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Beware of Model Tunnel Vision

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Sometimes that light at the end of the tunnel is a train

– Charles Barkley

Peter A. Scarpato

Truer words were never spoken. Our feature, the thought-provoking roundtable *Beware of Model Tunnel Vision*, raises the specter envisioned by Charles Barkley. Questioned by Leah Spivey and me, Guntram Werther, Kevin Madigan and Tom Edwalds shine informed, intelligent light on the problem of insurance managers over relying on models and under relying on experience. Next is Peter Bickford's *Speaking of Exchanges*, extolling the benefits of the currently-shelved but frequently-considered idea of an insurance exchange. Will exchanges rise like a Phoenix from the ashes? See pages 16-18.

Note: the alert *FIO Report – What does it mean to AIRROC Members?* Fran Semaya points us to her article on the AIRROC website (link provided) which outlines FIO's recommendations for steps to modernize and improve state insurance regulation.

Shifting gears, Catherine Isley and Connor Gants provide the tools to keep off the record discussions in their place, in *Negotiating with Confidentiality*. Beware those who believe that Federal Rule 408 alone conclusively cloaks their tête-à-tête. Our Legalese section features John Muldowney's *PA Workers' Compensation Law – Statutory Right to Subrogation*, showing insurers the path

to reimbursement of paid comp benefits from responsible third parties – a right, as John explains, not restricted to Pennsylvania.

We proudly introduce a new feature – Spotlight – getting you up close and personal with our run-off colleagues. Connie O'Mara and Bina Dagar present inaugural "Spotlighter" Diane Myers of Reliance, who provides insight into everything from her favorite quote to recommendations for AIRROC. Our line up of comparably interesting candidates is growing...keep an eye on future editions.

No one reading the magazine can ignore our beautiful illustrations – thankfully provided by illustrator Rafael Edwards. In *The Imagery of Runoff*, Maryann Taylor introduces our Chilean (he lives and works in South America) master, noting his background and experience, and taking us "behind the curtain" to show the creative process from article to idea to image.

To dispel the rumor that we are all work and no play, we introduce a new "fun feature," called *Run-off Word Play*. The genius of Edward Kabak, a senior legal officer from New York City, the game requires one to find industry words hidden within the text of an irrelevant narrative, like Word Search on steroids. So, for example, "The copiers there

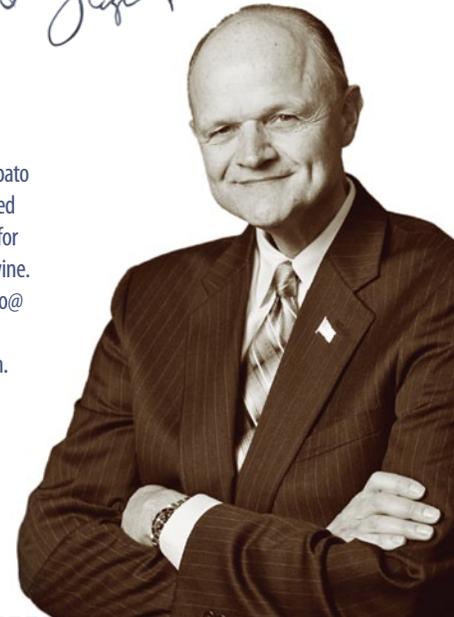
insure that Bill can run office procedures smoothly," find the words "reinsure" and "run off." Give it a try!

In *December NAIC Joint Issues Forum*, Kathleen McCain and Carolyn Fahey cover the topic of International Collections, discussed at AIRROC and IAIR's first ever co-hosted forum at the NAIC. Finish up with Carolyn's *The Groundhog was Right* article in AIRROC Update and our usual comprehensive Present Value and you have it.

Let us hear from you. ●



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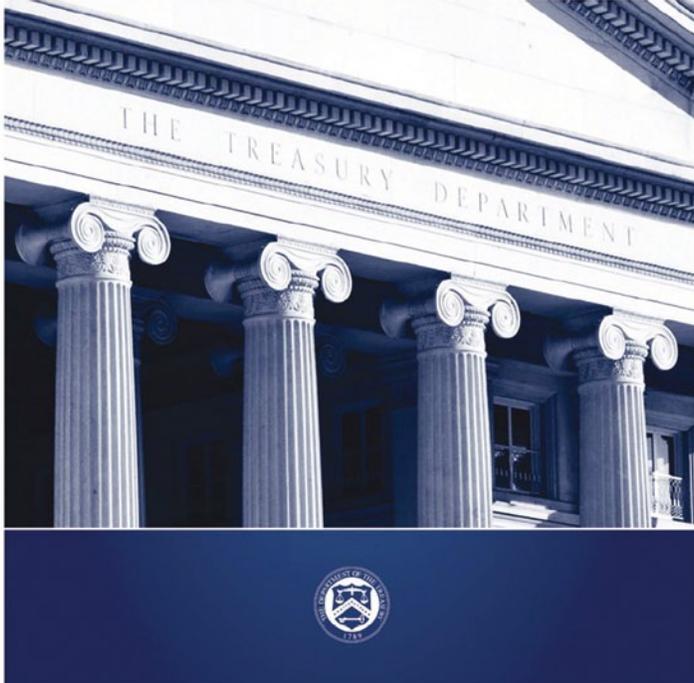
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HOW TO MODERNIZE AND IMPROVE THE SYSTEM OF INSURANCE REGULATION IN THE UNITED STATES

FEDERAL INSURANCE OFFICE, U.S. DEPARTMENT OF THE TREASURY
 Completed pursuant to Title V of the Dodd-Frank Wall Street Reform and Consumer Protection Act
 DECEMBER 2013



The FIO Report: What does it mean to AIRROC Members?

On December 12, 2013, The US Treasury released the long anticipated Federal Insurance Office Report entitled *How to Modernize and Improve the System of Insurance Regulation in The United States* (the “FIO Report”). Focusing on modernization and improvement in the current regulation of insurance, the FIO Report recommends certain steps that need to be taken: some steps by the states and others with the involvement of the federal government. You may find a summary of a few of the recommendations that is of interest to AIRROC’s membership at <http://www.airroc.org/fio>

– Francine L. Semaya

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Beware of Model Tunnel Vision

Co-Chair Leah Spivey and Editor Peter Scarpato moderated a roundtable discussion on exploring the pros and cons of reliance on models. The distinguished speakers were Tom Edwalds, AVP Mortality Research at Munich American Reassurance Company, Kevin M. Madigan, Director at PwC and Guntram F. A. Werther, Professor of Strategic Management at Temple University.

Reliance on Models in Insurance and Reinsurance

Peter Scarpato: *Leah Spivey and I are very happy to have our distinguished panel here today.*

Entities use models in different ways and at different levels, but is blind reliance on models alone the best approach?

Leah Spivey: *Kevin and Tom, in your areas of casualty and life business, have you seen a change in companies' reliance on models?*

Kevin Madigan: There's been some positive change lately in terms of catastrophe models. For a while, a lot of corporate decision makers weren't really making sure they understood what the models do and don't do when they found themselves in trouble.

So one good thing that's happened is that a lot of companies have spent time trying to make sure they actually understand these models and how to use them, recognizing that even the model vendors will tell you that you're not supposed to accept their answers as the gospel truth—they're just another form of information.

Another development in both life and casualty is the rise of capital models, and that's been driven forward by the new regulatory regime.

Tom Edwalds: The life industry is behind casualty in the application of predictive models. Models are being investigated and used to look at alternative methods for underwriting and pricing. There's been a push for a long time to change the way life insurance business is valued, such as adjusting the actuarial assumptions to give individual companies more flexibility to reflect their actual experience when calculating their liabilities.

One of the major areas is what's referred to as the middle market. Historically, many insurers have focused on high face value policies written for people looking for wealth protection. But for people near the middle of the income spectrum, there's a lot less life insurance protection than

perhaps there should be, which presents the opportunity for both direct writers and reinsurers to use predictive models as actuarial tools.

Madigan: You're right. Predictive analytics has exploded across the P&C industry, and now we're starting to see the use of predictive analytics outside of personal insurance.

Spivey: *Do you have any examples of how over-reliance on models causes problems?*

Madigan: The immediate headline is the number of companies that found themselves with way too much catastrophe risk, especially after Hurricanes Katrina, Rita, and Wilma. But I'm also seeing companies accepting the model answer as gospel and thinking they need to hold a lot less capital than they should. Because they think that they are diversifying risk, the model shows their capital requirement dropping.

Guntram Werther: Outside the industry, I think over-reliance on the models has caused problems in everything from war fighting to understanding international change and so forth. So I think these are generic problems that go across your industry and lots and lots of other industries.

More Sophisticated Models Don't Necessarily Produce More Correct and Reliable Analysis and Data

Werther: If you look at philosophers, they often emphasized that mathematical techniques are at the middle level of analysis (yielding general truths in human affairs), not at high levels of precision because of the interaction effects seen in social change. Statistics and models are 'for the most part true' approaches, not usually true for any specific case.

Edwalds: The one thing I always observe is that whenever you are constructing models of any kind, the primary concern is data quality and data integrity. If the



Predictive analytics has exploded across the P&C industry...

– Kevin Madigan

data is flawed, there is absolutely nothing that's going to come out of your model that will be of any value.

That is often overlooked; a lot of energy goes into building the structure of how the model is going to generate answers from data without paying enough attention to what data is actually getting put in. But if you have your valuation models set up and somehow you get totally wrong info in there, that flows straight to your books and six months later, you realized that was wrong.

Madigan: I think the more sophisticated the model, the more care you have to take. Generally, the more sophisticated the model, the more difficult it is for decision makers to actually use the results.

A really good, sophisticated model can produce lots of fantastic information, but a lot of decision makers who use model results don't think the same way the model builders think.

Edwalds: One issue you get into with sophisticated models is over-fitting the models to the data — where you actually picked up not true effects of the predictive variables on your outcomes, but you've picked up just noise in the data. And, you get a model that is too unstable for what you're trying to use it for.

Werther: If you view this across cultures, we think in numbers a lot more in the West than they do in other parts of the world. Some of the data that you get in other parts of the world are fictitious or they're figments of somebody's imagination, rather than precise. People need to remember that, especially when comparing data that's scattered across different cultural systems.

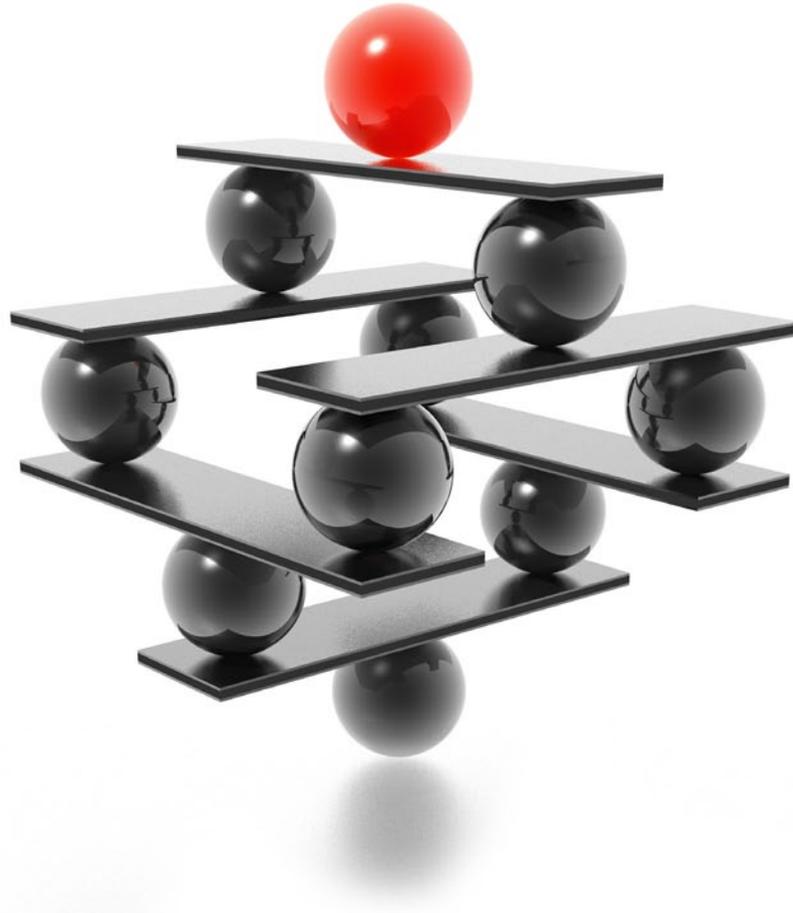
Scarpato: *Is there a way to make the models better, or make the people who use them more prepared, or to make these models as close to foolproof as possible?*

Madigan: I think, no. You have to make sure that people who use models understand their limitations. It's not about making the models better, because every model that's been used, as far as I can tell, keeps getting better. The issue is that they get so good that they're able to produce all kinds of wonderful information that people don't know how to use.

