

# AIRROC<sup>®</sup> MATTERS

Special Issue: AIRROC<sup>®</sup>/Cavell Commutation Event

# Rendez-Vous 2008



A NEWSLETTER ABOUT RUN-OFF COMPANIES AND THEIR ISSUES

www.airroc.org

*Message from CEO and Executive Director*

## Walking on Air...



By Trish Getty

**W**eeks after the AIRROC/Cavell Commutation & Networking Event from October 20 to 22, 2008, we are still walking on air since it was an incredible success in several ways! The official number of delegates of 464 sets an historical number worldwide for attendance at a commutation event. As our Chairman Jonathan Rosen best put in his comments at the gala dinner, "Wow!" At least 100 delegates approached me during the event to thank us for such a memorable, productive event.

When asked of delegates whether they were getting business done, the answer was a resounding, "Yes!" Hearing those comments was quite reassuring in that we achieved as well as exceeded our goal for the event.

Our second AIRROC/Cavell education day presented by Mealey's/BVR on October 20 was quite well received. The most frequent comment from attendees was that the topics were timely and the speakers excellent. Our hats are off to Co-Chairs of the education program, AIRROC Board Member Kathy Barker of Pro Solutions and Jonathan Bank of Locke Lord Bissell & Liddell LLP. We fully appreciate the time invested by Kathy, Jonathan and the speakers to present this fine program.

October 21 marked the date of the inaugural luncheon of the AIRROC Women's Networking

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## The Eye of the Storm: NYID's Chief Economist and Head of Liquidation Bureau Speak on Meltdown, Cleanup

By James Veach, Mound Cotton Wollan & Greengrass

**N**ew York Insurance Department Superintendent Eric Dinallo asked his chief Economist, Dr. Hampton Finer, and the head of the New York Liquidation Bureau, Mark Peters, to substitute for him and speak about the Department's response to fallout from the financial meltdown.



*Left to right: Jonathan Rosen, The Home Ins. Co., Mark Peters, Special Deputy Superintendent NYLB, Dr. Hampton Finer, Chief Economist of New York Ins. Dept., Jim Veach, Mound Cotton Wollan & Greengrass*

## The Economist's View

Dr. Finer, who has been sitting at Superintendent Dinallo's right hand for the past several months, described a September 12<sup>th</sup> call that "no regulator wants to get" — a call from the American International Group (AIG) asking for the Department's help. "The Department spends its time making certain that insuring entities are solidly reserved and maintain sufficient surplus." AIG's operating entities satisfied those tests, but by the end of the

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## First Rendez-vous Issue

**A**IRROC Matters concludes an eventful 2008 with its first issue devoted entirely to the Rendez-vous. The Committee believes that our annual gathering warrants its own issue, particularly given the quality of the educational program and related Rendez-vous Commutations and Networking activities that would otherwise not be captured in print.

Matters will conclude each year with a final Rendez-vous issue. Those who wish to reserve advertising space for next year's issue should contact Trish Getty at trishgetty@Bellsouth.net. If you wish to have additional copies of this year's Rendez-vous issue, please also contact Ms. Getty. I want to thank all of the Publications Committee members for their diligent and enthusiastic efforts throughout the year. In 2008, Matters took on a new look as we redesigned it to reflect AIRROC's trademark and to enhance the AIRROC brand.

While all the Publications Committee members contributed to this special issue, I wanted to thank the Rendez-vous issue ad hoc sub-group — Peter Scarpato, Bina Dagar, Teresa Snider, Trish Getty, Gina Pirozzi (Gina Pirozzi Consulting), Nicole Myers (Myers Creative), and James Veach — for their extra efforts to put this issue in your hands quickly.



As always, the Committee welcomes your comments and suggestions, including ideas for future features or articles.

Best wishes for a healthy and prosperous 2009.

*Ali Rifai*  
Publications Committee Chair

### Message from CEO and Executive Director **Continued from Page 1**

Group. While some already had meetings scheduled so could not attend, we still welcomed 50 women from around the globe. It was an interactive, enjoyable luncheon launched by Selinda Melnik and Mary-Pat Cormier, partners of Edwards Angell Palmer & Dodge LLP. Thank you, Selinda and Mary-Pat. We will move forward to lay the framework and objectives of the group.

AIRROC expresses a tremendous thank you to Event Chair Art Coleman who met and exceeded our expectations again this year and to Cavell who gave us such grand support, particularly Alan Quilter, Jim Moran, Wendy Gridley and Julie Ponsford. A multitude of people worked feverishly behind the scenes to make this event happen. While you can access all upcoming meeting and event dates on our website (www.airroc.org), we have set our dates the **AIRROC/Cavell Commutation & Networking event for October 19 to 21, 2009**. As details become available, such as the hotel and its location, they will be posted to our website.

Please also mark your calendars for February 11, 2009 when AIRROC/Cavell will again offer a one-day commutation meeting at the offices of Dewey & LeBoeuf, LLP in New York City. Registration (no fee) can be accomplished and details accessed through our website.

AIRROC offers their sincere congratulations to Dan Schwarzmann of PricewaterhouseCoopers who was awarded the 2008 AIRROC Run-Off Person of the Year, the fourth award of its kind granted by AIRROC. Read more about Dan in this issue.

