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Association of Insurance and Reinsurance Run-off Companies

AIRROC Matters

A Newsletter About Run-off Companies and Their Issues

Vol. 3 No. 1 | www.airroc.org | Summer 2007

Message from CEO and Executive Director

AIRROC and "Roll"


Trish Getty

By Trish Getty

Serving the needs of the AIRROC members, a significant representation of the worldwide run-off market, is the target. I reflect back to the first meeting of committees in January of 2005. Most were "checking out" other member participants. Today our members greet each other with the smile of a friend then work together on committees where multiple common issues exist. New members quickly acclimate and contribute to committees for which we are grateful since the more experience on board, the better the chances of identifying solutions.

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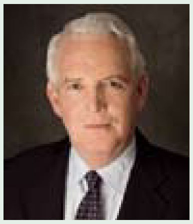
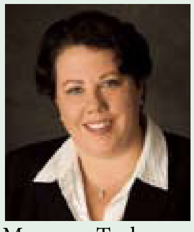
Notes from the Special Editors

Commutations: A Road to Finality


Michael T. Walsh


Maryann Taylor

By Michael T. Walsh & Maryann Taylor

The theme of this Special Edition of *AIRROC Matters* is a topic of great interest to AIRROC's members and the run-off community at large. Commutations are indeed one of the most vital tools to the strategic plans of run-off operations. Commutations have often been described as an art as well as a science and the collection of articles in this issue underscores that point.

Opening up this Special Edition is an article by Art Coleman (with a little help from his friends) entitled "Commutations – A Historical Perspective" which explores a few of the more unique commutations, with illuminating (and sometimes comical) "war" stories. Art Coleman has also included an excerpt from *A Practical Guide to Commutations* which outlines the factors to consider when embarking on a commutation.

We then move on to the nuts-and-bolts of commutations. Charles J. Widder's piece, "Commutations of Reinsurance Agreements: A Business Decision Based on Economics and Risk Appetite; A Collaborative and Negotiable Process," provides a comprehensive discussion on managing the commutation process from beginning to end. Following that, Mark Everiss and Chris Sage provide a hands-on analysis of "Drafting a Commutation Agreement."

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Notes from the Special Editors

Commutations: A Road to Finality continued from page 1

AIRROC Matters Special Editor Maryann Taylor, Editor Peter A. Scarpato and Special Editor Michael T. Walsh

One of the centerpieces of this Special Edition is a Roundtable discussion of the commutation process moderated by Special Editor Michael T. Walsh. In "A Roundtable Discussion: The Dynamics of the Commutation Process Examined Through Multiple Lenses," we brought together experts from various disciplines to present their views from a regulatory, legal, business and actuarial perspective on key issues, trends and areas of interest for those engaged in commutations. Our panelists included experts in their respective fields: Howard Mills (regulator), E. Paul Kanefsky (legal), Rudy Dimmling (business) and Tom Ryan (actuarial).

From the legal perspective, William A. Maher and Marc L. Abrams show what can happen when commutation clauses end up in court and suggest strategies to avoid litigation in their piece "Commutation Agreements in Court: Judicial Interpretation and Strategies for Avoidance."

Lastly, Mike Palmer provides an analysis of the Equitas and Berkshire Hathaway transaction in "The Deal of the Decade" with a report of Scott Moser's talk at the ARC Congress in London on February 27, 2007.

No issue is, of course, complete without Trish Getty's Message from the CEO and Executive Director, "AIRROC and 'Roll'," and the recurring KPMG "Policy Support Update."

The Publications Committee and your Special Editors wish to thank all of the contributing authors and panelists. We welcome feedback regarding this issue, as well as topics that may be of interest to the community for the next Special Edition. ■

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AIRROC – In this Issue

Special Edition – Commutations

Vol. 3 No. 1 • Summer 2007

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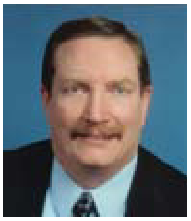
Think Tank

Commutations – A Historical Perspective


Art Coleman

By Art Coleman (with a little help from his friends)

When the opportunity arose to put together an article for *AIRROC Matters* on the historical perspective of commutations, I agreed as long as: (a) it could be a bit irreverent to the sacred beliefs of our industry, and (b) I could seek collaboration. As you will see, they agreed to both points.

I decided to go back to 1986 when I was hired at Continental Insurance as the Director of Reclamations. You may ask, as I did, "what's a Reclamation?" (Imitate Groucho Marks "Viaduct? – Why not a Chicken?") While it was a fancy word for collections, settlements and disputes, it is where I experienced commutations for the first time.

My first commutation was a relatively small one, at the time being just under $600k. I recall that it was comprised of $100k in balances, $350k in undiscounted reserves and $250k of something called IBNR (which for awhile I believe meant I Bought No Reinsurance! – I have now come to know that IBNR is determined with a blindfold and a dartboard!). We had to do something called "discount the reserves for the time value of money". Not really knowing how to do this I found that one of the guys in the office had a piece of shareware software on a 5 ½ inch floppy disk (hey, remember – it was 1986) that allowed you to calculate mortgage rates and present value (the other side had Ms. Pacman). Well, we did it and got the deal done for $575k. We never looked back from there – well maybe a bit!

I have now come to know that IBNR is determined with a blindfold and a dartboard!

So, to be fair to you, the reader, I reached out to some of my peers to divulge a few of their memorable commutations. Some of the responses were unprintable, while others expressed quite a bit of anger (so much for the "win-win" school of thought!). Others though, hit the mark right on the head.

Art Coleman is President of Citadel Risk Management,Inc. and can be reached at art.coleman@citadelriskmanagement.com.

The first entry comes from someone you all know, but has pleaded anonymity, as have the rest of the contributors.

> Some years ago, I was working for a ceding company that was engaged in a dispute with a number of its reinsurers on a particular treaty. An arbitration was pending, but in the spirit of good faith and reconciliation, the parties agreed to meet to consider commuting the treaty participations. The reinsurers had been acting callously and with considerable disregard for their obligations, I thought; I am sure that they thought our company had treated them poorly (or worse) in how the treaty was operated. Nevertheless, old bonds of friendship (and business-like pragmatism) prevailed, and we scheduled our meeting.
>
> The meeting was to take place at the office of the reinsurers' lawyers. Twelve representatives of the reinsurers were to attend, plus two of their lawyers, ... and me. Clearly, the logistical planning had been unsound.
>
> I was met in reception by the junior lawyer on the case. It seemed like a ten-minute walk through maze-like corridors to get to the conference room. As he was about to open the door, this lawyer looked me in the eye and said, "Ah, I am now bringing the lamb to the slaughter." I then entered the room where the twelve reinsurance men were all smiling broadly. They may

The meeting was to take place at the office of the reinsurers' lawyers. Twelve representatives of the reinsurers were to attend, plus two of their lawyers, ... and me. Clearly, the logistical planning had been unsound.

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Step-by-Step[1]

The following is an excerpt from the "Practical Guide to Commutations" which breaks down the process into simple step-by-step instructions. The full Practical Guide can be found at www.citadelriskmanagement.com\commutationguide.html.

1. Evaluation

A commutation will affect each party's financial condition, which should be measured before entering negotiations. For example, if the reinsurer is not carrying adequate reserves or IBNR provisions, the settlement amount could adversely impact the reinsurer's surplus.

2. Qualification

Both parties should set a cut-off date to be used in the presentation of balances, reserves and IBNR. Additionally, a timetable should be agreed incorporating:

- Who will reconcile liabilities and by what date?
- Who will prepare the IBNR study & when will it be ready for review?
- When will negotiations commence?
- Who will prepare the Commutation Agreement?
- By what date should the commutation be concluded?

3. Identification

All the information regarding each pertinent contract, policy or certificate must be gathered prior to valuation. In identifying exposures consider the following:

- Do the contract years run concurrently? Are there gaps and can they be explained?
- Have the parties to the contract changed names or was the business fronted?
- Was the reinsurer part of a pool or represented by an MGA?
- Does the broker have complete records that could fill any information gaps, such as reference numbers?
- Is the broker holding any pipeline adjustments or funds?
- Are there current Letters of Credit ["LOCs"]?

4. Valuation

When pricing the commutation, valuation usually consists of four components:

1. Paid Loss Recoverables
2. Outstanding Loss Recoverables
3. Incurred But Not Reported ["IBNR"]
4. Cash Credits (LOCs, Trusts, Cash-on-hand, etc.)

Reconciling Paid Loss Recoverables at the agreed cut-off date should be an area of little contention unless there is a contractual dispute.

It is usual for an actuarial or claims team to review the reasonableness of established case reserves. Understanding the cedant's reserving philosophy will help to determine future case reserve development and IBNR.

An actuarial or claims team can help to determine projected frequency and severity of claims for IBNR purposes by reviewing the following:

- Loss Development Analysis (Triangulation)
- Inception-to-date experience
- Type of business (proportional, treaty or facultative)
- Class of business (property, casualty, accident & health, etc.)
- Limits and attachment points (working or high layers)

There needs to be credit for the time value of money. This and other credits should be treated as a deduction to the net commutation amount or discounted accordingly.

5. Negotiation

Successful negotiations are performed by those who know the business, as well as other factors such as:

- Know your counterpart – how knowledgeable are they of the business being commuted?
- Be prepared — have all the material available in an organized manner.
- Have a number in mind — establish the highest and lowest amounts you consider acceptable. Your target figure should be somewhere in the middle.
- Understand the other side's strategy — consider their motivation for cutting a deal, their financial condition, or issues that will affect their position.

For the deal to be successful there should appear to be a "win-win" scenario for both sides.

6. Agreement

It is advisable to get legal counsel to draw up or at least review the Commutation Agreement, which should include:

- An exhibit identifying the contracts to be commuted.
- Incorporate any name changes the parties may have undergone.
- Restrict circulation of the document and terms, via a confidentiality clause, to those that have a right to know.
- Specify the date, method or payment and terms for execution of the agreement, including releasing any LOCs or Funds Held.
- Name the jurisdiction that would apply in the case of a dispute to the agreement.

Mistakes are costly and difficult to undo, so careful consideration and planning is necessary at each stage to produce a favorable outcome.