So instead of saying "I'm going to make the model better," you just say, "I think the model says the number should be X." But in reality, the model doesn't really say it should be X. It says it should be anywhere between Y and Z, but X is the best estimate between Y and Z.

Werther: The analyst part of this equation has really been underemphasized. I believe getting people to think creatively, insightfully, has received a lot less attention than producing greater and better models. I think that's where the industry and education need to improve.

Kevin wrote an article in 2012, which I think has it right. He used qualitative data, experience judgment insight, and the models as tools. And that's all it is.



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Beware of Model Tunnel Vision (continued)

It's a tool. It can be a great tool, but it is nothing more.

So what you're looking for there is the calibration: it should fit with the other types of investigative insights and methodologies we use. Qualitative data, experience and judgment — wise judgment — are very important, and are typically displayed by the people who actually do foresight well. And we need to recognize that and put the models into that mix as a way to make human judgment better; as adjuncts to the analyst.

Madigan: If you're in the position of relying on a model to make a decision, then you already have a certain amount of knowledge, expertise, and experience. The model is a tool. When we say models, we're really referring to computer models that have some sort of a mathematical, theoretical, engineering, and scientific basis to them.

Everything you use in your decision-making is a model, including the softer, more qualitative things. You have to think about all the different ways there are to analyze. Since it's just an analysis, you've got to synthesize all the information that you have, not necessarily focusing on having fantastic analysis, because then you miss a lot of other stuff that you should be looking at.

But it's really more understanding that you have a decision to make. What's the ramification of the decision you're supposed to make? What's all the information you can get? Why just pick some model that you may not even understand?

Nobody is making any decisions today that are much different than they were making 100 years ago or 50 years ago, including in the insurance industry. How did you make it before you had fancy computer models? So why throw all those other tools away? It's not like those tools aren't any good. It's that these models just give you even more tools.

Werther: Synthesis is an art-like experience of putting things together,



In the application of any model, you really need to have a decision maker who is extremely familiar with the subject matter.

– Tom Edwalds

whereas analysis is taking stuff apart. And those are different skill sets. The kinds of people that are good at synthesis are generally quite broad, artful thinkers.

Edwalds: In the application of any model, you really need to have a decision maker who is extremely familiar with the subject matter. You need to apply experience, judgment, review and assessment: Is this a reasonable result? And if something is surprising it requires investigation. Is it surprising because we found something new? Or is it surprising because you have serious errors somewhere either in your input data or in the model itself? You must look for other ways of confirming whether what you found surprising is a new factor or if it is simply a mistake.

Madigan: I was doing some work for a client around risk management of

natural catastrophe risk. They recognized that none of the models out there were actually going to give them anything close to the real answer, but they could give them really powerful information.

They found ways to use these models to provide information to help decide what kind of risk they want to take based on the risk they already have. They use the model to figure out where they fit in relative to the P&C industry. They focus on the exposure the model says they have, regardless of what the actual number might be, or where they want to be if the model is “right”. It's an interesting way to turn the model sideways and say we know the numbers are going to be wrong. But what can we live with in terms of where we fit into the overall world in which we operate according to this model?

Steps Senior Executives Take to Properly Choose Which Models to Use and How to Use their Output

Werther: I'm going to reference Mr. Kahneman, winner of the Nobel Prize. He used this idea of knowledge of broader experience – knowledge of the board – as the primary guide. But I would like to fold in some other work – if you know that each individual model is imperfect, if you know that each model will fail just as a crisis is arising, then you can use it the way that Kevin talked about, but you can also use arrays of imperfect models around the specific issue as a crisis foresight tool because – and the critical insight in here is – each individual model is going to fail in a different way.

Since models fail in different ways, you can use that information to triangulate what's going wrong in the system and use each model, as Kevin said, in the sideways way.

If you look at senior executives and dealmakers using an array of models around something they're interested in and understanding that they're all imperfect but they will fail differently and succeed differently, you get much more robust information that you can apply

Beware of Model Tunnel Vision (continued)

as improved judgment to whatever it is you're interested in.

Scarpato: *Dr. Werther, it sounds like the concept we're using to judge these models is business judgment – possessed by someone who can take a step back and assess what the model says and doesn't say.*

Werther: Yes, but this is where I would cross out the word 'business' and leave the word 'judgment.' Because what this comes down to is philosophical, and usually societal, cultural, political, legal judgments because no business operates in a vacuum – they operate in a specific culture and society, which has specific values and cognitive ways of looking at things that differ from all others.

So the model remains, to quote Andrew Ilachinsky, merely the adjunct to the analyst. Human judgment ends up as the key to all of this. When you look at Immanuel Kant, he tied this point together very precisely in his book Critique of Judgment. And I think we have to emphasize that these technical tools revolve around using wise judgment across multiple realms in which models can help us, but don't ultimately solve.

Scarpato: *Do models make everything seem significant and leave no way to tell which is more important, if you've got variables or different scenarios?*

Edwalds: On the life insurance side, the data has routinely for a long time been analyzed on millions of records. Of course, now with the advent of big data, it's in a much larger order of magnitude.

But it seems the issue you're referring to is that if the input data set has billions or trillions of observations and you're looking at different predictive variables that differ in frequency by a tenth of a percent, it's statistically significant based on the number of observations you have.

That's where models coming off the big data sets can be confusing. You'll get statistically significant results that perhaps are not that meaningful.

Werther: I think what's missing is the notion of perceiving 'internals' or 'ideas' to guide interpretation of the data. Kant,

Sir Isaiah Berlin and many others used the terms 'thread' or 'string' to make this point about what usefully holds raw information together to yield meaningful understanding.

What should be happening here is that idea, the internals – the broad experience – are well perceived and the models make assessment more robust; make it better. Too many people are now saying they have more and more data – big data – so we'll just run things until something fits. Something will fit. That's also probably the wrong something.

You have to make sure that the actual business folks making decisions that are executed in the business environment recognize that they're actually more important than the folks running the models.

– Kevin Madigan

Spivey: *How should new employees in the industry be trained to avoid this problem?*

Edwalds: Certainly, having new employees combine some academic background with some statistical techniques is a plus. You need to make sure that anyone that you're assigning to be part of your model buildup team, or the head of that team, is somebody whose primary skill set includes business judgment. Somebody who can look at the results coming out, and ask the question: are we seeing something surprising because we have a new fact, or because we just made mistakes?

Werther: The Director of National Intelligence has emphasized the need for three skill sets. One was synthetic thinking ability, which is what Kevin just said, tying things together. Second was knowledge of cultures and other people's social, political systems. And the third was linguistic and cultural skills.

What they're after is being able to think as other people think in the various societies, as well as being able to put that together and synthesize it.

Madigan: Tom is spot on. In fact, I think it's a problem everywhere in business that we get people who really know the technical framework, but don't really understand the environment in which models are being applied.

But at the same time, you have to make sure that the people who are using the results of the models know enough, that they're able to understand. And it doesn't mean they have to be experts in statistics or science, but be able to analyze and appreciate what any intelligent adult human being can understand – here's how the modeling process works, here are the weaknesses, here are the strengths, and move on.

You have to make sure that the actual business folks making decisions that are executed in the business environment recognize that they're actually more important than the folks running the models.

Scarpato: *As they promote people to management and senior level positions, companies must ensure that they've got somebody with enough experience to see the forest for the trees in the business. How do you do that?*

Madigan: Make sure you don't have a bunch of specialists and that the people actually doing all the tangible stuff understand the business that they're employed in. You've also got to make sure that the people applying the results of whatever kind of analysis understand enough about this analysis to know when it is absolutely giving you an answer and when it's just giving you information, and when that information is more or less trustworthy. It's really just about raising people to be more broadly educated.

Werther: That's exactly right. I've been looking at people who are successful with this. And what we see is that they have multiple career choices, they do more than one thing. They're generally older; 35 and up seems to be about a cut line. And they are also broad thinkers. They know

lots and lots of things. Now, if you think about this, universities are becoming more specialized and less generalist, so we're actually training people the wrong way.

Edwalds: One thing I have observed is that this has been an issue in the actuarial profession for my entire career and maybe longer. And that's because we have this credentialing process that involves a series of examinations and there are separate exams depending on what your specialty is. Entry level candidates get their career advancement by successively passing technical exams.

Before they get fully credentialed we must make sure that we build into the examination process—and some other things like the fellowship admission course—ways to assess the ability to look more broadly, to make sure there's an understanding of the underlying business.

But fundamentally, the exam process isn't going to fully evaluate that. So there is a challenge with the newly minted fellow who is almost always in high demand, but doesn't really have the understanding they need. But if they join the right organization, they can get the mentoring they need to develop that broad thinking and be able to understand the greater depth of the business they're in.

Madigan: That's what makes an actuary who's developed that broad understanding of the business in such demand. We've got the technical stuff and we can put that together with the really important stuff. It's just understanding how it's all used. But it's really hard to make much use of an actuary who only has the technical expertise. There's not a lot I can do with that person. And they hit the glass ceiling fast.

Edwalds: I agree with Kevin. The actuarial societies have made a real effort to try and make that part of the credentialing process, with some degree of success. But as I've said, it can't be perfect when you're fundamentally working around that examination-type process.

So if you know what you don't know, or at least have a clue about what you don't know, you're in better shape than if you don't have a clue.



Don't rely on historical patterns. They don't repeat themselves—they perhaps rhyme.

– Guntram Werther

Werther: If you think about it, technical expertise is absolutely necessary. But the way we train musicians and artists is essentially a mentoring process by which once they know how to play an instrument, we teach them how to make music, better music, higher quality music. And maybe that fits under this kind of a mindset.

And there's still more and more credentialing until, at some point, we simply say, okay, you know how to do the basic stuff, now we're going to make you into a musician, we're going to make you into an artist, we're going to make you into an analyst that understands how the world works, and that's essentially a mentoring process.

The solution is to do this inside your profession. Set up formal mentoring processes where the people who are actually good at this stuff teach other people how to improve over time.

Do Changes in the Global Economy and Technology Affect the Impact of Historical Patterns on Future Projections?

Werther: Don't rely on historical patterns. They don't repeat themselves—they perhaps rhyme. There are better ways to do futures foresight. But you have to take cognizance of those historical patterns and experiences.

The concept here is syndrome change, right? And the related concept to that is syncretism which is going from one form to another. Basically you start with these historical patterns and experiences and you move from there; you don't rely on them in terms of judging futures.

Edwalds: In the short term, if you are aware of the environment and can assure yourselves that certain key elements in the environment are reasonably stable, you can make these types of projections well enough to do your financial statements and price your [product] based on your historical patterns. But you need to be sensitive to changes. If you go back 50 years, the life insurance industry was based on fixed interest rate assumptions.

And when that really changed radically in the late '70s and early '80s, everybody was scrambling. Now what do we do? What interest rate do we assume as opposed to totally having to change our approach?

And that's the kind of thing you need to watch out for. You need to be aware of what the underlying assumptions are in your business. What are you absolutely relying on? Make sure those assumptions are still stable. Is that changing? In health insurance, the passage of the Affordable Care Act was a long time coming. That was discussed for at least 40 years before it actually passed. Various efforts were made to get there.

For the health insurance business, you need to be aware of what stresses are causing this conversation to take place. What do we need to do? Even though we may not be able to fix the outcome, what do we need to do to be able to survive whatever occurs?

Beware of Model Tunnel Vision (continued)

Spivey: *If actuaries have a clear understanding of this open reliability of data going into their model, why are there pages of disclaimers in the actuarial report?*

Werther: I don't think that anybody knows the reliability and scope of the data, which is why one ought to diversify the use of multiple methods and all the rest of it. The best you can do, in my view, is to have some sense of the reliability and scope of the data and think holistically from there.

Edwalds: I do think there tends to be, within our profession, a sense and understanding that your data is what makes or breaks your whole endeavor. Actuaries are always looking to get better data, but always realizing that they're going to have to make their decisions and recommendations on imperfect data. That is where all the disclaimers come from – comparing the data they actually have with the data they would like to have, and putting in disclaimers about what was lacking in what they received and why that limits the potential application of the results.

Madigan: If somebody from outside the company is writing a report or opinion, there is a recognition that “even if you guys have the best data in the world, and the best model in the world, I don't actually work inside the company, so there's a lot of stuff that I just don't know.” You can't do the qualitative evaluation. You can't do the synthesis. You can plot your judgment. It will automatically not be as good as when it comes from inside. There are always assumptions that have to be made. There are always adjustments that have to be made.

Edwalds: My comments were from the perspective of the internal actuary. Even when you're the one who's at least able to talk to people who are responsible for the actual data entry, you can get all the way down to what happens at the individual transaction level to get this data entered into our data stream.

Actuaries are always looking to get better data, but always realizing that they're going to have to make their decisions and recommendations on imperfect data.

– Tom Edwalds

But still that will only get you so far. It's going to make you aware of where you are – I think somebody used to refer to where the fish hooks are. They are the things that will snag you when they come through.

