



AIRROC

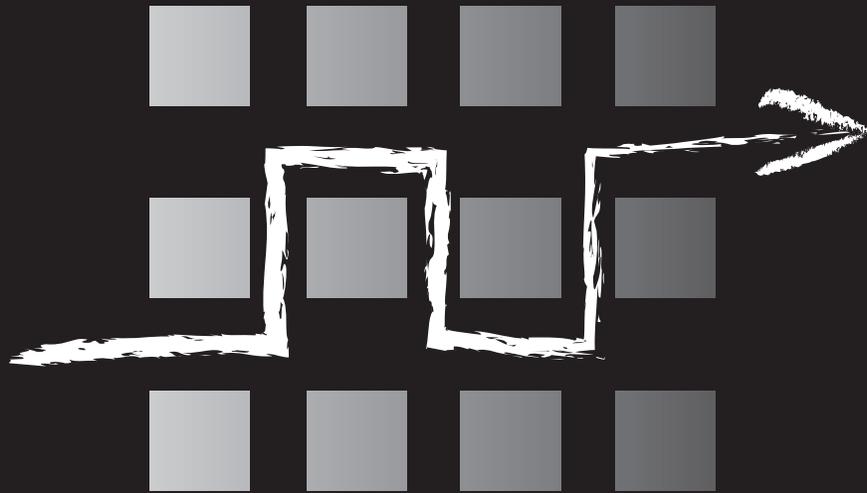
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Are We Really That Old?

Peter A. Scarpato

AIRROC turned 9 on December 14, 2013. How far we've come; how much we've accomplished. For this, we should be thankful in this holiday season.

Our year-end edition begins with *Commutation Clauses in Workers' Compensation Reinsurance Agreements*, Seema A. Misra and David V. Simunovich's tome on these diverse and prevalent provisions. Next, Carolyn Fahey interviews AIRROC Co-Chair Marianne Petillo, on winning the 2013 Women in Insurance Leadership Award. After *DRP Workshop—Take 2* summarizes the DRP's continued success via quotes from attendees, Carolyn presents AIRROC's Educational Summaries from the recent West Coast Regional, including topics such as how to prepare for an audit, whether to outsource, handling claims for ECO/XPL and sports-related head injuries, capped off by Steve McElhiney's Keynote Address. AIRROC Update completes this section with Carolyn's *Happy Birthday AIRROC!* (and also to me...) and Fran Semaya and Peter Bickford's Present Value.

Errors and Omissions

On page 27 of our Fall edition, Randi Elias' email address was incorrect. It is rellias@butlerrubin.com. On page 31 of the same issue, Teresa Snider's email address should read, tsnider@butlerrubin.com. We apologize for the errors.

Our Rendez-vous section overflows with topical articles and friendly faces. Kyle Medley kicks off *ADR Under the Microscope*, summarizing a panel's presentation of the pros and cons of various, innovative forms of dispute resolution. In *AIRROC DRP Roadmap*, Seema Misra recounts a workshop covering the DRP in substance and practice, followed by *Where Goest Thou? Future of the Run-off Industry* by Frank DeMento. NAIC's ORSA notes the comments of industry experts about Own Risk Solvency Assessment (ORSA) requirements. And Nick Pearson entreats us to *All hail the Sovereign* in "Regulatory Update," discussing a regulator's role in catastrophe insurance, federal and international solvency standards, federal insurance regulation and the state-based insurer insolvency framework.

I thoroughly enjoyed introducing the Rendez-vous Keynote Speaker, Dr. Guntram Werther, and summarizing his perspective on predicting future catastrophic events in *We Can Predict the Unpredictable*. Our own Connie O'Mara pays fitting tribute to Karl Wall, this year's AIRROC Run-off Person of the Year, followed by AIRROC's acknowledgement of Nathan Ortiz, a junior in Actuarial Science at St. John's University, as winner of this year's Trish Getty Scholarship. Finally, Carolyn offers *Mallon Preaches Diversity*, noting Mairi

Mallon's insights on social media and the challenges facing female professionals.

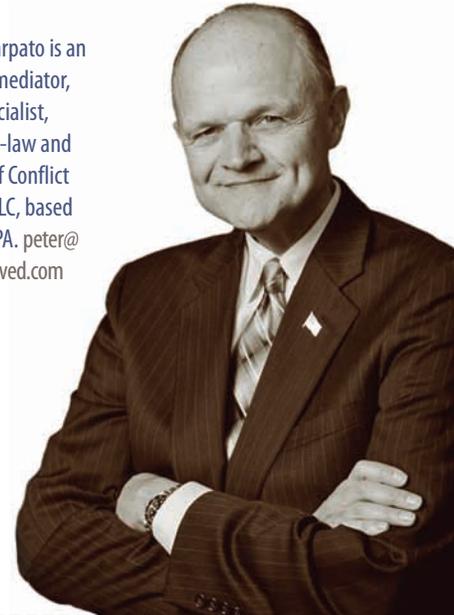
Of course, we are incomplete without a photographic collage of attendees enjoying the AIRROC Rendez-vous and boat ride around Manhattan.

And so, another year, another successful AIRROC event, and a feeling of promise for 2014. For co-chairs Leah Spivey and Keith Kaplan, and the entire Publication Committee, I wish you a joyous holiday season and a bounteous, healthy and safe 2014!

And as always, let us hear from you. ●



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



AIRROC® Publication Committee

Co-Chairs

Keith Kaplan
Keith.Kaplan@reliancenational.com

Leah Spivey
lspivey@munichreamerica.com

Editor & Vice Chair

Peter A. Scarpato
peter@conflictresolved.com

Assistant Editor

Maryann Taylor
mtaylor@bswb.com

Committee Outreach

Connie D. O'Mara
connie@cdomaraconsulting.com

Marc L. Abrams
mabrams@nldhlaw.com

Jonathan Bank
jbank@lockelord.com

Peter Bickford
pbickford@pbnylaw.com

Bina T. Dagar
bdagar@ameyaconsulting.com

Dale Diamond
dalediamond@comcast.net

Carolyn Fahey
carolyn@airroc.org

Samantha Ingram
singram@lockelord.com

Joseph Monahan
jmonahan@saul.com

Frederick J. Pomerantz
fred.pomerantz@wilsonelser.com

Francine L. Semaya
flsemaya@gmail.com

Teresa Snider
tsnider@butlerrubin.com

Vivien Tyrell
vivien.tyrell@rpc.co.uk

Greg Wyles
gwyles@moundcotton.com

Jonathan Yorke
jjyorke@edwardswildman.com

Marketing Consultant

G. Pirozzi Consulting
gina@gpirozzi.com

**Design & Illustration
Myers Creative Services**
nicole@myerscreative.net

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The Workers' Comp Pre-nup

Commutation Clauses in Workers' Compensation Reinsurance Agreements



A common issue arising during the runoff of a workers' compensation carve-out book of business is the implementation of commutation clauses, which provide for discharge of future obligations arising from a claim or group of claims.

While reinsurance contracts from these books routinely contain commutation provisions, the obligations arising under such clauses can vary widely, and each commutation clause must be evaluated on its own terms. At a minimum, commutation clauses often address two aspects to commutation: (i) a time period within which commutation can be raised and (ii) a process for valuation. This article discusses variations in these common features, and considers issues that can arise in the implementation of such clauses.

Illustrations

A common dichotomy used to categorize commutation clauses in workers' compensation carve-out agreements is a "mandatory" versus an "optional"/permissive commutation. However, whether a clause mandates commutation or not, the industry has long recognized the potential mutual benefits of commutation. Commutation clauses create an opportunity for the

parties to consider, at a time certain, the commutation of a contract, a group of claims, or individual claims. Some clauses enable a party to compel commutation over the other's objection, while others require mutual agreement; still others establish a framework through which the parties can revisit commutation negotiations at regular intervals if an agreement cannot be reached when commutation is first raised. Each clause should be evaluated to determine (i) when the commutation process may begin, (ii) how, and which, parties can commence the commutation process, and (iii) the rights and obligations of the parties during that process.

This exemplary clause compels commutation:

- It is understood that at any time following the expiration of this Agreement, but in no case later than 60 months following the expiration of this Agreement, *the Cedent shall submit a statement* listing amounts paid, and reserved, in respect of all reinsurance incurred losses. *This statement shall form the basis of a final agreed value for all such losses for all reinsurers.* The amount of reserves contained therein shall be determined by employing one of the following alternatives.... This statement duly signed by the Cedent shall then be deemed to be the full and final

statement of all known and unknown losses and the Reinsurer shall promptly pay any amounts that may be shown to be due. Such statement shall constitute a complete release of liability of the Reinsurer in respect of the term of this Agreement in respect of all known and unknown losses.

The following clause has some mandatory aspects:

- No later than 60 months subsequent to the date of any accident occurring on policies attaching under this Agreement, *the Cedent shall advise the Reinsurer of any outstanding claims* involving periodic payments during the period of this Agreement which have not been finally settled and which may give rise to a claim under this Agreement. *At that time, the Cedent and the Reinsurer shall, by mutual agreement, determine and capitalize such claim or claims.* Payment by the Reinsurer of its proportion of the amount or amounts, so mutually agreed, shall constitute a complete and final release of the Reinsurer in respect of such claim or claims.