The buzz in the room as so many met to conduct business, warm voices as people greeted one another, the clink of glasses at the gala dinner, sing-along's as the band played... sounds of a productive, enjoyable event. See you again next year! We hope this AIRROC Matters Special Issue sparks smiles and good memories from the event. ■

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# Rendez-Vous 2008

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Left to right: **1.** “Laughter...tension release,” Art Coleman, Citadel Re, Jonathan Rosen, Home Ins. Co., Mike Walker, KPMG, **2.** “Roundtable discussion,” Nick Pearson, EAPD, Ali Rifai, Centre Solutions, John O’Neill, Cavell, John Byrne, AXA Liab. Mgrs., **3.** Jim Veach, Mound Cotton Wollan & Greengrass, **4.** Wendy Gridley, Cavell, Anne Beaulieu, RFML, **5.** “Focus Intense” Mike Walker, KPMG, Janet Kloenhamer, Fireman’s Fund, **6.** Trish Getty, AIRROC, Mary-Pat Cormier, EAPD, Kristine Johnson, Navigant Consulting, **7.** Rendez-vous Band, **8.** “CNA’s Bryina Stark makes another friend,” **9.** “Insider Roundtable discussions”

*Women's Networking Luncheon*

## Women Also Listen



*Upper left:* Selinda Melnik, Edwards, Angell, Palmer & Dodge, *seated to her left:* Mary-Pat Cormier, Edwards, Angell, Palmer & Dodge. *Center:* Inaugural AIRROC Women's Networking Group luncheon. *Upper right:* (from left) Kay Wilde, Lovells, Melissa Cook, Cavell America

The AIRROC/Cavell Commutation Event saw the inaugural AIRROC Women's Networking Luncheon. This women's networking event – the first-ever of its kind for AIRROC – was co-hosted by Edwards Angell Palmer & Dodge LLP partners, Selinda Melnik and Mary-Pat Cormier. Ms. Melnik is an internationally recognized restructuring and insolvency attorney at EAPD. Ms. Cormier concentrates her practice on D&O and E&O/FI coverage and litigation issues who also moderated a session at the conference on the risk and liability exposures of the subprime crisis.

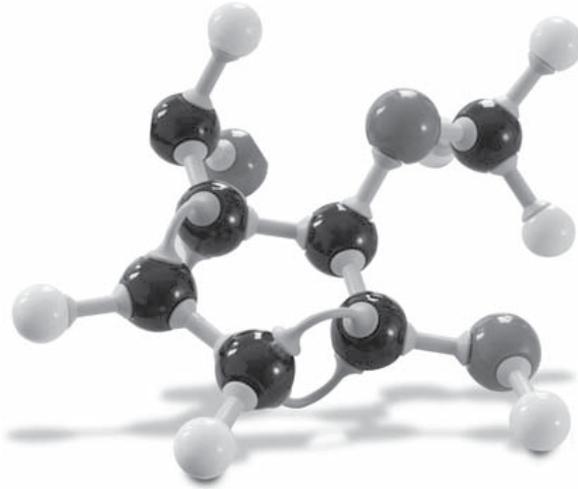
It was just a sample of what all attendees anticipate to be a regular feature of AIRROC gatherings. It attracted 50 attendees from an impressive array of companies, consultants, and law firms from around the world.

Trish Getty, CEO and Executive Director of AIRROC, welcomed guests and graciously thanked everyone for

their presence. Trish told a story about her early years, perhaps 1974 as reportedly the first female reinsurance auditor in the U.S., how she walked on eggshells for a couple of years as she proved herself as fully knowledgeable of reinsurance claims management, reinsurance contractual compliance manager and auditor in a male dominated sector of the industry at that time. She was just 26 years old at that time but already had nine years of experience in the insurance industry plus her mentor, National Indemnity Re's claims VP, was a Harvard law school grad then considered one of the dean's of reinsurance and a great teacher. Trish finalized by saying, "We've come a long way, baby!"

Co-host, Selinda Melnik spoke eloquently and passionately about her own experiences with notable women's networking organizations, such as IWIRC — the International Women's Insolvency & Restructuring

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## AIRROC Person of the Year: Dan Schwarzmann



2008 AIRROC Run-Off Person of the Year, Dan Schwarzmann, PricewaterhouseCoopers LLP

By James Veach, Mound Cotton Wollan & Greengrass

“When companies are forced to look at their operation and think about restructuring, it can be a great catalyst for change.” President-elect Barack Obama talking about General Motors? No, that’s Dan Schwarzmann, recently appointed head of Business Recovery Services at PricewaterhouseCoopers LLP (“PwC”) in the UK and AIRROC’s Person of the Year (in Run-off), commenting on how companies can best manage their way through the current downturn.

Introducing Mr. Schwarzmann, AIRROC Chairman Jonathan Rosen remarked on how AIRROC’s award winner is almost synonymous with solvent schemes of arrangement. Indeed, a 2004 survey of such arrangements characterized Mr. Schwarzmann as “something of a pioneer” in the realm of solvent schemes” attributed to him and his team at PwC 34 of the 40 such schemes issued at that time. Despite the growing support and general acceptance of solvent schemes, a nearly speechless Mr. Schwarzmann commented that he is “still trying to find the person who called them ‘schemes.’ It would have been so much easier if they had been called ‘plans.’”

