Special Year-End Issue



*For a complete index, see page 4*

Association of Insurance and Reinsurance Run-off Companies

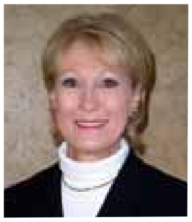
# AIRROC Matters

A Newsletter About Run-off Companies and Their Issues

Vol. 3 No. 2 | www.airroc.org | Winter 2007/2008

**Message from CEO and Executive Director**

## AIRROC Makes a Difference


Trish Getty

*By Trish Getty*

Once again, the AIRROC/Cavell Commutation & Networking Event held October 15-17, 2007 was a tremendous success. Our hat's off to Commutation Event Chair Art Coleman and Cavell for their incredible work together to bring us an event that runs smoother each year. We are also very thankful to the many others – too many to list - who labored behind the scenes to pull everything together. AIRROC extends a tremendous thank you to both our event sponsors and Cavell who made this event possible.

Jonathan Bank (Locke, Lord, Bissell) and Kathy Barker (Mitsui Sumitomo/Pro Solutions) co-chaired our education program presented by Mealey's, which offered an excellent faculty of speakers and topics targeted for the run-off market.

During the lovely gala dinner, our 2007 AIRROC Run-Off Person of the Year was awarded to the General Counsel of National Indemnity Re/Berkshire Hathaway Brian Snover, who entertained us with witty remarks during his acceptance speech. Congratulations, Brian! He later commented to me, "Look at what you have done to me, Trish! The first two Run-Off Persons of the Year are currently unemployed."

Following dinner, we were entertained by the band "Commutation Aid" that included Mike Walker of KPMG who sang "Hey Jude" and other Beatles' tunes in fine form. Everyone had a marvelous time, enjoying each

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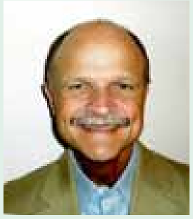
**Notes from the Editor**

## A Bit of the Old, A Bit of the New…


Peter Scarpato

*By Peter Scarpato*

In this year-end issue, we offer a bit of the old, a bit of the new: updates of articles' past, opinions of run off's future; summaries of presentations made, announcements of noteworthy events; words of success from our Executive Director Trish Getty and of encouragement from our departing Chair Andrew Maneval, to whom we ALL offer our deepest, sincerest "thank you."

In "Why We Work in 'Run-Off'" Andrew Maneval presents an amusing, honest and positive must read for all in this business occasionally haunted by undeserved self-doubt. Next, "Run-Off, Past, Present and Future"

*continued on page 3*

### Notes from the Editor

## A Bit of the Old, A Bit of the New…

continued from page 1

presents an interview Jim Veach and I conducted with Paul Dassenko and Oliver Horbelt, AIRROC's past and current Run-off Persons of the Year. Their comments explore the exciting contours of where we've been, where we are and, most importantly, what may lie ahead: an insightful analysis of capital markets, unique and potentially prophetic runoff transactions, the role and impact of existing, developing and debated regulations, and successful trends in run-off practice worldwide. We also present "BAIC and Scottish Lion Decisions: A Wake-Up Call for U.S. Creditors to Challenge Fairness of U.K. Solvent Schemes," by Joseph J. Schiavone, Jeffrey S. Leonard, Christopher P. Anton and Leslie J. Davis. In this condensed version of an article appearing in the February 16, 2006 edition of *Mealey's Litigation Report: Reinsurance*, the authors discuss subsequent cases that addressed fairness issues originally raised in the *BAIC* and *Scottish Lion* decisions.

