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airroc.org Vol. 8 No.1 Spring 2012

On the Ascent

SOLVENCY II...READY...OR NOT? • NRRA GROWS UP FAST • A SIT DOWN WITH TORTI AND LEE ON GTE RE • MEMBERS' SURVEY • EARNING OUR STRIPES • TACKLING RUN-OFF

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On the Ascent

Peter A. Scarpato

"Ascent: the act of rising or mounting upward" or, more relevant to this discussion, "an advance in social status or reputation." Merriam-Webster's Online Dictionary

On behalf of co-chairs Leah Spivey, Colm Holmes and the entire Publications Committee, I am proud to introduce our newly designed format for *AIRROC Matters*. Morphed from newsletter to magazine by the artistic hand of our production team, Nicole Myers and Gina Pirozzi, this redesign acknowledges and reflects AIRROC's ascent to prominence within the legacy business community. Its broadened perspective, contemporary motif and adroit artistry promote the vision and practice of our fine organization. The deft redesign touches all sections, new and old, as displayed by our thematic front cover.

We have infused content as well as color. In addition to regular features like Legalese, Think Tank, Policyholder Support Alert, Present Value and Regulatory, we have added new sections: (1) AIRROC Update: introduced by Trish Getty and featuring the latest and greatest news about AIRROC and (2) AIRROC Toolbox: featuring educational articles about the "nuts and bolts" of handling legacy and run-off business. Future editions may include additional sections of interest to our members.

We hope you enjoy and embrace the redesign. Any and all feedback would be appreciated.

In *Solvency II…Ready?...Or Not?* PwC's Jonathan Freedman and Henry Jupe explore the current status and future uncertainties of Solvency II, including its potential impact on companies and regulations both here and abroad. Next, our own Fred Pomerantz and Louis Castoria offer up *NRAA Grows Up Fast*, a study of the challenges surplus line brokers face from state and federal legislatures' failure to chart interstate compacts necessary to implement the NRAA. Finally, Len Fisher and Fred Pomerantz give us a comprehensive look at the Dodd-Frank Act's Federal Office of Insurance and the potential for future federal insurance regulation in *The Dodd-Frank Act: Is Insurance Modernization on the Horizon?*

Our first installment of the AIRROC Update includes Trish Getty's *Like No Other*, a reaffirmation of the many benefits of AIRROC membership, and *What's On Your Mind?* in which Trish summarizes the enlightening results of her three months of interviews with AIRROC members.

GTE Re, ever in the news, is seen from the inside in *A Sit Down With Torti and Lee*. Jim Veach and I had the pleasure of interviewing Commissioner Torti and Gary Lee, counsel for the Rhode Island Insurance Department, about the Rhode Island Restructuring Act, the GTE Re plan and challenges to the plan.

Our AIRROC Toolbox segment premieres with two pieces: *Earning Our STRIPEs,* Steve Street's article on the web-based platform that allows cedants and insurers to decrease wasteful data reprocessing by communicating with their reinsurers directly; and *Tackling Run-Off from the Cradle to the Grave,* Tolga Urkun's take on how best to manage a pool from run-off to scheme of arrangement.

Our Legalese section features *Consensual Alteration of Arbitration Clauses*, in which Larry Schiffer explains the differences between, and costs/benefits of, party-appointed versus all neutral arbitration panels, a hot topic in the ADR world.

As always, this is YOUR magazine that serves YOUR needs.

Let us hear from you. •

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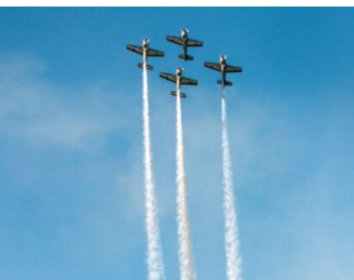

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Solvency II…
Ready?…Or Not?

illustration Rafael Edwards

Solvency II is the largest ever regulatory change for insurance firms within the European Economic Area ("EEA"). It applies to all (re)insurers in the EEA (including captives, branches and run-off) within scope and its objective is to place risk management at the heart of all insurance companies. It has a heavy emphasis on the governance framework and wide ranging implications for the Board, through development of key functions, structure, fit and proper standards and the Use Test.

Solvency II will set out new, strengthened EEA-wide requirements on capital adequacy and risk management for (re) insurers with a view to enhancing policyholder protection across Europe. The strengthened regime at a European level is intended to increase regulatory convergence across the EEA.

In light of the International Association of Insurance Supervisors' ("IAIS") updated Insurance Core Principals ("ICPs") and directives such as Solvency II, many supervisory bodies outside of the EEA are considering updating their own supervisory standards and structure. Components of Solvency II could be/are being adopted outside of the EEA by countries such as Bermuda and South Africa (to name a few).

Current status of the debate

We will discuss the proposed amendments to the Solvency II Directive as a result of Omnibus II in more detail in the next sections but the current proposals by both the European Council and Parliament indicate a one year delay in implementation to 1 January 2014; this date, the final part of the implementation road-map and the overall Solvency II timetable remain uncertain at the time of writing.

The industry is awaiting formal approval of the amendments contained in Omnibus II and an agreed set of Level 2 "implementing measures" which will provide further clarity on the shape of Solvency II beyond the rules already specified in the Directive ("Level 1") and supplementary consultation papers. Formal Level 2 discussions theoretically cannot begin until the Level 1 text has been agreed, though the Commission and European Insurance and Occupational Pensions Authority ("EIOPA") have given clear signals of the intended course they expect Level 2 to take to the industry.

Subject to the above, the timeframe to implement Solvency II remains tight and companies have already invested significant resources (in both time and cost) to ensuring that they will be ready in time. We have started to see a number of supervisors across the EEA set out their timetables for Internal Model Approval Process ("IMAP") applications and many are now also considering Solvency II disclosure requirements, which may start to take effect during the course of 2013, or earlier. Despite the lack of clarity around certain rules there is much that is known and sufficient material in the public domain to allow industry to start preparing for the changes.

Although the IMAP (including Internal Model Validation) is one of the most significant next steps for those that are applying, in many insurers' Solvency II programs there are numerous other work streams underway or imminent, including the Own Risk and Solvency Assessment (ORSA), public and private reporting and disclosure (Pillar 3), technical provisions/reserves, data quality, investment strategies, corporate structure, credit ratings and governance. From our experience the degree of readiness for Solvency II implemen–tation for companies and supervisors differs significantly as a result of a number of factors, both internal (such as lack of available resource, differing starting positions and differing board appetite) and external (lack of rule certainty at this stage). Either way, there is still significant work required before the implementation date and much that the industry can and is addressing now in order to be better prepared at the start date.

Omnibus 2 and Level 2 "implementing measures"

Omnibus 2 is a means to introduce a number of changes to the Solvency II Directive. Key areas of change are 1) implementation date, 2) introduction of transitional measures to phase in certain aspects of the new rules (including run-off) and 3) the role of EIOPA.

Once both the European Parliament and Council have finalized their own amendments to Omnibus 2 the "trialogue" between the European Commission, the Parliament and the Council can begin with the aim to produce a "Common Position" before the plenary in European Parliament and formal adoption of Level 1 in the European Council.

Considerations for the industry

At the time of writing, the following commentary does not apply to pure reinsurers that were in run-off before 10 December 2007 as the Directive expressly excludes these undertakings from Solvency II under Article 12, however this may change after further deliberations.

At this stage, only the Council has addressed the broader treatment of run-off (through its Presidency Compromise paper dated 21 June 2011). Parliament has stayed quiet on this topic.

Under the Presidency Compromise, (re) insurance undertakings which are in run-off at the date of implementation of Solvency II and exclusively administer their existing portfolio in order to terminate their activity may choose not to comply with Solvency II where the undertaking has satisfied the supervisor that it can and will terminate its activity before three years after the date of Solvency II implementation. If at any point the supervisor is not satisfied that they are going to achieve their plans, they may become subject to Solvency II rules. The three year exemption will only apply if the (re)insurer is not part of a group or if all group entities are in run-off.

Run-off companies utilizing the 3 year transitional provision proposed by the Council must notify their supervisor and submit an annual report setting out their plan to terminate their activities and progress against that plan.

What are the practical implications for run-off under current proposals?

In practice there will be a number of run-off companies that are unable for practical and commercial reasons to terminate within three years and will therefore be required to comply with Solvency II including capital calculation, governance and reporting requirements similar to live insurance undertakings. Proportionality will be considered by undertakings and supervisors where appropriate and we are strongly encouraging all relevant firms to start considering this impact and even discuss views with their supervisor.

Those seeking exemption from Solvency II based on the Council's draft proposals will need to have in place a plan to terminate activities within three years. The plan will need to be transparent with a possible focus on key milestones, resource requirements and strategic decisions amongst other factors.

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Solvency II…Ready?…Or Not? (continued)

European run-off insight

http://download.pwc.com/ie/pubs/2011_unlocking_value_in_run_off.pdf

In PwC's annual run-off survey "Unlocking value in run-off — A survey of Discontinued Insurance Business in Europe" a clearly growing theme is the possible impact of Solvency II on run-off. It is clear from the survey that the European run-off market is starting to think about the implications of Solvency II, but without rule-certainty, there are mixed views on what the impact may be.

Key findings include:

Increasing numbers of respondents believe that the practical implications of Solvency II will lead to an increased requirement for capital and focus on exit options for discontinued business. Across Europe, run-off is increasingly the subject of strategic plans, with over 90% of respondents stating that they have a strategic plan for dealing with their run-off business, and the majority of those stating capital release as the key objective.

Solvency II is strongly expected to be a driver for restructuring activity and respondents believe most activity will take place in Germany, the UK and Switzerland (although this territory is outside of the EEA it is seeking Solvency II equivalence). However, a significant number of restructurings in this respect is likely to be another year away or closer to the known outcome of Solvency II's impact on run-off. 63% of respondents believe that Solvency II will focus (re)insurers' attention on underperforming lines of business, and nearly half of all respondents believe that their organizations may acquire business as a result of Solvency II perhaps due to diversification benefits or strategic opportunities.

Much of the focus of the current restructuring activity we are experiencing is centered on consolidating organizational structures, sometimes in preparation for an exit. In particular, Part VII and insurance business transfer activity has been strong. A high proportion of respondents have been involved with some form of restructuring activity to date and many believe there will be more run-off disposal transactions in the next two years.

Solvent schemes of arrangement have been considered more by survey respondents than any other exit mechanism. Respondents also believe that there is a strong pipeline for run-off disposals and restructuring activity over the next two years. Those respondents that have considered exit appear to support the conclusion that the solutions need to be bespoke with all of the key tools being considered.