Other clauses set forth a more flexible process, in which one party must request commutation. In some instances, commutation must occur if either party requests it, but in others, commutation can occur only if both parties so agree:

Either the Reinsurer or the Cedent may request commutation of that portion of any excess loss hereunder represented by any outstanding claim or claims at any time after 10 years from the date of the expiration of this Contract. If both parties desire to commute a claim or claims, then within 60 days after such agreement, the Company shall submit a statement of valuation of the outstanding claim or claims showing the elements considered reasonable to establish the ultimate net loss and the Reinsurer shall pay the amount requested. If agreement, as outlined above, cannot be reached, the effort can be abandoned for 12 months at which time the issue of commutation may be reexamined as provided herein.

Likewise the scope of a commutation may vary. The following example provides for a claim carve-out:

- Beginning 60 months following the end of the Agreement Year and annually thereafter, the Cedent or the Reinsurer may request that Reinsurer's liability with respect to one or more unsettled incurred losses which may result in a claim by the Cedent under this Agreement be commuted. The Company shall submit a statement listing amounts paid and reserved in respect of all such incurred losses. This statement shall form the basis of a final agreed value for all such losses. The amounts of reserves contained therein shall be determined by employing one of the following alternatives: ... *The Cedent or the Reinsurer shall have the option not to commute any single loss.* Under such circumstances, the Reinsurer will continue to carry an appropriate reserve on its books and/or pay recoverables under this Agreement until such time as an agreement to commute is reached or until the claim is paid and settled.

Other clauses reference a claim-by-claim commutation:

- Seven years after the expiry of this Agreement, the Cedent shall advise the Reinsurer of all claims for said annual period, not finally settled which are

likely to result in a claim under this Agreement. No liability shall attach for any claim or claims not reported to the Reinsurer within this seven year period. *With respect to any claim under business covered hereunder, either the Reinsurer or the Company may after seven years from the date of occurrence of the claim, request commutation of the ultimate net loss hereunder.* Within 80 days after receipt by either party of the request to commute the claim, the Cedent shall submit a statement of valuation of the claim to be commuted. The Cedent and the Reinsurer shall agree upon the capitalized value of such claim to the reinsured layer and the Reinsurers shall pay to the Cedent the amounts so determined. Payment by the Reinsurer of any further liability in respect of such claim.

Commutation clauses create an opportunity for the parties to consider, at a time certain, the commutation of a contract, a group of claims, or individual claims.

- The Cedent shall advise the Reinsurer not later than 60 months of the date of loss of any claim not finally settled that may involve this Reinsurance. The Reinsurer may then, or at any time thereafter, *require that its liability with respect to one or more of such unsettled claims be commuted.*

As illustrated above, the first step in evaluating a commutation clause is to determine the time period at which an obligation is triggered. It is common to find time frames of between 5 to 10 years after expiration of the reinsurance contract, or even earlier. The time frame may also be based on the date of loss of an underlying claim. Sometimes, there may be annual or other periodic dates at which obligations arise, after the initial trigger date.

The next step is to determine what action is required and by whom. Must the reinsurer demand commutation? Must the cedent submit a notice of claims? In what format should these events occur? The trigger date often begins a process subject to negotiation. That discussion may cover whether all reinsured claims, or only certain claims, should be commuted. Parties considering a claim carve-out may consider factors such as the relative medical stability of a claim, whether the claimant is subject to ongoing structured settlement negotiations, and the potential for legislative changes that can alter the exposure.

Commutation clauses usually also address valuation, either by including an agreed methodology or leaving it subject to mutual agreement. Agreed valuations can vary greatly. One example follows:

The amount of reserves shall be determined by one of the following alternatives:

A. A calculation based on the following criteria:

- In respect of all "index-linked" benefits, annuity values shall be calculated based upon an annual discount of 0%, and an annual escalation of 0%, or as required by statute.
- In respect of all unindexed benefits, annuity values shall be calculated based upon an annual discount equal to the five year Treasury Bond rate at the time of commutation.
- In respect of all future medical costs, an annuity calculation shall be based upon the Company's evaluation of long term medical care and rehabilitation requirements, using an annual discount equal to the five-year Treasury Bond rate at the time of commutation, and an annual escalation equal to the Medical Care Consumer Price Index (CPI-MC) at the time of commutation.

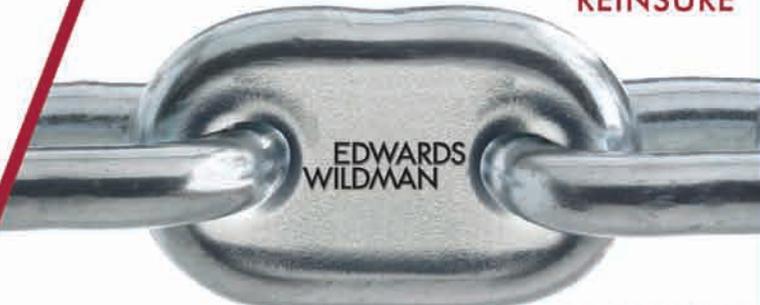
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The Workers' Comp Pre-nup (continued)

4. Where applicable, impaired life expectancy, survivors life expectancy, as well as remarriage probability shall be reflected in the calculation by employing tables required by statute.

B. The Company may determine the agreed value by purchasing (or obtaining a quotation for) an annuity from any A.M. Best's Class VIII "A" rated or better annuity writer.

These clauses may also expressly allow the parties to choose another method of valuation, other than the alternatives originally stated. Generally, there is also a mechanism whereby valuation disputes are resolved by arbitration, overseen by an appraiser or panel of actuaries, sometimes specified as those "regularly engaged in the valuation of Workers' Compensation claims."

Implementation

The variety in commutation clauses precludes uniform implementation, as each clause can set forth different obligations to commute and different valuation processes. The commutation

process is often complicated by the multitude of contracts involved. Many companies routinely entered into such agreements, which attached at both catastrophic layers and working layers. A party that has entered into such arrangements should identify the subject agreements, including participations through a pool arrangement. From the cedent's standpoint, gathering data to provide commutation statements involves the coordination of claims, accounting, and other business units.

During negotiations, parties will consider insuring reinsurance, and also other contractual terms which may bear upon the implementation or exercise of discretion under commutation clauses. For example, a party may decide not to exercise its commutation rights if a loss cap limits reinsurance coverage. Often times, the commutation clause incorporates a discovery period. However, even where there is no discovery period, the agreement may contain a sunset clause which ends the reinsurer's obligations after a specified

time period for either all or a category of claims. The parties may need to consider whether the sunset provisions impact the obligations triggered by the commutation clause. Given such complexities, counterparties with multiple reinsurance contracts may decide to negotiate a new approach altogether and to forego their prior contractual agreement. ●



Seema A. Misra is a litigation Partner in the New York office of Stroock & Stroock & Lavan LLP specializing in insurance and reinsurance matters. smisra@stroock.com. David V. Simunovich is a litigation Associate in the same office of Stroock. dsimunovich@stroock.com.

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Marianne Petillo Praised

AIRROC Co-Chair Receives Women in Insurance Leadership Award

Marianne Petillo, President and CEO of ROM Re and Co-Chair of the AIRROC Board of Directors, was selected as one of this year's Women in Insurance Leadership award winners. The award, sponsored by Insurance Networking News, strives to identify individuals who have made an impact on the operations and bottom line for their companies and recognizes the accomplishments of the industry's most influential female leaders whose innovation and leadership have redefined the insurance business. I had the opportunity to sit down with Marianne in her office to talk with her about this award and future plans for AIRROC.



Carolyn Fahey: *Marianne, I was personally thrilled to hear that you had been chosen for this award! After having worked with you on the board for the last 18 months and for many years prior in my role at the Reinsurance Association of America I feel that it was well deserved – congratulations! Can you tell me a bit more about the things that you did at your company, which led to this recognition?*

Marianne Petillo: Thank you, Carolyn. I appreciate your sentiments. I was nominated for the award by Hyland Software. They handle our workflow document imaging system. When I first came to ROM in 2001, everything was manual. There was no claim system – excel worksheets and hand written claim cards were the norm. Immediately, I recognized that a top priority should be to automate the office as much as possible.

We purchased what was then the best document imaging system on the market for the insurance industry and built a claims system that could handle reinsurance pools. This transformed the office entirely. All paper files were gone by the end of 2002, and while this stand-alone document imaging system was very useful, there was wasted effort because things had to be entered into multiple systems, thus creating opportunities for human error. ROM was looking for a way to integrate their systems so we could further cut down on the time it took to complete tasks, and eliminate the effect of human error. In addition, I knew that as a run-off company, it was inevitable that we would have to reduce staffing as the business downsized, so full automation was even more important. Hyland's system allowed ROM to integrate our financial systems to our workflow document imaging system. This partnership

caused significant reductions in processing times, which in turn led to economies of scale and overall cost savings. Manual processes have been either eliminated or reduced tremendously. The staff can now focus on the important issues and not get stuck handling administrative matters.