1 *These notes should not be treated as a substitute for obtaining legal advice specific to a particular commutation.*

Think Tank

Commutations – A Historical Perspective

continued from page 6

> have been pleased to see me, or optimistic of a conciliatory settlement, but I had no ability to recognize any of that. The two lawyers were also smiling, as if to suggest: "This dispute will put our children through college." The meeting lasted twenty minutes and was an absolute fiasco.
>
> Approximately a month later, we met again. Lawyers were forbidden from any participation in the meeting, which was held in one of the reinsurers' offices. We commuted the treaty.

Early in my career I was told once that reinsurance was defined as an honorable engagement between two parties. I later heard reinsurance defined as an honorable engagement between two parties, their auditors, lawyers and external actuaries. I think the latter definition speaks to how our business really works.

Our next submission comes from a one of the great collection/commutation people in the industry.

> In the 1980s, an alien pool closed down and sent a letter telling us we needed to go direct. We dutifully broke out the pool and started sending direct notices of loss and bills. One of the smaller players sent us a letter from their President saying he was going to be in Chicago and would like to meet us. When he arrived, he was accompanied by two other gentlemen who were there to translate for him.
>
> We calculated the value of the deal, paid, case and IBNR at about $3,000. After the preliminaries and the revelation of the amount he asked his cohorts if they happen to have $3,000 on them so we could do the deal. My colleague who was also in the meeting had earlier pointed out that the President was sporting a rather nice Rolex Crown Ambassador watch.
>
> We therefore proposed we would do the deal for his watch (which we figured we could fence on Van Buren Street for a least $5,000). The guy laughed and said he was serious about the deal and we said we were serious about taking his watch!
>
> Many years later his cohorts were in our offices on another matter and I went in to say hello. We had a good laugh over the failed "watch deal" but I had to ask why the President wouldn't do it. They told me it was because the watch wasn't insured!!

I later heard reinsurance defined as an honorable engagement between two parties, their auditors, lawyers and external actuaries.

> Another funny point; we submitted the deal to our central corporate HQ for approval … and it was REJECTED!!

Well, like they say, timing is everything! Knowing the two guys referenced in the story, they certainly would have received more than $5,000 for the watch.

Some deals have happy endings (for some) as can be seen in the next entry.

> Back in the late 1980s I was in the rural UK doing an audit trying to support what we believed to be an exorbitant Commutation offer from the Cedant. We knew they were hurting but the price $55M they were asking was ridiculous! Unfortunately, our review of the claims was telling a story that supported their position. Then our fortunes changed!
>
> It was Friday and after a quick (?) lunch at the nearby Pub, we were back at the office and attending to the after affects of the Pub in the "Gents". As we were doing our business, two fellows, who I later found out were from the Accounting Department, were talking and one said, "You know, I don't think we're going to be able to make payroll next week due to cash flow." A smile came across my face.
>
> We walked into the MD's office and offered $20M by close of business the following Monday, $10M the following January 3rd and $10M the January 3rd after that.

continued on page 28

Feature Article

Commutations of Reinsurance Agreements:

A Business Decision Based on Economics and Risk Appetite; A Collaborative and Negotiable Process


Charles J. Widder

By Charles J. Widder

The subject of entering into commutation arrangements has been discussed, argued about, written about, described in various accounting pronouncements, but rarely discussed as a critical process of the parties to the commutation. In this article, the author will attempt to share his thoughts and experiences as to the process of entering into and executing commutation arrangements between the contracting parties, the reinsurer and the ceding entity.

Background and Rationale

Every product has a shelf life. This is also true for reinsurance arrangements. When initiated and originally structured, the reinsurance agreement between the reinsurer who assumed the risks and the ceding entity that ceded the risks, both parties had business objectives to achieve from the original reinsurance transaction. Those business objectives may have included capacity relief for the ceding entity, stabilization of underwriting results, protection against catastrophic events and relief from managing highly technical and volatile books of business. Assuming the reinsurance arrangement performed as expected by the contracting parties (the converse may also be true), there comes a time when one or both parties to the original reinsurance arrangement may conclude that commuting the transaction may be in the interest of all concerned. What does the term "commutation" actually mean? Statutory accounting guidance in Statement of Statutory Accounting Principle No. 62, Property and Casualty Reinsurance, which is included in Volume I of the "Accounting Practices and Procedures Manual", defines the term as follows: "*A commutation of a reinsurance agreement, or any portion thereof, is a transaction which results in the complete and final settlement and discharge of all, or the commuted portion thereof, present and future obligations between the parties arising out of the reinsurance agreement.*" As such, it is not necessary to commute the entire reinsurance agreement. Perhaps certain layers within the reinsurance agreement, or clearly defined lines of business, or certain risk categories, or accident year data, if properly identified and reported may be subject to a commutation arrangement.

Every product has a shelf life. This is also true for reinsurance arrangements.

Charles J. Widder is President of CJW Consultants, LLC and can be reached at charles.widder@verizon.net.

Interested Parties to the Transaction

The most obvious answer to the above side heading is the reinsurer and reinsured or ceding entity. Having said that, the interested party in the case of the ceding entity might be an insurance department regulator, deputy or receiver if the ceding company is exiting a book of business, or, due to financial concerns, including a state of insolvency. The ceding entity, may in fact, have concluded that the reinsurance provided is no longer necessary and prefers to assume the liabilities back from the reinsurer along with a cash payment. This may be particularly attractive to the ceding entity if the development on the loss and loss expense reserves previously ceded to the reinsurer has been favorable to the reinsurer. Usually, the reinsurance contract will contain a clause that specifies the timing and conditions under which the contract can be commuted.

If an insurance department or court appointed receiver is involved, the rationale for entering into commutation discussions typically will be motivated by generating cash flow to discharge obligations of the entity being liquidated. Payment by the reinsurer is usually made on a "paid" basis for loss and loss adjustment expenses and not when those obligations are in reserve status. The entity being liquidated is typically cash constrained and it is in the best interest of the insureds and other creditors of the ceding entity to generate as much cash as possible to discharge its obligations, or portion thereof. Additional motivations may include concerns by the ceding entity that certain reinsurers on their program are no longer financially strong and pose a credit risk. Commutation is one of the tools available for managing this credit risk.

The Collaborative Process

Just as the reinsurer relied upon technical experts in various disciplines when the original reinsurance treaty was executed, a similar team of technical experts should be assembled to perform the due diligence when commuting the original agreement, or part, thereof. Typically, the team is composed of the following disciplines: financial, claims, actuarial, legal and underwriting. Reasons for entering into the commutation process should be agreed and documented. For the process to proceed efficiently, a project (team) leader should be responsible for mapping out the due diligence process. That leader can be a respected and knowledgeable person from any of the above disciplines. The author's experience has been with a financial executive leading the process.

A project plan is crucial to keeping the team on track as to document needs, analysis, deliverable dates and discussion with the counterparty to the commutation. Agendas should be used to keep the meetings of the commutation team focused, and minutes taken to document discussions, analysis of data, issues and strategies for resolving identified issues. Claims expertise is crucial to understand the nature and exposure of the reported reserves to be commuted. Disputed coverage issues need to be identified early in the process and communicated to the team. Legal and claims expertise is crucial to this process. The existence of any trust agreements, letters of credit and funds held needs to be evaluated and discussed with the legal representative to avoid legal entanglements down the road as to attachment and set-off rights, draw downs, state requirements (legal and regulatory) regarding set-off rights.

A reconciliation of account balances needs to be performed in conjunction with the due-diligence review. This is typically performed by the accounting department. Part of this process probably will include ongoing discussions with the counterparty to the commutation in order to reconcile account balances, funds held amounts, etc.

Just as the reinsurer relied upon technical experts in various disciplines when the original reinsurance treaty was executed, a similar team of technical experts should be assembled to perform the due diligence when commuting the original agreement, or part, thereof.

The Claims Department team member, in addition to addressing disputed claims, will provide invaluable assistance in reconciling the inventory of open reported claims between the parties to the commutation.

Actuarial support is needed to prepare a range of incurred but not reported (IBNR) loss and loss adjustment expense estimates by contract, or part to be commuted. Discount factors need to be applied to both the reported and IBNR claims to bring the outstanding liabilities to present value. The discount factors to be used will depend upon the type of business being commuted. Long tail liability claims will have deeper discounts and longer payout patterns than property claims.

The commutation team needs to review, analyze and reconcile all the data gathered and prepare a report that projects possible financial underwriting results, both to the reinsurer and ceding entity. The underwriting results should be developed based upon worst case, best case and expected case scenarios, then communicated to senior management to apprise them of possible financial impacts to the company from the proposed commutation. Buy-in by senior management is essential to proceeding with further negotiations with the counterparty.

The Negotiation Process

The underwriting and financial scenarios are used as a framework to discuss and resolve account balances, fund balances, outstanding claims and IBNR reserves with the ceding entity or its representative. The negotiation process should include reasonable and agreed time frames to conclude the process, rather than having an open ended process. Agreement upfront between the parties for handling immaterial amounts

continued on next page

can greatly expedite the process and avoid having the process bog down. Face to face meetings between the commutation parties can be extremely beneficial and promote focused attention on issues and expectations. Minutes of the meetings are crucial to maintaining order and closure on agreed account balances, reserves and coverage issues.

Ideally, each party to the negotiation process should walk away from the table satisfied that a reasonable and fair settlement has been reached.

It may be that one party is in a stronger negotiating position, either because of financial strength, better and more accurate record keeping, or timing for the final commutation agreement not being an issue. Regardless of party relative strength, the commutation negotiations should be conducted professionally and among equals. Each of the contracting parties has goals and objectives in the commutation process. It is important to discuss and understand those goals and objectives for each side. Ideally, each party to the negotiation process should walk away from the table satisfied that a reasonable and fair settlement has been reached.

The Final Product

A memorandum of understanding should be prepared to document the decisions reached, amounts to be discharged and method and timeliness of payment. This understanding should be the foundation of a written addendum to the treaty, including the release language of all current and future obligations of the parties to the commutation agreement. Legal and contract underwriting departments typically handle this part of the process. In the case of broker involvement, the intermediary can perform this process. Appropriate signatures and dates on the commutation agreement are executed (including state insurance regulatory) where required.