No stranger to awards, promotions, and recognition, Mr. Schwarzmann — who joined PwC in 1990 — is, among many other things, now overseeing the joint administration of Lehman Brothers European business. Despite his success, this year’s Person of the Year remains best known for that rare combination of outstanding achievement and true humility. Thanking his “clients for the opportunities they have given us and the trust they have shown in the

team,” he recalled how an act of kindness — posing the sole question to an internal PwC talk on insurance — led to his being “seconded” to the insurance team and fifteen plus years dealing with distressed insurance ventures.

...a 2004 survey of such arrangements characterized Mr. Schwarzmann as “something of a pioneer” in the realm of solvent schemes”...

Mr. Schwarzmann insists that he “has never had a dull day” in insurance accounting. Commenting on “how receptive the industry [has been] to innovation,” this year’s Run-Off Person of the Year quoted Steven Jobs’ observation: “Innovation distinguishes between a leader and a follower,” which pretty much sums up what distinguishes Mr. Schwarzmann from other insolvency practitioners. In that spirit, we note our award winner’s further comment that “many of the new ideas that (he) has seen in (insurance and reinsurance run-off) are now being applied in other areas of business, such as in the banking and pensions’ worlds.”



Left to right: Jim Veach, Kathy Barker, Dan Schwarzmann and Jonathan Rosen (AIRROC Chairman)

For Mr. Schwarzmann, whether denominated as a credit-crunch, a liquidity problem, or a crisis of confidence, the current “changes” in the insurance and financial markets will lead not only to more run-off, but also “more creative solutions” to the opportunities that will inevitably arise from more run-off in this fascinating time to work in the industry. He further stated his gratitude to AIRROC for “this extremely prestigious award” and to his PwC team for their winning attitude focused on delivery where bravery is recognized and where mutual trust and respect are key. ■

## Panel 1

## Report on Liability and Risk Exposure in Connection with Subprime Related Litigation



Left to right: Kathy Barker, PRO IS, Jonathan Bank, Locke, Lord, Bissell & Liddell, Tim Stalker, Nelson, Levine deLuca & Horst, Alan Kildow, DLA Piper US, Mary-Pat Cormier, Edwards Angell Palmer & Dodge

By Peter Scarpatò, Conflict Resolved, LLC

Mary-Pat Cormier, Alan Kildow and Tim Stalker addressed the liability and risk exposure in connection with subprime litigation. Mary-Pat characterized the problem as a mythical hydra: as the government's \$700 billion plan attempts to address one issue, other issues will develop, as evidenced by recent, wildly erratic market fluctuations. Though laudable, the government bailout will cause more regulatory scrutiny, ultimately challenging both direct insurers and reinsurers in many ways.

The factual chain of causation began with mortgage loans: debt obligations whose projected income was pooled and sold to trusts from which mortgage-backed securities ("MBS") were issued to investors seeking higher returns. As investors' thirst for higher yields increased, so did the level of MBS business, from \$120 billion in 2001 to \$625 billion in 2005. Post-Enron, investors' demand

*Though laudable, the government bailout will cause more regulatory scrutiny, ultimately challenging both direct insurers and reinsurers in many ways.*

for safer investments increased. As the need for mortgage income to support MBS obligations increased and the pool of well-qualified mortgagees dried up, banks and mortgage brokers turned to unqualified borrowers, reducing lending standards and asset-backed loans to ensure a steady stream of underlying debt obligations.

Next, Alan characterized the subprime debacle as the most significant financial crisis since the Great Depression, clearly outpacing the Savings and Loan

*The key issue again is foreseeability: did the officers and directors act prudently in the face of known, historical housing market risks?*

("S&L") crisis. Characterizing the credit mess as "a small explosion inside a nuclear device," Alan traced the factual links in the liability chain from the increase in securitization and need for investment yields in the late 1990s, through the development of derivatives and credit default swaps in the period 2001-2006 (citing AIG's London-based department as an example), through the Federal Reserve's lax monitoring of credit and low interest rates, and the ultimate impact of volume-driven mortgage brokers applying lax credit guidelines.

Beginning in 2006, warning signs of this credit calamity mirrored those which had predated the Great Depression and S&L crisis: the foreseeable housing market cycles. Despite this known risk, the entire MBS model was based upon the faulty premise that real estate price levels would continue to rise. The key liability question: despite this knowledge and foreseeable risk, why were investment banks buying and warehousing more and more mortgage debt in 2006, 2007 and even 2008?

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## Panel 2

# Regulatory Approach to Liquidation



Left to right: Kathy Barker, PRO IS, Mike Walker, KPMG, Bruce Shulan, Trenwick America Reins. Corp., David Brietling, Reliance Ins. Co. In Liq.

By James Veach, Mound Cotton Wollan & Greengrass

**M**ike Walker, Partner, Head of Restructuring, Insurance Solutions (KPMG) moderated a panel that included David Brietling, the Chief Liquidation Officer at Reliance Insurance Company (in Liquidation) and Bruce Shulan, President and CEO at Trenwick America Reinsurance Corporation. The panel addressed U.K. and U.S. regulation of insurance company receiverships.

