

**HR Strategies
in Run-Off**

Aligning run-off employees with strategic intent and operational results

6

**Leading Regulators
Address AIRROC**

Members
on Current
Regulatory
Developments

11

**Intermediary
Discussion—**

Facing the Past, Fixing
the Present and
Plotting
the Future

14

**THINK TANK
Claim Estimation**

A reinsurer's view of
the pitfalls of
accelerated
claim
estimation

16



A QUARTERLY NEWSLETTER ABOUT RUN-OFF COMPANIES AND THEIR ISSUES

AIRROC Matters

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Inaugural Issue

Notes from the Editor



Peter Scarpato

*By Peter A. Scarpato**

With great pride and pleasure, the Publications Committee submits this inaugural edition of "AIRROC Matters" to our membership! As its name attests, this newsletter – **your newsletter** – is intended to provide a quarterly forum to present, examine and introduce topics and events that *matter* to AIRROC's ever-increasing members and the run-off community at large. It is the product of many hours of work by your dedicated Publications Committee, led by its Chair, Ali Rifai, with whom I have the distinct pleasure to work. And it is open to topical articles, new ideas and critical commentary from *you*, our

members, and others in the run-off industry.

Our primary charge is to ensure that "AIRROC Matters" presents a meaningful cross-section of substantive articles and topical information and events. And this issue lives up to the task in many ways.

First, our contributors tackle two challenging, fundamental aspects of any run-off (a) keeping and motivating qualified employees and (b) quantifying and settling "unmatured" long-tail liabilities. In "HR Strategies in Run-Off," **Janet Collins** begins with an insightful analysis of the need for run-off managers to adopt unique human resources techniques to maintain staffing and maximize production and performance.

continued on page 3

Message from CEO and Executive Director

AIRROC, you've come a long way baby!

*By Trish Getty**

In August 2004, interested parties met to discuss whether we would form this association. After commitment by several charter members, we met again in October 2004 and decided to move forward with incorporation of

continued on page 4

Also in this Issue

Notes from the Editor	1
Message from CEO and Executive Director	1
KPMG Policy Support Update page	18



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The Run-off Tool Kit for AIRROC Members

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Inaugural Issue

Notes from the Editor

continued from Page 1

In the first installment of a two-part series, **Terry Kelaher** offers “Claim Estimation,” a reinsurer’s critique of accelerated payment and buy-out strategies currently used to run-off distressed and insolvent business. **Jonathan Rosen’s** response entitled “Bringing Claim Estimation into Perspective,” will appear in the Winter 2005 issue.

We also satisfy our obligation to keep you informed by presenting the key points of several important summer events and industry updates. In their piece “Leading Regulators Address AIRROC Members on Current Regulatory Developments,” **James Veach** and **Thomas Weinberger** capture the essence of AIRROC’s first official event, a Forum on Current Insurance and Regulatory Developments, held in New York on July 15, 2005, including insights on TRIA, SMART and finite reinsurance from New York Insurance Superintendent Howard Mills, former Arkansas Insurance Commissioner and NAIC President Michael Pickens, and North Dakota Insurance Commissioner Jim Poolman. My contribution, “Intermediary Discussion – Facing the Past, Fixing the Present and Plotting the Future,” summarizes the agreements, debates and issues resulting from the July 2005 panel discussion, set up by Keith Kaplan’s Intermediary Services Committee, between distinguished, experienced representatives of the intermediary community and AIRROC’s membership. And finally, as a recurring feature introduced

through **Nigel Curtis**, we include **KPMG’s Policy Support Update Alerts**, current status reports of both solvent and insolvent UK schemes of arrangement.

On behalf of Ali and the entire Publications Committee, I wish to thank all authors for their time, effort and brilliant submissions. Already our Winter 2005 issue looks to be another informative and thought-provoking one, with articles on regulatory supervision by **Hal Horwich**, email management by **Jon Neiditz** and **Jonathan Bank** and the other side of claim estimation by **Jonathan Rosen**. But we need more – AIRROC’s charter mandates an open forum and debate of concepts, opinions and ideas.

Future issues of AIRROC Matters will have an Op/Ed and Letters to the Editor page to publish your comments, criticisms and opinions on the form and content of your newsletter to ensure we cover current matters of interest.

Let us hear from you.

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

The Editorial Board of AIRROC Matters welcomes new and reprinted articles from authors on current topics of interest to the AIRROC membership and the run-off industry. The Board reserves the right to edit submissions for content and/or space requirements.

AIRROC

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The Publications Committee wishes to thank Mound Cotton Wollan & Greengrass for underwriting the cost of design of our first AIRROC Matters newsletter.

AIRROC Matters is published to provide insights and commentary on run-off business in the U.S. for the purpose of educating members and the public, stimulating discussion and fostering innovation that will advance the interests of the run-off industry.

Publishing and editorial decisions are based on the editor’s judgment of the quality of the writing, its relevance to AIRROC members’ interests and the timeliness of the article.

Certain articles may be controversial. Neither these nor any other article should be deemed to reflect the views of any member or AIRROC, unless expressly stated. No endorsement by AIRROC of any views expressed in articles should be inferred, unless expressly stated.

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Message from CEO and Executive Director

AIRROC, you've come a long way baby!

continued from page 1



Trish Getty

AIRROC in the State of New York that was finalized on December 14, 2004.