Accounting Treatment of Commuted Reinsurance

Statutory accounting guidance is contained in Statement of Statutory Accounting Principle (SSAP) No. 62, Property and Casualty Reinsurance. This guidance requires the ceding entity to recognize the present value payment (cash and/or securities) received in the underwriting accounts as a "negative" paid loss (income) and the loss reserves recoverable are eliminated (expense). Any resulting net gain or loss is reported in the statutory income statement as underwriting. The reinsurer recognizes the present value cash payment as a paid loss (expense) and eliminates the carried loss and loss adjustment expense reserves from its balance sheet (income), with the resulting net gain or loss reported as underwriting in the statutory income statement.

All commuted balances are removed from related schedules and exhibits of the annual statement by ceding entity and reinsurer.

The accounting treatment under U.S. GAAP is prescribed in Statement of Financial Accounting Standards (SFAS) No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts. The ceding enterprise is effectively re-assuming the obligations previously ceded to the reinsurer for a present value cash payment. The accounting recognition through the underwriting accounts is essentially the same as for statutory accounting described above for both ceding entity and reinsurer.

There is an added requirement for income recognition by the reinsurer, (assuming that the commutation transaction resulted in a gain) in that the total obligation to the ceding entity has to be extinguished. The language of the commutation agreement (addendum to the original contract) specifically releases the reinsurer from all current and future obligations for the business commuted. Therefore, the extinguishment of liability condition has been met.

Conclusion

The collaboration of various insurance and reinsurance disciplines is necessary to maximize the effectiveness and timeliness of the commutation process and ultimate agreement. Having a work plan with specific target dates sets the commutation process in motion and provides progress and feedback to the entire team. The negotiation then is predicated on documentation and analysis and dealing effectively with coverage issues and other differences with the counterparty to the transaction. Being able to provide a "win-win" situation to both parties is crucial to a successful outcome. ■

Feature Article

Drafting a Commutation Agreement


Mark Everiss


Chris Sage

By Mark Everiss & Chris Sage

This article addresses some of the legal and drafting issues that should be considered when preparing and negotiating a commutation agreement. While the article primarily focuses on commutations of reinsurances, many of the issues apply to commutations of direct business also.

Commutation agreement or commutation clause

The first step is to examine the relevant contract(s) to see if there is already a commutation clause in the contract(s). In circumstances where a single policy or treaty is being commuted, if there is a commutation clause included in the contract it may be possible to use it. When deciding whether to rely on an existing commutation clause, the following points will be relevant:

- Does the clause set out how the commutation will be valued? Is there a mediation or dispute resolution procedure if the valuation cannot be agreed? Many commutation clauses are, effectively, 'agreements to agree', that is they do no more than require the parties to discuss commutation terms, and under English law such clauses are not legally enforceable.
- What is the effect of commutation? Does the commutation cover the whole policy/treaty, or just part of it?
- What if there are future claims? Are all liabilities commuted?

If there is no commutation clause in the policy or the commutation clause does not meet the commercial agreement that has been reached then a separate commutation agreement will be required.

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Chris Sage is a Solicitor at Kendall Freeman and can be reached at chrissage@kendallfreeman.com.

Basic principles

Although they may seem rather simplistic, some of the fundamental questions which need to be addressed (and often are not resolved until the lawyers get involved) are:

Who are the parties?

The issue may be particularly complicated if the commutation relates to a book of business between the parties over a period of time. The results of any pre-commutation due diligence exercise will be of assistance in this regard, as that process should have identified each of the contracts that is being commuted and details of the original parties to them.

Consideration should be given to whether the original parties are still the appropriate parties to the commutation. Particular attention will need to be paid to this issue if there has been an insurance business transfer or if either party has merged with or acquired other (re)insurers.

... can pre-existing long tail liabilities be commuted without the consent of that affiliate?

Complications arise where insurance or reinsurance cover was originally granted to a company and its affiliates but one or more of the affiliates has since been sold off. Even if the contract provides for that affiliate to be excluded from cover from the point of sale, can pre-existing long tail liabilities be commuted without the consent of that affiliate? The answer to that question may depend on the terms of the policy.

Similarly, any reinsurance contract which is stated to be for the benefit of the reinsured "and/or their quota share reinsurers" (or similar wording) will require further analysis to establish whether or not those quota share reinsurers are parties to the contract.

What is being commuted?

Whether the commutation relates to a single policy, a facultative reinsurance, a treaty or an entire book, it must be precise in identifying its subject. Again, the

continued on next page

results of the pre-commutation due diligence will be key. How can the business being commuted be accurately and comprehensively described? What is the policy number? Is there a complete list of treaty numbers? If an entire book of business is to be commuted there is risk at both ends: either of missing something so that some contracts remain outstanding, or of commuting something very valuable that one or both parties did not even know existed. For example, a commutation of "all business written by X Insurance Company prior to 1995" may inadvertently include the contracts written through an underwriting agent to whom X had given its pen.

> ... precision in the wording is essential to ensure that the correct group of contracts is included in the agreement.

One exception to the general principle that the commutation should identify the contracts being commuted as precisely as possible is the concept, which a number of run-off managers have used over the years, of the 'accelerated' or 'global' commutation, which encompasses all the policies between the parties, whether identified or not and (if relevant) whether inwards or outwards. In certain circumstances this approach has the benefit of allowing the parties to close their books on a particular line of business or relationship without the expense of a full due diligence process, and therefore is particularly useful where there are large numbers of small value policies but records are incomplete or poorly maintained and where the risk that a policy may be commuted unknowingly is low value, even if high probability. Even in this situation, precision in the wording is essential to ensure that the correct group of contracts is included in the agreement.

Particular care should be taken where one or both parties are the product of a number of mergers – is it the policies written by all of the former companies that are to be commuted, or just one?

How much is being paid, and how?

Is the commutation payment a lump sum figure? If not, how is it to be calculated? If the reserves are backed by a trust fund or other collateral arrangement containing specific investments, consideration should be given to whether these will be transferred to the cedant, liquidated and the cash proceeds paid over, or valued with the equivalent amount being paid and, if the last of these options, who will value them?

If the consideration is to be calculated according to a complex formula, or on the basis of a valuation of assets, a clause providing for reference to an independent expert, to make any determination that cannot be agreed, can be included in the contract. The expert's decision will usually be binding in the absence of manifest error, meaning that there is a pre-agreed (and hopefully quicker and cheaper) alternative to going straight to the courts or an arbitration panel.

Ideally (for the cedant, and for contractual simplicity) the commutation balance should be settled in full on completion of the agreement. If this is not to be the case, there is a risk that a later payment may not be made. The ability to sue for the unpaid amount may have little value if the reinsurer is insolvent. Can the balance be secured somehow, for example does the reinsurer have a parent which can guarantee payment? Often a commutation agreement will provide that the reinsured has the option of treating the commuted reinsurances as reinstated if the reinsurer defaults on a payment, with the reinsured's alternative option being to sue on the agreement.

Some more technical issues to consider

The extent of the liabilities being commuted

Unless the commutation is in relation to a particular claim or claims, or is intended to preserve IBNR (perhaps because an agreement with a retrocessionaire has not yet been reached – as to which, see below), the commutation needs to be in respect of all liabilities, present or future, actual or contingent, known or unknown. It has been suggested that wording such as "all claims under the contract" without any qualification may only catch paid and outstanding claims.

Are there any unpaid balances due under any of the contracts? The wording suggested above settles or releases that liability as well, so any such amount should either be wrapped up in the commutation payment or specifically carved out of the wording.

Recoverability of commuted amounts

Ideally a reinsurer commuting an inwards policy will have agreed the commutation with its retrocessionaire before completing. If not, consideration will need to be given as to the extent to which commutation payments can be recovered from the retrocessionaire. In the UK, there is a notable absence of judicial guidance on recoverability issues. This is not, perhaps, unsurprising given the fact that most market participants have both inwards and outwards interests to consider and the huge commercial impact of a concrete decision.

... there is no doubt that the decision is an interesting and controversial one for market settlements and settlements containing an element of the recovery of IBNR.

The law

The recent decision of *English and American Insurance Co. Ltd. (In a Scheme of Arrangement) v Axa Re SA [2006] EWHC 3323* will be of great interest to reinsurers seeking maximum recovery on their retrocessions and to retrocessionaires being asked to pay claims comprising more than just 'paids'. In that case, Mrs Justice Gloster addressed an application for summary judgment (on the basis that there was not even an arguable defence to the claim) in a claim by a reinsured against its reinsurer for recovery of sums paid pursuant to a single settlement relating to Dow Corning (Dow) losses, of both paid claims and IBNR. Although the Judge did not, in fact, grant judgment for the sums relating to payments for IBNR by the reinsured, English and American Insurance Co. Ltd (EAIC), it would appear from her comments that she would have felt able to do so.

The Judge found that there had been a settlement which satisfied the requirements for settling a claim falling within the risks covered by the reinsurance contracts. Against the background of the 'follow the settlements' clause, the claim fell within the coverage of the contracts and EAIC had acted honestly and taken proper and businesslike steps in reaching the settlement – both these requirements being fundamental necessities as laid out in *ICA v SCOR [1985] 1LLR 312*. The payment to Dow by EAIC was in recognition of the fact that EAIC had liabilities to Dow of at least that amount.

The Judge considered that AXA had advanced no plausible basis for asserting it had a realistic prospect of defending EAIC's claim for at least the paid claims but found it was "just about conceivable, although unlikely" that AXA might have a defence to the amounts paid in respect of IBNR. Therefore, not least as a result of EAIC's counsel having conceded on this point, she did not grant summary judgment for that part of the settlement and a full hearing will now be heard in relation to that issue.

Comments

It is difficult to draw definite conclusions from this decision – it is not a lengthy one and does not go into the detail of the evidence actually presented by the parties. However, although in the context of recoverability it does not lay down any firm principles, there is no doubt that the decision is an interesting and controversial one for market settlements and settlements containing an element of the recovery of IBNR.