*After a company fails, Mr. Walker finds that U.K. procedures are more flexible than the U.S. response or at least are perceived as more flexible.*

The Panel began with a general discussion of the differences between U.S. and U.K. insolvency procedures with respect to when and how insurers enter receivership. For Mr. Walker, the U.K. regulators focus less on specific, enumerated grounds for moving against an insurer and more on a cash flow and balance sheet analysis. Mr. Shulan pointed to the varied and specific provisions in the state insurance statutes, e.g., failure to provide a timely or accurate annual statement, risk based capital, and other specific requirements whose violation can trigger an application to rehabilitate or liquidate a U.S. insurer.

After a company fails, Mr. Walker finds that U.K. procedures are more flexible than the U.S. response or at least are perceived as more flexible. He attributes the perception of flexibility to: (1) U.K. practitioners' having more "wobble room," particularly with respect to winding up procedures that have been around for more than

100 years; and (2) the use of creditors' committees that encourage course correction and innovation.

Both of the U.S. panelists referred to the NAIC's Restructuring Mechanisms Group as an example of a U.S. willingness to consider more flexible receivership procedures. Mr. Shulan walked through the requirements for New York's Regulation 141 and touched on Rhode Island's attempt to introduce a species of solvent schemes in the U.S. As Mr. Shulan put it, Regulation 141 offered U.S. cedants an opportunity to save the "patient before it's too late," but still give individual cedants a chance to opt out of a Regulation 141 Plan, a feature not present in U.K. schemes of arrangement.

*U.S. panelists referred to the NAIC's Restructuring Mechanisms Group as an example of a U.S. willingness to consider more flexible receivership procedures.*

If an insurer fails, how do receivers and creditors get them out of receivership? The U.S. panelists generally agreed that budget constraints, fiduciary obligations, and state insolvency laws may deprive an insurance receiver of the skilled management needed to pay creditors and quickly close an estate. "At the very moment that the failed company needs skilled and experienced managers, those managers depart and new personnel move in who are also constrained by regulatory requirements and restricted budgets." Mr. Brietling concurred, noting that particularly with respect to the collection of reinsurance, expertise and intermediaries often flee just when they are most needed.

*continued on page 26* ►

## Rendez-vous 2008 Gala Dinner



Left to right: **1.** Standing: Calvin McNulty, Bazil McNulty, Heather Kerick, Art Coleman, Citadel Re, John Halls, Compre Administrators. Seated: Steve Petch, Cavell, Clive O'Connell, Barlow, Llyde & Gilbert, Mike Fitzgerald, CNA, Martin Rebisz, Nationale Nederlanden Overseas, **2.** Art Coleman, Citadel Re, **3.** Standing: Dan Schwarzmann, PwC, Zack Phillips, Business Insurance, Jonathan Rosen, Home Ins. Co. in Liquidation, Karl Wall, Enstar, Colm Holmes, Centre Solutions, Kathy Barker, PRO IS. Seated: Trish Getty, AIRROC, Andrew Maneval, Horizon Mgmt., Terry Kelaher, Allstate, Marcia Scheimer, Centre Solutions, **4.** Jonathan Rosen, The Home Ins. Co. in Liquidation, AIRROC Chairman, **5.** Standing: Andre Lefebvre, Arrowpoint Capital, Freddie Acevedo, Assurant, Darryl Ashbourne, KPMG. Seated: Peter Taylor, John Byrne, AXA Liab. Mgrs., Peter Recka, LDG Reins. Corp. **6.** Standing: Steve Adkins, Minster, Steve Goate, Reinsurance Solutions, Walter Gross, Reliance Ins. Co., Ron Tolley, RFML. Seated: Bina Dagar, Ameya Consulting, Ray Eppinger, Cambridge Integrated Services, Ben Webber, KPMG, **7.** Standing: Sarann Reed, Guy Carpenter, Anne Beaulieu, RFML, Steven Bazil, Bazil McNulty, Vickie Moore, KPMG, Richard Emmett, PRO IS, Simon Hawkins, PwC. Seated:



Mark Everiss, EAPD, Donna Penfold, Global Reinsurance, Michael Cook, Navigant Consulting, Wendy Gridley, Cavell, **8**. “Mr. Commutation” Jim Moran, Cavell, **9**. *Standing*: John Sarchio, Chadbourne & Parke, Michael Dobias, Davies, Arnold, Coopers, Alan Quilter, Randall & Quilter, *seated from left*: Bill Power, Scottish Lion Ins. Co., Mike Walker, KPMG, Julie Ponsford, Cavell, Pat Fee, Clarendon Ins. Group, **10**. *Standing*: Barry Weissman, Sonnenschein, Richard Rutty, RSM, Cindy Koehler, Liberty Mutual, Mike Walsh, Boundas Skarzynski, Walsh & Black. *Seated*: Larry Greengrass, Mound Cotton Wollan & Greengrass, Eric Kobrick, AIG, Susan Grondine, Cavell, Peter Wedge, SCOR, **11**. *Standing*: Keith Kaplan, Reliance Ins. Co., Frank Kehrwald, Swiss Re, Dale Diamond, AXA, Mike Zeller, AIG, Larry Schiffer, Dewey & LeBoeuf. *Seated*: Ed Gibney, C NA, Marianne Petillo, ROM, Joe DeVito, Navigant Consulting, Janet Kloenhamer, Fireman’s Fund, Karen Amos, Resolute Mgmt. Services **12**. Trish Getty, AIRROC, Andrea Lerch, Hannover Re, Renate Schaper-Stewart, Hannover Re, **13**. Edeltraut Funch, Hannover Re, Klaus Kune, Hannover Re