I recall the excitement in the air on January 6, 2005, when our committees met for the first time and again on March 16 and July 21.

My personal reward was observing our many attendees from many different walks of life come together, roll up their sleeves and work together to search for solutions to their common problems in this run-off industry. When we meet now, I see friends coming together who are comfortable with one another. It is apparent from comments that AIRROC members find great value in simply having a forum where they can meet, talk and break bread together.

What progress we have made in less than one year! Our committees are Benchmarking Research, Commutation Event, Early Closure, Education, Finance, Intermediary Services, IT/Website, Legislative/Amicus, Marketing, Publications and Reinsurance. We continue to develop our committee purposes and directions thanks to the dedication not only of AIRROC members but others from whom we solicited help. LeBoeuf, Lamb, Greene and MacRae has given incredible time and expense to provide services and a meeting place as our legal counsel. Navigant Consulting created our logo, pamphlets and website not to mention continued website services. Many others have worked endless hours to present this kickoff publication of "AIRROC Matters." We are very thankful to all of these people who understand the importance of this run-off association.

AIRROC currently has thirty-eight member companies and we expect that number to grow in 2006. We roughly estimate that AIRROC represents approximately \$100B of the run-off industry.

Most have heard the fantastic news that AIRROC has joined forces with Cavell Management to hold its first commutation and networking event in the

Meadowlands on October 24-26, 2005. We expect the event to be a smashing success and the only significant commutation event in the U.S. in 2005. Delegates (identified on our website at www.airroc.org) have registered from around the world.

We continue to develop one of our most important missions, education, which will be further discussed in our December issue. It has been my pleasure to serve this excellent, talented Board of Directors whose focus is awesome. It is obvious that we are poised for the future. Enjoy our inaugural issue of "AIRROC Matters" because we do matter!

**Ms. Getty is CEO and Executive Director of AIRROC. She can be reached at trishgetty@bellsouth.net.*

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Feature Article

HR Strategies in Run-Off



Janet Collins

By Janet Collins*

People make the difference! You can address most challenges in a business environment: you can take a look at your competitors, emulate their systems and their processes, and buy in expertise. However, the success of delivering business results boils down to the collective ability, motivation and intent of those you employ. The unique DNA of an organisation or group of people, the culture, the “way things are done around here,” must be aligned to the strategic intent of the business and the operational results that the business needs to deliver to succeed.

It’s a simple idea: human behaviour has a direct and measurable impact on the effectiveness of an organisation. Integrated HR processes and systems that are aligned with the business objectives are critical to develop and sustain the right environment in which to deliver results.

Integrated HR processes and systems that are aligned with the business objectives are critical to develop and sustain the right environment in which to deliver results.

Given that run-off is the fastest growing sector in the insurance market and the ultimate goal of any run-off should be to achieve finality in the shortest practicable time, run-off raises a number of HR challenges:

- How, if you are moving from active underwriting to run-off, do you manage the change?
- How do you generate a result-driven culture with the sense of urgency necessary to deliver maximum value?
- How do you develop individuals to meet the challenges of the job?
- How do you attract and retain the best people as the run-off progresses?

- How do you release staff in a way that supports them and the business as the run-off reaches finality?

As a real life example, these questions needed to be addressed when Tawa acquired CX RE at the end of 2002; it was the largest UK domiciled reinsurance company in run-off at the time with undiscounted gross claims reserves of \$2.2 billion and a diverse and complex portfolio of international liabilities. With a business plan to implement an accelerated run-off strategy and a target of de-scaling the company within five to seven years, this was not going to happen without an innovative approach, the success of which would, ultimately, rely on the quality of the staff. With a starting point at acquisition of 58 people, with limited or no experience of run-off, there was a challenge ahead!

Almost three years on, Tawa was able to assemble some of the best talent and experience in the market; the staff has developed state of the art systems and processes, they are delivering results and are enjoying themselves in the process! Tawa recruited over a third of its people in the past two years, staff turnover is very low, sickness absence is well below national averages (a good indicator of whether people want to get up in the morning!) and feedback from the staff in quarterly “climate” surveys show them to be a motivated group of people who are proud of what they are doing and the organisation to which they belong.

So, how did Tawa tackle these questions?

How, if you are moving from active underwriting to run-off, do you manage the change?

Mind the Gap!

Determining whether you are leaping a chasm or making small changes to achieve your strategy for the run-off is the first step and looking at both the “soft” and “hard” areas of the business is of crucial importance. Research indicates that it is often the unresolved

cultural and people issues that destroy value and cause business failure. Those companies that focus on people, systems and process, as well as the financial and legal issues which are a usual feature, are far more likely to be successful. So, in terms of tips for success.....

- Base any transition strategy on the management of the key economic value drivers;
- Determine the 20% of actions that will drive 80% of the value, with the greatest probability of success in the shortest timeframe;
- Act with speed; the shorter the transition period the less value will be lost during transition. In any transition phase there is likely to be a loss of productivity, and a downturn in morale, which threatens value. Speed will make a difference. Aim for a 100 day window to determine and control the value drivers; capture and communicate early wins during this period;
- Structure small, short-term, fast paced teams, to expedite the planning process;
- Ensure proactive communications with all stakeholders;
- Clarify organisational roles early – be clear on accountability, decision authority and interrelationships;
- Promote the “way of doing things” through leadership behaviours – culture change starts from the top.

