ASSOCIATION OF INSURANCE AND REINSURANCE RUN-OFF COMPANIES

AIRROC® MATTERS

A NEWSLETTER ABOUT RUN-OFF COMPANIES AND THEIR ISSUES

Vol. 5 No. 2 www.airroc.org Summer 2009

Message from CEO and Executive Director

Ready, Set, Go!


Trish Getty

By Trish Getty

As I take pen to paper in the dog days of summer in Atlanta, July, 2009, I think about what is **hot** on the minds of most AIRROC committee members these days… the AIRROC/Cavell Commutation & Networking Event set for October 19-21, 2009. Picture little mice running around, working feverishly behind the scenes to arrange and track event registration, hotel matters, AIRROC/Cavell coordination, marketing plans, ramping up our "AIRROC Matters" special Rendezvous edition, finalizing the education agenda for October 19, etc. AIRROC appreciates all of the time, effort, support and dedication of so many who make this event a resounding success year after year. At the end of the day, all will appear seamless… our goal.

Our early thank you to the event sponsors who make our delegates' attendance economically feasible so that we can get business done, close old books and get on with the rest while enjoying one another's company. Thank you.

Please register very soon for the October Event through either www.airroc.org or www.commutations-rendezvous.com.

Meanwhile the AIRROC Legislative/Amicus Sub-Committee "Small Claims Task Force"

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Are You Getting the Most Value from Your Actuary?


Tom Ryan


Jason Russ

By Tom Ryan and Jason Russ

Actuaries play various integral roles in the efficient functioning of the runoff industry. These roles include projecting liabilities, estimating payout patterns, assisting in realizing reinsurance assets, modeling financial results, and pricing commutations. Actuaries may use complex methods to provide these services, and the product of their work may not always be well understood. Misinterpretations or misunderstandings of the results can be costly. This article describes the key disclosures actuaries should be providing with their work product along with frequent items of confusion; references are made throughout to the Actuarial Standards of Practice (ASOPs) that govern actuarial work done in the United States, specifically ASOP #43, which became effective in 2007. We provide pertinent questions to ask your actuary to ensure your understanding of their work. Better understanding will lead to better decision making and will add greater value. To illustrate these concepts, we provide a series of fictional case studies.

Actuaries play various integral roles in the efficient functioning of the runoff industry.

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Notes from Editor and Vice Chair

AIRROC Tops the Charts!


Peter Scarpato

By Peter A. Scarpato

Knowing the demands of a discriminating palette, AIRROC takes pride in satisfying members' desire for education, networking and streamlined ADR processes. Your Publications Committee is ever vigilant to garner and present topical information from experienced sources. Without articles from people like you, we have nothing. As you enjoy another edition, please consider using this newsletter to get valuable information out to your peers.

Now on with the show. After Trish propels us forward with news of upcoming events in *"Ready, Set, Go,"* Tom Ryan and Jason Russ from Milliman submit *"Are You Getting the Most Value from your Actuary?"* Their piece describes critical disclosures that must accompany actuaries' work product and provides you with important questions to eliminate confusion about actuaries' work. For anyone who has stumbled, dazed and confused, out of a meeting with their actuarial colleagues (and I love them dearly), this is a must read.

Art Coleman provides *We're Movin' on Up!* which highlights our upcoming Commutations Event, including but not limited to (lawyer-speak if I ever heard it) our new locale, the East Brunswick, New Jersey Hilton Hotel. The new venue offers more than ever before, including CLE-approved educational presentations, more networking, golf, casino night and comedy club festivities, and, our favorite, the return of The Rendezvous Band!

Keeping us up-to-date on proposed U.S. run-off legislation, Jim Schacht submits *"Enhancing the Insurer Resolution 'Toolbox'."* In Jim's view, AIRROC can enhance important U.S. public policy by adopting the proposed "Uniform Insurer's Run-Off & Resolution Law" – needed help for insurers wishing to wind-up their operations. In his deft analysis, Jim first explains the need for the law, its principles and objectives, and its major provisions, before urging AIRROC's Board of Directors and members to adopt it.

James A. Hall of Huggins Actuarial provides a valuable historical perspective in *"Captive Runoff, History, Outlook, and Perspective,"* tracing the run-off experience of single-parent and group captives and addressing whether special U.S. legislation to assist captive run-off is warranted and if so, in what form?

In *"AIRROC: A Smash Hit in Scottsdale,"* I summarize the well-received panel presentation, moderated by Trish Getty, from this past April's Scottsdale Insurance Insolvency & Reinsurance Roundtable, hosted by H.B. Litigation. The panel included me, Jonathan Bank, Ali Rifai, Michael Zeller and David Brietling. The topics: run-off market solutions, strategies, and options, alternative dispute resolution options, for solvent and insolvent companies, and AIRROC's new Dispute Resolution Procedure. Based upon the audience attendance, participation and feedback - and H.B's request that we all do it again as a webinar on August 18, 2009 – the presentation was a success for AIRROC.

Ben Gonson of Nicoletti Gonson Spinner & Owen LLP graces our Legalese section with *"Recovery of Commutation Payments."* Ben adroitly traces historical American and English precedent on the issue whether commutation payments —

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AIRROC® Matters – In this Issue

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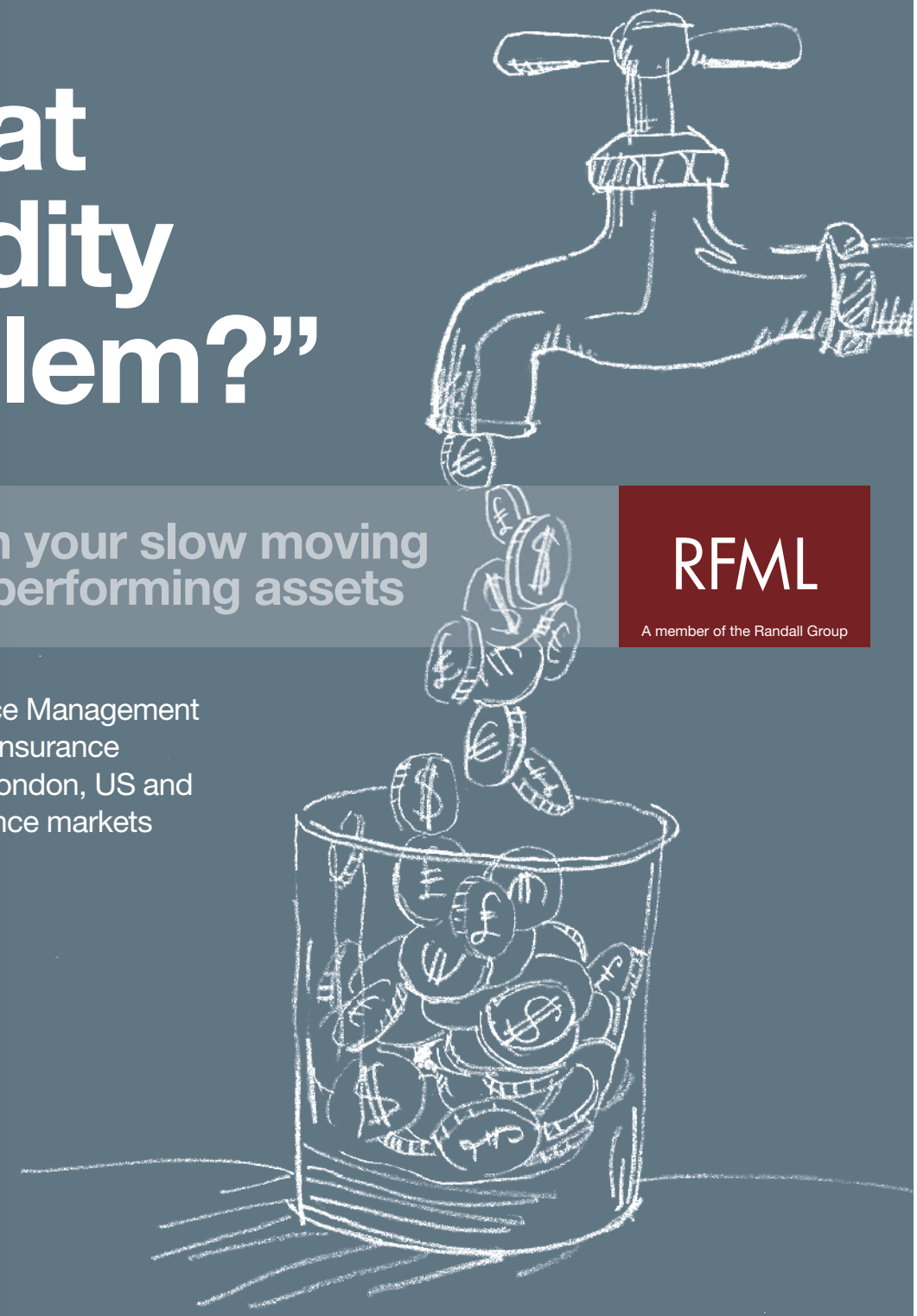
“What liquidity problem?”



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Are You Getting the Most Value from Your Actuary? continued from page 1

Case #1: You are looking to commute a specific contract, and you receive an actuarial report that includes an estimate of the unpaid losses for that contract. Can you rely on the estimate?

ASOP #43 requires actuaries to disclose the intended purpose of use of any unpaid claim estimate. What was the purpose in this case? If the purpose was to provide an overall estimate for financial reporting purposes, it is possible the estimation of results for specific contracts was secondary, done as a rough allocation. This should be viewed differently from the case where an actuary has specifically identified the purpose of the estimate as to provide assistance for the commutation of that specific contract. In either case, the actuarial report should also provide a description of the methodology and assumptions, which would also assist in judging the reasonableness of relying upon the actuary's estimate.