Spivey: *When I've been in a room with business experts and actuaries who have run certain models and come up with a pick, what they think is the right answer, I often sense some contention. What I have used at times as a remedy is having the actuaries open up the process a little earlier on, before they've come up with their pick, even before actual peer review, just to share with those business experts the thinking and reasoning for certain assumptions. Do you think that might be a good remedy?*

Edwalds: I definitely agree. I have seen many cases where there has been open consultation with the other business experts. Actuaries developing assumptions, talking to the underwriters, and talking to marketing people, to get a sense of what's in this particular business that we're trying

to value or price. I've seen other cases where actuaries are coming up with that number in a vacuum instead of working with other business experts throughout the process.

Madigan: I used to do a lot of asbestos reserving. I spent most of my time talking to attorneys and claims analysts. I would say, “based on everything you showed me, these are the assumptions that seem reasonable, what do you think?” I would spend a significant amount of time doing that before I ever gave them a number. Once I gave them the number, we would then reassess all those assumptions.

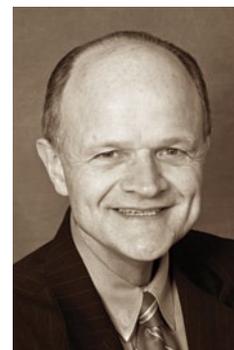
Werther: Looking at people who are actually good at this in everything from stock market to international relations, that's what you see. The reason the intelligence community produced ‘fusion centers’ is to try to inject sharing and integration into the judgments of the most secret organizations imaginable. And they're opening up to really a startling degree. They're literally reaching out and talking to people to look at assumptions and things like that, because in-house doesn't make it.

So this is not just happening in the actuarial profession, this is happening across the spectrum because the problem is the same.

Scarpato: *Thank you all for a very candid and robust discussion. This will be of great value to our readers. Leah and I greatly appreciate your collective experience and the time and the energy that you put into this discussion.* ●



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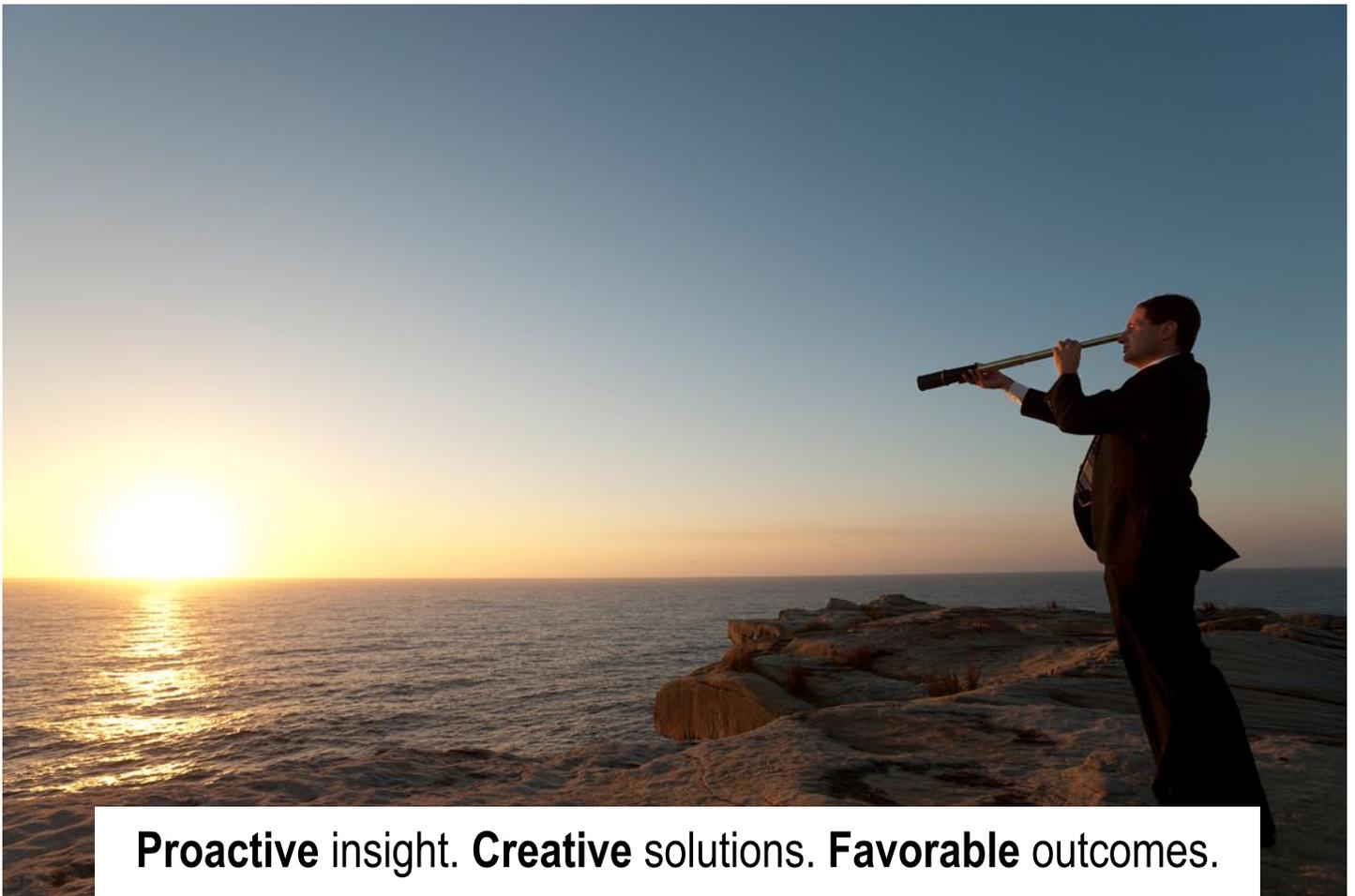
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Speaking of Exchanges...

Will the Phoenix Rise?

With all the attention and chatter these days about the health insurance exchanges under the Affordable Care Act, it is not surprising that there may be some jostled memories about the decades-old, failed attempts at establishing insurance exchanges in the US similar to or based on the Lloyd's model of a syndicated marketplace. But actually, the concept has never gone away and continues to be in the conversation today, albeit softly.

A Look Back

First a bit of history – or reminiscence, if you will. Long ago, in a time before

the explosion of alternative insurance markets, including excess liability facilities, captives, risk retention groups, sidecars, cat bonds or insurance linked securities, there was a severe capacity crisis. With few options available at the time to bring new capital to the table, the idea of establishing a Lloyd's-type syndicated market in the US grew, resulting in the passage in 1978 of legislation in New York authorizing the creation of the New York Insurance Exchange (Article 62 of the NY Insurance Law). Unfortunately, before the Exchange could become a reality – it opened in early 1980 – the market cycle had moved from very hard to soft and was getting even softer. Shortly after the NY Exchange opened, two other states – Illinois and Florida – adopted authorizing legislation followed by the

creation of exchanges in those states. Exchange authorizing legislation was also adopted in Texas and the Province of Ontario in Canada, and was under consideration in a few other states. The authorizing legislation remains on the books in New York, Florida, Illinois and Texas, although the Illinois statute is scheduled for repeal in 2017.

At its height in 1984, the NY Exchange annual report proclaimed that it ranked in the aggregate as the eighth largest U.S. reinsurer by premium and fifth largest by policyholder surplus, with 35 active syndicates. After this initial period of spectacular growth and expansion, however, the NY Exchange had ceased operations by 1987 — a short seven years after opening — with a number of its syndicates having been declared insolvent and in various stages of

receivership or run-off. Likewise, the exchange in Florida, over-optimistically named the Insurance Exchange of the Americas, collapsed in disarray and scandal in early 1987; and the Illinois Insurance Exchange, which later changed its name to the INEX Insurance Exchange, lasted the longest – into the early 2000s – but was never a significant market and is no longer active. The collapse of these insurance markets would seem to have buried forever any thought of attempting to create a syndicated insurance market in the US. But forever is a long time, and like a dormant flower in the desert, some things are never truly gone.

A Re-Emerging Idea

Fast forward twenty years, when in 2007 the NY Superintendent of Insurance, Eric Dinallo, discovered that the exchange authorization legislation, Insurance Law Article 62 along with three supporting regulations (89, 89A and 89B), was still on the books and started a dialogue with regulators and industry representatives about the feasibility of reestablishing an exchange market. Superintendent Dinallo's successor, James Wrynn, continued this dialogue and persuaded his then-boss, Governor Paterson, to endorse the exchange revival in his January 2010 State-of-the-State address. In that address, the Governor, with a nod to the recent past financial crisis, stated that: "By bringing together the buyers and sellers of complex commercial insurance, the Exchange will reaffirm our status as the focal point of international trade and finance. It will also curtail the types of transactions that were unregulated that decimated the global economy."

Superintendent Wrynn also moved the project from talk into action by establishing a prestigious group of interested elements of the insurance and financial industries, regulators and legislators, with the goal of developing a plan of action for the establishment of a new modern exchange facility. The working group included sub-groups

covering such topics as capitalization, operations and technology, regulatory oversight and markets. In June 2010 the working group issued its recommendations for establishing a modern insurance risk exchange based on five basic principles:

1. Provide a strong and secure capital base to support regulatory and rating agency acceptance;
2. Provide for prudent and flexible oversight;
3. Provide an efficient, cost-effective and technologically advanced platform for the facility and its members;
4. Achieve 50 State access for syndicates on both a reinsurance and surplus lines basis; and
5. Provide as expansive a market as possible through legislative and regulatory support.

The idea of reestablishing an exchange has had its skeptics and naysayers from the beginning.

Over the course of the next year a plan of action based on these recommendations was drafted, with the last draft dated July 25, 2011. Unfortunately, by this time, the legislation merging the New York insurance and banking departments into a new department of financial services was only a few months from implementation and the focus on anything other than the merger was minimal. The plan to implement the Working Group recommendations was never formally published and the exchange project once again became dormant. Was this finally the end for the idea?

Skepticism and Paranoia

The idea of reestablishing an exchange has had its skeptics and naysayers from the beginning. What has changed in the past three decades to make a Lloyds-

style insurance exchange workable in the US today when it did not seem to work before? Why do we need another market in the middle of seemingly endless capacity? How can an exchange overcome the regulatory and tax disadvantages of operating in the US? What assurances are there that a new exchange will not be as inefficient and costly as its predecessor? How would a new facility overcome the limitations of existing legislation that is outdated and not conducive to the needs of a successful facility? Why, indeed, even bother?

What is often missing in these conversations, however, is a factual assessment of the NY Exchange at the time of its closing. When the Exchange suspended operations in the Fall of 1987, it had a significant number of syndicates that were solvent, well capitalized (for the time and for the business they were writing), well managed, profitable and – most importantly – willing and anxious to continue operating on the Exchange. This growing community on the Exchange also included syndicate underwriting managers beginning to develop a following, and brokers willing and able to continue placing business with those trusted managers and syndicates. In other words, a true sense of market was developing on the Exchange. The problem was that the voices of these factions willing to continue the development of a true syndicated marketplace, were drowned out by the powers in control – primarily representatives of some major carriers and brokers that were never fully committed to the exchange concept, and who effectively forced the closing of the facility. Abandoned by the major companies and brokers, the remaining players could ill afford to risk the chance of being left behind to turn out the lights.

Adding to this historic skepticism arising from the failure of the old exchanges is the current concern – or paranoia? – of US insurance regulators for equity capital, which would play a major role in

Speaking of Exchanges (continued)

any modern exchange facility. Last April, New York's Superintendent of Financial Services, Benjamin Lawsky, speaking on the state of the US and world economies at a highly regarded conference in NYC, voiced concern about "private equity firms . . . becoming active in the acquisition of insurance companies." Why? Because "these private equity firms are more short-term focused – when [insurance] is a business that's all about the long haul." Subsequently, the New York regulator used this concern as the basis for imposing increased capital and financial controls on the purchase of two life insurers by private equity firms, and in December the Financial Condition Committee of the NAIC formed a new working group, the Private Equity Issues Working Group, to consider the development of rules to monitor and control risks associated with private equity and hedge fund ownership or control of insurance company assets. Considering that the most successful, oldest insurance market in the World, Lloyd's, is a syndicated market based on non-traditional capital, this singular attention to private equity is remarkable.

The Current Effort

The current support for a new, syndicated insurance risk exchange is driven largely by capital providers and global-minded insurance professionals that understand the value of a platform combining modern technology with syndicated capital in a controlled environment. These interests, however, recognize that such an initiative, while it would be industry-driven, cannot proceed successfully without the support of insurance regulators. With the momentum created by the Dinallo and Wrynn efforts, but which were halted by the silence of current New York regulators, it is a hope but not a certainty that the industry leaders who led the revival effort will be willing to continue to be available to the project should the NY regulators break their silence and support the concept.

...state regulators might want to take a closer look at the potential that could be created by a state-based insurance risk exchange facility.

