as well. Thus, nearly 40% of all states have enacted laws for insurers on corporate governance.

The stated purpose of the Model Act is to "[p]rovide the Insurance Commissioner a summary of an insurer or insurance group's corporate governance structure, policies and practices to permit the Insurance Commissioner to gain and maintain an understanding of the insurer's corporate governance framework." Model Act, Section 1(A)(1). Together, the Model Act and Model Regulation have four key areas of required focus: 1) governance framework and structure; 2) policies and practices of the Board of Directors and the Board's committees; 3) policies and practices for directing senior management; and 4) oversight of critical risk areas. Model Regulation, Section 6. Within these areas, the Model Regulation establishes sub-topics on which companies should focus, all within the spheres of self-evaluation, transparency, accountability, and leadership.

Great companies come in all shapes and sizes, and various management styles; but long-term success among them always includes the key feature of top down, strong corporate governance.

An insurer subject to the Model Act and Model Regulation must fully explain how the organization is governed, self-evaluated, and directed, from the Board of Director level through its various committees and downward to senior management. In preparing compliance disclosures, insurers already exhibiting strong corporate governance will possess the policies, procedures, leadership, and track record to show their regulators how they walk the walk. Insurers lacking strong corporate governance will have an opportunity to focus with a self-critical eye and build a strong governance culture from the top down.

Whether your company is within a Model Act state or not, now is the time for all insurers to take stock of their corporate governance practices and truly consider whether shortcomings therein might permit, or even foster, increased regulatory scrutiny, adverse circumstances that could create reputational harm to the organization, or even worse calamities.

Great companies come in all shapes and sizes, and various management styles; but long-term success among them always includes the key feature of top down, strong corporate governance. The insurance industry has an opportunity and, in many states, a statutory mandate, to focus and improve on corporate governance, and migrate to a position of greater strength, industry wide. ●

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The Impact of the Tax Reform Act on the Insurance Industry

Touted as the most significant federal tax legislation since 1986, Public Law 115-97 – informally known as the "Tax Cuts and Jobs Act" (the "TCJA") – was enacted on December 22, 2017. This article examines the potential impact of several provisions of the TCJA on the insurance industry.

The changes in the TCJA to domestic corporate tax provisions, including the corporate tax rate reduction and elimination of the alternative minimum tax, should benefit insurance companies.

However, a number of provisions that apply specifically to insurance companies were included as revenue raisers. Among these are changes in the tax reserve calculations for life and property and casualty ("P&C") insurance companies, changes to the deferred acquisition cost and proration rules for life companies, and a modification of the discounting rules for P&C companies. Although these changes may increase the taxable income of insurance companies, they are not as onerous as earlier proposals, and they are intended to reduce the tax compliance burden by simplifying reserve calculations and better aligning such calculations with evolving statutory accounting practices.

International tax provisions are likely to have significant consequences (mostly unfavorable) for insurance companies with activities outside of the United States.

General Corporate Provisions

- The federal corporate income tax rate is reduced to 21%.
- The corporate alternative minimum tax is repealed.
- Net operating losses ("NOLs") incurred after 2017 cannot be carried back, but can be carried forward indefinitely to offset only up to 80% of taxable income in any year.
- Taxable income is generally recognized no later than when it is taken into account as revenue in the taxpayer's financial statements.

Insurance Company Tax Provisions

NOLs of Insurance Companies

The TCJA repeals the previous special operations loss carryover and carryback

provisions for losses generated by life insurance companies after 2017 and applies to them the general corporate NOL rules (described above). P&C companies, however, continue using the old rules, which allow NOLs to be carried back for two years and carried forward for 20 years, and to offset 100% of taxable income.

Computation of Life Insurance Reserves for Tax Purposes

The TCJA changes the computation of life insurance reserves for purposes of determining the deduction for reserve increases. Life reserves for most contracts generally are the greater of (a) the net surrender value of the contract, or (b) 92.81% of the reserves determined under the statutory reserve method. For variable contracts, the net surrender value of the contract is replaced with the separate-account reserve amount (if greater than the net surrender value). Life reserves cannot exceed the amount of statutory reserves in the financial statements of the company. The TCJA requires using CRVM/CARVM in effect as of the date the reserve is determined instead of the issue date, which is expected to simplify calculation of life reserves.

The difference for existing contracts between the new reserve and the old reserve is taken into income (or deducted) ratably over eight years.

The TCJA shortens the period for taking into account income or loss resulting from other changes in method of computing life insurance company reserves to four-years for income and one year for losses.

Discounting for P&C Companies

The TCJA changes computation of reserves for P&C companies by extending the discount period for long-tailed policies and using a method that generally should increase the discount interest rate. The TCJA provides that the interest rate used for discounting reserves is determined based on the corporate bond yield curve rather than mid-term AFRs.

International tax provisions are likely to have significant consequences (mostly unfavorable) for insurance companies with activities outside of the United States.

The TCJA also repeals the election permitting a taxpayer to use its own historical loss payment patterns and extends the period over which some reserves are discounted.

Any income (or loss) resulting from the adjustment is included ratably in income over eight taxable years starting in 2018.

Deferred Acquisition Costs

The TCJA increases the capitalization rates of "specified policy acquisition expenses" from 1.75% to 2.09% for annuity contracts, from 2.05% to 2.45% for group life contracts, and from 7.7% to 9.2% for all other specified contracts. The amortization period is increased from 120 months to 180 months.

Proration Rules

Life insurance companies are required to reduce their deductions, including the dividends received deduction ("DRD") and the reserve deduction, to reflect that a portion of their tax-exempt income is used to increase policyholders' reserves or is attributable to policyholders. The TCJA simplifies the calculation of the DRD and reserve deductions by fixing the company's share at 70% and the policyholders' share at 30% (instead of the previous complex allocation formulas).

P&C companies are required to prorate the deductible amount of their incurred loss reserves. The TCJA replaces the previous 15% proration percentage with 25% to account for the corporate tax rate reduction.

Life Insurance Contracts in the Secondary Market

The TCJA overrules the portion of Revenue Ruling 2009-13, which held that on sale (but not surrender) of a life insurance policy, the seller's basis is reduced by the cost of insurance. The TCJA's repeal of this holding applies retroactively to sales of life settlement policies entered into after August 25, 2009. A number of new reporting requirements apply to purchases of insurance policies by persons unrelated to the insured.

International Taxation

BEAT

A new Base Erosion and Anti-Abuse Tax ("BEAT") imposes a minimum tax on a corporation's "taxable income" calculated by adding back deductions for payments to foreign affiliates and a portion of net operating loss carryovers. The BEAT applies to taxpayers that have average annual gross receipts in excess of $500 million (for the three prior tax years) and a "base erosion percentage" of at least 3% for the taxable year (2% for a member of a financial group). The BEAT may affect insurance companies with foreign affiliates because base erosion payments include any premium or other consideration paid to a related foreign reinsurer. Currently, it is unclear whether the addback of deductions will apply to gross premiums or net profit on the ceded business.

Participation Exemption and Repatriation Tax

The TCJA shifts the U.S. corporate tax system closer to a territorial system by providing a participation exemption for foreign-sourced dividends (but

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The Impact of Tax Reform (continued)

not for Subpart F inclusions) paid by certain foreign corporations to 10% U.S. corporate shareholders and imposes on 10% U.S. shareholders a one-time tax on unrepatriated and previously untaxed earnings and profits of specified foreign corporations at the rate of 15.5% for cash and other liquid assets and 8% for other earnings. There is an election to pay this tax in installments over eight years.

The TCJA repeals the indirect foreign tax credit for dividends received from a foreign corporation, but retains it for Subpart F inclusions.

Modifications of CFC Rules

Notwithstanding the general territoriality rule, the TCJA imposes a new tax on a U.S. shareholder's share of a controlled foreign corporation's ("CFC") "global intangible low-taxed income," or "GILTI," at a 10.5% rate. GILTI is active income in excess of an implied return of 10% of the CFC's adjusted basis in tangible depreciable property used to generate the active income.

The TCJA changes the definition of "U.S. Shareholder" for purposes of the application of the Subpart F provisions. Under the new definition, a "U.S. Shareholder" is a person who owns at least 10% of the vote or value of the foreign corporation (previously, value was irrelevant). Another significant change is that certain stock owned by foreign persons may now be attributed to a U.S. entity in which it owns an interest for purposes of making the U.S. person a "U.S. Shareholder." Many existing corporate structures will have to be reexamined and modified in light of these changes.

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PFICs

The TCJA changes the passive income test for purposes of the passive foreign investment company rules by generally excluding income derived in the active conduct of an insurance business by a corporation only if the applicable insurance liabilities constitute more than 25% of its total assets. ●



Micah W. Bloomfield (left) and Michelle M. Jewett (center), Partners in the Tax Practice Group of Stroock & Stroock & Lavan LLP, and Daniel Martinez (right), associate in Stroock's Tax Practice Group.