This past year, Hyland and ROM worked together to move our server-based system to a hosted environment when Hurricane Sandy knocked out ROM's offices for over a month. It was during this critical fourth quarter that ROM only lost one week of downtime when Hyland's team provided remote access to ROM's employees within days of receiving our server. As a result, ROM was still able to complete all critical year end operations on time, and lost no data in the process, although telephone service was another matter.

Fahey: *That's really fantastic, Marianne. It is always great to hear success stories like this. System transitions are never easy to navigate. Your foresight and skills as a leader were definitely put to the test in guiding ROM and your staff through this. As a woman leader in the industry, what words of advice would you give to other women that aspire to leadership roles?*

Petillo: Be honest, be yourself, be fair to others and treat them how you would want to be treated. Decide what it is you really want in your career, and find a mentor/sponsor to help you reach your goals. Work hard, and don't be afraid to take risks, be creative in resolving issues, and think outside the box. The road less traveled is sometimes the right one. One of my favorite quotes from a great leader in world history is from Winston Churchill: "Success is not final, failure is not fatal; it's the courage to continue that counts." Always remember this as you go through the ups and downs in your career.

Fahey: *Great advice! Now turning to your leadership role at AIRROC – having been a founding board member and now serving on the Executive Committee of the Association for several years, how have you seen the role of AIRROC change in the industry?*

Carolyn Fahey

Petillo: When the core group of companies gathered in ROM's offices for the very first AIRROC meeting, we were simply a "blip on the radar screen". We had great ideas, but didn't really know if they would come to fruition. We were a start up organization with growing pains and had no name or brand recognition. Now, nine years later, we've seen the organization grow to the success it has become today, with over 50 members, corporate sponsors, and individual event sponsors. Our education programs are of the highest caliber, and AIRROC continues to expand its reach by conducting regional programs across the U.S. and in London. This organization has filled a void where before nothing like it existed. As the industry continues to cut costs, AIRROC has made it possible to conduct a measurable amount of business in one setting at the organization's premier event every October, and bring people face to face for perhaps the first time. When in a dispute, it's much easier to disagree with someone over the phone or through email. People are generally nicer to each other in person, so more disputes get resolved, relationships are built, and common ground is reached.

[AIRROC] has filled a void where before nothing like it existed.

Fahey: *What do you think is the most valuable role that AIRROC brings to the insurance industry?*

Petillo: While the education programs and the DRP are wonderful, I think the networking opportunities and relationship building AIRROC provides are invaluable.

Fahey: *I have been given the opportunity to work with AIRROC and to make an impact on the industry and without leaders like yourself on the board, would not have been able to do so. As you know, we recently had conducted a board strategic planning session and have formed groups to look at some initiatives for AIRROC in 2014. In your personal opinion, what do you want to see AIRROC focus on in 2014?*

Petillo: Other than the continued growth of its member base, I'd like to see the AIRROC website expanded so it is more user friendly to everyone. I think that in its current form, the website is under-utilized. I would also like to investigate the possibility of creating an accreditation program for individuals in the run-off sector.

Fahey: *Many thanks, Marianne, not only for your time today, but for all that you have done for AIRROC and for the industry over the course of your career. Yours is truly an inspiring leadership story.* ●

Carolyn Fahey is Executive Director of AIRROC. carolyn@airroc.org

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Mary A. Lopatto

202.463.2502 | mlopatto@cozen.com

Robert W. Tomilson

215.665.5587 | rtomilson@cozen.com

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DRP Workshop – Take 2

The second time's the charm! AIRROC's second 2013 DRP Workshop was a big success....

Due to the success of the first DRP Workshop hosted by Foley & Lardner in their spacious Chicago office, Foley & AIRROC brought the event to New York City. Held September 10 at AIG's headquarters, the day revolved around a mock dispute. The morning session set the stage for the disagreement between the two parties and the attendees were divided into teams to represent either "Coyote" or "Road Runner" and tasked with working out the dispute. Representatives from the team had the opportunity to present their views to an arbitrator and awaited his final ruling. The workshop was designed to highlight the streamlined nature of AIRROC's Dispute Resolution Procedure so that participants could gain a better understanding of how it can be applied to real disputes they have in their companies.

Conference Leaders had this to say:

As Chair of AIRROC's DRP Committee, I was extremely pleased with both the turnout and execution of the NY event. Faculty members were well prepared and engaging, and attendees dove right into the mock exercise and were enthusiastic participants. Overall, the seminar served as a great platform for the DRP process, and provided a worthwhile educational and networking opportunity for all involved.

—Glenn Frankel, The Hartford/First State

We at Foley have enjoyed developing this workshop with AIRROC and spreading the word about the DRP. The workshop ultimately depends on how seriously the participants assume their roles and it was gratifying to see just how enthusiastic they were.

—Peter B. Steffen, Partner, Foley & Lardner

Attendees had this to say:

AIRROC's September DRP Workshop was fun and informative for me and my colleagues. It was particularly interesting to see how different the outcomes were for each group. I look forward to the next one!

—Sarah Russell, Travelers Insurance Co.

The DRP workshop was well-planned and presented by insightful industry professionals. Everyone participated and took the exercise seriously, adding their own interpretations of the issues. Reinsurance is a relationships business, and AIRROC brings together some of the best people in the industry.

—Dea Rocano, AIG

The September 2013 DRP Workshop was a well conceived, organized and professionally presented program, with ever present audience participation. It truly was one of the best AIRROC workshops I have attended.

—John D. Ghigliotti, ROM Reinsurance Management Company, Inc. ●





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aidan.mccormack@dlapiper.com
 +1 212 335 4750

William Popalisky
william.popalisky@dlapiper.com
 +1 212 335 4665

www.dlapiper.com



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AIRROC Educational Summaries

AIRROC hosted the second West Coast regional education session on September 14 at the gorgeous Balboa Bay Club in Newport Beach. The picturesque setting provided a perfect backdrop for a day of panel discussions and a mock arbitration workshop.

Prep for the Exam

How to Prepare for an Audit

Summary by Andrew Costa

Devonshire's Garry Nelson moderated the first panel discussion of the day which explored how an insurance company should prepare for an audit by one of its reinsurers.

Mr. Nelson began the discussion by introducing each of the panelists. Ariane Entrikin is the Vice President, Controller at Devonshire. She was joined by Devonshire's Mark Haapala, Assistant Vice President, Claims Manager. They spoke from the perspective of an audit firm representing a reinsurer. Garry Ibello, Assistant Vice President of Fireman's Fund, addressed the group representing a ceding company facing an audit by its reinsurer. Finally, Frank DeMento of Crowell & Moring LLP discussed various legal issues associated with the audit process.

Ms. Entrikin began the forum by discussing how the reinsurer/cedant relationship is often characterized as one of utmost good faith rather than a fiduciary relationship, given that the parties to reinsurance transactions have significant reinsurance expertise. Most reinsurance agreements contain an access to records clause which provides an express audit right.

Reasons a reinsurer may decide to initiate an audit include questions concerning billing/cession accuracy or reserving, disputes over the allocation of indemnity and expense payments or the interpretation of contract wording. Reinsurers might analyze remaining exposures if a

commutation is being considered or may simply verify that inuring reinsurance has been properly applied.

Mr. Haapala detailed the types of materials an auditor might request in advance or at the review. This is largely dependent upon the nature of the audit; for example is it a premium or a claim audit; are cessions being questioned; or are underlying risks, systems and internal controls to be reviewed?

Materials typically requested in advance of an audit include copies of slips, wording and cover notes if the reinsurer's records are incomplete. Placement/renewal details can reveal what the original intent was of the contracting parties. Claims manuals, organizational charts, and interviews with key personnel in advance of the on-site review can significantly improve productivity while on-site. Records typically provided on-site include claims files and accounting reports.

Mr. Ibello discussed the importance of confirming the details of the audit team members, the scope of their review and agreeing on which records would be provided and how (paper vs. electronic). Policies and procedures for the audit team to follow need to be considered as well. A confidentiality agreement is usually negotiated in advance of the review and a wrap up meeting discussing the auditor's preliminary findings is often requested at the conclusion of the audit.

Lastly, Mr. DeMento discussed a number of legal issues related to access to records by a reinsurer, which are complicated by the potential of waiving the attorney/client privilege. Various court cases were detailed and the common interest doctrine was also brought up. Arguments as to whether the interests of insurers and reinsurers are always aligned were discussed. Court decisions on this issue can vary between jurisdictions. Lastly, legal concepts concerning self-evaluative or self-critical analysis privilege and trade secret protections were discussed and audience questions were entertained afterwards.

Andrew Costa, Assistant Vice President, Claims at Devonshire. acosta@devonshiregroup.com



West Coast Regional

To Outsource or Not to Outsource...

Summary by John B. West

Devonshire's John West moderated a panel discussion that compared the ways in which companies manage run-off and the pros and cons of their options.

Mr. West introduced the panelists with a brief bio on each participant. Garry Nelson, the President of Devonshire, began the discussion by positioning the options for managing run-off. Jim Foster, a Senior Vice President with Everest Re, spoke from the perspective of a company in the seller's position. Mr. McElhiney followed and spoke from the buyer's perspective. Finally, Mr. Toce, an actuary with Ernst and Young, relayed the process an actuary goes through in a potential transaction, without falling on either side of the buy/sell equation.