Enhancing the prospects of recovery of commutation payments

For a reinsurer, it may be useful to include in the commutation agreement separate valuations in respect of admitted liabilities, outstanding claims and IBNR to support a claim against a retrocessionaire. In addition, an obligation could be included to require the cedant to continue to provide claims information following the commutation to support further claims against a retrocessionaire. There may be more technical solutions to the problem but these are more complex and would need to be explored with your lawyers, taking account of the specific facts of the case.

continued on page 28

Message from CEO and Executive Director

AIRROC and "Roll" continued from page 1

Despite the ever-changing nature of the run-off market, the consensus of the AIRROC Board of Directors is that our mission statement remains on point. I present again our statement as a reminder of why we exist:

"The mission of the Association is to promote and represent the common business interests of insurance and reinsurance companies in run-off. The Association's objectives will include improving professional and managerial standards and practices, and enhancing knowledge and communications within and outside of the run-off industry through educational activities."

The **AIRROC/Cavell Commutation & Networking Event** will take place again at the Sheraton Meadowlands, NJ on October 15-17, 2007. Last year's attendance was 360; expected this year 400. It appears that we will once again meet expectations. *(An event application is included on page 18 of this issue.)*

Speaking of education, the AIRROC Education Committee (Co-chaired by our Chairman Andrew Maneval of Horizon/Hartford and Jonathan Bank of Lord, Bissell & Brook) is progressing very nicely with Mealey's on the October 15-16 program. Attending attorneys, solicitors and barristers will gain seven CLE/CPD credits including one hour of ethics. AIRROC will absorb the cost of accreditation filings. What a bonus!

I attended the Norwich Rendezvous June 11-14 to touch base with many friends from the UK, Europe, Asia and other countries while enjoying the camaraderie of my US friends.

Our one-day commutation and negotiation event on February 21, 2007 in NYC was a tremendous success with 111 confirmed delegates and a few walk-ins. I have released to our membership and others many of the numerous positive comments; however would like to quote one that simply struck me:

"The Commutation Day was very worthwhile. We were able to meet with representatives from companies based in the UK and on the West Coast, as well as with others outside of the New York area, saving time and travel expense. Our meetings went very well and we established action plans for proceeding with contract reconciliations and other analyses necessary to advance the commutation process. The advantage of face-to-face meetings is that it makes it easier to develop a working relationship with the other party, and to establish a commitment with that party to devote the internal resources necessary to complete commutation pricing and evaluation in a reasonable period of time. We should definitely plan to do this again in February 2008, and LeParker Meridien/NYC is a fine venue."

Hence, we have our marching orders. The next one-day Commutation and Issue Resolution Day will be February 27, 2008, hopefully in the Penthouse Room of LeParker Meridien. Plan accordingly!

Nearly 100 attended our February 22, 2007 membership meeting at the offices of our counsel, LeBoeuf, Lamb, Greene & MacRae in midtown NYC. Our education sessions were stellar with credit to so many facilitators including Joe Fritsch, New York Dept. of Insurance. We plan again to present education sessions during our July 26, 2007 membership meeting. Many have submitted topics that are under consideration.

Remember to access **www.airrocc.org** where, among many other items of interest, you will find the dates and locations of upcoming membership meetings now set through July 2008.

Continue to spread the word about AIRROC and the value of relationships and our objectives. There are other companies who would benefit from membership but it is difficult to identify and recruit all. Encouraging communication with others in the run-off industry is important to recruiting. We appreciate your help.

Solutions matter to AIRROC. ■

Ms. Getty has been active in the insurance and reinsurance industry for over forty years, specializing in reinsurance claims. She has significant experience evaluating liability and reserve adequacy and planning and implementing claims and operational audits. In 1996, Trish expanded her focus to include sales and marketing of reinsurance services. In addition to active business, Trish has provided consulting services to regulators for the reinsurance administration of troubled and liquidated companies. She can be reached at trishgetty@bellsouth.net.

AIRROC'S Commutation and Negotiation Event
February 21, 2007, New York City

Working through issues and numbers face-to-face produces results, perhaps closure. Relationships are invaluable.

commutations and networking event

registration form

October 15-17, 2007, Sheraton Meadowlands, New Jersey

AIRROC CAVELL

Company Name	
Company Address	

Delegate details

Title		Forename		Surname	
Company Representing					
Telephone				Fax	
Mobile/Cell				E-mail	
Title		Forename		Surname	
Company Representing					
Telephone				Fax	
Mobile/Cell				E-mail	
Title		Forename		Surname	
Company Representing					
Telephone				Fax	
Mobile/Cell				E-mail	
Special Dietary Requirements					

Your contact details will be used to provide a Delegates 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. ☐

Registration fee and payment

The registration fee is US$600/£350 per delegate (US$450/£250 for AIRROC members and US$500/£300 for ARC/RAA members).

For UK£ registrations: Completed registration forms together with your cheque payable to Cavell Management Services Limited, should be sent to Wendy Fitch at Rose Lane Business Centre, 51-59 Rose Lane, PO Box 62, Norwich NR1 1JY.
Tel: 01603 599407, Fax: 01603 599441, Email: wendy.fitch@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, 1100 Cornwall Road - 3rd Floor, Monmouth Junction, NJ 08852.
Tel: 732-398-4401, Fax: 732-398-5025, Email: edward.gibney@cna.com

Credit cards can now be accepted for US$ registrations only, via the AIRROC website, www.airroc.org

Every company which is a member of AIRROC is entitled to one FREE registration.

Please tick if appropriate ARC/RAA Member ☐ AIRROC Member ☐

Cancellation of bookings:
Prior to 1st Sept 2007 - 100% reimbursement, prior to 1st Oct 2007 - 50% reimbursement and from 1st Oct thereafter - no reimbursement.

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.

Accomodation

A special rate of $150 (exc. taxes) per person, per night has been agreed with the hotel, for attendees of the AIRROC and Cavell Commutations event. Please refer to this when making your accommodation arrangements. However, you may wish to stay at another hotel of your preference.
Sheraton Meadowlands Hotel and Conference Center, East Rutherford, New Jersey, USA. Tel: 001 201 896 0500. www.sheraton.com/meadowlands

FOR FURTHER INFORMATION ON THE EVENT, PLEASE CONTACT:

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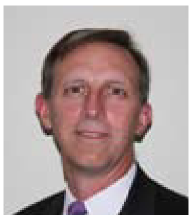
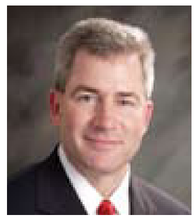
Feature Article

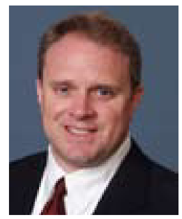
A Roundtable Discussion: The Dynamics of the Commutation Process Examined through Multiple Lenses

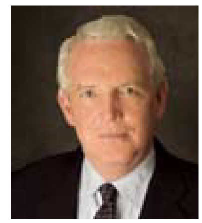
Moderated by Special Editor Michael T. Walsh


Rudy Dimmling


Paul Kanefsky


Howard Mills


Tom Ryan


Mike Walsh

Commutations necessarily tap human resources from various disciplines assigned not only with the responsibility to achieve the goal, but also to define, calculate, support, negotiate, consummate and document the goal.

Against this backdrop, we thought it would be interesting to convene a Roundtable discussion of experts from various disciplines to discuss the dynamics of the commutation process with the expectation that it would yield some lively discourse. We were not disappointed. The Special Editor, Michael T. Walsh of Boundas Skarzynski Walsh & Black, LLC, served in the John McLaughlin role, as moderator and host. Our panel of experts consisted of Howard Mills, the former Superintendent of Insurance for the State of New York, now with Deloitte as our regulatory authority, E. Paul Kanefsky of Edwards Angell Palmer & Dodge, LLP bringing a legal perspective, Rudy Dimmling, former Chief Administrative Office of Centre, as our business expert and Tom Ryan of Milliman presenting an actuarial view.

Mike Walsh: Thank you all for making yourselves available today for a discussion of one of, if not the key issue in effective run-off operations — commutations. I thought I would start with a rather basic question: What are some of the key issues you would identify that are unique to run-off companies in approaching commutation?

Rudy Dimmling: What is unique with commutations in a run-off environment is that you want to avoid having the original underwriters doing the commutations, which I have seen all too often. You really need to take it out of the hands of the underwriting unit because they usually have emotional ties to the deals that they originated. It is imperative to have a good commutation team bringing together the various disciplines within the company — actuarial, legal, accounting, tax, risk and investment management. In addition, good negotiators, which are essential to effectively executing commutations and having the right team in place, are crucial.

Paul Kanefsky: I agree with Rudy as to the effectiveness of commutation teams. As outside counsel, I have been part of such teams for companies in run-off, often where the commutation resolves a legal dispute but also when a company simply wants support for legal and drafting issues. Also, companies in run-off tend to seek global commutations to resolve all open matters with a given insurance company. A global commutation, which may include setoffs and other complications, usually involves more complex negotiations and drafting concerns, which is another reason for outside counsel to be part of the process.

continued on next page

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Tom Ryan: As an actuary our goal is to put a number or value on the liabilities involved in the commutations in a run-off situation. A lot of the contracts were written a long time ago, the wording is ambiguous, and one of the challenges is to understand what was the intent of the coverage. You can read a reinsurance contract on its face but that necessarily is not the way it has been interpreted and operated by the parties. So it is helpful to have access to in-house knowledge, someone who is familiar with the contracts and sometimes that does not happen in a run-off situation.

Howard Mills: I think you put your finger on something that is a regulatory concern. When you talk about the absence of underwriters and absence of staff — from the regulators' point of view, you are concerned about who is running the shop and who is there to do the work. The degree of interest on the part of the regulator is really a factor of whether or not there is a threat of insolvency. If it is a relatively healthy run-off where there are limited solvency concerns, the regulator is not likely to be that involved — obviously where there is a greater degree of financial peril and a possibility of reserves not being sufficient, then the regulatory involvement is much more intense.

Mike Walsh: What are the trends members of the panel have seen with respect to involvement or oversight of regulators with respect to commutations involving run-off companies that might have some solvency issues?

Howard Mills: I think the trend that we are seeing now is a greater willingness on the part of regulators to become involved and to be helpful in moving commutations along.

There are basically two things that no regulator wants to have happen on his or her watch: One is insolvency, and two is putting the company into liquidation. We are seeing a far greater willingness on the part of the regulators to get involved in very proactive and progressive approaches such as Regulation 141 type situations.