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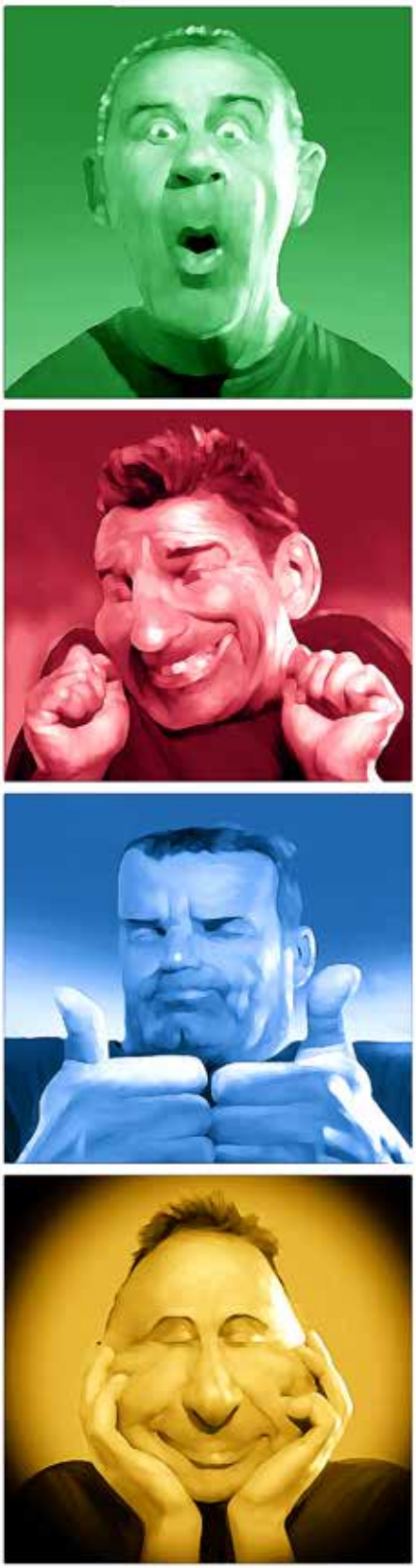
Anticipation. Excitement. Commitment. Patience. That Order.

In the previous three articles, we took a journey that would be a dream if it were a holiday itinerary: Europe and its uniform legal and regulatory framework for portfolio transfers; then Europe met the U.S., which with small but steady steps is trying to develop its own system for legal finality and insurance business transfers; and finally, we focused on Rhode Island, Connecticut and Oklahoma and the current discussion about legal finality statutes in the U.S. and the reasons for which such legislation is slow to develop. We also discussed why use of the Rhode Island statute is taking longer than originally anticipated.



What is delaying matters? What are the concerns? Are these unique to the U.S.?

There seems to be recognition of the difficulty in achieving a uniform approach to insurance business transfers in the U.S. and a general belief that a federal approach is near impossible. As a European that is very committed to uniformity, freedom of movement, and the idea of collaboration for the common good without losing one's cultural and national identity, I still struggle to see why this area of insurance regulation in the U.S. could not be carved out and dealt with differently so that it would deliver a level playing field for all players and states.

There seems to be a belief that a portfolio transfer is somehow an exotic creature that interferes with a contractual arrangement with which one should never interfere. What about the robust approval process that must be followed before it actually concludes? What about the need for the transferor to ensure that its reputation remains intact following the sale and the safeguards that are put in place with this in mind? And what about the transferee, who must ensure that it does a good job in order for his business plan to be met and its shareholders to be kept happy and that their investment is well-managed? All these interests and considerations go a long way towards ensuring that policyholder rights (the other contracting party) are protected following the contractual change. We often hear that claims settlement is actually better in the hands of legacy acquirers. This is not surprising. The portfolio transferred would most likely be a non-core portfolio managed by a small team that perhaps had little involvement in the company's core/active business. When it lands on the transferee's balance sheet, it becomes a core part of the acquirer's value creation and receives top management attention.

While considering the issue of interference with the original contractual arrangement, I wonder how this is protected when faced with bankruptcy. When insurance companies fail, the contractual arrangement is fundamentally altered and, accordingly, regulators and courts do their best to protect policyholders' rights. But we have all seen how it often ends.

Equally, what about the contractual relationship in the case of a sale of the entire entity? Regulators are entrusted with approving the sale of an insurer. Is that not an interference with policyholder contractual rights? Do we not rightfully trust that the commissioner, entrusted with this decision, will ensure that policyholder rights are observed in the context of this business transaction? And why is the sale of part of the insurance company's business so different from the sale of the whole business and the legal entity?

Interestingly, the point of contractual interference and the relevance of the acquirer's identity was a point made very strongly by the President of the German

Insurance Association at their recent annual general meeting. This was made in response to political commentary on proposed transfers of life business, but it is a point that is equally relevant to the discussion about non-life transfers: "*The discussion generally suffers from the fact that it is conducted inappropriately. In most cases of portfolio transfers, it is not about the sale of customers or contracts, but a company, which is not an unusual process. In addition, the buyers are in turn insurance companies, which must comply with the relevant legal rules.*"

Last summer, we saw that the Covered Agreement between the U.S. and the EU eliminated the need for collateral for EU insurers writing in the U.S., a major step towards the notion that recognition and equivalence is possible. The statement from both sides of the Atlantic in July 2017 encapsulated the key message that should guide all legislators in their efforts towards achieving a level playing field for our industry. They said it conveys *"benefits to EU and U.S. insurers and reinsurers operating across the Atlantic by offering them regulatory certainty, while maintaining consumer protection."* My reading is this: we accept that regulators across the globe do have the same goals in mind and that acknowledging this can only help the global nature of our industry to operate on a level playing field. And perhaps equally key to this is the fact that if one regulator or jurisdiction fails, we all fail.

Since the last article, we have seen two important developments: Oklahoma submitted Senate Bill No. 1101, the "Insurance Business Transfer Act." At the same time, the Senate passed the Tax Reform Act, which contains various provisions that directly affect the insurance industry, in particular, what is famously or infamously known as BEAT – the Base Erosion and Anti-Abuse Tax. This is discussed elsewhere in AIRROC Matters and the industry is still assessing the full impact. It is evident that there will be winners and losers, as in every tax environment. The most notable winner is Berkshire Hathaway, which noted in its eagerly awaited letter to the shareholders that $29 billion out of the declared $65 billion gain for 2017 was "delivered when Congress rewrote the US Tax Code." Insurers with non-U.S. affiliates may not be so fortunate.

…most notable winner is Berkshire Hathaway, which noted in its eagerly awaited letter to the shareholders that $29 billion out of the declared $65 billion gain for 2017 was "delivered when Congress rewrote the US Tax Code." Insurers with non-U.S. affiliates may not be so fortunate.

Furthermore, the proposed Oklahoma statute provides the "basis and procedures for the transfer and statutory novation of policies from a transferring insurer to an assuming insurer by way of an Insurance Business Transfer (IBT) without the affirmative consent of policyholders or reinsureds. This is an enormously positive development and it goes beyond the Rhode Island legislation in terms of what business it potentially covers, as it would appear not to be limited to P&C lines of business. One can only hope that other states will follow and we can perhaps move towards a Model Act?

There is no doubt that there is a fair wind favouring insurance business transfer efforts and there is a general consensus among practitioners that legal finality will be a useful tool for U.S. companies when looking to dispose of portfolios, creating leaner balance sheets as well as achieving capital and operational efficiency. The European process and the efforts made in the U.S. should deliver certainty, protection, and seamless business continuity for policyholders. Surely, this should also deliver to the industry and commissioners alike the confidence to pursue this robust process. ●

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Results Are *In*...

AIRROC Co-Sponsors First PwC Global Insurance Runoff Survey

In January 2018, we launched the eleventh edition of our run-off survey, in conjunction with both IRLA and, for the first time, AIRROC. Our survey was expanded to account for the worldwide nature of the run-off market and estimated the value of the global non-life run-off market to be at least US$730bn. It is no shock that the U.S. dominates the global market by value and, by our estimate, is the site of almost half of the world's non-life run-off liabilities.

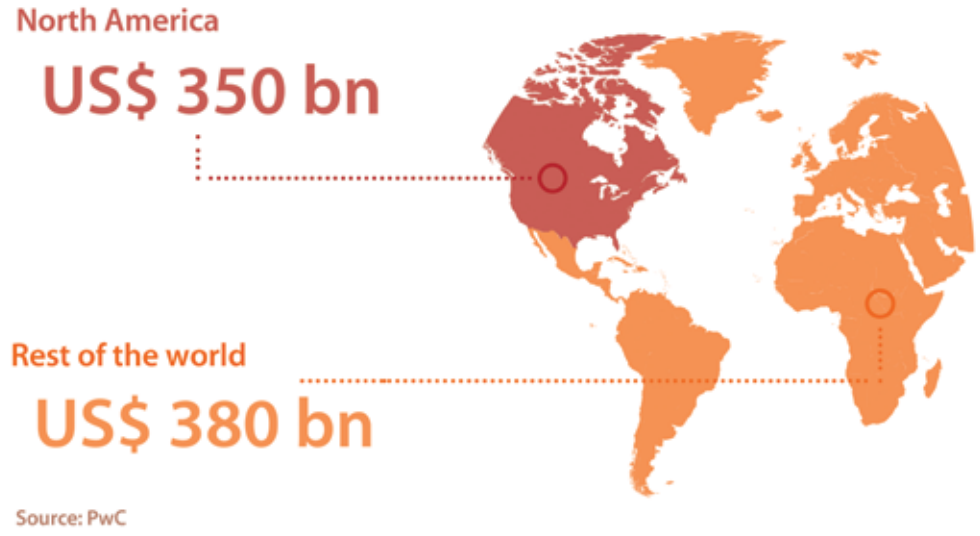
Our Survey covered a wide range of run-off issues. These include the importance of legacy management in the current market, the objectives of run-off participants, as well as the opportunities and challenges they face in pursuing their strategic goals. It is clear that challenges remain for market participants in meeting their objectives. In particular, U.S. respondents cited adverse loss development as their most significant challenge. This is consistent with U.S. carriers remaining very much on the front line of asbestos claims deterioration. Indeed, almost 60% of U.S. respondents highlighted asbestos as the claims type that they were most concerned about. It was interesting to see that European respondents were more concerned about liabilities relating to motor books.

It is clear that the appetite amongst run-off acquirers is buoyant with Survey respondents, indicating a range of factors set to influence the sector. Run-off transactions in 2017 followed the upward trend of deal activity seen in 2016 and early signs indicate that the strong market is poised to continue through 2018. While respondents highlighted Continental Europe as a particularly busy sector for legacy disposals over the next two years, the U.S. has witnessed lots of run-off related activity so far in 2018. This activity includes sellers looking at reinsurance deals, as well as regulatory developments around Insurance Business Transfers, which remain a hot topic, and potential new IBT rules in Oklahoma. This activity reflects the increasing recognition by owners of discontinued insurance business of the benefits associated with pro-active management of legacy liabilities and back books.