And AIRROC's progress continues: in her article "AIRROC Makes a Difference," Trish Getty highlights our programs' continuing successes, most notably our October 2007 Commutation Event with Cavell, and presents the events calendar for 2008, including the March 5, 2008 AIRROC/Cavell Commutation Day at Le Parker Meridien, NYC. From the February 2007 New York Commutation Day, we present "Panel Discussion Special: London Market Update," comments from an AIRROC/Helix UK Ltd panel moderated by Mike Palmer and including Mike Walker, Philip Grant, Peter Sharp and Julian Ward. The panel discusses developments and trends in the London run-off market, including consolidation, two-tier service standards, price hikes and a breakdown of traditional processes. Also, for those who either could not attend or would like a refresher, Bina Dagar and other Publication Committee members present "Mealey's Educational Sessions," a summary of topics discussed at panel sessions from the Commutation and Networking Rendezvous in October 2007.

As promised, "something old and something new:" Nigel Curtis' ever-evolving, ever-important KPMG "Policyholder Update" and a NEW regular feature, the "Present Value" page, designed to keep us informed of current events and comments involving companies, people and transactions in our market. Contributions from members openly and thankfully accepted.

Also, our next newsletter, a special edition on dispute resolution, will include a roundtable discussion on topical issues in run-off dispute resolution and articles exploring matters such as pre-hearing security, panel appointment, arbitration versus litigation versus mediation, ways to improve run-off dispute resolution, and other matters unique to our corner of the business.

Finally, I wish to thank our Board, Ali Rifai, our Publications Committee Chair, all Committee members whose tireless, diligent work produces this publication, and YOU, AIRROC's membership, for your continuing interest in and support of *AIRROC Matters.* This is your voice.

Let us hear from you.

Best wishes for a happy, healthy and prosperous Holiday Season and New Year! ■

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

## AIRROC – In this Issue

### *Special Year-End Issue*

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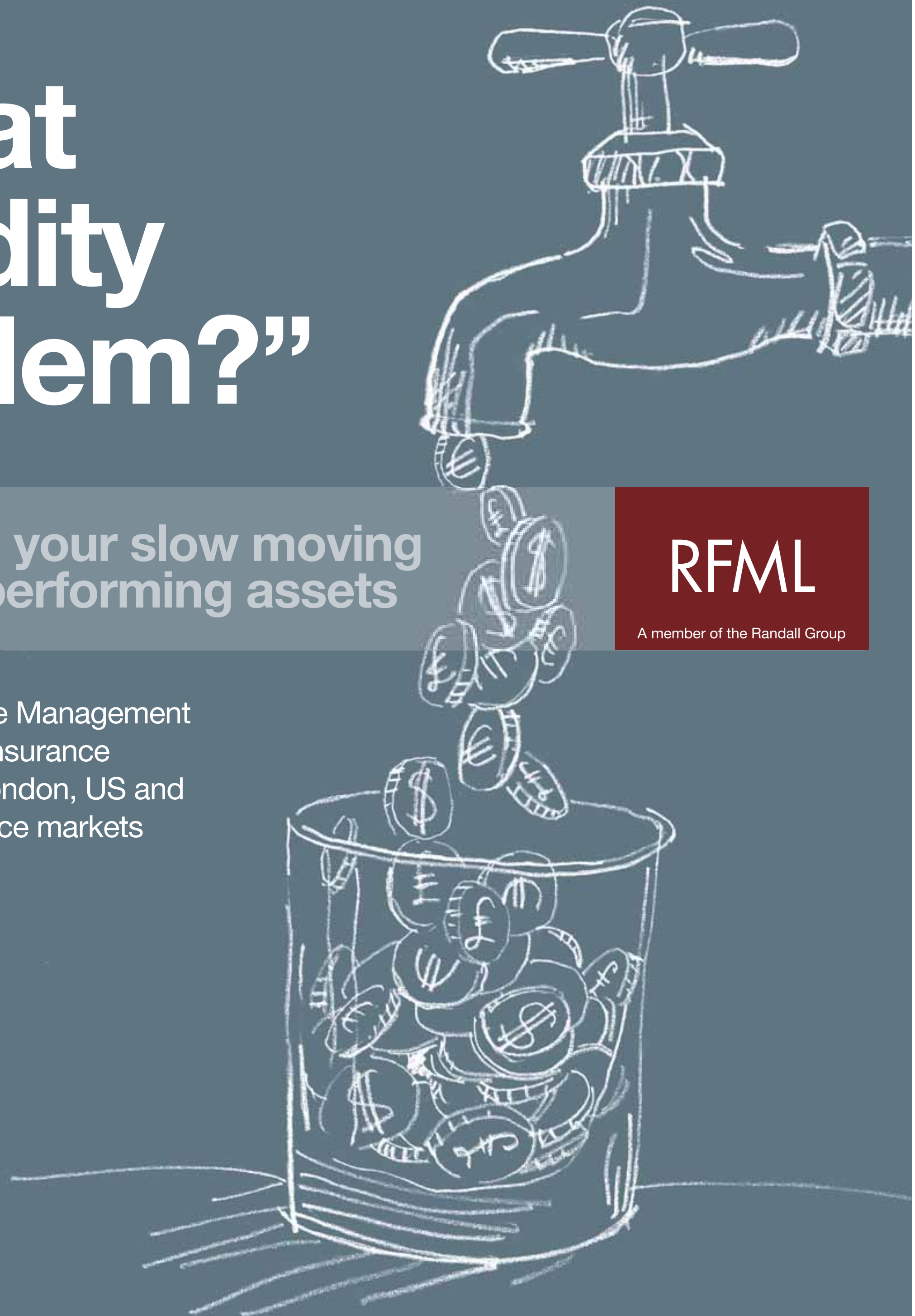
## AIRROC Board of Directors