Any user relying on the actuary's work needs to understand that the estimates may have been done in a short time period or with limited access to those with the most knowledge of the book.

ASOP #43 refers to several other disclosures that may also assist. For example, constraints may exist in the performance of an actuarial analysis, such as those due to limited data, staff, or time. If, in the actuary's judgment, the constraints create a significant risk that a more in-depth analysis would produce a materially different result, the actuary should communicate this risk. Often during the review of liabilities for a transaction, due to timing or confidentiality issues, an actuary may not have the desired access. Any user relying on the actuary's work needs to understand that the estimates may have been done in a short time period or with limited access to those with the most knowledge of the book.

"Any user relying on the actuary's work needs to understand that the estimates may have been done in a short time period or with limited access to those with the most knowledge of the book."

Case #2: You are looking to limit the risk of future adverse development on a runoff block's reserves through the purchase of retroactive reinsurance. An actuarial report provides a range of unpaid loss estimates. Can the high end of the range be used to judge the limit needed for this protection?

A range of reasonable estimates is typically narrower than a range of possible outcomes and is usually produced by appropriate actuarial methods or alternative sets of assumptions than an actuary considers to be reasonable.

"Range" is a term that can result in confusion when used by actuaries. There are two common types of ranges – a range of reasonable estimates and a range of possible outcomes – both are referred to commonly only as ranges.

A range of possible outcomes includes all the possible results of the claims process. This type of range is usually generated by statistics or simulations but can also be based on scenario testing or historical observation. A distribution generally describes all possible outcomes.

A range of reasonable estimates is typically narrower than a range of possible outcomes and is usually produced by appropriate actuarial methods or alternative sets of assumptions than an actuary considers to be reasonable. Be warned – no objective boundaries exit for a "reasonable" range – it is very subjective and based on judgment of the actuary.

When provided with a range, ask what type of range are we discussing – reasonable estimates or possible outcomes? How was the range determined? What is the likelihood of outcomes outside the range? Is the range based solely on the variability of historical data, or does it include a provision that the future might be unlike anything that has ever occurred before? Once these questions are answered, one is in a better position to understand how to use the results.

"A range of reasonable estimates is typically narrower than a range of possible outcomes and is usually produced by appropriate actuarial methods or alternative sets of assumptions than an actuary considers to be reasonable."

Case #3: You are deciding upon the total reserve to book for a block of business. An actuarial report provides an estimate of the unpaid loss, which the actuary calls a "best estimate." Is it appropriate to book this amount?

The term "best estimate" is insufficient guidance, as it begs the question "best estimate of what?" According to

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Are You Getting the Most Value from your Actuary? continued from page 7

ASOP #43, the actuary must provide further description of any unpaid claim estimate. This description should include:

- Intended measure – for example, mean, median mode, low estimate, high estimate, mean plus a specific risk margin, etc. A term now used by some is "actuarial central estimate," which represents the expected value over the range of reasonably possible outcomes
- Whether the estimates are gross or net of recoverable
- Whether the estimates are discounted for the time value of money

If this information is not explicitly detailed in the actuarial communication, ask the actuary for it. Armed with this information one could make a better decision as to the appropriate reserve to book.

…it is rare that different actuaries provided with the same data and information will provide point estimates of liabilities that match exactly.

Case #4: You are negotiating a commutation with a cedant, and both your actuary and the actuary for the cedant have provided estimates, but they differ significantly. How can this be reconciled?

It can be difficult to understand and explain, but it is rare that different actuaries provided with the same data and information will provide point estimates of liabilities that match exactly. It is, thankfully, slightly more often that ranges of results provided by different actuaries can be similar or overlap, but these too can be very different. When faced with these differences, it is important to understand what is driving differences – are there different methods being used and why? What are the strengths and weaknesses of each method related to the particular task at hand? Are the methods the same but different key assumptions used? Are the two actuaries even measuring the same thing? Remember the confusion regarding "ranges" and "best estimate".

Often the different results are from actuaries on different sides of the negotiating table in a transaction or negotiation. When this occurs, there is a need to determine what details each side is willing to provide and acknowledge that each may have to give information to get information. To be most efficient, each side must focus on areas where judgment differences are most likely to occur; the actuary should be able to provide insight to assist in this.

Conclusion

To get the most value from an actuary's work, users need to understand what the actuarial work-product represents. One may not need to understand precisely the underlying actuarial methods but knowing the key assumptions and what the results represent are critical and will lead to better, more informed decision making. ■

Jason Russ and Tom Ryan are consulting actuaries and Principals in the New York office of Milliman, Inc. Both Jason and Tom specialize in providing actuarial services to the run-off community – in the U.S. and abroad. They can be reached at Jason.Russ@milliman.com and Tom.Ryan@milliman.com.

Notes from Editor and Vice Chair

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typically a blend of unpaid, recoverable claims, outstanding loss reserves and IBNR — are recoverable under reinsurance agreements. Ben's analysis culminates with recent decisions that sustain a panel's decision to permit such recoveries.

Add Nigel Curtis' usual dose of *"Present Value"* (run-off "pop culture" and KPMG's *"Policyholder Update"* and "the deed is done."

We are your voice in the run-off world. Let us hear from you. ■

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

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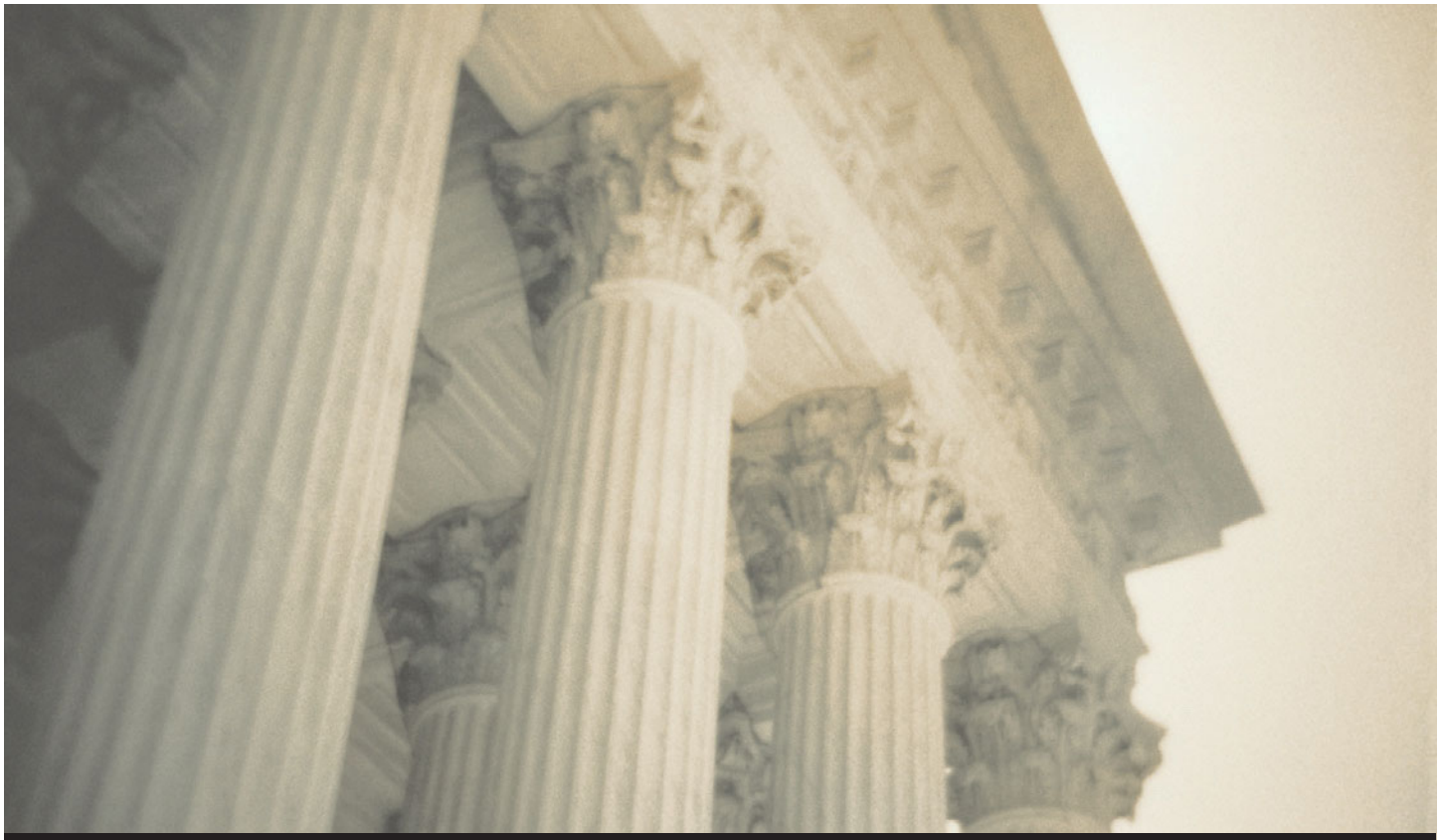

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Think Tank

Enhancing the Insurer Resolution "Toolbox"


James Schacht

By James Schacht

AIRROC has a rare opportunity to substantially enhance public policy in an important part of the financial regulatory system in the U.S. by adopting the proposed "Uniform Insurer's Run-Off & Resolution Law" for insurers that need to wind-up their affairs. "Run-Off" has become an important part of the insurance industry in the last couple of decades but no insurance statute defines the term or regulates the process when it needs to be done to ensure accountability and other safeguards or grants authority to make the procedure effective.