Currently the most common type of run-off transaction in the U.S. involves retrospective reinsurance placed over a portion of the back book, covering a number of liability types. Often these will be in the form of an adverse development cover, such as some of the mega deals that were seen last year. Traditional M&A transactions remain a viable exit route for U.S. entities in run-off and, in contrast to some of the retrospective reinsurance mega deals, activity at the smaller end of the corporate entity scale has been vibrant as acquirers look at captives and risk retention groups as well as (re)insurance companies. This activity has been enhanced as the market sees continued interest from a range of investors and new start-up entrants seek to challenge the established consolidators. All of this contributes to the evolving run-off landscape.

In the U.S., there have been well-documented legislative developments in relation to insurance business transfers that potentially provide an alternative to traditional pure reinsurance solutions.

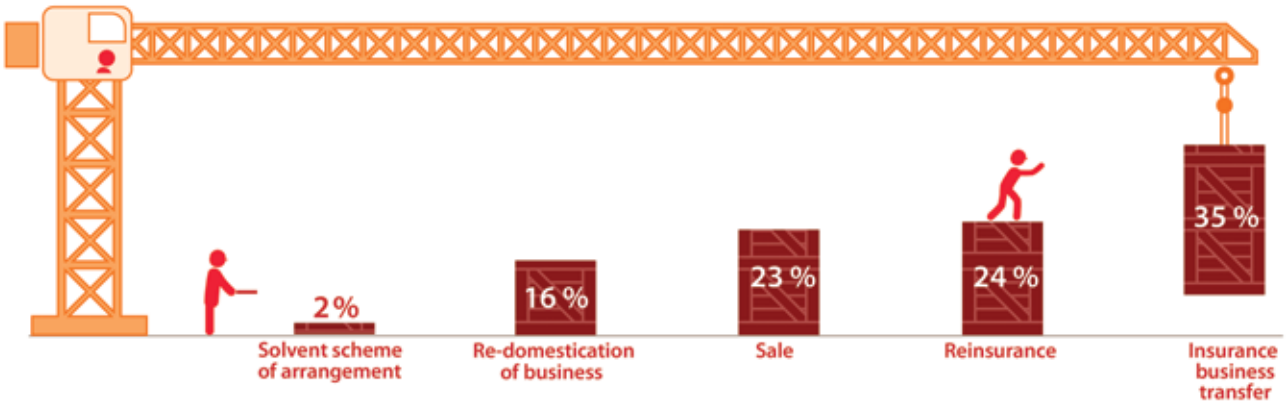
The value of the North American run-off market approximately equals that of legacy liabilities for the rest of the world



The results from our Survey show that, while some respondents believe that there will be a large number of U.S. legacy transactions, others are more cautious. This seems to highlight the pivotal, yet binary, nature of successful U.S. insurance business transfer legislation – simply put, if one of the U.S. states delivers a successful series of transfers, there may be many such transactions. If not, there may be very few. Accordingly, 2018 may be a milestone year in seeing how IBT's progress in the U.S.

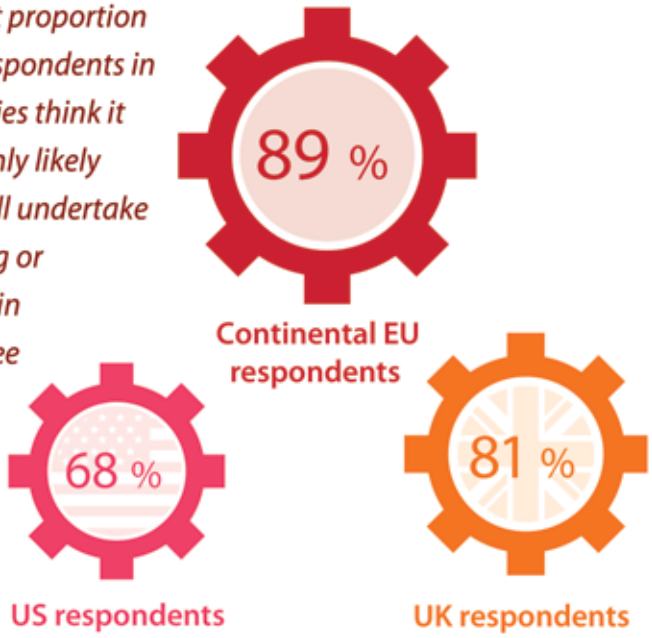
As our Survey has demonstrated, the run-off landscape continues to evolve and the next few years may produce further significant developments, particularly in the U.S. where all stakeholders continue to explore the best way of managing legacy in innovative ways. We would like to extend our thanks to everyone that took part in the Survey. ●

Over a third of all respondents expecting to undertake restructuring activity in the next three years anticipate using insurance business transfers (IBT). This includes 41% of US respondents, despite a US IBT mechanism remaining untested.



Source: PwC

A significant proportion of Survey respondents in core territories think it likely or highly likely that they will undertake restructuring or exit activity in the next three years.



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Insurance Solutions

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Cue the Mediator

Hiring a Mediator to Save Costs in Superfund Cases

Connie D. O'Mara


Bill Hengemihle, Sr.
Managing Director at FTI Consulting

In almost 40 years of dealing with CERCLA liability claims, we have learned a thing or two. In November of last year, A.M. Best opined that environmental exposures were "97% funded" at $41 billion in reserves. This is good news compared to 2003, when A.M. Best viewed environmental losses as underfunded by 45% based on a projected ultimate loss of $56 billion.

But then, as now, there were warnings that a dwindling Superfund would result in increased pressure on Potentially Responsible Parties (PRPs) to clean up contaminated sites. Regardless of what happens with budget cuts at the EPA (or in Scott Pruitt's soundproof booth, https://tinyurl.com/yd8a22wc), insurers and reinsurers are managing significant losses related to contamination. Regardless of whether transaction costs for policyholder involvement at these sites are "defense" or "indemnity" (covered or not), litigation over liability, damages, and coverage is often counter-productive.

In last September's EECMA and AIRROC joint Symposium on Mega-Superfund Sites, the participants heard from a wide range of panelists on the unique challenges facing insurers in handling these claims. The material was so thorough and wide-ranging that AIRROC's editorial staff felt our usual Education Summaries could not do justice to the topics covered. This article focuses on one topic in the agenda that is particularly relevant for managing these complex exposures: "Challenging Issues in Allocation of Liability." The author had an opportunity to interview Bill Hengemihle, Senior Managing Director at FTI Consulting, on how mediation is critical to this process and how a mediator adds value in containing costs. Bill is engaged by PRP groups to serve as an arbitrator or mediator of complex cost allocation disputes.

Connie O'Mara: *It strikes me that a Superfund case is a little like an orchestra — you have many parties, some in groups, that can create a lot of chaotic noise if they are not properly organized. Do you feel like a conductor who has to get the group orchestrated?*

Bill Hengemihle: Yes. But first you have to have all the necessary instruments grouped properly. So, the first key is to achieve broad membership in the PRP group as early as possible, when "entry costs" are low. While the EPA will issue notice letters to the most readily identifiable PRPs at a site, agency resources for the PRP search are often constrained and the enforcement team will prefer to avoid multiple rounds of liability notice letters to PRPs; thus, "once-and-done" is better. A mediator who understands the EPA criteria for PRP identification, and has credibility with the agency, can orchestrate an allocation process to include as many PRPs that meet the notice criteria as possible by developing "nexus packages" that the EPA can rely upon for newly-identified PRPs. The outreach process to PRPs—in other words, asking them to join the group and participate in the allocation procedure—is the next critical step. PRPs should be aware that the EPA can contribute funds for this process by hiring a "convenor" to contact all EPA notice recipients and encourage their participation, often through a series of letters, calls, and meetings. Significantly, EPA involvement at the convening stage can elevate the level of urgency or importance that the invitees will associate with the process and influence them to become involved. This is good, as empty chairs are always a problem—whether for an orchestra or a PRP group.

Connie: *So, you have a multitude of parties with varying degrees of involvement—then what happens to symphonize the allocation process?*

Bill: An "Allocation Process Design Agreement" is negotiated. This should specify how allocation information will be gathered and how it will be managed.

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Cue the Mediator (continued)

It needs to be "right-sized" to accommodate the scope and scale of issues in dispute; generally speaking, larger sites require more due process, and thus more procedure and cost, but the agreement should be flexible to allow off-ramps for accelerated mediation, thus avoiding unnecessary transaction costs or delays should opportunities for a short cut to a settlement arise. For larger PRP groups, you will usually have "tiers" of parties: voting participants and non-voting participants, depending upon the amount of involvement and control individual parties wish to invest in the process. Most CERCLA ADR proceedings involve "evaluative mediation," where the mediator (in the role of "neutral allocator") will make an allocation recommendation that predicts what a trial court would likely produce, but it will often be non-binding and subject to reallocation as more information is developed. Often, the hallmark of a good allocation is that everyone is left feeling equally unhappy with the outcome, but with a sense that their advocacy was heard and their position was thoughtfully considered, even if not reflected in the allocation to the full extent desired.

Connie: *How do you determine what factors to use in allocating costs?*

Bill: CERCLA case law provides some guidance. The neutral allocator will always consider the "Gore Factors" and "Torres Factors," but there is no definitive list of equitable factors and they are always selected and applied based on site-specific circumstances. In some cases, the participants direct the allocator to develop a "Method Report" that provides allocation guidelines and presents a framework or methodology for developing the allocation, and then seeks buy-in from all participants early in the process. While you need enough detail so that the parties have confidence in its fundamental fairness, you also need enough flexibility to deal with gaps in information. It is highly specific to the parties and the site under negotiation. That is why the role of an experienced mediator is critical, as you need a neutral party who can drive the process forward without undue influence by any one group or party.