**Feature Article**

# "Why We Work in 'Run-Off'"

Andrew Maneval

*By Andrew Maneval, Chair, AIRROC Board of Directors*

We are sometimes asked, "Do you like your job?" We may happen to get invited to parties and are asked, by new acquaintances, "What do you do for work?" These seem like such easy questions. But we answer them vaguely or softly, change the subject, or even just make something up. Once, I worked as "a repairman for the Hubble Space Telescope." I know — *Calling Dr. Freud!*

First, there is *anyone* who works for an insurance company. Then, there are people whose job it is to "downsize" their companies! If you're in "claims" and you're not Wallace Stevens, keep quiet at the party. Or maybe you're a bill collector. That's well liked. Are your days spent on GAAP and stat accounting? An "actuary"? And, what's *reinsurance?* This is like jumping from ring to ring in Dante's Inferno!

What we do, every day, is about solving the very toughest problems. More often than not, those problems have been so large they wore down our own companies!

Why *do* we work in run-off? I know us. I've been one of us for a long time. We really like what we do. So, the better question is, how do we explain *to others* why we do this work? Can we convince others to move over into the run-off operations from the ongoing insurance business, to accept job offers in our companies, or to join up as workers in our industry?

Do we need to convince anyone else? It's so hard to do. Katrina losses occur and most of society paints a mustache on the evil insurance professional's face. An insurance company becomes insolvent and everyone thinks "Enron".

But that's precisely where the key is for finding the pride and fulfillment in our work. What we do, every day, is about solving the very toughest problems. More often than not, those problems have been so large they wore down our own companies!

So, we deal not with one problem at a time, but with *three:*

**First**, the threshold problem of insureds and reinsureds that have sustained terrible losses and need loss payments;

**Second**, the problem of stakeholders in our companies, trying, through us, to find a means by which to pay valid claims, to make good on the original promise, to fairly and promptly distribute assets that rightly belong to creditors, or to permit the movement of capital into productive, valuable activities; and

**Third**, the problem of performing these many critical functions when we are generally disliked, mistrusted, challenged, and harassed by customers, parent companies, state insurance departments, politicians, and basically everyone else, probably down to the *actual* repairmen of the Hubble Space Telescope!

…we have the broadest opportunities for resolving complex, impenetrable, multi-faceted problems of any job I know. For most of us, the field of endeavor is wide open.