Status of the debate in the US

In the US, the National Association of Insurance Commissioners ("NAIC") is reviewing and updating US insurance regulation through its Solvency Modernization Initiative ("SMI"), which has included in-depth review of insurance regulatory practices in other territories. The NAIC's primary focus to date has been on the IAIS's revised ICPs. However, the Solvency II proposals have also been reviewed in detail by the NAIC, in particular given their significant overlap with many of the key areas of the ICPs, and in some respects the SMI is expected to lead to greater convergence between US regulation and practices in Europe.

Most significantly, at the end of 2011 the NAIC adopted initial proposals and guidance for US insurers to carry out an ORSA covering their US and (if applicable) international operations, and to comply with associated enterprise risk management ("ERM") requirements. While the legal mechanism and implementation date for the requirements are still being discussed at the NAIC, the NAIC's target is to comply with the ORSA and ERM requirements contained in ICP16 (Enterprise Risk Management for Solvency Purposes) by 2014.

Given the strong links between the US and European insurance markets, the NAIC has also been in regular dialogue with EIOPA, and is discussing equivalence in the future, potentially through a transitional program proposed as part of Omnibus 2. US equivalence would have a significant impact for many insurers operating between the US and European markets, and in particular has the potential to streamline group supervision arrangements.

However, the NAIC has stated formally that it does not intend to make wholesale change to US regulation, nor to implement Solvency II as a package in the US. There are several aspects of the ICPs and Solvency II that the NAIC has ruled out, including the use of internal models for calculating minimum regulatory capital levels (in contrast to the calculation of internal capital targets for the ORSA) and the calculation of a formal regulatory capital requirement at group level. The NAIC views the US regulatory framework as effective, and believes that it achieves the same high regulatory standard that Solvency II aims for. The NAIC's view is therefore that EIOPA should assess equivalence on an outcomes-basis, and should allow for variation in the exact regulatory tools and methods used.

In conclusion

Staying up to date through 2012, preparing proactively for the new regulations and considering the important strategic questions that Solvency II raises will be vital in order to be well-positioned for the new environment. ●

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NRRA Grows Up Fast

FIO May Rescue Gaps Left in the Dodd-Frank Act

Surplus line brokers found a newborn left on their doorstep on July 21, 2011, the day when the Nonadmitted and Reinsurance Reform Act (NRRA) took effect.[1]

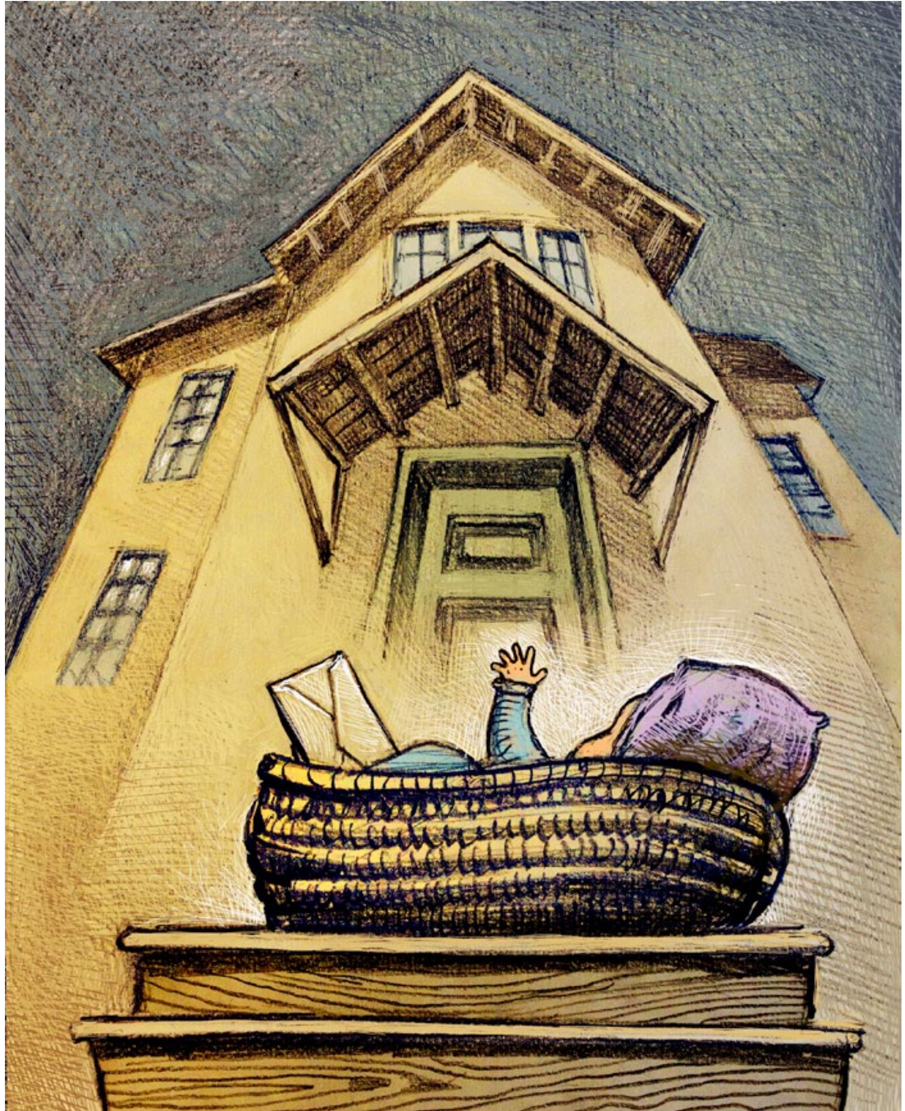

illustration Rafael Edwards

Despite a 12-month gestation from the day NRRA was signed into law as part of the Dodd-Frank financial industry reforms to its effective date, the states failed to use the grace period to reach uniform agreement on any of the proposed interstate compacts to allocate surplus line tax revenues, leaving brokers with a crazy quilt of state "conforming" laws and filing forms to decipher and track.

In fairness, many states had higher priorities on their agendas, such as balancing budgets in times of slashed revenues and increased demands for services. Congress likewise had little time to spare for insurance issues, being preoccupied with raising the debt ceiling and nearly causing the first default by the U.S. Government on its obligations.

The surplus lines industry is left with an infant law to feed and care for. Messrs. Dodd and Frank, the law's putative parents, clearly did not provide for the details of its upbringing. Consider:

1. Home is where the head is? Several states' conforming laws elaborate on NRRA's definition of a corporate insured's "home state," the threshold determination under NRRA as to which state's laws apply. NRRA adopts a headquarters test, rather than looking to the state of incorporation. That's an easy standard to apply to, for a company like Apple, but not all organizations have such well defined nerve centers. California's NRRA statute provides that "if the insured's high-level officers direct, control and coordinate the business activities in more than one state, the state in which the greatest percentage of the insured's taxable premium for that insurance contract is allocated" will be the home state. Allocating premium for multi-state property insurance is a cinch, but liability insurance isn't so simple. The test also leads to the prospect of multiple home states if, for example, a company that is directed from two states has a predominance of its D&O premium allocated to State A, but its EPLI premium is more heavily weighted toward State B.

2. Paperwork. NRRA does not establish a national clearinghouse or similar mechanism to allocate premium taxes among states that have joined either of the two competing, and inconsistent, multi-state compacts for tax sharing. In the absence of a national system, some states have developed their own forms and formulas for surplus line brokers to report on how premiums are allocated, even where the result under the NRRA is that only one state receives all of the premium tax revenue. California's Chapter 83, Statutes of 2011, effective January 1, 2012, for example, requires surplus line brokers to provide data on tax allocations on multi-state premiums beginning on March 1, 2012, though the California Commissioner of Insurance can decide to forego the

report. Thus, a "simplified" system under NRRA becomes more burdensome and less predictable. It also outsources government data-collection functions to the brokerage community.

3. Other loose ends. NRRA left at least as many issues unanswered as it answered. Though it established an exception for "exempt commercial purchasers" to state-based requirements that brokers submit proposed insureds to multiple admitted carriers before resorting to the surplus lines market, NRRA did not expressly preempt existing state rules that similarly exempted "industrial insureds." The two terms are not synonymous, each having complex definitions. The result: Having determined the commercial insured's home state, the broker must next determine whether the insured meets NRRA's test for exemption, and if not, must apply the home state's industrial insured test. If the insured meets neither set of criteria, the home state's due diligence submission requirements must be followed.

Compacts and conflicts

In a statement to the House Subcommittee on Insurance, Housing and Community Opportunity, the Independent Insurance Agents & Brokers of America (IIABA) cautioned that NRRA's intent could be thwarted by inconsistent rules and procedures set by states. The IIABA position paper, delivered to Congress just one week after NRRA took effect, commented, "The NRRA was intended to streamline and simplify the surplus lines regulatory system. It would be a very peculiar outcome and an unintended consequence of Congress's action if the NRRA's enactment ultimately prompted state officials to develop an even more complex and cumbersome regulatory structure for the agents, brokers, and purchasers of surplus lines insurance."

In particular, the IIABA was critical of one of the multi-state compacts, the Nonadmitted Insurance Multi-State Agreement (NIMA), because its allocation methodology "is of considerable concern to the private sector and it is one that fails to satisfy the principles that IIABA and others expect from such a system. NIMA's proposed allocation system would be more complex and cumbersome than that in place today and would require the collection of information that is not even utilized in the underwriting process."

NIMA includes an allocation method and a clearinghouse that will be available only to NIMA member states.

Both NIMA and its primary competitor, the Surplus Lines Insurance Multi-State Compliance Compact (SLIMPACT-Lite, so called because it is a revised version of an earlier proposal), allow surplus lines tax revenues to be shared among states that have joined the same compact. NIMA includes an allocation method and a clearinghouse that will be available only to NIMA member states. In contrast, SLIMPACT-Lite, would set up a commission to determine the methodology. As a practical matter, neither system is yet up and running and there is little prospect of agreement by the states as the first quarter of 2012 draws quickly to a close.

Some states, including California, Colorado, Delaware, Idaho, Illinois, Michigan, Missouri, New York, Pennsylvania, Virginia and Washington, adopted neither NIMA nor SLIMPACT-Lite during their current legislative sessions, instead enacting what might be termed "home state takes all" statutes, under which those states will assess their premium tax rates on 100 percent of surplus line premiums paid by insureds headquartered there, and have agreed to share the proceeds with no one.

California further changed the rules of the game by creating two classes of surplus lines carriers. Surplus lines brokers are allowed to place business with carriers in one class, those that have at least $45 million in capital and surplus. To place coverage with a carrier that has less than $45 million (but at least $15 million) there are added filing requirements. This appears contrary to NRRA's clear requirement that if the insured's home state approves a surplus lines carrier with $15 million in capital and surplus, and that carrier is licensed in other states, the broker may place coverage on risks that are present in those states. NRRA's mandate for uniform state eligibility is the greater of the minimum capital and surplus required by the home state or $15 million (which may be further reduced upon a demonstration of compelling circumstances, but in no case to less than $4.5 million).