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## Panel 3

# Ceding Policy Buy-Backs and Commutations



Left: James Sion, Allianz Global Corporate & Speciality. Middle: Marvin Mohn, Tawa Mgmt., Gail Goering, Lovells, Andrew Maneval, Horizon Mgmt. Group Right: Kathy Barker, PRO IS, Jonathan Bank, Locke, Lord, Bissell & Liddell

By Amy B. Kelley, Butler Ruben Saltarelli & Boyd LLP

The panel on Ceding Policy Buy-backs and Commutations was chaired by Gail Goering of Lovells LLP. Joining her on the podium were Paul Bugden of Clyde & Co., Andrew Maneval of Horizon Management Group LLC, and Marvin Mohn of Tawa Management Ltd. The panel's discussion focused on whether commutation payments are recoverable under reinsurance and retrocessional contracts. It was agreed

*...there was consensus among the panel members that paid claims and outstanding claims...are generally recoverable. The more remarkable question is whether commutation payments reflecting IBNR are (or should be) recoverable.*

that there is very little law on this point in either the United Kingdom or the United States. As a general matter, however, there was consensus among the panel members that paid claims and outstanding claims (at least so long as the party seeking to recover has ascertained a loss) are generally recoverable. The more remarkable question is whether commutation payments reflecting IBNR are (or should be) recoverable.

There was discussion of several recent cases that provide at least some direction on this point. In *English & American Insurance Company Limited vs. Axa Re SA*, the English Commercial Court distinguished between paid claims and IBNR when considering EAIC's motion for summary judgment against its reinsurer, Axa, arising out of an underlying settlement of breast implant losses. The court granted EAIC's motion with respect to the portion of the underlying settlement reflecting paid claims. The

court, however, declined to grant summary judgment on the IBNR element of the underlying settlement, holding it was "conceivable, although unlikely that Axa might have a defense in relation to settlement amounts paid in respect of IBNR as opposed to paid claims." The English court thus left the recoverability of the IBNR portion of the settlement to be decided after a full trial on the merits. According to Paul Bugden, English law remains "in a state of flux" following this decision.

On this side of the pond, Andrew Maneval identified two recent arbitration awards (made public in subsequent proceedings to vacate and confirm the awards) which provide at least some insight as to how this issue is being addressed by U.S. arbitrators. According to Maneval, in two separate arbitrations involving Global Reinsurance Corporation and Argonaut Insurance Company, the panels refused to allow for the recovery of future paid liability obligations. Rather, the panels held that such future obligations could only be recovered from the retrocessionaire if, in fact, the losses were ultimately paid by the underlying carriers at some point in the future. It remains to be seen, however, whether this reasoning will be applied in other U.S. decisions.

The panel's general consensus was that there is no clear answer to the question at this point in time. All agreed that a reinsured negotiating an inwards commutation would be wise to put its reinsurer/retrocessionaire on notice of the commutation prior to the final agreement. It was further agreed that in order to maximize the chance of recovery, a reinsured should ensure that it will be in a position to demonstrate to the reinsurer/retrocessionaire (or arbitration panel) that there was a rational basis for the commutation value. ■

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## Panel 4

# Part VII Transfer – Equitas/Resolute Update



Left to right: David Brietling, Reliance Ins. Co. In Liquidation, Klaus Endres, AXA Liability Mgrs., Alexandre Scherer, AXA Liability Mgrs., Robert Romano, Locke Lord Bissell & Liddell, Clare Swirski, Clifford Chance, Dan Schwarzmann, PricewaterhouseCoopers

By Nick Stern, Edwards Angell Palmer & Dodge UK LLP

This session focused on the process within the UK for transferring portfolios of business from one insurer/reinsurer to another known as Part VII transfers (they have been given this name because the legislation governing the transfers is Part VII of the Financial Services and Markets Act 2000) and their enforcement within the US. It also provided an overview of the proposed transfer between Equitas/Resolute and the Berkshire Hathaway Group. The panel for the session was Clare Swirski of Clifford Chance LLP, Robert Romano of Locke Lord Bissell & Liddell LLP and Dan Schwarzmann of PricewaterhouseCoopers LLP, who acted as moderator.

The session began with Mr Schwarzmann and Ms Swirski providing an overview of the practical and legal issues connected with implementing a Part VII transfer in the UK. In summary, first, they explained the main reasons that such transfers are used. Secondly, they set out the three main ways that policyholders' interests are protected, namely (i) the oversight of both the English regulator, the Financial Services Authority, and the English High Court, (ii) the central importance of the independent expert who assesses the impact of a transfer on creditors and (iii) the opportunities for creditors to set out their concerns and if necessary appear before the Court to object formally. Thirdly, they explained the formal procedural steps required to implement a transfer.