This may sound like complaining, but it's not. These features are exactly the most exciting and rewarding aspects of run-off work: we're active where the greatest need exists. I'm not comparing us to EMTs but, in the corporate world, we live in the absolute *vortex of troubles.* By residing there, we have the broadest opportunities for resolving complex, impenetrable, multi-faceted problems of any job I know. For most of us, the field of endeavor is wide open.

There is an old saying that compares the sometimes

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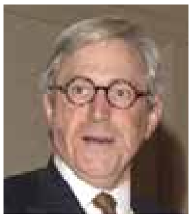
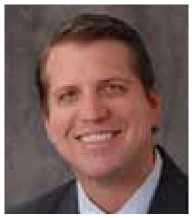
*Andrew Maneval is President of Horizon Management Group, LLC, a subsidiary of The Hartford Financial Services Group, Inc. where he is responsible for managing run-off operations. His e-mail address is amaneval@horizonmgt.com*

Think Tank

# Dassenko and Horbelt: Run-Off Past, Present, and Future


Paul Dassenko


Oliver Horbelt


James Veach


Peter Scarpato

*Editor Peter Scarpato and Publications Committee member James Veach, interviewed Paul Dassenko and Oliver Horbelt, AIRROC's past and current Run-Off Persons of the Year, to get their take on the state of the run off industry — past, present and future. Our thanks to Paul and Oliver for their insightful (and inciting) comments.*

**P. Scarpato:** During your tenures as AIRROC's first and second Run-off Persons of the Year, what were the most significant developments in the run-off industry?

**P. Dassenko:** During my year, those responsible for managing capital — both private equity and on balance sheets of insurance and reinsurance companies — became very interested in run-off. That interest continues to grow and the level of interest is extraordinary.

**O. Horbelt:** Private equity and hedge fund money came into this market on a very opportunistic basis. The run-off industry as such had not done the best job managing capital efficiently. This opened the window for players seeking interesting investment vehicles.

> **The run-off industry as such had not done the best job managing capital efficiently. This opened the window for players seeking interesting investment vehicles. – Dassenko**

Another trend that I saw — not so much to completion but ongoing — has been the development of Solvency II. When fully implemented, Solvency II will influence how run-off is conducted and how insurancompanies in general manage their existing liabilities.

**P. Dassenko:** Solvency II will make companies that have been able to ignore capital efficiency focus on these issues and, in turn, may guide them towards managing

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*Paul Dassenko is Principal and Sole Shareholder of Azure Advisors, Inc., a firm specializing in advice to insurers on run-off and solvency issues. He is also an active arbitrator and is on the IAIR arbitrators' list. Until March 31, 2007, he was President & CEO of Converium Reinsurance (North America) Inc., before which he served as Managing Director of GIO Insurance Ltd (Australia) and Director of Insurance Operations and Senior Officer of Transit Casualty Company in Receivership. He can be reached at pedassenko@aol.com.*

*Oliver Horbelt is an independent consultant with advisory mandates in the areas of run-off management and insurance risk securitization. From 2003 until summer 2007, Oliver was managing the Centre Group of Companies, most recently as President and Chief Executive Officer. Before joining Centre, Oliver was a Managing Director at Swiss Re and a member of Credit Suisse First Boston's Equity Capital Markets practice. He can be reached at ojh218@yahoo.com.*

*James Veach is a Partner with Mound Cotton Wollan & Greengrass. He concentrates his practice on insolvency, reinsurance arbitration/litigation, commutations, contract wording, government relations, and other run-off-related matters. He can be reached at jveach@moundcotton.com.*

their run-offs more tightly or disposing of them.

**J. Veach:** Both of you are speaking at the International Association of International Receivers Capital Market's Conference on October 24th. Is that event more evidence of interest in run-off investment opportunities?

**O. Horbelt:** I think so. We'll still have to see if we are talking about a sustainable business model or if it's just been a couple of opportunistic trades. But whenever you have sophisticated markets participating in our run-off market, it's a serious indication that there's a sea of change underway and that we haven't seen the end of that change.

