ASSOCIATION OF INSURANCE AND REINSURANCE RUN-OFF COMPANIES

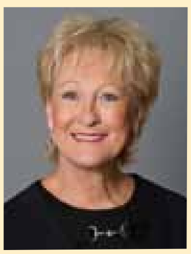
AIRROC® MATTERS

A NEWSLETTER ABOUT RUN-OFF COMPANIES AND THEIR ISSUES

Vol. 7 No. 3 www.airroc.org Fall 2011

Message from Executive Membership Director

"Nothing But Blue Skies From Now On…"



Trish Getty

Remember that lovely song? This is the way I feel about AIRROC, as do so many others. For even given grey skies in our legacy books, we can gain so much from AIRROC membership. There are many benefits so let me count the ways.

The most significant benefit is the camaraderie experienced by attending AIRROC membership meetings. If members have missed meetings, it's something that you should reconsider. Our meetings are held in New York City, so most have other reasons to be there and can justify the expense and time. Several members have expressed how getting to know one another at these meetings allowed them to settle disputes – another advantage of effective communication.

Of course, education is a key factor for both our membership meetings and the October commutation event. The education co-chairs remain aware of current topics that affect legacy books and feed off of topic suggestions from our members and others.

AIRROC's regional education sessions have been well received by our members who send those working on the lines every day to learn

continued on page 40

Think Tank

Roundtable Discussion on Legacy Management

Moderated by Art Coleman and Peter Scarpato

Art Coleman Jim Sporleder Mindy Kipness Klaus Endres Peter Scarpato

Recently, our Chair Art Coleman and Editor Peter Scarpato sat down with Mindy Kipness of Chartis, Klaus Endres of AXA and Jim Sporleder of Allstate to discuss several issues related to Legacy Management.

Art Coleman: *Thank you all for making yourselves available today for a discussion on legacy management. I thought we would start off with a rather basic question for all participants: how does your company define legacy management?*

Jim Sporleder: At Allstate Insurance Company, we have decided over the years to put parts of the company that are no longer part of our core businesses into what we now call our legacy book of business. In Allstate's case, the legacy book was initially excess property liability and assumed reinsurance business that included a lot of asbestos and environmental losses. The employees who specialize in those areas, while still working for the overall company, are focused on what has become our run-off book of business.

This book has evolved and now includes other small areas of business that the company no longer writes on a core basis. It has become an area that consists

continued on page 5

Rendez-vous
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See pages 23-24 for info and registration

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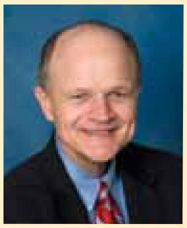
"Gimme Shelter"


Peter A. Scarpato

Apt words following an East Coast earthquake and hurricane, penned by Mick Jagger 42 years ago as an end-of-the-world apocalypse song. The message resonates today, with threats of war, terrorism, nuclear armament and global warming. But it is our ability to come together, collectively seeing clear solutions in the face of murky problems that sustains us. That same ability is exhibited by members of this fine organization AIRROC, at our annual Commutation Event and other membership meetings, where the industry's best and the brightest gather to get the business of legacy run off done. To you, we dedicate this issue.

In her melodic *Nothing But Blue Skies From Now On…*, Trish aptly summarizes the many known and unknown benefits of AIRROC membership. Next, Art Coleman and I present a *Roundtable Discussion on Legacy Management*, in which Klaus Endres, Mindy Kipness and Jim Sporleder trade and compare valuable insights into this often unique and challenging process. The Secretary of your Publications Committee, Joe Monahan, offers *Due Diligence Considerations for Run-off Acquisitions,* summarizing comments from the buyer's and seller's perspectives made by a panel of Richard Fabian, Richard Hershman and Neal Moglin, at our March 2011 Membership Meeting.

Our section on Regulatory Develop–ments features *New York Insurance Department Changes Regulation of Multi-Beneficiary Reinsurance Trusts*, Stewart Keir's and Robert A. Romano's excellent discussion on the Department's recent change in the regulation of multi-beneficiary reinsurance trusts to accommodate non-U.S. run-off reinsurers. Andrew Rothseid keeps us current on GTE Re's status with *The Rhode Island Solution.* And for those still pondering our Special Edition on Insolvency, we offer *The Property and Casualty Guaranty Funds* by Rowe W. Snider and Julie L. Young, a retrospective on the funds' 43 years of service.

Finally, this edition presents summaries of the educational presentations from Dewey & LeBoeuf's July 13, 2011 Run-off Symposium, Nigel Curtis' Present Value and the KPMG Policyholders Support Update.

Let us hear from you.

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

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

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

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AIRROC® Matters – In this Issue

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Roundtable Discussion on Legacy Management *continued from page 1*

of business that is not part of the core Allstate business and its operations are handled on a specialized basis.

Klaus Endres: At AXA Liabilities Managers, our legacy management is in respect of whole companies or entire portfolios, where the business is no longer being underwritten. This is predominantly the case for assumed reinsurance where the whole group decided to exit actively underwriting reinsurance roughly six years ago.

Mindy Kipness: Until very recently, when we entered into a large, well-publicized loss portfolio transaction involving most of our asbestos exposure, we have managed runoff and legacy business within the profit center that wrote the business. We do not segregate runoff books into a separate operation under separate management.

Jim Sporleder is Vice President and Assistant General Counsel at Allstate Insurance Company in South Barrington, Illinois. He manages the Specialty Operations Law Practice Group which handles ceded and assumed arbitrations and litigation for Allstate's legacy book of business. His practice group also helps draft and approve Allstate's present day catastrophe reinsurance program. He can be reached at jsporled@allstate.com.

Klaus Endres joined AXA Liabilities Managers in 2008 as Executive Vice President in charge of global business development and acquisitions of run-off portfolios/companies, including US transactions. He is a German national based in Paris and can be reached at klaus.endres@axa-lm.com.

Mindy Kipness is the Senior Vice President of Reinsurance Finance for the Global Reinsurance Division of Chartis Insurance Company, a wholly owned subsidiary of AIG, where, for the past 16 years she has had oversight of Commutations, Insolvency and Solvent Scheme related collections and negotiations, reinsurance management reporting. Mindy was awarded the AIRROC Person of the Year Award in 2010. She can be reached at mindy.kipness@chartisinsurance.com.

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

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We do focus on whether reinsurers are active or in run-off. If the reinsurer is active, we will frequently involve the reinsurance placement officers in collection matters given the ongoing relationship. However, if we are dealing with a run-off reinsurer, our reinsurance collections, direct claims staff and legal team would typically take the lead in resolving recoverable issues.

Art Coleman: *Do any of the other companies look to the future with respect to discontinued policies or contracts within a live book of business as run-off? For example, let us say XYZ Company was a commercial insured of the company for years but it's now discontinued and it's gone to another carrier and there's a couple of thousand claims that are being better managed. Is there ever any thought of moving that policy and the claims associated with it to the people who typically would handle run-off? Is that something that either AXA or Allstate would consider?*

Jim Sporleder: We do not. Allstate is primarily focused on auto, homeowners and life insurance. Years ago we were also involved in excess/surplus and ceded and assumed reinsurance, which is now at the core of our legacy book. Because our legacy employees understand environmental matters, they sometimes get involved in helping other claims people at Allstate in homeowners work with discreet things like environmental problems involving a homeowners' policy. So our legacy claims people do help that way. In some cases, the legacy side actually handles those specialized claims, but in most cases they act as a consultant. I don't think that is anything quite like what Art was mentioning.

Klaus Endres: At AXA, we would also not treat individual discontinued policies as legacy or run-off contracts and therefore they would not be managed by the legacy or run-off teams. Such policies would remain within the rest of the active portfolio.

We would only consider cutting out such a portfolio and give it to the run-off specialists AXA Liabilities Managers if it were, say, a whole line of business in a country that was put into run-off and if it were of substantial size.

Peter Scarpato: *The profits and pundits of the industry like to look at and talk about trends, and think about the future by looking at the past. Have any of you seen any trends in legacy management over the past five or ten years, and if so, can you give us your unique perspectives about them?*

Jim Sporleder: The biggest trend we have seen is the consolidation via loss portfolio transfer or by actual purchase of companies by larger companies. Even though Allstate is not involved in these transfers, we are affected by them

continued on page 6

Roundtable Discussion on Legacy Management *continued from page 5*

because we have both ceded and assumed business with companies that become consolidated.

The impact to us, of course, is not just the name change on the listing of the company, but consolidation also changes your relationship with the consolidated company. We have also seen this in the broker area.

Peter Scarpato: *Mindy, what is your perspective?*

Mindy Kipness: Well, I have to agree about consolidation among the brokers. Another trend looking back at the past five or ten years was the onset of many solvent schemes from the U.K. Solvent schemes arrived with critical deadlines. Often there were multiple schemes at the same time, so it was a difficult period. I think that has slowed down.

In addition, between 2002 and 2004, certain large reinsurers were downgraded, had ownership changes, or were placed into runoff or some stage of insolvency. Since 2001 you've had 9/11, huge CATs, the recent Japan earthquake and reserve strengthening in the market. All of these events that have taken place over the past ten years have led to the concentration and consolidation of reinsurers.

Peter Scarpato: *Klaus?*

Klaus Endres: Yes, for me, a key trend is more professionalism. Most people you see nowadays working on run-off and legacy issues are specialized in that area and are very experienced and professional.

The second trend, on a global basis, is where in the past the U.K. had been the focus of run-off, with all of the completed schemes of arrangement that focus has been shrinking and will continue to shrink. Over time there will be more focus on run-off in the U.S. and Continental European markets.

> *... I expected more impact of the financial crisis of 2008/2009.*

And lastly, maybe a non-trend: I expected more impact of the financial crisis of 2008/2009. I don't think that it impacted the run-off sector that materially, except for lower investment returns on financial assets.

Jim Sporleder: To add to what the others have just said, over the last five or ten years the term "run-off" book of business, which used to be a bad word, has become a cottage industry. Organizations like AIRROC have developed, and now we all realize that there are other companies with similar books of business. Sometimes those books of business are even coveted by other companies.

Peter Scarpato: *One of the items that was briefly mentioned before is broker consolidation. Do you think that the broker and run-off consolidations that have occurred are good or bad from the legacy management standpoint?*

Mindy Kipness: One of the concerns with newly consolidated brokers is that there is a new team in place; the specialists who were our contacts may be gone from the newly consolidated company. The new folks may not be aware of the history of the contract placement, which may create confusion, and files may get lost, both of which will delay collection of reinsurance recoverables. This follows the confusion created by the various mergers and acquisitions of runoff reinsurers.

Membership in AIRROC has aided us as well as other members in identifying the contacts for principal-to-principal relationships and, if needed, contacts at run-off brokers or replacement brokers.

Jim Sporleder: With respect to the intermediaries, of course, these books of business are no longer generating premium, so even though they've tried to keep up, contracts are not given the importance that the new broker business gets. So, it's putting more pressure on the run-off companies to do some of that themselves or to maintain records that they wouldn't ordinarily otherwise have. We've also found that sometimes, when you move old businesses within brokers, records are lost or people that were there, like Mindy just said, are no longer employed at the consolidated broker.

It becomes a little more of a strain on maintenance of documents and relationships, when brokers become imbedded in other brokers and we start to lose some of the original direct relationships.

Klaus Endres: I couldn't agree more, on the last point Jim mentioned. We had several occasions where brokers didn't perform the services that they should have. Some brokers have merged and in the process of doing so data was lost on claims that were not handled anymore, creating serious issues. So more and more we're using specialized broker replacement services to improve our cash flow.

Mindy Kipness: We find that the active brokers are still servicing our legacy business, especially when Chartis is one of the broker's current markets. However, we do get personally involved. We have lead collectors who go to London and accompany the broker on principal-to-principal visits to ensure that our issues stay in focus.

Peter Scarpato: *When you read about the U.S. economy in general, one big topic is outsourcing. Is outsourcing impacting*

continued on next page

the legacy management business, and if so, how? How are "outsourcers" typically compensated and managed?

Klaus Endres: From my experience very large insurance groups with large run-off reserves tend to keep most functions in-house. Only quite selective tasks are outsourced for these large groups – I mentioned broker replacement before. I see many small and medium insurers just not having the necessary scale to do things in-house, so they tend to use outsourcing services quite a lot. And the same I guess is true for receiverships, et cetera, where outsourcing is also a topic.

Outsourcing, per se, is not the general trend. I would say that consultants are only used when there is a selective service needed.

Mindy Kipness: We only use consultants in a selective manner, depending on the specialty of the provider. Outsourcing, per se, is not the general trend. I would say that consultants are only used when there is a selective service needed.

Jim Sporleder: I agree with Klaus and Mindy. We haven't really emphasized outsourcing in our area, although I'm sure that management will look at outsourcing if it ever became useful or important; but at the present time, we do almost everything in-house.

Peter Scarpato: *Do you all agree, as mentioned before, that the financial crisis really hasn't impacted legacy management at all as much as was expected?*

Mindy Kipness: The reinsurance buyers are scrutinizing reinsurers more closely . Actually, reinsurers and insurers have held up well after the financial crisis. They took their lumps in their investment portfolios, but, generally speaking, they are solid. The price of entry into the business has increased, so the reinsurers that are able to enter are strong. You have regulatory changes such as Solvency 2, which are designed to help ensure the strength of reinsurers. I recently read an interesting article in Business Insurance indicating that 46% of 38 reinsurers surveyed by Towers Watson are looking to invest more aggressively over the next year because of low interest rates.

I guess it depends how they manage that opportunity, and how that will affect their strength on a going-forward basis, but right now they seem strong. Everyone seems to be more careful, so the industry, relatively speaking, doesn't seem to have suffered too badly.

Jim Sporleder: From my perspective, I haven't seen that much change throughout the company except that the word "expenses" is used much more than ever before. Everybody is trying to reduce their outside and inside expenses, because the economy is difficult, and everything is looked at more under a microscope.

One area in my practice that I've noticed having an effect on expenses is that the number of arbitrations being brought has been reduced. I think this is because outside legal expenses are making budgets tight and companies are trying to resolve disputes outside of the arbitration process.