In view of the erosion of state regulation since the 2010 adoption of the Dodd-Frank legislation and the creation of the Federal Insurance Office (FIO), state regulators might want to take a closer look at the potential that could be created by a state-based insurance risk exchange facility. In its recently issued and long overdue report on the modernization and improvement of the system of insurance regulation, the FIO prods state regulators with a not-so-subtle threat of increasing federal involvement:

"The need for uniformity and the realities of globally active, diversified financial firms compel the conclusion that federal involvement of some kind in insurance regulation is necessary. Regulation at the federal level would improve uniformity, efficiency, and consistency, and it would address concerns with uniform supervision of insurance firms with national and global activities."

The Plan to implement the Recommendations of the Industry Working Group listed the following benefits for state regulators:

- A highly capitalized, fully secure market;
- Prudent internal management structure;
- Significant security through a central fund;
- Collection point for premium and for allocation of taxes;
- Transparency through accessible data;

- On-shore market for high volatility risks; and
- Diversification through new sources of capital.

A truly state-based, nationally accepted insurance risk exchange could provide state regulators with an excellent example of their capability of supporting a seamless national market with the potential as an effective global competitor.

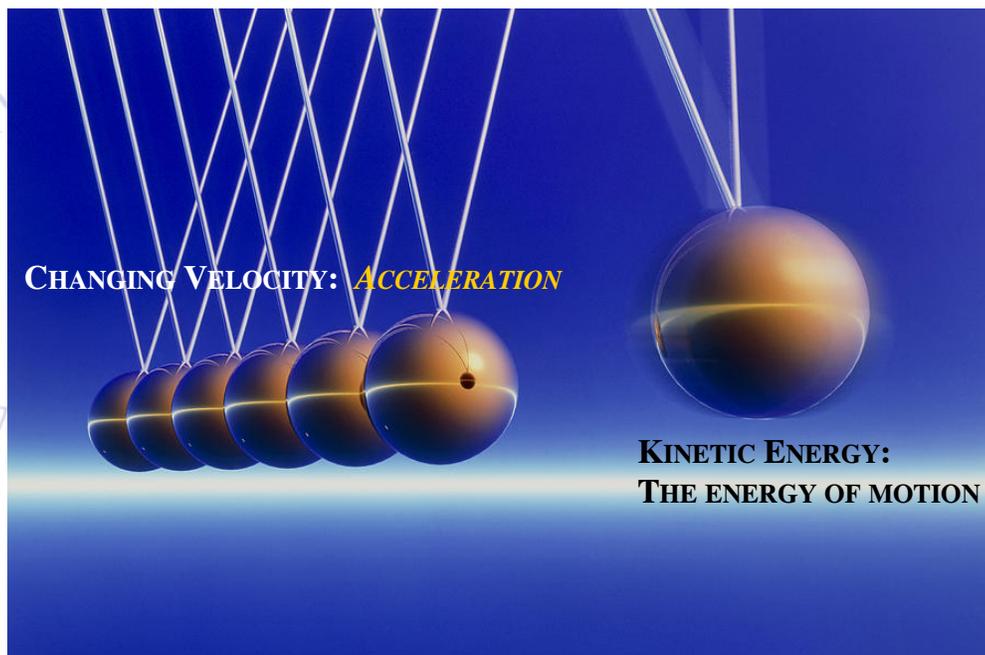
No market can or should be all things to all people. There are certainly many in the insurance and investment communities that will conclude that an insurance exchange makes no sense for them. There are many others, however, looking for new options and opportunities for which a viable, well-conceived insurance risk exchange makes sense. If regulators are willing to step up and acknowledge the potential of such a market in the US, the conversation could once again turn into action. ●

NOTE: The author was General Counsel to the old New York Insurance Exchange, and was Special Advisor to the Exchange Working Group. A copy of the draft plan to implement the Working Group recommendations, and other articles and documents relating to the insurance exchanges have been posted by him on his website at <http://www.pbnylaw.com/ny-insurance-risk-exchange/>.



Peter H. Bickford has over 40-years in the re/ insurance business. An ARIAS- certified reinsurance arbitrator/umpire, he writes frequently on regulatory and solvency issues. pbickford@pbnylaw.com

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SOFT on People... HARD on Issues

On Wednesday, February 26, 2014, AIRROC and Butler Rubin hosted a dynamic and innovative negotiation workshop at the elegant Standard Club in Chicago, Illinois. One of the attendees was so inspired by what was learned that day that she put pen to paper and sent me this verse to capture her experience of the day. That's a first for AIRROC so I have shared it below....

Carylyn W. Feehey

AIRROC & Butler Rubin successfully collaborated to present An innovative negotiation workshop – an exciting Lynn Cohn event. The presentation was quite impressive and delightfully unique Her strategies are sure to strengthen your negotiation technique.

Pre-negotiation prep requires you make the right analysis– Keep your strategies “authentic” or suffer negotiation paralysis. Assess each other’s interests; listening’s a critical part– Position isn’t everything & creativity trumps your heart.

Don’t be anchored or so we’ve been told... Make the first proposal – your BATNA is your gold. Negotiate on interests – don’t focus on positions Develop your alternatives but leverage dispositions.

Remember it’s important to analyze your “Wait & See” Keep your options open and employ reciprocity. Don’t forget to take into account the transaction cost And the unfortunate possibility that your BATNA could be lost!

Whenever you’re at an impasse, great negotiators do their part They know their opponent’s BATNA & exude creativity from the start. Learn to counter first – rather than just simply saying “yes” Has often proved to be quite a lucrative negotiation finesse.

This elusive process called “negotiation”, where does it all begin? As Lynn advised, you have to be in the “Interest” circle to win! Of course you can’t achieve this without “Power & Rights” But the combination of all three – almost always delights.

Soft on people... & Hard on issues... was the golden take-away Use aspirational thinking & maximize your “Lucky Day.” Incorporate Reasonable World to win the negotiation lotto – Begs you give serious consideration to Lynn’s negotiation motto.

In closing, my thanks to AIRROC, Butler Rubin, Lynn and all the rest The workshop proved quite valuable; outdoing the very best. Kudos to all those who attended & to those who dedicated their time Your talents were truly appreciated and I commend you all in rhyme.

— Anonymous

AIRROC Negotiation Workshop a Resounding Success



Negotiating with Confidentiality

Catherine E. Isely &

Supplementing the Protections of Rule 408

Connor T. Gants

“First, do no harm” is a maxim associated with the medical profession, but the same holds true for negotiations. The first step in a successful negotiation is to ensure that your statements don’t come back to haunt you if the negotiation stalls. Federal Rule of Evidence 408 provides security for parties by prohibiting settlement offers, or other statements made during settlement negotiations, from being admitted as evidence to prove the validity or amount of a claim in dispute.¹ But Rule 408’s protection is less robust than parties recognize. Before negotiating, litigants should consider whether additional measures are necessary to protect the privacy of their settlement communications.

The Policy and Protection Afforded by FRE 408

Federal Rule of Evidence 408 provides that settlement offers regarding disputed claims – or other statements made during settlement negotiations – are inadmissible as evidence “to prove or disprove the validity or amount of a disputed claim.” For example, if a policyholder in a \$100 million coverage action offered to settle for \$50 million, the defendant could not use that offer to prove that the policyholder’s claim is overstated.

As one court explained, “the rule reflects the reality that permitting consideration of settlement offers as reflecting an admission of liability in the amount of the offer would seriously discourage parties from discussing settlement or making settlement offers.” *Cheyenne River Sioux Tribe v. U.S.*, 806 F.2d 1046,

1050 (Fed. Cir. 1986). “[T]o encourage free and frank discussion with a view toward settling the dispute,” Rule 408 prevents using these offers to prove the validity or amount of a disputed claim. *United States v. Reserve Mining Co.*, 412 F. Supp. 705, 712 (D. Minn. 1976).

A party might conclude that Rule 408 adequately protects its statements in settlement negotiations. But as parties learn too late, there can be serious consequences for relying solely upon Rule 408.

Admissibility for “Another Purpose”

Importantly, Rule 408 only prohibits admitting into evidence settlement offers or statements used “to prove or disprove the validity or amount of a disputed claim.” Rule 408 (b) allows the court to admit this evidence “for another purpose.” The rule lists examples of other purposes, including “proving a witness’s bias or prejudice, [and] negating a contention of undue delay” that could help a counterparty who seeks to disclose the settlement negotiations. Because this list is not exhaustive, a skilled attorney might persuade the court to view the phrase “another purpose” broadly – to the detriment of your case.

In *Athey v. Farmers Insurance Exchange*, a plaintiff sued his insurer for bad faith denial of his uninsured motorist insurance claim, and for breach of contract. 234 F.3d 357, 359 (8th Cir. 2000). During a settlement conference before a magistrate judge, the insurer refused to offer any amount to settle the breach of contract claim unless the insured agreed to abandon his bad faith claim. The insured’s attorney promptly withdrew as counsel, and at trial, testified about the insurer’s statements. The insurer argued that Rule 408 protected these statements, but the trial and appellate courts disagreed. The

appellate court explained that controlling state law made attempts to condition the settlement of a breach of contract claim on the release of a bad faith claim, *itself* evidence of bad faith, concluding that the settlement communication “was ‘offered for another purpose,’ and the district court did not abuse its discretion by admitting it.” *Id.* at 362. Thus, a \$75,000 insurance claim turned into a \$635,000 judgment, including punitive damages – based in no small part on a statement the insurer apparently believed to be innocuous, made during a settlement conference. *Id.* at 361.

Rule 408 falls short because it “is merely a rule of evidence,” and does not protect against your counterparty’s public disclosure of the terms of your settlement discussions.

More commonly, courts allow settlement communications to be used to prove the amount in controversy (*Vermande v. Hyundai Motor Am., Inc.*, 352 F. Supp. 2d 195, 202 (D. Conn. 2004)), to provide a jurisdictional basis for a declaratory judgment action (*Rhoades v. Avon Prods., Inc.*, 504 F.3d 1151, 1161 (9th Cir. 2007)), or to prove a party’s knowledge of certain facts (*Kraft v. St. John Lutheran Church*, 414 F.3d 943, 947 (8th Cir. 2005)). In complex litigation, at least one issue other than the claim’s “validity or amount” is in dispute. Relying solely on Rule 408 to protect you could, therefore, be your undoing.

Other Limitations: Discovery and Actual Dispute

Rule 408 falls short because it “is merely a rule of evidence,” and does not protect against your counterparty’s

Negotiating with Confidentiality (continued)

public disclosure of the terms of your settlement discussions. *Alpex Computer Corp. v. Nintendo Co.*, 770 F. Supp. 161, 166 (S.D.N.Y. 1991). Furthermore, third parties in subsequent lawsuits may seek the discovery of your settlement communications, as “Rule 408 only protects disputants from disclosure of information to the trier of fact, not from discovery by a third party.” *Folb v. Motion Picture Indus. Pension & Health Plans*, 16 F. Supp. 2d 1164, 1171 (C.D. Cal. 1998). Most litigants want their settlement discussions to be confidential, for business or other litigation reasons, and should consider additional measures to protect their privacy.

Given Rule 408’s limitations, litigants should consider additional measures available to ensure they may negotiate candidly without the risk of providing admissible evidence.

Because many legal disputes develop slowly out of commercial relationships, parties should also know that Rule 408 only applies to statements made during “compromise negotiations.” *Big O Tire Dealers, Inc. v. Goodyear Tire & Rubber Co.*, 561 F.2d 1365, 1372-73 (10th Cir. 1977). Where discussions have not “crystallized to the point of threatened litigation,” Rule 408 may not protect them. *Id.*; but see *Weems v. Tyson Foods, Inc.*, 665 F.3d 958, 965 (8th Cir. 2011) (recognizing and adopting lower standard requiring only “an actual dispute or difference of opinion” regarding a party’s liability for or the amount of a claim” to establish a dispute under Rule 408).

Litigants should also know that Rule 408 cannot be used to shield problematic documents. As one court explained, the Rule “does not require exclusion of any

evidence otherwise discoverable simply because it is presented in the course of compromise negotiations.” *ABM Indus., Inc. v. Zurich Am. Co.*, 237 F.R.D. 225, 228 (N.D. Cal. 2006).

Letter Agreements as a Partial Solution

Given Rule 408’s limitations, litigants should consider additional measures available to ensure they may negotiate candidly without the risk of providing admissible evidence. One option: a letter agreement between the parties stipulating to a broader set of protections.

Such an agreement should be drafted to fit the unique circumstances of each litigation, addressing the potential pitfalls discussed above. For example, if negotiations occur at an early stage of a dispute, e.g. before a complaint is filed, the agreement could stipulate that the claim’s validity or amount within the meaning of Rule 408 is disputed. The agreement could also protect against future uncertainties, such as the broad reach of the “another purpose” exception.