Mr. Nelson detailed the advantages and disadvantages of both in-house and outsourcing options. If management is willing to devote the time and energy to develop and actively support a run-off strategy that includes sound claims management and a reasoned and systematic commutation program, in-house runoff is a viable option. Where a major class of business or the entire business line is put into runoff, however, it is good business sense to look at outsourcing the runoff. This is usually more economical considering the internal costs of keeping a runoff.

Mr. Foster outlined a number of factors the current owner must consider when deciding whether to keep or outsource management of run-off exposures. Keeping or outsourcing run-off management both implicate strategic and financial considerations, and the balancing of those considerations

will likely be specific to the owner's circumstances and goals.

Mr. McElhiney presented the considerations from the buyer's perspective. He described two basic types of buyers: traditional and capital markets. The objectives and processes of each type will vary, but deals can come to both through a variety of sources: brokers, direct client access, investment bankers, and departments of insurance. Core expertise and value realization are also differentiating factors.

Mr. Toce demonstrated his perspective on expected versus actual outcomes of a potential transaction and explained that variability is sometimes more important than expected values. He also explained the concepts of variability, risk aversion and utility theory and the importance of each.

The panel then responded to questions from the audience.

For those considering outsourcing, select a run-off administrator who has the skills that are important to your strategy. The best predictor of what a company can do for you is what they themselves have done. Beware of firms that are quick to say what they could do—ask what results they have already accomplished for others.

John B. West, Senior Vice President, Business Development, at Devonshire. jwest@devonshiregroup.com

McElhiney Muses the Biz

Keynote Speaker

Summary by Andrew Costa

The AIRROC West Coast Conference was pleased to have Steve McElhiney as this year's conference Keynote Speaker. Mr. McElhiney is the Chairman and President of EWI Re of Dallas and EWI Re (UK), Ltd (London) and is President of



Page 14 (from top): Carolyn Fahey, AIRROC. Tom Toce, Ernst & Young; Paul Ginnett, Fireman's. Frank Kehrwald, Swiss Re. Page 15 (from top): Michael Robles, Crowell; Michael Degnon, Zenith Insurance; John West, Devonshire; Frank DeMento, Crowell. Brian O'Sullivan, Crowell; James Foster, Everest Re; Jim Sporleder, Allstate; Frank Kehrwald, Swiss Re; Michael Robles, Crowell. Garry Nelson, Devonshire.



Educational Summaries / West Coast Regional (continued)

Vermont's Tall Pines Insurance Company. His experience in the insurance industry has spanned over two decades. His background in corporate finance and reinsurance provides a unique insight into the recent convergence of the capital and reinsurance markets. Prior to joining EWI Risk Services, he served as: Corporate Treasurer of Argonaut Group, CFO of Overseas Partners US Re, Senior Vice President, Reinsurance of TIG Insurance and Associate Director of Reinsurance of Fireman's Fund. Mr. McElhiney received MBA and BS degrees from the University of Southern California. He holds the CPCU, Associate in Reinsurance, and AIAF certificates and is a Past President of the CPCU Society.

Mr. McElhiney spoke about current macro reinsurance trends, gave an overview on CAT losses and finished his presentation by providing an overview on capital markets and reinsurance. Mr. McElhiney's discussion of macro reinsurance trends covered various topics including global growth, industry profitability, emerging CAT zones (both in the U.S. and globally), interest rate pressures and profitability and regional carrier and broker challenges. He explained how the low growth experienced by the U.S. economy and the government's monetary policies over the past several years has led to decreased profits within the domestic insurance industry. Mr. McElhiney detailed the property and casualty insurer's corporate return on equity results as compared to all industries within the United States between 1987 and Year End 2010. There has been an overall underperformance of the insurance industry as compared to all domestic industries during this time frame with steeper decreases when CAT losses occurred.

A discussion of increased CAT exposures was supported by some interesting demographic changes within the United States over the past decade. The population within the U.S. has increased 9.7 percent between 2000 and 2010, shifting towards coastal areas. Half of the population and insured risks are

concentrated within 50 miles of the U.S. coast. There have also been huge increases in domestic residential and commercial development along the coasts with a combined 6.6 trillion dollars of insured risks found in coastal property located in Texas, Florida and New York. Thunderstorms and tornado events cost \$14.9 billion in insured losses and \$27.7 billion in economic losses in 2012.

Mr. McElhiney's discussion of the capital markets covered alternative reinsurance mechanisms, insurance company acquisitions, intermediary consolidations, CAT bonds and contingent capital vehicles. Mr. McElhiney mentioned that Bermuda and the Cayman Islands are attracting more special purpose insurers which are often backed by hedge funds as private equity is not a good fit with the P&C insurance model because it seeks a 7-10 year investment horizon that is usually not correlated with market cycles, and CAT bonds are growing in acceptance as alternative investment vehicles.

Andrew Costa, Assistant Vice President, Claims, at Devonshire. acosta@devonshiregroup.com

Are They In or Out?

ECO/XPL

Summary by Frank DeMento

Andrew Costa of Devonshire, Michael Frantz of Munich Re, and Frank DeMento of Crowell & Moring, spoke at the Insurance and Reinsurance Regional Education Conference. Andy, Mike and Frank discussed claims for ECO / XPL and the (re)insurability of punitive damages. Extra Contractual Obligations claims are claims brought by the underlying insured against its insurance carrier, seeking damages arising out of the insurer's alleged faulty handling or defense of a claim. A distinguishing characteristic of an ECO claim is that it falls *outside* of the coverage provided by the underlying insurance policy. Excess of a Policy's Limit claims are claims brought against the insured by a third

party and that would be covered by the underlying policy *but for* the policy limits. The question for reinsurers and cedents alike is whether reinsurance is available to cover ECO or XPL claims. The answer depends on a number of factors, including but not limited to, whether the reinsurance contract contains specific clauses providing for such coverage, if a separate E&O policy exists that provides similar coverage, to what extent the reinsurer was involved in the claims handling and/or is required to follow the cedent's fortunes, and whether state laws on the insurability of punitive damages are applicable. Generally speaking, a reinsurer's liability to its cedent is determined by the parameters of the reinsurance contract entered into by the parties. The more specific and accurate parties can be in drafting language for the ECO/XPL clause, the greater guidance they will have when an ECO/XPL situation arises. Parties to a reinsurance contract may also need to address whether state law has any bearing on the reinsurance recoverability of ECO claims. In particular, parties to a reinsurance contract may dispute the applicability of state laws on the insurability of punitive damage awards, as a number of states prohibit insurance of punitive damage awards as a matter of public policy. At a minimum, when faced with a claim for reinsurance coverage for a punitive damages award, the parties must address: (1) which state law applies, (2) whether that state prohibits the insurability of punitive damages as a matter of public policy and under what circumstances, (3) whether that state public policy would apply in the reinsurance context, (4) whether any specific contract language exists that explicitly provides for such coverage, and (5) whether other language in the contract – such as a follow the fortunes or honorable engagements clause – bears on the issue. Recent decisions have demonstrated that

punitive damage awards remain an issue for insurers and reinsurers and illustrate the potential importance of determining what portions of a cedent's settlement with its insured is related to ECO or XPL claims when the contract either limits or prohibits reinsurance of such liabilities.”

Frank DeMento is Counsel in the Insurance/ Reinsurance Group at Crowell & Moring, LLP. fdemento@crowell.com

Mock Panel Uses its Noggin

On sports-related head injuries

Summary by Michael K. Robles

One of the highlights of the conference was the afternoon interactive session: “What a Headache: Mock Reinsurance Arbitration and Roundtable Concerning Sports Related Head Injuries.” Participants were provided a hypothetical fact pattern involving claims for reinsurance coverage arising from an insurer's settlement of claims of athletes who allegedly sustained head injuries in a fictional sports league. Michael Robles and Brian O'Sullivan of Crowell & Moring LLP presented “closing arguments” – Mike on behalf of the cedent, Brian on behalf of the reinsurer – to a mock arbitration panel comprised of Frank Kehrwald (Swiss Re), James Foster (Everest Re), and James Sporleder (Allstate). Following the argument, participants were divided into groups and asked to act as mini-arbitration panels and decide the various issues presented. After reporting their conclusions, participants were treated to a look behind the curtain as our mock arbitration panel conducted their deliberations in the open before all participants. ●

Michael K. Robles is Counsel to Crowell & Moring, LLP. mrobles@crowell.com



Page 16 (from top): Steve McElhiney, EWI Risk Services; James Foster, Everest Re; Garry Nelson, Devonshire; John West, Devonshire; Steve McElhiney, EWI Risk Services; Tom Toce, Ernst & Young; Brian O'Sullivan, Crowell. **Page 17 (from top):** Michael Fitzgerald, Inpoint; Stephen Manders, Swiss Re; Frank DeMento, Crowell; Ariane Entrikin, Devonshire; Garry Nelson, Devonshire; Gary Ibbello, Fireman's; Mark Haapala, Devonshire. Frank DeMento, Crowell; Mark Haapala, Devonshire; Gary Ibbello, Fireman's; Ariane Entrikin, Devonshire. Frank DeMento, Crowell; Michael Frantz, Munich Re; Andrew Costa, Devonshire.