The regulator plays a very unique and important role as the referee in the commutation process, to impart the whole concept of equality and fairness whether it is a reinsurer or an insurer and whether to bring the retrocessionaires into this equation. I think that the regulator is also going to be looking at who is first in line and naturally they are always going to want to prioritize in favor of claimants versus reinsurers.

Paul Kanefsky: Clearly, where liquidation can be avoided through liquidator-approved commutations, as in a successful New York Regulation 141 plan, everybody can win.

Tom Ryan: In terms of stepping back to the general point, when there is not an issue of financial insolvency or instability we usually do not see a lot of regulatory involvement, but when there is a situation of flirting with insolvency, the Regulation 141 setup in New York works pretty well. I think we would like to see things continue down that road.

Paul Kanefsky: Additionally, even when a company is already well into liquidation, a supportive liquidator can be a great facilitator of commutations that both help the insolvent company and are fair to the other party, especially in multifaceted relationships, as when the solvent company is both a creditor and a debtor of the company in liquidation. I have seen farsighted and cooperative liquidators who, recognizing the potential for mutually beneficial economic results, actively shepherd complex, multi-party commutations through to court approval.

Mike Walsh: Does the panel feel that there have been any new developments in the involvement of retrocessionaires in the commutation process?

> The days when a retrocessionaire simply "followed the fortunes" of its reinsurer regarding a commutation without considerable due diligence are all but over. – Kanefsky

Paul Kanefsky: The days when a retrocessionaire simply "followed the fortunes" of its reinsurer regarding a commutation without considerable due diligence are all but over. A retrocessionaire wants to know how its reinsured's commutation payment is being allocated: Is it all paid losses? How much is case reserves? How much, if any, is IBNR? Is the payment allocable to actual, identifiable claims as opposed to "notional claims" based on actuarial projections? Is the payment just a negotiated lump sum that a retrocessionaire may have a problem passing on to its own reinsurers?

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

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covered by the treaty. U.S. law is much more liberal, but many defenses may still be available, ranging from treaty wording issues to the economic reasonableness and good faith basis of the transaction.

The commuting reinsurer wants to make sure that its retrocessionaires will support the deal and not raise objections that could lead to a later dispute. We generally recommend notifying the retrocessionaires of a proposed commutation fairly early in the process, once you have agreed on the structure of the commutation and the approximate amount of the payment. More detailed discussions and provision of requested documentation will follow, and a draft commutation agreement may be provided to retros for comment and signoff.

I have been involved in situations where two sets of agreements were prepared — the commutation agreement itself and, not long after, a separate agreement between the reinsurers and their retrocessionaires, in which the retros agree to pay their proportionate shares of the reinsurers' commutation payments. The retrocessional agreement is contingent upon the commutation going through, and works almost in unison with it. In fact, the deal can be structured so that there is one pot, into which the reinsurers pay their retained portions of the commutation amount, and the retrocessionaires pay the amounts they have accepted.

Retrocessionaires increasingly want to understand what their piece of the liability is and what documentation and modeling exists that supports their share. – Ryan

Tom Ryan: I would agree with Paul. Retrocessionaires increasingly want to understand what their piece of the liability is and what documentation and modeling exists that supports their share. This can get pretty complex when talking about excess layers and allocating IBNR. It is definitely a trend that we are seeing that "follow the fortunes" is no longer a guiding principal but rather more emphasis is being placed on demonstrating why the reinsurer believes the retrocessionaire owes this money, with a demand for a higher degree of supporting documentation.

Rudy Dimmling: I want to echo what Paul said regarding timing. Timing is critical here. Bringing a retrocessionaire into the process too early does not work. It will just complicate matters, because commutations are by design one of negotiation, and commutation structures are always evolving. So if you bring them in too early it will be fruitless, because you end up negotiating a tri-party type settlement. Bringing retrocessionaires in too late could be disastrous as well. It could create problems down the road in which they could argue of not being involved in the process or that the commutation is unfavorable or unfair to them. So I think it is critical from a commutation team perspective for the person spearheading the commutation to have the experience to know at precisely the right time to bring in a retrocessionaire within those discussions.

Mike Walsh: One of the areas of concerns faced by run-off companies is the potential for unwinding of pre-insolvency commutations as being preferential. What can be done to minimize this risk and/or to provide comfort to commuting partners?

Paul Kanefsky: You want to protect yourself as much as possible through language drafted into the agreement. As a matter of potential damage control, the lawyer for the party worried about another party's financial status wants to negotiate the strongest provisions possible to protect the client's interests and avoid ultimate exposure much greater than bargained for in the commutation. Of course, you do not want to commute with a company you expect to go under any week or month, because that may just be a preferential transfer waiting to happen, as opposed to the usual situation where a company may be seen as vulnerable to impairment but viable for the foreseeable future.

The basic problem for a cedent in a simple commutation is that the reinsurer becomes insolvent and the liquidator takes back the commutation payment as a preference or fraudulent transfer. Since the agreement itself might still stand, there will have been a release so that the cedent no longer has the right to recover against the reinsurer. This threshold issue is easily taken care of by a "reinstatement" clause providing that if a preference occurs and the payment is taken back, the agreement becomes null and void and the parties are returned to their original status as though the agreement did not exist. The rights of the cedent are revived so that it can file a valid proof of claim or otherwise seek to obtain at least partial reimbursement from the insolvent estate. In more complicated commutations, such as those including different levels of reinsurance — perhaps a quota share plus inuring protections —the parties can provide for indemnifications and other features to mitigate additional exposure triggered by a party's insolvency.

Rudy Dimmling: From a business perspective, what I have seen is that no matter how good your legal team is and how you go about crafting the legal document, you really cannot eliminate the risk of a preferential or fraudulent transfer. There is nothing you really can do to fully protect yourself. To go back to one of the previous questions we discussed earlier, you can try to utilize certain structures that are available to eliminate potential preference issues — Regulation 141 in New York is a case in point.

Tom Ryan: I would agree with Rudy, you can not eliminate the risk of these potential claw-backs. However, in terms of minimizing the risk from an actuarial perspective you can have strong documentation so that if there is a problem you can go back and show that you used the best practices, the right method, the correct data and a well documented plan to make your case that the final value of the commutation was fair.

Howard Mills: With regard to providing some comfort to commuting partners and facilitating the process moving forward, if you have an Insurance Department that is very proactive and engaged, a couple of advisory meetings with the regulator explaining this is where we are can avoid a more serious situation. It not only helps the process, but it can provide that comfort because it indicates that there is regulatory support which often I have found eases a lot of concern.

Mike Walsh: A question many of our readers may find interesting is what roles do you see outsourcing firms playing in commutations and how are these firms most effective?

Rudy Dimmling: Many run-off companies do not have the resources to fully execute a commutation strategy and an outsourcing firm can provide levels of expertise specifically needed such as actuarial, accounting, legal, IT and negotiating the commutation. Implementing a commutation strategy is as much art as science, it requires an effective deal manager to negotiate a favorable settlement.

Tom Ryan: Many of these outsourcing terms bring to the table a specialized knowledge or area of expertise. Sometimes where the company looking to commute is a foreign company, they might hire a US-based outsourcing firm to give them sort of boots on the ground here to understand the lay of the land and that can prove to be very effective. Also, some of these outsourcing firms specialize in certain types of claims. For example, I am aware of one firm that handles a lot of construction defect claims which are very different in terms of their life cycle, when they are reported, how they are closed and exposure trigger issues from other types of claims. Because this firm does so much work with theses types of claims, they have a much better understanding of how these claims are going to play out and what to expect in the future on these losses which translates into a real advantage going into any kind of commutation negotiations. That level of knowledge provides leverage and they were more effective in the commutation negotiations.

Paul Kanefsky: Where multiple companies are involved, as in run-off reinsurance facilities or pools, it is essential that you have a "clearinghouse." You need a professional run-off administrator to handle the accountings and the actuarial work for all of the companies involved, otherwise a commutation may never happen. Participating companies are not typically going to let a fellow pool or facility member run the show, and the necessary in-house expertise to handle all aspects of a multi-party commutation may not be available in any event.

> In years past senior management viewed run-off as expense management. Now boards and senior management realize the value that can be created for the firm and for shareholders by implementing a quality commutation team to extract value and return for shareholders. – Dimmling

Rudy Dimmling: I think the industry is evolving and AIRROC and other organizations like that are growing. In my opinion there is a paradigm shift from run-off being perceived as a backwater type role. In years past senior management viewed run-off as expense management. Now boards and senior management realize the value that can be created for the firm and for shareholders by implementing a quality commutation team to extract value and return for shareholders. Companies are beginning to see that staffing their own teams on discontinued units makes sense because they know their business and know their deals. In essence the outsourcing firms are almost becoming a victim of their own success.

Mike Walsh: Thank you all very much for participating in what I think was a very lively and informative session. ■

Feature Article

Commutation Agreements in Court:

Judicial Interpretation and Strategies for Avoidance

William A. Maher

Marc L. Abrams

By William A. Maher & Marc L. Abrams

In a perfect world, a commutation agreement between two long-term reinsurance partners would represent a paragon of contractual clarity, delineating with exactitude the particular treaties and facultative certificates covered by the commutation. As several federal court opinions demonstrate, the drafters of commutation agreements do not always reside in this perfect world. Besides demonstrating the occasional fallibility of commutations, these cases also reveal which clauses in commutation agreements are most likely to be subject to dispute — namely, clauses referencing which reinsurance agreements are subject to the commutation. In this article, we first discuss the few federal cases that have interpreted disputed commutation agreements and then provide observations for parties and practitioners seeking to avoid — rather than inspire — future litigation proceedings involving commutation agreements.

> ...these cases also reveal which clauses in commutation agreements are most likely to be subject to dispute — namely, clauses referencing which reinsurance agreements are subject to the commutation.

William A. Maher is a Founding Member of Wollmuth Maher & Deutsch LLP where he leads the firm's Reinsurance Dispute Resolution practice. He can be reached at wmaher@wmd-law.com.

Marc L. Abrams is Counsel at the firm of Wollmuth Maher & Deutsch LLP and practices in the areas of reinsurance, insurance and general commercial litigation. He can be reached at mabrams@wmd-law.com.