Mr Romano provided a US perspective on the Part VII procedure. In particular he explained that where the contracts being transferred were subject to US law, the transfer was likely to need recognition and enforcement in the US. He explained that there were two main methods for attempting such recognition. First, recognition may be attempted using Chapter 15 of the US Bankruptcy Code. However, he noted that due to conflicting decisions under the predecessor legislation (section 304 of the US Bankruptcy Code) and the lack of any relevant decisions under the current legislation, there was some uncertainty as to whether Chapter 15 could be used to recognise Part VII transfers. The alternative method was to seek recognition on a state by state basis. He noted that this may be preferred by companies that do not wish to be associated with bankruptcy procedures.

*... where the contracts being transferred were subject to US law, the transfer was likely to need recognition and enforcement in the US.*

Finally, Ms Swirski provided an overview of the agreement between the Berkshire Hathaway Group and Equitas/Resolute first to reinsure and then to assume (using a Part VII transfer) Equitas' remaining liabilities. She explained that the purpose of the Part VII transfer, which is currently being prepared, is to transfer the liabilities of the remaining Lloyd's Names reinsured into Equitas to a new company. ■

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## Panel 5

# Purchase and Sale of Reinsurance Recoverables



Left to right: Andrew Maneval, Horizon Mgmt. Group, Jim Moran, Reinsurance Finance Mgmt., Steve Ryland, PRO Ins. Solutions, Larry Schiffer, Dewey & LeBoeuf

By Bina Dagar, Ameya Consulting

Moderated by Larry Schiffer of Dewey & LeBoeuf LLP, Jim Moran of Reinsurance Finance Management Limited (RFML) and Steve Ryland of PRO Insurance Solutions Ltd. discussed the purchase and sale of reinsurance recoverables—why companies consider selling them and the benefits of doing so; how companies can effectively purchase and sell them; the need for speed; the role of a credit controller; the pricing of this instrument; and, finally, the different approaches within the international markets.

*The aim is to seek finality by freeing resources through reduced efforts to collect and by refocusing on core business activities.*

Reinsurance recoverables may be defined as assets available to pay creditors in case of insolvency. Companies consider selling such assets to convert uncertainty into certainty. Certainty would mean capital efficiency, protection of corporate reputation, avoidance of counterparty financial exposure such as penalties against overdue balances and protection against credit risk. The aim is to seek finality by freeing resources through reduced efforts to collect and by refocusing on core business activities.

Besides accelerated cash flow from upfront cash for otherwise problematic reinsurance debts, the obvious benefits of the sale are increased liquidity and asset certainty. Furthermore, the release of provisions offers potential balance sheet improvement. And finally, the seller sees a reduction of administration costs from the sale of these assets.

The panel stressed the need to know one's principals especially the pool members. Many cedants cannot identify their reinsurers and the ultimate payer of their claim. Researching the provenance of counterparties/reinsurers allows the party to effect an offset, which would reflect as a payment on the balance sheet even if no money is exchanged. Creditors used to rely on brokers to determine debtors. In today's market that reliability has vanished. Especially hard hit are those reinsured by pools whose members are not easily identifiable. The value of personal contacts helps in tracking down reinsurers and controlling credit. Speed is crucial, otherwise time bars may nullify debts after a certain time, not to speak of lost investment and interest income on outstanding debts.

The role of the credit controller is not just to be a bean counter, but to actually control debts. According to Moran, this requires a proactive outlook in finding one's reinsurers and staying in touch with them through attendance at events such as AIRROC's Rendez-vous.

*continued on page 26*

## Electronic Survey

# AIRROC Matters Survey Results

By Teresa Snider, Butler Rubin Saltarelli & Boyd LLP

The AIRROC Matters Survey was an electronic survey sent by email, which sought information on attitudes people in the industry have on nine topics related to run-off. Sixty individuals completed the survey, sixty-five percent of whom are employed by a member of AIRROC. The remaining thirty-five percent of the respondents identified themselves as employees of insurance or reinsurance companies that are not AIRROC members (15%), consultants (10%), attorneys (7%), and employees of an insurance department or reinsurance broker (3%).

Questions 1 through 8 of the survey asked whether the respondents strongly agreed, agreed, disagreed, or strongly disagreed with the statements in those questions, and provided an opportunity for respondents to make comments. Question 9 sought information on why people participate in AIRROC events.