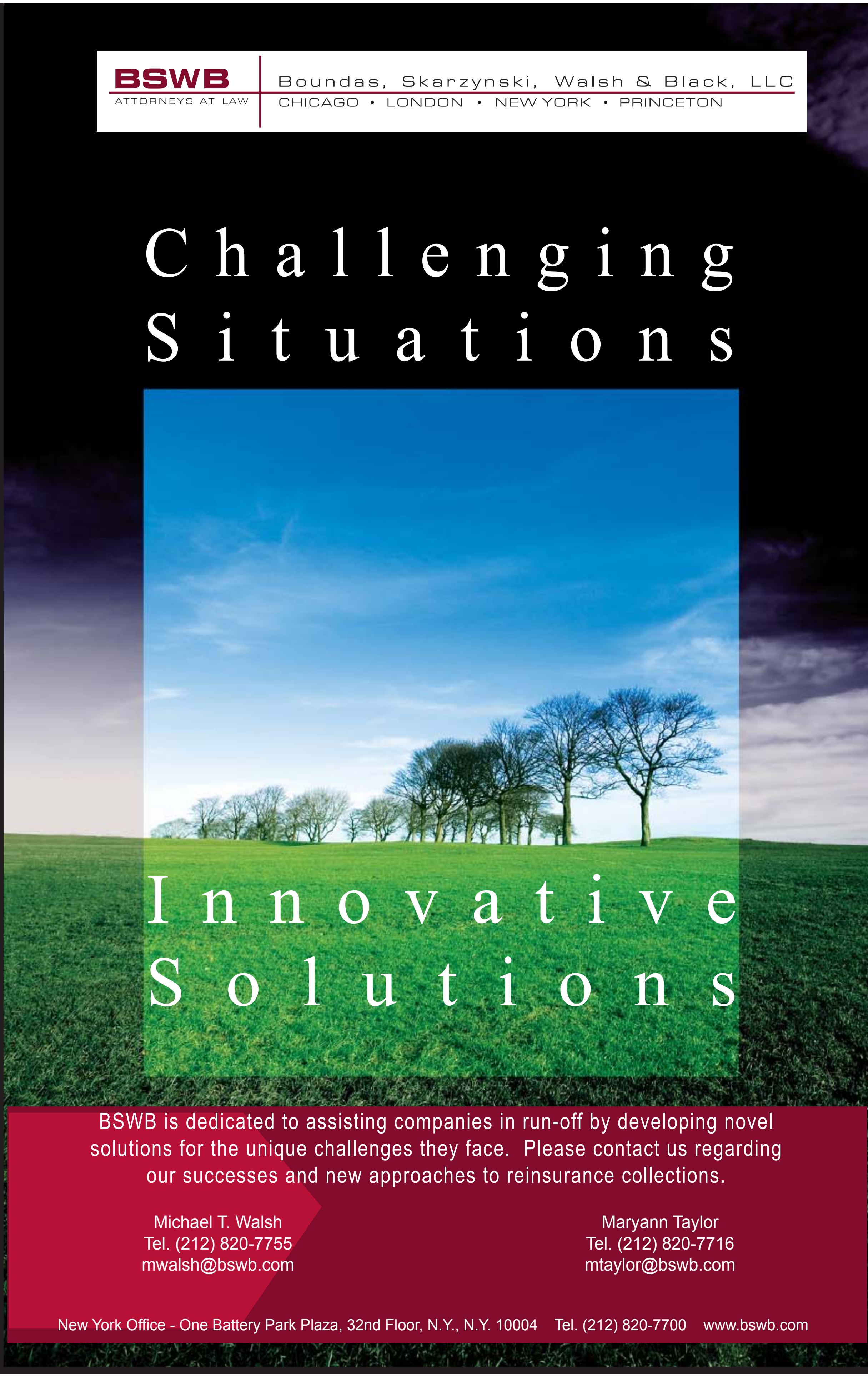
Art Coleman: *To follow-up that point that Jim just made is the reduction in – sometimes I think about the economy and the cost of capital and trying to conserve capital. Is there a concern amongst legacy managers about handling disputes and the fact that it's the cost of actually pursuing an arbitration becomes prohibitive in legacy business?*

Jim Sporleder: We do try to do as much work, especially on smaller cases, as we can on an in-house basis because the expense of outside firms has become so great that you can only afford to arbitrate the very large cases. And, if you do actually arbitrate a dispute, you try to find a cost effective counsel. We have also had success using the AIRROC small claims arbitration process which Mike Zeller led. I was on Mike's drafting committee, along with many others at AIRROC. I commend everyone to read it on the AIRROC website. It's something that companies can use to save money. The process includes an agreement that estoppel will not apply, and to me, that's the most important part of the whole thing. We all concern ourselves, when we commence an arbitration, with the fact that if the result goes against us, that that result might be used in some future way against our interest.

…the beauty of the system that AIRROC created is that you can have an arbitration on a half a million dollar case, where otherwise you wouldn't even be able to arbitrate it.

Well, the beauty of the system that AIRROC created is that you can have an arbitration on a half a million dollar case, where otherwise you wouldn't even be able to arbitrate it. You can do it inexpensively and not have the arbitration result affect future claims. So we've liked using the process and I'm hoping that the other members of AIRROC and even non-AIRROC companies take a look at it. It's much less expensive and with regard to the cost of capital, you

continued on page 9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Roundtable Discussion on Legacy Management *continued from page 7*

can move claims that you otherwise couldn't move and do it for less money than utilizing a typical arbitration.

Peter Scarpato: *Since we are on the topic of expenses, what about the use of mediation as a dispute resolution tool? Have any of you either in your company or outside heard of mediation being used to handle legacy issues?*

Mindy Kipness: I would just say that our Corporate Legal Department takes an active role in looking at all opportunities to resolve matters outside the formal dispute resolution process, and that includes examining streamlined procedures where possible. Sometimes, even though you're trying to manage legal fees and related expenses, it may take initiating legal action to get the other side to pay attention, so we balance that consideration and use all available methods to resolve our differences.

Jim Sporleder: We've looked at mediation. I've tried to put forth the idea a few times, and it just hasn't frankly worked. We're still open to the idea, but it just hasn't seemed to be something that the reinsurance industry has caught onto yet.

Art Coleman: *The next question, how do you manage the maintenance of insolvency records and filing timely claims and do you have dedicated resources for studying the administration of schemes of arrangement?*

Mindy Kipness: We have a dedicated staff in both the Corporate Legal Department and in the Reinsurance Finance Department overseeing our exposure to insolvent estates. Both groups are responsible for, among other tasks, ensuring that the requirements of each insolvent scheme are clearly defined. The first critical issue is to make sure that internal personnel know about these requirements so they can provide us with the necessary information. So these two groups, in addition to handling the aggregation of the exposure and the formal filings and actions, track the various relevant dates, such as: proxy date; filing date; cutoff date; and dates of creditor meetings. They also interpret the rules of the estate related to issues such as IBNR evaluation and the scope of the estate, which is a big issue when you're looking at the scheme documents.

Art Coleman: *So you almost treat it as if it's a separate asset.*

Mindy Kipness: No, not so much a separate asset, but rather an impaired asset. Once a reinsurer is insolvent its recoverable may not be in your normal workflow regarding Schedule F, collections, and renderment of accounts. You may only collect through the claim filing with the estate and negotiation of the claim value. That responsibility is transferred over to Reinsurance Finance and the Corporate Legal Department. The amount of your claim is based on information from Reinsurance Accounting and the Collections groups because the exposure is the same as that which is going to the active solvent markets. However, the management of the potential collection or dividend is left to the Reinsurance Finance and Corporate Legal teams.

Art Coleman: *Jim, what is Allstate's position regarding insolvency records and then studying schemes of arrangement and bar dates and things like that?*

Jim Sporleder: We at Allstate have taken this issue very seriously over the years. We have dedicated lawyers that handle the insolvency collection effort of the run-off book. We have worked with our business people and over the last 25 years, and have filed hundreds of claims with reinsurers that have become insolvent.

We have worked with our business people and over the last 25 years, and have filed hundreds of claims with reinsurers that have become insolvent.

As you've mentioned, Art, every year some of these insolvencies finally pay dividends, although, sometimes they pay in piecemeal and you get a partial dividend one year and some then next. We have found that it's good to keep up on, number one, making your claim filings within the required time. That's critical because if you don't, you'll lose, perhaps, 20 cents or more on the dollar. You also need to follow up and continue to update your claim, because if your reserves go up, the insolvent estate won't know unless you tell them.

So, we found that it's important to keep updating the different insolvent estates to find out where they are in terms of closing out the estate. And every year we receive hundreds of thousands of dollars from the different estates. I call it the gift that keeps on giving. While it's not huge money, it's something that you have to do to at least try to protect your company's interest in collecting reinsurance from insolvent estates.

Art Coleman: *Thanks Jim. Klaus, at AXA, is it the same way? Is there a dedicated unit that looks at insolvency filings and schemes of arrangement?*

Klaus Endres: Yes, we have dedicated resources for these topics. Given our background, we do not have that much exposure to insolvent estates because our outward reinsurance protection is mostly with European entities. Therefore, U.K. solvent schemes are more relevant for us than U.S. insolvent estates.

continued on page 10

Roundtable Discussion on Legacy Management *continued from page 9*

Jim Sporleder: If I could just add one thing about solvent schemes. We handle that issue in my part of the law department, too. And, we have found that when we get a new solvent scheme in, it's important to read it immediately. Sometimes they have due dates, sometimes you have to decide whether to vote yes or no, and you have to decide how the scheme interacts with your book of business and figure out where you're impacted. Every scheme seems to have different wording that could affect you differently than the previous scheme. They all seem to add a little something. So it's important to read them carefully. Although they are long and written in legalese, we give them priority because we realize that they're not all the same. Finally, you have to read them to make sure that you're complying with all terms, and you're doing all the things necessary to vote within a timely fashion.

Art Coleman: *Is there any concept within Allstate, Chartis or AXA of selling the receivables of insolvent entities to third parties?*

Jim Sporleder: No. We've not done that. We handle everything ourselves in-house and we've never really done any factoring like that.

Mindy Kipness: At Chartis we've never done that as we have the infrastructure to handle the work involved and want to maximize the dividend received.

Peter Scarpato: *Klaus, can you comment on any differences in legacy management, or in the types of portfolios that are seen in the U.K. and Continental Europe versus what is typically seen in the U.S.?*

> *Run-off is not a taboo topic, but a well-structured transaction-driven business, with a strong involvement of service providers..*

Klaus Endres: Yes, sure. For me the U.K. is in some ways the most advanced market, especially when it comes to finality solutions and transactions. It is really a transaction-driven market: Part VIIs, sale of run-off entities, solvent schemes of arrangements, et cetera. Run-off is not a taboo topic, but a well-structured transaction-driven business, with a strong involvement of service providers. The U.K. is in my view also a quite mature run-off market with potentially shrinking numbers in the future: Many transactions that can be done, have now already been done. So reserves are going down because they're schemed, et cetera.

In Continental Europe, run-off is still often regarded as a taboo topic you don't want to talk about, a skeleton in the closet. The insurers are skeptical about outsourcing, also because they are concerned about their reputation. But there is now also a tendency to be more transparent and even to become more transaction-oriented. While there is no equivalent to a U.K. solvent scheme of arrangement, portfolios start to be sold via Part VII-style portfolio transfers and entire run-off companies via stock transfer deals.

And the arrival of Solvency II in two years will also change the market a lot because suddenly there will be a big capital charge on runoff books, which did not exist under Solvency I.

> *…the U.S. run-off market seems very big in comparison to the current U.K. and Continental European markets, including many individual books with more than $1 billion of reserves.*

Finally the U.S. run-off market seems very big in comparison to the current U.K. and Continental European markets, including many individual books with more than $1 billion of reserves. It is not yet a very transaction-driven market, given that some mechanisms like a Part VII and a scheme of arrangement do not exist – with the notable new exception of the GTE Re example in Rhode Island.

Art Coleman: *Does anyone else have any viewpoints on that international side?*

Jim Sporleder: I think I would point out that the reason we haven't seen the whole scheme concept take shape as much in the United States, is because of our consumer-oriented legal system and the fact that one can never feel like its book of business is static because there always seems to be some new direction that losses occur from. And what these schemes try to do is crystallize the losses so that the scheme can decide to pay X number of dollars today for a book and feel confident that the book will not grow and that you're agreeing to a fair crystallized price.

The reason we probably see the scheme concept occurring in Rhode Island is that GTE Re was an assumed book of business. The ceding companies maybe felt a little more comfortable with agreeing to a scheme. The problem with doing more schemes in the United States may be that people aren't as sure about the future liability of their book of business.

Art Coleman: *How does a company with a long history of legacy business, sometimes as long as decades, handle records and data management?*

Jim Sporleder: That has always been an important issue for me. I can tell you a humorous story that goes back to the late 1970s and early 1980s. I was a young lawyer here at

continued on page 25

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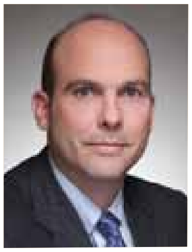
Think Tank

Due Diligence Considerations for Run-Off Acquisitions



Joseph C. Monahan

By Joseph C. Monahan

At the AIRROC Membership Meeting on March 1, 2011, Richard Fabian, General Counsel and Director of Litigation for Riverstone Resources and Richard Hershman, Senior Managing Director and leader of FTI Consulting's Global Insurance Services Practice participated in a panel led by Neal Moglin of Foley & Lardner where they discussed the perspective of both buyer and seller regarding due diligence in the run-off context. The panel opened by discussing some of the strategic considerations for the potential seller, acknowledging that there is a difference between selling a distressed company versus selling one that is in an organized run-off. Likewise, there is a difference between selling a company that is just entering a run-off process versus one that has been in run-off for a number of years. Mr. Hershman noted that if a company is unable to determine whether to sell or not, then it is important that it take steps to study the issue more fully. Indeed, there are times when waiting to go to market may actually be the best strategy. For instance, a seller might first need to understand data problems or sort through some volatility in the book of business. In those situations, waiting to go to market until those problems can be addressed can be advantageous for the seller. Of course, if the company is truly distressed, the need to sell may be more immediate.