Plot the road-map for change

Machiavelli in 1514 summed it up when he said “There is nothing more difficult to handle, more

Organisations only change when the people in them change and people will only change when they accept that changes must occur, so engage people in identifying the necessary changes right from the start.

doubtful of success and more dangerous to carry through than initiating changes”; and a myriad of surveys on the subject consistently back him up!

Three out of four change programmes fail to deliver the required results.

- Organisations only change when the people in them change and people will only change when they accept that changes must occur, so engage people in identifying the necessary changes right from the start;
- Paint the vision for the future and work with employees to determine what needs to be done, how it needs to be done, who will do it and in what order;
- Get expert help if you don’t have the experience in managing change and organisation development in-house;
- Determine the milestones and dependencies and ensure strong project management disciplines to ensure delivery; and
- It may seem easier to impose change and tell people what to do – it isn’t! It doesn’t work!

The step Tawa took with the acquisition of CXRE was to involve all staff in determining what changes needed to be made and seven project teams were formed looking at some of the critical success factors for a run-off business.

From the initial brainstorming and output of sixty pages of flipchart we moved on to formal project teams with core deliverables and transition plans across key areas of the business including reviewing processes and systems to support a run-off strategy.

The process produced fantastic results. It delivered key changes in process and systems necessary for the run-off strategy, and communicated the collective mindset that was necessary to manage a successful run-off.

“An HR strategy must support the business strategy” – a pretty obvious and non contentious statement, but how often does this happen in practice? One of the problems, often, is that the business purpose and strategy is not very well defined and as a consequence the HR strategy has little focus or indeed relevance to the needs of the business. The HR strategy therefore needs to be set in the business context if it is to answer our other challenging questions.....

continued on next page

Feature Article

HR Strategies

continued from Page 7

How do you generate a result-driven culture with the sense of urgency necessary to deliver maximum value?

A balanced set of measures....

- Get the people involved in determining the critical success factors and key measures on which to measure and manage the success;
- Implement a balanced set of measures that support the key performance indicators;
- Involve them in translating these to high level team objectives and their individual plans and goals; and
- Encourage them to self appraise against agreed performance measures and support them in making improvements.

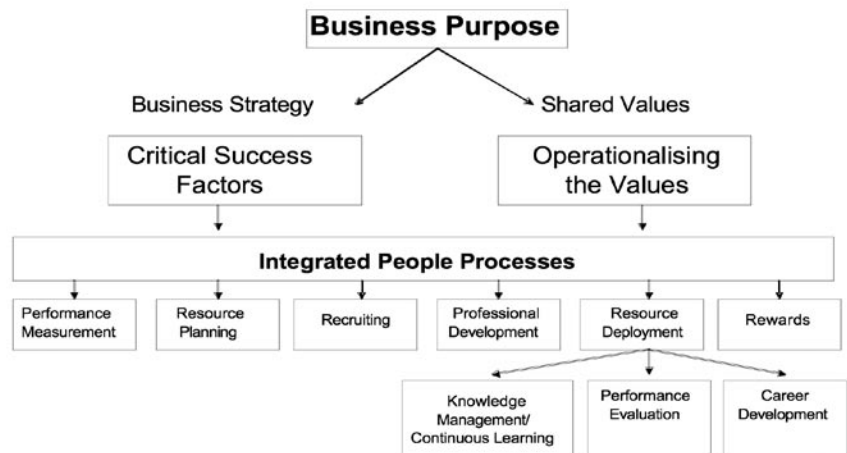
Tawa built the balanced scorecard for CX RE in the first few months following acquisition. It migrated from a background where the performance appraisal process had fallen into disuse, to one where every individual was part of developing performance measures and appraising their performance.

Rewards aligned to the success of the business and individual effort and performance....

When you are asking your team to deliver extraordinary results, economic alignment between them and the business is of fundamental importance. The right approach to this is to:

- Ensure that financial rewards promote the relationship between the effort made, and overall results;
- Remember the non financial rewards – a thank you goes down well!

“Operationalising” The Business Plan



- Ensure a balance between the extrinsic rewards (money) and the intrinsic needs of a work-life balance, a worthwhile job and a good place to work.

When implementing a reward strategy to support the new business model, include a number of factors that the staff value, such as flexible working, support for qualifications and study, as well as financial rewards linked with the overall success of the business, individual performance and the need to retain as the run-off progresses.

How do you develop people to meet the challenges of the job?

The answer to this lies in your capacity to:

- Invest – time, money, effort;
- Develop a continuous learning culture where people are encouraged to review, reflect and refine;
- Create the “space” for people to learn;
- Identify and target those core competencies needed to facilitate delivery of the business and focus development on these core areas; and
- Measure the results.

As well as technical excellence, you must identify a number of core competences to facilitate your business strategy. Learning and development is a com-

petence that is core to any business operations and is delivered through investment in external training and internal coaching activity.

How do you attract and retain the best people as the run-off progresses?

In our experience, word gets round! Attracting the right people becomes easy if you have the right environment, as your team members are quite happy to tell friends and contacts in the market of their experiences. You must aim to continue to offer your people a challenging environment in which to develop their skills. This includes providing an ongoing stream of run-offs to do great things with.

When implementing a reward strategy...include a number of factors that the staff value, such as flexible working, support for qualifications and study, as well as financial rewards.....