- 1) **Quantity of Disputes:** Eighty-five percent of the respondents agreed (68%) or strongly agreed (17%) that companies in run-off have more disputes than active companies do, with the remaining fifteen percent disagreeing.
- 2) **Quality of Disputes:** Fifty-five percent of the respondents agreed (43%) or strongly agreed (12%) that companies in run-off are more likely than active companies to take unwarranted positions on claims. Forty-five percent disagreed (35%) or strongly disagreed (10%) with this proposition. One respondent commented that companies in run-off are also “more likely to pay attention to real issues” while another stated that companies in run-off are “less likely to make ‘commercial settlements.’”
- 3) **Timing of Claim Payments:** Seventy-eight percent of the respondents agreed (47%) or strongly agreed (31%) that companies in run-off take more time to pay claims than active companies. The remaining twenty-two percent disagreed (19%) or strongly disagreed (3%). Three respondents cautioned against generalizing about the timing of claims payments by different companies in run-off. Two other respondents expressed the view that delays in claims payment may be a result of fewer claims staff or resources, and another respondent expressed the more cynical view that delays are usually part of a cash management strategy.
- 4) **Reputation:** Eighty-two percent of the respondents agreed (65%) or strongly agreed (17%) that the fact that a company or portion of a company is in run-off is perceived less negatively than it was five years ago, with the remaining respondents disagreeing (15%), strongly disagreeing (2%), or unable to provide an opinion on the topic (1%).
- 5) **Quality of Personnel:** Eighty-one percent of the respondents agreed (47%) or strongly agreed (34%) that employees handling run-off operations are of at least the same caliber as employees handling on-going operations, with the remaining nineteen percent of the respondents disagreeing (17%) or strongly disagreeing (2%). Three respondents commented that employees of run-off organizations are more experienced and seasoned, while one respondent feels that a lack of high quality personnel is “consistent throughout the industry.”
- 6) **Regulation:** Fewer than half of the respondents agreed (29%) or strongly agreed (19%) that regulators should take a more active role in the oversight of run-off operations. The majority of the respondents disagreed (34%) or strongly disagreed (18%) that more regulator involvement was needed.
- 7) **Brokers:** Ninety-eight percent of the respondents agreed (44%) or strongly agreed (54%) that brokers provide a different level of service to active clients than to run-off clients.
- 8) **Conferences and Seminars:** Ninety-eight percent of the respondents also agreed (52%) or strongly agreed (46%) that there is value to attending conferences and seminars that focus solely on issues affecting discontinued operations.
- 9) **AIRROC:** Seventy-three percent of the respondents participate in AIRROC events because of networking opportunities. The second-most popular reason for participating in AIRROC events is for the opportunity to progress or complete business deals (52% of the respondents), with thirty-nine percent of the respondents citing the educational events as a reason for their attendance.■

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## The Eye of the Storm Continued from Page 1

week “we understood after conversations with both investment bankers and Treasury officials that we had no option but to consider other options.” In Dr. Finer’s opinion, the prospect of an AIG holding company bankruptcy and the recognition that no one in these conversations knew exactly how a bankruptcy of the holding company would play out, led to the Federal Reserve’s \$123 billion loan.

While giving “Federal officials credit for recognizing the importance of maintaining AIG as a viable entity,” Dr. Finer believes that, on balance, state regulators did their job over-seeing AIG’s risk-bearing entities. Dr. Finer attributed AIG’s solvency struggles to AIG’s securities lending operation. “The problem here was that although we had tremendous power at the risk-bearing level, we did not have the same authority over entities providing financial products.” According to Dr. Finer, “the main lesson here is that the insurance regulation model worked much better than the deregulated federal oversight model.” In the future, insurance regulators need the capacity to regulate at both the operating company and the holding company levels.

What shape will future insurance regulation take? Dr. Finer suggested that recent events, events that continue to evolve, see, e.g., Walsh, *Where Did the Cash Go: AIG Has Used Billions*

*from the Fed but Hasn’t Said for What*, B1, N.Y. Times, October 30, 2001, may constitute a “big blow” to Basel II and Solvency II and may inhibit moves toward principles based accounting rules. “I think that we will have to slow things down a bit,” perhaps recognizing that we are not seeing the “same type of liquidity crisis among the risk-bearing or operating entities that we have seen in the financial market.”

## The Receiver’s View

Mr. Peters picked up on Dr. Finer’s comments on risk bearing entities overseen by state regulators and turned to his role as the receiver for insurance entities that failed for less exotic reasons. From Mr. Peters’ perspective, the most important development at the Liquidation Bureau he oversees has been movement towards greater transparency.

When he arrived at the Bureau in 2006, the Bureau had no chief financial officer, no chief compliance officer, and no chief technology officer and the Bureau had never been audited in its nearly-100 year history. “For the first time in 99 years, we did [a top-to-bottom] audit.” In June 2008, the Bureau released a Report on Internal Controls. “My staff

*continued on next page*

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## The Eye of the Storm **Continued from Page 24**

looked at me as if I had two heads,” but Mr. Peters wanted the public to see the Bureau’s problems and he had in the internal audit report posted on the Bureau’s website. For a copy of the report on the just completed audit of the Bureau’s 2006 financial statements, see [http://www.nylb.org/Documents/NYLB\\_Annual\\_Report\\_2006.PDF](http://www.nylb.org/Documents/NYLB_Annual_Report_2006.PDF).

Mr. Peters discussed the Bureau’s efforts resuming payments from the New York security fund for taxis and ambulances, close additional estates, and address the shortfall at Executive Life of New York, as well as the sale of Midland Insurance Company. With respect to Midland, Mr. Peters sketched out his proposal to sell Midland’s assets and liabilities using an approach “cobbled together” by counsel inside and outside the Bureau.

In the broadest terms, Mr. Peters intends to seek bids to pay approved claimants a percentage of their claims,

e.g., twenty cents on the dollar. He will also retain an outside agency to project how many cents on the dollar Midland’s liquidator could pay if the estate were closed pursuant to NYIL Article 74. According to Mr. Peters, Midland will not be sold unless bidders can beat the Bureau’s own projected payout.