Judicial Enforcement of Letter Agreements

Scholars have expressed skepticism that courts would enforce such agreements,² and a party should consider all possible responses by a presiding judge if such an agreement needs to be enforced. Nonetheless, several U.S. courts have enforced these agreements. In *Victor G. Reiling Associates v. Fisher-Price, Inc.*, the court cited the “strong public policy favoring settlements and encouraging uninhibited settlement negotiations” in determining that “the parties’ confidentiality agreement will be enforced.” 407 F. Supp. 2d 401, 404 (D. Conn. 2006). Although the court kept out the evidence on Rule 408 grounds, the stipulation provided a strong alternative ground for the court’s decision.

Similarly, in *Apple, Inc. v. Motorola Mobility, Inc.*, the court enforced a “Mutual Non-Disclosure and Rule 408 Agreement” between litigants that restricted information exchanged during settlement negotiations and other inter-party communications. Case No. 11-CV-178, 2012 WL 5416941 (W.D. Wis. Oct. 29, 2012). The parties had agreed to bar the use of any documents contained or exchanged in settlement correspondence “in any manner or for any purpose other than in connection with the settlement negotiations between them,” as well as other, more tailored restrictions. The court carefully applied their agreement, excluding all evidence relating to the parties’ conduct after the agreement was reached except for that conduct allowed by the non-disclosure agreement.

Other courts have also enforced Rule 408-related agreements to exclude evidence (e.g., *Osteotech, Inc. v. Regeneration Techs., Inc.*, No. 3:06-cv-04249, 2008 WL 4449564 (D. N.J. Sept. 25, 2008)) or to strike portions of pleadings reflecting information learned in settlement discussions (e.g., *Pension Advisory Grp., Ltd. v. Country Life Ins. Co.*, 771 F. Supp. 2d 680, 708 (S.D. Tex. 2011)). One federal Court of Appeals even suggested that if a party wishes to make a settlement demand without providing a basis for a declaratory judgment action, it enter into a “suitable confidentiality agreement” to provide broader protection than Rule 408. *SanDisk Corp. v. STMicroelectronics, Inc.*, 480 F.3d 1372, 1375 n.1 (Fed. Cir. 2007).

Remember: confidentiality letter agreements are contracts, susceptible to all normal contract enforcement defenses. See *Osteotech, Inc.*, 2008 WL 4449564 at *3.

Beware of Third Parties

A final warning: Although a letter agreement may help prevent your counterparty from disclosing settlement communications, in most jurisdictions such letters do not shield those communications from

third party discovery. Among federal Courts of Appeals, only the Sixth Circuit has recognized a “settlement communications privilege.” *Goodyear Tire & Rubber Co. v. Chiles Power Supply, Inc.*, 332 F.3d 976 (6th Cir. 2003). Most courts have rejected the existence of the privilege, e.g., *In re MSTG, Inc.*, 675 F.3d 1337 (Fed. Cir. 2012), while some take a middle ground, allowing discovery of settlement communications upon a “particularized showing of a likelihood that admissible evidence will be generated” by discovery, *Bottaro v. Hatton Assoc.*, 96 F.R.D. 158, 160 (E.D.N.Y. 1982).

Letter agreements may still serve some purpose in subsequent discovery disputes, such as requiring your counterparty to make all efforts to resist

discovery. They may also help persuade the next judge that she should exercise her discretion to prevent the settlement communications from being disclosed. But a party should not assume a confidentiality letter agreement will prevent third parties from obtaining relevant documents in future discovery. ●

Endnotes

1 This article only addresses the Federal Rules of Evidence. Although many states have similar rules governing the admissibility of settlement communications, those rules may be interpreted or implemented differently by the various state courts.

2 E.g., Wayne D. Brazil, *Protecting the Confidentiality of Settlement Negotiations*, 39 *Hastings L. J.* 955, 1026-1029 (1988).

Butler Rubin hosted an AIRROC Negotiation Workshop at The Standard Club Chicago on February 26, 2014. Professor Lynn Cohn, the Director of the Center on Negotiation and Mediation at Northwestern Law School, led the well-attended all-day program, which included interactive lectures, actual negotiations and the opportunity to get individualized feedback on performance.

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PA Workers' Compensation Law

John J. Muldowney

Statutory Right to Subrogation

Very few employers and their insurers would rank Pennsylvania as a favorable forum for workers' compensation claims. Yet, subrogation recovery remains a well-protected right of relief for employers and their insurers in this Commonwealth. The effectiveness of subrogation as a right of recovery in Pennsylvania is due to its statutory genesis. This article emphasizes the positive impact of Pennsylvania's statutory scheme in protecting the subrogation recovery rights of employers and their insurers.

Statutory Foundation

The concept of subrogation is based on two general equitable principles (i.e., fairness):

1. To prevent a claimant from receiving payment twice for the same injury ("double recovery") and;
2. To ensure that the party at fault is ultimately held responsible for the injury claimed.

While subrogation is conceptually rooted in equity, subrogation rights under Pennsylvania law are directly derived from statute under Section 319 of the Pennsylvania Workers' Compensation Act (the "Act").

Section 319, in relevant part, provides:

Where the compensable injury is caused in whole or part by the act or omissions of a third party, the employer shall be subrogated to the right of the employee, his personal representative, his estate or his dependents, against such party to the extent of compensation payable under this Article by the employer...
77 P.S. sec. 671 (emphasis added).

The extent of compensation paid equals medical expenses plus indemnity benefits. See *Thompson v. WCAB (USF&G Co.)*,

566 Pa. 420, 781 A.2d 1146 (Pa. 2001). Subrogation recovery under Pennsylvania law means that an employer who issues workers' compensation payments to an injured employee can recover such payments from the injured employee when the employee obtains a settlement and/or verdict award from the alleged tortfeasor(s) in an action arising from the same incident as the compensable work injury.¹

The classification of subrogation rights as statutory, rather than equitable, is a monumental distinction. Subrogation derived from common law equity is subject to equitable limitations, whereas subrogation recovery derived from statute is unassailable to most equitable challenges.

Equitable Challenges Thwarted

Pennsylvania courts have consistently rejected equitable challenges to an employer's right to subrogation recovery under the Act. In upholding this "absolute" statutory right, the courts have rejected the following arguments as bases for eliminating or reducing the employer's subrogation recovery:

1. *Lack of Cooperation* – The employer's failure to cooperate with the employee in the third party action does not bar or reduce the employer's subrogation recovery. *Winfree v. Phila. Elec. Co.*, 520 Pa. 392, 554 A.2d 485 (Pa. 1989); *Kelly v. WCAB (A-P-A Transport Corp.)*, 107 Pa. Cmwlt. 223, 527 A.2d 1121 (Pa. Commw. Ct. 1987).

2. *Lost Evidence/Spoliation* – The loss of evidence by the employer, which would have assisted plaintiff in his third party claim, does not serve to bar the employer's right to subrogation. *Thompson v. WCAB (USF&G Co.)*, 566 Pa. 420, 781 A.2d 1146 (Pa. 2001); *Glass v. WCAB (City of Phila.)*, 61 A.3d 318 (Pa. Commw. Ct. 2013).

3. *Subrogation Recovery Should be Reduced by Claimant's Comparative Negligence* – A claimant's right to recovery in a third party action, reduced by his own comparative negligence, does not reduce the employer's right to recovery of the full lien amount. *Goldberg v. WCAB (Girard*

Provision Co.), 152 Pa. Cmwlt. 559, 620 A.2d 550 (Pa. Commw. Ct. 1993).

4. *Employer's Partial Responsibility for Injury* – The employer's statutory right to subrogation may not be challenged by an allegation that the employer was partially responsible for the employee's injury. *Heckendorn v. Consol. Rail Corp.*, 502 Pa. 101, 465 A.2d 609 (Pa. 1983).

5. *Laches* – Laches, an equitable doctrine which serves to bar a party from seeking relief when he fails to do so in a timely manner, is not applicable to the statutory right of subrogation. *Superior Lawn Care v. WCAB (Hoffer)*, 878 A.2d 936 (Pa. Commw. Ct. 2005).

In affirming the employer's absolute statutory right of subrogation against equitable challenges, the Pennsylvania Supreme Court in *Thompson v. WCAB (USF&G)*, 566 Pa. 420 781 A.2d 1146 (2001), reasoned: "The General Assembly already having weighed the equities, it would be inappropriate for this Court to approve of ad hoc equitable exceptions to subrogation."

Despite the straightforward statute, backed by unwavering support from the Pennsylvania appellate courts, equitable challenges may continue to be raised by claimants seeking to protect their double recovery. Such challenges may occur in the workers' compensation forum and/or in third party forums.

The Shield of Exclusivity

Employers and their counsel may be faced with various challenges from opposing counsel in the civil forum, as well as civil litigation judges, and/or mediators concerning the rights and/or amounts of subrogation recovery. Fortunately, the absolute statutory right of subrogation is further protected by the exclusivity provisions of the Pennsylvania Workers' Compensation Act, which serve as a shield to protect against adverse decisions by outside forums. See, Section 303(a) of the Pennsylvania Workers' Compensation Act, as amended.

¹ Under Section 401 of the Act, the term "employer" includes its "insurer". 77 P.S. sec. 701.

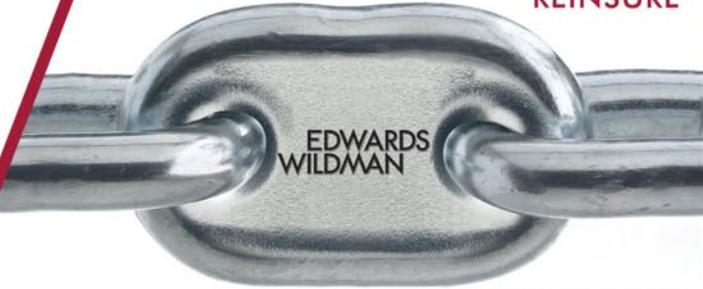
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Subrogation (continued)

A few examples of the effects of the exclusivity shield are referenced below:

1. *Civil Courts May Not Determine a Waiver of the Subrogation Lien* – Failure of the workers’ compensation carrier to appear at a third-party common pleas pre-trial conference does not serve as a waiver of the employer’s subrogation rights, even when the court of common pleas had found that such conduct served as a waiver. *Romine v. WCAB (CNF, Inc.)*, 798 A.2d 852 (Pa. Commw. Ct. 2002).

2. *Denial of the Subrogation Right in a Civil Forum Does Not Prevent Subrogation Recovery* – No res judicata/collateral estoppel effect arises from a civil court decision regarding determination of an employer’s subrogation rights. The denial of the employer’s subrogation right in a civil forum does not bar the employer from asserting such right in the Workers’ Compensation forum. *PMA Ins. Grp. v. WCAB (Kelley)*, 665 A.2d 538 (Pa. Commw. Ct. 1995).

3. *Even a Verdict in Favor of Defendant May Not Extinguish an Employer’s Subrogation Rights* – A verdict in favor of the defendant, where the parties had entered into a high/low settlement agreement with a guaranty to the claimant of recovery regardless of the jury verdict, does not extinguish the employer’s right to recovery under such a settlement agreement. *Id.*

4. *Molding of a Verdict or Settlement in a Third-Party Action Does Not Limit the Rights of Recovery* – A molding of a verdict or settlement to include only recovery of pain and suffering damages does not eliminate the employer’s right to full subrogation of its lien. *Bumbarger v. Bumbarger*, 190 Pa. Super 571, 155 A.2d 216 (Pa. Super. Ct. 1959).

5. *The Filing of a Post-Verdict Action Does Not Stay Subrogation Recovery* – The claimant’s filing of a post-verdict complaint for abuse of process, allegedly arising from the underlying third-party action, does not serve to stay the employer’s right of subrogation recovery. *Stout v. WCAB (Pensbury Excavating, Inc.)*, 948 A.2d 926 (Pa. Commw. Ct. 2008).

...it is of little recourse to assert the absolute right of subrogation long after the claimant has spent his third party settlement funds.

Regardless of any representations or determinations by any third party forums, the determination of whether an employer/insurer is entitled to subrogation remains within the exclusive jurisdiction of the workers’ compensation authorities. Thus, any determinations outside of the workers’ compensation forum have no effect on the employer’s subrogation rights.

Pennsylvania Compared with Subrogation Schemes of Other States

As with Pennsylvania, the analysis of the right to subrogation recovery by employers in other states begins with the statutes of each individual state. However, the means by which subrogation can be obtained and the limitations on the recovery can vary greatly from one state to the next. Many states, by statute and judicial interpretation, provide limitations based on the percentage of employer liability for the alleged injury and/or provide equitable limitations of recovery under the “made whole doctrine”. *The Made Whole Doctrine*, Gary L. Wickert, Esq.