A photograph of a classical building facade with ornate architectural details, including columns and decorative moldings, set against a blue sky with light clouds.

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New York, NY 10022
Phone: 212.223.4000
Fax: 212.223.4134

San Francisco, CA

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San Francisco, CA 94111
Phone: 415.986.2800
Fax: 415.986.2827

Orange County, CA

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AIRROC Board of Directors & Officers 2014

Back row left to right: Art Coleman (Immediate Past Chairman), Citadel Risk ; David Raim (Counsel), Chadbourne & Parke ; Michael Baschwitz, Zurich; Glenn Frankel, The Hartford; Ann Weikers, RiverStone Resources; Sylvain Villeroy de Galhau, AXA Liabilities Managers; Keith Kaplan, Reliance; Michael Fitzgerald, Inpoint; Karen Amos, Resolute; Jeffrey Winters, Legion; Frank Kehrwald, Swiss Re; Bill Littel (Secretary), Allstate. **Front Row Left to Right:** Edward Gibney (Vice Chair), CNA; Carolyn Fahey, AIRROC Executive Director; Marianne Petillo (Co-Chair), ROM Re; Katherine Barker (Co-Chair), Armour Risk; Leah Spivey, Munich Re America; Mindy Kipness, AIG; Joseph DeVito (Treasurer), DeVito Consulting

Happy Birthday AIRROC! (and also to me...)



AIRROC turns 9 on December 14, 2013 (and I turn 21!)

So, regardless of the fact that only part of that statement is true, imagine my surprise when I was working on the AIRROC website recently and noticed that AIRROC was incorporated on MY birthday. A match made to be.

Since birthdays are inevitably about numbers, I have pulled together some numbers related to AIRROC's accomplishments in 2013:

- AIRROC has held a total of 8 membership events this year – more than the organization has ever offered in a calendar year.
- Attendee surveys of all of these events have been extremely favorable. 96% of the attendees rated the events Excellent or Very Good.
- A total of 841 individuals attended AIRROC events in 2013 – 639 of these or 75% of these were from AIRROC members or Corporate Partners.

- We added 6 Corporate Partners in 2013 – the first year that this initiative was offered. Our inaugural partners are: Alvarez & Marsal, Butler Rubin, Cozen O'Connor, Crowell & Moring, Freeborn & Peters, Locke Lord.

- 4 new members joined us, all within the new managing member or broker member classification: Buxbaum Loggia, Devonshire, EWI Re, McNulty Re.

- We have expanded our communication and industry outreach efforts through our new database by increasing the number of individuals that receive information on AIRROC happenings by 60% in the last year.

These are all indicative of AIRROC's continued relevance and service to our members and the legacy industry as a whole. The momentum will continue as we look ahead into 2014. The dates for the Spring and Summer Membership meetings have been announced – March 11-12 and July 15-16 – where we will convene at the offices of Chadbourne & Parke at the famous “30 Rock”.

Other AIRROC dates for your calendar:

- It's A Deal! A Workshop on Negotiation Strategy and Technique with Butler Rubin in Chicago. Date: February 26
- Eastern Regional Education Day with Edwards Wildman in Boston. Date: April 9
- Mid-West Regional Education Day with Locke Lord and Allstate in Chicago. Date: June 12

Looking forward to our paths crossing in 2014. Here's wishing all of AIRROC's constituents a warm and wonderful holiday season.

Cheers! ●



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

News & Events

Regulatory News



NAIC Budgets Funds for ORSA and Principles-Based Reserving Staffing

In October, the NAIC presented its 2014 Budget that included funding for staff to implement and oversee its recent Principles-Based Reserving and Own Risk and Solvency Assessment (ORSA) initiatives. The proposed budget provides for the addition of two actuaries for the implementation of the complex principles-based reserving requirements. The NAIC is pushing forward with this initiative even though the new requirements have been adopted by only a few states to-date and are opposed by both New York and California. The NAIC is also budgeting for a new staff position to oversee the implementation of the ORSA Model Act adopted in 2012 and which will require the development of ORSA plans and filings beginning in 2014. The proposed 2014 NAIC budget, totaling over \$93 million, will be acted on at the NAIC Fall Meeting, December 15-18, 2013, in Washington, DC.

FIO Issues Reinsurance Report

In October 2013 the Federal Insurance Office (FIO) issued its report on the impact the of the 2010 Nonadmitted and Reinsurance Reform Act (NRA) on the ability of state regulators to collect data on reinsurance in view of

the NRA's deference to the authority of the reinsurer's home state, including the prohibition of a non-domiciliary state regulator from requiring a reinsurer to provide financial information other than financial information provided to the regulator in the domiciliary state. The 4-page Report concluded after a brief background analysis that the NRA has not had an adverse impact on the ability of state regulators to access reinsurance information for regulated companies.



EU-U.S. Dialogue Project: Supervisory Colleges Best Practices Forum

On December 14, 2013, immediately preceding the NAIC Fall National Meeting at the Washington Marriott Wardman Park Hotel in Washington, DC, the Steering Committee of the EU-U.S. Dialogue Project held an open meeting to "launch the initiatives" agreed upon in the EU-U.S. Dialogue Project.

Industry News

Catalina Holdings Purchases Alea Group from Fortress Affiliate

In September 2013 Catalina Holdings (Bermuda) Ltd ("Catalina"), announced it has agreed to acquire Alea Group Holdings (Bermuda) Ltd. ("Alea Group") from FIN Acquisition Limited, a

subsidiary of investment funds managed by affiliates of Fortress Investment Group LLC ("Fortress"). Alea Group is predominantly a property casualty reinsurer which went into run-off in 2005 and was acquired by Fortress in July 2007. According to Catalina, as of June 30, 2013, Alea Group had total assets of US\$540m, gross reserves of \$270m, net reserves of \$252m and net asset value of \$103m. The acquisition will be an all cash transaction and is subject to regulatory approval by the Bermuda Monetary Authority and New York Department of Financial Services.

Randall & Quilter Acquires Flagstone from Validus

Randall & Quilter Investment Holdings Ltd ('R&Q') announced in October 2013 that it acquired the entire issued share capital of Flagstone Alliance Insurance and Reinsurance Ltd ('FAIR'), a Cyprus domiciled insurer and reinsurer, from the Validus Group.

FAIR, which commenced underwriting in 2000, went into run-off in 2010 and comprises primarily international reinsurance business with net reserves of c.\$16.4m equivalent as at June 30, 2013. The all cash consideration payable by R&Q was announced as c.\$24.1m, a discount to the estimated adjusted net asset value of c.\$28.1m. The business will be managed by R&Q Insurance Services Ltd. and all of the assets of FAIR will be held in UK based bank and custodian accounts other than very nominal balances held to pay local expenses. According to R&Q, the Superintendent of Insurance in Cyprus has been informed of the transaction, which is not subject to any further regulatory approvals.

People on the Move

James Veach, Esq., Partner at Mound Cotton Wollan & Greengrass, and Assistant Editor of AIRROC Matters, has decided after many years of excellent service, to leave the AIRROC Publication Committee.



From the start, Jim was a pivotal member of the Committee, serving as both special editor of the Rendez-vous edition and more generally as a force for quality and creativity. He wrote articles, interviewed industry executives for our roundtable discussions and solicited key players in the business as both authors and speakers for AIRROC. His leadership and presence on the committee will be missed, although we hope that his stellar contributions will continue in the future.

James Sporleder, Vice President and Assistant General Counsel at Allstate Insurance Company elected to retire from the company on November 30, 2013. He was employed by Allstate for over 34 years in the Law and Regulation Department. He was in charge of all legal matters involving Allstate's legacy book of assumed and ceded reinsurance matters. He spent a great deal of his time handling Allstate's reinsurance arbitrations. In retirement, Jim will continue in his activity as an arbitrator. He is presently an Arias certified arbitrator as well as available on the list of AIRROC arbitrators. Jim's new email

address is sporleder.arbitrations@gmail.com and his new cell number is 847.400.4214.

Christopher W. Reichow has been named Corporate Claims Counsel for R&Q Solutions LLC working out of their Philadelphia office. His responsibilities include assisting R&Q's senior management on corporate, legal and regulatory matters.

Bob Sirois has been named Commutations Manager for RiverStone Resources L.L.C. Bob brings his 22 years of experience in the commutations arena at CNA to RiverStone and will be working out of the office of another Fairfax Holdings company, Odyssey Re, in Stamford, CT. A regular at all AIRROC Commutations Rendez-vous and other AIRROC events, we wish Bob continued success in his new position.