California's NRRA conforming legislation also replaces the List of Eligible Surplus Line Insurers ("LESLI") with a List of Approved Surplus Line Insurers ("LASLI"). The difference is not merely semantic, though insurers that were on the LESLI list as of July 20, 2011 list are grandfathered onto the LASLI list. The difference is that carriers not already approved in the California market are required to file all the documents mandated in the California Insurance Code and pay the appropriate filing fees to receive approval, even if they are already approved in the insured's home state. Alternatively, the surplus line broker may make those filings for the non-approved carrier. The California statute raises questions regarding the pre-emotive intent of NRRA to establish a level playing field.

Some other states have ignored the NRRA's statement that "an insured's home State may require. . . insureds who have independently procured insurance to annually file tax allocation reports with the insured's home State." Currently, about one-quarter of the states do not tax independently procured insurance premiums on the same basis as premiums for coverage placed through a surplus line broker. Thus, if the home state does not impose such a tax on the entire premium, can another state tax the portion

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NRRA Grows Up Fast (continued)

of the premium that is allocable to risks present in that state? Here again, the level playing field is developing some hazardous bumps and divots.

For the surplus line broker, the alphabet soup of multi-state compact acronyms does not make a nourishing meal. While there are handy online guides to NRRA and the states' statutes (NAPSLO.org and CIAB.com are two worth visiting), brokers do not need a heaping helping of complexity added to their already challenging jobs.

FIO to the Rescue?

For all the campaign rhetoric about the supposedly "radical" and "socialist" tendencies of the current administration, the two hallmarks of its domestic policy thus far have been half-measures. Healthcare reform did not take the fork of the road toward a single-payer, federal solution, but an insurance-based path, to be supplemented by state-based exchanges. The Dodd-Frank Act, to which NRRA was an add-on, left Wall Street still pretty much in charge of Wall Street, and left the majority of insurance regulation to the states, where it has traditionally been.

Along with NRRA, there was another insurance add-on to Dodd-Frank: the creation of a Federal Insurance Office. Michael T. McRaith, who spoke on a panel of experts for the opening general session of the Professional Liability Underwriting Society's International 2006 Conference on "the increasing impact of U.S. federal law in defining professional liability risks, and potentially in regulating the insurance industry," was appointed this year to head the FIO.

The five-speaker panel, moderated by TV journalist Forrest Sawyer, was anything but unanimous in its views. While there was undeniable federal influence in D&O liability insurance exposures in the post-Enron era, the prospect of Uncle Sam directly regulating the insurance industry received mixed reviews. For his part, Director McRaith stood strongly in favor of continued insurance regulation at the state level, while some panelists favored bringing down the barriers to a unified system of surplus line approval, either through concerted effort by the states or by federal preemption.

For the surplus line broker, the alphabet soup of multi-state compact acronyms does not make a nourishing meal.

In the NRRA and the companion law creating the FIO, everyone on the panel may have gotten something that he wished for that day. Barriers to surplus lines carrier eligibility have come down, though not quite as dramatically or thoroughly as the Berlin Wall. Focusing on the insured's home state for both regulation and taxation will eventually simplify the broker's job, though NRRA needs some serious tweaking through improved multi-state compacts or federal action to make that happen.

For its part, the FIO can help the process simply by encouraging the organizations that developed the NIMA and SLIMPACT-Lite plans to keep working on simplifying procedures and its standardizing filings.

In the longer term, the FIO is empowered to enter into agreements with other nations for "prudential measures regarding the business of insurance," and to determine, subject to federal judicial review, whether some types of state laws are preempted by those agreements. It can also issue subpoenas, and conduct studies regarding the "modernization of insurance regulation." Those powers appear to give the FIO a sufficiently large stick to fix NRRA, if the states do not find the carrot sufficiently motivating.

Notwithstanding calls from some insurance trade organizations for it to take a larger role in regulating the insurance industry, it is unlikely the FIO will assume that posture. In a press release from the United states Department of the Treasury dated December 9, 2011, Deputy Treasury Secretary Neil Wolin, reaffirmed the place of state regulators in overseeing the insurance industry at the FIO's first conference addressing insurance regulation. Deputy Treasury Secretary Wolin and FIO Director Michael McRaith, himself a former insurance director in Illinois, both stated that they support the state regulatory system. As required by the NRRA, a report from FIO Director McRaith, which will include recommendations for the modernization of insurance regulation, is due 18 months after the effective date of the NRRA, by which is January 21, 2012.

For now, the gaps in NRRA and the inconsistencies in corresponding, conforming state laws leave brokers with a difficult path to travel. The inconsistencies in the requirements applicable to eligible surplus lines insurers and the refusal of some states to recognize the intended new rules harmonizing state recognition, and taxation, of independently procured insurance will inevitably lead to court challenges. As the orphan statute matures, it may fulfill its original goals and make the U.S. market a more even and efficient playing field. ●

Notes

1 A slightly abridged form of this article first appeared in the September 2011 Property Casualty 360⁰. An expanded version was published in the FORC Journal. This article is Reprinted with permission by FORC.

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The Dodd – Frank Act

Is Insurance Modernization on the Horizon?

Background: Signed into law by President Obama on July 23, 2011, The Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203), or "Dodd-Frank", enacted Title V., Subtitle A, Section 502 (codified at 31 U.S.C. § 313), created a new Federal Office of Insurance ("FIO") whose Director is appointed by the Secretary of the Treasury. The first Director, Michael McRaith, was formerly Director of the Illinois Insurance Department. In November 2011, the Treasury Secretary created a Federal Advisory Committee on Insurance ("FACI") to provide advice and recommendations directly to the FIO Director. The FACI is comprised of 15 members including seven insurance commissioners, six industry executives, a university professor, and a consumer advocate.

The FIO is charged [Dodd-Frank § 502, codified at 31 U.S.C. § 313 (c)] with the following duties:

- Monitoring the insurance industry including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the U.S. financial system;
- Monitoring the extent to which the underserved communities have access to affordable insurance;
- Making recommendations to the Financial Stability Oversight Council (FSOC) with respect to the designation of an insurer, including its affiliates, as being subject to regulations as a nonbank financial company;
- Assisting in the administration of the Terrorism Risk Insurance Act Program;
- Coordinating federal efforts and develop federal policy on prudential aspects of international insurance matters including representing the United States in the International Association of Insurance Supervisors ("IAIS"); and
- Consulting with state insurance regulators concerning matters of national or international importance; and determining whether state insurance laws are preempted by international agreements under certain circumstances.[1]

FIO Reporting Requirements

Beginning September 30, 2011 and on or before September 30 of each calendar year, the Director must submit a report to the President and certain congressional committees on any actions taken by the FIO regarding preemption of inconsistent state insurance measures and a report on the insurance industry and other information deemed relevant by the Director or requested by a Congressional committee.

Not later than September 30, 2012, 31 U.S.C § 313 (o)(1) the Director is required to prepare a report describing the breadth and scope of the global reinsurance market and the important role such market plays in supporting the U.S. insurance market. 31 U.S.C. § 313 (o) (2) further requires that, not

Leonard M. Fisher, Frederick J. Pomerantz

photo / Rafael Edwards

later than January 1, 2013, the Director must prepare a report to be updated not later than January 1, 2015, describing the impact of federal preemption on the regulation of credit for reinsurance and reinsurance agreements on the ability of state regulators to access reinsurance information for regulated companies in their jurisdictions.

Finally, not later than 18 months from the enactment of the Dodd – Frank Act, 31 U.S.C. § 313 (p)(1) the Director must prepare a study, together with a related report to be submitted to Congress, on methods to modernize and improve the U.S. insurance regulatory system (the "Modernization Report"). 31 U.S.C. § 313 (p) (2) sets forth the following twelve items the study and report are to consider:

- Systemic risk regulation with respect to insurance;
- Capital standards and the relationship between capital allocation and liabilities;
- Consumer protection for insurance products and practices, including gaps in state – based regulation;
- The extent of national uniformity of state insurance regulation;
- Regulation of insurance holding company systems on a consolidated basis;
- International coordination of insurance regulation;
- The costs and benefits of potential federal regulation of insurance;
- The feasibility of regulating specified lines of insurance solely at the federal level;
- The ability of federal regulation to minimize regulatory arbitrage;
- The impact that developments in the international regulation of insurance might have on potential federal regulation of insurance;
- The ability of federal regulation to provide robust consumer protection; and
- The potential consequences of subjecting insurance companies to a federal resolution authority including the effects of any Federal resolution authority (i) on the operation of state insurance guaranty fund systems, including the loss of guaranty fund coverage if an insurance company is subject to a federal resolution authority; (ii) on policyholder protection including the loss of the priority status of policyholder claims over other unsecured general creditor claims; and (iii) in case of life companies on the loss of the special status of separate account assets and liabilities and (iv) on the international competitiveness.

In addition, 31 U.S.C. §§ 313(p) (4) and (p) (5) require, respectively, that this study and report are to include recommendations to carry out or effectuate the report's finding and require that the Director shall consult with the state insurance regulators, consumer organizations, representatives of the insurance industry and policy holders, and other organizations and organization experts, as appropriate.

Public Input on Modernization Report

In furtherance of Dodd – Frank's requirements to study and prepare the

Is Insurance Modernization on the Horizon? (continued)

Modernization Report, on October 17, 2011, the Department of Treasury published in the Federal Register (Vol. 76, No 200 page 64174 – 64175) a notice and request for comments due December 16, 2011 with respect to all the criteria discussed above. Additionally, the FIO convened a conference on December 9, 2011 at the Treasury Department to discuss "Modernizing and Improving the Insurance Regulation System." Deputy Treasury Secretary Neil Wolin, in remarks to the Conference attendees, made clear that regulating the insurance industry was not one of the responsibilities of the FIO. Nothing in Dodd – Frank alters the fact that "insurance is fundamentally regulated by the States." Continuing, Wolin stated that despite the insurance sector's size and importance (8% of GDP and 2% of the work force) …"before the Dodd – Frank Act was passed, the Federal government had no central repository for comprehensive insurance expertise. Dodd – Frank fixed this glaring omission so that, through FIO we will have the institutional capability to develop and coordinate insurance policy at the federal level more effectively than in the past." http://www.treasury.gov/press-center/press-releases/Pages/tg1382.aspx.

In general, the consensus of the conference was that the FIO was important but there was disagreement on the role it should play. The participants did agree that the FIO was an "impact single point of contact" at the federal level on insurance issues especially institutional ones. See www.PropertyCasualty360.com/2011/12/09/industry.