The statutes of Pennsylvania’s neighboring states of Delaware, New Jersey, and New York, are similar to Pennsylvania in providing subrogation recovery without reduction for employer liability and/or equitable limitations. *Workers’ Compensation in All 50 States*, Gary L. Wickert, Esq. The New York statute does, however, provide that an action can be brought against an employer for contribution when the injury, as defined by statute, is a “grave injury”. *Id.*

States in which the employer’s liability for an injury provides a percentage based reduction in the amount of subrogation recovery, include: Alaska, Arizona, California, Idaho, Kentucky, Louisiana,

Minnesota, New Mexico, Texas, and Utah. *Id.*

States in which equitable limitations based on the nature and/or amount of damages recovered include: Arkansas, Colorado, Georgia, Kansas, Massachusetts, Michigan, New Mexico, and South Carolina. *Id.* In summary, these states limit the recoverable amounts from subrogation to medical expenses and wage loss, while disallowing recovery from third party damages that are non-economic such as pain and suffering.

Preserving the Actual Recovery

While Pennsylvania provides a more expansive base of subrogation recovery than many other states, it is of little recourse to assert the absolute right of subrogation long after the claimant has spent his third party settlement funds.

Third party actions should be closely monitored by the employer and/or their counsel to determine the status of a third party action and evaluate potential recovery. A written agreement should be obtained from the claimant’s third party counsel to escrow funds from the third party settlement/award prior to satisfaction of the lien. Absent a written agreement, the claimant’s third party counsel is under no legal or contractual obligation to protect the lien of the employer. *CNA Ins. v. Ellis and Weiss*, 764 A.2d 1118 (Pa. Super. Ct. 2000) (published without opinion). Mere notification to the claimant’s third party counsel of the workers’ compensation lien is not enough to impose an obligation on claimant’s third party counsel to protect the lien. *Id.*

In the event that claimant’s third party counsel will not sign a written agreement to protect the subrogation lien, an attorney should be retained to represent the employer’s interest in subrogation recovery. It may be necessary for the employer’s attorney to intervene in the third party action to ensure recovery of the lien in advance of the distribution of the third party award or settlement. At the very least, a stipulation should be obtained from the claimant’s third party counsel confirming agreement to the lien distribution.

Recovery and Settlement

The issue of subrogation recovery often arises during settlement negotiations of the pending third-party litigation. In attempting to obtain a settlement of the third party action, counsel for both the third party plaintiff and defendant (and even the third party judge) may place pressure on the employer to compromise its subrogation lien. In responding to such pressures it should be kept in mind that 1) The employer is under no obligation to compromise; and 2) the ultimate goal is to obtain the maximum amount of subrogation recovery. Accurate analyses of both the liability and anticipated damages in the third party case are essential for determining whether a lien should be compromised to effect settlement.

In civil cases involving a significant workers' compensation lien, with less than certain civil liability, an agreed upon compromise of the workers' compensa-

tion lien might be advisable. Under these circumstances, the employer's workers' compensation representative should be apprised of settlement negotiations and/or even involved in a settlement conference. Of course, such participation should be entered into with caution, with the exclusivity protections of the workers' compensation asserted.

To achieve maximum subrogation recovery it may be advisable to retain and consult with counsel to evaluate the potential value of the third party recovery, monitor the third party action, confirm agreement to lien protection, intervene if necessary, participate in third party settlement conferences, and follow up with a petition in the workers' compensation forum to effectuate lien recovery.

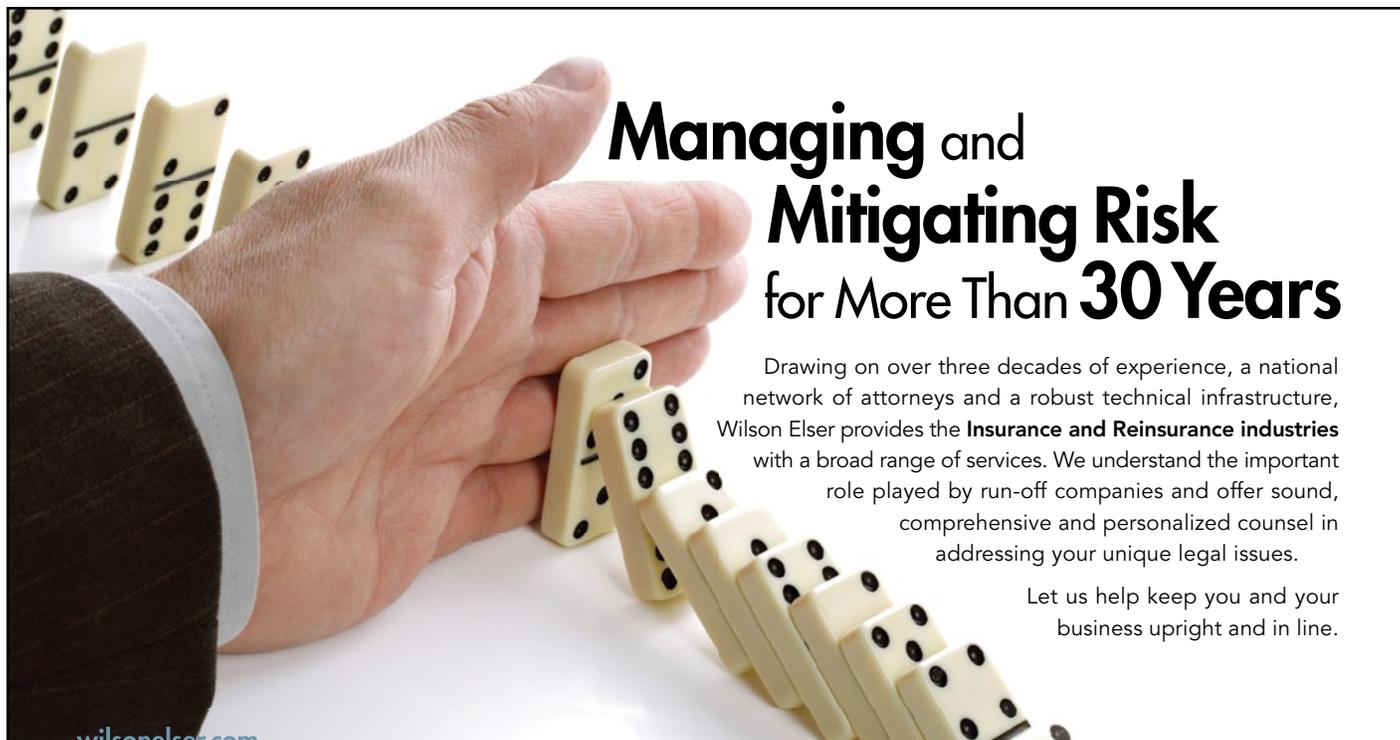
Conclusion

Subrogation recovery remains a well-protected statutory right under the

Pennsylvania Workers' Compensation Act, as confirmed by the relatively consistent decisions of the Pennsylvania courts. To maximize recovery under this right it is important to recognize the types of third party recoveries subject to subrogation, know the limitations of such recoveries and preserve the actual subrogation recovery by assistance from counsel when necessary. ●



John "Jack" Muldowney is a Partner in the Yardley, PA office of Hill Wallack LLP, where he is a member of the Complex Litigation and Workers' Compensation practice groups. jmuldowney@hillwallack.com



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Musing with Diane Myers

Vice President of Commutations, Reliance National in Liquidation



Illustration / Rafael Edwards

The difficulty lies not in new ideas but escaping the old ones.

– John Maynard Keynes

This is a favorite quote from Diane Myers, our Spotlight member for this issue. Her work in negotiating over 700 commutations around the globe is based on finding the sweet spot of benefits for both her company and negotiating counterparties. She does this through strategic planning and detailed analysis as well as an understanding of the changing economic forces that challenge companies to find new ways to resolve liabilities and issues. We recently had the opportunity to get to know Diane better.

You've worked at Harbor, Transit Casualty, as a consultant, and now you are Vice President of Commutations at Reliance. Can you tell me a key lesson you have learned over your career?

First and foremost, establishing a favorable reputation in the industry

is very important during a person's entire career. There are no shortcuts to maintaining your reputation and relationships with others. Second, success and accomplishments are often determined by the extent that other people are included in your work and decisions.

If you could have a second career, what would it be?

Actually, I enjoy my career in reinsurance. In my current position, I am able to utilize several skills such as strategic planning, reserve evaluations, liability analyses, marketing, finance, and negotiations simultaneously. Deadlines can be challenging at times, but commutations also create unique learning opportunities.

What do you like most/least about your current position?

Our commutation program has continued to meet expectations year after year and we have completed hundreds of settlements with reinsurers. Of course,

this also means our commutation work at Reliance will eventually come to an end.

What industry publications do you read on a regular basis?

Business Insurance, Best's and several others via web sites.

What educational sessions or conferences do you attend and why?

Other than AIRROC, I usually attend American Conference Institute and Casualty Actuarial Society events to meet with other professionals and stay informed about industry developments.

What is your favorite quote?

I have two favorite quotes that continue to inspire me. "The harder the conflict, the more glorious the triumph" (Thomas Paine), and "The difficulty lies not in the new ideas, but in escaping from the old ones" (John Maynard Keynes).

What is your favorite leadership manual/book?

Peter Drucker has probably had the longest influence on my professional life. I recommend "The Essential Drucker" and "The Effective Executive."

What might (someone) be surprised to know about you?

I enjoy exploring and being outdoors.

What sorts of trends do you see in the industry?

From my personal perspective, a few of the trends are:

- Some companies are anticipating changes in economic conditions and have exited certain lines of business or initiated M&A discussions.
- Continued expansion into alternative risk facilities.
- Business processes are becoming increasingly mechanized, even in claims and underwriting.
- There appear to be fewer dedicated resources in runoff, which may be due in part to restructured operations around the world.

How did you first become involved with AIRROC and what was your first impression of AIRROC?

Exhilarating and intense! We usually conducted over 30 meetings during the first few Rendezvous meetings.

If you could change one thing about AIRROC, what would it be?

I would like to see the topics covered in the educational sessions and speaker

series expanded to include other areas that significantly impact our entire industry and not just runoff.

The interest in AIRROC seems to be growing. Why do you think that is?

AIRROC provides an excellent forum, for very little cost, to conduct business. I still think the best way to work through a complicated reinsurance transaction is by meeting in person.

What would you like to see in the Magazine?

The Magazine is well prepared and informative. Thanks to all who have taken so much of their personal time and contributed to its success. ●

Connie D. O'Mara, connie@cdomaraconsulting.com
and Bina Dagar, bdagar@ameyaconsulting.com

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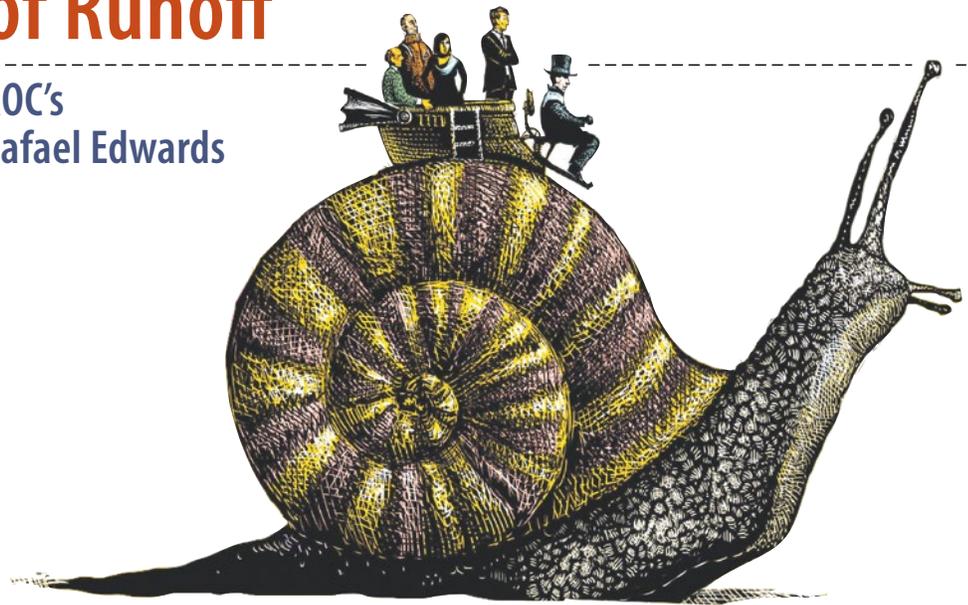
The Imagery of Runoff

Drawing Attention to AIRROC's Transcendent Illustrator, Rafael Edwards

The results are in! Membership feedback regarding the new look and design of the AIRROC Matters magazine has been overwhelmingly positive. One of the elements that jumps out and receives exalted praise is the aesthetic look, feel, and appeal of our original illustrations. Taking your cue, we provide the back story to the artist who creates our eye-catching and distinct illustrations and explain the process of how the concepts are developed, or in other words, how the imagery blossoms.

Our illustrator, Rafael Edwards, resides in Chile, adding a true international aspect to our design team. Rafael's background is in drawing, mostly pen and ink, and engraving, mostly in black and white. He honed his artistic skills by engaging in scientific illustration, primarily biology related. Although lacking in creativity, this early phase provided a fertile training ground.