Carroll McNulty & Kull LLC (CMK) announced in September 2013 that it has opened a new office in Chicago. The Chicago expansion comes on the heels of the opening in July of CMK's new location in Philadelphia, and adds to CMK's established locations in New Jersey and New York. Joining CMK from the Chicago office of Cozen O'Connor are: **John D. LaBarbera, Benjamin A. Blume, Matthew T. Walsh, Daisy Khambatta and Martha E. Conlin.** Joining CMK from the Chicago office of Meckler Bulger Tilson Marick & Pearson are: **Carlos del Carpio, James J. Hickey and Mary E. Fechtig.** ●

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 flsemaya@gmail.com or Peter Bickford at pbickford@pbnylaw.com.

W I N T E R 2 0 1 3

MARK YOUR CALENDAR

January 30-31, 2014

IAIR Insolvency Workshop
Tempe, AR
www.iair.org

February 26, 2014

It's A Deal! A Workshop on Negotiation Strategy and Technique
Chicago, IL
www.airroc.org

March 11-12, 2014

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

April 4-6, 2014

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

April 9, 2014

Eastern Regional Education Day with Edwards Wildman
Boston, MA
www.airroc.org

June 12, 2014

Mid-West Regional Education Day with Locke Lord and Allstate
Chicago, IL
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Michele L. Jacobson

mjacobson@stroock.com

William D. Latza

wlatza@stroock.com

Robert Lewin

rlewin@stroock.com

Andrew S. Lewner

alewner@stroock.com

Seema A. Misra

smisra@stroock.com

Royce F. Cohen

rcohen@stroock.com

STROOCK & STROOCK & LAVAN LLP
NEW YORK • LOS ANGELES • MIAMI • WASHINGTON, DC
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AIRROC/R&Q Commutation & Networking Event 2013

AIRROC members and supporters flocked together once again to the NJ Meadowlands for a redesigned, revitalized Rendez-vous, complete with dinner cruise. The event spanned less time, achieved more results and honored Karl Wall as Run-off Person of the Year.



ADR Under the Microscope

Summary by Kyle Medley

On October 14, 2013, Raenu Barod, a Partner at Barger & Wolen, LLP's New York and London offices, led a panel discussion at the opening educational session of the Rendez-vous on the pros, cons and innovations of various forms of Dispute Resolution Mechanisms. The distinguished panel represented a broad cross section of the industry – Bruce Byrnes, Senior Counsel at Berkshire Hathaway; Christopher Reichow, Corporate Claims counsel at R&Q; James Scrimgeour, Senior Counsel – Reinsurance at The Travelers; and Steven C. Schwartz, a Partner at Locke Lord LLP. The Panel discussion provided some fresh insights and challenges to the conventional wisdom on this topic and gave valuable insight into the in-house preference and experience.

The discussion reviewed the conventional wisdom on the benefits and disadvantages of arbitration versus litigation as forms of dispute resolution and challenged aspects of those basic

assumptions. Panel members went on to discuss the factors that impacted their preference for one type of dispute resolution process over another. Further discussion centered around the need, in this economic climate, for a greater focus on the most efficient and cost effective outcome in dispute resolution and how this has influenced panel members in pursuing creative strategies for combining the best features of different dispute resolution methods. Panel members also expressed their views on their emerging experience of mediation as another possible and effective tool in the settlement of certain types of reinsurance disputes.

In contrasting arbitration with litigation, one of the topics discussed by the Panel was whether arbitration was more cost-effective in that it reduced amount of discovery in a dispute. While reference was made to recent experiences in which arbitrators seemed to be allowing expansive discovery in an effort to ward off accusations by a party of “due process” violations, it was noted and agreed that many arbitrators are unconcerned about such hollow threats and appear to be making more of a concerted effort to get “back to

the basics” of arbitration, meaning a truncated resolution mechanism without the exhaustive discovery available and often used in litigation. Mr. Scrimgeour noted that he believes that Courts, too, are headed in the direction of limiting discovery, as evidenced in the proposed changes to the Federal Rules of Civil Procedure. The proposed changes to the Rules of Civil Procedure would include reducing the length of depositions and the default number of discovery demands, as well as making discovery “proportional” to the amount at issue in the action. These changes might erode some of the perceived cost differences between arbitration and litigation.

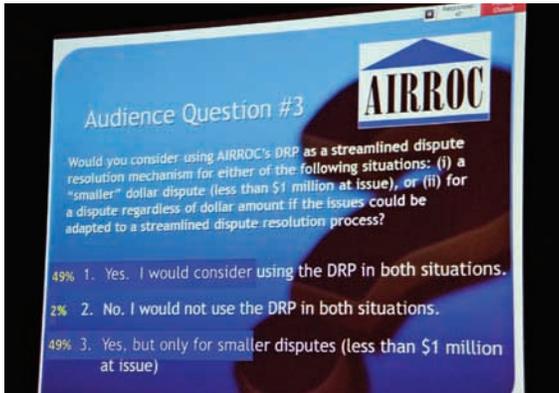
In addition to the critical issue of costs, other differences in arbitration and litigation that the panel discussed included third-party discovery, privilege, confidentiality, expertise (i.e., industry arbitrators vs. judges), and finality of the award or decision. One theme that ran through these topics was the flexibility of arbitration. For example, it was agreed that, with respect to privileged materials, arbitrators were much better equipped to respect the common interest privilege between reinsurers and ceding companies.

The panel members discussed their individual preferences for different types of dispute resolution processes depending on the nature and size of the dispute. Some had worked on “hybrid” arrangements where agreement was made between the parties to move out of arbitration into a federal court setting where it was more appropriate to the dispute. The merits of mediation were discussed and the panel agreed that mediation should always “be in the toolbox” of dispute resolution devices, as mediators can often apply “tough love”



Page 24 (from left): Steven Schwartz, Locke Lord; Jamie Scrimgeour, The Travelers; Raenu Barod, Barger & Wolen; Bruce Byrnes, Berkshire; Chris Reichow, R&Q.

Page 25 (from top): Marianne Petillo, ROM Re; Karen Amos, Resolute; Marcus Doran, The Hartford; Seema Misra, Stroock & Stroock & Lavan; Jonathan Rosen.



to parties to either resolve all of their differences, or at least limit the issues that require resolution. Although the quality and experience of the mediator was viewed by all as an essential prerequisite to embarking down the path of mediation.

In sum, the panel provided a fresh look at the current issues facing insurers and reinsurers with respect to dispute resolution. While parties do not always have the luxury of choosing a dispute mechanism after a disagreement has already developed, the panel stressed the need to anticipate issues more purposefully in the drafting of contracts so as to best suit any disputes that might arise in the future. Although imperfect in some respects, the majority of the Panel still view arbitration as the most efficient dispute resolution mechanism. Within that context, however, some were in favor of a having a federal court judge as the sole arbitrator in “bet your company” type cases.

Kyle Medley is an Associate at Barger & Wolen LLP.
kmedley@bargerwolen.com

AIRROC DRP Roadmap

How Should the DRP Be Applied to My Dispute

Summary by Seema A. Misra

The interactive workshop, “An AIRROC DRP Roadmap: How Should the DRP Be Applied to My Dispute,” kicked off with an introduction by Jonathan Rosen, who explained that the Dispute Resolution Process (“DRP”) evolved from a specific need – voiced openly and frequently during past Rendez-vous meetings – for a mechanism to efficiently resolve small balances (less than a million dollars) on which parties have a genuine difference of opinion, but which do not merit the time and cost of a traditional arbitration. Indeed, a live voting session at the workshop’s outset revealed that traditional arbitrations often took more than a year to resolve, with total costs amounting to more than the value of the dispute.

The DRP creates a flexible framework within which parties can custom-design a timely, cost-effective resolution of such disputes. Rosen highlighted the few, fixed features:

First, the parties must agree on a single neutral arbitrator. AIRROC maintains a list of arbitrators, who, as a service to the community, have agreed to perform DRP arbitrations for \$150/hour.

Second, the DRP presumes there will be no discovery, unless parties agree otherwise.

Finally, there will be no live witnesses or other hearing testimony, and the process is confidential, with a binding final award that will be enforced only if there has not been compliance.

Thereafter, Karen Amos (Resolute) and Marianne Petillo (ROM Re) candidly shared their experiences in successfully resolving smaller dollar disputes. In a discussion moderated by Seema Misra (Stroock), the audience was given a roadmap of the issues, questions and considerations in designing a DRP arbitration. Both Amos and Petillo agreed

Educational Panels (continued)

that early cooperation in selecting the arbitrator, or failing that, another random selection process, was critical. The Panel then presented the variety of features which the parties could agree on, such as the form of award (including, high-low damages), limited use of counsel, the scope of discovery (documents and depositions), and whether the hearing required testimony. It was evident that if parties are committed to the process and maintaining their relationships, the DRP provides a valuable alternative means of dispute resolution.

The audience then separated into cedent and reinsurer groups and discussed three fact patterns – aggregation, late notice, and contract interpretation. Each group was asked to brainstorm if it could use the DRP, and if so, how to tailor it to the facts. The breakouts and subsequent negotiations provided a

lively means of discussing what aspects of traditional arbitration were truly necessary. All of the groups reported that they had agreed to use the DRP, as well as the qualifications of the single arbitrator. In a closing voting session, 43% of the audience reported it would use the DRP without qualification, and the remaining 53% would use it for smaller disputes. The audience identified impediments, in order: (i) the inability to agree on a single arbitrator (43%); (ii) counter parties' refusal to use the DRP (30%); (iii) lack of knowledge of the process (17%); and, (iv) the suitability of available arbitrators (11%).