It is inconceivable that other large balance sheets with extraordinary credit ratings are not thinking: "Why can't we manage not only our capital but our earnings with a tightly focused, robust run-off operation?" – Dassenko

**P. Dassenko:** The lineup of speakers at the Capital Markets conference is extraordinary and good evidence of the level of interest.

**P. Scarpato:** Going back to Solvency II, can you comment on how that may affect run-offs and/or schemes of arrangement.

**P. Dassenko:** I don't know whether it will dramatically affect current schemes or run-off plans. My thinking has been focused on how this interest might affect books of business where people haven't looked at run-off seriously or haven't considered its implication.

**O. Horbelt:** The whole area of capital management will be highlighted and at the forefront of strategic thinking in the insurance industry in the future. Run-off — that is, the management of existing liabilities and what to do with them — will become more prominent and integrated.

**P. Dassenko:** This field is now clearly dominated by Berkshire Hathaway. It is inconceivable that other large balance sheets with extraordinary credit ratings are not thinking: "Why can't we manage not only our capital but our earnings with a tightly focused, robust run-off operation?"

But the difficulty for much of the private equity market is the sell side, not the buy side. Private equity as buyers are extremely interested. It's the sellers and regulators that have difficulty with private equity as a run-off investor.

**P. Scarpato:** Will Berkshire Hathaway's deal with Equitas legitimize this area of investment for other companies?

**O. Horbelt:** If they have the appetite and courage to make those kind of long-term bets in latent exposures, yes. Berkshire Hathaway has a unique business model that will be hard to duplicate.

**P. Dassenko:** I'm not sure it will be interesting for others to duplicate. But they can meet other objectives by looking for similar types of run-off opportunities. Compared to Berkshire Hathaway, Swiss Re has only stuck its toe in the water and that's probably true for Munich Re as well.

**O. Horbelt:** Yes. Swiss Re has been very active on the life side, where they have been buying quite a lot of closed blocks of life transactions. But it's true that the whole field of the property/casualty run-off has been left to Berkshire Hathaway to harvest.

The whole area of capital management will be highlighted and at the forefront of strategic thinking in the insurance industry in the future. – Horbelt

**P. Dassenko:** The real opportunity here is for large balance sheets to have a counter- cyclical business unit that can provide earnings when the rates in the marketplace and underwriting are not where they should be and throw off reserves when needed to offset an extremely strong rating cycle.

**P. Scarpato:**Will the state of the run-off business in 2008 and beyond go in these directions?

**P. Dassenko:** We need to see more successful transactions outside of Berkshire Hathaway to really look into our crystal ball and say, "This is the future."

**O. Horbelt:** With respect to established market participants, I don't expect an increased level of interest or appetite for significant run-off transactions in the next two to three years. With Solvency II requirements developing, however, I think we will see increased interest in securitization options to manage an in-force

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book of business and to use capital market solutions to increase capital efficiency.

P. Dassenko: That's an extremely important point. If private equity becomes more successful in acquiring run-off portfolios, the time horizon for realizing the benefits will be much shorter than some portfolios can accommodate. This creates a need for securities products that operate on a longer time horizon, which is absolutely critical to maintain private equity's interest.

O. Horbelt: A small number of very successful hedge funds has engaged in insurance-linked securities and has a very sophisticated investor structure already participating in life and non-life exposures. And the hedge funds have managed successfully to transfer insurance risk into tradable capital markets securities. In the long term, that's where the focus will be. In the meantime, we'll see some opportunistic trades, but I don't think the market as such will become much more efficient.

P. Scarpato: Let's shift gears to regulation and regulators. Do state and other regulators accept and support decisions to place books of business or entire companies into run-off?

P. Dassenko: My experience with regulators is extremely positive. This is true both in a sale of the portfolio, which is the most recent transaction I've been involved with, as well as when a company is capital-impaired.

[N]ot sure that we always do a good job of communicating with regulators in anticipation of the need for their support in run-off. – Dassenko

The regulators I had the privilege to deal with were intelligent, supportive, and there when I needed them.