Often, the hallmark of a good allocation is that everyone is left feeling equally unhappy with the outcome, but with a sense that their advocacy was heard…

Connie: *Does the EPA get involved in the allocation?*

Bill: Sometimes, but mostly from the standpoint of relying upon the allocation outcome to develop the appropriate roster of "performing parties" to implement a cleanup under a consent decree and the identification of "buyout parties," meaning the PRPs may be able to participate in the consent decree by making a fixed cash payment to resolve their liability. The latter scenario is often referred to as a de minimis settlement and the EPA will need to understand how de minimis parties were identified by the allocation process. The PRP group will want the EPA to support the allocation outcome in this respect, so keeping the EPA informed on the allocation process along the way is a good idea.

Connie: *Based on my own experience in handling environmental claims and assessing the exposures they present, I know the process of allocation involves a massive amount of historical, technical, and scientific information…*

Bill: Don't forget "environmental forensics," which includes dating the approximate time of disposal and fingerprinting the source of contaminants. Their "fate and transport" can include models for tracking contaminant sources to locations where they accumulate in the environment.

Connie: *So, you have a whole host of experts and probably enormous amounts of data. Does the mediator hire the experts and develop the database?*

Bill: Well, you need to tailor your investigation to the most important factual questions that go into a fair allocation. You start with a disclosure questionnaire and from there you develop a record on what else you need: more documents, interviews of employees, etc. For example, the mediator often hires expert advisors on technical issues for the PRP group, so it is a neutral process and not prejudiced against any party or group of parties. It is, of course, much more cost efficient to have neutral experts rather than to have battles between experts for competing parties. At the end of the day, you are probably only going to have a small fraction of the necessary facts collected, given the passage of time and unavailability of disposal documents and witnesses, but mediation is as much a people business as a fact-based negotiation. Frankly, in the mediation context, cost allocation can be just as much an art as it is a science. If a mediator effectively manages the emotions, including biases and perceptions tied to each individual party's sense of what's fair, as well as the facts, he or she can orchestrate a process that is cheaper, faster, and fairer than any litigated outcome.

The foregoing discussion reveals the value of mediation in both the context of Superfund cases as well as any multi-party complex claim scenario. A neutral party can organize the facts, the parties, the law and the lawyers, hire neutral experts, and intercede with claimants to focus on a solution more efficiently than parties with competing interests. ●

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

AIRROC is Hopping into Spring

It just so happens that I am writing this article on the first day of spring … although as I look out my office window, there is a wintry mix outside. The groundhog sure was right this time.

Let's hop away from winter and that groundhog and focus on springing ahead into a terrific year for AIRROC. I have BIG announcements to share with you.

ANNOUNCEMENT 1: We have a new venue for AIRROC NJ 2018. We have chosen the Westin Jersey City Newport for the October Forum and are looking forward to this new location, as well as the new program and new dinner venue. Goodbye New Brunswick — Hello, Jersey City!

ANNOUNCEMENT 2: We are pleased to bring a new event to New York this summer. The Runoff Deal Market Forum will be hosted with Mayer Brown on June 6th. It will focus on deals, acquirers, sellers, and investors with a curriculum that will take an in-depth look at the current state of runoff deals.

ANNOUNCEMENT 3: We have learned that the size of the global runoff market is $750 billion. AIRROC participated as a co-sponsor for the first PwC Global Insurance Runoff Survey. PwC is a long-standing source of information on the European market and it decided to expand its reach to the U.S. this year by partnering with AIRROC to collect the data on the U.S. The survey can be accessed on the AIRROC site at http://www.airroc.org/pwc-global-insurance-runoff-survey. A summary of the findings can also be found in this issue of AIRROC Matters (page 14).

ANNOUNCEMENT 4: Rolling ahead with the success of the joint AIRROC/EECMA event last year, we are planning a second one with a different focus. Join us in Philadelphia on September 6th for a deep dive into the various aspects of climate change when we present the AIRROC/EECMA Climate Change Symposium.

ANNOUNCEMENT 5: AIRROC will now be hosting Webinars. Look for our web-based training initiatives geared to those who are learning about legacy. The board approved and budgeted for a set of six programs on the following topics:

1

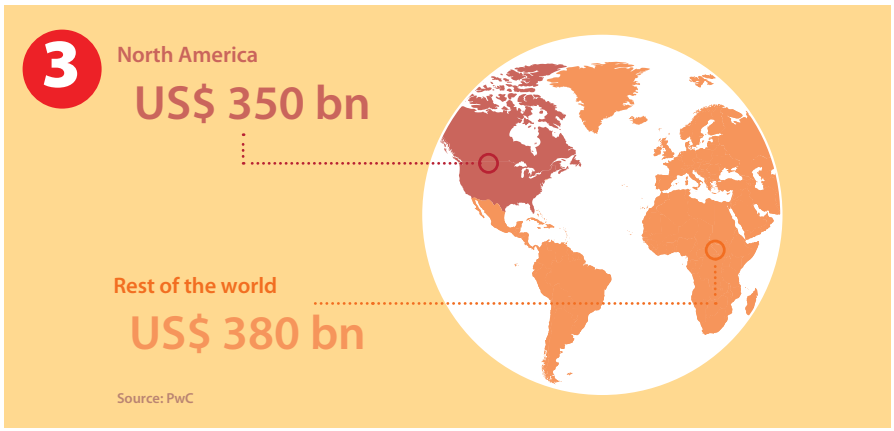
2

AIRROC's VISION is to be the most valued (re)insurance industry educator and network provider for issue resolution and creation of optimal exit strategies.

AIRROC's MISSION is to promote and represent the interests of entities with legacy business by improving industry standards and enhancing knowledge and communications within and outside of the (re)insurance industry.

Message from the Executive Director

Carolyn Fahey



Overview of Runoff; Introduction to Long Tail Claims; Reinsurance from a Runoff Perspective; Introduction to Mergers and Acquisitions; and Overview of Dispute Resolution Methods.

If that isn't enough, the AIRROC rabbit that I am will be hopping around the U.S. and the United Kingdom to represent AIRROC at some very important industry events such as the EECMA Annual Meeting, the NAIC, the IRLA Congress, the IAIR Workshop … and more.

Our full schedule for the rest of the year follows – I hope to see you at more than one.

June 6 – Runoff Deal Market Forum

June 12 – Chicago Regional Education Day

July 17-18 – Summer Membership Meeting, New York City

September 6 – AIRROC/EECMA Climate Change Symposium, Philadelphia

September 18 – Boston Regional Education Day

October 14-17 – AIRROC NJ 2018, Jersey City, NJ

HOPPING Over and Out!

Carolyn

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

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Photos: Jason Gerber

AIRROC at 180 Maiden Lane

AIRROC kicked off the 2018 programming with co-sponsoring firm Stroock Stroock & Lavan in downtown NYC on January 17. It was a snowy day but that didn't stop our attendees! A crowd of 80 came to hear education sessions on topics such as, "Managing the Program Manager," "The Future of Claims," "Florida Bad Faith," "Insurance Business Transfer Statutes," and a keynote by former Delaware Insurance Commissioner Karen Weldin Stewart. It was a great way to start the year for AIRROC members.

Photos Jean-Marc Grambert

Educational Summaries

Lessons from the Front: Managing the Program Manager

Regan Shulman (Vice-President and Deputy General Counsel of Arch Insurance Company) and Michele Jacobson and Robert Lewin (both Partners at Stroock) discussed the historical issues that insurance companies have faced in relationships with program managers and offered practical solutions on how to manage those relationships productively.

The panel began by reminding attendees of historical scandals involving MGAs and MGUs, including Unicover, and referenced the Dingell Report, which recommended additional regulation of the relationship between insurance companies and MGAs/MGUs. Next, the panel discussed the pros and cons of relationships with program managers. Among other benefits, the panel noted that use of a program manager provides enhanced premium volume and distribution channels, as well as access to niche markets that might otherwise be unavailable to the insurer. One of the principal potential detriments to an agency relationship is the fact that the MGA/MGU may have no skin in the game and is normally incentivized to generate premium.

Ms. Shulman suggested that this issue could be addressed by tying the program manager's compensation to experience and by agreeing to initial premium caps that could subsequently be adjusted. The panel discussed other possible detriments, including the potential that the program manager could commingle funds from multiple programs, that the insurance company may not have adequate access to records relating to the program, that the program manager might fail to promptly pay claims, and that, in the event of a dispute between the program manager and the insurance company, the flow of information would cease, jeopardizing reinsurance relationships.

The panel then discussed how to set up program business to avoid these lurking pitfalls. In light of previous scandals involving program managers, the panel stressed the need to perform due diligence and proper vetting of the proposed program manager before entering into the relationship. In addition, New York Insurance Department Regulation 120 and the NAIC Model Managing General Agents Act provide guidance on written agreements with program managers, including the need for a written agreement that clearly sets forth financial and reporting responsibilities and makes clear that the program manager holds all funds in a fiduciary capacity. The written agreement should specify applicable underwriting controls, such as premium caps and renewal criteria, and appropriate claims controls, including conditions under which the insurer should receive copies of the claim file and limitations on the program manager's authority. Further, the parties should clearly outline the responsibilities, if any, assigned to the program manager in connection with the reinsurance for the program. Lastly, the written agreement should contain provisions pertinent to the relationship between the insurer and the program manager, including termination and suspension provisions, as well as dispute resolution procedures.

Finally, the panel emphasized the need for the insurer to oversee the program manager in a "hands-on" manner, suggesting the appointment of an in-house person to monitor compliance with reporting and payment terms and to maintain near-constant communication with the program manager.

Summary by Randi Ellias, Partner, Butler Rubin Saltarelli & Boyd LLP, rellias@butlerrubin.com

Florida Bad Faith Claims: Best Practices In Claims Handling

Joanne McGovern (Claims Regional Vice-President for ProSight Specialty Insurance), joined Laura Besvinick and Julie Nevins (both of Stroock & Stroock & Lavan) to discuss the dynamics of claims-handling in Florida, the hallmarks of good faith claims-handling, and avoiding bad faith claims.