Mark Grier, Vice Chair, Prudential stressed that "the biggest challenge is that there is no federal regulation of insurance in the U.S. and little understanding of insurance at the federal level." He also stated the "FIO can serve to focus on the distinctness of U.S. insurance and position the U.S. in international debate." He added that, "there is a 'knee jerk' reaction to attempt to fit insurance in the banking model." But he stated that the banking framework is not appropriate for insurance. Grier suggested that "the FIO can play a role in establishing a distinct identity for insurance in the U.S." See report by Williams and Jensen PLLC, Treasury hosts conference on insurance regulation, posted December 12, 2011, www.reinsurance.org/files/Treasury%20Conference-%20Insurance%20Reform-Dec92011(1).pdf.

People are hopeful that he will focus on issues like harmonization of state procedures and approvals that could benefit the industry and its consumers…"

Director McRaith moderated the final panel, Prudential Standards for Insurance Companies. The panelists included Birny Birnbaum, consumer representative, Forrest Krutter, SVP/GC, Berkshire, and Marlene Debel, Treasurer, Met Life. McRaith related that some have raised concerns about a federal regulator and questioned panelists on how it was different to have "50 plus" state regulators as opposed to a single federal regulator. Krutter stated that a "number of concerns are somewhat localized" making individual state regulation viable for those areas, arguing that "insurance companies chose to operate in those markets knowing the regulations, and that the public has benefited from local regulators". See report by Williams and Jensen, PLLC, www.reinsurance.org. The Director asked the panelists if they believed that state insurance regulators possessed the expertise to execute the regulatory objectives and understand the panelists' complex companies. Birnbaum stressed that state regulators should "catch up" to the data mining methods used by insurance companies to create better predictive models of behavior while Krutter believed that state regulators have advanced in step with the firms they regulate stressing that the "regulators job was not to over analyze but only to see if the company can meet their obligation." See report by Williams and Jensen, PLLC, www.reinsurance.org. Howard Mills, former Superintendent of the New York Insurance Department and now Chief Advisor for Deloitte's (New York) National Insurance Group concluded that the FIO Director "showed that he was looking at this very seriously; and gave observers reason to expect a reasonable report. People are hopeful that he will focus on issues like harmonization of state procedures and approvals that could benefit the industry and its consumers…" See "Federal Insurance Office Modernization Conference Anticipates Report Due January" by Anthony O'Donnell, dated December 12, 2011, http://www.insurancetech.com/regulation/232300345.

The Industry's Comments to the FIO

The insurance industry responded to the December 16, 2011 deadline for comments to enable the FIO to prepare its Modernization Report. Comments were made by every constituency of the insurance industry and included, among others, the American Council of Life Insurers, the National Association of Mutual Insurance Companies, the Committee on Capital Markets Regulation, the Ohio Department of Insurance, the Property Casualty Insurers Association of America, and the Risk and Insurance Management Society, Inc.

Finally, we wish to highlight the comments of The Committee on Insurance Law of the New York City Bar Association. Its letter can be found at http://www.nycbar.org/44th-street-blog/2011/12/19/insurance-law-committee-submits-comments-to-federal-insurance-office-on-federal-role-in-insurance-regulation-2/ (the "Bar Comments").

The Bar Comments are truly a diverse representation of the insurance industry

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Is Insurance Modernization on the Horizon? (continued)

and are impartial as to the shape of state vs. federal regulation: "We express no view herein on the proper allocation (if any) of insurance regulatory responsibilities between the states and the Federal government". Instead the Bar Comments "focused on six areas in which a Federal role is evolving or contemplated by the passage of Dodd-Frank, and we offer in turn our comments on how such a role could be helpful or harmful to public policy." The six areas addressed by the Bar Comments are:

- The U.S. can help insurers in enforcing foreign judgments against off-shore reinsurers more effectively than individual states;
- Market conduct and insolvency regulation should be handled by the same level of government (state or federal);
- The U.S. can help to achieve in harmonizing the insurance laws of the various states to promote uniformity;
- State receiverships of insurance companies have a number of unique characteristics, which historically have been the province of the states; the Committee opposed "incorporating insurers into the Federal Bankruptcy law or into the specialized insolvency regimes of Federally-regulated entities" such as banks;
- Policyholder priority over other claimants in a liquidation and the need to continue protecting the status of "separate accounts" underpinning some products such as variable insurance and annuity products should be maintained; and
- Any future Federal regulators of insurance should not " impose or enforce requirements but rather...work collaboratively with the entities they regulate in an effort to understand their businesses, limitations, strengths, weaknesses and concerns."

Of interest to the federal vs. state regulation of insurance argument is the discussion in the Bar Comments with respect to the problems caused by the provisions of Dodd-Frank relating to non-admitted or surplus lines insurance. Under Section 521(a) of Dodd-Frank, no state other than the home state of any insured may require payment of any premium tax for non-admitted insurance. States "may" establish procedures to allocate among other states the surplus lines premium taxes paid to an insured's home state. Dodd-Frank further provided (§ 521 (b) (1)) that Congress "intends" that each state adopt "nationwide" uniform requirements, forms, and procedures providing for the allocation of the premium taxes among the states. The legislation, however, did not set forth the method of allocation to achieve such result. Accordingly, two competing "compacts" as well as a possible compromise are contending for support among various states with some large states like New York reluctant to join any side for fear of losing tax revenues. This uncertainty affects not only surplus lines producers and insurers but also potential policyholders with difficult risks to place due to regulatory confusion and uncertainty from potential tax liabilities, which might impede the placement of needed coverage.

...Against the background of Director McRaith's comments before Congress and the December 9, 2011 Industry meeting, it is currently impossible to conclude whether the FIO will opt for more federal regulation.

Reading the Tea Leaves

Against the background of Director McRaith's comments before Congress and the December 9, 2011 Industry meeting, it is currently impossible to conclude whether the FIO will opt for more federal regulation. It is important to note that Deputy Wolin made it clear that "Nothing in the Dodd-Frank Act alters the fact that insurance is fundamentally regulated by the states."

It is clear, however, that change is coming as Director McRaith made clear at the December 9, 2011 conference:

The question is not whether, but how, we can improve and modernize regulation in the U.S. We don't expect everyone to walk out holding hands. What we do expect is a lively discussion of the issues facing the industry. See FIO to Develop and Coordinate Insurance Policy at the Federal Level. http://www.insuranceregulatorylaw.com/2011/12/fio-to-develop-and-coordinate-insurance.html. ●

Notes

1. After only four months on the job, Director McRaith, in written testimony before the House Committee on Financial Services Subcommittee on Insurance on October 25, 2011, characterized the FIO as follows:

"My aspiration is to develop a foundation of interaction between the FIO and State regulators, to establish customs and practices that best serve the United States, our economy, the insurance industry and consumers….Per the Dodd – Frank mandate, the FIO will monitor all aspects of the insurance industry, including identifying issues or gaps in the regulation of insurers that could contribute to a systemic crisis in the insurance industry or the United States financial system; assess the accessibility and affordability of insurance products to minorities, low – and moderate – income persons, and underserved communities; coordinate federal policy in the insurance sector, and offer its expertise to the Financial Stability Oversight Council..." (http://www.treasury.gov/press-center/press-releases/Pages/tg1339.aspx)

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The AIRROC Board of Directors continually takes a step back to look at this association and to ask ourselves how we can be better and more valuable to our members. We are unique in our approach to finding solutions to resolve issues entangled in our legacy books. The results are savings through smart settlement of the claims.

We are special because we foster relationships between counterparts and educate through cutting edge topics presented not only during our October commutation event but during our membership meetings. Member participants who do not regularly attend all of our meetings are missing out! Through attendance, members gain incredible knowledge of current happenings not only in the U.S. but in the UK and Europe. The Education Committee's challenge is to remain informed on new issues facing legacy books so that we can present them to you. Feedback during the education sessions can be quite stimulating and valuable.

While some are aware of the positive response to using the DRP (Dispute Resolution Procedure), our hope is that more will see the value in using this cost efficient and expedient process. We are planning an article for the next edition that chronicles the experiences of those who have used the DRP. The procedure can be found on our website, www.airroc.org. We currently have 63 AIRROC approved arbitrators of which 47 are ARIAS certified. Members have access to the arbitrator list posted to our website.

As mentioned in my message in the Rendez-vous Edition of "AIRROC Matters," this edition contains comments received from our members who were interviewed last summer and fall.

Thank you to Jeff Mace (AIRROC Legal Counsel) and Larry Schiffer of Dewey & LeBoeuf for accommodating us all these years by hosting our meetings in their offices and providing us with delicious lunches.

Again, thank you to our Publications Committee who continues to pound out one great newsletter after another. Since I participate on their monthly calls, I fully understand the great deal of work the committee members put forth to keep our newsletter interesting and informative. Should any of you wish to author an article, please contact our Editor-In-Chief Peter Scarpato at peter@conflictresolved.com. We welcome your input, particularly since by working together, we gain an informative and broad prospective.

We would like to ask for your help as we strive to continue to grow our membership. In your conversations with others who are not AIRROC members but could benefit from membership, please encourage them to contact me or any board member to discuss our association and perhaps join us. The more experience we have on board, the better.

We look forward to seeing you soon! ●

Trish Getty is AIRROC's Executive Membership Director and a member of the AIRROC Matters Publications Committee. She has been active in the insurance/reinsurance industry for over 40 years. trishgetty@bellsouth.net

What's on Your Mind?

AIRROC Membership Survey

Throughout August, September and October, I interviewed well over sixty AIRROC member participants. The AIRROC Board of Directors and I thought the interviews would give us more insight into what our members find valuable.

We also sought out replies to other questions as set forth below. I hope you enjoy reading the answers as much as I enjoyed my conversations with the members, most now old friends.

Remember, that we are always ready to listen to our members and will carefully consider all suggestions.

In a nutshell, it appears that we are doing well. Whew!