Seema A. Misra, Partner in the New York office of Stroock & Stroock & Lavan LLP. smisra@stroock.com

Where Goest Thou?

Future of the Runoff Industry

Summary by Frank DeMento

On October 15, 2013, Lloyd Gura of Mound Cotton Wollan & Greengrass moderated a panel led by Jim Moran of R&Q Liquidity Management, Ali Rifai of Zurich Centrally Managed Businesses, Steven Ryland of Armour Risk Management Ltd., and Frank DeMento of Crowell & Moring. The title of their presentation was, "The Evolution of the Run-Off Industry: A Prospective Look."

The panel began by exploring recent changes in the run-off industry during the last five years. Such changes include

months also include low interest rates, combining simple and complex claims operations, greater regulatory oversight, minimum capital requirements, the cost of overhead and operating expenses, legacy exposures freezing capital and increasing uncertainty, not to mention medical inflation.

The panel then moved from discussing the challenges facing companies with legacy business to discussing how to more efficiently manage internal blocks of run-off business, the benefits of properly managing run-off liabilities (capital extraction), and then offered solutions to regulatory challenges in the US, Europe and Bermuda. The panel concluded by focusing on the future of the legacy M&A markets in the US, UK, Continental Europe and beyond. The panelists offered advice on opportunities for growth and how to best develop



the emergence of a few large run-off entities from a much larger pool of smaller entities, a large increase in the number of investors in run-off, and a diversification of business lines entering run-off.

The panel then moved on to discuss the current run-off market place. It was the consensus that long tail risks and capital efficiency drive the market. Run-off entities are assuming these long tail risks by portfolio transfers and purchasing entities or captives. However, the acquisition of run-off is becoming increasingly difficult as a result of increased regulation and reserving issues. Challenges for the legacy sector in the next twenty four

untapped markets to drive future growth in the run-off industry. The run-off sector is growing and continues to draw the attention of companies and investors alike as the potential for capital extraction/capital efficiency increases opportunities to generate value from billions of dollars in reserves year over year.

Frank DeMento is Counsel to Crowell & Moring LLP. fdemento@crowell.com

Page 26: Mark Goodman, Freeborn Peters; Barry Franklin, Zurich; Jay Rosario, Munich Re; Kevin Madigan, PwC. Page 27: Lloyd Gura, Mound Cotton; Jim Moran, R&Q; Steven Ryland, Armour Risk; Ali Rifai, Zurich; Frank DeMento, Crowell & Moring.

NAIC's ORSA Risk Management for the Enterprise – A Trek to Earn Your Star

Summary by Mark R. Goodman

A panel of industry experts discussed the NAIC's "Own Risk Solvency Assessment" or "ORSA" requirements. Kevin Madigan of PriceWaterhouseCoopers LLP, Jay Rosario, Enterprise Risk Manager of Munich Reinsurance America, Inc., and Barry Franklin, General Insurance Chief Risk Officer of Zurich Insurance, North America provided guidance on the ORSA requirements and on what companies should be doing to prepare. The panel was moderated by Mark Goodman, Partner with Freeborn & Peters, LLP.

being considered for adoption in the states. The Model law requires that a company have a risk management framework in place, that it regularly conduct a risk assessment (addressing the factors laid out in the Model Act and in the NAIC ORSA Guidance Manual) and that it provide an ORSA summary report to its lead state regulator, beginning in 2015.

Kevin Madigan suggested that rather than viewing ORSA as just another regulatory burden, companies should view enterprise risk management as an extension of its overall business plan, and as another tool to advance the company's business goals. As Kevin put it, "how would you manage your risks if there were no regulations?"

Jay Rosario of Munich Reinsurance America provided the perspective of his company's approach to preparing

company's approach to the ORSA requirements. Since his company also is part of a large international insurance group, it already has a rigorous risk management framework in place, so that it is well placed to respond to the ORSA requirements when they are adopted by the states. Barry also described Zurich's overall risk management policies for measuring, assessing and managing various types of risks, such as a financial risks (credit risks, investment risks, reinsurance credit risks), underwriting risks and operational risks.

The panel addressed a number of questions, including the confidentiality of the summary ORSA reports to be filed with regulators. All of the panelists shared the concern, evidenced in the NAIC's Model Act itself, that the summary reports must be kept confidential by regulators, since a



Kevin Madigan of PwC provided an overview of the ORSA requirements. Kevin emphasized that the risk assessments that ORSA will require are an extension of the kind of enterprise risk management that companies have been doing for some time. He provided a history of the evolution of enterprise risk management requirements under international insurance regulation requirements, putting ORSA in the context of risk assessment requirements already in place in the EU and elsewhere. ORSA is a response to the International Association of Insurance Supervisors' Insurance Core Principles No. 16, Enterprise Risk Management. The NAIC ORSA Model law was adopted in September of 2012, and is

for the ORSA requirements. As a large international insurance group, Munich Re America already has a rigorous risk management framework in place that will be leveraged to satisfy NAIC ORSA requirements. Echoing Kevin's comments, Jay said that his company views enterprise risk management as a means for generating shareholder value while protecting policyholder interests, and not merely as something to be done to satisfy minimum regulatory requirements. Jay also provided an example of his company's capital ratio thresholds and actions that consider both shareholder and policyholder interests.

Barry Franklin of Zurich Insurance, North America reported on his

company's risk management strategy is highly confidential, proprietary information. The panel also addressed reporting on a company by company basis to different regulators and the importance of not just filing a group risk report. Finally, the panel addressed questions about risk management issues that may be unique or particular to run-off companies or run-off operations of ongoing companies, such as the operational risks created by legacy computer systems, management of personnel in a run-off operation and the management of reinsurance collection and claims management in run-off.

Mark R. Goodman is a Partner at Freeborn & Peters LLP. mgoodman@freeborn.com

Educational Panels (continued)

All Hail the Sovereign

Regulatory Update

Summary by Nick Pearson

Day Two of the education sessions wound up with a presentation on insurance regulatory issues. The panel was moderated by Nick Pearson, a Partner in the Insurance and Reinsurance Department of Edwards Wildman Palmer LLP and the panelists were Martha Lees, Senior Policy Advisor at the New York Department of Financial Services, Denise Brignac, Chief Deputy Commissioner of the Louisiana Insurance Department, Peter Maloney, Chief Legal Officer of QBE North America and Matt Wulf, Vice President of State Relations and Assistant General Counsel of the Reinsurance Association of America.

The panel first addressed the role of the regulator in catastrophe insurance, with specific focus on Superstorm Sandy. Martha Lees described the New York Department of Financial Services' role as seeking to ensure fair treatment of insureds through, among other things, implementing a mediation program for disputed claims and being responsive to policyholder complaints. All members of the panel acknowledged the existence of political pressure to resolve claims in

the context of large scale catastrophes, but agreed that it was important to recognize the legitimate need of insurers to only pay those claims rightfully falling within the scope of coverage.

The next topic dealt with federal and international solvency standards, and specifically whether or not insurance companies should be subject to federal solvency regulation under Dodd-Frank, and the appropriate role of solvency standards being promulgated by the International Association of Insurance Supervisors. Matt Wulf felt that the application of solvency standards by the Federal Reserve Board to those insurers designated as systemically important was potentially problematic in light of the difference between the businesses of banking and insurance. The rest of the panel agreed and also expressed concern about the lack of insurance regulatory experience at the federal level. There was general agreement that adoption of international solvency standards at the state level would be met with considerable resistance and the panelists did not expect to see their implementation.

The panel then turned their attention to the possibility of broader federal regulation of insurance. Denise Brignac thought it was highly unlikely that the federal government would seek to take on a substantially greater role as a regulator, although she expects to see the

federal government seek to play a greater role in certain specific areas such as healthcare. On the whole, the panel felt that there was little likelihood of a move from state-based to federal regulation.

The final topic addressed by the panel was insurer insolvency under the state-based system currently in place. Pete Maloney opined that a typical insurance company insolvency takes too long and was concerned that assets that otherwise could be distributed to claimants were getting paid out in administrative expenses over the course of the many years the estates are typically kept open. The other panelists agreed that this was a problem but, given the need to treat similarly situated claimants equally, there was no consensus on how the process could be abbreviated. This was particularly true in light of the potential for reinsurer liabilities being enlarged if liquidators were allowed to close out estates based on estimated liabilities.

At the close of the panelists' discussion, there was a brief but lively question and answer period. ●

Nick Pearson, Partner, Edwards Wildman Palmer LLP.
npearson@edwardswildman.com

Panel (from left): Denise Brignac, Louisiana Insurance Department; Martha Lees, New York Department of Financial Services; Peter Maloney, QBE Re; Matthew Wulf, RAA.



...a broad systems-level view and a multiple-integrated perspective view help illuminate emerging “rare” outcomes.