Bad faith claims have become something of a "cottage industry" in Florida. Certain policyholder counsel employ bad faith "set-up" strategies, particularly in cases where the liability is uncertain, but there are high damages. In practice, there is little difference between what is required for a bad faith claim in Florida state court and ordinary negligence. Although the legal standard is different, it is very difficult to prevent a bad faith claim from getting to a jury in Florida state court.

Florida is one of the few states that require a settlement offer even without a demand where the liability is "certain" and the damages are significant (e.g., likely beyond policy limits). A failure to settle, even absent a policyholder demand, is one frequent scenario for a bad faith claim. Another major problem is the time-limited settlement demand, where the policyholder may attempt to set up a bad faith claim by providing some, but not enough, information. The panelists agreed that it is important to get ahead of the process by, for instance, making a settlement offer first, if possible, to show that the insurer is being proactive. Other suggestions were to ask for information before the insurer hears from the policyholder and to invite the policyholder to a meeting to discuss possible resolution. Should the policyholder say that it is "not ready," the insurer has effectively gotten itself out of bad faith territory. It is particularly important to stay engaged with the policyholder when there may not be enough in limits available (e.g., because there are a number of insureds). The panel also discussed the importance of the claims-handler being mindful that comments in text messages will be treated the same as if they were written in the claim file, and that cell phone records (both for company phones and personal phones) may be subject to subpoenas. Other principles of good, common sense claims-handling are making sure that the policyholder is aware of settlement opportunities and the risks of an excess judgment, advising the policyholder of

probable outcomes, and acting in the "best interests" of the insured.

Insurers also face special risks when they offer a defense under a reservation of rights. Florida courts permit the policyholder to reject the defense as offered and to take control of the defense. Most Florida courts will treat the offer of a defense subject to an ROR as a denial of coverage and permit the policyholder to enter into a consent judgment. The panel discussed the requirements for collection of the judgment, including the existence of coverage, breach of the duty to defend, that the settlement amount was reasonable, and some good faith component (i.e., absence of collusion). Although liability is not technically at issue, it will often be a "back door" consideration relevant to the reasonableness of the amount of the settlement.

Summary by Robert D. Goodman, Partner, Saul, robert.goodman@saul.com

Insurance Business Transfer Statutes

A panel comprised of Eleni Iacovides of DARAG, Vincent Laurenzano and Bernhardt Nadell of Stroock & Stroock & Lavan, Jim Wrynn of FTI Consulting, and Frank Schmid of AIG discussed the various statutory and regulatory provisions governing insurance business transfers. The panel addressed traditional statutory and regulatory procedures for handling impaired and insolvent insurers in the United States, more recent U.S. statutes and regulations for voluntary restructuring of solvent insurers (including Rhode Island's Regulation 68, Vermont's Legacy Insurance Management Act, the Connecticut Division Statute, and proposed Oklahoma legislation), schemes of arrangement and Part VII transfers in the U.K., and the legal framework in the European Union. The panel also addressed Loss Portfolio Transfers (LPTs) and Adverse Development Covers (ADCs).

Jim Wrynn noted that a major issue has been the "laser focus" in the United States on consumer protection (particularly, the interest of policyholders). A second issue has been the focus on insolvent and impaired companies, rather than solvent companies seeking finality with respect to old liabilities. Jim noted that Rhode Island's Amended Regulation 68 may go "as far as we can go," but "legal finality" remains an open question.

Vincent Laurenzano and Bernhardt Nadell addressed in detail the features of the various statutory and regulatory approaches. With respect to Rhode Island's Amended Regulation 68 and similar voluntary restructuring provisions, the principal question is whether other jurisdictions will recognize the transfers. The result is that there remains considerable legal uncertainty.

Eleni Iacovides discussed the European legal framework, arguing that in Europe transfers "work" and "quite easily" if the prescribed steps are followed. The "beauty" of the European framework is finality: "it will be over if you want it to be over." In order to do a transfer in Europe, the insurer needs to be solvent. The drivers are the cost of capital, claim volatility, and the desire for finality. The position of the policyholder will be as good as or better than before because the insurer will be as well capitalized or better capitalized than before.

Frank Schmid discussed LPT and ADC concepts as alternatives to the insurance business transfer and division approaches. All concepts involve the transfer to policyholders of both financial and nonfinancial commitments. And all concepts play important roles in business restructuring beyond the realm of discontinued business. The insurance business transfer framework is an important tool for corporate restructuring and the improvement of capital allocation across the insurance industry.

Summary by Robert D. Goodman, Partner, Saul, Robert.goodman@saul.com

The Future of Claims

Jake Acosta of EY presented insights on the future of claims. Acosta explained that, in early 2016, EY conducted research to understand where claims operations are headed. EY's research included interviews with executives at commercial insurers, industry analysts, and FinTech leaders. EY's research revealed six key drivers of change in the industry.

1. Decreasing Claims Volumes

Acosta stated that, while claims frequency will continue to decrease in some lines, severity may increase in others. Claims frequency is expected to decrease in part due to increased use of sensors for monitoring homes and businesses. Auto claims frequency and severity are expected to continue declining as a result of improved driver training and vehicle safety, including driver assistance technology. EY's study suggested increased volatility of claims and a likely increase in severity in some product areas.

2. Severe Weather

Severe weather is expected to drive an increased frequency and localization of weather-related claims. Acosta noted that there are not enough third-party vendors to outsource weather claims. Consequently, insurers are building specialized teams to quickly respond to major events, such as fire and hurricanes. These teams are expected to provide better service and a faster response. Technology is expected to assist with preparation for such events to reduce impact of the events and to more quickly respond.

3. Sensor Revolution

Acosta explained that the increasing use of sensors in businesses and homes will reduce claims frequency and severity. Sensors can be used to monitor for fire and flooding, permitting faster responses. In cars, sensors could be used to auto report accidents to an insurer and record information about the accident.

4. Digital Disruption

The EY study showed that the insurance industry is being impacted by forces outside the industry, where customers

are becoming accustomed to self-service. Acosta noted that customers will be increasingly willing and able to allow the handling of less-complex claims through completely digital channels. Acosta noted that insurers will be able to mine significant data to assist in evaluating risk.

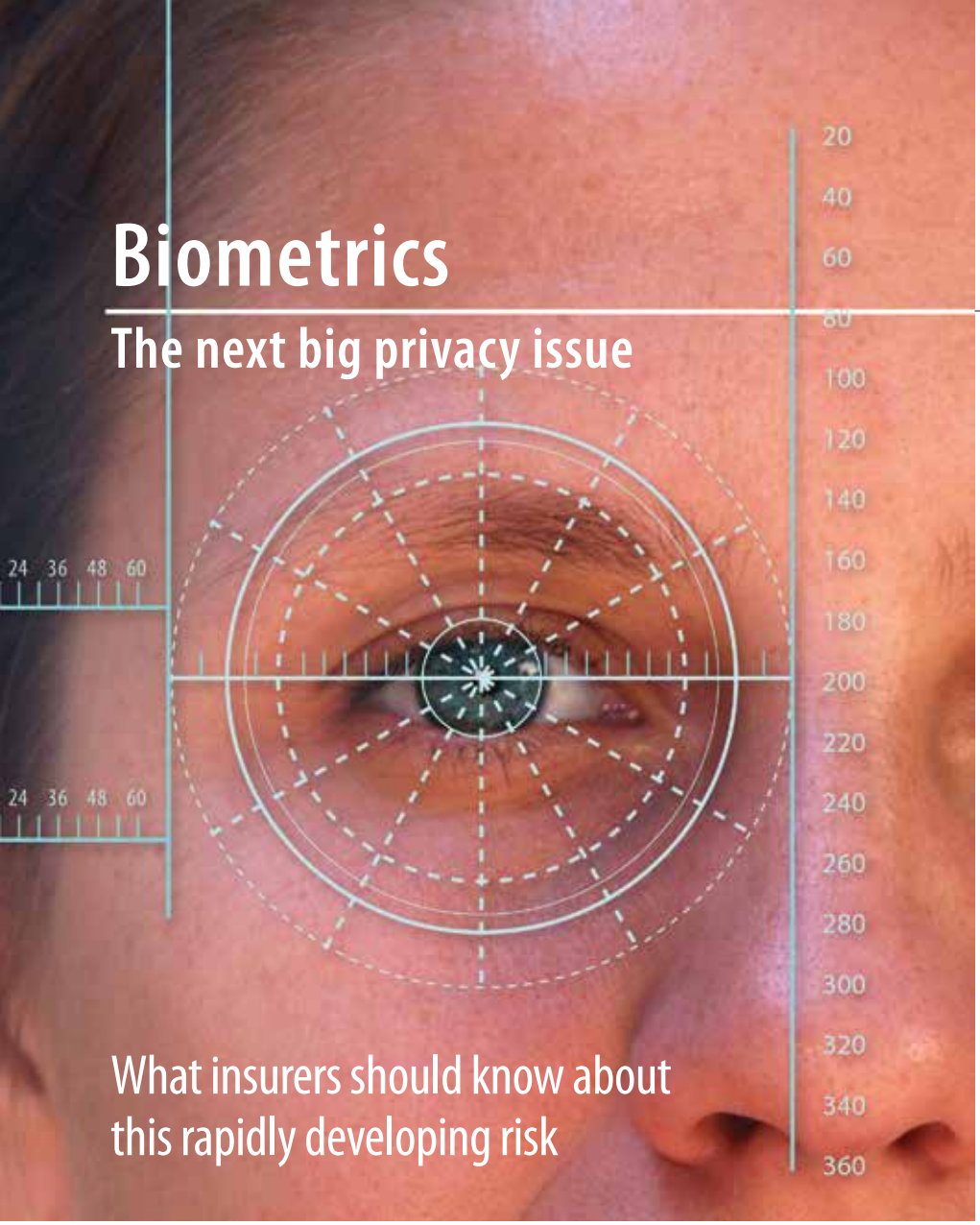
5. Better Risk Management

Acosta explained that large businesses have become more proactive with improved risk management capabilities, with a greater focus on return from capital, including insurance arrangements. Businesses are tracking claims incidents and have clearer insights into the costs of risks. Acosta explained this is likely to drive a decrease in claims from these types of policyholders.