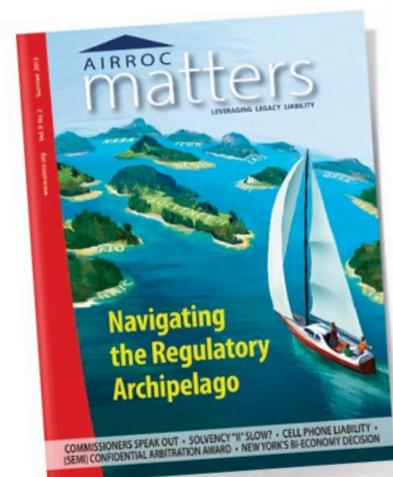
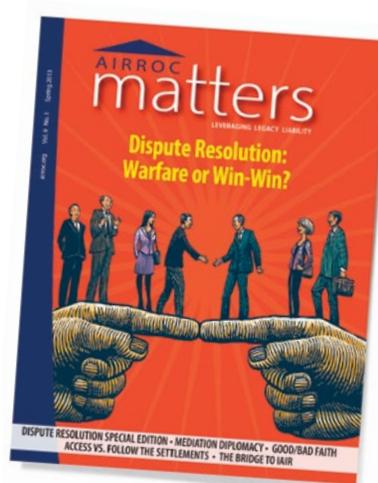
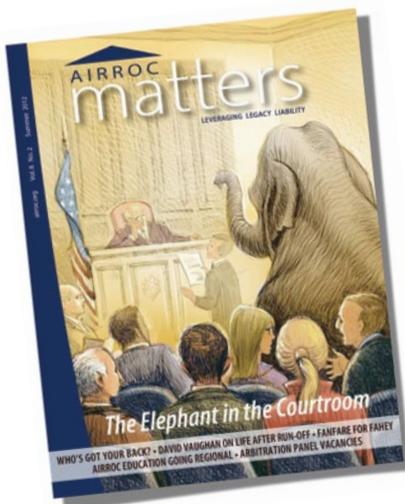
Rafael's creative journey in illustration began in San Francisco as a staff artist for a silk screen company working



with the music and film industry. As one might expect, given the eclectic culture of the San Francisco area, Rafael created designs for all the big rock'n'roll bands of the time including big names such as the Rolling Stones, Rod Stewart, the Bee Gees, and Santana. His Hollywood creds include T-shirt designs for Star Wars prior to the movie's release. He flew to Hollywood to meet the producers while George Lucas was working out of a movie set trailer in the Century City parking lot. Over the last decade or so, Rafael freelanced with design studios, magazines and Ad agencies in Houston, and later nationwide, through agents in California and New York. Rafael claims that he is well suited to illustration as he has a tendency to comment on other

people's work, and that is exactly what illustration is all about. Illustration is the interpretation and comment on the written word via another medium.

The cover illustrations process for AIRROC Matters starts with a free-thinking, collaborative, concept-development phase in which the design team—Nicole Myers, Gina Pirozzi and Peter Scarpato—review the articles, boil them down to their essence, and come up with a general framework. Next, Rafael is brought into the picture, both figuratively and literally. Through trial and error and many sketches, he builds upon the framework in designing a visual idea that fits. Rafael clarifies that the goal of his illustrations are not to explain the article to the readers, but rather to intuitively enhance the viewer's



interest and understanding of what's to come. The focus is to make the article engaging and attractive so that the reader, who may not be predisposed to reading it, feels enticed to find out more. Many times this results in a resort to clichés—imagery that already exists and has a specific meaning in the minds of the reader. Rafael's view is that we live in a media-oriented culture and to him, "existing images are an interesting source of raw materials for building new ones."

As you can imagine, visual depiction of legacy and run-off themes are quite challenging. Such exciting topics to the most engaged run-off professional certainly do not lend themselves to lavish visual translation. Rafael and the design team also strive to introduce subtle humorous elements to the work. His favorite cover you ask? "The Elephant in the Courtroom" – Summer 2012 issue.

The focus is to make the article engaging and attractive so that the reader, who may not be predisposed to reading it, feels enticed to find out more.

"I feel we broke ground with it. It's not something you'd expect on the cover of an insurance trade magazine and yet, the message got through very effectively and, on the other hand, it opened the path for many 'wilder' images in the following issues of AIRROC Matters. These images contrast with the rather technical tone of the general content, giving the magazine a 'lighter' and attractive component that makes it special and more complete." As apparent from Rafael's AIRROC Matters

body of work, not only does he meet the challenges of crafting stimulating imagery, but he is consistently pushing the boundaries of excellence in creating a distinct and uniquely original trade dress for AIRROC Matters. Many thanks Rafael. We look forward to receiving that clear cellophane package containing the next issue of AIRROC Matters. ●



Maryann Taylor is a Principal at Boundas, Skarzynski, Walsh, & Black, LLP. mtaylor@bswb.com

HOW TO PLAY: The game is played by several people, standalone or against the clock. You are given an unrelated, zany anecdote of few short sentences within which are hidden five or more words on a common topic such as in reinsurance. A word may stand by itself, or in linked letters across two or more words. The letters must be adjacent, not separated by other letters not forming part of the desired word or phrase. Homonyms are also answers – for instance, if you're trying to find colors, the word "read" transcribes to its homonymic "red". Rarely, words are also spelled backwards.

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AND HE HIT A HOMERUN OFF OF PITCHER ROY HALLADAY... HE DREW HIS SWORD HIGH TO DISPLAY HIS STRENGTH...

Run-Off Word Play: The Secret Game of Linked Letters

The New Food Promotion

Barney was a fancy food promoter who used instant win sweepstakes as a sales tool; he was one of a number of experts at seeding prizes in national promotions for the new line Transparent tea brand, a product for the casual tea drinker. In his spare time Barney collects Shakespearean originals which he purchases from Thomson & Sons, a rare book dealer in Newport,folios and other originals to be exact The inventory was so valuable that they hired a security guard to stop customers and frisk management and executives entering and exiting the premises. This angered some but as the owner said "We do everything for the collector and since we more than do our bit, rage is just not an appropriate response." Thomson also defended his practice of selling the documents together with the rest of an archive, not breaking it up. "We keep the core in sure,the core in sure," he emphasized" because our customers like it better this way" said he with a sly smile..

The answers and the sentence casualty ced- ing experts arbitrage risk management port- folios to reinsurance -reinsure is set forth two times hence to reinsure Casual tea=casualty Seeding=ceding Our bit rage= arbitrage Experts Risk management is contained in frisk man- agement Portfolios is in Newport folios And core in sure is reinsure--repeated as set forth above it makes to reinsure

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The Groundhog Was Right....



Thanks to Our Corporate Partners

We had six more weeks of winter but at last Spring has finally sprung. (I, for one, am ready to come out of hibernation...) The cold and seemingly very long winter aside, the activity level around launching AIRROC into a new year did not stop...

Our kickoff event for 2014 was a Negotiation Workshop in Chicago on February 26. Presented in conjunction with Butler Rubin, attendees were treated to a day of skills building on negotiation. Our guide was a preeminent expert in the field – Professor Lynn Cohn, the Director of the Center on Negotiation and Mediation at Northwestern University School of Law.

In March we returned to “30 Rock,” the offices of Chadbourne & Parke for the Spring Membership Meeting. The education day featured two sessions on lead paint – one on the epidemiology of the disease and a second with a lively discussion on lead paint claims from varying perspectives. An update on the NFL Litigation, on key US court rulings, and on an insurer’s standing in Chapter 11 cases was also covered.

On April 9 we are holding a Regional Education Day in Boston hosted by Edwards Wildman and Alvarez & Marsal. Then on June 16 Locke Lord and Allstate will host the Chicago

Regional. These programs offer timely and diverse agendas – register today!

Remember that if you missed some of AIRROC’s programs our members have access to articles and presentation materials on the AIRROC website.

Watch for:

- The announcement of the venue for our October Commutation and Networking Forum.
- Member training on how to best use the searchable features of the AIRROC website.
- The release of the new AIRROC Strategic Plan including some initiatives for the website, mediation/arbitration, and accreditations.

Remember to visit www.airroc.org to get current information and to register for our events. See you soon! ●

I am pleased to announce AIRROC’s 2014 group of Corporate Partners – Alvarez & Marsal, Butler Rubin Saltarelli & Boyd LLP, Carroll McNulty & Kull LLC, Freeborn & Peters LLP, Locke Lord LLP, Mayer Brown LLP, Mound Cotton Wollan & Greengrass, and White and Williams LLP. AIRROC Partners have committed their support to the organization and our initiatives. Watch for their speakers and attendees at our events all year! ●



Carolyn Fahey joined AIRROC as Executive Director in May 2012. She brings more than 20 years of re/insurance industry and association experience to the organization. carolyn@airroc.org

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News & Events

Regulatory News

Credit for Reinsurance Update

At the December NAIC meeting held in Washington, DC, the NAIC approved four (4) jurisdictions as “Conditional Qualified Jurisdictions.” Reinsurers domiciled in these four (4) jurisdictions are eligible to be certified for reduced reinsurance collateral requirements under the NAIC Credit for Reinsurance Model Act and Regulation. The four Supervisory authorities approved by the NAIC are: The Bermuda Monetary Authority; The German Federal Financial Supervisory Authority; The Swiss Financial Market Supervisory Authority; and The United Kingdom’s Prudential Regulation Authority of the Bank of England.

As of December 2013, 18 US jurisdictions have adopted the NAIC Revised Credit for Reinsurance Model Act and/or Regulation. Legislation is pending in a number of states and the NAIC is considering adding the Credit for Reinsurance Model Act and Regulation to its list of required accreditation standards. To date, reinsurers have been certified in Connecticut, Florida, New Jersey and New York. There are additional applications for certified reinsurers pending in California, Missouri and Pennsylvania.

If you are aware of items that may qualify for the next “Present Value,” such as upcoming events, comments or developments that have, or could impact our membership, please email Fran Semaya at fsemaya@gmail.com or Peter Bickford at pbickford@pbnylaw.com.

Industry News



ING Completes Sale of interest in SulAmérica to Swiss Re

In January 2014 ING completed the sale to Swiss Re Group of 37.7 million units in SulAmérica S.A. ING received a total cash consideration of approximately EUR 180 million for the 37.7 million SulAmérica units, which represent a direct stake of approximately 11.3%. The transaction reduced ING’s stake in the Brazilian insurance holding to approximately 10%.

SAC Capital Advisors Sells Reinsurance Business to Duperreault Led Investor Group



A group of investors headed by former Marsh & McLennan Companies, Inc. chair, **Brian Duperreault**, reached agreement in December 2013 to purchase the reinsurance business of SAC Capital Advisors, LP, the

Steven Cohen hedge fund. The sale was necessitated by SAC’s settlement of insider trading allegations that prohibits SAC from managing outside investors’ money. Upon completion of the acquisition SAC Re’s name was changed to Hamilton Re, Ltd., a Class 4 property/casualty reinsurer in Bermuda. In January 2014, Hamilton Re elected Sanford “Sandy” Weill, the former chair of Citigroup, as its chair with Brian Duperreault as its CEO.

Tower Group Being Acquired by ACP Re; Renewal Rights Being Acquired by AmTrust and NGHC



ACP Re, Ltd., a Bermuda-based reinsurer, agreed to acquire 100% of the outstanding stock of financially troubled Tower Group International (Tower) for \$172.1 million. The controlling owner of ACP Re, Ltd. is a trust established by the founder of AmTrust Financial Services (AmTrust), Maiden Holdings, Ltd. and National General Holdings Corp. (NGHC). The transaction calls for a subsidiary of ACP Re, Inc. to be merged into Tower with Tower as the surviving entity. In addition, AmTrust has agreed to acquire the renewal rights and assets of Tower Group’s commercial lines insurance operations, and NGHC has agreed to acquire the renewal rights and assets of Tower Group’s personal lines insurance operations. The acquisition has been approved by the boards of both companies and, subject to regulatory approval, is expected to close in the summer of 2014.

NKSJ Holdings Acquires Lloyd's Insurer, Canopus Group

NKSJ Holdings (“NKSJ”), a top three Japanese insurer, has agreed, through its insurance subsidiary Sompo Japan Insurance Inc. (“Sompo Japan”), to purchase 100 per cent of the shares of Canopus Group Limited (“Canopus”), a specialist reinsurer predominantly operating in the Lloyd's market. Under this agreement, Sompo Japan will pay Canopus £594 million subject to adjustment to reflect any changes in its tangible net asset value reflected in its audited tangible net asset value at December 31, 2013. Subject to regulatory approval, the transaction is expected to close in the second quarter of 2014. On completion, Canopus will be managed as a separate specialty insurer as part of NKSJ's core group insurer, Sompo Japan.

CNA Financial to Sell Life & Group Insurance Business

In February 2014, CNA Financial Corp. (CNA) announced it would sell its life and group insurance business, Continental Assurance Company, to a subsidiary of Bermuda based Wilton Re Holding Ltd. The transaction, expected to be completed in the 2nd quarter 2014, will reduce CNA's non-core life and group gross GAAP insurance reserves by \$3.4 billion, or 25%, and dispose of CNA's payout annuity business.