From the buyer's perspective, Mr. Fabian explained that in a situation where the buyer is acting as "white knight" to a distressed company, the buyer may have more leverage than it would otherwise have, but such leverage does not come without risks. He noted, however, that it is rare that there will be red flags sufficient to cause a buyer to walk away entirely, as most issues that are identified can be addressed through price. Having said that, he identified as some of the bigger red flags significant regulatory issues, financials in disarray or a mass exodus of employees that could aid the potential buyer in getting a handle on the books. He noted that at times, a buyer may want to just purchase a piece of the book as opposed to the whole business, and gave as an example the instance where there is a disagreement as to how the various pieces of the business are likely to develop. He explained that the key to understanding what has happened with the business and why it is being sold are the financials, and that sellers would do well to have those financials cleaned up as best as possible before going to market so as to allow potential buyers to understand the story behind the story.

…the key to understanding what has happened with the business and why it is being sold are the financials, and sellers would do well to have those financials…

Mr. Moglin inquired as to the desirability of employee retention plans, and Mr. Fabian responded that they are both good and bad. While they can add to the cost of the acquisition, they can be very desirable if they allow the acquiring company to keep those people that it wants to keep from the target company. Mr. Moglin also asked what his thoughts were regarding aggressive commutation plans designed to reduce the volatility of the book, and Mr. Fabian responded that that is not always a positive, as volatility can provide some opportunities for investment returns where, for instance, claims are resolved for far less than the amount held in reserve.

The discussion then turned to the first steps for a potential seller with the specific considerations of whether to involve an investment banker in the process. For Mr. Hershman, this turned largely on whether or not the seller has sufficient M&A expertise in-house and familiarity with the deal process. In that instance, it was his opinion that the seller probably does not need to involve an investment banker. Absent those things, however, he indicated that it is advisable to involve an investment banker. He emphasized, of course, that the ownership of the selling entity will play a large role in this decision, as a publicly held company responsible to its shareholders may have certain considerations while a company owned by a hedge fund or privately held might analyze the issue differently. He also indicated that the size of the deal is not necessarily determinative, particularly in recent years. Mr. Hershman noted that for the seller, finding the market is the real trick. If the seller thinks that a hedge fund is the most likely buyer, then bringing in an investment banker can be very helpful, given their contacts and experience in the hedge fund

continued on page 14

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Due Diligence Considerations for Run-Off Acquisitions *continued from page 13*

markets. Conversely, an exclusive deal can be the way to go where the seller knows what it has to sell and knows who the best potential buyer is. One benefit of this process is speed and efficiency, and it can also make sense when there is little pressure to get the best possible price on the table. Where there is such pressure, due to ownership concerns or some other consideration, then an auction can be a better means to establish that the best price was obtained.

Mr. Fabian noted that as the buyer, dealing with an investment banker can be an added layer of complication, as there can be significant restrictions on the format of information provided and the use to which it can be put, the number of copies that can be made, etc. He explained that an exclusive deal is far preferable for the buyer, again given the concerns regarding information flow. He noted that a buyer can better its chances to have exclusive opportunities by focusing on its relationships, and its reputation in the market, and added that having ready capital available is always advantageous.

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When evaluating indication offers, Mr. Hershman noted that the highest offer may not always be the best offer…

The discussion then turned to the due diligence process itself, with all participants acknowledging the importance of being professional while not being overly aggressive. For the seller, at Phase I of the process, its interest is in trying to stimulate interest in trying to attract buyers. Accordingly, it might want to give the description of the company in "teaser" format, providing just enough information to attract interest. Once such interest is generated, more information about the company and the opportunity can be provided in interviews with the seller's people. For the seller, it is important to control which of its personnel should be interviewed so that it can be sure that the story that needs to be told is being conveyed. Mr. Hershman recognized that until the seller provides its audited financials, its projections for the business and its actuarial report, there probably would not be a reliable indication offer coming from a buyer. Mr. Fabian noted that he thinks most buyers will commit substantial resources to the first look at the business involving actuarial, finance and department heads, and even go so far as to look at claim files in order to determine a fair indication price. Mr. Fabian also noted that when reviewing documents regarding any open litigation, privilege issues can be implicated and those issues should be evaluated carefully. He emphasized, however, that it is nonetheless important to review this material.

When evaluating indication offers, Mr. Hershman noted that the highest offer may not always be the best offer, but recognized the pressure from various stake holders to obtain the highest price, including from regulators and shareholders. There are, however, certain intangibles to be considered, such as the reputation of the buyer and the likelihood that the final number will not be significantly adjusted downward as the process continues. He noted that the seller should be concerned about any "outlier bids," that is, those falling well outside of a reasonable range.

In getting to a deal, Mr. Hershman noted that there can be significant difference between the initial indication offer and the final price. Moreover, it is not uncommon to have the deal structure include a post-closing adjustment, which can be

continued on page 42

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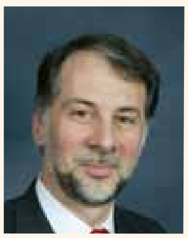
Regulatory Developments

New York Insurance Department Changes Regulation of Multi-Beneficiary Reinsurance Trusts


Stewart Keir


Robert A. Romano

By Stewart Keir and Robert A. Romano,
Partners, Locke Lord Bissell & Liddell LLP

The New York Insurance Department (the "NYID") has recently adopted a change in its regulation of multi-beneficiary reinsurance trusts ("MBTs") to accommodate non-U.S. reinsurers in run-off. Non-U.S. reinsurers are permitted to obtain accredited or approved reinsurer status in the various states by establishing an MBT for the benefit of U.S. cedents as an alternative to individual collateralization. Heretofore, all of the states have required that these reinsurers maintain a minimum surplus of $20 million. That level of surplus becomes problematic when the reinsurer goes into run-off and its covered reinsurance liabilities diminish and become disproportionally small when compared to that surplus amount.

The NYID has recently amended Regulation 20 to permit a reduction in the minimum surplus to less than $20 million if: (i) the reinsurer has permanently discontinued underwriting new business secured by the trust for at least three full years; and (ii) the Superintendent finds, based on an assessment of the risk, that the MBT surplus is adequate for the protection of U.S. ceding insurers, policyholders and claimants in light of reasonably foreseeable adverse loss development. However, the minimum surplus may not be reduced to an amount less than 30 percent of the reinsurer's covered reinsurance liabilities.

> *… the minimum surplus may not be reduced to … less than 30 percent of the reinsurer's covered reinsurance liabilities.*

This change will allow adjustment of MBT surplus in light of covered reinsurance liabilities, ease the potential cash-flow strain on the reinsurer and enhance the reinsurer's ability to manage liquidity.

New York's action is only the first step in solving the problem that these companies face. In order to fully address the problem, other states must follow New York's lead. The NAIC is currently in the process of amending its Model Law on Credit for Reinsurance and is considering following New York's action. Nationwide action is important if the reinsurer wishes to maintain its accredited/approved status in the other states where its cedents are domiciled.

Stewart Keir, a Financial and Regulatory Specialist in the New York office of Locke Lord, assisted Tawa Management, Ltd., a U.K. run-off manager, in its efforts to modify the New York regulation and the NAIC Model Law. ■

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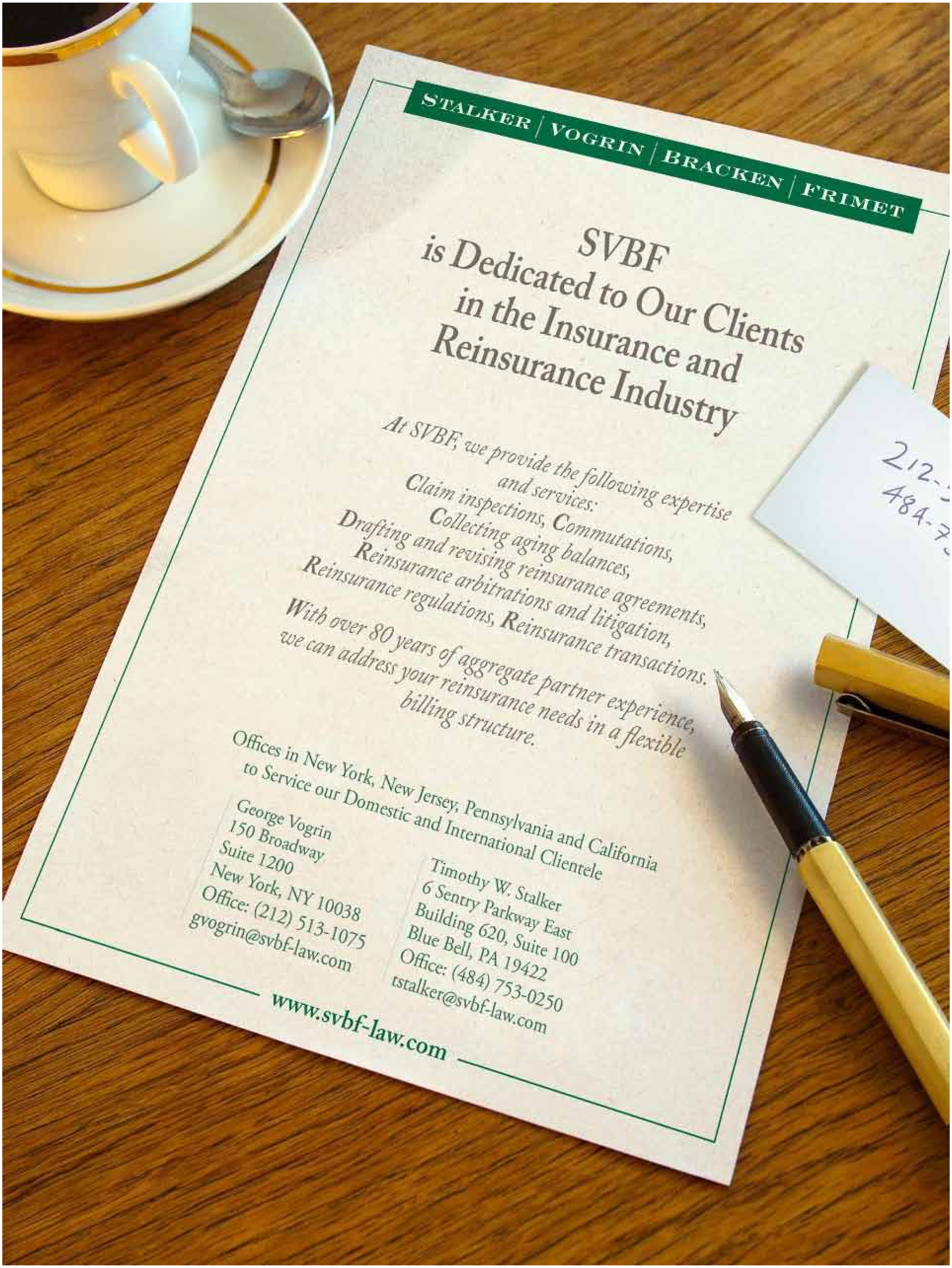
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The Rhode Island Solution


Andrew Rothseid

By Andrew Rothseid

In granting the petition of GTE REinsurance Company Limited ("GTE RE") to implement the first Rhode Island (and U.S.) commutation plan, the Superior Court of Rhode Island validated the long held – but until now untested - belief that the U.K. and Bermuda solvent scheme of arrangement process could, and should, apply to appropriate U.S. domiciled companies. Presuming that the Superior Court's decision is affirmed on appeal, the Rhode Island commutation plan provides a further option for concluding run off exposures.[1]

Presuming that the Superior Court's decision is affirmed on appeal, the Rhode Island commutation plan provides a further option for concluding run off exposures.

The questions now are whether (1) the Rhode Island process will be embraced by companies seeking to end their long and often wasteful run off operations ensuring payment to their creditors and release of capital to their shareholders and (2) regulators in other states will look at the Rhode Island statute and the GTE RE commutation plan as models for the future development of run off solutions in their own states:

Regardless of the answers to those questions, the GTE RE commutation plan demonstrates that the Rhode Island adaptation of the U.K. (and Bermuda) solvent scheme of arrangement process works for the right type of company seeking to honor its obligations to its customers and its shareholders provided the process is clear, fair and transparent.

What is a Commutation Plan and What is its Purpose?

A commutation plan is a compromise or arrangement provided for by Rhode Island Statutes Ch. 27-14.5-1 et seq. ("Voluntary Restructuring of Solvent Insurers") (the "R.I. Statute") between a company and its creditors, which becomes legally binding on the company concerned and all creditors if: (a) a majority in number representing three-quarters in value of the creditors present and voting in person or by proxy, vote in favor of it at a meeting convened with the leave of the court; and (b) the court subsequently approves the compromise or arrangement.

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The essence of the GTE RE commutation plan, in effect, of every solvent scheme of arrangement, is to ensure that the implementing insurer or reinsurer honors all valid claims that are submitted in a timely manner such that creditors (specifically reinsurance cedents or, if appropriate, direct commercial insureds) are paid one hundred percent of the net present value of their agreed claim.

Run off operations, whether as a free standing legal entity in run off or, as is often the case, a line of business controlled by an active underwriting company, even one that writes current business in the same legal entity, can be long, drawn out processes that distract management, incur (often needless) expense, and trap capital that could be used for more profitable purposes. This is especially the case in the historic traditional run off blocks – those that effect underlying long tail liability types of claims.

Run off solutions are few – particularly in the United States. Reinsurance to a third party fails to eliminate the risk legally from the entity that issued the original cover. Sale to a strategic or financial investor is the most common solution, but value to the owner is often lost – either in the valuation of the to be acquired business, transaction costs or adverse loss development guarantees frequently requested by the buyer. Ongoing run off management can be unfocused and lacking metrics that tie performance to risk elimination and value creation strategies.

In recent years, primarily in the London insurance market and, to a lesser, but no less significant, extent, the Bermuda insurance market, the scheme of arrangement has been transformed from a vehicle used initially to resolve long standing insolvent companies to one that has proven effective in addressing solvent run off as well.

Although the U.K. and Bermuda solvent scheme of arrangement processes have been implemented in roughly one hundred situations in the last fifteen years, GTE RE's commutation plan is the first attempt by a solvent U.S. property and casualty reinsurer to accelerate the closure of its business, honor all valid and timely claims in full, and eliminate its prospective liability to all reinsurance cedents.

Although the U.K. and Bermuda solvent scheme of arrangement processes have been implemented ... GTR RE's commutation plan is the first attempt by a solvent U.S. property and casualty reinsurer to accelerate the closure of its business ...