I. Federal Authorities Discussing Disputed Commutation Agreements

Although there are not many federal authorities discussing disputed commutation agreements, *Continental Casualty Co. v. Northwestern Nat'l Ins. Co.*, 427 F.3d 1038 (7th Cir. 2005) serves as a useful illustration of how a commutation agreement can go awry. In this proceeding, the Seventh Circuit Court of Appeals reviewed a commutation agreement beset with ambiguity. The Cedents maintained that the disputed agreement only commuted three facultative certificates that the Reinsurer had issued to Continental Casualty Company ("CCC"). On the other hand, the Reinsurer interpreted the commutation agreement far more broadly, arguing that it also commuted as many as 2,200 reinsurance contracts that the Reinsurer had issued to a corporate affiliate of CCC, namely Continental Insurance Company ("CIC"). *Id.* at 1041.

The commutation agreement itself shed little light on the dispute. The schedule of covered reinsurance agreements merely contained the entry "0709 Bellafonte Reins" – i.e., a reference to the predecessor of the Reinsurer who had actually issued reinsurance agreements to both of the affiliated Cedents. Given the indeterminacy of this provision, the federal district court considered a variety of extrinsic evidence to determine the scope of the commutation, ultimately granting summary judgment in favor of the Cedents and adopting a narrow reading of the commutation agreement. *Id.* at 1041-43. The federal district court's ruling was subsequently affirmed by the Seventh Circuit.

The Seventh Circuit's grounds for reaching its decision are instructive. At the outset, the most probative evidence supporting a narrow reading of the commutation were several pre-commutation facsimiles exchanged between the parties, which suggested that the "outstanding receivables by claims" due to the Reinsurer amounted to a number ($22,783.55) that could only be reached by adding three claims arising under the three facultative certificates issued to CCC. The Seventh Circuit reasoned that although these pre-commutation facsimiles "do not prove unequivocally that [the Reinsurer] knew that only these three facultative agreements were commuted, they negate [the Reinsurer's] position that it was unaware completely of what agreements were included in the category '0709 Bellefonte Reins.'" *Id.* at 1041-42. The Court then held the Reinsurer's post-commutation conduct against it, finding that: (1) its failure to electronically demarcate as "commuted" all facultative certificates issued to both Cedent affiliates as well as claims arising thereunder, demonstrated that the Reinsurer did not believe that all 2,200 agreements were covered by the commutation; and (2) the Reinsurer's communications with the holding company of the two Cedent affiliates (*i.e.*, CNA) seeking a global commutation implied that the disputed commutation agreement applied narrowly. *Id.* at 1042-43.

The Seventh Circuit then rejected several of the Reinsurer's arguments supporting a broad reading of the commutation agreement. *First*, the Court disagreed that the parties' decision to exchange an IBNR figure during commutation negotiations indicated that they were pursuing a global commutation, notwithstanding the difficulty of calculating IBNR for just three facultative certificates. In particular, the Court found this argument to rely on "speculation," which it need not have accepted as true. *Id. Second*, the Court disregarded the fact that the Cedents had applied one of the Reinsurer's payments under the commutation agreement to a particular facultative certificate issued to CIC (rather than CCC). The Seventh Circuit reasoned that the commutation agreement did not expressly preclude the Cedents from applying the commutation payment to non-commuted contracts. *Id.* Finally, the Court refused to credit a notation by CCC's signatory to the commutation agreement stating "All assumed Bellafonte Re Fac . . . ", which appeared next to the ambiguous "0709 Bellafonte Re" language. The Court found that this notation was "cryptic," especially since the writer of the note was not available for deposition. *Id.* at 1043.

In *Mid Century Ins. Co. v. American Centennial Ins. Co.* 1997 U.S. App. Lexis 5181 (9th Cir. 1997), the Ninth Circuit reached an opposite conclusion, preferring to construe a disputed commutation agreement on a global basis. At issue in this proceeding was whether the disputed commutation applied globally to cover both treaties that the Reinsurer had issued to a Cedent as well as facultative certificates issued to an independently managed affiliate of the Cedent, given that the commutation bound the "[Cedent] on behalf of itself *and its affiliates, parents and subsidiaries*."

Affirming the district court, the Ninth Circuit Court reached the same conclusion, holding that "if the parties intended to separate" the facultative certificates issued to the Cedent's affiliate from the commutation "they should have said so."

Id. at *10 (emphasis added). Granting summary judgment in favor of the Reinsurer, the federal district court found that the commutation agreement unambiguously covered reinsurance agreements issued to both the Cedent and its affiliate – notwithstanding that the affiliate separately controlled and managed the facultative certificates issued to it. Affirming the district court, the Ninth Circuit Court reached the same conclusion, holding that "if the parties intended to separate" the facultative certificates issued to the Cedent's affiliate from the commutation "they should have said so." *Id.* In reaching this result, the Ninth Circuit found that the Cedent's argument – *i.e.*, that "if the parties had intended a global settlement of all treaties and facultative certificates, the commutation agreement would have used the word 'and' instead of 'on behalf of'" – relied on a meaningless distinction. *Id.* at *9 -*10 ("[t]here is no significant difference between the word 'and' and the phrase 'on behalf of,' as those terms are used here."). The Court then rejected the Cedent's misrepresentation claim: *i.e.*, that during pre-commutation negotiations, the Reinsurer had led the Cedent to believe that the commutation only applied to the treaties issued to it, and not the facultative certificates issued to the Cedent's affiliate. *Id.* at *11-*12. On the contrary, the Court found that the Cedent had done nothing to determine the "precise extent of its reinsurance business" with the Reinsurer "even though that information was readily available."

Finally, in *National Union Fire Ins. Co. of Pittsburgh, P.A. v. Walton Ins. Limited*, 696 F. Supp. 897 (S.D.N.Y.

continued on next page

1988), the Reinsurer and Cedent agreed that the commutation agreement applied to three insurance programs involving the Cedent, but could not agree on whether the commutation also applied to a fourth program referred to as Interstate Towers, which was administered for the Cedent by the Delaware Valley insurance agency. The Cedent sought a narrow reading of the commutation, arguing that prior to the commutation, the parties had not discussed the Interstate Towers program, had not exchanged data relating to it, and did not reference it in various draft versions of the commutation exchanged by the parties. *Id.* at 899-900. In response, the Reinsurer pointed out that the final version of the commutation agreement agreed to commute "[Reinsurer] Contract numbers 10652/80, 12348 (Delaware Valley…)." According to the Reinsurer, the term "Contract No. 10652" – which it had inserted into the final version of the commutation – referenced the reinsurance contract covering the Interstate Towers program, while the term "Delaware Valley" referred to the managing agent who administered the Interstate Towers program. *Id.* The Cedent attempted to blunt the Reinsurer's arguments on the grounds that the "Delaware Valley" managing agent also administered one of the indisputably covered programs (*i.e.*, Contract No. 12348) and that, in any case, the contract numbers appearing in the commutation were merely used by the Reinsurer for its own internal bookkeeping purposes. *Id.*

As elementary as it sounds, parties to a commutation agreement must come forward with explicit language addressing the effect of the commutation agreement on various corporate affiliates — or face possible litigation on this issue.

After considering these arguments, the Court ruled in favor of the Reinsurer, finding that the commutation agreement unambiguously covered the Interstate Towers program; in particular, the Court was persuaded that the clause "Contract No. 10652 . . . Delaware Valley" could only have been used to include the Interstate Towers program in the commutation. *Id.* at 900-901. The Court then dismissed the Cedent's fraud and mistake claims based on the Reinsurer's "unilateral" insertion of the disputed contract number (*i.e.*, Contract No. 10652) into the final draft of the commutation, finding that: "while negotiating a release involving nearly $25,000,000, [the Cedent and the Reinsurer] were dealing at arms' length – substantially in a debtor-creditor relationship – and were certainly not in a trust or confidential relationship. [The Cedent] could have inquired concerning the contents of the release at any time." *Id.* at 903.

II. Observations and Suggestions for Parties and Practitioners Seeking to Avoid Commutation Disputes

The three cases discussed above provide several useful guidelines for companies and practitioners who are considering entering into a commutation agreement.

First, the fundamental issue for the parties in the two Circuit Court cases was whether the commutation agreements covered reinsurance contracts issued to the actual commuting party alone or to its corporate affiliates too. Ceding companies with affiliates that each maintain independent relationships with the same reinsurer should proceed with caution and would be well served by explicitly excluding from the commutation agreement those reinsurance agreements issued to corporate affiliates of the cedent – to the extent the cedent is seeking a narrow commutation agreement. Conversely, reinsurers who are seeking a global commutation, which includes agreements issued to the cedent and its affiliates should explicitly indicate so. As elementary as it sounds, parties to a commutation agreement must come forward with explicit language addressing the effect of the commutation agreement on various corporate affiliates – or face possible litigation on this issue.

Second, in attempting to discern the intent of a disputed commutation agreement, a Court will carefully review the post-commutation conduct of the parties. As the Reinsurer in the *Continental* matter learned, its failure to electronically demark a "C" alongside those contracts it believed to be commuted significantly weakened its argument in favor of a broad commutation agreement. Although a company has no obligation to follow any particular organizational methodology, it would be prudent for a company to develop and maintain a system reflecting its particular understanding of whether and to what extent a commutation affects its various treaties, certificates and claims. Similarly, to the extent reinsurance partners have already commuted a certain subset of agreements they would be well advised to maintain a consistent position in further commutation discussions affecting other agreements. Again, as the Reinsurer in the *Continental* matter discovered, by taking a seemingly inconsistent position in its commutation discussions with an affiliate of the Cedent, its conduct was held against it.

Third, Courts are not averse to considering parties' pre-commutation conduct in attempting to illuminate a disputed commutation agreement. For instance, in the *Continental* matter, the Court found that the pre-commutation facsimiles exchanged by the parties referencing covered claims supported the Cedent's narrow interpretation of the commutation. Similarly, in the *National Union* matter, the Reinsurer was able to point to pre-commutation communications which "summarized all the reinsurance contracts… and which contained the [Reinsurer] contract number" to blunt the Cedent's argument that it had no knowledge that the particular contract number referred to the disputed program. More generally, the point is this: A party should make sure that its pre-commutation communications are in harmony with its understanding of the scope of the commutation agreement – or risk having these communications used against it.