6. Modernized Technology

The EY research showed that robotic process automation (RPA) or programmable software is expected to handle simple claims, which will more often be settled automatically. Acosta explained that technology will allow claims to be filtered for complexity and assigned accordingly. For example, a claim for less than a certain threshold (*e.g.*, $1,000), might be fully automated. Future claims operations will be leaner and will consist of smaller, more specialized work forces. As simple claims become automated, only complex claims will be handled by humans. Claims professionals of the future are expected to be more analytical, data driven, and collaborative. Claims are expected to be handled by teams of people, with a reduction in the number of hand-offs between staff and departments. ●

Summary by Julie Rodriguez Aldort, Partner, Butler Rubin Saltarelli & Boyd LLP, jaldort@butlerrubin.com



Biometrics

The next big privacy issue

What insurers should know about this rapidly developing risk

Picture a world in which you use your fingerprints, rather than keys to open your front door; where you pay for items by taking a selfie; where your heartbeat serves as your password. Biometrics —automated recognition of individuals based on unique characteristics—are making all of this possible. But maybe not surprisingly, the commercial use of biometrics raises numerous privacy and security concerns, which are worth exploring.

Defining biometrics

It's important to understand how biometrics are defined and how they work on a basic level. In simple terms, biometrics involve the measurement and analysis of unique physical and behavioral characteristics to determine 1) who a person is and 2) if he or she really is who they claim to be. Distinct physical traits include fingerprints, vein, retina, and voice patterns, as well as facial measurements (like the distance between someone's eyes or the shape of their cheekbones). Behavioral identifiers can include an individual's signature and keystroke patterns, gait, hand-eye coordination, and response times. After these biometric identifiers are captured, data is extracted, and then translated into codes and stored in a database or on a portable device like a smart card. Future data is compared to the established biometric template for authentication purposes.

The advantages of biometrics as a means of identification and authentication include reduced costs (no more replacing lost ID cards) and added convenience (no more carrying key fobs, or having to reset or remember multiple passwords). Biometric data cannot be lost or forgotten. Because biometric identifiers are unique and immutable, they are considered more secure than passwords. However, it's still possible to hack or trick scanning devices. And biometric information can be stolen. In 2015, hackers breached the U.S. Office of Personnel Management and stole the fingerprints of more than five million government employees.

Biometric uses

There has been a tremendous uptick in the use of biometrics by the private sector due to a decrease in size and cost of biometric devices, combined with the desire for quicker, more efficient methods of authentication. For instance, banks are using retinal scans instead of passwords as a way to access online banking. Hospitals have implemented palm-vein scans to prevent misidentification of patients. Airports are increasingly replacing boarding passes with face and fingerprint scans to strengthen and speed up the boarding process. Colleges use them as a method of accessing dorms, and to confirm identification ahead of test taking.

While many organizations utilize biometrics for security, retailers are further taking advantage of facial-recognition systems to identify customers, and to direct them to specific products, or make recommendations based upon prior purchases. Car manufacturers are designing vehicles that require fingerprint or iris recognition to start their cars. Many cars will also automatically adjust seat location, music preferences and dashboard displays after identifying the

driver. Auto companies are developing ways to monitor driver eye movements and heart rates to counter inattentive behavior and to prevent accidents. Sensors will be able to scan drivers' faces for signs of drowsiness, track stress levels, and set phones automatically to "do not disturb."

Few regulations on the books

There are no U.S. federal laws governing biometric data. The Federal Trade Commission has issued recommended best practices for companies that use biometrics, but it has not promulgated any rules. The EU's General Data Protection Regulation, which will take effect in May 2018, expands protections for personal information and does address biometric data; this will impact U.S. companies that do business in EU member states or have EU employees.

Three states currently have laws that apply to biometric data: Illinois, Texas and Washington. (Other states' privacy laws may encompass biometric information, depending on how they define personal information.) Illinois' "Biometric Information Privacy Act" (BIPA) is the most stringent state law. It requires providing written notice and obtaining written consent before private entities can obtain and store biometric identifiers or information. A biometric identifier is defined as a "retina or iris scan, fingerprint, voiceprint, or scan of hand or face geometry," while biometric information is defined as "any information, regardless of how it is captured, converted, stored, or shared, based on an individual's biometric identifier used to identify an individual." Entities are further required to take steps to protect this information from disclosure, and to develop policies for retaining and disposing of it. BIPA permits a private right of action for liquidated damages and attorneys' fees when there are violations. For each negligent violation, the prevailing party may recover $1,000 or actual damages, whichever is greater. For intentional or reckless violations, parties may recover $5,000 or actual damages, whichever is greater. In Texas and Washington, only the state attorney general can bring suit, and the remedy is civil penalties.

A biometric identifier is defined as a "retina or iris scan, fingerprint, voiceprint, or scan of hand or face geometry," while biometric information is defined as "any information, regardless of how it is captured, converted, stored, or shared, based on an individual's biometric identifier used to identify an individual."

The litigation landscape

BIPA was enacted in 2008, but it wasn't until 2015 that plaintiffs' attorneys started filing lawsuits alleging statutory violations. Today, more than 60 BIPA class actions are pending. The suits are generally based upon the defendants' use of fingerprints or facial recognition technology. The majority of fingerprint suits involve employers who use fingerprints for employee timekeeping purposes. However, some suits have been filed against businesses that use fingerprints (rather than membership cards) to identify customers. Class actions against tech and social media companies, like Facebook, Google and Shutterfly, stem from their use of facial-recognition software to scan images and create a template for each face based upon its unique characteristics. (These templates are stored in a database, and when new images are uploaded, they are compared to the templates and matches are noted.)

In both types of suits, plaintiffs allege that the defendants failed to 1) obtain consent to use of this biometric information, 2) disclose how the information would be stored, used, or shared, and 3) advise how they planned to ultimately dispose of the information. The entities sued have set forth numerous defenses, including that BIPA does not apply to biometric data obtained from photographs, since the statutory definition of biometric identifiers expressly excludes photographs. However, courts have held that data obtained from photos can constitute scans of facial geometry, which fall within the BIPA definition. See, for example, Monroy v Shutterfly, Inc., 16 CV 10984 (N.D. Ill. 2017), a US District Court decision from September 2017.

Defendants have also argued that a private right of action under BIPA is limited to aggrieved persons, and that plaintiffs have not suffered actual injury. The Second District of the Appellate Court of Illinois agreed with this position in a December 2017 decision. The defendant in Rosenbach v. Six Flags Entertainment Corp., 2017 IL App (2d) 170317, used a biometric fingerprint scanning and identification process for its theme park's season pass holders. The plaintiffs did not allege actual injury, but they argued they would not have purchased the pass had they known of the defendants' conduct. The court held that while BIPA does not define "aggrieved," the plain meaning of the term requires actual injury, adverse effect or harm. Plaintiffs who allege only technical violations of the act without injury cannot recover damages.

In February 2018, a federal judge denied Facebook's motion to dismiss a class action alleging that the company's "Tag Suggestions" program violated BIPA. He found the plaintiffs alleged concrete violations of privacy. The judge noted the Supreme Court expressly recognizes the violation of a statutory procedural right (without any additional harm alleged) can be sufficient to satisfy the standing-to-sue requirement. The plaintiffs also alleged that Facebook had not provided

Technology – Driving the future of runoff.

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Biometrics (continued)

them with notice or opportunity to withhold consent.

The impact on insurance coverage

Should insurers be concerned about biometric claims? It depends largely on the lines of business they write. Commercial general liability (CGL) policies provide coverage under personal and advertising injury provisions for damages due to publication of material violating a person's right to privacy. But unless biometric information is shared with a third party, it is unlikely to be considered as published. Several CGL exclusions may be applicable, including the Access or Disclosure of Confidential or Personal Information and Data-Related Liability Exclusion. The Employment-Related Practices Exclusion should also bar coverage for employee claims. However, these claims may be covered under Employment Practices Liability Insurance (EPLI) policies, many of which provide coverage for workplace invasions of privacy under a definition of "wrongful act." Cyber policies also cover privacy breaches in certain cases, but the definition of confidential information in the policy may not encompass biometric data. Other cyber policies may only apply if confidential information is disclosed to a third party. Frequently, companies use third parties to collect and store biometric information, and plaintiffs may argue this use constitutes disclosure. Cyber policies may contain exclusions for claims resulting from unauthorized collection of data.

What lies ahead

Commercial use of biometrics is expected to increase drastically in the next few years. There will be more than 5.5 billion biometrically enabled mobile devices by 2022, according to a forecast by Acuity Market Intelligence. As a result, we expect to see additional regulation. Alaska, Montana, Connecticut and New Hampshire are among the U.S. states currently considering biometric privacy laws.

Many entities are probably unaware of the legal risks associated with using biometric information. As such, insurers should take a leading role in educating clients, to ensure they are aware of and in compliance with applicable laws, and they are utilizing best practices. These practices include developing written policies, implementing protocols for protecting data, and insisting that vendors are aware of and adhering to biometric standards and regulations. Both insureds and insurers should be monitoring this emerging risk, as we expect it to develop rapidly. ●

Lisa Simon, Swiss Re, lisa_simon@swissre.com

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AIRROC "Springs" Ahead

Educational Summaries

Though it wasn't feeling like Spring, and a Nor'Easter hit New England so hard it left many unable to travel, AIRROC's Spring Membership meeting drew more than 100 attendees over two days. The familiar format of a day for business and education meetings made it a productive combination for our members and supporters. The Education Day featured timely and interesting topics: PwC Global Insurance Runoff Survey, September 11th Coverage Retrospective, Cumis Counsel, E-Cigarettes, and Ethics for In-house Counsel.