GTE RE and the Commutation Plan

GTE RE was formed as a Bermuda corporation in 1976 as a wholly-owned subsidiary of GTE Corporation. In 2000, GTE Corporation and Bell Atlantic Corporation combined their businesses by merging GTE Corporation with a subsidiary of Bell Atlantic Corporation. Bell Atlantic Corporation subsequently changed its name to Verizon Communications Inc., GTE RE's current ultimate parent.

GTE RE insured and reinsured casualty risks of GTE Corporation and its affiliates, primarily in the U.S. and Canada, from 1962 until mid-1997. This related business was novated to another Verizon controlled captive before GTE RE commenced the commutation plan.

From 1978-1989, first as Telect Insurance Company Ltd., and later under its present name, GTE RE reinsured third-party property and casualty risks of U.S. and international insurance organizations, including pools, via quota share, excess of loss and loss portfolio transfer contracts, all of which have been in run off since 1990 (the "Non-Related Business").[2]

This Non-Related Business was brokered and written through GTE RE's own underwriting staff and through an agency agreement with Belvedere Underwriting Agents Limited.

GTE RE began the formal process to honor its obligations and close its business when it moved its domicile from Vermont (where it had been domiciled since 1994) to Rhode Island in late June, 2010. In July, 2010 the Rhode Island Superior Court granted GTE RE permission to convene a meeting of creditors to determine whether sufficient creditor support existed to implement its proposed commutation plan.

GTE RE's Creditors

During the time that GTE RE underwrote its Non-Related Business, it participated in reinsurance agreements with approximately 560 cedents. An undetermined number of these cedents have either been liquidated, dissolved or otherwise no longer exist.

Since the Non-Related Business was written, GTE RE has commuted or transferred the risk by loss portfolio transfer of approximately 120 cedents.

GTE RE carries no reported reserves for approximately 315 cedents as it has received no report of any ceded reserve or any form of accounting activity regarding these cedents in a significant period of time. More than half of these 315 cedents, in fact, 227 cedents, were covered by short tail property or catastrophe covers that expired long ago.

The remaining cedents who have reported no reserve or loss activity, approximately 88 cedents, are covered by casualty contracts. However, these cedents have reported no activity, either in the form of paid loss or outstanding reserves, whatsoever, in a significant period of time. For instance, of these 88 cedents covered by casualty contracts:

> Seven or eight percent of the 88 have reported no activity in the 6 to 10 years preceding December 31, 2009 – the date ascribed in the commutation plan as the "Ascertainment Date";
>
> Eleven or twelve percent of the 88 have reported no activity in the 11 to 15 years preceding the Ascertainment Date;
>
> Twenty seven or thirty one percent of the 88 have reported no activity in the sixteen to twenty years preceding the Ascertainment Date; and
>
> Forty three or forty nine percent of the 88 have reported no activity in twenty years or more preceding the Ascertainment Date.
>
> GTE RE's remaining business and the business for which it carries reserves relates to casualty business issued to roughly 125 cedents. These cedents are based around the world.

As of December 31, 2010, GTE RE reported total liabilities of roughly $49 million. Its Schedule F showed assumed paid loss recoverable and case reserve balances of roughly $6.8 million. GTE RE has no meaningful retrocessional protection associated with the 125 cedents whose risks comprise the carried case reserves. In sum, GTE RE has a mature, developed assumed reinsurance block of business which, while it ascribes to a survival period in excess of 25 years, has seen case reserve decreases in recent years.

As noted, the R.I. Statute requires approval by creditors representing 50% by number and 75% by value of those creditors who vote, in person or by proxy. At a

continued on page 20

The Rhode Island Solution *continued from page 19*

November 30, 2010 Meeting of Creditors, GTE RE's commutation plan was approved by more than 87% by number and 97% by value of those reinsurance creditors who voted, either in person or by proxy. On December 15, the Court affirmed the vote from the Meeting of Creditors.

In its April 25th decision, the Court ruled that the R.I. Statute was constitutional, that its implementation would not have an adverse material effect on any creditor. On April 27, 2011, the Court entered an Implementation Order in connection with its April 25th decision and set a Final Claims Submission date or "bar date" of August 1, 2011 for the submission of claims.

The Rhode Island Solution

The R.I. Statute became law in 2002. The R.I. Statute required that rules and regulations necessary to implement the R.I. Statute be enacted and that no commutation plan could be accepted by the Department of Business Regulation ("DBR") until the regulations were promulgated.[3] Regulation 68, which sets forth the processes and procedures by which a commutation plan comes into being became effective in 2004 and was amended in 2009.

Despite the passage of time between the effective date of Regulation 68, September 5, 2004, no insurer or reinsurer had applied to the DBR to pursue a commutation plan until GTE RE filed its application in June, 2010.

Why did it take so long? The R.I. Statute itself provides the answer. Only a "commercial run-off insurer" can apply to implement a commutation plan. How does the R.I. Statute define a "commercial run-off insurer"? It is:

> A run-off insurer is [one that [h]as liabilities under policies for property and casualty lines of business"] domiciled in Rhode Island whose business, excluding all business subject to an assumption reinsurance agreement, includes only the reinsuring of any line(s) of business other than life and/or the insuring of any line(s) of business other than life, workers' compensation, and personal lines insurance.[4]

How many eligible candidates for a commutation plan were present in Rhode Island from the effective date of Regulation 68 through the time that GTE RE moved its state of domicile to Rhode Island from Vermont? The answer is believed to be zero.

There are run off insurers domiciled in Rhode Island but none fit the definition of a "commercial run-off insurer" until GTE RE decided to move to Rhode Island and apply to the DBR for permission to commence a commutation plan.

There is nothing exceptional to the definition of a "commercial run-off insurer." In fact, insurers and reinsurers that choose to implement U.K. and Bermudian solvent schemes of arrangement are similarly limited. Personal lines ("compulsory covers") are excluded from the U.K. and Bermuda scheme processes. A further distinction is found in the inherent application of the commutation plan to the entire insurer rather than, as is the case in the U.K. and Bermuda, to the "company and its creditors or any class of them."[5] Accordingly, a U.K. insurer seeking to implement a solvent scheme of arrangement can do so as to a particular class of creditors rather than in Rhode Island where the absence of such expansive language leads to the conclusion that only the whole insurer may avail itself of the commutation plan process.

Why has the GTE RE Commutation Plan been Successful?

Is it odd that the first attempt "out of the gate" met with success?[6] An assessment of some of the salient provisions of the commutation plan demonstrates the efforts that GTE RE has taken to design the commutation plan around the concerns of its creditors.

Is it odd that the first attempt "out of the gate" met with success? An assessment ... of the commutation plan demonstrates the efforts that GTE RE has taken to design the commutation plan ...

The Composite Reserve

Most solvent schemes of arrangement value the creditors' claims based upon an actuarial methodology. GTE RE used its actuarial assessment of its obligations to its creditors as one component to its allocation of reserves among its creditors.

GTE RE allocated its reserves among its creditors based upon what it has referred to as a "Composite Reserve" methodology. The Composite Reserve takes into account losses reported by GTE RE's creditors, outstanding loss reserves ("OSLR") together with its actuarial assessment of incurred but not reported reserves ("IBNR") based

continued on next page

upon its historic loss experience. However, rather than relying solely on reported OSLR and developed IBNR, GTE RE took into account the cedents' billing history, together with the estimated survival period for the liabilities at issue. This has allowed GTE RE to, in most instances, arrive at a figure that represents the commercial value of the reinsurance protection that the creditors are forgiving in the commutation plan.

The Composite Reserve is based on a weighted average of 1 times GTE RE's IBNR/OSLR Gross Reserve plus 5 times GTE RE's Survival Gross Reserve. The resulting weighted average figure is discounted for the time value of money.

The IBNR/OSLR Gross Reserve is calculated by multiplying the outstanding reserves reported to GTE RE by its creditors by GTE RE's actuary's loss development factors attributable to GTE RE's Non-Related Business over the period of loss experience during GTE RE's run off.

The Survival Gross Reserve is calculated by taking the amount of losses that have been billed to GTE RE by the creditors for the 5 year period immediately preceding the Ascertainment Date and dividing that total billed figure by 5 to come up with an annualized figure. The annualized figure has been multiplied by a twenty five and seven tenths (25.7) year survival ratio to come up with the Survival Gross Reserve.

The resulting combination of 1 part IBNR/OSLR Gross Reserve and 5 parts Survival Gross Reserve has been discounted to net present value using the yields quoted for U.S. Treasury Strips for the estimated survival period.

Independent Chairman and Claims Adjudicator

In an effort to distance the administration of the commutation plan from those who have overseen or perhaps will oversee potentially contentious processes, GTE RE selected an independent Chairman of the Meeting of Creditors (rather than using either the commutation plan Advisor or counsel to the company to serve in that capacity.) Although compensated for his time by GTE RE, the selection of the Chairman, Andrew Maneval, a founding member of AIRROC, was intended to instill in the creditors the clear sense that their concerns would be addressed at the Meeting of Creditors.

Similarly, as virtually all of the Non-Related Business was placed with GTE RE by brokers acting for the ceding companies, GTE selected an individual with decades of insurance and, in particular, broking experience, Clement Dwyer, the former Head of North American Broking Operations for Guy Carpenter, to act as the commutation plan Adjudicator.

The Future

Although there are various other tactics that were employed and integrated into the design of the GTE RE commutation plan that aided in its development, can and will this type of process be replicated?

Hopefully, the answer to these questions is "Yes." However, the limitations of the R.I. Statute and the make-up of U.S. domiciled insurers and reinsurers have to be considered in evaluating future prospects for subsequent commutation plans. If anything, the GTE RE commutation plan has demonstrated that the process works best for assumed reinsurers in run off. (They have no direct exposures similar to those that have given rise to policyholder concerns in prior schemes of arrangement.)

The final question is whether the lessons and efforts to reach a successful conclusion with the GTE RE commutation plan will apply to other ... commercial run off insurers ...

GTE RE was not a "one off." It is not the only assumed reinsurer domiciled in the U.S. that could move its registered address to Rhode Island. The final question is whether the lessons and efforts to reach a successful conclusion with the GTE RE commutation plan will apply to other, perhaps not so discreet, commercial run off insurers as to allow for the commutation plan process to have a wider application as a run off solution throughout the United States. ■

Notes

1. The unsuccessful objectors to the GTE RE commutation plan have appealed to the Rhode Island Supreme Court from the Superior Court's April 25 Decision and subsequent April 27, 2011 Implementation Order. Rather than comment on the Court's Decision or the appeal, the focus of this short article is on the R.I. Statute, the ancillary regulation, and the application of the commutation plan process to other similarly situated insurers and reinsurers.
2. GTE RE commuted any remaining loss portfolio transfer contracts during 2005.
3. R.I. Statute, Ch. 27-14.5-6.
4. R.I. Statute Ch. 27-14.5-1.
5. Part 26 U.K. Companies Act 2006.
6. Five cedents voted against the commutation plan. Three were controlled by one legal entity; and two others as well. GTE RE has resolved its issues with one of the other two "No" votes.

Present Value

$$PV = \frac{C}{i}\left[1-\frac{1}{(1+i)^n}\right]$$

By Nigel Curtis

Run-Off News

Tokio Marine Europe files for Chapter 15 bankruptcy

In July, Tokio Marine Europe Insurance Limited (TMEI), part of the Tokio Marine Group, filed for protection from creditors under Chapter 15 in U.S. Bankruptcy Court for the Southern District of New York. Headquartered in London, TMEI listed 1,000 to 5,000 estimated creditors, assets of more than $100 million and liabilities of more than $100 million. The company underwrote commercial property, casualty and marine insurance, went into runoff in 2004 and then placed the portfolio into a solvent scheme of arrangement which was approved by the U.K. High Court in February 2011. Chapter 15 protection is designed to ensure the scheme is respected in the U.S.

The scheme covers inwards reinsurance business written by TMEI through stamp numbers T0304, T0403 and T0502 and reinsurance business transferred to the company by Tokio Re. TMEI remains solvent and was rated AA- for financial strength by Standard and Poor's in January 2011.

Ageas transfers run-off to Swiss Re

After a rebrand from Fortis to Ageas, the Netherlands-based insurer is to transfer all of the reinsurance captive run-off business of Intreinco N.V. to Swiss Re by the end of 2011. Intreinco underwrote the reinsurance liabilities of current and former Ageas insurance subsidiaries between 2000 and 2008 and ceased underwriting any new business in 2009. The move is part of Ageas' commitment to extract maximum value for shareholders from legacy issues and to simplify its organizational structure. Ageas is ranked among the top 20 insurance companies in Europe.

Swiss Re acquires Zurich U.K. run-off

Swiss Re has purchased the U.K. runoff business of Zurich Specialties London Limited (ZSL). The portfolio is predominantly U.S. and U.K. broker placed commercial casualty policies written on both a direct and assumed basis. ZSL has not underwritten new business since 2005. The transaction, which is at book value and part of Zurich's strategy to divest most of its non-core business, should release $1.5 billion of capital for redeployment and allow repatriation over time of $360 million of regulatory capital to the parent company. Completion is subject to regulatory review and court approval.

Catalina completes acquisition of Glacier Re

Bermuda-based Catalina Holdings has completed the acquisition of Glacier Re, the Swiss based reinsurer in runoff, following consent from FINMA, the Swiss Financial Markets Supervisory Authority. As previously reported, Glacier Re underwrote a diversified book of predominantly short tail reinsurance (property and catastrophe) between 2004 and August 2010, when it went into runoff.

Other recent acquisitions by Catalina include Quanta Capital Holdings in 2008, Alea U.K. in 2009 and Western General Insurance in 2010. With the Glacier Re acquisition, Catalina now has total assets of $2 billion.

People

AIRROC Board Member, **Mike Palmer** has joined the board of Citadel Risk Services U.K. He was previously with R&Q group where he was Marketing & Business Development Director, and prior to that Helix U.K. Limited. Citadel Risk Services U.K. provides back office services and solutions for the re/insurance market and is part of the Citadel Risk Group.

Legacy specialist Compre has appointed **Tom Whittingdale** as head of its audit and consultancy team. With over 20 years of experience in the London market, Tom takes over from **Jonathan Hughes**, who will continue to support Compre's business development while moving to a part-time role.