Trish Getty

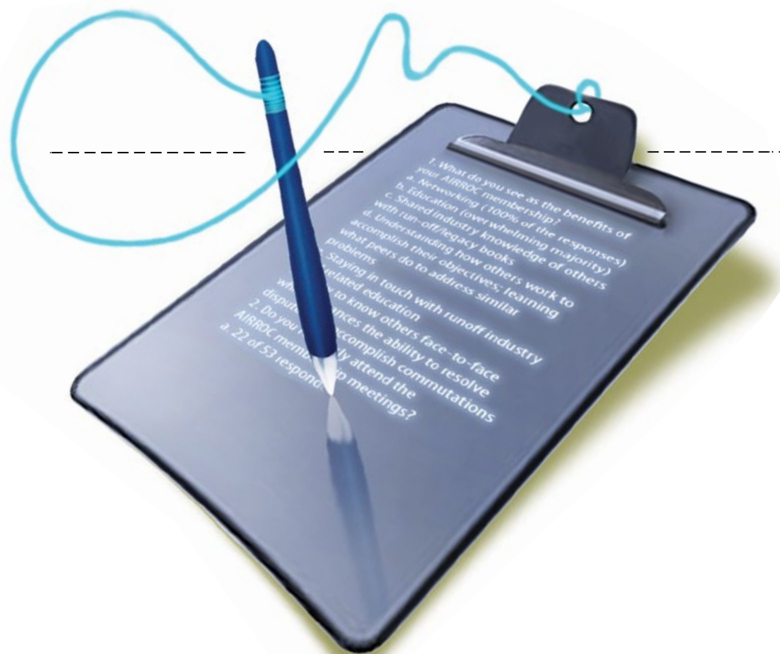

illustration / Myers Creative

1. What do you see as the benefits of your AIRROC membership?

a. Networking (100% of the responses)
b. Education (overwhelming majority)
c. Shared industry knowledge of others with run-off/legacy books
d. Understanding how others work to accomplish their objectives; learning what peers do to address similar problems
e. Staying in touch with runoff industry and related education
f. Ability to know others face-to-face which enhances the ability to resolve disputes and accomplish commutations

2. Do you regularly attend the AIRROC membership meetings?

a. 22 of 53 responded "Yes"
b. If not, budget or time concern were the conflicts

3. Are you aware of the Dispute Resolution Procedure?

All interviewed responded "Yes"

4. Do you know about the results of those who have used the DRP?

16 of 51 responded "Yes"

5. Have you used the DRP? Most said "no" because:

a. The right situation to use the DRP has yet to present itself
b. Few disputes
c. Inability to convince opposing party to agree to use the process

Note: Nearly all felt the concept is excellent. Suggestion of regional programs for a mock DRP were received since it would, in all likelihood, make parties feel more comfortable about the process.

6. Would you recommend the DRP to others?

The few who have used it said, "Yes"

7. Would you recommend AIRROC membership to others with legacy books?

Definitely "yes."

8. Are you aware of the AIRROC Regional Education programs?

The overwhelming response was "yes" but some did not know they were held or the topics presents. Those who attended or sent staff were quite positive in their responses.

9. If so, is there a topic/s that your company would benefit from by AIRROC holding a regional education program in your city or one nearby?

a. LOC's, trust agreements, collateral requirements, what in lieu of LOC's?
b. Understanding the LPT's, the players and how to price
c. How to read and understand Schedule F
d. Mock DRP
e. How to commute residual WC using mortality rates and other considerations
f. Small balance issues, how to resolve, how to finalize old treaties in a reasonable fashion
g. How to finalize longtail claims
h. Where is the next generation of run-off coming from? Regulatory related?
i. Mutuality concerning acquisitions since there may be some case law lurking regarding the setoff right
j. Solvency II
k. Current European initiatives
l. Any topic related to longtail

10. Are you aware of other benefits of AIRROC membership such as discounts on registrations that AIRROC arranges with certain conferences?

Surprisingly, few remembered. It was pointed out that if a member sent many employees to conferences, that alone could pay for the annual AIRROC membership fee.

11. Do you or your staff attend the October commutation event?

60% interviewed replied "yes." Some replied "no" since they do not want to send a message that they are in the commutation mode. A handful said "no" because they had no disputes.

12. Do you find "AIRROC Matters" valuable, useful and informative?

100% responded "Yes."

13. Can you suggest any changes you would like to see in "AIRROC Matters?"

All responded "no."

14. Do you find the AIRROC website informative and useful?

It was surprising to learn that few use the website. If accessed, it was to determine meeting dates, register for meeting attendance and to view delegates attending.......

Other general comments:

1. Suggestion of one half-day education session to delve deeper in the topics presented.
2. Encouraging as many as possible in-house staffers to the October commutation event.
3. Add testimonies from those who have used it on the website.
4. AIRROC was needed fifteen years ago.
5. Just keep doing what you are doing. ●

A Sit Down with Torti and Lee on GTE Re

AIRROC Matters Editor Peter Scarpato and Publications Committee member James Veach sat down with Joseph Torti, III, the Rhode Island Deputy Director and Superintendent of Insurance and Banking and Gary Lee, Partner at Morrison & Foerster, to get their perspective on Rhode Island's Voluntary Restructuring of Solvent Insurers statute, R.I.G.L. 1956, Title 27, Chapter 14.5 ("Act"). Enacted in 2002 and effective in 2004, the Act immediately attracted several run-off entities to Rhode Island, but had yet to be applied to a restructuring plan. As our readers and AIRROC Rendez-vous attendees know (see A. Rothseid, "The Rhode Island Solution," AIRROC Matters, Fall 2011, and "U.S. Solvent Designers Share AIRROC Run-off Award," AIRROC Matters, Rendez-vous Edition 2011) that changed last year when Providence County Superior Court Judge Michael Silverstein approved GTE Reinsurance Company Limited's (GTE Re) Commutation Plan.

This interview covered the Act, the GTE Re Plan, and a challenge to the Plan. Mid-interview, it was announced that an appeal from Judge Silverstein's decision had just been withdrawn, closing the door on any appellate argument before the Rhode Island Supreme Court (see, In re GTE Reinsurance Company Limited, C.A. No. PB 10-3777 [R.I. Super. Ct. Jan. 12, 2012]).

We wish to thank Commissioner Torti and Mr. Lee for their time and candor during the interview.

Joseph Torti III , Rhode Island Deputy Director and Superintendent of Insurance and Banking

Jim: *Mr. Torti, please start us off with background on the Restructuring Act.*

Joe: The Rhode Island Insurance Development Task Force first proposed restructuring/commutation plan legislation to make Rhode Island a more attractive domicile for insurance companies. The Task Force included Rhode Island legislators, the Governor's office, regulators, insurance professionals, and attorneys who handled insurance matters in Rhode Island. Members of the Task Force knew about solvent schemes in the U.K. and someone on the Task Force suggested bringing that legislation to Rhode Island.

Peter: *Do you propose to amend the Act or change the approval process?*

Joe: We did recently amend the Act based on what we learned during the GTE Re process. For example, we made it easier to hire consultants and experts to help us review proposed commutation plans. Those amendments passed the Rhode Island legislature last year without any difficulty.

Gary: Any regulator or interested party who wants to see how the Rhode Island process works should also consider the items on the checklist that the Department created as part of its approval process. The checklist does not displace the Act or its related regulations[1], but does highlight what the Department is looking for.

The checklist was created while considering whether or not the Commissioner would approve the GTE Re commutation plan before it went to the Superior Court and then to the creditors. With respect to GTE Re, we looked at issues that policyholders might raise. We considered these issues from a drafting perspective, an economic perspective, and a judicial perspective.

Peter: *Have either of you been asked by regulators in other states to explain how the Act works? Do you have an information package for regulators based on your GTE Re experience?*

[1] Rhode Island Insurance Regulation 68 – Commutation Plans.

Gary Lee, Morrison & Foerster, counsel for the Rhode Island Insurance Department

Joe: We haven't put together an educational package for other regulators. Frankly, it's difficult to get their attention on this issue when there are so many other issues at the top of their agendas.

Jim: *One follow-up question: You participated in the drafting of an NAIC White Paper on alternatives to traditional receiverships entitled* Alternative Mechanisms for Troubled Companies. *Are you aware of any efforts to follow up on the White Paper?*

Joe: I'm chair of the (E) or Financial Conditions Committee at the NAIC. A sub-group of the (E) Committee drafted the White Paper. Nothing is underway with respect to a follow up to the White Paper, although now would be a good time to talk more about alternatives to traditional receivership.

Jim: *How did the White Paper come about?*

Joe: Former Delaware Deputy Commissioner Michael Vild knew about the Rhode Island Act. Mr. Vild, an attorney who had practiced bankruptcy law before joining the Delaware Department, proposed forming a Working Group to explore alternatives to receivership and then added solvent schemes to the mix.

The Working Group got a strong reaction at its initial public meeting. Some of the receivers in the audience – and some of the regulators in the working group – didn't like solvent schemes. Frankly, when we began development of this statute in the late 1990's, I myself didn't know that much about solvent schemes or how the Act would operate.

After many meetings of the working group, attitudes softened. Although the White Paper didn't come out the way I would have written it, the paper is a good source of reference materials on Part VII transfers, New York's Regulation 141, schemes for solvent and insolvent companies, and other mechanisms and alternatives to receivership.

Please note that it's not as if there are *no* discussions underway about alternatives to traditional receiverships within the NAIC. But so many other things are being dealt with by the (E) Committee that we have not had an opportunity to reactivate the White Paper working group.

Peter: *Refocusing on Rhode Island, have applications to redomicile to Rhode Island increased as a result of GTE Re?*

Joe: When we first passed the Act several years ago, I received many calls and emails asking for information on the Act. After a couple of years, that interest faded. Since GTE Re, however, we have seen an increase in interest.

Jim: *Is there a particular kind of company that calls or shows interest? Do you believe that the Act works better for a pure reinsurer than a company that unites direct business and also assumes reinsurance?*

Gary: Let me address the latter question first.

If you were to go back and look at the history of solvent schemes of arrangement in the U.K., you would find that the first schemes involved companies with a small number of creditors, typically reinsurers with less complex capital structures, certain types of claims, and fairly mature run-off books. The people that I have spoken to recently who are interested in the Act look a lot like GTE Re.

The same thing that happened with solvent schemes in the UK will happen with the Rhode Island Act. People will become more comfortable with the Act and how it works, a body of information on how the Act works will develop, and the Department's processes will evolve.

Joe: It's obviously easier to prepare a restructuring plan for a pure reinsurance company. That's why we're glad the first company to propose a plan did not write direct business. All of GTE Re's creditors were professional insurance companies

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A Sit Down with Torti and Lee on GTE Re (continued)

and most of them understood the process.

Nevertheless, the Act also works for direct writers who have been in run-off for an extended period of time. I don't think the Act would work that well for a company that's just gone into run-off or has a large amount of primarily personal lines business.

That said, the Act allows a company to segregate its commercial business and, as Gary noted, as we do more of these, we will handle more complex transactions.

Peter: *Let's shift back to GTE Re. Odyssey Re objected to the plan and its objections focused on the contract clause. Did you anticipate any objections based on something else, for example, classes of creditors?*

Gary: We didn't anticipate an objection based on class. That goes back in part to the checklist that the Department followed before the GTE Re redomestication and then the commutation plan itself.

We looked at whether one class or two was appropriate and did so on both a legal and an actuarial basis. We looked at the business that GTE underwrote. We looked at whether the claims had commonality and did so as part of an actuarial review of the development of the losses and IBNR.