September 11th– A Coverage Retrospective

Day Pitney's Michael Mullins and Jonathan Zelig reprised a session from the Hartford Regional Education Day last summer. The presentation focused on a review of contractual controversies, single or multiple occurrence questions, and measuring business interruption; the presenters also highlighted a few lessons learned for insurers.

Larry Silverstein, a property developer and investor, sealed a 99-year lease for the World Trade Center complex on July 24, 2001 for $3.2B, just over a month before the attack. On September 11, 2001, two hijacked airplanes hit the twin towers, sixteen minutes apart.

The $3 billion question: Seeking two policy limit payments, Silverstein claimed each crash was a separate attack and a separate occurrence. Insurers argued that the plot to hijack and attack on that day represent a single occurrence. The answer: It depends on the definition of occurrence.

A lifelong New Yorker, the Hon. John S. Martin Jr., presided over multiple September 11th policy language cases. Three companies, The Hartford, St. Paul, and Royal, proved they had bound coverage under the WillProp Form that defined occurrence as attributed "to one cause or to one series of similar causes." Those "cause"-based reinsurers won their single occurrence argument. On the other hand, the Allianz policy language defined occurrence as a "loss or series of losses, disasters, or casualties arising out of one event." Allianz lost its case.

Lesson number one: In insurance policy language, "cause" is a less-restricted term, while "event" represents a particular time, place, or way. To Allianz, the attack was the event that led to a series of losses. The judge declared that each hijack could also represent an "event" and sent the case to a jury. "Event" and "series" language is often susceptible to counter-interpretation. Not surprisingly, the Lower Manhattan jury sided with the insured and authorized a double policy limit payment. Lesson number two: Avoid high-profile and local jury cases.

So how should we measure a business interruption coverage period resulting from an expensive, unique loss? Duane Reade Pharmacy manages about 200 stores in the New York area, 120+ of which are in Manhattan. The World Trade Center store location was the chain's most profitable store. For many years, it was unclear how long it would take to rebuild the location and if the site would become a memorial generating equally profitable store traffic. Duane Reade was a single renter in the complex and had no control over the construction decisions. The complex reopened in 2014, taking 13 years and 56 days to rebuild.

Insurers argued that Duane Reade could have rebuilt and operated at another location, at which time the restoration period should terminate, and that one of the other 120 locations near-by would profit from redirected traffic. Insurers paid $9.8M to the chain. Seeking a larger settlement, Duane Reade took the argument to court. The policy language discussed a "reasonably equivalent store and a reasonably equivalent location," and "rebuild, repair, or replace." Duane Reade held general coverage for all of its store locations. It did not have specific coverage for this most profitable store. The Court's intention is to incentivize

Educational Summaries (continued)

business to "get back to work" and sided with insurers that the chain could find reasonable equivalence at another location. Lesson learned here: Buy specific coverage to protect a unique risk.

Summary by Lindsay York Carter, lindsay.yorkcarter@thehartford.com

What is *Cumis* Counsel and When Do I Need One?

Eileen Ridley, a partner and litigation lawyer with Foley & Lardner, provided a primer on the circumstances requiring appointment of independent counsel, sometimes referred to as "Cumis counsel," as well as the rights and obligations of the insurer and the insured once independent counsel has been appointed.

The term "Cumis counsel" derives from the decision in San Diego Navy Fed. Credit Union v. Cumis Ins. Society, Inc., 162 Cal. App. 3d 358 (1984), later codified in California Civil Code Section 2860(a). Essentially, the insurer is required to retain independent counsel for its insured when the manner in which defense counsel would defend the case might impact coverage. Generally, the insurer must retain independent counsel where there is a significant, not theoretical, conflict between its interests and the interests of its insured, such as where the underlying action implicates both covered and uncovered claims. That conflict must be actual, not potential. A reservation of rights in and of itself does not require the appointment of independent counsel. The requirement that an insurer appoint independent counsel does not arise with respect to allegations or facts in the underlying litigation as to which the insurer denies coverage. California Civil Code Section 2860(a) allows the insured to waive its right to independent counsel if that waiver is express, in a signed writing that contains specific language prescribed by the statute.

Independent counsel represents the insured, not the insurer, and the insured controls the case following appointment of independent counsel. The insurer retains the right to control settlement, and the insured must meet its obligation to cooperate with the insurer by disclosing all information other than privileged information concerning coverage and by keeping the insurer apprised of and consulting with the insurer on all matters regarding the action. Information disclosed to the insurer by the insured or independent counsel is not a waiver as to third parties. Further, any dispute over a claim of privilege is subject to in camera review by the court. The method for exercising this right to in camera review is somewhat difficult to implement, as it might require the insurer to file a separate action.

Under Section 2860(a), the insurance policy may provide a methodology for selecting independent counsel. The insurer may require that independent counsel have certain minimum qualifications, so long as those qualifications are reasonable. In addition, while the insurer must pay independent counsel's fees, the rates charged must be similar to those paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended. The insured may retain more expensive counsel, if the insured pays the difference.

Finally, the insurer may use the same adjuster to handle both the underlying claim and the coverage claim, notwithstanding the appointment of independent counsel. The insurer need not segregate its liability and coverage files.

Summary by Randi Ellias, Partner, Butler Rubin Saltarelli & Boyd LLP, rellias@butlerrubin.com

Evaluating Risk in the E-Cigarette/Vape Industry

Bob Alpert and Patrick Lowther of Morris, Manning & Martin LLP presented on risks in the e-cigarette

and vape industries and offered insights into the role that insurers may play in this growing industry.

Mr. Alpert began by providing background information about Electronic Nicotine Delivery Systems (ENDS). Consumers use ENDS for a variety of reasons, including quitting smoking, saving money, using indoors, or experiencing some of the 8,000+ flavors of e-liquids on the market. Due to this demand, the ENDS industry is expanding rapidly. In 2013, ten years after the first patent was obtained, global sales exceeded $7 billion. The global market is projected to reach $61.4 billion by 2025, and experts predict e-cigarette sales will eclipse cigarette sales within 10 years. At the same time that the market is expanding, the industry is also consolidating, as larger companies acquire mom-and-pop shops.

As the industry has grown, so have incidents linked to e-cigarettes—since 2009, there have been nearly 200 combustion incidents. At the root of these incidents is the lithium-ion battery used to power ENDS devices, which can explode when overheated causing severe injuries. Thus far, those injuries have included second- and third-degree burns, broken bones necessitating facial reconstruction surgery, and even death.

As a result, the industry has already faced a number of legal challenges. Mr. Lowther described these actions, which fall into three categories: (1) product liability; (2) consumer protection; and (3) class actions. The product liability actions alleging that design defects, manufacturing defects, and warning defects contributed to injuries incurred in combustion incidents. Notable verdicts include a $1,885,000 verdict in *Ries v. Zolghadr* (Cal. Super. Ct. 2013) and a $1,240,000 verdict in *Heinlein v. Varpormax Inc.* (N.Y. Sup. Ct. 2016). There have also been consumer protection and class lawsuits alleging that e-liquids expose users to harmful chemicals and at least one class action alleging false advertising about the propensity of e-cigarettes to help users quit smoking.

Recently, there has been an uptick in regulation of ENDS devices at the federal, state, and local levels, including prohibition on sale to minors, requirements of warnings about potential for addiction, and flavor and indoor use bans. Technological advancements to minimize risk associated with ENDS devices are also underway, with researchers working to develop safer batteries.

Mr. Alpert and Mr. Lowther concluded by discussing the opportunity for insurers as the industry grows and becomes more sophisticated. On the underwriting side, insurers can mitigate risk by including exclusions or limits on battery-related claims. On the claims side, insurers should research their targets before bringing a subrogation claim, because many entities in the industry are foreign or judgment proof.

The presentation drew questions from attendees, as the insurance industry considered the implications of e-cigarettes and vape devices. Questions asked include: How are ENDS devices taxed? Should applications for life/health insurance include questions about e-cigarettes? What are the long-term health effects of e-liquids? Presently, the industry is so young that answers to these questions remain to be seen.

Summary by Sandra Durkin, sdurkin@butlerrubin.com

Cybersecurity for law firms: professional liability and ethical considerations

At the AIRROC conference on March 14th, Michael Goldstein and Barry Temkin of Mound Cotton Wollan & Greengrass LLP gave a presentation about ethical issues for lawyers raised by cybersecurity events.

Cybersecurity events, including hacking, are on the rise at law firms. Nor is external hacking the only threat faced by law firms. Some data breaches may be attributable to employee negligence, such as a law firm employee leaving a laptop, cell phone, or other electronic device in a taxi, car trunk, coffee shop, or

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Educational Summaries (continued)

other public place. Moreover, information stored in the cloud, or transmitted via unsecured servers, may be vulnerable to unauthorized intrusions.

Recent law firm data breaches have included the outside hacking by Chinese nationals into the computers of the mergers & acquisitions groups at two major law firms, resulting in significant insider trading and an enforcement case by the U.S. Securities & Exchange Commission against the overseas nationals (but not the law firms). In addition, former clients of a Chicago law firm have filed a federal class action against the law firm alleging that they were injured because of the firm's failure to maintain data security.

The presentation analyzed recent developments in lawyer cybersecurity and explained the nascent but growing trend toward stepped-up scrutiny of law firm data protection, including by state ethics regulators and the organized bar.

New York has announced the promulgation of cybersecurity regulations by the New York Department of Financial Services, effective March 1, 2017. The new DFS rules apply to all entities under its jurisdiction, including insurance companies, insurance agents, banks, charitable foundations, holding companies, and premium finance agencies. The New York DFS regulations require encryption of all non-public information held or transmitted by the covered entity, and require each regulated company to appoint a chief information security officer ("CISO"), who must report directly to the board of directors and issue an annual report, setting forth an assessment of the company's cybersecurity compliance and any identifiable risks for potential breaches. Of particular interest to law firms who represent financial institutions is §500.11 of the new DFS regulations, which requires each covered entity to "implement written policies and procedures designed to ensure the security of information systems and non-public information that are accessible to, or held by third-parties doing business with the covered entity." Thus, covered entities, including insurance companies, who provide access to personal identifying information to third-party vendors must certify not only that their own information systems are adequate, but that the information security systems of vendors with whom they do business are also secure and protected.