Tom Booth is to replace **Alan Quilter** as Chief Financial Officer at runoff specialist Randall and Quilter (R&Q). Founding CFO Alan Quilter will assume the new executive position of Chief Operating Officer. Tom Booth has been with R&Q since October 2009 as corporate finance director. He was previously a corporate adviser and investment banker, specializing in the non-life insurance industry.

* * *

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

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For further information on the event please contact:
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Company Name

Company Address

Post/Zip code

Delegate details

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Company Representing

Telephone | Mobile/Cell

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Company Representing

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Your contact details will be used to compile a delegate list that is accessible from www.rqih.com and www.airroc.org and will only be maintained for a reasonable period. Please tick here if you **DO NOT** consent.

Photographs will be taken at various social events. Please tick here if you **DO NOT** consent to your image being included on our websites at a later stage.

Please tick here to book a space at the **Educational Sessions on Monday 17th October**

It is assumed all delegates will attend the opening dinner on the Monday night. **However, if you are unable to attend, please tick here**

Registration fee and payment

The registration fee for AIRROC Members is US$595/£400 for 2011. The registration fee for all other delegates is set at US$895/£600

To register and pay on-line using a credit card, please visit www.airroc.org . Payment can only be accepted in US$.

For UK£ registration: You may either complete your registration form and email to wendy.gridley@rqih.com and an invoice will be sent to you.
Or you can post your registration form along with a cheque, payable to 'R&Q Insurance services', to Wendy Gridley, R&Q Insurance Services, 110 Fenchurch St, London EC3M 5JT.

For US$ registration: Completed registration forms together with your cheque payable to AIRROC, should be sent to:
AIRROC Administration Office / PO Box 9001 / Mount Vernon, NY 10552 or for overnight mail: 131 Alta Avenue / Yonkers, NY 10705
For more information, call the Administration Office at +1 914 966-3180 x117 or email caroleacunto@airroc.org

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

Please tick here if you are an **AIRROC Member**

Cancellation of bookings:
Prior to 1st Sept 2011 - 100% reimbursement, prior to 1st Oct 2011 - 50% reimbursement and from 1st Oct thereafter - no reimbursement.

Vendor booth hire

Once again we will install full size booths that will be displayed in the networking hall. Each 'U shaped' booth is 10 feet wide by 8 feet deep and allows for a full back-drop display. There is also an 8 foot table and two chairs to allow you to hold meetings at the booth and save the cost of buying a networking table ($500). In addition. each vendor gets one free comp admission to the event. We have priced these to be competitive at $1000. Please tick this box to reserve a vendor booth

Table hire

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

Accommodation

A special rate of $144 (exc taxes) per person, per night has been agreed with The Hilton, for attendees of the event. To take advantage of the preferential room rates, please be sure to make your reservation no later than 2nd October. Again this year, we have adopted an automated on-line booking system with The Hilton to ensure you can keep control over your own room reservation. You can make an on line booking by visiting **www.hilton.com/newjersey**. However, you are of course free to stay at another hotel of your choice. See our website for other options.

Roundtable Discussion on Legacy Management *continued from page 10*

Allstate and the controller in the Reinsurance Division called me into his office and asked me if we could start destroying records because it was becoming so expensive. Of course that was when asbestos was starting to occur, and I said to him I did not think it was a good idea. But he pushed on me, and I said well, why don't you let me store the records in my basement? And he kind of laughed, but he knew I was serious too. I didn't want to recommend that those records be destroyed. Thankfully he agreed with me because he saw that I was concerned about it. And now that we've seen things occur that we've seen over the last couple of decades, records are critical. We sometimes have disputes with companies that can't find their records, and they're in a tough spot.

So maintaining those records and sometimes scanning them is critical. Records start to get old and yellow, the old telexes start to become unreadable.

Art Coleman: *Let's go to Mindy. I mean, you would think Chartis and AIG have a bunch of records out there sitting in storage facilities. Probably got to be one of the largest expenses you guys carry for legacy management.*

> *There have been problems over the past few years in the market like the U.K. warehouse fire or 9/11 where documents were destroyed in the World Trade Center. But luckily most of the documents have been maintained and scanned.*

Mindy Kipness: There's a lot that's in storage and much that has been scanned. There have been problems over the past few years in the market like the U.K. warehouse fire or 9/11 where documents were destroyed in the World Trade Center. But luckily most of the documents have been maintained and scanned.

Klaus Endres: I think we have the same challenge on the paper documentation side as was just mentioned. Another key topic are the legacy IT systems and whether you incur the cost and risk of migrating all run-off to a single IT system, or if you incur the cost and hassle of keeping the old systems alive.

Art Coleman: *Thanks. Jim, is that as big a concern at Allstate where you probably have had the same systems in place for years?*

Jim Sporleder: Yes, we've got somewhat of the same problem that Klaus mentioned. Expenses drive decisions with regard to our different computer systems. You might in the past have had one computer system for ceded and one for assumed, and sometimes companies would have little pieces like Fidelity Surety on a different system. We've tried to limit the number of systems and consolidate and simplify to save expense. Thankfully, we don't have the problem that Klaus probably has because we haven't picked up and consolidated other books, but even in our operation, which hasn't changed much, we've had the problem of trying to consolidate systems.

My business collegues work very hard on trying to keep the systems simple and accurate, and to consolidate as much as possible.

Art Coleman: *The industry really started looking at run-off as something separate probably back in the mid to late 80s and since that time a lot of the people who were involved in these books of business when they were still alive have since retired. Is there a practice of keeping in touch with people who have retired to go back and get legacy knowledge?*

Mindy Kipness: Absolutely. Generally speaking, when you're talking about the underwriting issues, people who placed the business are long gone. However, since this is a small industry, we find that people who have moved to other companies or retired are still willing to come back and cooperate with us. Their new companies usually allow them to cooperate, probably because they recognize that they may ask us to reciprocate and make one of their former employees available on occasion.

Klaus Endres: We try to keep a healthy mix in our staff between those with the decades of experience and some new joiners. We don't have a special program to reach out to retired people, but we have many people on board with 30 to 40 years of experience.

Jim Sporleder: With regard to Allstate we've taken the issue seriously. Most of our business was written in the 60s, 70s and 80s and those employees, of course, are now getting up in years and sometimes are not with us anymore. We've also had to work with the situation where a lot of our underwriters were let go because we were no longer writing new business, and those people may not have been happy to have been let go. So, we have been working hard to maintain relationships, addresses and phone numbers. Sometimes these people are employed with different companies. Sometimes they're retired. We have a core people group at my company who still know and maintain relationships with many of those people.

Now, these former employees are becoming fewer and fewer, as I mentioned, because of the passage of time. The people that we have left are critical in terms of being used in arbitrations or finding out what happened in the past. So, yes, maintaining relationships is important and we work hard at it.

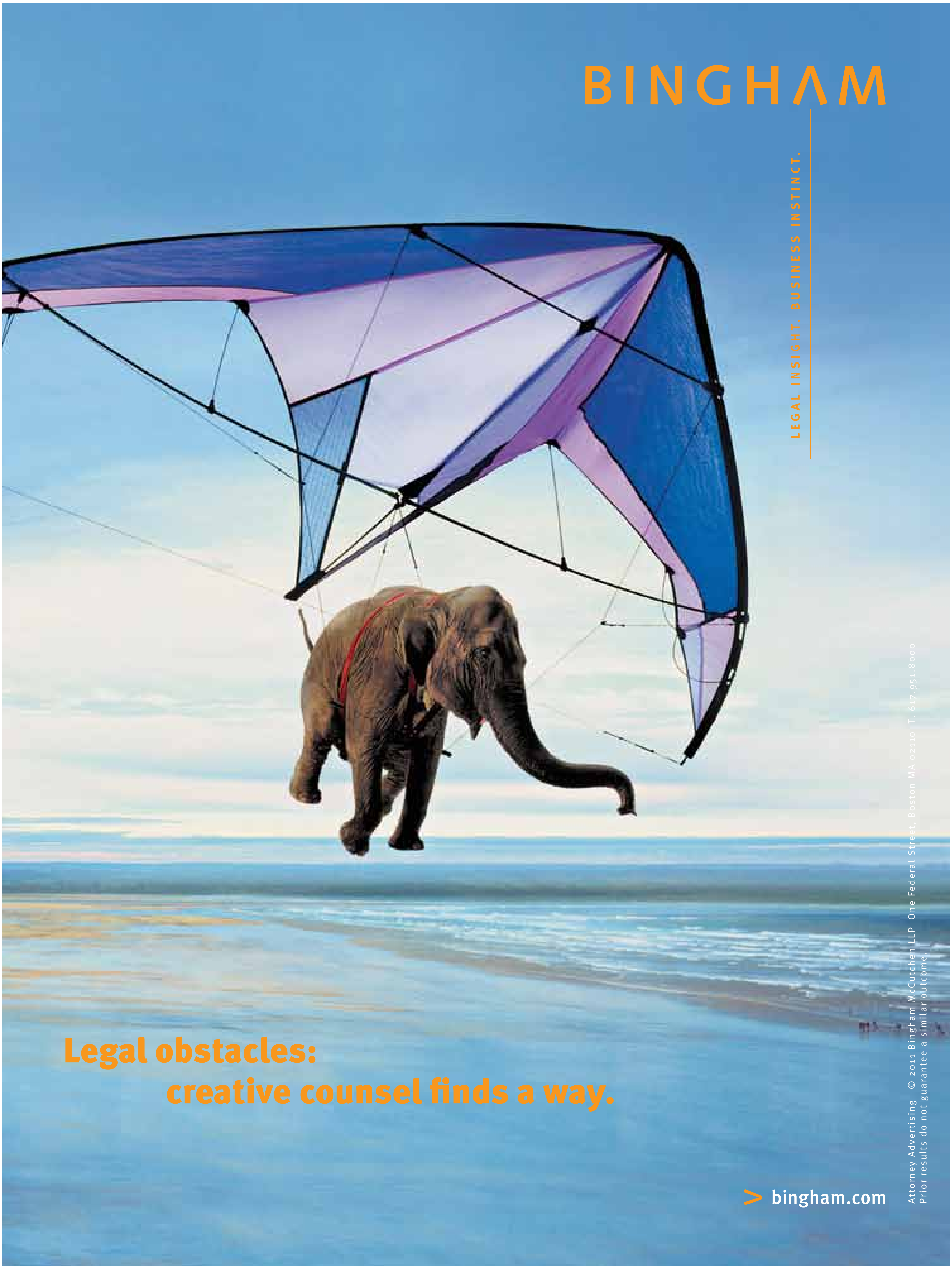
Klaus Endres: We see these topics even in run-off M&A transactions, where we as AXA Liabilities Managers are acquiring books and companies in run-off. In this context we have already worked several times with insurers which wanted to divest their run-off simply because their senior run-off experts were about to retire and the company didn't know how to manage the portfolio effectively going forward.

Art Coleman: *That's a really good point when you're doing M&A work to have to consider the fact that you've got to maintain the legacy.*

Peter Scarpato: *From the standpoint of what you know generally or what you've heard in the industry generally, how do managers of legacy business value or keep track of their relationships with the current pool of arbitrators?*

Jim Sporleder: I'll chime in on that one. When I talk to my boss and he asks me what are the important parts of my job, I tell him that the number one important part of my job is maintaining relationships with arbitrators. And, it's something that takes decades. When we do have disputes where each side names three arbitrators and then you have to strike two and then you're down to a flip between two people, it's important for you to personally know as many arbitrators as possible so that when you have to make these selections, you are comfortable with the possible umpire.

continued on page 27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Roundtable Discussion on Legacy Management *continued from page 25*

One of the fears I'll always have is that there will be a situation where all three arbitrators are individuals you don't know. So, attending AIRROC meetings, being involved in task force study groups and drafting committees are important. There are unintended consequences to each - which often involves meeting new people. I always try to meet as many people as I can every time I go somewhere just for the reason that arbitrators are a moving study. They have a work span of maybe 20 years, sometimes longer, but it's a continuing process with new arbitrators coming on board and older ones who are retiring from the arbitrator industry.

Art Coleman: *What do you think about the impact of GTE's re-domestication insolvent scheme in Rhode Island? Do you think that this is going to be something we're going to see more of? And what do you think the impact of this is on legacy and financial strategies?*

Mindy Kipness: We are generally not in favor of solvent schemes, and as far as I am aware there's been no news of a new trend.

Jim Sporleder: I don't know if it's a unique situation. So I always thought it was more likely that the next scheme might occur where the reinsurer has limited assets and the ceding company would probably rather have crystallization of their losses.

But, overall, I think I agree with Mindy that in the U.S. we have not taken to the idea as well as the United Kingdom and Europe has. And, I'm not sure what will happen in the future. My guess is probably not as many will occur as you would think.

Klaus Endres: For me it depends a lot on whether we will see the next 2-3 companies being "schemed" in Rhode Island successfully soon – in which case GTE Re could have triggered a whole wave of transactions. Otherwise it is just as likely that GTE Re stays a one-off case, which was successful given its quite unique context.

Art Coleman: *Well I mean there's two things that GTE RE has going for it. One is that it hadn't written business in a long time. So there has been sufficient time for the book to crystallize in itself and just in its normal runoff. But the second thing and probably what companies like Allstate and Chartis has against it is the fact that it's a very viable parent, writing that long tail books of business. So is that the main criteria for why people do not like something like the GTE RE?*

Mindy Kipness: I don't like being forced into a commutation. If you want to engage me in a commutation discussion, let's have a discussion. The agreement was entered into by two parties, and both of the original two parties should be able to decide when it ends. If it's a solvent scheme that's almost insolvent it's a different question than those companies just trying to exit a business in an expedited way.

Art Coleman: *Sure. Jim, same thing for you, is it the viewpoint of a solvent parent that really makes you think the way you do?*

Jim Sporleder: Well I think at our company we're not completely against the idea. We're certainly skeptical. In the GTE RE case, you would think that the question would become whether you can force the solvent parent to put more money into the limited GTE RE situation, and that becomes an issue of whether you can somehow pierce the corporate veil. So, you can't get blood out of a turnip. If a scheme is handled properly, and there's little hope of getting more money from a parent, it might be the best thing to do a scheme – if long tail business is crystallized fairly. Why companies which have long tail business don't like schemes is because they are not given enough credit for the IBNR – the claims that could occur in the future that we don't even know about right now.