O. Horbelt: You can't help but compare insurance regulators with what the Federal Reserve is going through right now. They've played this dual role of keeping markets intact while making sure that our ultimate customers — policyholders — are being served. That's a very difficult task to manage. I've always found regulators here and abroad to take a pragmatic view as long as it can be proven that policyholders' interests are being addressed.

P. Dassenko: I'm not sure that we always do a good job of communicating with regulators in anticipation of the need for their support in run-off. Sometimes those of us who work for a company's owners — the shareholders — aren't always good about saying: "This is coming down the pike," giving regulators a little warning, and seeking their input early on.

This allows me to segue into one of my favorite topics — the importance of the run-off team and the highly focused individuals who have to execute a run-off plan. That's a missing component. There's no question about the interest of capital markets and about the regulators' support for a solution to discontinued books of business. What we don't always do is execute a tightly focused run-off plan.

I don't know about companies jumping in when a company is under siege from the rating agencies. That involves a lot more management and hands-on experience than most private equity groups possess. – Dassenko

The difference between run-off and underwriting is that in run-off your margin for error could be next to nil. If you're underwriting and rates are good and profits are great, your execution can be terrible, but the company is still going to do just fine. But ultimately, if capital finds a way to be more efficient in our business, I think the model that we use in run-off, the model we use for decision making, capital allocation, and managing claims and investments will be a model that's embraced in other aspects of the insurance industry and may not be limited to the insurance industry.

J. Veach: Will private equity funds or capital markets invest in a company with a declining rating and try to turn it around?

O. Horbelt: Wasn't that kind of what happened at Converium, Paul?

P. Dassenko: In many ways we had taken much of the risk away from the investment before the company was auctioned. We had twenty-four months of reserve stability and twenty-four months of solid earnings. Things looked pretty good to potential buyers.

Ultimately, Berkshire Hathaway was successful in its bid, but I don't know about companies jumping in when a company is under siege from the rating agencies. That involves a lot more management and hands - on experience than most private equity groups possess. And if the company is headed into a tailspin, private equity investors may not have the confidence in existing management to follow it down.

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**J. Veach:** Would private equity hesitate for fear of regulatory impediments?

**O. Horbelt:** Gerling is a good example. No existing larger reinsurance company thought that acquiring the business for renewal and expansion purposes would be meaningful because part of the business would end up with them anyway. At the same time, meaningful private capital did not move into the company and we all know what happened.

I agree with Paul that if the managers of private equity cannot prove that they can do a better job operating the company, they will never be able to convince their capital providers to enter into the transaction and the regulators won't see any reason why they should approve it.

**P. Dassenko:** If the regulators see a strong parent behind a troubled company or a non-performing portfolio of business that's a good candidate for run-off, I can't envision a scenario where regulators would opt for private equity over the regulated balance sheet. The regulator will favor the balance sheet that's under his/her control and supervision in every instance.

Certain private equity managers may talk about time horizons for releasing dividends and aggressive strategies for dealing with claim payments, but regulators want to hear about policyholders being satisfied to the full extent of their contractual obligations and employees being treated fairly. Those are not themes that all private equity people have focused on sufficiently.

**P. Scarpato:** To operate better and more efficiently, does the run-off industry need more legislation and more regulatory oversight, or less?

**O. Horbelt:** A very tricky question. Usually with regulation, I would think less is more in a highly efficient, stable marketplace where market forces take care of little eruptions in the market. But the insurance industry as such has not proven to be efficient and stable.

> The amount of supervision that the industry receives is tremendous if you think about it, yet all the forces combined have not prevented the fallout that we have experienced recently. – Horbelt

Let's not forget the role of the rating agencies, for example. The amount of supervision that the industry receives is tremendous if you think about it, yet all the forces combined have not prevented the fallout that we have experienced recently.

I don't think that increased regulation per se is an effective means to control the run-off market, at least not with respect to policyholder protection.

**P. Dassenko:** Regulators should stay with their existing brief and that is to look after the policyholder and increase industry and policyholder options to make the market a friendlier place for additional capacity.