Perhaps the biggest mistake one can make is to use inherently short term methods to secure long term commitment to the business. Let's take as an example the complexity of retaining staff to the end of the run-off. A quick fix might be to take the approach of "golden handcuffs" – ensuring people stay to the end of the run-off with large retention payments. In Tawa's experience, keeping people in their seat does not mean they will do a good job and does not stop inertia creeping in. Retention bonus payments may ensure people stay, but it is no guarantee of quality results.

For Tawa, the fundamentals are:

- Motivate! Ask what motivates your people – preconceived assumptions should be avoided, as they are usually wrong;
- Get the financials "right" but don't rely on financial incentives alone – it's not enough;
- Create an environment where people have a sense of purpose and belonging; and
- Use financial and non financial measures where necessary to ensure the right people are retained to the end of the run-off.

How do you release staff in a way that supports them and the business as the run-off concludes?

Inevitably, people will move on and you should hope that when the time comes, your staff leave more skilled than when they arrived. Tawa recommends that you seek to:

- Ensure employability; no organisation can guarantee a job for life but they can ensure their people have the right skills and experience to find their next position;
- Put in place proactive manpower planning and a culture that supports adaptability so that people can be redeployed where applicable;
- For those who cannot, or will not make the transition, take decisive action being mindful of employment law and aiming to ensure a sense of fairness on how difficult issues are managed;
- Be honest, open and communicate; in the absence of information people will make it up; and
- Ensure people get the appropriate time to look for their next position and proactively support them with this – use contacts and networks and outplacement.

What does it mean for you?

Do you recognise these challenges? Does your organisation want to deliver stakeholder value? Are you looking for a workforce that feels committed and has a real stake in what they do rather than just compliant? Are you looking for collaboration and adaptability?

If the answer to these questions is yes, you should be interested in securing an effective HR strategy, because you will not deliver the results you want without one!

**Ms. Collins is Head of HR and Operations at Tawa Management Limited in the UK. She can be reached at janet.collins@tawa.net.*

The Director of Tawa Management Limited in the UK is Charles D. Thresh. He can be reached at charles.thresh@tawa.net.

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Feature Article

Leading Regulators Address AIRROC Members on Current Regulatory Developments

By James Veach and Thomas Weinberger*



James Veach



Thomas Weinberger

Steps from Ground Zero and only a week after the terror attacks in London, Mound Cotton Wollan & Greengrass (“MCW&G”) sponsored a Forum on Current Insurance and Regulatory Developments, the first official event of the Association of Reinsurance Run-Off Companies (“AIRROC”). The Forum was held on July 15, 2005 at the Downtown Association in New York, and featured a panel that included New York Superintendent of Insurance Howard Mills, former Arkansas Insurance Commissioner and President of the National Association of Insurance Commissioners (the “NAIC”) Michael Pickens, and North Dakota Commissioner of Insurance Jim Poolman. James Veach, a partner at MCW&G, moderated the discussion.

Superintendent Mills opened the forum with an impassioned plea for the extension of the Terrorism Risk Insurance Act of 2002 (TRIA). He highlighted the vital role TRIA has played in ensuring the affordability and availability of terrorism insurance in the U.S. market, and its positive effect on the U.S.

Superintendent Mills opened the forum with an impassioned plea for the extension of the Terrorism Risk Insurance Act of 2002 (TRIA).

economy as a whole. In the months following the September 11th attacks, the insurance market faced severe disruptions. Businesses were forced suddenly to pay higher premiums for less coverage or forgo insurance for terror risks altogether. Many managed their terror risks by avoiding projects that carried a

higher level of terror risk, and many construction projects were stalled because insureds could not obtain coverage for terror risks.

While TRIA was adopted as a temporary program to allow the insurance markets to stabilize and develop the capacity to handle terror risks, there is little evidence that the markets have stabilized. The recent attacks in London only served to underscore the continued need for a federal backstop — the London insurance markets and the UK economy did not suffer



Current Insurance Regulatory Developments – July 15, 2005.

Left to right: Hon. Howard Mills, New York Superintendent of Insurance, Hon. Jim Poolman, North Dakota Commissioner of Insurance, Michael Pickens, partner at Friday, Eldredge & Clark

from any disruption after the July 7 attacks because the UK has a government-backed pool in place to handle terrorism risks.

Comparing TRIA to the operations of the FDIC, Superintendent Mills argued against those in Congress who maintain that terrorism risk is a free market issue and that the government must not be involved. At the same time, Superintendent Mills acknowledged that, over time, trigger levels would have to be raised and the insurance industry should develop private solutions.

Superintendent Mills believes, based on conversations with officials in the Bush administration, that

continued on next page

Feature Article

AIRROC Forum

continued from Page 11

TRIA will be extended. He cautioned the industry, however, to be realistic and suggested that the extension would most likely not be a simple extension of TRIA. Superintendent Mills emphasized that there can be no gap in TRIA and that time was running out. In New York, it already is difficult to obtain multi-year coverage due to the uncertainty over TRIA's extension, and exclusions are being written into policies.

Superintendent Mills also touched on the recent controversy involving finite reinsurance and the actions taken by the New York Insurance Department, including the disclosure obligations and chief executive officer attestation requirements in the New York Department's Circular Letter No. 8. Given the recent NAIC action on this matter, Superintendent Mills noted that the New York Insurance Department will withdraw Circular Letter No. 8 if the NAIC adopts its current proposals regarding finite reinsurance. Superintendent Mills also unveiled the Department's



Left to right: Hon. Howard Mills, New York Superintendent of Insurance, Hon. Jim Poolman, North Dakota Commissioner of Insurance, Michael Pickens, partner at Friday, Eldredge & Clark

corporate practices unit. This unit will help the regulators better regulate and monitor the industry and to deal with problems surgically, without the need for companies and the industry, as he put it, to be "tried in public first."