Art Coleman: *I guess that's a double-edged sword, isn't it, because you take a look at a company that's as old as GTE RE, if it were a newer company that had been writing business on a claims made basis or, you know, or such as that or risk attaching you could easily say okay, it's easier to peg the IBNR because we know that there's a limited number of claims that can impact it. But in this case you're talking about a company that wrote in the prime time of losses occurring.*

Jim Sporleder: Yes. And, there are things like climate change issues, electromagnetic issues and there are still issues out there that can affect all long tail books of business. And, as much as the actuaries say they don't think that those losses are going to occur, the point is, the companies are not happy because they're sitting there with the potential future liabilities depending on what the legal system does. And, the reinsurer that's doing the scheme is able to crystallize their liabilities while you can't.

So I think what Mindy is getting at is it may seem fair to the reinsurer that's able to get off the risk by use of a scheme, but the ceding companies still have that unknown for the next 10 or 20 years.

Art Coleman: *That is a good point, which leads to a follow-up on that. As Jim mentioned climate change issues and electromagnetic issues, what are some of the other things that keep you awake at night or keep legacy people awake at night hoping that somebody doesn't come up with a new mass tort? Is there anything you are particularly concerned of or aware of?*

I don't like being forced into a commutation. If you want to engage me in a commutation discussion, let's have a discussion.

Mindy Kipness: There isn't anything we are particularly concerned about. We are constantly on the look out for brewing areas of dispute and, I think, do an effective job at spotting them and being proactive in addressing them.

Klaus Endres: Another dangerous risk could be inflation – also driven by the current global financial situation with several major economies fighting with high levels of debts. What does that mean for claims and medical inflation which are impacted by these kinds of inflationary tendencies?

Art Coleman: *I remember hearing someone say a few years ago that, this is before 2008, that they didn't think medical inflation was going to be a problem because it'll just wash against financial investment rates. And that's definitely not the case now.*

Peter Scarpato: *We have already heard about some effective expense management controls, like using the AIRROC Dispute Resolution Process and handling arbitrations in-house, but I want to take a half step back and ask generally about expense management in handling legacy business. Since these legacy books of business, or entire subsidiaries handling legacy business, are part of a larger viable organization, how important is the issue of expense management and what are some of the main ways that legacy managers control expenses?*

continued on page 28

Roundtable Discussion on Legacy Management *continued from page 27*

Mindy Kipness: I think that there's always a desire to manage expenses, especially if it's runoff. However, you have obligations. What's left on the legacy book is the claims obligations and resulting handling cost. And so whether it's legacy or new business, we have to meet our obligations and we handle expense controls in the same manner as the normal expense controls of the whole organization.

Jim Sporleder: One thing that I think that the companies have been doing, including ours, is trying to at least document all our expenses, because in the past, an embedded legacy book like ours could just be looked upon as a drag on the company. Now, there's more an intention to try to at least figure out what things are costing. Is it outside legal expense? Is it employees? Is it buildings? And, sometimes, if you just make a list of those things and try to keep track of those relative to the investment income that your reserves would otherwise make, it helps give you an idea of how your company's doing and where you can try to save expenses. I think a company should have to push on expenses, always trying to reduce them by finding ways to do things more inexpensively. And, I think that's what the next several years will be about.

Mindy Kipness: But Jim, wouldn't you say that that's for new and legacy, that management of expenses. I mean that's – wouldn't that be universal for both?

Jim Sporleder: That's probably true. I'm just involved in legacy management, but I'm sure it's happening everywhere.

Klaus Endres: Cost transparency is typically quite difficult for internal run-off operations, given that they share typically overarching functions like IT, finance etc. with the ongoing business.

At AXA Liabilities Managers we can achieve this transparency much more easily, given that we are a separate international entity with 340 employees, including Finance, IT, HR, etc.

Good expense management is also not about being as cheap as possible, but about the smartest and most effective trade-off between reducing cost and having the required quality and quantity of resources on critical subjects, e.g. having strong claims handlers and commutation experts. Getting this balance right gets even more difficult as the run-off matures and you ideally try to reduce the expenses in line with the reserves – which is very difficult as sometimes the most complicated claims and insureds stay with you until the end.

Mindy Kipness: I would just say that the bigger issue in this industry is the expense management by the runoff market, by the legacy market, by the markets that have consolidated and are managing their cash flow. And for us the challenge is to ensure that those markets pay attention to our claims and pay them promptly.

Peter Scarpato: *Right, that is an excellent point which gets back to the premise of my question concerning expense management of legacy business within a viable company. And the unstated premise is that there may be a slight difference in the availability of money to run your legacy management programs effectively. Specifically the availability of money for companies that are purely runoff companies or companies that purchased and are managing books of runoff business may be different than the viable company.*

Mindy Kipness: Yes, and from my perspective as a cedent it may become necessary to give the reinsurer an economic incentive to pay our claims, such as avoiding the costs associated with legal actions. These costs will likely include paying for counsel, paying a high interest rate on any judgment rendered, and possibly having to post security during the pendency of the proceeding. In many instances, initiating legal proceedings is warranted.

Art Coleman: *I want to change and get into where the industry's going to be going. And how it's going to get there, what the effects are going to be? So the question is how will runoff M&A transactions be and the acquisition of runoff entities, lost portfolio transfers, etcetera, be affected by SSAP 62R?*

Klaus Endres: Some of you may have heard about these changes to the accounting standard SSAP 62R. With these changes a "seller" can get a more beneficial accounting treatment of a loss portfolio transfer ("LPT"), if the transaction follows the requirements of SSAP 62R. You get full credit in terms of RBC capital and immediate credit for the potential profit you achieve on that transaction.

However it involves several quite strict requirements, including that that the acquirer has to give typically an unlimited cover via the LPT and has to be rated at least as good as a seller. So while it's an interesting new mechanism, I haven't seen it being used in practice, although it's now in place 1 ½ years.

My personal prediction is that the focus will remain on stock transfer deals for entire run-off companies and traditional loss portfolio transfers for run-off portfolios, because especially for APH no rated acquirer seems willing to give the unlimited cover required by SSAP 62R.

Peter Scarpato: *Consistency is a word that's been kicked around in a lot of different environments. Typically when you get into a legacy management environment or a runoff environment, you're a bit off track, dealing with a situation that the original underwriters who shook hands when the deal was penned, didn't anticipate. So when you deal with companies as a legacy manager and in particular when you deal with reinsurers, is the concept of consistency important and relevant? Must it apply across the board with your reinsurers or do you need a sort of a safety net of flexibility to deal with different situations?*

Jim Sporleder: Yes. I think that if you can be as consistent as possible, you should try. It's probably an impossible thing just because-different people are handling different claims over years of coverages. And, there's always an opponent or an attorney who might be saying "well you were inconsistent back in 1985." This happens more so now than in the past when parties used to rely on confidentiality agreements that made reinsurance transactions and arbitrations much more confidential. Today, there seems to be more transparency. Things are getting in courts and there's more possibility of somebody saying you've been inconsistent.

So, I think the most important thing to do is to be fair under each circumstance and if you can be consistent, too, that's great.

Mindy Kipness: We have specialists in the direct and reinsurance claims departments who help ensure we handle claims in a professional manner consistent with our obligations. Our direct claims folks do not get involved in reinsurance issues. Our reinsurance claims personnel and reinsurance collections teams work towards ensuring that our reinsurers understand the basis of the underlying settlement and that the reinsurance claim is presented in a manner that is consistent with our rights and obligations under the reinsurance contract.

continued on next page

Peter Scarpato: *I have a question for you and again other people can chime in. How important is it for companies that are handling this legacy business to maintain relationships with organizations like AIRROC or ARC even ARIAS? Is that like a fundamental what you need to do? And how does it impact or benefit your ability to handle that legacy business?*

Mindy Kipness: This is a people business and engaging directly with the players is very important. It's critical to move issues along to conclusion. And by attending conferences people learn who to contact. In addition to the three venues that you mentioned, some of our reinsurance collectors also attend the International Association of Claims Professionals conferences, which used to be known as Excess/Surplus Lines. We think these venues are critical.

Klaus Endres: I couldn't agree more with Mindy. I find these organizations and the events organized of fundamental importance because as Mindy said, it's a people business. To know the people, to be able to network, to discuss business topics I think makes these events invaluable.

Mindy Kipness: I would just add to what Klaus just said that, although you can move a deal along by email and phone for months, person-to-person contact moves it along that much more. And the timing, I mean coming back to AIRROC, AIRROC comes at a good time of the year, close to the end of the year, with representatives from the U.S., U.K., and Continental Europe.

Jim Sporleder: I agree with all of what Mindy and Klaus have said. We send several people from our legacy group to AIRROC and ARIAS. And, like I said before, we get lots of unintended good consequences from meeting people, making relationships, making friends and knowing where to go if we have an issue. It's well worth it.

Art Coleman: *On that note, on behalf of AIRROC and Peter Scarpato, I want to thank you all very much. This is very interesting. I think this is going to really make a great supplement to AIRROC Matters. So thanks everybody for your time.* ■

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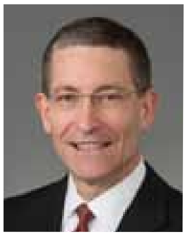
Feature Article

The Property and Casualty Guaranty Funds



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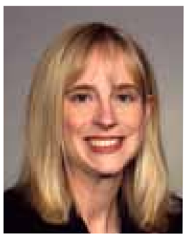

Julie L. Young

By Rowe W. Snider and Julie L. Young

The guaranty fund system was established in 1968 by state legislators, regulators, and the insurance industry as a way to protect policyholders in the event of an insurer's insolvency. The primary and overriding purpose of the guaranty fund system is to pay outstanding policy claims on behalf of insolvent insurance companies. Since its inception, the property and casualty guaranty fund system has paid more than $26.4 billion to policyholders and claimants affected by more than 550 insolvencies nationwide. This article provides a summary of the key components of the guaranty fund system.

... the property and casualty guaranty fund system has paid more than $26.4 billion to policyholders and claimants affected by more than 550 insolvencies nationwide.

Guaranty Fund System Design

Guaranty funds are privately-funded and comprised of nonprofit state-based entities. Independent guaranty funds operate in every state and the District of Columbia. Guaranty funds are individual organizations, typically created by authorizing statutes. Most guaranty funds are based, in whole or in substantial part, upon model acts promulgated by the National Association of Insurance Commissioners.

The guaranty funds are generally made up of all licensed property and casualty insurers writing in a particular state. Typically, insurers are required by law to become members of the guaranty funds in the states where they write business.

Rowe W. Snider and Julie L. Young are Partners at Locke Lord Bissell & Liddell LLP and can be reached at rsnider@lockelord.com and jyoung@lockelord.com, respectively. *The authors thank NCIGF for its assistance and contributions to this article.*

In most states, the guaranty funds are supervised by a board of directors. The board members are generally selected from the participating insurance companies, and in some instances may include public members outside of the insurance industry. In many states, the insurance regulator approves the election of board members. The guaranty funds generally operate pursuant to written plans of operation that must be filed and approved by the state insurance regulator. Many guaranty funds employ executive directors and professional claims staff that implement the plans of operation.

Guaranty Fund Triggers

In most states, the guaranty fund is triggered when a state court finds an insurance company insolvent and issues a final order of liquidation. The guaranty funds then work cooperatively with the insolvent insurer's receiver, who is charged with liquidating the insolvent insurer's estate, subject to the court's supervision. Through their association, the National Conference of Insurance Guaranty Funds ("NCIGF"), the guaranty funds form coordinating committees for estates with claims in multiple states, and these committees interact with the receiver to ensure an efficient guaranty fund process.

After liquidation, the receiver transfers the claim files to the state's guaranty fund. In recent years, this transfer has been accomplished through electronic data transfers, aided by uniform data and reporting systems utilized by the guaranty funds and the liquidation estates. Guaranty fund representatives promptly begin to adjust and, where appropriate, pay covered claims, similar to claims adjusters in a solvent company. The guaranty fund claims staff applies knowledge of the state tort laws and guaranty fund laws, each of which can affect the particular covered claim obligations. Particularly in periods of heavy insolvency activity, many guaranty funds also use professional third-party claims administers to handle certain kinds of high volume claims, such as workers compensation claims.

Guaranty Fund Coverage

Guaranty funds defend, adjust, and pay policy claims within limits set by state laws and insurance contracts, and the parameters of the guaranty fund coverage vary depending upon each state's laws. Some of these laws limit guaranty fund benefits, and serve to conserve resources and benefit the estates.

