ASSOCIATION OF INSURANCE AND REINSURANCE RUN-OFF COMPANIES

AIRROC® MATTERS

A NEWSLETTER ABOUT RUN-OFF COMPANIES AND THEIR ISSUES

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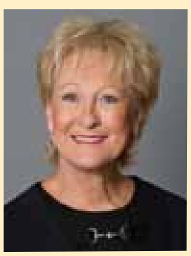
Message from Executive Membership Director

"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

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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

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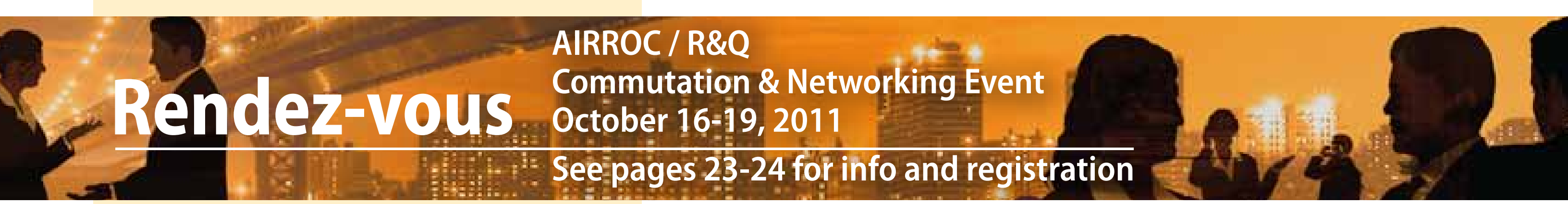

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of business that is not part of the core Allstate business and its operations are handled on a specialized basis.

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.

Peter A. Scarpato is President of Conflict Resolved, LLC, based in Yardley, PA. He can be reached at peter@conflict–resolved.com. Peter is the Editor of AIRROC Matters.

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

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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*

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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

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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.

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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.

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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

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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.

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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?*

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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.

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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.

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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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