Mr. Peters also discussed a 180-day period in which Midland policyholders would assess bids for Midland and resolve disputed claims. He stressed that this effort — which he characterized as never having been attempted in any other U.S. insurer liquidation proceeding — might inspire other innovative run-off efforts for U.S. receivers. In his words, the Midland proposal and other innovative approaches are needed to “free us up to deal with whatever may come down the road” from the current financial market meltdown. ■

## Women’s Networking Luncheon **Continued from Page 8**

Confederation, which she founded. And Mary-Pat Cormier enthusiastically endorsed women’s networking events, noting that the number of women’s networking events has grown significantly in the past three to five years and provide meaningful opportunities for women in the industry to meet one another.

The luncheon provided a solid foundation on which to build future events. Following a discussion of the format that future events could take, Kristine Johnson of Navigant Consulting suggested that each table des-

ignate one or two people to sit on an ad-hoc committee to discuss possible events and women’s networking meetings at future AIRROC events. The AIRROC Women’s Networking Group will soon identify a foundation, objectives and meeting dates.

If you would like to participate in the ad-hoc committee established during the luncheon, please contact Trish Getty at [TrishGetty@bellsouth.net](mailto:TrishGetty@bellsouth.net) or Kristine Johnson at [kjohnson@navigantconsulting.com](mailto:kjohnson@navigantconsulting.com). ■

## Panel 1: Liability and Risk Exposure **Continued from Page 11**

Once the market for mortgage-backed securities froze and mark to market accounting doomed book values of even the safest securities, the bubble burst. Alan’s conservative estimate of potential liabilities exceeds \$1 trillion, an unprecedented amount which could seriously impact the insurance and reinsurance markets. D&O and E&O policies hold the highest potential for exposure. The key issue again is foreseeability: did the officers and directors act prudently in the face of known, historical housing market risks? According to Mary-Pat, while these policies may be implicated, each claim must be carefully analyzed, because coverage issues and exclusions could reduce or eliminate the ultimate exposure (e.g., the ERISA exclusion, intentional conduct/personal profit exclusions, insufficient disclosures in applications, etc.). Both Mary-Pat and Alan agreed that heightened regulatory initiatives will most likely increase the number and scope of these claims.

Finally, Tim Stalker discussed the reinsurance implications of the subprime credit crisis. Essentially, reinsurers will react in many ways to their potential exposures: they will (a) carefully dissect and apply key provisions in the underlying D&O and E&O policies, (b) analyze whether ceding companies improperly aggregated a series of acts into one occurrence to minimize the impact of applicable retentions, (c) assess whether a good-faith settlement was made before the underlying coverage determination, (d) determine whether the cedent improperly valued the underlying settlement to recoup high loss adjustment expenses, (e) determine whether and why the underlying settlement allocation differed from the ceded reinsurance allocation and (f) otherwise scrutinize the record for ex gratia payments. ■



## Panel 2: Regulatory Approach to Liquidation Continued from Page 13

With respect to regulatory oversight by different states where a group of insurers are domiciled in many states, Mr. Brietling observed that several Reliance entities were consolidated on the eve of insolvency so that its receiver avoided struggling with different statutory schemes in different states. Mr. Shulan pointed to different guaranty fund thresholds in different states and suggested that federalization of some aspects of guaranty funds operation might eliminate the perception that policyholders are treated arbitrarily based solely on geography.

Noting that the Rendez-vous is all about commutation, Mr. Brietling pointed out that reinsurers often want to deal with a liquidated entity, but it may take a receiver years to

calculate the failed insurers' losses well enough to commute responsibly. "We sent out almost 2 million packets to policyholders and others just to understand our exposure and to be able to report to the Court." Of course, once you have that information, Mr. Brietling continued, "you must — in your fiduciary capacity — be able to satisfy yourself and the court overseeing the receivership that you are getting fair value for your commutation." Mr. Shulan commented on the circumstances surrounding an insolvency that may limit the receiver's ability to commute or, as he put it, "the cause of a given insurer's insolvency may have a lot to do with how easily a receiver can commute a failed company's reinsurance program." ■

## Panel 5: Purchase and Sale of Reinsurance Recoverables

Continued from Page 21

The panel briefly discussed a formula that debt purchasers use to price their quotes to sellers. This involves assessing the book value of the debt and subtracting from it the contribution from value of certainty (such as supporting data/coverage issues/reinsurer willingness to pay) and the cost of collection at net present value.

International markets have some similar and some differing approaches to managing these assets. Each market imposes some penalty - either a solvency or a statutory one (on Schedule F in the US or Solvency II in Europe); certainly, each market incurs a balance sheet penalty; and the assignment language is quite similar among the countries in spite of the varying legal interpretations across jurisdictions. Differing approaches relate to the geographic issue typical of the US. With Lloyd's, there's a provision against slow-paying companies. Europe is considered to be the most difficult market in that assets have to be valued at exit value approach, i.e. the price has to be discounted to exit value of the book being sold.

Ultimately, does it matter who buys the debt? No, especially not to the seller. He has cash and doesn't care! Buying reinsurance recoverables is more attractive to discontinued business than to live markets; nevertheless, live companies may see value in it if they want to offload liability from their balance sheet, to achieve finality, to improve ratings and/or to achieve overall efficiencies. ■

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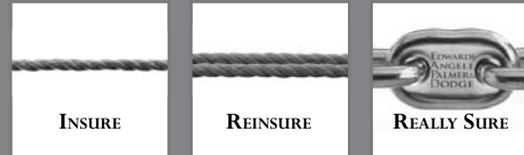
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