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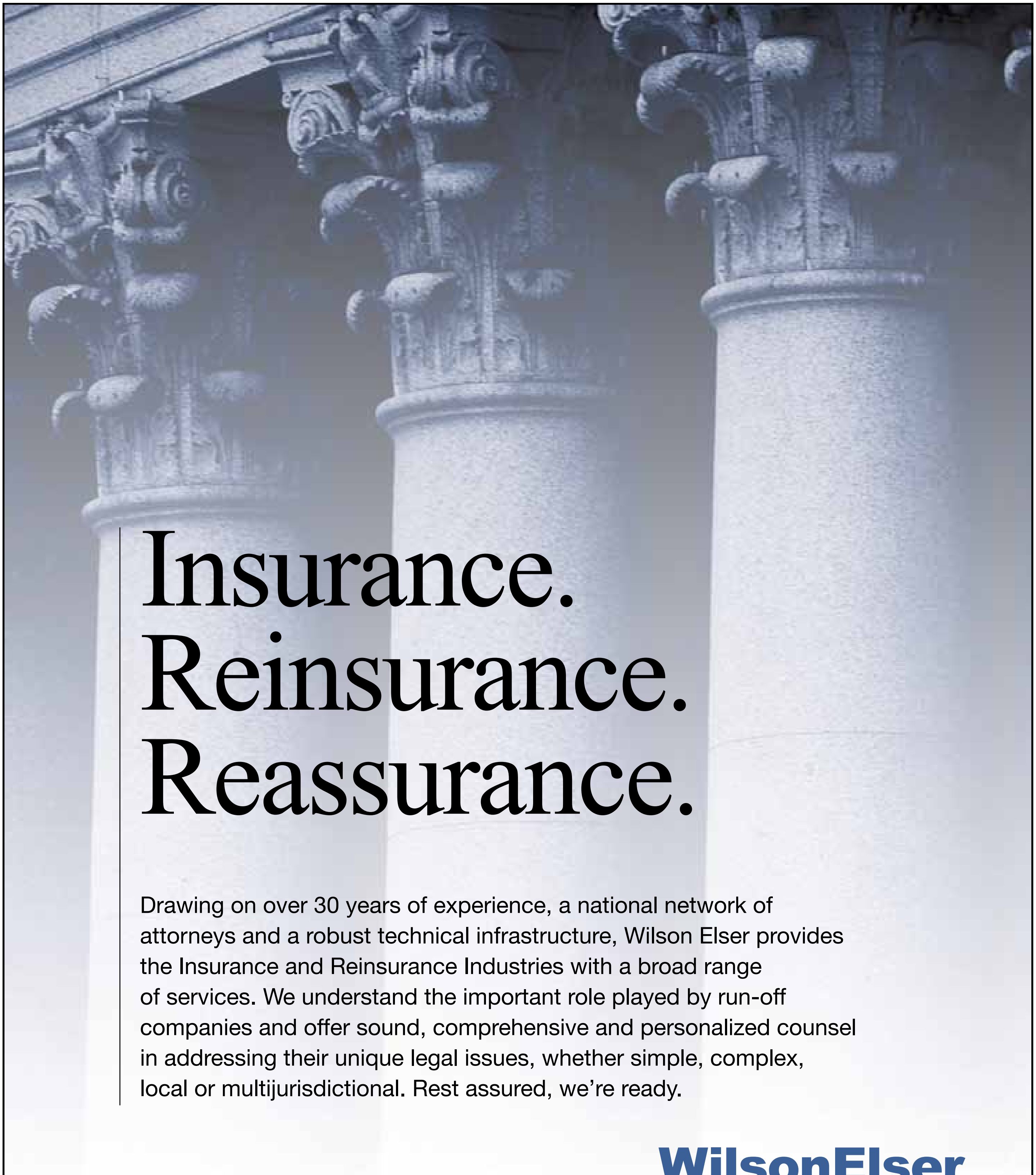

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The Property and Casualty Guaranty Funds *continued from page 30*

One important aspect of the guaranty fund laws is the statutory "other insurance" provisions. These provisions require claimants to first exhaust all coverage provided by other solvent insurance before proceeding against a guaranty fund, thereby making the guaranty fund a remedy of last resort. Any recovery by a policyholder from "other insurance" reduces the obligation of the guaranty fund on the claim, and ultimately reduces the total amount of the policy claims against the liquidation estate.

Other guaranty fund limits include statutory caps on claims obligations. Guaranty funds pay covered claims within the limits set by individual state laws and the claimant's insurance policy. Most commonly, the claim limit is $300,000 on covered claims, although some states cover as much as $500,000 to $1,000,000 per claim. Capping the amount paid on covered claims allows the guaranty funds to retain sufficient funds to pay claims, and ensures the fund's ability to serve all covered claimants. With respect to workers compensation claims, however, most guaranty funds pay 100% of statutorily defined workers compensation benefits, subject to the availability of "other insurance" as described above.

Another important guaranty fund limit relates to high net worth insureds. More than thirty guaranty fund statutes limit benefits to those policyholders whose net worth does not exceed $25 million or similar statutory amounts. By statute, the net worth is often calculated using the net worth of the policyholder and its affiliates on a consolidated basis. The net worth provisions generally (a) exclude high net worth insureds from guaranty fund benefits, or (b) permit the guaranty funds to recover certain benefits paid out under policies issued to high net worth insureds. In practice, these net worth provisions assure that the resources of the guaranty fund system are focused upon the insurance consumers most in need of protection.

Guaranty Fund Resources

To fund covered claim payments, the guaranty fund system employs a post-insolvency funding mechanism. Covered claims are generally paid from a pool of money drawn from three sources: (1) the insolvent insurance company's remaining liquid assets, often periodically distributed by the estates pursuant to a process known as "early access"; (2) premium-based assessments on insurance companies licensed to write business in the state; and (3) in some instances, cash already on deposit with state regulators.

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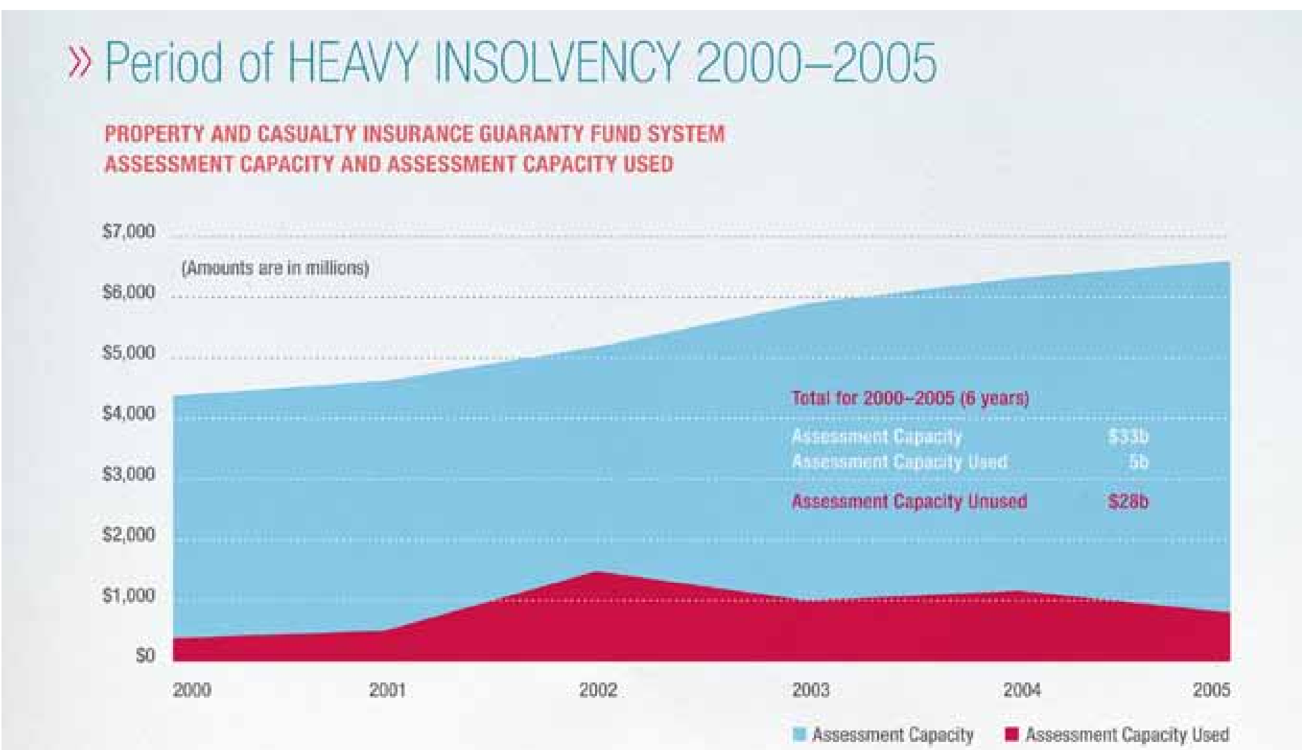
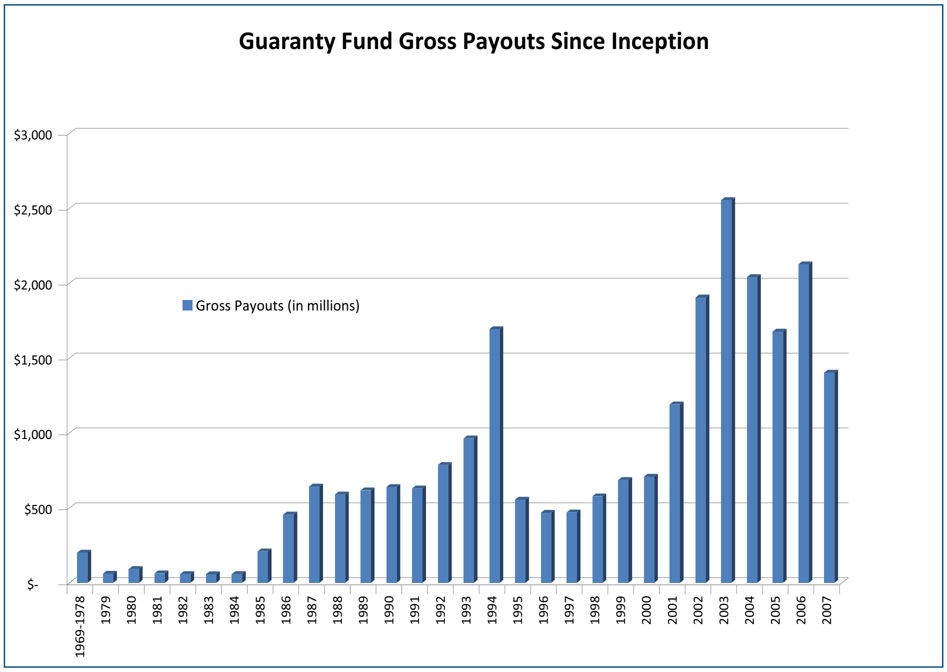


The Property and Casualty Guaranty Funds *continued from page 33*



Most insolvent insurance companies retain sufficient assets to fund a significant portion of the guaranty funds' obligations, and so a large portion of the claims are paid using the insurer's own remaining assets, including reinsurance collections. Any shortfall is generally made up by the guaranty fund accessing available state deposits, and making the necessary assessments on other insurance companies doing business in the state. Every insurer licensed to write in a state must pay an assessment to that state's guaranty fund. Generally, this assessment is capped at no more than 2% of an insurer's "net direct written premium" each year.

In some rare instances, where the traditional funding sources were insufficient, guaranty funds have turned to the bond market. Utilization of the bond market has proven to be an inexpensive way to raise cash to pay current obligations, while allowing the bonds to be paid off over an extended period using future assessments and estate distributions.

Guaranty Fund Efficiency

The guaranty fund system pays covered claims efficiently. Nationwide, annual guaranty fund general operating expenses are about $66 million, with a staffing level of around 500 employees.

The efficiency of the guaranty fund system is reinforced by the system's overall operating costs when contrasted with those of the insurance industry generally. Research by the NCIGF shows that in 2005-2007, the operating expenses of guaranty funds were moderately to significantly lower than the insurance industry in loss adjustment expenses and general operating expenses. This expense study may be viewed at http://www.ncigf.org/media/files/2005-2007_GF_Expense_Review.pdf.

Guaranty Fund Capacity

The guaranty fund system is solid. From 2000 through 2005, the property and casualty insurance industry experienced its heaviest period of insolvency activity, with guaranty fund payments spiking in 2003 and tapering off in recent years.

During this period, the guaranty fund system paid out $10 billion against an assessment capacity of about $33 billion. Of the $10 billion paid, $5 billion was ultimately recovered from the insolvent companies' assets and statutory deposits. Currently, the overall assessment capacity of the property and casualty guaranty fund system is about $6.7 billion, renewable every year.

Conclusion

... the guaranty fund system is well positioned to serve as an efficient and effective means of providing a carefully drafted safety net for the property and casualty industry.

For more than 40 years the property and casualty guaranty fund system has worked to protect the public and mitigate the adverse consequences to policyholders of insolvent insurers. The system operates under state law to honor insurance obligations to policyholders, beneficiaries, and claimants who find themselves insured by – and having claims against – an insolvent company. Working cooperatively with state insurance regulators, the guaranty fund system is well positioned to serve as an efficient and effective means of providing a carefully drafted safety net for the property and casualty industry.■

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2011 Runoff Symposium

Welcome and Opening Remarks by Larry Schiffer and John S. Pruitt

Left: Dewey & LeBoeuf's Larry Schiffer and John S. Pruitt, Insurance Regulatory Department

Transferring Legacy Liabilities – New Methodologies and Techniques

By Bina T. Dagar

Speakers: *Evan D. Bennett*, Director, Reinsurance Consulting, Blackman Kallick LLP, *Brian Fannin,* Senior Vice President, Swiss Reinsurance America Corp., *W. Michael Flaharty,* Managing Director, FTI Consulting.

At the Runoff Symposium hosted by Dewey LeBoeuf, an impressive panel of experts discussed four areas of retroactive reinsurance:

1. What is retroactive reinsurance?
2. What are the statutory accounting considerations of retroactive reinsurance?
3. What other options are there to address legacy?
4. When should one think about legacy?

Following is a brief summary of the salient points discussed by the panelists.

- Retroactive reinsurance protects an entity from financial loss from claims which have *already occurred* but which have not yet been resolved. This typically covers for loss reserves on multiple historical accident or underwriting years. There is latitude in structuring the cover with a horizontal or vertical split of risks.
- In its earliest incarnation, retroactive reinsurance was used to discount loss reserves. No underwriting risk transfer was present, and losses were known with virtual certainty. This benefited the transferring party that released its "trapped" reserves and bolstered its policyholder's surplus. The NAIC responded with the introduction of a new accounting treatment (SSAP 62), whereby the reinsurer must assume significant insurance risk and must understand that a significant loss may be realized from the transaction in order for it to qualify as an insurance contract.
- Other options available are as follows:

  a. *Adverse Development Cover,* which indemnifies loss reserves above a certain threshold; cover may attach below the company's carried reserves.

  b. *Novation*, whereby the company may effect a full release of liability without having to conduct retroactive accounting.

  c. *Portfolio Transfer* is Part VII mechanism in the U.K. Its analogous option in the U.S. is SSAP 62R. Effective January 1, 2010, the NAIC permits companies to book certain retroactive transactions using the same rules that apply for prospective accounting.

  d. *Entity Purchase*, which allows a full release of liability and the assumption of all administrative function by the acquiring party.
- Legacy matters when a company is seeking a *strategic reorientation* such as the desire to exit a business line or market; to suspend operation through either closure with legal finality or hibernation of an alternative risk retaining entity such as a captive; or to attain economic finality in an M&A context.

An entity may consider legacy to achieve *operational*

continued on next page

Left: Evan D. Bennett, Blackman Kallick LLP, W. Michael Flaharty, FTI Consulting, Brian Fannin, Swiss Reinsurance America Corp.

efficiency through a reduction in administrative expenses, compliance costs and claims handling costs; a replacement of its internal retrocession agreement; a consolidation of its multiple operating entities; or a relief from collateral costs.