AIRROC has a rare opportunity to substantially enhance public policy…by adopting the proposed "Uniform Insurer's Run-Off & Resolution Law" for insurers that need to wind-up their affairs.

About two years ago, Terry Kelaher, Senior Vice President of Allstate Insurance Co, then chair of the AIRROC's Legislative and Amicus Committee, appointed me to lead a subcommittee that was to consider the need for "run-off" legislation, and, then if appropriate, to develop it. An outstanding group of individuals was assembled with expertise in insurance, reinsurance, bankruptcy law, guaranty funds, regulation and insurance receivership law to participate in that effort. After over a year of study and discussions, a new law was created – the Uniform Insurer's Run-Off and Resolution Law (UIRRL).[1] This work product was submitted to the AIRROC Board of Directors in March, 2008 by Mr. Kelaher and me.

The author is a former three term Director of the Illinois Department of Insurance, long time insurance receiver and now heads The Schacht Group, a consulting firm that specializes in run offs and restructurings, regulatory consultation, public policy issues, expert testimony and other consulting activities for the insurance industry and its regulators. He can be reached at jim@theschachtgroup.com.

The purpose of this article is four-fold. First, to explain why the law is needed; second, to cover the principles and objectives which guided the drafting of this new statute; third, to briefly outline the major provisions of the proposed law; and finally, to urge its consideration for adoption by the AIRROC Board of Directors and the Association's members.

It was felt that the U.S. marketplace would not support "schemes of arrangement" or other similar devices that seek to "wind-up" clearly solvent insurers before all claims mature.

When the subcommittee commenced its work, it was quickly decided that there was no need to change or supplement existing law with respect to insurers that seek to withdraw from the marketplace and wind up their affairs when sufficient capital exists to satisfy all ultimate obligations. It was felt that the U.S. marketplace would not support "schemes of arrangement" or other similar devices that seek to "wind-up" clearly solvent insurers before all claims mature.

However, insurers which are troubled or possibly insolvent need a new statutory framework as an alternative to the receivership statute or as a complement to an administrative supervision law. At the present time, there is no statutory mechanism or framework for a troubled insurer to wind-up its affairs other than through a receivership proceeding which is lengthy and costly. A troubled insurer is defined as one who has ceased underwriting, is financially distressed and may be unable to satisfy all ultimate claims when due. This is the definition adopted by the subcommittee for determining eligibility for the UIRRL.

The subcommittee observed that, with limited exception, regulators have been reluctant to experiment with alternatives to traditional receivership for troubled insurers even though sufficient general authority appears to exist under most insurance laws to do so. The fear of criticism in the event the experiment fails too often

1. The subcommittee was ably supported by Lynn Roberts of Dewey & LeBoeuf, LLP who served as reporter and drafter and Peter Ivanich, Partner, of the same firm who gave technical advice and guidance and other support to the subcommittee.

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Enhancing the Insurer Resolution "Toolbox" *continued from previous page*

All too often, a receivership proceeding provides a safe haven and comfort to a regulator faced with a troubled insurer.

stifles creativity. All too often, a receivership proceeding provides a safe haven and comfort to a regulator faced with a troubled insurer. It was noted that the present receivership system does not allow a major or even an influencing role for the insurer or its creditors. The subcommittee concluded that a new mechanism was needed to allow the troubled insurer and/or creditors to develop a plan that would allow a fair and prompt resolution of the carriers' obligations. It recognized that certain powers and authorities would be needed to permit execution of such a plan and these are contained in the proposed law. It was also decided that insurance regulators should approve the plan and oversee the Plan's implementation.

The subcommittee concluded that a new mechanism was needed to allow the troubled insurer and/or creditors to develop a plan that would allow a fair and prompt resolution of the carriers' obligations.

For insurers that are clearly insolvent, it was concluded that an alternative to the current receivership system was needed. In this regard, it was noted that the present receivership system is plagued by systemic problems that have been identified by many other studies and reports. One of the most glaring shortcomings of the current system is that those with the most knowledge and insight, the management of the insurer, and those with the most to lose, the creditors, are for the most part excluded from the process. For example, under current receivership law in most jurisdictions, only the insurance commissioner can be the receiver and propose a receivership plan. This places a public official in control of what is a private matter. In those rare instances when a proposed plan is challenged by creditors, all too often the Court applies an administrative review standard rather than whether the plan represents the best and most reasonable solution in the circumstance for policyholders and claimants. The UIRRL is designed to address these and other problems by creating a new statutory mechanism preceding receivership that will allow an insurer and/or creditors to find a solution before government is in "command and control". The subcommittee realized that achieving adoption of the UIRRL, first by AIRROC, and then individual states, would not be easy because of a strong vested interest in the status quo, the lack of saliency with the public and complexity of the subject.

There were several principles and objectives that guided the subcommittee's work:

- First and foremost, the statutory scheme prescribed should promote efficiencies and maximize and preserve value for creditors.
- The troubled or clearly insolvent insurer and its creditors should be given an opportunity to create and implement a resolution plan, rather than being immediately subject to a system where government is in "command and control."
- Guaranty funds should be given the chance to participate in a resolution plan when covered claims (personal lines and small commercial insurance) are present, since it may provide considerable cost savings to the industry and taxpayers.
- The statute should be written generally so as to permit creativity and innovation, and grant sufficient power and authority to be effective.
- The resolution process should be transparent, open, and should require accountability to creditors particularly policyholders, claimants and reinsureds.
- The statute should apply only to insurers that are clearly troubled and have ceased underwriting and not be a mechanism to permit clearly solvent issues to accelerate claims.
- The statute should only be directed toward resolution of obligations and not restructuring and reorganization so as to permit an insurer to return to the marketplace.
- The insurance regulators' role should be to approve and oversee the Plan and its implementation and, if insurance contracts are being modified, a Court should be involved.
- The statute should only apply to property and liability insurers and reinsurers.
- Lastly, the subcommittee observed that whether an insurer, particularly one that underwrote "long tail" liability lines is solvent or insolvent is not always clear yet current law presumes that it is a bright line.

Briefly, the UIRRL establishes standards and procedures for the expeditious resolution of property and

continued on next page

Enhancing the Insurer Resolution "Toolbox" *continued from previous page*

casualty insurance business, including reinsurance contracts if the applicant is a reinsurer. The business that is the subject of the UIRRL is business in run-off, but only when indemnification and payment of all future losses can no longer be assured. The insurer, as "Applicant" or its creditors may propose a plan to be effected under the UIRRL upon approval by the Regulator and/or the Court, that will achieve finality as to the Applicant's claims-payment obligations at a time before the Applicant is placed into a formal delinquency proceeding. Thereby, the UIRRL allows an Applicant to maximize its ability to pay losses. Both section 4 and section 5 of the UIRRL, thus, provide to an insurer a means of distributing assets in a manner more efficient and more remunerative to policyholders and claimants than would be the case if such insurer were to become subject to a proceeding under rehabilitation and liquidation statute.

The business that is the subject of the UIRRL is business in run-off, but only when indemnification and payment of all future losses can no longer be assured.

The resolution process allowed under the UIRRL is overseen by the insurance regulator and/or the court and permits the participation of parties to which the insurer is obligated. The UIRRL provides for two separate types of resolutions. Section 4 of the UIRRL establishes standards and procedures for a plan of resolution based upon the voluntary commutation by mutual agreement of certain of the Applicant's contractual relationships. Section 5 of the UIRRL sets forth the standards and procedures under which an Applicant, whose business or financial circumstances are not resolvable by voluntary commutations of its agreements (either because its business is too complex, and/or because its creditors, including policyholders, cedents and reinsurers, are too numerous) may seek regulatory support for, and court approval of, a plan for the adjustment of the Applicant's obligations to policyholders and creditors. Such a plan under Section 5 can be implemented upon acceptance by creditors and policyholders whose claims are affected by the plan of the treatment of such affected claims. Alternatively, Section 5 allows a court to approve a plan over the objection of a class of creditors or policyholders, provided that at least one affected class of policyholders has voted to accept the plan, and the plan adheres to certain substantive and procedural protections of all policyholders and creditors. Throughout a proceeding under the UIRRL, the regulator retains full authority to commence a proceeding for supervision, conservation, rehabilitation or liquidation, if the UIRRL proceeding turns out not to be the best method of distributing assets.

The proceedings authorized by the UIRRL differ from "schemes of arrangement" as carried out in the UK, Bermuda and Australia, which allow such arrangement for companies that are unquestionably solvent. Similarly, the UIRRL does not permit the crystallization and payment of outstanding and IBNR claims such as allowed by the solvent scheme law of Rhode Island.

The UIRRL does not require that an Applicant be insolvent, but to qualify as an Applicant and effectuate a Plan under the provisions of the UIRRL, the proposed provisions do require that the Applicant be in a state of financial distress – with capital below a specified level such that future insolvency would be possible, absent resolution of the Applicant's obligations through a plan under the UIRRL.

The UIRRL does not permit a book of business or a segment of an Applicant's business to be resolved. Only an entire company may be eligible for resolution.

The UIRRL does not permit "Part VII" business transfers, as are allowed, for example, under UK law.

The UIRRL anticipates that state insurance guaranty funds and the National Conference of Insurance Guaranty Funds will have an important role in facilitating the resolution plans developed under the law. As a result, and as indicated in the drafting notes, certain statutory changes in the guaranty fund laws of adopting states will be required to effectuate the UIRRL.