We also did as much testing as we could on whether there were pure IBNR creditors and if so, how many. Then we looked to see whether having more than one voting class would be consistent with the Act and the regulations.

Based on our actuarial review of the book, we concluded that a separate class would be inappropriate, particularly given the commonality of the claims, the nature of the reinsurance business, and the lack of substantial, pure IBNR creditors.

We were also concerned that if we created another class, it might give rise to a veto where none was warranted. At the end of the day, this was all laid out before Judge Silverstein at the initial hearing. We weren't surprised that no one challenged the lack of a second class. We felt that if a request for a second class of creditors had been raised, the Court would have denied it.

Peter: *Did you anticipate any other objections?*

Gary: No. This was the test case for the Act, the amount of analysis that went into the plan's structure and economic provisions was such that we believed nothing in the plan would innately draw an objection.

If there were going to be an objection, we assumed it would come down to a fundamental challenge as to whether or not there should or shouldn't be restructuring plans in the U.S. for solvent insurers or reinsurers.

Jim: *GTE Re had many cedants and many of those cedants were located outside of the US. Did it help or hurt that some of these entities were located in jurisdictions that for years had solvent schemes?*

Gary: Having cedants who had experience with solvent schemes of arrangement in other jurisdictions helped GTE Re and limited the number of objections. People familiar with this process understand that you can achieve reasonable or even better commercial outcome with a solvent scheme.

Joe: Don't forget that GTE Re was originally a Bermuda company. As a result, many cedants were familiar with Bermudan solvent schemes.

Peter: *You did elicit objections from U.S. cedants Odyssey Re Clearwater Insurance Company and Hudson Insurance Company (Odyssey). How will that appeal come out?*

Gary: Well, this is recent news. Odyssey/Clearwater have settled their claims with GTE Re. So, Judge Silverstein's opinion will simply stand as is.

Joe: I'll add that if the appeal goes no farther, the Court wrote a well-reasoned decision that will serve as precedent in Rhode Island. If the appeal did proceed, I think that the decision would be upheld in the Rhode Island Supreme Court.

Jim: *Has the Act created any jobs in Rhode Island? Has the Governor's office congratulated you?*

Joe: I can't say that the Act created lots of jobs in Rhode Island, but it certainly created some jobs and kept other jobs here. As I previously pointed out, we had companies in run-off redomicile to Rhode Island. The number of insurers domiciled in Rhode Island would have been much smaller than it is right now, without the Act.

The Act made the industry aware that Rhode Island is not afraid of run-off. We want Rhode Island to be a center of excellence for run-off and other types of alternative structures much like Vermont, casts itself a jurisdiction that welcomes captive business. We have had several companies redomicile to Rhode Island since passage of the Act and they recognize that regardless of whether they propose a restructuring plan today, the solvent schemes option is always available to them.

With respect to Governor Chafee, we have spoken to the Governor's staff about GTE Re and they're excited over this development. We've also spoken to members of the legislature who've been following the Act from the beginning and they're also pleased. Going forward, we have lots of support from the Governor's office and the legislature.

Peter: *I want to focus on something that you alluded to before, the* BAIC *and* Scottish Lion *decisions. Did they have any relevance with respect to GTE Re?*

Gary: Yes, we looked at both the *BAIC* and *Scottish Lion* cases, as well as the cases in between and after. We wanted to make sure – hearkening back to the point I made earlier – that we had the ability to engineer, through our checklist, best practices for any entity looking to promote a commutation plan in Rhode Island – practices that they would follow.

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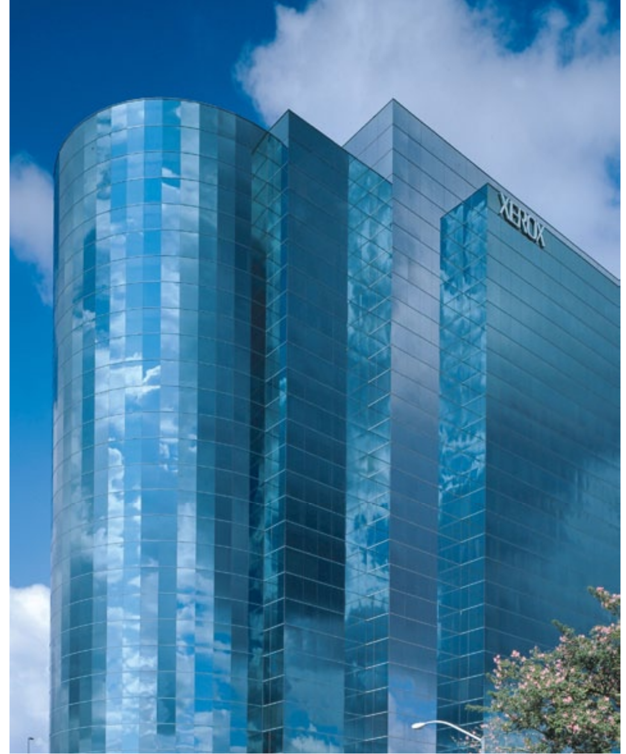

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A Sit Down with Torti and Lee on GTE Re (continued)

We looked at the criticism that emerged from these cases and the commentary on the cases. We specifically considered non-manipulation of classes, reversion to run-off, disclosure of fees, and overall clarity. In large measure, our checklist is based on the criticisms that came out of the *BAIC* and *Scottish Lion* cases.

Peter: *Will the Rhode Island Department issue be quarterly or other periodic reports about the progress of the GTE Re plan?*

Joe: We receive periodic reports from GTE Re, obviously. If Odyssey Re appeal goes to the Supreme Court, you will hear from us. Other than that, we don't plan on continuing to pass along reports on GTE Re.

Peter: *One last question: can you predict where solvent schemes will stand ten years from now, both in Rhode Island and in the rest of the United States?*

Joe: We hope that in ten years Rhode Island will have completed many successful restructuring plans and as a result, we will see similar legislation adopted in other states. If these schemes are done correctly, they are an excellent alternative to run-off and can be good for regulators, policyholders, creditors, the company itself, and its owners.

I don't know whether schemes will ever spread in the U.S. to insolvent companies as they have in the U.K. and other jurisdictions. We've got a well-tested liquidation process for insolvent companies in the U.S. and I doubt that schemes or restructuring plans for insolvent insurers will become as prevalent here as they are abroad.

Peter: *We thank you both for your comments and your time.* ●

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ALERT
KPMG LLP (UK)

Edition No. 37

Policyholder Support Alert

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

Solvent Schemes – Recent Developments

TOKIO MARINE EUROPE INSURANCE LIMITED ("TOKIO MARINE")
The bar date for the above company's Scheme of Arrangement passed on 12 October 2011. Further information is available on www.TMEISCHEME.com.

Insolvent Estates

HIGHLANDS INSURANCE COMPANY (UK) LIMITED (IN ADMINISTRATION)
The Scheme for the above company's reinsurance creditors was approved at the Meeting of Creditors held on 10 August 2011. The Scheme became effective on 22 September 2011 and the bar date has been set as 20 March 2012. The Scheme for the company's direct insurance creditors was terminated on 22 September 2011. Further information is available on their website www.ukhighlands.co.uk.

ENGLISH & AMERICAN INSURANCE COMPANY LIMITED
The scheme payment percentage for the above company was recently increased from 35% to 40% and uplift payments are currently being issued to creditors.

SOVEREIGN MARINE & GENERAL INSURANCE COMPANY LIMITED
The scheme payment percentage for the above company was recently increased from 85% to 97% and uplift payments are currently being issued to creditors.

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

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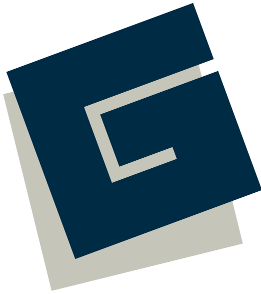
News & Events

Nigel Curtis

Grafton Europe closes



Grafton Europe, launched in December 2009 to take on long tail liabilities of European captives, has put its liabilities into run-off. The Guernsey-based company, licensed in Malta, had a quota share partnership with Berkshire Hathaway and marketed itself as the first A.M. Best A- rated insurance company to specifically focus on the European captive insurance industry.

In November 2011, A.M. Best down–graded Grafton (Europe) Insurance Company's rating to B++ and concurrently withdrew the ratings due to the company's request to no longer participate in A.M. Best's interactive rating process after their decision to put the current liabilities into run-off. The Grafton Group now intends to focus on the US self-insurance market.

Old Lyme runoff acquired by Sirius

White Mountains Solutions, the specialist runoff subsidiary of Sirius Group, has acquired the run-off loss reserve portfolio of Old Lyme Insurance Company Limited from Fairfax Financial Holdings. The novation of the Bermuda reinsurer's $23 million loss reserves was closed on December 30, 2011.

The deal with Old Lyme, which has been in runoff since 2008, is the seventh run-off acquisition by White Mountains Solutions.

ARC proposed name change

Following consultation with its members, the Association of Run-Off Companies (ARC) has announced that the organization has obtained in-principle permission from the UK Financial Services Authority and Companies House to change its name to Insurance and Reinsurance Legacy Association Limited (IRLA).

The change is subject to a forthcoming Extraordinary General Meeting at the ARC Congress 2012, to be held on June 14 at the Grand Hotel, Brighton.

PEOPLE

AIRROC Board Member **Mike Fitzgerald** has joined Devonshire as Vice President of Business Development. Mike previously was President and CEO of Global Resource Managers, where he spent 15 years building and heading up CNA's discontinued business.

Prior to that, he held senior level financial roles with the Continental Insurance Company. Devonshire provides insurance and reinsurance consulting services to U.S., Bermuda and London entities, including acquiring and managing discontinued business, audits and inspections, due diligence, internal operations and compliance reviews, commutations, litigation support and financial management support.

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

Earning our STRIPEs

Three years ago, coupled with a consultancy assignment looking at the cost of managing legacy business and Tawa's own frustrations with the growing frictional costs of processing (re) insurance business, Tawa started to look at how technology could provide the answer. Steve Street, a Director of STRIPE picks up the story...

That insurance and reinsurance processing is inefficient is probably not headline news to anyone. The frictional costs of doing business in our industry erode the premium dollar, making the products more costly for the buyer while cutting into wafer thin margins for the seller. It was this conclusion that led us to consider how we could introduce a technology solution, initially for our own businesses to help simplify a complex and over engineered process (particularly when it comes to long-tail claims) and mitigate costs; costs driven up by a range of factors whether it's too many touch points in the system, too many hand-offs, too much reconciliation, or simply too many inconsistencies.

The result was the development of STRIPE (Straight Through (Re) Insurance Processing Environment). STRIPE is a web-based platform enabling insurers and cedants to deal with their (re)insurers directly, reducing re-processing of data. STRIPE supports the single keying of data and allows rapid, secure and evidenced delivery of transactions to all worldwide markets. It significantly improves cash flow through instantaneous notification to (re) insurers, eliminating backlogs and other inefficiencies associated with traditional claims collection processes.