Pickens focused his remarks on the State Modernization and Regulatory Transparency Act

(SMART). Pickens noted that Congress is committed to some form of federalization of insurance law, whether it is a federal charter for insurance companies, the SMART Act, or something in between. Pickens stressed that the insurance industry must be a part of the process and make its voice heard on SMART.



AIRROC Chairman Andrew Maneval, (on left) and James Veach (on right) explain the virtues of AIRROC membership to Steven Acunto, President, CINN Worldwide, Inc.

Voicing his strong opposition to federal pre-emption of state insurance laws, Pickens explained how SMART does not use pre-emption, but rather the threat of pre-emption to encourage states to implement, enforce and regulate promised reforms, including reforms in the NAIC 2003 Action Plan. Pickens described how states have made significant progress in bringing about uniformity of laws and processes in the areas of producer and company licensing reforms, making better products available to consumers and working to protect consumers from fraud in viatical settlements and on military bases. Despite the best efforts of the insurance regulators, reforms have stalled in some states due to a lack of focus in the legislatures and political concerns. In his words, state insurance regulators sometimes need a "big stick" — the threat of federal pre-emption — to spur legislators to act.

Pickens volunteered that SMART may be just the tool state regulators need to help expedite reforms — over-regulation is not healthy for the industry and harms consumers and greater uniformity is beneficial to

all market participants. Whether SMART can deliver on that promise remains to be seen, but Pickens urged the industry to work to make the SMART proposal the best, most effective, and most user friendly tool to meet the common objective of better consumer protection and greater consumer choice through regulatory reform.

Veach asked whether the SMART Act is all about rate deregulation. In response, Pickens expressed concerns that rate deregulation can be a race to the bottom, and that a competitive rating law, similar to the one in Arkansas, would serve both the consumers and the industry. Under a competitive rating law, the regulators' job is to ensure that a rate is not excessive, too low or discriminatory. Prior approval of rates, however, can be a quagmire. Approaching the same issue from another angle, Commissioner Poolman opined that rate deregulation is the key provision of the SMART Act, and that the leading proponents are those in the P&C industry who want rate and form deregulation. He noted that the North Dakota legislature recently killed a rate deregulation proposal

...Commissioner Poolman noted that the regulators' principal concern remains the solvency of the insurance companies.

because no legislator wanted to tell his or her constituent that he or she was taking away the regulators' authority to approve a rate increase — and that same debate will take place in Congress.

Commissioner Poolman, who is also the Chairman of the Life and Annuities (A) Committee at the NAIC, reviewed the major issues before the NAIC, including the finite reinsurance proposals discussed by Superintendent Mills, alternatives to the collateralization requirements imposed on foreign reinsurers, and the application of Sarbanes-Oxley provisions on insurance companies.

Focusing on the current accounting control proposals, Commissioner Poolman noted that the regulators' principal concern remains the solvency of the insurance companies. All of these proposals impose signifi-

cant costs, especially on mutual companies and privately held insurers. Accordingly, it is incumbent upon the regulators to establish that the benefits to the consumers of these regulatory proposals outweigh their costs.

Turning to topics before the NAIC's Life and



Left to right: Trish Getty, CEO and Executive Director of AIRROC, James Veach, partner at Mound Cotton Wollan & Greengrass, Andrew Maneval, Chairman of AIRROC

Annuities (A) Committee, Commissioner Poolman discussed efforts to strengthen insurable interest laws and continued debate over investor-owned life insurance. He also discussed the need for a complete overhaul of how we calculate reserves for life insurance. In Commissioner Poolman's opinion, the redundant reserves required under current regulations raise costs for insurers and consumers without providing a real benefit. The committee is beginning, what Commissioner Poolman described as, "a long, arduous process" to move to principles-based reserving.

**Mr. Veach is a Partner, and Mr. Weinberger is Special Counsel, at Mound Cotton Wollan & Greengrass.*

MCW&G appreciated the opportunity to sponsor the Forum, the first of what should be many successful AIRROC events. We look forward to meeting with you again at the upcoming AIRROC/Cavell Commutation & Networking meeting in October.

Feature Article

Intermediary Discussion – Facing the Past, Fixing the Present and Plotting the Future



Peter A. Scarpato

By Peter Scarpato*

According to its Mission Statement, AIRROC will enhance the knowledge and communications among all entities within and outside the run-off industry, while striving to promote and represent their common business interests. Additionally, by its charter, our Intermediary Services Committee will “research and monitor solutions to industry trends... [and] intermediary performance issues... [.]”

The July 2005 Intermediary Panel Discussion arranged through AIRROC’s Intermediary Services Committee represented the quintessential fulfillment of all these objectives.

Under the general heading “intermediary challenges and concerns with respect to run-off and insolvent business,” Ted opened the discussion and challenged ... to acknowledge, analyze and suggest solutions to the most common, perplexing problems ... among run-off companies and their intermediaries.