Finally, one striking point that the foregoing cases demonstrate is that courts may view commutation disputes through a different lens, especially when compared to arbitration panels. It is unlikely that an arbitration panel would have granted summary disposition to the Reinsurers in the *Mid-Century* and *National Union* cases – effectively relying on the contractual language to the exclusion of the parties' conduct. Indeed, both of these courts apparently viewed the commuting parties as arms' length in nature – with the *National Union* Court essentially allowing the Reinsurer to unilaterally insert a material clause into the commutation agreement that had apparently never been discussed by the parties. Clearly, these courts did not perceive the relationships between the Cedents and the Reinsurers as honorable engagements.

It is also unlikely that an arbitration panel would have precluded the Cedents in *Mid-Century* and *National Union* from developing extrinsic evidence supporting their respective contractual interpretations. And all three of the cases discussed above emphasized technical readings of the particular commutations, oftentimes at the expense of more equitable "custom and practice" arguments developed by the losing parties. In sum, these three rulings suggest that parties entering into commutation agreements would be wise to consider the advantages and disadvantages of allowing an arbitration panel – rather than a court – hear their commutation disputes. In a similar manner, parties can use the commutation agreement itself to explicitly state whether the duty of utmost good faith applies in the context of negotiating and consummating the commutation agreement. *See, e.g.*, *PXRE Reinsurance Co. v. Lumbermens Mut. Cas. Co.*, 2004 U.S. Dist. Lexis 9343 (N.D. Ill. 2004) (court refusing to import duty of utmost good faith into a retrocessional agreement which contained a full integration clause stating that "there are no general or specific warranties, representations or other agreements . . . except as specifically set forth").

It is somewhat perverse that a commutation agreement — which by its nature is designed to resolve disputes between reinsurance partners — may sometimes lead to more disputes.

It is somewhat perverse that a commutation agreement – which by its nature is designed to resolve disputes between reinsurance partners – may sometimes lead to more disputes. Nonetheless, as the three foregoing cases demonstrate, there are ways that parties can help protect themselves from commutation disputes – or at the very least, buttress their interpretations of disputed commutation agreements through pre-and post-commutation conduct. Although following these techniques will never create a perfect world of commutation agreements, they may inspire modest improvements – or, as Alexander Hamilton reportedly said: "I never expect to see a perfect work from imperfect men." ■

Think Tank

Commutations – A Historical Perspective continued from page 8

> We did not mind the 8 hour flight home that evening!

They say that the doctrine of "caveat emptor" means, "let the buyer beware". Knowing the two parties involved, this was certainly a "win-win" scenario.

This next story was one of my favorites and shows that there really is a humane side to our industry (it's not frequently shown — but it is there nonetheless).

> Late 1980s lower Manhattan, mid-afternoon and I had a 3 p.m. appointment with a gentleman from a German reinsurer that was in run-off. There is a monsoon of a thunderstorm going on and I realize that the meeting will probably be late.
>
> I had been going over my financials and was thinking that I would have a hard time getting the $300K that was my wish list amount never mind my walk-away number of $250K from this reinsurer.
>
> At 2:58 p.m. I receive a call from the front desk advising that my visitor has arrived. When he gets to my office there is a man that could not have been wetter if he stood for an hour under Niagara Falls without an umbrella. We tried to dry him off with paper towels but why bother!
>
> This gentleman sits down in my now replaced chair and states that his company is in run-off and while appearing to be (and probably was) very uncomfortable he advises that he is only willing to pay $500K for the commutation.
>
> This could have been the fastest commutation on record. We asked if he had reviewed the business and if he was sure of his price. He then advised that if pushed there was probably a bit more that could be had but he would have to go back to management for approval.
>
> My associate and I stepped outside on the premise of getting him more towels and some coffee. We agreed that to take more than $400K from him would be in really bad form. We actually had to argue with him to get him to pay the lower amount!

It seems that today, we use phrases such as exit strategies, solvent and insolvent schemes and that the business seems like more of an exact science than it was *back in the day*. The best lesson we can probably learn from the past is that the best deal is not necessarily the one where the numbers are right – the lesson is that this is still a people business and relationships make for better deals.

Anyone who thinks that the business of run-off is boring just is not having enough fun! ■

Feature Article

Drafting a Commutation Agreement

continued from page 15

Choice of law and dispute resolution

Finally, although by no means specific to commutations, a choice of law clause should be included in all contracts and a method for resolving disputes – either litigation in the courts or arbitration. If the latter, the parties should consider what form of arbitration will be used. ARIAS provides a standard clause which can be used if the ARIAS rules are being adopted. It is also becoming more common to include a clause requiring the parties to submit to mediation before commencing more formal proceedings. Usually these clauses do not provide for a binding resolution, but they provide some comfort that an effort will be made to avoid escalating a dispute unnecessarily.

Conclusions

While many companies have commutation agreements on their precedent system, many situations demand far more than merely an exercise in 'filling in the blanks'. As with all new contracts, from new policies to outsourcing services, careful due diligence at the pre-contract stage and precise drafting of the agreement will prevent potentially very expensive mistakes. ■

Feature Article

The Deal of the Decade

Speaking in public for the first time since the deal was announced, Equitas Chief Executive Officer Scott Moser addressed the Association of Run-Off Companies (ARC) yearly congress at the Merchant Taylors Hall on 27th February 2007.

Mike Palmer reviews the deal and looks at what it means for policyholders, cedents, and the wider market. Mike also looks at what precedent if any, the Equitas scenario sets for tackling Lloyd's open years or post-Equitas run-off issue.

Mike Palmer

By Mike Palmer

Creation of Equitas and Setting the Scene

Before Scott outlined the "deal of the decade", he went through some key milestones in the creation of Equitas and the build-up of what lead Equitas to becoming the cornerstone of the massive losses suffered by Lloyd's in the 1980s and the 1990s. Following the comprehensive reconstruction and renewal exercise, Equitas reinsured 1992 year and prior liabilities of Lloyd's names. Equitas was funded with almost $12 billion premium and reinsured risks written by 390 syndicates over more than 750 separate reinsurance programmes spanning 220,000 different reinsurance policies with 3,000 reinsurers. So with all of that in the past Scott went on to define the deal that had been struck with Berkshire Hathaway, the Omaha based organisation that will take on the full liabilities of Equitas in a two-stage process.

Four Guiding Principles

Scott Moser outlined the major principles under which Equitas sought to find finality:

- Reinsurance needed to be massive – practical finality achieved.
- Equitas needed the right to seek novation – within a structure that maximised the chances of approval.
- Equitas required a "gold-plated" solution of high quality financial security.
- Governance was required to protect the Lloyd's syndicate names.

Mike Palmer is a Director at Helix UK Limited, a provider of consultancy, administration and support services to the insurance and reinsurance industry. He can be reached at mike.palmer@helixuk.com.

The Deal at High Level

Scott Moser outlined the eight key stages of the Berkshire Hathaway deal:

1. Equitas transfers all of its assets to National Indemnity.
2. Equitas keeps £172 million.
3. Lloyd's contributes £72 million.
4. National Indemnity conducts run-off and pays liabilities up to Equitas reserves $8.7 billion plus an additional $5.7 billion.
5. Parties seek transfer of liabilities and Equitas can buy up to $1.3 billion more cover.
6. Lloyd's contributes another £18 million.
7. National Indemnity either retains an AA- rating or puts money in trust or posts a letter of credit.
8. If a situation deteriorates markedly Equitas can play an active role in conducting a run-off.

The Deal Structure

Under phase one National Indemnity:

- Reinsures ALL of the reinsurance obligations of Equitas.
- Agrees to pay liabilities up to Equitas claims reserves plus a further $5.7 billion – total cover of around $13.8 billion. This is set out in the table below:

Total Cover	$ Billion
Net claims reserves as of 31.03.2006	8.7
Additional reinsurance	5.7
Net payments	(0.6)
Total	13.8

- National Indemnity takes on the staff and operations of Equitas and conducts the run-off at its own expense.

Phase One – The Reinsurance Premium

The premium payable is:

- All Equitas assets less £172 million and
- The contribution from Lloyd's of £72 million.
- Effective cost to Equitas is £286 million.
- Equitas surplus at 31 March 2006 £458 less retained by Equitas (£172) giving a total of £286 plus Lloyd's contribution £72 million – total phase one premium £358 million.

Phase One – Return Premium Potential

- Small return premium expected to be paid.
- FSA advise that maximum they will consider during phase one is £50 million.
- Equitas believe they will be able to secure FSA's approval for making the payment this spring or summer 2007.

Phase One – Deal Contingencies

The following are required:

- Approvals and waivers from the FSA.
- Approval of New York insurance authorities for the release of EATF assets.
- Approval of Equitas trustees.
- If steps do not occur by 31 March 2007, deal collapses unless parties agree to extension.
- Lloyd's must gain approval at an EGM to pay its contribution (this approval has subsequently been given).

Phase One - Summary

- Procures a massive amount of reinsurance.
- Protects the financial integrity of reinsurance.
- Establishes rights of names to assure run-off conducted properly.
- All economic benefits of the deal are crystallised.
- Total cover of £13.8 billion is assured.
- Cover is not linked to National Indemnity's future investment profits or losses on assets transferred.

Phase Two - Novation

- Propose to seek novation under UK law.
- Option to purchase up to additional $1.3 billion reinsurance.
- Novation not possible today due to technical defect within FSMA.
- HM treasury consulting now on a proposed amendment to fix defect.
- Parties seeking novation must get approval of FSA and court.
- Court must be satisfied policyholders no worse off.
- Deal structured to provide an attractive setting for court approval.

Phase Two – Additional Cover

- Equitas has an option to buy up to $1.3 billion of cover in event of court approval.
- Additional reinsurance should be recognised by courts and policyholders as an improvement in situation.
- Option to purchase additional cover:
  - Only open until 31 December 2009.
  - Expires if reserves deteriorate by $2 billion or more.

Phase Two - Lloyds

- Lloyd's will contribute £18 million on 31 December 2009 regardless of the novation.
- After novation, Equitas hopes to pay a further return premium.