Legacy allows an entity to *manage capital* by protecting it against adverse developments; by making risk capital available for growth or acquisitions; by managing rating agencies' pressure especially when the outlook is negative; and by stabilizing earnings against volatility from reserves.

The panel discussed captive runoff considerations. Everyone knows the popular domiciles of Bermuda and the Cayman Islands, however, more than half the states in the U.S. allow captive domiciles now. In the past, captives were mostly used for basic needs to front specific lines of business. Today, they have evolved into more developed and complex vehicles. A variety of reasons exists for a company to exit the captive market. As with the non-captive business, an entity may wish to strategically reorient itself or to recover capital. The entity may want to repatriate elsewhere, either offshore or in another state. Or it may exit to gain finality.■

Rhode Island's Voluntary Restructuring of Solvent Insurers Law: An Insider's View

By Frederick J. Pomerantz, Wilson Elser Moskowitz Edelman & Dicker LLP

On April 25, 2011, the Rhode Island Superior Court granted a motion by GTE REinsurnace Company Limited ("GTE RE") to implement a commutation plan for an accelerated closing of the business of the still-solvent U.S. reinsurance company without a lengthy runoff or liquidation. GTE RE is the first Rhode Island company to use the 2002 Voluntary Restructuring of Solvent Insurers law, codified as Rhode Island Chapter 27-14.5-1 *et. seq*. (the "Statute").

In a joint presentation before the Runoff Symposium, Andrew Rothseid, principal of RunOff Re.Solve LLC, the commutation plan advisor for GTE RE and Gary S. Lee, a partner of Morrison & Foerster LLP, counsel for the Rhode Island Department of Business Regulation ("DBR") in connection with the GTE RE runoff plan (the "Plan"), offered an insider's view of how Rhode Island's Voluntary Restructuring of Solvent Insurers law works. Mr. Rothseid and Mr. Lee discussed the background, purpose and benefits of the Statute, the steps that were involved in preparing the Plan for filing, the respective roles of the Superior Court and the DBR, the lessons learned from the Plan and developments in solvent scheme practice. [*See also,* Andrew Rothseid's article entitled *The Rhode Island Solution,* page 18].

The Rhode Island statute is unique in that no other state statute expressly and transparently permits solvent runoff. It closely models the Companies Act in effect in the United Kingdom and Bermuda, which permits closure through a "scheme of arrangement." Under U.K. and Bermuda law, a deal is agreed between an insurer and its creditors in which the insurer pays 100 percent of the net present

continued on page 38

Rhode Island's Voluntary Restructuring of Solvent Insurers Law *continued from page 37*

Left: Andrew Rothseid, RunOff Re.Solve LLC, Gary S. Lee, Morrison & Foerster LLP

value of the agreed amount of the insured liabilities, and an orderly and equitable distribution follows. In the United States, there are some exit strategies available under state law, including but not limited to reinsurance protection, loss portfolio transfers, assumption reinsurance, voluntary surrender of certificates of authority, recapitalization and turnaround, sale of the company and accelerated runoff through accelerated commutations in New York and Rhode Island.

The closest any other state (besides Rhode Island) has come to enacting procedures of this nature is New York Insurance Law section 1321 and New York Insurance Department Regulation 141 (11 N.Y.C.R.R. Part 128). However, the New York law and regulation require that an insurer commute liabilities with all parties on the same terms and that the insurer, prior to proposing a commutation plan, be deemed insolvent or impaired by the Insurance Department.

The speakers compared the salient features of the Statute and the Companies Act, particularly the Statute's intent to ensure that creditors receive 100 percent of the net present value of the subject insurer's actual and prospective liabilities.

As originally enacted, the Statute required the subject insurer to be domiciled in Rhode Island. Thus, to avail itself of the Statute, GTE RE, originally incorporated in Bermuda, was required to redomesticate to Rhode Island. As enacted, the Statute does not require prior notice of redomestication to the creditors of the subject insurer. The Statute permits a newly organized insurer to redomesticate to Rhode Island for the express purpose of coming within the scope of its provisions. Subsequently adopted amendments permit a subject insurer to transfer a portion of its liabilities, including entire lines of commercial business, to a newly organized Rhode Island domestic insurer, which meets the state's capital and surplus requirements, solely to enable the runoff to proceed.

The speakers discussed the issues that arose during the proceedings before the Superior Court, including, among others, (1) the objections to the Plan and the challenge to the constitutionality of the Statute raised by a handful of related creditors, (2) timing issues and (3) the composite reserve methodology developed to allow cedents to receive the full value of their claims. The specific challenges were brought under the Contracts Clause, Article I, section 10, Clause 1 of the United States Constitution, which states in relevant part that, "A State may not pass any…law impairing the obligation of contracts." The speakers' presentation included a summary of the Superior Court's analysis refuting the challenge.

Further, the speakers discussed the steps taken by the DBR to ensure the fairness of the Plan to all classes of creditors and whether its terms could adversely affect certain creditors. This included the DBR (1) ensuring that its evaluation of the Plan was based on the best information available, (2) considering all aspects of the Plan, (3) commissioning an independent actuarial review and (4) keeping the information flow regarding the proceedings confidential and the DBR's deliberations privileged.

The speakers revealed that the objecting creditors have since filed an appeal to the Rhode Island Supreme Court and asked the Superior Court to stay its order as to such objecting creditors, if only to prevent mootness (depriving the matter of practical significance or rendering it purely academic). However, a briefing schedule has not been set and it is difficult to predict when the Supreme Court will rule on the case or even whether a ruling will come this year.

In conclusion, although it is difficult to predict whether the Rhode Island's Voluntary Restructuring of Solvent Insurers law will become a model for other states, the successful administration of the GTE RE runoff will allow other companies to consider solvent runoff as a safe and expeditious alternative that allows creditors to receive 100 percent of the net present value of the subject insurer's actual and prospective liabilities.■

The Medicare Secondary Payer

By Roy A. Franco, FrancoSignor, LLC

Medicare Secondary Payer became law on December 5, 1980, but did not receive much attention until it was amended in 2007 by the Medicare & Medicaid Schip Extension. This change has caused great debate and confusion making insurance carriers responsible to electronically report information about settlements, judgments and awards involving a Medicare beneficiary plaintiff. Failure to comply with this new reporting law carries a stiff penalty. If any of the 164 data fields for a single reportable event is not correctly filled, Medicare will reject the record and the insurance carrier can be held responsible to pay $1,000 for every day the claim is late. As Medicare only allows access to report this data once per quarter, any claim that is not accepted by Medicare during the reporting period could incur $90,000 in penalties before the next reporting window opens.

Left: Marybeth M. Rice, Reinsurance Company U.S., Michael R. Merlino II, Sedgwick Claims Management Services

At least an insurance carrier can plan to mitigate that exposure. A more serious problem is how to identify the Medicare beneficiary in the first place. It would be easy if Medicare was only for people 65 or over, however it is not. About 15% of the Medicare population includes minors, disabled workers, kidney dialysis patients as well as those that have contracted Lou Gehrig's disease. The only way to find out is to ask every claimant and if uncertain about the answer to ask Medicare. However, Medicare requires a Social Security Number to be asked, and that in and of itself presents a challenge for claims handlers, especially those that adjust liability claims. Since there are no safe harbors for a good faith effort to identify a Medicare beneficiary, the insurance carrier that fails to report a claim because of not reasonably knowing that the claimant was a Medicare beneficiary is still responsible for the penalty. Thus, great care has to be taken to develop a strategy to deal with those situations.

Medicare will use the information it collects from this new reporting responsibility for two purposes: 1) to improve its recovery claims; and 2) to coordinate future medical benefits. In terms of the former, Medicare must be paid back what it is owed once the obligation arises by the insurance carrier to pay the Medicare beneficiary. As Medicare can collect from anyone, including the insurance carrier (even if it has already paid the Medicare beneficiary the settlement, judgment or award amount), the carrier will want to now know this amount at time of claim resolution and pay it directly. This will take time, as Medicare is slow to identify what it is owed – about four months – and this delay will add cost to the claim.

As for coordination of future benefits, the obligation under the law is clear, according to the Centers for Medicare & Medicaid Services ("CMS"). CMS has not issued any formal rules which has created confusion and challenges for parties attempting to resolve cases that clearly involve future medical care. Most follow the rules laid out by CMS for Workers' Compensation cases, but that presents its own challenges.■

Outsourcing Nuts and Bolts for Runoff Entities

By Bruce C. Shulan, The Princeton Partnership, LLC

Robert Finkel, a partner in the corporate group of Dewey & Leboeuf, whose practice involves the representation of clients in large scale outsourcing transactions, presented the second part of the presentation. Finkel's presentation focused on four topic areas: an overview of the current state of the outsourcing marketplace; current trends in outsourcing; a discussion of a changing paradigm for outsourcing deals; and a review of key issues that arise in outsourcing agreement negotiations.

Finkel noted that 2010 was a relatively soft year for the major outsourcing service providers. The growth rate for the industry was only about 2.5%, which compared unfavorably to 2009's growth rate of over 5%. Finkel noted that the softness in the marketplace presented opportunities for buyers of outsourcing services as the market has be come very competitive. Many observers expect the outsourcing marketplace to rebound in 2011 and beyond.

continued on page 40

Outsourcing Nuts and Bolts for Runoff Entities *continued from page 39*

Left: Robert M. Finkel, Dewey & LeBoeuf LLP, Bruce C. Shulan, The Princeton Partnership LLC

Finkel continued by noting that there are a number of significant trends that are influencing the outsourcing marketplace, including the emergence of cloud computing and the continued growth of offshore outsourcing. There seems to be a trend toward further standardization of service offerings, in part as a result of the growth of cloud computing.

In terms of the functions runoff entities are outsourcing, Finkel reported that a wide variety of functions are now being outsourced, including commutations, claims, collections, accounts, recoveries, IT, actuarial services and audit and inspections.

The final part of his presentation addressed the key issues to address in outsourcing contracts. As an initial matter, every client should conduct detailed due diligence on the selected vendor. A thorough due diligence review is not only sound business practice, but also recommended as a best practice under various regulatory guidance. Finkel noted that key contract issues to address under the agreement include: protection of intellectual property and confidential information; data privacy and security; IP licensing and ownership; control over personnel; business continuity planning; termination rights; liability caps and exit rights and termination assistance.

Finkel stated that for clients seeking to obtain services from an offshore provider, additional considerations should be addressed in the contract, including IP protection, employee attrition, local law compliance, privacy and security, and dispute resolution provisions, such as arbitration.

In concluding, Finkel noted a number of points. First, outsourcing in general is becoming more regulated and subject to additional laws here and abroad. Second, data security related risks are increasing and more companies than ever have been subject to data breaches. Finkel observed that the best way for companies to protect themselves from data security and other risks under their contracts is to choose their vendor carefully and negotiate a contract that protects the company adequately against potential liabilities that might arise if the vendor does not perform its obligations as required under the agreement. ■

Message from Executive Membership Director "Nothing But Blue Skies From Now On..." *continued from page 1*

more about their business objectives. Our plans for the coming year including Philadelphia and more . . ..

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Take a moment to review "Voice of AIRROC Member" located on the left bottom side of our homepage (www.airroc.org) where many have stated the value of AIRROC membership. Those statements say it all. We hope that you will talk about AIRROC and the value of membership to those you encounter in the legacy world. They, as well as you, will benefit from membership.

After a brief sabbatical, I am "back on the block," energetic to grow AIRROC and bask in its light. ■

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

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Alert No. 36

KPMG Policyholder Support Update

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

Solvent Schemes – Upcoming Key Dates

TOKIO MARINE EUROPE INSURANCE LIMITED ("TOKIO MARINE")

Schemes for the above company were approved at Meetings of Creditors help on April 7, 2011. The Schemes became effective on April 15, 2011 and the bar date has been set as October 12, 2011. Further information is available on www.TMEISCHEME.com.

Other Recent Developments

ENGLISH & AMERICAN UNDERWRITING AGENCY ("EAUA") POOLS

The bar date for the above company's Scheme of Arrangement passed on April 11, 2011. Further information is available on www.englishandamericanpools.com.

ALLIANZ GLOBAL CORPORATE & SPECIALTY (FRANCE); AGF MARINE AVIATION TRANSPORT AND COMPAGNIE D'ASSURANCES MARITIMES AERIENNES ET TERRESTRES ("CAMAT"); ALLIANZ IARD; DELVAG LUFTFARHT VERSICHERUNGS AG; NÜRNBERGER ALLGEMEINE VERSICHERUNGS AG (IN RESPECT OF THE CAMOMILE UNDERWRITING AGENCIES LIMITED BUSINESS)

The bar date for the above companies' Scheme of Arrangement passed on February 21, 2011. Further information is available on www.CUAL-scheme.co.uk.

Insolvent Estates

ENGLISH & AMERICAN UNDERWRITING AGENCY ('EAUA') POOLS (ENGLISH & AMERICAN INSURANCE COMPANY LIMITED, THE INSURANCE CORPORATION OF SINGAPORE (UK) LIMITED AND THE HOME INSURANCE COMPANY (IN LIQUIDATION) - INSOLVENT PARTICIPANTS)

See Other Recent Developments above.

HIGHLANDS INSURANCE COMPANY (UK) LIMITED (IN ADMINISTRATION)

The Scheme Meeting was held on August 10, 2011. Further details can be found on their website www.ukhighlands.co.uk. ■

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

Due Diligence Considerations for Run-Off Acquisitions *continued from page 14*

subject to some negotiation based on what information was available to the buyer at the time of the transaction. For instance, if there were no current audited financial statements, the parties can build in an adjustment after the fact, usually six to twelve months after closing.

Mr. Fabian noted that while representations and warranties can be used to work around the problem where certain information is simply unknown at the time of the transaction, it is far better to have the information since the seller will likely negotiate to limit representations and indemnification provisions. He noted that it would be far better to have the information and adjust the price accordingly at the front end of the deal.

Finally, Mr. Moglin asked Mr. Fabian whether there is a time that the buyer should just say "no." Mr. Fabian reiterated that a significant regulatory or licensing issue would be a great concern, as would be a threat to the value of the assets due to, for instance, stock market considerations, but that for the most part, even significant issues can be resolved using price adjustments. ■

Association of Insurance and Reinsurance Run-off Companies

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