We Can Predict the Unpredictable

Rendez-vous Keynote Speaker Dr. Guntram Werther



By Peter A. Scarpato

Called in at the last minute to substitute for New Jersey Commissioner Kenneth Kobylowski, Dr. Guntram Werther was AIRROC’s Keynote Speaker on the topic, “When Black Swans Aren’t.” Dr. Werther is a professor of Strategic Management at the Fox School of Business, Temple University.

A Black Swan event is a rare, large-scale, large-impact unpredictable occurrence, such as 9/11. In his presentation, Dr. Werther disputed the findings of analysts such as Nassim Nicholas Taleb, author of *The Black Swan: The Impact of the Highly Improbable*, that virtually all such catastrophes cannot be forecasted under current methods. Dr. Werther’s contribution to this dialogue is to offer solutions to help better forecast such events, eliminating their classification as “black swans.” In particular, he hones in on the quantitative and qualitative methodological relations between and timing of observable changes in data to improve the predictability of the unpredictable.

One of Professor Werther’s key premises is our current individual, organizational and some say myopic overreliance on complex models *alone* to forecast catastrophic events, derived from a lack of synthetic/syncretic thinking. In fact, if we apply the proper combination of technical data and inferential analysis, “[m]ost ... rare, large-scale, large impact events have practically knowable emergences.”

There are, in Dr. Werther’s view, cognitive and philosophical groundings and perspectives that improve forecasting and risk/uncertainty assessment. “It’s generally a matter of perspective,” he noted, using the example of the world from the standpoint of the turkey and turkey farmer. To the turkey, fed and cared for 364 days of the year, all is fine until Thanksgiving, when its world abruptly ends. But to the turkey farmer, the entire year leads up to this very, well-known event. So, in attempting to predict the turkey’s unpredictable demise (from the turkey’s perspective), we must examine and integrate broader perspectives of US culture to ensure

we analyze and understand the world from the turkey farmer’s view. We must avoid single disciplinary explanations and foster multidisciplinary, holistic thinking and “syndrome” views. And we must use relevant lessons from history, remembering that “history doesn’t specifically repeat itself, but does generally rhyme.”

Bottom line: a broad systems-level view and a multiple-integrated perspective view help illuminate emerging “rare” outcomes. The concept of syncretic thinking is crucial: be grounded within changing processes and focus specifically on changing forms. We must teach future analysts to learn holistic profiling of change processes, to deal better with the interface of quantitative and qualitative issues and better judge the timing of a system’s shifting events. Just before catastrophic events, noted Dr. Werther, certain analysts or models begin to diverge significantly from the usual, mainstream opinions, a signal that something is coming.

This thinking applies to economic, socio-political and global/regional crisis forecasting. In fact, Dr. Werther cited several examples of what others called Black Swan events that, under close scrutiny, were indeed predictable: 9/11 (the FBI had several warnings) and the 2008 financial crisis (predicted by analysts in 2005).

Dr. Werther, along with Tom Edwalds from Munich Re and Ken Madigan from PWC, will participate in a roundtable discussion, published in the first 2014 issue of AIRROC Matters, focusing on the application of Dr. Werther’s analyses to insurance and reinsurance. ●

Peter A. Scarpato is Editor and Vice Chair of AIRROC Matters. peter@conflictresolved.com

Above: Dr. Guntram Werther and Peter A. Scarpato.

Karl Wall Wins Annual Accolade AIRROC Run-off Person of the Year 2013



By Connie D. O'Mara

Kathy Barker, AIRROC Board Co-Chair, presented Karl Wall, Non-Executive Chairman of Enstar Holdings US, with the 2013 Run-off Person of the Year award. The award was sponsored by Butler Rubin Saltarelli & Boyd LLP. As members know, this award is presented each year to recognize the most effective and innovative individuals in the run-off industry. Mr. Wall was nominated and selected by his peers. His extensive career in the effective management of run-off books epitomizes the professionalism of the industry.

Karl began his career in run-off in 1981 working for a division of Providence Capital Group on the Slater-Walker run-off in London. He credits Shaker Youssef, a good friend and mentor, and an early pioneer in run-off management, with introducing him to this segment of

the business. In his acceptance speech at this year's Rendez-vous Reception and Dinner Cruise, Karl pointed out that he had never met anyone who started out wanting a career in run-off, but looking back over three decades, he described how run-off managers have faced challenges and financial problems that have created a dynamic and sophisticated profession.

His history of innovation includes participation in the management buyout and runoff of American Centennial Insurance Company and Consolidated Insurance Limited (UK) from Beneficial Financial Corporation (DE) in 1987. He also served as Executive Vice President of Facility Insurance Corporation from August 1997 until December of 2003; that entity was formed as the result of his work with members of Swiss Re in privatizing the Texas State Workers' Compensation Facility. In 1999, he was

part of an investor group that acquired General Accident Company of Puerto Rico. He started International Solutions LLC in 1996 and worked there until 2005 when he joined Enstar US. Enstar Group's core focus is to acquire and manage insurance and reinsurance companies in run-off and provide management, consulting and other services to the global insurance and reinsurance industry.

In his remarks, Karl speculated about where the source of run-off work will be in the future. Whatever the source of future challenges, AIRROC congratulates him on having the ingenuity and professional expertise to deal with those opportunities and craft efficient solutions. ●

Connie D. O'Mara of O'Mara Consulting, LLC.
connie@cdomaraconsulting.com

Above: Kathy Barker, AIRROC Board Co-Chair and Karl Wall, Enstar.

Trish Getty Scholarship

Nathan Ortiz is Second Recipient

Nathan Ortiz, a junior in Actuarial Science at St. John's University, became the second recipient of AIRROC's Trish Getty Scholarship Fund. Mr. Ortiz graciously accepted the \$5,000 scholarship on board the Hornblower Hybrid yacht during the reception and cruise event on October 15, 2013. He remarked that he is "proud and honored to receive the scholarship and looking forward to joining the insurance industry when he graduates." Trish Getty, AIRROC's Executive Director emeritus and namesake of the scholarship, attended to present the award. She noted that Nathan's enthusiasm for the field and interest in



the business exemplified the reason that the scholarship was established.

Mr. Ortiz is on the Dean's List with a 3.62 GPA. He has successfully completed one qualifying actuarial exam and is currently employed part time both as an underwriting intern at XL Group and at UPS.

Trish said, "This young man is amazing and obviously a creative thinker. One

comment Nathan made to me was that he loves weight lifting at the gym and he applies that energy to his real life work. He also talked about his hardworking family, as exemplified by their sacrifice and dedication to work. I was so proud to present this award to Nathan." ●

Above: Carolyn Fahey, AIRROC; Nathan Ortiz; Trish Getty

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Mallon Preaches Diversity

Women's Networking Luncheon

States and Bermuda, providing both traditional public relations consultancy and social media training and advice. A recognized thought leader in social media, Mairi tweets as @reinsurancegirl, and LexisNexis has voted her reinsurancegirl blog one of the top 50 blogs in the insurance law community for two years running. Prior to founding Rein4ce, Mairi was a senior insurance and reinsurance journalist writing for most of the re/insurance industry trade publications.

In her address, Ms. Mallon gave the audience some insight and advice on how to utilize social media to develop a personal brand. She said that to effectively use the new communication tools you need to determine what you want to say and who your audience is. She noted that @reinsurancegirl on Twitter now has 5,000 followers! While this isn't very large in the grand scheme of Twitter activity, this is certainly an incredible accomplishment in the reinsurance world. As insurance company use on Twitter becomes more prevalent, individuals and companies should look at the examples of companies such as Travelers, Chubb

and Swiss Re that have very effective campaigns to provide information to their audiences about the companies.

As this was a Women's Networking Luncheon, Mairi touched on some of the challenges professional women face, and shared some telling comments that she had either overheard or had been made to her throughout her career. While this hasn't hindered her success, she feels that women who succeed have to become quite skilled in dealing with discriminatory situations – she cited statistics that only 4.2% of the US Fortune 1,000 companies and only 2.1% of the Fortune 500 have Women CEOs. In closing she offered that all industries would benefit from education geared toward both men and women about the benefits of having diversity on boards and in leadership positions in companies.

After Ms. Mallon's address, she and the attendees had a lively discussion sharing experiences and views that some of the individuals had experienced over the course of their careers. The discussion was enlightening for all who attended. ●

Carolyn Fahey is Executive Director of AIRROC.
carolyn@airroc.org

By Carolyn Fahey, AIRROC

The Women's Networking Luncheon was sponsored by Edwards Wildman Palmer LLP. Both men and women attend this lunch, a signature part of the NJ event. The luncheon drew a crowd of about 75.

Leah Spivey of Munich Reinsurance America (member of the AIRROC Board of Directors and Co-Chair of AIRROC's Publication Committee) welcomed the keynote speaker, Mairi Mallon, Rein4ce co-founder and Chief Executive Officer. Mairi is a well-known insurance and reinsurance public relations professional who is one of the industry's leading proponents of social media. Mairi has worked with companies in London, the United



@reinsurancegirl says developing a personal brand is important for women in the insurance industry





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Adrian Mecz (UK)
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For more information please contact:
Joe McCullough, 312-360-6327
jmccullough@freebornpeters.com