Phase Two – If no Novation by 2009

- If phase two does not occur by 31 December 2009, Equitas may:
  - Continue to seek court approval of novation with new arrangements for additional reinsurance.
  - Abandon novation and purchase reinsurance.
  - Buy no further reinsurance and seek FSA approval to pay a further return premium.
  - Decide on some combination of these choices.

Phase Two – Legal Finality

- We realise names want *legal* finality.
- Transaction designed to provide greatest opportunity to achieve it.
- Names are well protected if this is not possible.

continued on next page

Feature Article

The Deal of the Decade continued from page 31

Conclusion

- Agreement is validation of our strategy.
- Affirmation of claims dealing methodologies.
- Names want to sleep easy.
- They have the world's best mattress.

But What Does All of this Mean for the Rest of Us?

It would seem there is no doubt that the Equitas deal will become a defining event or moment in terms of the management of prior year's business – a kind of coming of age maybe for the likes of Lloyd's discontinued business and for a legacy business sector that had previously been largely ignored outside a fairly narrow circle of insurance practioners and professional advisers. It would also seem clear that senior executives of many major insurance groups all over the world are now coming to a similar conclusion about the use of strategic run-off techniques on live and discontinued business. It could be said that almost every reinsurer that has ever existed "since the dawn of time" must effectively have run-off and legacy issues. But the sheer scale of the Equitas deal will make it a defining moment.

The world's largest run-off vehicle since day one of its creation, the 2006 ARC/KPMG run-off survey put Equitas total liabilities at £4.4 billion. More importantly the deal also shows recognition by Lloyd's that the exposure to prior year's liabilities is indeed a brake on future development.

So, does the deal of the decade mean that Equitas and Lloyd's have severed its links on the past and will never have to look at run-off again? Certainly the figures would indicate not, in 2002 the ARC/KPMG run-off survey put Equitas total liabilities at £7.6 billion.

At the same point the run-off liabilities of 1993 and following years of non-life Lloyd's syndicates came to £5.4 billion.

By the 2006 survey which was based on 2005 results Equitas liabilities had gone down to **£4.4 billion** but Lloyd's 1993 and post-open years liabilities had increased to **£7.5 billion**. So is the past about to repeat itself?

In another presentation at the same ARC congress Peter Taylor of Lovells spoke at length about asbestos toxicity, comparing it to the "perfect storm" and sought comments from the audience on what might be the next perfect storm. Using this analogy it is probably fair to say that the post-Equitas Lloyd's run-off is not as toxic as the APH ridden content of the older years however, it would probably be complacent of Lloyd's to consider the current open years syndicates as free from the perfect storm.

So, two questions spring to mind as by-products of the "deal of the decade":

1) Clearly the Berkshire model for run-off of long tail liabilities is not one of proactive or overt commutation policy. I have heard Ajit Jain (who heads Berkshire's catastrophe insurance operation) say on one occasion that he sees run-off as a game of inches! For my money, many of those inches and more importantly yards will not be measured by commutation. What scale of impact will this have on future London market commutation deals and strategies?
2) What is a true finality solution for its pre 1992 open years, leaves Lloyd's with a quandary; what will they now do with the post 1992 open years, or £7.5 billion worth of run-off liabilities? To-date only one Part 7 transfer (small life syndicate) has been approved by Lloyd's. This leaves RITC as the only open solution for the corporation or will they decide to dig a little deeper into the tool box of run-off solutions? ■

KPMG

Policyholder Support Update — Alert No. 19

KPMG's Restructuring Insurance Solutions practice has been providing e-alerts to the insurance industry regarding Schemes of Arrangement for many months. These e-alerts act as a reminder of forthcoming bar dates and Scheme creditor meetings. If you do not already receive these alerts, please access www.kpmg.co.uk/insurancesolutions.

Solvent Schemes – Upcoming Key Dates

LASALLE RE LIMITED

The above company's Scheme was approved at the Meeting of Creditors on 11 April 2007 and was subsequently sanctioned by the Court on 27 April 2007. The bar date has been set as 30 August 2007. Further information is available on www.lasallerescheme.com.

OSLO REINSURANCE COMPANY (UK) LIMITED; OSLO REINSURANCE COMPANY ASA

By Order of the High Court of Justice of England and Wales, Meetings of Scheme Creditors, for the two companies above, were convened on 12 February 2007. The Oslo Reinsurance Company (UK) Limited scheme was subsequently sanctioned. The anticipated claims bar date has yet to be announced. The Sanction hearing for the Oslo Reinsurance Company ASA Scheme will be held in the week commencing 11 June 2007. Further information is available on www.oslore.no and www.kpmg.co.uk/insurancesolutions.

RELIANCE NATIONAL INSURANCE COMPANY (EUROPE) LIMITED

The above company's Scheme was approved at the Meeting of Creditors on 2 February 2006 and was subsequently sanctioned by the Court on 20 October 2006. The bar date has been set as 21 May 2007. Further information is available on www.whittingtoninsurance.com/publicity/schemes.php and www.kpmg.co.uk/insurancesolutions.

WALTON INSURANCE LIMITED

By Order of the Supreme Court of Bermuda, a Meeting of Scheme Creditors for the above company is to be convened for the purpose of considering and, if thought fit, approving a Scheme of Arrangement. The Meeting will be held at the offices of Appleby Hunter Bailhache, Canon's Court, 22 Victoria Street, Hamilton, HM EX Bermuda on 17 May 2007. Further information is available on www.waltonscheme.com.

ARION INSURANCE COMPANY LIMITED

The above company's Scheme was approved at the Meeting of Creditors on 12 March 2007 and was subsequently sanctioned by the Court. The bar date has been set as 29 June 2007. Further information is available by e-mailing saleem.malik@us.pwc.com.

COMPAGNIE EUROPEENE D'ASSURANCES INDUSTRIELLES S.A.

By Order of the High Court of Justice of England and Wales, Meetings of Scheme Creditors for the above company are to be convened for the purpose of considering and, if thought fit, approving a Scheme of Arrangement. The meetings will be held at the offices of PricewaterhouseCoopers LLP, 1 Embankment Place, London, WC2N 6RH on 11 May 2007. Further information is available on www.ceai.co.uk.

EUROPAISCHE RUCKVERSICHERUNGS-GESELLSCHAFT IN ZURICH (EUROPEAN REINSURANCE COMPANY OF ZURICH)

The above company's Scheme was approved at the Meeting of Creditors on 20 December 2006 and was subsequently sanctioned by the Court. The bar date has been set as 23 July 2007. Further information is available on www.rgmpool.com.

GREAT LAKES REINSURANCE (UK) PLC

By Order of the High Court of Justice of England and Wales, a Meeting of Scheme Creditors for the above company is to be convened for the purpose of considering and, if thought fit, approving a Scheme of Arrangement. The meetings will be held at the offices of PricewaterhouseCoopers LLP, Plumtree Court, London, EC4A 4HT on 18 June 2007. Further information is available on www.gluksolventscheme.co.uk.

RELIANCE NATIONAL ASIA RE PTE LIMITED

The above company's Scheme was approved at the Meeting of Creditors on 26 September 2006 and was subsequently sanctioned by the Court. The bar date has been set as 14 May 2007. Further information is available on www.whittingtoninsurance.com/publicity/schemes.php.

WILLIS FABER (UNDERWRITING MANAGEMENT) (WFUM) POOLS

By Order of the High Court of Justice of England and Wales, Meetings of Scheme Creditors, for the Scheme Companies who participated in the WFUM Pools, were convened on 27 October 2006. The Sanction hearing for the 14 WFUM Pools Scheme Companies for whom votes were taken is currently scheduled for 18 July 2007. The anticipated claims bar date has yet to be announced. Further details are available at www.kpmg.co.uk/insurancesolutions and www.wfumpools.com.

Other Recent Developments

AXA INSURANCE UK PLC; ECCLESIASTICAL INSURANCE OFFICE PLC; GLOBAL GENERAL AND REINSURANCE COMPANY LIMITED; MMA IARD ASSURANCES MUTUELLES; SWISS REINSURANCE COMPANY (IN RESPECT OF THE GLOBAL LONDON MARKET (GLM) POOL BUSINESS)

By Order of the High Court of Justice of England and Wales, Meetings of Scheme Creditors, for the five companies above were convened on 28 February 2007. The court hearing to sanction the Schemes previously scheduled for 14 March 2007 has been deferred pending completion of the vote valuation by the vote valuer. Further information is available on www.glmpool.com.

CAVELL INSURANCE COMPANY LIMITED

The above company's Scheme was approved at the reconvened Meeting of Creditors on 25 April 2005. The Company has postponed their application to the High Court of Justice of England and Wales for the Scheme to be sanctioned the date of this application has yet to be announced. Further information is available by e-mailing steve.aldous@castlewood.co.uk.

CHEVANSTELL LIMITED

The above company is proposing to implement a Solvent Scheme of Arrangement. A Practice Statement Letter was sent out to brokers and known policyholders on 7 December 2005. On 17 August 2006 an agreement to sell the company to Randall & Quilter Investment Holdings Limited was announced. Further information is available on www.chevanstell.co.uk.

NRG VICTORY REINSURANCE LIMITED

The Meeting of Creditors held on 23 May 2006 was adjourned. The date and location of the reconvened meeting has yet to be announced. Further information is available on www.nrg-solventscheme.co.uk.

RIVERSTONE INSURANCE (UK) LIMITED; MITSUI SUMITOMO INSURANCE COMPANY (EUROPE) LIMITED; SIRIUS INTERNATIONAL INSURANCE CORPORATION (PUBL) (IN RESPECT OF THE ORION POOL BUSINESS)

The above companies expect to apply to the High Court of Justice of England and Wales for permission to convene Meetings of Creditors. The date of this application has yet to be announced. Further information is available on www.rsml.co.uk/solvent/.

Insolvent Estates

UIC INSURANCE COMPANY LIMITED

The 27 March 2007 bar date for the above company's Scheme has now passed. Further information is available at www.uic-gt.com.

WILLIS FABER (UNDERWRITING MANAGEMENT) (WFUM) POOLS (SOVEREIGN MARINE & GENERAL INSURANCE COMPANY LIMITED - INSOLVENT PARTICIPANT) ■

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


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