People on the Move

Inga Beale, former Canopus CEO (see above), was appointed in December 2013 to succeed Richard Ward as CEO of Lloyd's effective in January 2014. Inga becomes the first woman CEO of Lloyd's in its 300-plus-year history.

Leah Spivey, a member of the Board of Directors of AIRROC and Co-Chair



of its Publication Committee, has been promoted to head the Business Run-off Operations Department of Munich Reinsurance America, Inc. Leah has more than 25-years of experience in claims and run-off with significant expertise managing complex insurance and reinsurance claims.

Peter A. Scarpato, Vice Chair of the AIRROC Publication Committee and Editor-in-Chief of *AIRROC Matters*, has been appointed Assistant Vice President of Ceded Reinsurance for ACE Insurance Company in Philadelphia, starting a new chapter in Peter's well-recognized career as an arbitrator, mediator, run-off specialist and attorney in the insurance and reinsurance industry. ●

IN MEMORIAM

Known by many of his colleagues as the “Dean of the Reinsurance Bar,” **Eugene Wollan** died in February after a 60-year career with the law firm bearing his name, Mound Cotton Wollan & Greengrass (yes, 60 years with the same firm!) He authored the treatise *Handbook of Reinsurance Law*, wrote regularly for numerous professional periodicals and was Editor of the *ARIAS Quarterly*, a Contributing Editor of *The John Liner Review* and a member of the Editorial Board of *Risk Management Reports*.

SPRING 2014 MARK YOUR CALENDAR

March 29 – April 1

NAIC Spring National Meeting
Orlando, FL
www.naic.org

April 4-6

IRU Spring Conference
Amelia Island, FL
www.irua.com

April 9

AIRROC Regional Education Day
Boston, MA
www.airroc.org

April 23-24

ACI Run-Off & Commutations Forum
New York, NY
www.americanconference.com

May 8-9

IRLA Annual Congress
Brighton, UK
www.irla-international.com

May 13-14

NAIC International Insurance Forum
Washington, DC
www.naic.org

June 12

AIRROC Regional Education Day
Chicago, IL
www.airroc.org

July 15-16

AIRROC Summer Membership Meeting
New York, NY
www.airroc.org

December NAIC Joint Issues Forum

AIRROC and IAIR: Hosts with the Most

AIRROC and IAIR presented their first co-hosted program the afternoon of December 16, 2013 at NAIC Winter Meeting in Washington, DC. The planning and development was spearheaded by IAIR Issues Forum chair, Kathleen McCain, and AIRROC Executive Director, Carolyn Fahey.



International collections was the first topic of discussion for a panel that included Calvin McNulty, CEO of the McNulty-Re Group, Amine Belahbib, Vice President of the McNulty-Re Group (MENA Region), and Mike Walker, a Partner with KPMG UK. They took the audience “around the world” in just an hour with their insights and stories about their work with many cultures.

A key point made by all three panelists is that in-person interaction is crucial! If you aren't able to travel to meet with individual companies, there are several large international conferences that can help accomplish this goal – some examples include the Federation of Afro-Asian Insurers and Reinsurers (FAIR), Rendez-Vous de Septembre in Monte-Carlo, the General Arab Insurance Federation (GAIF), the Singapore International Reinsurance Conference (SIRC) and the African Insurance Organization (AIO) Conferences. Just as with AIRROC events in the US, attendance is a good way to meet with representatives from multiple companies to further business deals.

In addition to recognizing that there are cultural differences in working with other countries, it is also important to be aware of the changing market values of currencies. Commutations will likely be easier for countries when their currency is strong (unless “locked-in” via original contracts) and this should be closely monitored.

OFAC requirements involving countries/entities/individuals that are sanctioned also need to be continuously reviewed for past and current contract placements. In addition to current OFAC regulations and all other equivalent international governmental requirements, contracts should be drafted to include provisions involving reinsurers/retro coverage whereby those placements are made with entities that may become sanctioned and/or “prohibited to do business with.”

Calvin offered some important points to be aware of in dealing with Latin American countries. In general, these countries have a long history of reinsurance placements (many via the UK market) but current and/or future political developments must be closely monitored to determine the optimal time for settlement of paid or commutations. His advice is to make sure that you have the assistance of someone that “knows the ropes” in dealing with a company located in a Latin American country.

Amine provided commentary and history on dealing with companies in Africa and the Middle East. Knowledge of the history of colonization is key as working in certain countries may be like working within the bureaucracy of the “mother” country. In many of these nations, a king either owns the business interests or the owners have direct connections to the royal family. Make sure you know who you are talking to and keep in mind that these cultures are very easily offended – and don't easily “forgive and forget” an outsider that has crossed the line. Calvin offered that the same is true in the Far East – they are quite particular about

nuances and cultural norms. Knowing the history behind deals is important, and they are knowledgeable about reinsurance and contract terms. In-person time is extremely important in these cultures.

Mike Walker offered his perspective on commutation activity in the UK, which has reduced significantly in recent years. This is largely because the key contributing factors – Equitas and the insolvencies that occurred in the 1990s – are no longer driving that activity and have not been replaced by other drivers. There have been no new insolvencies since 2001, for example, and the wave that occurred in the 1990s is winding down and paying out their assets. He also suggested that consolidation in the industry, where about 80% of the technical reserves that are in runoff are now concentrated with only eight entities, has contributed to the reduction in commutation activity.

He also made reference to the increasing focus on run-off by regulators with two new reports having been released by the Prudential Regulation Authority – one on capital standards and the other on schemes of arrangement. Both are presently in the comment period so it is too early to tell the effect they will have on the industry, but he did opine that the effect on runoff is likely to be substantial, particularly due to the requirement that the PRA approve certain types of transactions. He also confirmed that it has now been agreed that the effective date for Solvency II is January 1, 2016, and this is likely to have an impact on commutation and transaction activity in the near future.

Charlie Richardson, a Partner at Faegre Baker Daniels, followed the international panel with a lively and entertaining view of the current issues and goings on in Washington, D.C. He touched on many topics during his presentation, including the Federal Stability Oversight Council's designation of AIG and Prudential as non-bank systemically important financial institutions. He spoke of

the continuing debate related to the designations and the involvement of the Federal Reserve as the regulator of SIFIs.

Charlie then turned to the happenings at the Federal Insurance Office (FIO). The FIO is involved in international issues and Charlie pointed out that what happens abroad can wash back on U.S. regulators and their best practices. The FIO Advisory Committee on Insurance is turning its attention to captives, Hurricane Sandy and other hot topics. Charlie then provided his views on the long awaited report on insurance modernization from the FIO that was issued just days before the program. He touched on several of the points in the report, including suggestions for receiverships and the guaranty systems. He noted that the FIO report was generally supported, and he outlined how the report is likely to generate discussion both on and off Capitol Hill, this year and beyond.

Following Charlie's commentary on the regulatory environment, two partners from Butler Ruben in Chicago took the stage. Catherine Isely and Jim Morsch provided an update on the latest court activity of impact to AIRROC and IAIR members. Catherine touched first on a shift in the way that late notice defenses to reinsurance claims are being viewed by reinsurers following recent court decisions. Historically, a late notice defense was raised by reinsurers in claim negotiations where the facts warranted it, but was rarely pursued as a sole defense to coverage in arbitration or litigation because the defense was unlikely to gain traction in those forums. That landscape may change in 2014 as recent federal and state court decisions provide reinsurers with additional ammunition to argue late notice defenses and assert related bad faith claims. Cedents should expect increased scrutiny by reinsurers concerning any lag between the time the cedent learned of its claim and the time the cedent reported that claim to the reinsurer. Cedents may also need to consider these developments in the case



From top: Calvin McNulty, Mike Walker, Carolyn Fahey and Jim Mumford

law when valuing late-noticed claims in any negotiation.

Catherine then turned to developments in allocation law. She discussed decisions applying differing standards of "reasonableness" to the "follow-the-allocation" doctrine, and addressed the objective standard of "reasonableness" applied by one court versus the focus on a company's motivation in reaching a settlement applied in other decisions. Jim also alerted the audience to recent occurrence-related decisions in the mold and construction defect contexts, as well as recent junk fax class action litigation and related coverage issues.

Jim Mumford, First Deputy Commissioner with the Iowa Division and Chair of the NAIC Receivership and Insolvency Task Force, provided updates and highlights of NAIC committee meetings. He started by commenting on the FIO report, stressing that it encourages uniformity in reporting by state regulators and insurance guaranty funds. Jim then turned to the goings on with the International Association of Insurance Supervisors (IAIS) and the Financial Stability Board (FSB), and Dan Daveline, Assistant Director-Financial Analysis at the NAIC joined him on the stage. Jim and Dave talked about the FSB's *Key Attributes of Effective Resolution Regimes for Financial Institutions*, the IAIS Insurance Core Principles and their view of potential concerns to US insurers in the application of the international standards. They also addressed recent guidance from the FDIC on resolution plans for globally systemically important financial companies or companies that are "too big to fail." Jim ended the presentation with highlights of issues before the Receivership and Insolvency Task Force. ●

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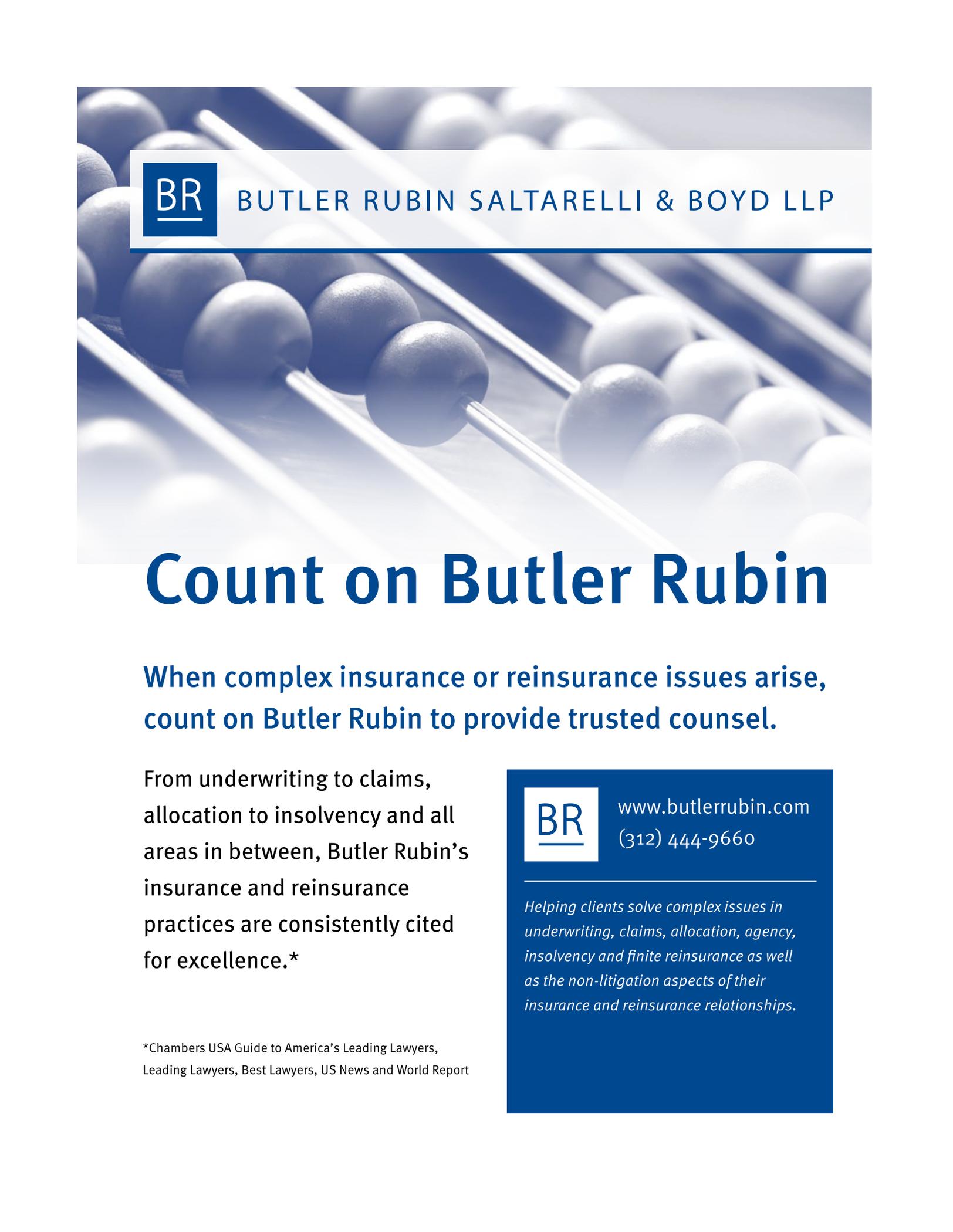
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