Not for the want of trying

The (re)insurance industry is often derided for its failure to come to grips with technology and its history is littered with the remnants of IT initiatives that failed to deliver because they were simply too ambitious, too complex, or just too costly to implement. Perhaps though we shouldn't be too hard on ourselves; this is after all a complex business environment we operate in. Legacy business can have tails of 40 or 50 years and records, often made up of fixed data and unformatted text, need to be maintained for up to 80 years. This complex market processing has led to the development of a multiplicity of in house systems which, because of the significant investment made in them, have had a longevity way beyond the norm. And because of that investment, it is of little surprise that many organisations stick to what they know given the perceived risk and exposure to their operations of moving to new systems.

None of this should be a barrier however to improving the time it takes to speed up collections and notifications or for finalizing settlement and commutation. Issues like these led us to start thinking about how we could develop a solution to effectively speed up the processing of legacy claims between cedant and reinsurer.

Taking the first step

In 2009, Tawa plc committed to the idea of developing STRIPE. At first we simply presented a model of what we were proposing, and asked the market what their reaction would be if they could use a system that did x and y. As we moved forward to a working prototype, we set up a user group to help us with the functionality and look and feel of the design so we could be sure that what we were developing was along the right lines.

The result, officially launched in 2010 at Monte Carlo, was STRIPE, which went live for our own businesses in that year. Subsequently, since we offered it industry wide, we have seen an increasing number of companies adopting STRIPE. Today there are nearly 150 companies connected to the system.

Rapid and transparent delivery

So what exactly is STRIPE and what does it offer? As previously mentioned, STRIPE enables the processing of claims and other post placement transactions directly from the insured or reinsured to its (re)-insurers. Though developed initially off the back of our own needs in the legacy space, it is now proving just as effective for current and future business, offering distinct time and cost saving advantages. These improvements have generated a growing interest across the live market.

In effect, STRIPE figures out the connectivity issues between parties and delivers the information to and from those parties via the web. It is able to work directly with all markets including the London Market through ECF (the London market electronic claim file initiative) and CLASS (claim loss advice and settlement system), where it has been necessary to involve a London based broker in the process. STRIPE is also capable of transacting Acord messages, an internationally

photo / Rafael Edwards

recognised standard of messaging in the (re)-insurance market. This level of universal connectivity is critical.

Removing layers of process and cost

Ultimately STRIPE works to remove layers of process and cost wherever your business sits in the (re)insurance chain.

Benefits to insureds and reinsureds include:

- complete control and transparency
- improved cash flow;
- a single platform to access all markets and brokers;
- the opportunity to replace a non-performing broker on legacy business;

while for new business...

- an insured or reinsured can focus the broker on value-added activity such as placement.

For brokers, the benefits include:

- reducing processing costs (or even eliminating them) alongside increased efficiency;
- better client servicing as automation eliminates the need for broker re-processing and potential errors;
- potential to control or eliminate long tail processing obligations for legacy business; whilst for new business, an opportunity to focus on what they do best.

As far as (re)insurers are concerned, they will see benefits such as:

- better customer service and enhanced reputation;
- reduced processing costs;
- standard presentation of claims;
- reduced exposure to dormancy particularly from legacy business.

Using the system

So far, feedback from the market has been very positive. Examples of uses for STRIPE in the market:

- a cedant has adopted STRIPE to replace a traditional broker replacement contract enabling them to make significant cost savings;
- a broker has been able to reduce the cost of servicing business by utilising STRIPE;
- it has provided an International broker with the ability to transact directly in to the London Market, eliminating London broker processing costs, surely a good thing for the long-term health of the industry;
- a reinsurer using STRIPE has reported a significant reduction in processing costs whilst achieving improved speed of transaction and communication with its clients.

STRIPE does of course provide the option to reduce or eliminate the broker's involvement in processing, and most brokers prefer not to be weighed down by the burden of back office processing long after any brokerage or commission has been banked. Brokers clearly prefer to concentrate on the areas where they add value — namely in the identification of risks, structuring programmes, placement and, claims advocacy if issues arise. The burden to the broker balance sheet in balancing the cost of processing versus adding true value to the (re)insurance transaction is becoming increasingly unsustainable and is even further exacerbated when looking at legacy portfolios where the client relationship is no longer current.

Embracing the challenge

So what are the challenges to market wide adoption of a system like STRIPE? Top of the list is probably tradition – and our industry is steeped in it – which can make it hard to persuade companies to adopt a new approach. People have a way of doing things and can be apathetic, if not resistant to change. Sufficient market volume however can create critical mass and with nearly 150 organisations now using and communicating through the STRIPE platform, that may be enough to persuade many that the risk of adopting a new approach is minimal and the potential upsides significantly outweigh any perceived risk.

A global approach

Global rules, not local standards, are critical, and the adoption of ACORD standards, for instance, has opened the door to initiatives like STRIPE. The good news is that this standardisation should see hubs like STRIPE competing for business, while market participants use their leverage to obtain greater functionality and even more value.

It's been a long time coming, but with the advent of initiatives like STRIPE, we can at last say that the market is finally starting to realize real progress on how it uses technology to strip out those frictional costs. ●

Steve Street, a Director of STRIPE Global Services Ltd., has over 30 years experience in reinsurance management positions in brokers and (re)insurers, focusing on reinsurance, claims, consulting and business development.
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Tackling Run-Off from the Cradle to the Grave

Tolga Urkun

Tolga Urkun at Pro Insurance Solutions on taking the WFUM Pools from run-off through to a scheme of arrangement.

The recent declaration of a 97% payout by KPMG, the Scheme Administrators of the Sovereign Marine & General Insurance Company ("Sovereign"), is rightly seen as a triumph of how to manage a highly complex insolvency. However this is only half the story, which has its origins in the Willis Faber (Underwriting Management) Limited (WFUM) Pools. The ability for Sovereign to declare such a high dividend percentage was in large part due to the continued unified management of the WFUM Pools, which kept pool members together, generating benefits and efficiencies, ultimately to the advantage of the creditors.

Sovereign was incorporated in 1880 to insure plate glass and was underwriting several classes of business since the 1900's. Willis Faber & Dumas Limited was set up in 1920 and acted as underwriting agent to a number of insurance companies, both in the UK and overseas, including Sovereign. This then became WFUM in 1972. A further agency, Devonport Underwriting Agency Limited, was set up in 1982. It ceased underwriting in 1985 and the administration was taken over by WFUM. The WFUM Pools went into run-off in 1991. Sovereign (which had the largest participation at approximately 50% of the estimated liabilities) entered provisional liquidation in July 1997. The administration of the WFUM Pools was maintained on a unified basis and Pro was appointed run-off manager on 12 August 1998 (subsequently taking on the role of Scheme Manager).

The WFUM Pools' structures were some of the most complex ever seen in the London market with thousands of underwriting stamp and year combinations across a wide spectrum of business classes. Add to that the highly complex and intricate intra-pooling reinsurance arrangements and it is clear that the run-off challenge was significant.

Keeping it together

Having been appointed as run-off manager, one of Pro's first priorities was to work with Run-Off 1997 Ltd, the successor to WFUM, to ensure that the pools were kept together and pool members did not splinter and go their own way. A key component was to ensure all pool members were managed fairly. IT systems providing clarity played a critical role in this process. Pro developed bespoke IT systems capable of managing the complex pooling arrangements.

> *The WFUM Pools' structures were some of the most complex ever seen in the London market with thousands of underwriting stamp and year combinations across a wide spectrum of business classes.*

Handling the financial accounting in a pooling arrangement is also very complicated, even more so in run-off, and particularly where one member is insolvent, which leads to different drivers and objectives. Managing relationships with third parties such as client auditors was again critical.

The success of the run-off however was underpinned by an effective claims management process, resulting in over 1,000 policy buy backs and commutations, and a managed reinsurance recovery process, including 500 reinsurance commutations.

Managing and Adapting to Specific Challenges

An example of the many challenges managing a pool such as WFUM was that, owing to the insolvency of the lead insurer, there was limited access to market appointed attorneys or their reporting. Nevertheless, the need for taking consistent, reasonable and robust coverage defence positions / claims agreement criteria remained. Critically, this required the maintenance of a highly qualified team of claims experts conversant with the market issues and practice, able to understand and analyse claims in detail and provide a unified, robust and fair claims agreement process despite the added challenges of varying objectives of pool members.

A further challenge was ensuring the protection of all pool members' reinsurance assets. The hesitancy/unwillingness of reinsurers to agreeing to collections from a pool with an insolvent underwriter together with the lack of motivation from the brokers to continue to support a complex pool in run-off was leading to heightened threat of time bar. Many of the reinsurers could not distinguish between balances due to Sovereign and the solvent pool members in their records. This necessitated the maintenance of a highly qualified credit control team able to engage with reinsurers (from all corners of the world), presenting and protecting WFUM's assets with commitment to proactive enforcement and recovery. This was achieved in a number of ways such as commutation agreements, cash settlements, structured set-offs, agreement of claims without settlement coupled with standstill (hold harmless)

Tolga Urkun is a senior manager at Pro. He has developed specialist expertise in management and closure of pools including the implementation of both insolvent and solvent schemes of arrangement. tolga.urkun@proisinsurance.com

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Tackling Run-Off from the Cradle to the Grave (continued)

agreements to allow for future set-off and, in case of reinsurers' insolvency or scheme process, submission and defence of proof of claims.

Because many multinational pool members also underwrote business outside the WFUM Pools (and in some cases continued to do so) the reinsurers have relationships with the pool members outside WFUM. This necessitates effective and clear communications with the pool members, which not only protect the members' reinsurance assets but also protect reputation and on going business relationships.

Scheme of Arrangement

The scheme phase, with the move to an initial reserving scheme of arrangement for Sovereign, became effective in January 2000 while the cut-off Schemes for pool members were sanctioned and became effective and binding in 2007 with a Bar Date in April 2008. The sanction of the WFUM Pools Schemes followed the refusal by Mr Justice Lewison to sanction the Scheme proposed by The British Aviation Insurance Company ("BAIC"). The WFUM Pools Scheme was designed to be fair to creditors and to ensure that the observations made by Mr Justice Lewison in BAIC were addressed.

Engaging with creditors

Recognising that effective communication would be critical, Pro carried out extensive early liaison with policyholders, working closely with Run-Off 1997, KPMG, the pool members and their advisers. The aim was to ensure the terms and the design of the scheme was transparent.

Managing pools is a complex business, which demands high levels of expertise and use of bespoke IT solutions.