The subcommittee firmly believes that the UIRRL deserves consideration by AIRROC and its members since it is urgently needed to address the problems of marginally solvent or insolvent companies. ■

Feature Article

Captive Runoff, History, Outlook and Perspective


James Hall

By James A. Hall

For-profit insurers and reinsurers have occasionally needed to back away from a niche in which they have not been successful. Over the years, there have been failures of insurers and reinsurers which inevitably result in runoff, whether called liquidation, receivership, a "scheme of arrangement," or some other label. Somewhat less disastrous than a failure is the fire sale, in which new capital is provided to bear risk in the company, at the expense of the previous owners, who lose some or all of their ownership interest. For example, think of AIG shareholders' capital being replaced by new capital from the U.S. Treasury, or think of Bear Stearns' shareholders' capital being replaced by new capital from JP Morgan Chase, plus certain guarantees from the Treasury.

Single-parent captives and group captives have their own distinct reasons for going into runoff. Over the course of several underwriting cycles, certain single-parent captives discovered losses suffered from competing in the assumed reinsurance business were far greater than the tax benefits expected from writing unrelated business, and their parents decided to support their captives through a long and expensive runoff, often to protect the reputation of the parent via honorable satisfaction of the obligations of its subsidiary.

Over the years, there have been failures of insurers and reinsurers which inevitably result in runoff, whether called liquidation, receivership, a "scheme of arrangement," or some other label."

During recent soft markets, several group captives (among others, certain risk retention groups) lost members to commercial insurers and decided to cease underwriting operations, and go into runoff. Also, in recent soft markets, single-parent captives already licensed and capitalized, have sometimes been left unused by their parents, and are de facto in runoff. Further, following a number of mergers at the parent level, the number of single-parent captives left in runoff by their newly-merged parents has added to the total number of runoffs in the captive sector.

…in recent soft markets, single-parent captives already licensed and capitalized, have sometimes been left unused by their parents, and are de facto in runoff.

In 2002, Rhode Island enacted public law 381, allowing solvent insurers to restructure (and to redomicile to Rhode Island) for the purpose of runoff. To date, no insurers have moved to Rhode Island under this law. Reasons suggested for the lack of action include uncertainty about how regulation will develop around the new law, uncertainty about how courts will treat claims involving a redomesticated insurer, or possibly concern that controversy over another redomestication and runoff could create reputational risk.

In a state where captive regulation is mature, with a robust community of captive managers and other professionals, no such legislation is required. Captives already redomesticate among captive domiciles. Captive managers already manage a number of captives in runoff with somewhat less effort than required for management of a captive still writing business. Group captives already have been licensed for numerous exotic coverages, and reinsurance of a runoff book has already been written by numerous reinsurers. All that is required to support a domestic runoff operation is capital, expertise, and the strategic decision to provide a market for captive runoff business. Such a market can be risk-bearing or administrative:

1. A risk-bearing captive runoff company might look like a group captive, with the group members being either the group of captives in runoff or the group of parents of those captives. In either case, the manager of the group captive has the same tools as the manager of a more traditional company in runoff, but the underwriting decision made by the manager of the group runoff is how much capital to require from each new member of the group. The alternative to member-

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James A. (Jim) Hall is a Consulting Actuary at Huggins Actuarial Services and can be reached at jim.hall@hugginsactuarial.com.

Feature Article

We're Movin' on Up! AIRROC/CAVELL Commutation & Networking Event


Art Coleman

By Art Coleman

To East Brunswick New Jersey, to a Deluxe Hotel with More Room…

AIRROC and Cavell are excited to have the 2009 event (Our 5TH!) at the Hilton Hotel in East Brunswick, New Jersey starting on October 19th and running until Wednesday, October 21st. While the Sheraton Meadowlands served us well for four years, we needed more room and a venue that was more suitable to the needs of our growing list of delegates.

The Hilton Hotel boasts over 440 rooms with the full amenities one would expect from a top of the line hotel. You can take a tour of the facility by going to their website which is: **http://hilton134-px.rtrk.com**. The Hotel has easy access directly off of Exit 9 on the New Jersey Turnpike. Make your reservations at:

http://www.hilton.com/en/hi/groups/personalized/EWRBHHF-AIR-20091019/index.jhtml

The room rate is $139 per night and a great value in this economy.

Last year saw almost 500 attendees representing 215 companies and from the registrations to-date we will see the same or more this year. For this year we have one fixed rate of $525 for the full three days of meetings.

As for the agenda for the jam packed three days, we start out on Monday, October 19th with a full day Educational Session Hosted by HB Litigation Conferences LLC giving you the opportunity to earn up to 5 CLE credits (details on our Website www.airroc.org).

Also, for those so inclined, there is our annual Golf Event which this year will be held at Royce Brook Golf Club in nearby Hillsborough, New Jersey (buses will leave the Hotel at 6:45am). AIRROC's Annual Membership and Open Board Meeting is at 4pm on Monday afternoon. A cocktail reception and Gala Dinner follows and the day ends with a ***by demand*** performance by the now famous ***Rendezvous Band*** and Drinks in the Sports Bar.

Tuesday, October 20th is a day of Networking. Tables and Vendor Booths are available for meetings (contact anne.beaulieu@rfml.com for details and any other Registration related questions). Tuesday is also the Annual Women's Networking Luncheon (they had so much fun last year that they decided to allow men to attend this year!). A Cocktail Party winds up the Networking which is followed by our Annual Casino Night.

Wednesday October 21st sees more Networking followed by a Night of Comedy at the nationally known **Stress Factory Comedy Club**. The show will be preceded by Dinner and an Open Bar. Bus transportation will be provided.

We are working on several initiatives to attract new companies to the event, primarily Risk Carriers. In addition, our Sponsors will be well represented and available to discuss their Products and Services with you. We thank them immensely for their patronage which has allowed us to keep the costs of this event the most reasonable of all of the Industry conferences.

So, we look forward to another successful Commutation and Networking Event and most importantly to seeing you there. If you have any questions please drop me a line at: *art.coleman@citadelriskmanagement.com.* ■


Hilton Hotel East Brunswick

Art Coleman is the President of Citadel Risk Management, Inc., which is part of Citadel Re (Bermuda) and works with Insurers and Reinsurers regarding Exit strategies as well as Captive and Program underwriting and management through their Segregated Cell Company. He can be reached at art.coleman@citadelriskmanagement.com.

AIRROC/CAVELL COMMUTATION & NETWORKING EVENT
Registration Form

Company Name

Company Address

Post/Zip code

Delegate details

Title | Forename | Surname

Company Representing

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E-mail

Title | Forename | Surname

Company Representing

Telephone | Mobile/Cell

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Special Dietary Requirements

- Your contact details will be used to compile a delegate list that is accessible from www.commutations-rendezvous.com and will only be maintained for a reasonable period. Please tick here if you **DO NOT** consent. ☐
- Photographs will be taken at various social events. Please tick here if you **DO NOT** consent to your image being included on our website at a later stage. ☐
- To ensure a seat is allocated to you, please tick here if you will be attending the **The HB Litigation Conferences Educational Sessions on Monday**. ☐
- **It is assumed all delegates will attend the opening dinner on the Monday night. However, if you are unable to attend, please advise at time of registration.**

Registration fee and payment

The registration fee for 2009 is set at US$525/£375 for all delegates. - To pay by cheque:

For UK£ registrations: Completed registration forms together with your cheque payable to Cavell Management Services Limited, should be sent to Wendy Gridley at Rose Lane Business Centre, 51-59 Rose Lane, PO Box 62, Norwich NR1 1JY.
Tel: 01603 599407, Fax: 01603 599441, Email: wendy.gridley@cavell.co.uk

For US$ registrations: Completed registration forms together with your cheque payable to AIRROC, should be sent to Ed Gibney at Global Resource Managers, 1249 So. River Road, Cranbury, NJ 08512-3603.
Tel: 609-395-3497, Fax: 609-655-6607, Email: edward.gibney@cna.com.

To register and pay with a credit card: Credit cards are accepted for payment in US$ only. Please visit the AIRROC website, www.airroc.org

Every company which is a member of AIRROC is entitled to one FREE registration. You should notify anne.beaulieu@cavellamerica.com, if you wish to claim the space and your attendance will be registered via her.

Cancellation of bookings:
Prior to 1st Sept 2009 - 100% reimbursement, prior to 1st Oct 2009 - 50% reimbursement and from 1st Oct thereafter - no reimbursement.

Vendor booth hire

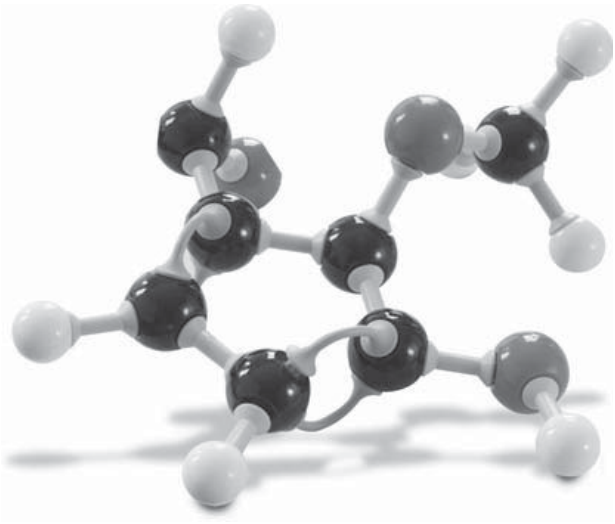
This year, in addition to our new and better venue we have engaged a company that will install full size booths that will be displayed in the Networking Hall. Each 'U shaped' Booth is 10 feet wide by 8 feet deep and allows for a full back-drop display. There is also an 8 foot table and two chairs to allow you to hold meetings at the booth and save the cost of buying a Networking Table ($500). In addition. each vendor gets one free comp admission to the event.
We have priced these to be competitive at $3,500. Please tick this box to reserve a vendor booth ☐

Table hire

If you wish to hire a table in the main hall for your meetings please tick box ☐ Please add an additional US$500/£300 to your registration payment.