For the discussion, the Committee, chaired by Keith Kaplan, assembled a distinguished and experienced panel that collectively represented over 150 years of experience in the business. Deftly moderated by E.W. “Ted” Blanch, Jr., the group included Edward J. Eighmey of Guy Carpenter, Peter Fennell of AON, Michael O’Malley of Holborn, Stephen W. Renshaw of Towers Perrin, Darren J. Ruschy of Benfield and Michael N. Tisdale of Willis.

Under the general heading “intermediary challenges and concerns with respect to run-off and insolvent business,” Ted opened the discussion and challenged his panel and the audience to acknowledge, analyze and suggest solutions to the most common, perplexing

problems – and most frequent misunderstandings – among run-off companies and their intermediaries. Among the issues addressed were:

- the view that collection problems often arise from global premium and offset issues rather than claims disputes;
- the intermediaries’ unanimous position that the same level of service is applied to both active and run-off/insolvent clients;
- the recommendation that run-off managers and intermediaries meet immediately when run-off begins to plot their future relationship and manage expectations;
- the opinion that run-off reinsurers often present intermediaries with inconsistent documentation requests;
- the problem of cedents entering run-off and flooding intermediaries with an “avalanche of claims;”
- the hotly debated dispute between intermediaries who feel that run-off company staff cuts detrimentally impact their service and run-off companies who claim that intermediaries often assign their least experienced employees to handle issues requiring more experience (a claim which the intermediary panel denied);
- the issue of when intermediaries “earn” their commission and whether run-off companies should pay them extra commissions to handle discontinued business;
- the pros and cons of run-off entities bypassing intermediaries and negotiating claims/collections disputes and commutations directly;
- the issue of the time value of money, most frequently encountered when LPT is involved;
- the importance of a run-off company’s deci-

sion to be either “operationally conscious” or “economically conscious” when managing its operation.

The discussions were animated, candid and respectful — but necessary to expose the myth and reality of each side’s positions to intense scrutiny and cleansing debate.

In closing, Ted Blanch emphasized the benefits of open and continued dialogue among all constituents and extolled the virtues of redefining the objective operation and subjective relationship between run-off company and intermediary. He challenged intermediaries and run-off entities to rethink the model: what if you determine the collective costs to administer run-offs to close and use 50% of that amount to set up a separate entity to assume the intermediary’s run-off responsibilities?

Food for thought for the future.

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



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First in a series of articles on the pros and cons of accelerated claim estimation

Think Tank

Claim Estimation



Terry Kelaher

By Terry Kelaher*

An involuntary settlement of reinsurance recoverables through claim estimation is a highly controversial matter that much of the insurance industry and regulators continue to study. In theory, other than the contractual issues, it seems like a great idea. Most agree that speeding up and maximizing payouts to creditors and reducing the administrative costs of receiverships or distressed companies

Reinsurers are incapable of investigating a claim or interposing a defense where no notice has been received, where the identity of the claimant is unknown and it is not known whether the event has even occurred.

are noteworthy goals. Achieving those goals through the use of claim estimation, however, is not the right answer. Claim estimation, and the concomitant acceleration of reinsurance recoveries, violates the terms of the reinsurance contract, is riddled with inaccuracies and may, in turn, ultimately be used to trigger payment from guaranty funds.

Contractual Difficulties

Involuntary claim estimation to accelerate payments of reinsurance recoverables, unlike contractual commutations, violates the terms of the reinsurance agreement. Reinsurance is a contract of indemnity. By the express terms of the reinsurance agreement, a reinsurer is required to pay or “indemnify” the ceding company where the ceding company has paid or is required to pay. This is “we pay if you pay.” Claim estimation eviscerates this fundamental element of a reinsurance agreement. To require reinsurers to pay on the basis of an estimate of what the ceding company thinks it may pay – even if it never pays – destroys the core indemnification tenet of the agreement. A vol-

untary commutation allows the parties to voluntarily modify their contractual arrangement under the reinsurance agreement. This approach differs dramatically from a forced non-contractual estimation and payment acceleration.

Proponents of claim estimation point to the insolvency clause to suggest there are no contractual impairments to estimation. This clause exists to ensure the enforceability of reinsurance contracts by a receiver where the ceding company has become insolvent, but a claim amount is certain and owed by the insolvent insurer to the insured. The insolvency clause is then triggered by requiring the reinsurer to pay the receiver without diminution based on the insolvent’s ability to pay all or part of the claim amount due. The insolvency clause does not alter the nature of the reinsurance agreement or void the contractual liability provisions. Indeed, numerous courts have rejected attempts to use the insolvency clause to rewrite the parties’ obligation under the reinsurance. Moreover, the specific notification requirements contained in the insolvency clause binding the liquidator to provide notice to the reinsurers of the pendency of each claim reiterate the contractual difficulties with claim estimation. Such additional obligations, as to each pending claim contained in the insolvency clause, could not be honored where reinsurers are asked to pay based purely upon an estimate of unknown claims. Reinsurers are incapable of investigating a claim or interposing a defense where no notice has been received, where the identity of the claimant is unknown and it is not known whether the event has even occurred. The right to participate in a proceeding to determine claims, as provided for in the insolvency clause, is a contractual right that the estate must satisfy. This is an essential contractual right that protects the reinsurers from the possibility of exaggerated claims. Claim estimation abrogates that right.