First contact

Apathy on behalf of policyholders can be a major problem and getting their engagement at an early stage is a key part of any scheme of arrangement. The courts and the companies affecting the scheme of arrangement are keen that every effort is made to contact creditors. Pro endeavoured to speak to as many as possible to help them understand how the proposed process would affect them and what it would mean if the company was closed. As a result of this communications strategy, this scheme received substantially more votes, both in number and as a percentage of policyholders, than any other scheme before it, demonstrating what can be achieved through a well-crafted process.

In July 2007 the FSA issued a guide to its decision making process in respect of insurance schemes of arrangement, which again emphasised the importance of fair treatment of policyholders and clear communication. The steps taken in the WFUM Pools Scheme provide useful precedents in meeting those FSA requirements.

Key Lessons for a Pool Run-Off and a Successful Scheme

Managing pools is a complex business, which demands high levels of expertise and use of bespoke IT solutions.

When pools enter into run-off, the complexity demands a high level of communication between the run-off manager and all the pool members and the accompanying advisers, auditors and regulators.

Managing pools in run-off presents specific challenges, which are further complicated by insolvency of pool members. These challenges can be overcome by carefully structuring teams with specific knowledge and skills.

When members of a pool enter into schemes of arrangement, the need for specific expertise, bespoke tools, strategic planning, project management and communication skills become even more prevalent.

Provided the process is properly implemented and executed, the results can be very favourable for all stakeholders.

All of the foregoing contributed towards the high payout of 97% for Sovereign's creditors and a successful closure for the Scheme companies. ●

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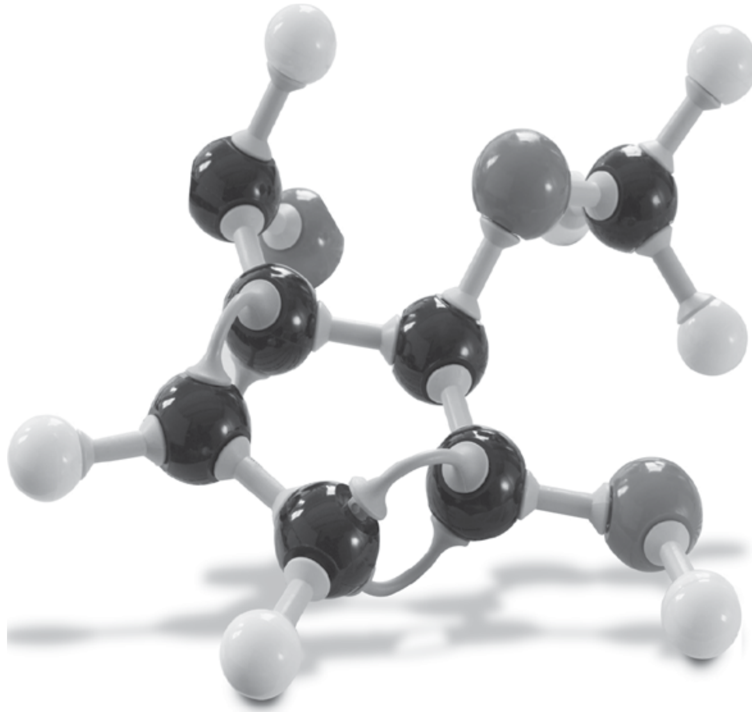

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Consensual Alteration of Arbitration Clauses

Larry P. Schiffer

Complaints about reinsurance arbitration clog conference agendas and fill up the trade publications. Among the complaints are those about the party-appointed arbitrator system, which allows arbitrators to be predisposed to the appointing party; i.e., an advocate arbitrator.

When a dispute arises, often years later, the arbitration provision becomes the primary source of how the dispute will be resolved. If it is the "traditional" arbitration clause allowing for party-appointed advocate arbitrators, the parties will appoint an arbitrator they hope will be predisposed to their position and "vote" their way in panel deliberations.

By adhering blindly to the contract's arbitration provision, parties perpetuate an arbitration system based upon advocate arbitrators, which exacerbates the complaints parties have about the process. This article explores the option of dumping the contract's arbitration clause and crafting a new, external arbitration provision that eliminates advocate arbitrators and uses a neutral panel selection process. This option is open to all, but has more relevance to runoff companies because of the potential savings achieved by switching up the way disputes are heard.

Complaints About the Party-Appointed System

We are all familiar with the myriad complaints about the traditional party-appointed arbitration system. Here are a few. First, there is the arbitrator "interview" process, which some take to an extreme. Potential arbitrators may be showered with documents and information about the dispute in an effort to "educate" them about the righteousness of the appointing party's position. Sometimes this includes (improperly) privileged attorney-work product and attorney-client communications. Efforts to cajole the potential arbitrator into a firm commitment to support the party's position throughout the arbitration also take place.

Second, there are the efforts some parties make to insure that their party-appointed arbitrator will hold sway over potential umpire candidates. This includes "gaming" the system by proposing only one viable umpire candidate (who is thought to be friendly to or more easily influenced by the party-appointed arbitrator) alongside stalking horse candidates that are likely to be struck by the other side.

The conflict between doing the right thing based on a fair and objective reading of the evidence and securing future appointments by adhering to the appointer's position is a very real and very serious problem.

Third, there are the challenges made to the other side's party-appointed arbitrator. These challenges may escalate where the arbitrator is that party's "regular" arbitrator or counsel's "go-to" arbitrator. While it is difficult to challenge an arbitrator appointment prior to the final award, some court challenges are successful. Even where a court challenge is unlikely to work, some parties and counsel think nothing of withholding the hold-harmless agreement if they are concerned about the other side's arbitrator.

Finally, there is the specter of lack of future appointments by that party or counsel if the party-appointed arbitrator does not come through. Party-appointed arbitrators are not the business executives of yesteryear that volunteered to serve the industry by sitting as arbitrators. Most arbitrators do this for a living and need to keep the appointments flowing. The conflict between doing the right thing based on a fair and objective reading of the evidence and securing future appointments by adhering to the appointer's position is a very real and very serious problem. And while we would like to think that our arbitrator friends are above this inherent conflict, it understandably weighs on their minds. This conflict often leads to untoward results or compromise awards so that each arbitrator can say that the result was successful for their side.

The Costs Associated with the Party-Appointed System

The frictional costs associated with arbitrator interviews, a drawn out umpire selection process, court challenges to the selection process or the impasse caused by failing to sign a hold-harmless, and the results of over-zealous advocacy by party-appointed arbitrators in the deliberation room to protect the prospect of future appointments is enormous. While there are good reasons why selecting an arbitration panel takes time, it should not take months or years. When an inordinate amount of time is spent on these machinations, precious resources are diverted from resolving the actual dispute. And while some may say this is money well spent if the right party-appointed arbitrator is paired with the right umpire so as to come as close to guarantying a result as possible, continued gaming the system will only lead to continued dissatisfaction.

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Consensual Alteration of Arbitration Clauses (continued)

One only has to look at some recent court cases where months and sometimes years have been spent on preliminary challenges to the composition of the arbitration panel. Repeated trips to court before a panel is even constituted are a huge cost for parties to incur. But parties have been incurring those costs because the alternative of appearing before a panel that is favorably disposed to the other side may be more costly.

Are Neutral Panels the Answer?

The argument for neutral arbitration panels is not new. We have been advocating for brokers and parties to use neutral panel clauses and selection mechanisms for years. See Mirror, Mirror on the Wall, ARIAS•U.S. Quarterly, Vol. 17, No. 4 (4th Quarter 2010); Leveling the Playing Field: An Analysis of Neutrality Issues in Reinsurance Arbitration, ARIAS•U.S. Quarterly, Vol. 13, No. 1 (1st Quarter 2006). A neutral panel takes the little devil off the shoulder of the arbitrator and allows each arbitrator to do what arbitrators are supposed to do in the first place: decide all matters justly, exercising independent judgment, without any outside pressure affecting the decision. See Code of Ethics for Arbitrators in Commercial Disputes, Canon V (American Arbitration Association 2004); Guidelines for Arbitrator Conduct, Canon II (ARIAS•U.S.). It is unfortunate, but apparent, that if parties want their disputes fairly and objectively resolved using independent judgment, then the party-appointed advocate arbitrator system must end and a neutral panel system must be installed.

There are many ways to skin the neutral panel cat. In international arbitration neutral panels are standard.Even in US commercial arbitration, neutral panels are typical. The revised AAA/ABA Code of Ethics for Arbitrators presumes neutrality. In the UK and Bermuda, parties appoint arbitrators, but those arbitrators by law must be neutral and independent.

In spite of the outward appearance of neutrality, allowing parties to appoint arbitrators with knowledge of the appointment still conflicts with the arbitrator's duty to act in a neutral, independent manner. Regardless of everyone's good intentions, knowledge of the appointment affects the arbitrator's behavior toward that party's positions even if it is subtle or subliminal.

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The more effective approach is not having an appointing party. Neutral panel selection avoids this issue altogether. Mechanisms exist for selecting a neutral panel. See Procedures for the Resolution of U.S. Insurance and Reinsurance Disputes, Neutral Panel Version (September 2009); ARIAS•U.S. Neutral Selection Procedure. By using a neutral selection process and by requiring all arbitrators to be disinterested, impartial, and neutral, the pressures on party-appointed arbitrators from the traditional system are eliminated. Because arbitrators will not feel beholden to an appointing party, arbitrators will be free to decide disputes objectively and fairly.

Post-Contract Arbitration Agreements

In runoff, disputes arise over contracts negotiated and signed years ago. There is no ongoing business relationship and no prospect of future business (only future disputes, negotiations, and commutations). So what can runoff companies do about pre-existing traditional arbitration clauses? The same thing anyone can do; agree to arbitrate differently (the AIRROC Dispute Resolution Procedure is such an example).

Parties can enter into a new, stand-alone arbitration agreement using neutral party-appointed arbitrators, or better a neutral panel selection process without party appointments, to avoid the problems that continue to beset the traditional system. This is the same as agreeing to settlement discussions or agreeing to mediate, or agreeing to arbitrate where the contract has no arbitration clause.

Conclusion

The advantage here is enormous. Companies in runoff can avoid the time and money spent on appointing the right advocate arbitrator, disputing arbitrator appointments, and suffering nightmare scenarios that often end up in court. Parties can craft an extra-contractual arbitration agreement to avoid problems, streamline the process, or opt into a set of rules to create a private, confidential arbitration that is more economical and efficient than litigation or traditional arbitration, and which has a better chance of an objective and fair outcome. This is a natural solution for companies in runoff.

Of course, it takes two to tango. Both parties have to agree that finding a faster, cheaper, and better way to resolve their dispute is a good idea. This will only work if all parties commit to change and agree to abandon the party-appointed advocate arbitrator way of life. ●

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