Accommodation

A special rate of $139 (exc taxes) per person, per night has been agreed with The Hilton East Brunswick, for attendees of the event. To take advantage of the preferential room rates, please be sure to make your reservation no later than 2nd October. Go to: http://www.hilton.com/en/hi/groups/personalized/EWRBHHF-AIR-20091019/index.jhtml. However, you are of course free to stay at another hotel of your choice. See our website for other options.



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Message from CEO and Executive Director *continued from page 1*

chaired by Michael Zeller is finalizing the process and forms to be posted on our website (www.airroc.org) and will soon solicit arbitrators to participate in the AIRROC Dispute Resolution Procedure. Our timeline to activate the procedure is late this fall, perhaps October 2009.

Art Coleman has planned several regional education programs across the country in 2009. These sessions are targeted at mid level staff and managers. The first, on June 2nd at CNA Plaza in Chicago and presented by Lovells was a tremendous success. The topic of this first session was a Dispute 101 hands-on workshop. Two other sessions have been agreed: one in Boston on September 23rd, at the offices of Choate, Hall and Stewart and co-sponsored by Choate and Pro Insurance Services. Another in New York sponsored by Chadbourne & Parke will take place later this year. Topics for those sessions are still being designed.

The Publication and Education Committees solicit your input with respect to articles and education topics. For articles, please contact Peter Scarpato, Vice Chair and Editor-in-Chief, at peter@conflictresolved.com. For education topics, contract either of the Education Committee Co-Chairs Kathy Barker (Kathy barker@prois-inc.com or Karen Amos (Karen.amos@resmsl.co.uk). Thank you for listening, participating and making AIRROC such a meaningful association. An option on Facebook: What's on Your Mind?… We Seek Solutions.® ■

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

Captive Runoff, History, Outlook and Perspective *continued from page 14*

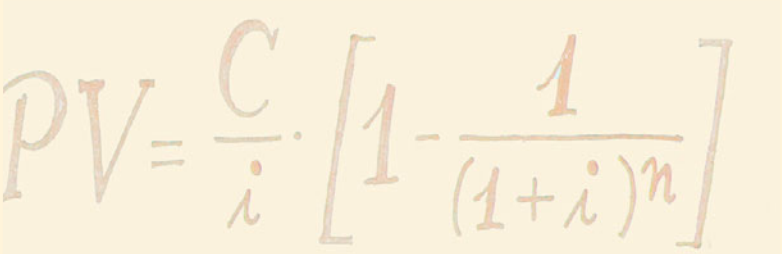
ownership is to abandon the captive license status, and to attempt to be licensed as a more traditional for-profit insurer or reinsurer. Yet another alternative is for a runoff company to buy an existing captive. This may be more difficult in certain domiciles than in others, but the UK firm of Randall & Quilter has already bought at least one captive and one captive manager (in two different domiciles).

2. An administrative services captive runoff company could look like a traditional captive manager, providing staff to support only the accounting and operational support offered to the typical single-parent captive. The capital at risk remains as it was under the prior administration, and the only risk born by the captive manager is the reputational risk of managing a captive at the time statutory surplus becomes deficient. An established captive management company can keep its market share by offering runoff services for individual captives at a reduced fee, considering that it is not going to be providing services related to new and renewal policies and premiums.

If a state like Vermont, with a robust community offering support services for captives and a mature regulatory team in the Banking, Insurance, Securities, & Health Care Administration were to consider legislation like Rhode Island's PL 381, an immediate concern would be how to fund the regulatory operations without the premium tax produced by so many on-going captives and other insurers. The Rhode Island approach spelled out in PL 381 includes fees for each runoff company somewhat larger than the fees charged to insurers that are going concerns, and a similar approach could be used to fund the continued robust regulatory resources of Vermont. Vermont regulators already have the discretion to approve only new insurers with enough capital for the risks proposed in the license application, and the capital required for a given runoff would be a logical starting point for the licensing decision. ■

Present Value

By Nigel Curtis



Run-Off News

RenaissanceRe acquires Spectrum

Bermuda-based RenaissanceRe Holdings announced on June 5, 2009, that it will acquire Spectrum Partners, Ltd., whose principal operating subsidiary is Spectrum Syndicate Management Ltd., the Lloyd's Managing Agent responsible for the run-off of Syndicate 53. See www.spectrumins.com.

Lloyd's Reduces Run-off Years

According to Lloyd's 2008 annual report, the number of underwriting years of account in run-off was significantly down (from 54 in 2007 to 37 in 2008). A number of specialist syndicates were set up to underwrite third-party reinsurance to close (RITC) and this has led to strong competition in the run-off market. No fewer than six managing agents have written RITC in the past two years, enabling 18 syndicates to close. In aggregate, run-off years reported an overall profit of £104m including investment income and syndicates backed by insolvent members supported by the Central Fund reported a small overall surplus. See www.lloyds.com.

Charles Taylor Consulting buys Axiom

In May 2009, Charles Taylor Consulting (CTC) announced it had acquired Axiom Holdings Limited to create a new Insurance Support Services Division. CTC provides management services to mutual and captive insurers and aims to integrate its existing run-off operations (LCL) into CTC Axiom. Axiom, which employs 143 people in London, provides insurance support services to both the active and run-off Lloyd's and London insurance markets. The new division will be managed by Mike Peachey, Managing Director LCL Services. See www.charlestaylorconsulting.com.

Equitas Achieves Finality for Names

On June 25, 2009, the High Court in London made an order approving the statutory transfer of 1992 and prior non-life business of members and former members of Lloyd's to Equitas Insurance Limited, a recently authorized insurance company within the Equitas Group. The transfer became effective on June 30, 2009 and covers all the business reinsured by Equitas Reinsurance Limited at the time of Reconstruction and Renewal in 1996, including the PCW syndicates' business reinsured by Lioncover Insurance Company Limited and the Warrilow syndicates' business reinsured by Centrewrite Limited.

Policyholders now benefit from a $7 billion reinsurance cover from National Indemnity Company over and above Equitas' March 31, 2006 carried reserves, and open and closed year Names have now achieved finality in respect of their 1992 and prior year non-life Lloyd's liabilities under English law. See www.equitas.co.uk.

People

Johan Lagerwall, Executive Vice President at Wasa Run-Off, left the company in April 2009 to form his own consulting firm, Lagerwall Consulting. Based in Stockholm and with 35 years experience in reinsurance, he will provide arbitration, commutation, claims handling, inspection, due diligence and marketing services.

In May 2009, **David Pearson** was appointed as Chief Executive Officer of Helix UK Limited. Mr. Pearson has held various senior roles with Capita London Market Services and more recently was Managing Director of Lambourn Insurance Services. Following its purchase by AXA in 2008, Helix has since acquired two broker replacement portfolios; a Marine LMX book with AXA Liabilities Managers from Alwen Hough Johnson and around 30,000 accounting entries from Arthur J Gallagher UK.

Alan Gray, Inc. has set up a European operation based in London office and has appointed Julian Ward, former CEO of JTW Reinsurance Consultants, as its Director of European Operations. Alan Gray, with offices in Boston, New York, Philadelphia, Hartford, Charlotte and Los Angeles, is known for premium and claims auditing, MGA and TPA inspections, actuarial, accounting and financial reviews, legal fee auditing and reinsurance collection work.

Juliette Stevens, a partner with the discontinued business group at Clyde & Co. has left the firm to become Director and General Counsel at Ruxley Ventures, the insurance run-off investment specialist.

Sharon Sharkey has joined Global Reinsurance Consultants to head-up their new London office at 148 Leadenhall Street. Ms. Sharkey has many years experience in the London and Australian reinsurance markets, and was most recently a Business Consultant with PRO Insurance Solutions. Global Re's UK head office will remain in Battle, East Sussex.

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

Feature Article

AIRROC: A Smash Hit in Scottsdale!


Peter Scarpato

By Peter A. Scarpato

On April 25, 2009, I had the distinct pleasure of speaking on a panel of AIRROC representatives, moderated by our own Trish Getty, at the Scottsdale Insurance Insolvency & Reinsurance Roundtable, hosted by Sharon Boothe and H.B. Litigation Conferences. In addition to Trish and me, our group included Jonathan Bank, Ali Rifai, Michael Zeller and David Brietling. The topics, near and dear to all our hearts, were: run-off market solutions, strategies, and options, including alternative dispute resolution options, for solvent and insolvent companies, and AIRROC's newly formed Dispute Resolution Procedure.

Against the backdrop of H.B.'s finely managed and executed conference and the resplendent setting of Scottsdale, our presentation was well-attended and well-received. Trish deftly took each of us through a series of questions, designed to elicit critical information on the variety of choices available to tame the run-off monster, be it solvent or insolvent. This article summarizes key points for those of you who could not attend.

…the run-off business model changed dramatically when rating agencies and regulators began to take a hard, critical look at mountainous A&E reserve increases.