The organized bar is now starting to look carefully at lawyers' ethical and professional liability responsibilities to ensure the security of client data. Lawyers' duties of competence and confidence are embodied in ABA Model Rules 1.1 and 1.6. ABA Model Rule 1.1 provides that: "A lawyer shall provide competent representation to a client." New York's counterpart is similar, and further provides, in a comment, that: "To maintain the requisite knowledge and skill, a lawyer should…keep abreast of the benefits and risks associated with technology the lawyer uses to provide services to clients or to store or transmit confidential information."

In March 2017, the New York County Lawyers Association issued its opinion on lawyers' ethical duty to ensure technological competence. According to NYCLA ethics opinion 749, lawyers are required by the Rules of Professional Conduct to keep up with technological developments, "cannot knowingly reveal client confidential information, and must exercise reasonable care to ensure that the lawyers, employees, associates and others whose services are utilized by the lawyer not disclose or use client confidential information."

In conclusion, 2017 has brought us a comprehensive new regulation from the New York Department of Financial Services that appears to be a harbinger of things to come, as well as new ethics opinions from the organized bar suggesting that lawyers now have an ethical duty to maintain technical competence in order to maintain the security of client confidential information.

These developments are forcing law firms to be cognizant of the very real and significant risks they face in the 21st century, and to acquire the technology sufficient to keep abreast with their clients' cybersecurity needs. ●

Summary by Michael Goldstein, mgoldstein@moundcotton.com and Barry Temkin, btemkin@moundcotton.com

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News & Events

Francine L. Semaya & Peter H. Bickford

Regulatory News

Covered Agreement/ Reinsurance Model Act Update

In February, the **NAIC** held a hearing in New York to receive comments addressing the reinsurance collateral provisions of the Covered Agreement between the U.S. and the EU, which eliminates U.S. reinsurance collateral requirements for qualified reinsurers domiciled in EU member countries. The states have five years to implement new rules, or current state credit for reinsurance laws and regulations imposing such requirements will begin to be preempted after 42 months. New York State Department of Financial Services Superintendent Maria T. Vullo, chair of the **NAIC Reinsurance (E) Task Force,** said preemption should be avoided and that there are a variety of paths states could follow in order to conform with the covered agreement. In addition, Vullo and the other regulators attending the hearing believe that the covered agreement has forced reconsideration of state solvency regulation for ceding insurers with the loss of collateral. Other issues were covered including how to deal with those jurisdictions that are outside of the EU: i.e., should the same elimination of collateral be extended to "qualified reinsurers" under the current regulatory scheme as provided for in the **NAIC Credit for Reinsurance Model Act and Regulation**?

NAIC Officers

Effective January 1, 2018, Tennessee Insurance Commissioner **Julie Mix McPeak** became president of the **NAIC**. McPeak has led the Tennessee Department of Commerce and Insurance since 2011. Maine Insurance Superintendent **Eric A. Cioppa** is president-elect; South Carolina Insurance Director **Raymond G. Farmer** is vice president; and Hawaii Insurance Commissioner **Gordon I. Ito** is secretary-treasurer.

National Flood Insurance Program (NFIP)

The **FEMA** concluded a reinsurance placement for the **NFIP** in 2018, transferring $1.46 billion of the program's financial risk to 28 private reinsurance companies, effective from Jan. 1, 2018 until Jan. 1, 2019. The placement covers portions of **NFIP** losses above $4 billion arising from a single flooding event. **FEMA** paid $235 million for the coverage.

Financial Stability Oversight Council (FSOC)

Thomas Workman, retired president and CEO of the New York-based Life Insurance Council of New York Inc. has been confirmed to be the independent insurance expert on the **FSOC,** the only voting position on the **FSOC** specifically filled by a member with knowledge of insurance. He was nominated by President Trump in November 2017 and confirmed by the Senate in March 2018. **Workman** will serve a six-year term, replacing Roy Woodall on the council. Woodall, a former Kentucky Insurance Commissioner, was appointed by President Obama in May 2011 and confirmed by the Senate in September 2011.

Established by the Dodd-Frank Act, the **FSOC** is authorized to identify and monitor excessive risks to the U.S. financial system arising from the distress or failure of large, interconnected bank holding companies or non-bank financial companies, or from risks that could arise outside the financial system.

Industry News

It has been some time since there has been a blockbuster property/casualty M&A transaction, so the announced purchase of Bermuda based **XL Group Ltd.** by French insurer **AXA SA (AXA)** was interesting. Is it the start of a new wave of major acquisitions?

AXA agreed to buy for $15.3 billion in cash. **AXA's** Chief Executive Thomas Buberl said the deal will enable **AXA** to dominate the global property/casualty market, and reduce its exposure to the volatility of financial markets. XL's CEO Mike McGavick added that "the intent is to combine XL Catlin's operations with AXA Corporate Solutions, forming AXA's new global P&C insurance and reinsurance division."

The acquisition will be the biggest insurance deal since 2015 and the largest-ever European purchase of a U.S. insurer, according to data compiled by Bloomberg. There were few other recent transactions of note, however, and the largest of those was a "going private" transaction.

In January, the majority shareholders of **AmTrust Financial Services Inc. (AmTrust)** announced a $2.7 billion plan to take the insurer private. The deal was funded by founding family members and shareholders George and Leah Karfunkel along with its CEO Barry Zyskind and private equity funds from Stone Point Capital. The Karfunkels and Zyskind currently own 55 percent of **AmTrust.** "As a private enterprise, we will be able to focus on long-term decisions, without the emphasis on short-term results," Zyskind said in a statement.

Chicago-based insurer **Kemper Corp.** has agreed to acquire Birmingham-based **Infinity Property and Casualty Corp. (Infinity)** in a cash and stock transaction valued at approximately $1.4 billion. Infinity sells auto insurance in the specialty, nonstandard segment. It has approximately $1.4 billion in 2017 direct written premiums, 88 percent of which is nonstandard auto and the rest

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

Present Value (continued)

commercial vehicle and classic car business. The combined company will have a more diversified portfolio across auto, home, life, and health insurance with approximately $2.2 billion in nonstandard auto insurance premiums, more agency relationships and greater efficiencies, according to the parties.

New Member

Crawford Italia, with offices in Milan and Rome, has become an AIRROC International Member. Crawford Italia is the Italian affiliate of Atlanta based Crawford & Company, the world's largest independent provider of claims management solutions to the risk management and insurance industry as well as self-insured entities, with an expansive global network serving clients in more than 70 countries.

People (and firms) on the Move

In March 2018, **Michael McRaith,** who served as the first director of the **FIO** from 2011 to 2017, joined New York-based investment firm **Blackstone Group L.P. McRaith** will be a managing director for **Blackstone Insurance Solutions**, a recently formed unit providing investment advice and other investment-related products to insurers. Prior to becoming **FIO** director, **McRaith** served more than six years as director of the Illinois Department of Insurance and was an officer of the NAIC.

AIRROC International Member **Compre**, the independent insurance and reinsurance legacy specialist, made senior management changes effective March 2018. **Nick Steer**, a founding director of **Compre**, stepped down as group CEO, but remains within the group, advising on future acquisitions as non-executive Deputy Chairman.

Will Bridger, managing director of acquisitions and **Mark Lawson**, group actuarial director, will, subject to relevant regulatory approvals, jointly take on the role as co-CEOs.

AIRROC partner law firm, Chicago-based **Freeborn & Peters** expanded its Insurance and Reinsurance Industry Team with the addition of attorneys **Melissa B. Murphy, Steven D. Pearson, Michael J. Braggs** and **Sarah E. Chibani.** Ms. Murphy and Ms. Chibani are based in the firm's Tampa, Fla., office. Mr. Pearson joins Freeborn's Chicago office, and Mr. Braggs is based in the firm's Richmond, Va., office.

In January 2018, **Laurie A. Kamaiko** joined Saul Ewing Arnstein & Lehr as a Partner in the firm's New York City office. Laurie will chair the firm's Cyber Insurance practice as well as join its Cybersecurity & Privacy group and the Insurance group. Laurie can be reached at Laurie.Kamaiko@saul.com.

Chubb has named **Tracey Laws** to a newly created position, Senior Vice President, General Counsel, Global Government and Industry Affairs, effective January 2, 2018. Tracey will provide legal, regulatory and policy guidance and advice to Chubb's state, federal and international government affairs team. Tracey was formerly Senior Vice President and General Counsel at the Reinsurance Association of America. She can be reached at tracey.laws@chubb.com.

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Re Basics: Demystifying Reinsurance
New York, NY
www.reinsurance.org

MAY 14-16
IRLA Annual Congress
Brighton, UK
www.irla-international.com

MAY 16
IFNY/ELANY/TIPS
Surplus Lines and Reinsurance Forum
New York, NY
www.ifny.org

JUNE 6
Runoff Deal Market
New York, NY
www.airroc.org

JUNE 12
Chicago Regional Education Day
Chicago, IL
www.airroc.org

JULY 17-18
AIRROC Summer Membership Meeting
New York, NY
www.airroc.org

JULY 17-18
Re Claims: Navigating the World of Reinsurance
New York, NY
www.reinsurance.org

AUGUST 4-7
NAIC Summer National Meeting
Boston, MA
www.naic.org

AUGUST 6
Current Issues Forum at the NAIC AIRROC/IAIR
Boston, MA
www.airroc.org

SEPTEMBER 6
Climate Change Symposium AIRROC/EECMA
Philadelphia, PA
www.airroc.org

SEPTEMBER 18
Boston Regional Education Day
Boston, MA
www.airroc.org

OCTOBER 14-17
AIRROC NJ 2018 Commutations & Networking Forum
Jersey City, NJ
www.airroc.org

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