The Inaccuracies of IBNR

Apart from contractual issues, claim estimation is fraught with inaccuracies due to its reliance on IBNR loss estimates to determine the values to be used. IBNR losses are actuarial estimates that insurers and reinsurers use for accounting purposes to ensure sufficient funds will be available to pay any meritorious claims which may arise in the future. A fundamental aspect of IBNR loss estimates is that they may and often are adjusted over the course of time to reflect many factors, including subsequent claim experience and fluctuations in the legal climate (which in the United States, is a significant variable). The calculation of IBNR was never intended to compel reinsurers to make loss payments or to accept forced commutation values as used in solvent schemes. Therefore, under claim estimation, a reinsurer is called upon to pay a claim where the injured party cannot be identified, the type of injury cannot be verified to determine the basis of coverage, the date and time of the loss cannot be ascertained to determine whether the event took place during the term of the policy and the estimate of the cost is fraught with inaccuracies. Because these essential elements are, by definition, absent in IBNR calculations, IBNR claims are not recoverable under an insurance policy and, in turn, a reinsurance contract.

The wide variance among different actuaries and the extreme difficulty in estimating industry wide exposures – not to mention the virtual impossibility of accurately estimating emergence at an individual claimant level – exemplifies the inherent difficulties with claim estimation.

Notably, actuaries recognize the inherent uncertainty of IBNR projections and typically establish ranges, not specific dollar values. Those ranges can vary significantly and fluctuate over time. Specifically, in the Integrity liquidation, numerous actuarial firms have been hired to estimate the liability of Integrity. According to the RAA, Mary Lou O’Neil, Milliman & Robertson, Tillinghast Towers-Perrin, and Ernst & Young in a peer review of O’Neil’s work have all performed actuarial studies on the Integrity

estate. The Integrity estate is noteworthy not for the number of major actuarial firms which have reviewed its liabilities, but for the substantial disagreement among so many actuarial firms concerning Integrity’s liabilities. Rating agencies, too, have had difficulty estimating environmental and asbestos liabilities. In 1994, A.M. Best projected that environmental and asbestos liabilities would range between \$55 billion and \$623 billion. Those projections were revised in 1996. The result: its mid-range projection was drastically reduced from \$260 billion to \$57 billion and its worst-case scenario projection was reduced from \$623 billion to \$92 billion. The wide variance among different actuaries and the extreme difficulty in estimating industry wide exposures – not to mention the virtual impossibility of accurately estimating emergence at an individual claimant level – exemplifies the inherent difficulties with claim estimation. Requiring reinsurers to pay or cedants to settle based on such projections will ultimately result in significant inaccuracies.

Guaranty Associations

Claim estimation also has the potential to harm guaranty associations. For example, under many state liquidation laws, claims by policyholders must be covered under insurance policies in order to share in the distribution of assets. This same requirement is often found in Guaranty Fund laws. If IBNR became the basis for billing reinsurers, policyholders and third parties could assert that the IBNR amount establishes a floor for their respective claims under Guaranty Fund laws. The obligations of the guaranty associations to pay such amounts as “covered claims” under policies issued by insolvent insurers could potentially have an adverse and unfair impact on the liabilities of those associations and, in turn, the solvent insurance industry, which funds the guaranty associations.

Statutory Landscape

Several states – Illinois, Missouri, Connecticut and Utah – have enacted legislation permitting some form of claims estimation but have limited the ability to col-

continued on page 19



Policyholder Support Update - Alert No. 9 (August 2005)

Submitted by KPMG LLP (UK)'s Corporate Recovery Insurance Solutions team.

This alert, kindly provided by KPMG, includes recently reported details, relating to schemes of arrangement for both solvent and insolvent UK insurance companies, which you may find of interest. A summary of all cut-off schemes of arrangement with effective dates after 1 January 2004 may be found on KPMG's website <http://www.kpmg.co.uk/crinsurancesolutions>. The information on this website is updated weekly.

Solvent Schemes

1) The British Aviation Insurance Company Limited ("BAIC")

The High Court refused to sanction the proposed scheme of arrangement at the hearing on 20 July 2005. The company has been granted leave to appeal the decision. Further details are available at www.baicsolventscheme.co.uk.

An article (published by Insurance Day 15 August 2005) by Tony McMahon, Head Partner of KPMG Insurance Solutions, which comments on the implications of this judgement in the UK schemes market, along with a copy of the judgement itself can be found on our website at www.kpmg.co.uk/crinsurancesolutions.

Upcoming Key Dates

2) Sphere Drake Insurance Limited

The High Court of Justice of England and Wales has sanctioned the solvent scheme of arrangement of the above company. The effective date of the scheme was 6 May 2005. The bar date was 5 September 2005. Further details are available at www.sdopools-solventscheme.co.uk

3) Lion City Run-Off Private Limited

By Orders of both the High Court of Justice of England and Wales, and the High Court of Singapore, a Meeting of Scheme Creditors for the above company is to be convened for the purpose of considering and, if thought fit, approving a scheme of The Meeting of Creditors scheduled to be held at the offices of KPMG LLP UK, 1-2 Dorset Rise, London EC4Y 8EN, United Kingdom on 1 September 2005 was postponed. Further information may be obtained

by emailing Andrew Campbell at LionCityRun-Off@omniwhittington.com

4) Unione Italiana (UK) Reinsurance Company Limited

The above company's scheme was approved at its meeting of creditors on 23 February 2005 and has been sanctioned by the Court. The effective date of the solvent scheme of arrangement was 9 June 2005. The bar date is set for 7 October 2005. Claim forms were circulated to scheme creditors on 10 June 2005. Further information is available at www.cavell.biz/schemes.