To set the proverbial stage for the entire interactive discussion, Jonathan Bank explained that while claims departments within active companies had been "running off discontinued operations" for decades, the run-off business model changed dramatically when rating agencies and regulators began to take a hard, critical look at mountainous A&E reserve increases. Beginning in the UK, opportunistic entrepreneurs realized that separate entities could be established to handle this legacy business, creating a new industry employing savvy people with unique skills to accomplish unique goals. Eventually the concept traveled westward to the US, where we now have, in Jonathan's opinion, primarily two run-off models:

- **The Berkshire Model:** Adopting the view that "no claim is due before its time," Berkshire and others with formidable balance sheets holding sufficient reserves allow claims to mature to their natural resolution and expiry. Free from the typical pressure to reduce expenses and accelerate settlements, these companies focus on minimizing loss costs, proper reserve investment and management across the projected path of claims maturation and payment.
- **The "Traditional" Model:** These run-offs follow the typical path of accelerating commutations and policy buy-backs, designed to reduce exposure and expenses against a backdrop of insufficient reserves and minimal to zero premiums. Typically, there is also an increased emphasis on reinsurance collections.

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

mark your calendar

October 7-10, 2009: National Association of Professional Surplus Lines Offices (NAPSLO) Annual Convention, Orlando, FL. See www.napslo.org.

October 11-14, 2009: Excess/Surplus Lines Claims Association Annual Conference (ESLCA), Fairmont Southampton, Bermuda. See www.xslca.org.

October 19-21, 2009: AIRROC/Cavell Commutation & Networking Event, Hilton East Brunswick, NJ. See www.airroc.org.

October 25-29, 2009: Baden-Baden Reinsurance Meeting, Germany. See www.badendirectory.com.

February 23-24, 2010: 11th ARC Discontinued Business Congress, Merchant Taylors Hall, London, England. See www.arcrunoff.com.

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AIRROC: A Smash Hit in Scottsdale! continued from page 21

…the amount of regulatory oversight is very specific to the state insurance department, company, type of business and quality of run-off plan and the management/staff executing the run-off.

The next topic concerned the scope of regulatory oversight and concern in the run-off market. In contrast with the FSA's more flexible approach in the UK, the intensity of US regulatory input is directly proportional to the amount of personal lines business in run-off book. In Jonathan's and the entire panel's experience, run-off managers in this business have virtually no ability to leverage insureds and accelerate claims resolution. Especially for workers' compensation, they are forced to follow the Berkshire model. As I stated at the presentation, my own experience running of a mixed direct and reinsurance book confirmed the "seismic shift" in regulatory focus and concern for policyholders. Change the business to commercial and reinsurance, and watchful regulators like those in California, Illinois, New York and Pennsylvania afford run-off managers more leeway, understanding that sophisticated counterparties can manage down this business quickly, safely and effectively. In David Brietling's experience, the amount of regulatory oversight is very specific to the state insurance department, company, type of business and quality of run-off plan and the management/staff executing the run-off.

…without federal regulatory legislation, we have no opportunity in the US to employ regulatory or statutory tools to run-off direct business.

In response to Trish's inquiry about the type and effectiveness of run-off options, Ali Rifai confirmed the lack of US approaches for personal lines business, noting for example NY's Regulation 141 which only applies to professional reinsurers, and the minimal usage of Connecticut's and Rhode Island's statutory run-off mechanisms. In his view, without federal regulatory legislation, we have no opportunity in the US to employ regulatory or statutory tools to run-off direct business. Ironically, because section 15 of the new US Bankruptcy Code makes it somewhat easier for US courts to recognize the administration of foreign insolvency, bankruptcy or debt restructuring proceedings, UK reinsurers can obtain a release of exposures easier than their US counterparts.

Ali's experience mirrored those of other panelists; companies entering into run-off have different strategies:

…several elements of the insolvent companies' business impact your run-off structures and strategies, including their business models…

- **Voluntary Run-off:** Ali noted that both the Berkshire Model and the quicker Traditional Model still leave primary control with management; and
- **Rehabilitation or Liquidation:** Where the company must officially acknowledge some level of impairment and cede varying levels of control to regulators.

As an experienced run-off manager, Ali recognized that, if the underlying book is personal lines, your only effective options are either to run-off per the Berkshire Model or to sell the book to another entity (especially if you wish to extract capital). In contrast, commercial insurers and reinsurers can establish an expedited timeframe, provided they carefully and completely develop, track and update a specific, comprehensive run-off plan.

Ali's sentiments were echoed by both Jonathan Bank and David Brietling. In the solvent context, Jonathan noted the "sea change" which occurred when larger, successful companies dedicated the time and talents of their best people to manage their run-offs. David indicated that several elements of the insolvent companies' business impact your run-off structures and strategies, including their business models, distribution structures, central or decentralized operations, complexity of reinsurance systems, and expertise of remaining employees. Ali advanced the point about employee expertise, seeing a direct relationship between the increased acceptance of prematurely removing capital from discontinued operations and broader array of lucrative careers available in the run-off industry. All panelists agreed that you can learn more when you deconstruct an entire company and its business than when you develop and implement a business plan for an on going business.

Trish next asked David Brietling to address the differences in operational policies between solvent and insolvent run-offs. In his view, both are similar in their under-

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AIRROC: A Smash Hit in Scottsdale! continued from page 23

lying goals, need for directed, effective management and mission to commute exposures and satisfy creditors.

Differences include:

- **Claims Handling:** Claims managers of solvent run-offs have more flexibility to negotiate large, complex settlements and policy buy backs with direct insureds. They can fix and pay off their exposure in available dollars. In contrast, liquidators initially only value, and do not pay, claims. For example, in Reliance's estate, approximately 70% of the liability is handled by state guaranty funds, with Reliance handling (and merely valuing) the remaining 30%.
- **Reinsurance**: Managers of insolvent business often have very limited control over claims handled by guaranty funds. Since the primary goal is to marshal all available assets of the estate, especially reinsurance, liquidators must have an efficient mechanism to gather and send necessary data to reinsurers.
- **IT:** Recognizing the importance of business-like claims handling and prompt reinsurance reporting, liquidators must spend some of their often fixed pool of assets to build and maintain complex IT systems relating to centralizing operations, guaranty fund data feeds and various reporting flows to different stakeholders in ways not necessary for the former, viable entity. In the case of reinsuance systems, if done properly, the return through increased collections can be many multiples of the system costs. In addition, new systems are necessary to handle proof of claims and the resulting notices of determination issued by the estate.
- **Human Resources:** While HR policies likely differ substantially between solvent and insolvent entities, one factor remains the same: both need well-educated, experienced and motivated employees to properly execute the business plan. One major difference: Even though their employees are technically working themselves out of a job, liquidators must fairly and honestly communicate that staff is obtaining valuable skills, providing a service to the industry and receiving a competitive salary and benefits, including retention and merit bonuses and severance where appropriate and warranted. Here Ali noted inexperienced run-off managers' classic mistake of prematurely firing underwriters – the very people who understand the recorded and often "unrecorded" structure of the business and can offer IT invaluable help in designing the proper system and capturing the flow of business.

While HR policies likely differ substantially between solvent and insolvent entities, one factor remains the same: both need well-educated, experienced and motivated employees to properly execute the business plan.

David next addressed methods to accelerate insolvency close outs. On the claims and reinsurance side, (a) time limits can be set for claimants to file and liquidators to value proofs of claim ("POCs"), (b) the liquidation court can approve a time limit for claimants to provide data to value contingent POCs, barring which the claims receive lower priority, (c) the liquidator can set a final bar date, and (d) a defined, targeted commutation strategy for reinsurance can be created and implemented. At its core, David sees this as a "cash flow model," requiring the proper assessment and tracking of cash inflows and outflows with a unifying purpose of valuing and paying creditors' POCs, or at least a partial distribution, as soon as reasonably possible.

The final major point of the presentation, addressed by Michael Zeller and me, was alternative dispute resolution ("ADR") in the run-off context. Initially, I noted that two major points during the morning presentation – reducing costs and accelerating settlements for run-offs – are core goals of ADR. The more run-off managers understand about the availability, benefits and suitability of mediation and arbitration, as opposed to the burdens and costs of litigation, the more flexibility they have to choose the right solution for the right issue. In making this crucial decision, one must appreciate that mediation gives parties more control over three key aspects of dispute resolution – POWER:

The more run-off managers understand about the availability, benefits and suitability of mediation and arbitration, as opposed to the burdens and costs of litigation, the more flexibility they have to choose the right solution for the right issue.

the ability to have the parties themselves, as opposed to a third party court or panel, control their path to a resolution of their dispute, often in ways beyond the panel's or court's

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authority; OPPORTUNITY: the chance to have a trained mediator guide the parties through the rough spots to ultimately achieve a resolution; and PREDICTABILITY: the parties' ability to have direct input into the precise terms, conditions and timing of their settlement. If you are managing a run-off with a fixed, limited budget and have less than adequate, supportive documents and witnesses, the ability to exercise more control over your disputes becomes paramount.

Why, asked Trish, do experienced reinsurance run-off experts need to pay another person to help them negotiate their disputes? The answer, in my view, is that, most often, the "real" broader problem between the parties lies hidden behind the narrow issues in the immediate dispute. Run-off managers may reject a claim or require more information for a variety of reasons not necessarily discussed with their counterparty, including budgetary restrictions, smaller staff, insufficient supporting documents, a readjustment of the former active company's lax practices, etc. Under the careful steps of a skilled mediator, this problem may be solved by the creation of an acceptable operations protocol between the parties – something neither party previously discussed. Also, experience and egos often go hand in hand. Mediators play an essential role in distilling them out of the equation and focusing parties on what really matters. Finally, for lawyers who fear that recommending ADR might reduce their run-off business revenue, I explained that the more you recommend ADR strategies that work and save the client money, the more they will trust you with future business.

Finally, Mike Zeller explained AIRROC's new Dispute Resolution Procedure (DRP). Recognizing the problem that the costs of traditional arbitration occasionally make this form of ADR cost prohibitive for the large number of small claims in run-off, AIRROC summoned and charged a Small Claims Task Force to develop the procedure. In its final form, the DRP offers a fully developed set of forms and procedures, including a panel of experienced arbitrators who must agree to charge a maximum of $150/hour, plus allowed retainers. The parties (a) must agree on a suitable level of discovery (referring disputed items only to the arbitrator), (b) do not need outside counsel representation (c) should consider the DRF for "smaller" disputes involving about $1MM and (d) need only fill out an Initiation of Proceedings Form to begin the process. The DRF sets forth qualifications for inclusion on the arbitrator list: 10+ years working for an insurer or reinsurer, or ARIAS-certified status. If the parties do not agree on the arbitrator, the DRF provides a random selection process. ■

Recovery of Commutation Payments


Ben Gonson

By Ben Gonson

Much uncertainty exists surrounding the issue of whether commutation payments are recoverable. A commutation payment will typically comprise a mixture of unpaid claims (amounts notified by the reinsured as being due and payable), outstanding claims (estimates of future liabilities for known losses reported to the reinsurer) and incurred but not reported or IBNR (estimates of the value of possible future liabilities).

Much uncertainty exists surrounding the issue of whether commutation payments are recoverable.

In the December 2008 edition of AIRROC Matters, the panel on Ceding Policy Buy-backs and Commutations discussed whether commutation payments are recoverable under reinsurance and retrocessional contracts. There was consensus among the panel members that paid claims and outstanding claims (at least so long as the party seeking to recover has ascertained a loss) are generally recoverable. However, there was no clear answer as to whether commutation payments reflecting IBNR are, or should be, recoverable.

English Law

As noted in "Commutations Come Into The Spotlight" appearing in the July 12, 2005 edition of Insurance Day, commutations have been "long established in the UK and London Markets" and "are now beginning to snowball in other markets around the world, such as Europe and east Asia, and lately even in the US."

In the London Market, a protocol established at the end of 2003 by the Association of Run-Off Companies provided guidelines on how commutations should be recoverable. The protocol was not widely accepted in the London Market. During this time period many articles were written in the London Market concerning whether commutation proceeds should be recoverable. In Commutations – An English Law Guide (Sept. 2004), Richard Leedham noted that unpaid claims should be recoverable. Regarding outstanding claims, Mr. Leedham noted that "it is certainly arguable under English law that if outstandings relate to the settlement of known paid claims, and the decision to settle them has been made in an honest and business-like manner, then they should be recoverable." Regarding IBNR, Mr. Leedham noted that it was unlikely that IBNR was recoverable under English law from retrocessionaires because "IBNR cannot amount to a legal liability, and therefore is not a loss settlement of a relevant claim within the terms of the insurance and reinsurance policies."

In a roundtable discussion of the dynamics of the commutation process contained in the Summer 2007 Edition of AIRROC Matters, one of the panelists stated that with respect to London business with English choice of law or forum clauses, retrocessionaires are armed with court decisions supporting the view that they are not obligated to indemnify the retrocedent for portions of a commutation payment that do not represent "loss settlements" expressly covered by the treaty.

In the London Market, a protocol established at the end of 2003 by the Association of Run-Off Companies provided guidelines on how commutations should be recoverable.

In the article entitled "Drafting a Commutation Agreement" contained in the Summer 2007 Edition, the authors noted that there was a notable absence of judicial guidance under English law on the issue of whether commutation payments can be recovered from retrocessionaires. In both the December 2008 and Summer 2007 editions of AIRROC Matters, there is a reference to *English and American Ins. Co. Ltd. (In a Scheme of Arrangement) v. Axa Re SA* [2006] EWHC 3323 ("*Axa Re*"). In *Axa Re*, the insolvent ceding company, English and American Ins. Co. Ltd. ("E&A"), entered into a settlement with its insured and sought in turn to recover a proportion of that settlement

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Ben Gonson is a Partner at Nicoletti Gonson Spinner & Owen LLP and can be reached at bgonson@nicolettilaw.com.

from its 100% reinsurer, Axa. Axa refused to indemnify E&A, arguing that it was not required to follow the settlement because it was an interim good faith payment without admission of liability on a without prejudice basis, under a full reservation of rights, and that there was no identification of which claims E&A had settled and whether they fell within the terms of the reinsurance contracts (or were IBNR or ex-gratia payments). The settlement was part of a London Market settlement for all past, pending and future known or unknown claims by Dow Chemical against the London market insurers in respect of breast implant and associated costs. The judge concluded that the claims had been settled in a proper and businesslike manner since not only the London market, but also Axa's own willingness to settle in these amounts (which was communicated in an open letter to E&A which the Court admitted in evidence) indicated that payment was proper. As the Court concluded that there was no realistic prospect of Axa establishing that it did not have a liability to E&A for at least part of the claim, E&A was entitled to summary judgment in respect of claims which had been paid and which E&A could evidence. Regarding the future claims/IBNR component of the settlement, the judge stated, "it is just about conceivable, although unlikely, that Axa might have a defense in relation to settlement amounts paid in respect of IBNR, as opposed to paid claims, and I give Axa the benefit of the doubt in that respect."

American Law

There is no direct substantive law in the United States concerning whether commutation payments may be recovered from a retrocessionaire. In the United States, arbitration awards in 2007 between Global Re and Argonaut have resulted in a mixed bag of rulings concerning whether such proceeds are recoverable. In one ruling, the arbitration panel simply stated that the commutation payments Global sought to cede to Argonaut were not claims, losses or settlements within the terms of the excess of loss retrocessional agreements and were thus not recoverable. In another arbitration, the panel denied Global Re's claim against Argonaut for commutation balances but stated that, on a going forward basis, as claims that were the subject of the commutation were resolved by the original ceding company and reported to Global Re, Argonaut may be billed by Global Re for those claims. This type of ruling underscores the need to include, in a commutation agreement, a provision requiring the ceding company to provide claims information following the commutation to support recovery against a retrocessionaire.

In a third arbitration, the panel found that Global Re's commutation payment was covered under the excess of loss retrocessional contracts. The final award concluded that "[t]he evidence presented at the Hearing established that the ... claims comprising the commutation transaction [with Home] were covered by the original reinsurance contracts issued by [Global]." The question for the Panel was "whether a loss settlement, as used in these [Treaties], includes compromise of liability under all the

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[Original Reinsurance Contracts] as distinct from the liability of an individual loss settlement under a single [Original Reinsurance Contract]." Noting that "virtually all loss settlements, both in insurance and reinsurance, involve compromise and include a so-called contingent component ...." and that "the comprehensive nature of the commutation between [Home] and [Global] represents a distinction without a difference to the validity of a loss settlement under the [Treaties]" the Panel found the commutations were covered by the treaties.

Global Re then moved in the United States District Court for the Southern District to confirm the award. Argonaut cross-moved to vacate the portion of the award requiring it to indemnify Global Re for the commutation payments. In its cross-motion, Argonaut contended that the panel manifestly disregarded the law with respect to the commutations in three aspects. First, Argonaut contended that the panel ignored the unambiguous provision of the treaties requiring that Global provide notice of claims and an opportunity for Argonaut to associate itself with any claim before it must accept liability. Second, Argonaut contended that the panel ignored the unambiguous definition of "Loss Occurrence" in the treaties by finding that the contingent liabilities allocated to Argonaut based on actuarial studies were losses covered under the treaties. Finally, Argonaut contended that the Panel misapplied the "follow the fortunes" doctrine to expand the coverage of the treaties.

The Southern District first noted that for a panel to manifestly disregard the law, the law must be clearly applicable and be well-defined and explicit. The Southern District rejected Argonaut's first contention because there

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was no evidence that Argonaut was prejudiced by any late notice. The Southern District rejected Argonaut's second contention by stating that "while a narrow reading of the 'Loss Occurrence' clause to particular losses that had already occurred might exclude contingent liabilities, the Treaties were interpreted by the Panel as 'honorable undertakings' not as strict legal documents. Because the Panel was given substantial freedom to interpret the Treaties and offered a colorable justification for their interpretation based on industry practices, this Court cannot conclude that they ignored the 'Loss Occurrence' definition." Finally, the Southern District rejected Argonaut's third contention by noting that "once the Panel interpreted the Treaties to include contingent claims as a loss covered under the Treaties, the Panel properly applied the "follow-the-fortunes" doctrine to preclude review of Global's decision to settle the contingent claims."

There has been one Privy Council decision applying New York law which found, in the context of an insolvency, that IBNR was recoverable pursuant to a loss settlement clause that required the reinsurer to pay based upon "the liability of the reinsured." *Bodden v. Delta American Reinsurance Co.* (Cayman Islands), 2001 citations - 1 BCLC 482, 2AC 328, 2WLR 1202, BPIR 438,UKPC 6; 2002 citation – Lloyd's Rep IR 167.

Follow the Settlements Applied Differently

There appears to be a difference between English and American law on the issue of how far the follow the settlements doctrine can be extended. This difference is exemplified in two cases where English and American courts reached opposite conclusions as to whether a reinsurer must a follow a settlement made pursuant to the Wellington Agreement, which was entered into between asbestos manufacturers ("producers") and their insurers in 1985. Pursuant to Wellington, each producer agreed to pay a share of every settled or adjudicated asbestos claim asserted against one or more Wellington signatory producers in accordance with the producer allocation formula, whether or not the claimant alleged exposure to its asbestos products. By agreeing to this allocation formula for all claims, the producers avoided the need to assert cross-claims against each other in the underlying asbestos suits.