5) Cavell Insurance Company Limited

The solvent scheme of arrangement proposed was approved by the requisite majority of scheme creditors at the reconvened meeting held on 25 April 2005. The Company has postponed their application to the English High Court for the Scheme to be sanctioned whilst they await the outcome of an appeal in the Canadian Court. Further information is available at www.cavell.biz/schemes.

6) The Scottish Lion Insurance Company Limited The Scottish Eagle Insurance Company Limited La Mutuelle Du Mans Assurances IARD

By Orders of the High Court of Justice of England and Wales a meeting of scheme creditors for the above companies is to be convened for the purpose of considering and, if thought fit, approving a scheme of arrangement. The Meeting of Creditors was held at the offices of PriceWaterhouseCoopers LLP, 1 Embankment Place, London, WC2N 6RH, United Kingdom on 5 September 2005. Further information may be obtained by contacting The Scottish Lion Underwriting Agencies Limited, 5th Floor, Cutlers Exchange, 123 Houndsditch, London. Further information is available at the relevant companies website:

www.scottishlionsolventscheme.co.uk

www.scottisheaglesolventscheme.co.uk

www.mmaukbranchsolventscheme.co.uk

Other Recent Developments

7) The Mercantile & General Reinsurance Company Limited

The Meeting of Scheme Creditors was held on 26 April 2005 at which the requisite majority of scheme creditors voted in support of the scheme. The scheme

was sanctioned by an order of the Court of Session, Scotland on 1 September 2005. Further details are available at www.mgre.co.uk.

8) **Gordian Runoff (Uk) Limited (Formerly Gio (Uk) Limited)**

The solvent scheme of arrangement proposed was approved by the requisite majority of scheme creditors at the meeting held on 3 March 2005. The 22 July 2005 hearing scheduled to sanction the scheme has been adjourned whilst Gordian considers the best way forward in light of the recent BAIC judgement (refer above). The scheme is not yet effective. The Further details are available at www.gordianuk.co.uk.

9) **Dutch Aviation Pool**

The companies which together comprise the Dutch Aviation Pool are proposing schemes of arrangement with their respective creditors in relation to certain business. The names of the 18 Scheme Companies are listed at our website: <http://www.kpmg.co.uk/crinsurancesolutions>. By order of the High Court, Scheme Meetings for each category of Scheme Creditor will be held at the offices of CMS Cameron McKenna LLP, Mitre House, 160 Aldersgate St, London EC1A 4DD at 11am on 15 September 2005.

Further information is available by contacting the proposed Scheme Manager: DAP Holding N.V, Hoogoorddreef 54E, PO Box 23320, 1100 DV Amsterdam Z.O, The Netherlands. Email: dapscheme@assurpools.nl.

10) **QBE Reinsurance (Uk) Limited (Formerly Allstate Reinsurance Co. Limited)**

The results of the meeting of scheme creditors which took place on 27 July 2005 have not been announced. A Court date to sanction the scheme has not been announced and therefore the scheme is not yet effective. Further information may be obtained via email at zuginfo@qbe-europe.com.

Insolvent Estates

11) **Compagnie Europeenne De Reassurances SA**

The above company's scheme was approved at its meeting of creditors on 7 July 2005 and has been sanctioned by the Court. The effective date of the solvent scheme of arrangement was 20 July 2005. The bar date is set for 10 November 2005. Claim forms are available from www.pwc.com/uk/cer. All queries should be directed to the Joint Scheme Administrators, Compagnie Europeenne de Reassurances SA, 31 Great George Street, Bristol BS1 5QD, United Kingdom.

12) **Municipal General Insurance Limited**

The bar date for the above scheme has been notified as 15 January 2006. All Scheme Claims must be notified to the Joint Scheme Administrators, Municipal General Insurance Limited, Friary Court, 13-21 High Street, Guildford, Surrey, GU1 3DG by 5p.m on that date.

Please refer to KPMG's website (www.kpmg.co.uk/crinsurancesolutions) for the latest position on the cases discussed in this Alert and others currently being proposed.

Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future.

If you wish to subscribe to the KPMG regular email alerts, please contact Mike Walker on mike.s.walker@kpmg.co.uk.

Think Tank

Claim Estimation

continued from Page 17

lect from reinsurers based on that estimate. According to the RAA, claims estimation has been defeated in bills in Alabama, California (introduced and defeated three years in a row), Idaho, Mississippi, Oklahoma, Pennsylvania, Rhode Island, and Tennessee.

Conclusion

Claim estimation is the subject of large debate in the insurance industry. While increasing payouts to creditors and reducing administrative expenses are important goals, claim estimation is not the proper remedy to achieve them. Claim estimation violates the sanctity of the reinsurance agreement, is based on actuarial assumptions which are riddled with inaccuracies, and has the potential to trigger numerous guaranty fund issues. Application of claim estimation and accelerated reinsurance recoveries sets a dangerous precedent and turns the hallmark of an indemnity agreement on its head.

**Mr. Kelaher is Vice President at Allstate Insurance Company in Chicago. He can be reached at tkelaher@allstate.com.*

Jonathan Rosen's response, "Bringing Claim Estimation into Perspective" will appear in the Winter 2005 issue.

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