In both cases reinsurers argued that payments made by insurers on behalf of producers under the producer allocation formula were not covered reinsurance losses absent proof that the underlying claimants were actually exposed to the insured's product. In *Unigard Security Ins. Co v. North River Ins. Co.*, 762 F. Supp. 566 (S.D.N.Y. 1991), *aff'd in part, rev'd in part on other grounds,* 624 F.3d 1049 (2nd Cir. 1993) ("*Unigard*"), the American court required the reinsurer to follow the settlement because the Wellington Agreement was a good faith settlement of claims and involved payments reasonably falling within the terms of the reinsured policies. The American Court noted that "while under the allocation formula [the insured] sometimes contributed to settlements of claims on which it might not legally have been liable, at the same time [the insured] benefited from the fixed percentage contributions that other producers made to claims on which [the insured] would have been chiefly liable." 762 F. Supp at 589. In *Hiscox v. Outhwaite,* 2 Lloyd's Rep. 524 (Q.B. Comm. Ct. 1991), the English Court found that the reinsurer was not obligated to follow the ceding companies settlement as "the disputed payments were in respect of non-insured claims, which by definition were not within the scope of the reinsurance contracts. They did not become insured, and therefore reinsured, claims, merely because [the signatory insurers] agreed to treat them as if they were." 2 Lloyd's Rep. At 531.

There appears to be a difference between English and American law on the issue of how far the follow the settlements doctrine can be extended.

Conclusion

Since loss settlements often involve contingent components, commutation payments representing IBNR arguably should be recoverable from retrocessionaires pursuant to the follow the settlements doctrine under certain circumstances. This doctrine has already been liberally extended in the United States for complicated settlements involving policy buybacks (*North River Insurance Company v. ACE Reinsurance Company*, 361 F.3d 134 (2d Cir. 2004) and for Wellington Agreement settlements that reflect payments for both covered and uncovered claims (*Unigard*). One American court has now ruled that an arbitration panel did not manifestly disregard the law by requiring the reinsurer to reimburse the ceding company for commutation payments that reflect contingent liabilities. ■

Insurance company restructuring can be hard to swallow for everyone involved. Innovative solutions must be crafted so that whenever possible, all parties can resolve positions equitably. Bingham has the legal knowledge and worldwide experience to resolve these troubled situations and ensure that important relationships don't sour.

For more information, please contact:
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Alert No. 30

KPMG Policyholder Support Update

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

Solvent Schemes – Upcoming Key Dates

DEUTSCHE RÜCK UK REINSURANCE COMPANY LIMITED ("DRUK")

The above company's Scheme was approved at the Meeting of Creditors on 18 May 2009. The Scheme became effective on 16 June 2009 and the bar date has been set as 15 December 2009. Further information is available at www.deutscherueckuk.com.

CITY GENERAL INSURANCE COMPANY LIMITED

The above company's Scheme was approved at the Meetings of Creditors on 3 February 2009. The Scheme became effective on 24 April 2009 and the bar date has been set as 21 October 2009. Further information is available at www.citygeneral.co.uk.

Other Recent Developments

ALLIANZ GLOBAL CORPORATE & SPECIALTY (FRANCE); ASSURANCES GÊNÊRALES DE FRANCE I.A.R.T.; DELVAG LUFTFARHT VERSICHERUNGS AG; NÜRNBERGER ALLGEMEINE VERSICHERUNGS AG (IN RESPECT OF THE CAMOMILE UNDERWRITING AGENCIES LIMITED BUSINESS)

A Practice Statement Letter was sent to all known brokers and policyholders on 30 April 2009 indicating each of the above company's intention to propose a Scheme of Arrangement for each of the companies involvement in the business underwritten for them by Camomile Underwriting Agencies Limited ("CUAL"). The above companies intend to apply to the High Court of Justice of England and Wales for permission to convene Meetings of Creditors although no date for this application has been announced. Further information is available at www.CUAL-scheme.co.uk.

THE MEADOWS INDEMNITY COMPANY LIMITED

By order of the High Court of Justice in England and Wales, Meetings of Scheme Creditors for the above company were convened for the purpose of considering and, if thought fit, approving a Scheme of Arrangement on 27 May 2009. The outcomes of the Meetings are not yet known. Further information is available by emailing meadowsenquiries@ambant.com.

THE SCOTTISH LION INSURANCE COMPANY LIMITED

The sanction hearing for the proposed solvent scheme will convene on 7 July 2009 in the Scottish High Court in Edinburgh. Further information is available at www.scottishlionsolventscheme.com.

HARRINGTON INTERNATIONAL INSURANCE LIMITED

The bar date for the above company's Scheme of Arrangement passed on 19 June 2009. Further information is available by e-mailing scheme@harringtonintl.com or jamesbennett@kpmg.bm.

GLOBAL GENERAL AND REINSURANCE COMPANY LIMITED; GLOBALE RÜCKVERSICHERUNGS-AG

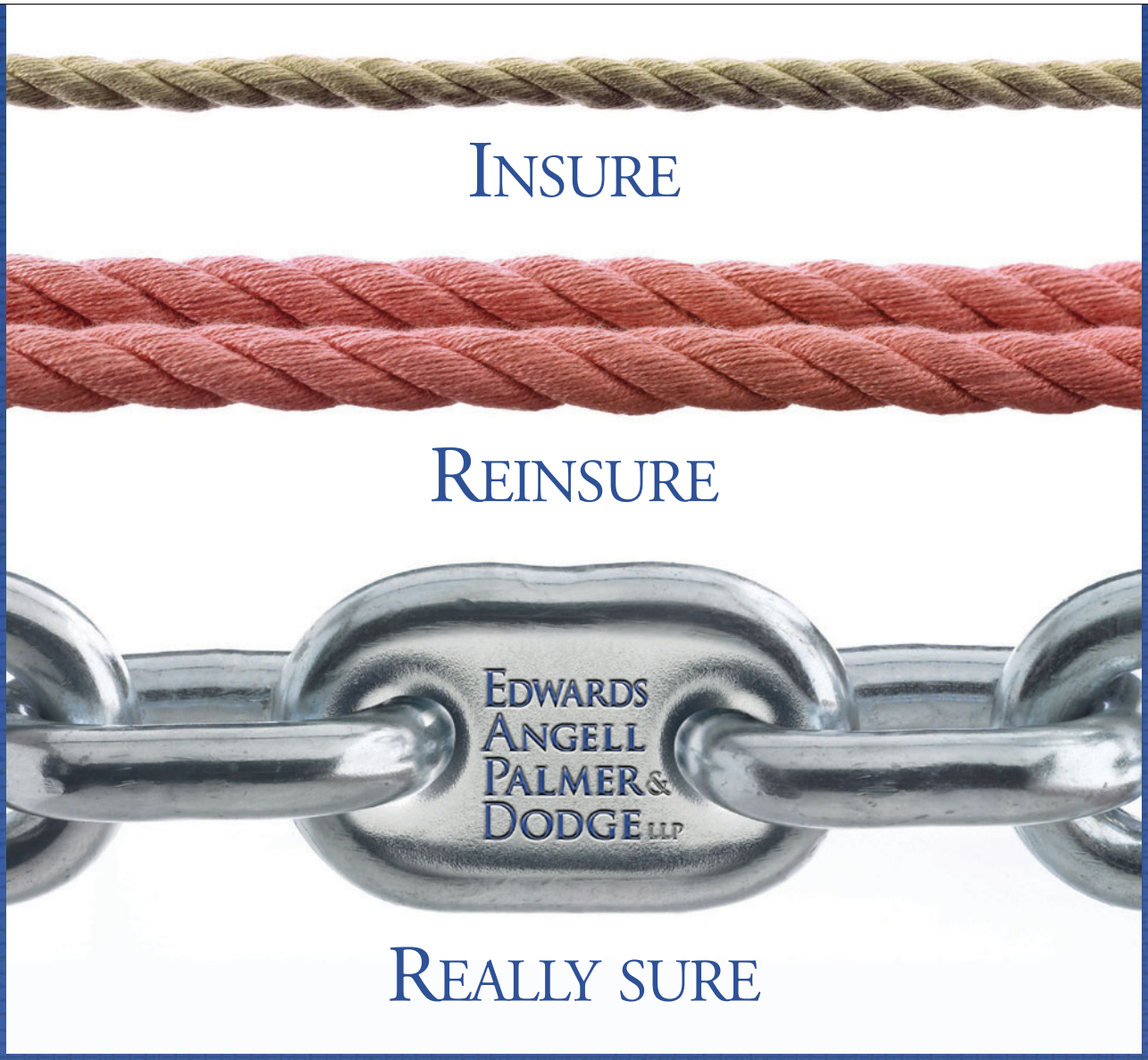
The bar date for the above companies' Schemes of Arrangement passed on 8 June 2009. Further information is available on www.globalre.com/schemes.

Insolvent Estates

HIGHLANDS INSURANCE COMPANY (UK) LIMITED

By order of the High Court of Justice in England and Wales, a Meeting of Scheme Creditors for the above company was convened for the purpose of considering and, if thought fit, approving a Scheme of Arrangement on 18 June 2009. The outcome of the meeting is not yet known. Further information is available at www.ukhighlands.co.uk. ■

Please do not hesitate to contact **Mike Walker,** *Head of KPMG's Restructuring Insurance Solutions practice 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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