> … when it comes to a real crisis, regulation will always be reactive. Therefore, less regulation is probably more desirable — a price that one pays for believing in free market forces. – Horbelt

If regulators succeed in those areas — and they limit themselves to those areas — I think that's enough for capital to seek its own level, and then determine the level of interest it has in run-off business.

**J. Veach:** Is there an area where regulators could exercise more freedom to assist in run-off operations? One thing that comes to mind is the Regulation 141 plans in New York, the only state where this option exists.

**O. Horbelt:** Regulation 141 in New York — which I know has attracted interest from the private equity side— allows those markets to acquire potentially long-term liabilities and then scheme them out similar to an arrangement in the UK or in Bermuda. But when it comes to a real crisis, regulation will always be reactive. Therefore, less regulation is probably more desirable — a price that one pays for believing in free market forces.

**P. Dassenko:** If regulators feel constricted by the existing statutory framework or the existing regulations, that's exactly what should happen. Ultimately, regulators have a very specific job and that is to protect policyholders and to create an environment where policyholders have plenty of market choices.

**J. Veach:** What is the most progressive jurisdiction in the world with respect to run-off and how far behind is the United States?

**O. Horbelt:** Given the UK's historic market position, its regulations have proven to be effective for both the marketplace and policyholders in achieving finality for potentially long-term liabilities.

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**P. Dassenko:** I suppose I would highlight the options available for run-off in the UK and Bermuda, both of which have a history of schemes, as well as Australia, which has the possibility of schemes. Ultimately, the European community is going to have a fairly forward-thinking legislative and regulatory climate. But efficiency is not the objective for every policyholder or every reinsured.

The United States is focused on consumer protection and inefficiencies are generated at a level where the consumer doesn't need the regulator's protection. I'm thinking of very large corporations who are perfectly capable of looking at the solvency of their insurer or reinsurers, making a decision, and ultimately suffering the consequences if their analysis is imperfect.

In the United States, we protect Fortune 50 companies pretty much the same way we protect widows and the orphans. Sophisticated buyers of insurance or reinsurance probably need little or no protection from their regulators. I would not lower the level of protection for homeowners and small business people — that's an area where efficiency shouldn't be the primary objective.

> …but we often see a paralysis in a liquidation where you have trade-offs between the speed of pay-out versus the guarantee that policyholders across the board are being treated equally. – Horbelt

**J. Veach:** Both of you discussed regulators and their role protecting policyholders. Do you believe regulators are only concerned about policyholders until a company fails and then almost forget about them?

**P. Dassenko:** I don't know if they're forgetting about them. Many policyholders have access to guaranty funds which take some pressure off regulators.

**J. Veach:** I was thinking about those widows and children and the more fortunate Fortune 50 companies. Guaranty fund payments usually top out at $300,000 - $1,000,000. Isn't there a lot of pressure on regulators to free up these claims and pay out money to policyholders who may feel that they've been forgotten?

**P. Dassenko:** If we could tier liabilities between those consumers who need protection and those consumers who don't deserve that level of oversight, we could achieve greater efficiencies in liquidation in the United States. Money would flow more quickly, liquidations would be a great deal less expensive, and ultimately more money would go into the policyholder's pocket.

**O. Horbelt:** That goes back to what Paul said about fairness of regulation. The regulators' job is to treat policyholders fairly and equally, but we often see a paralysis in a liquidation where you have trade-offs between the speed of pay-out versus the guarantee that policyholders across the board are being treated equally.

**P. Dassenko:** The statutes tell you that the creditors must be treated equally within a statutory priority arrangement and the courts are there to enforce those arrangements. I don't know whether regulators really need to step in for the Fortune 50 company.

**P. Scarpato:** What can managers do to maximize the operation and results of their run-offs given new technological and other advances you have encountered over the last few years?

**P. Dassenko:** My favorite question of the day. The sooner companies become aware that run-off is a good thing, and that analysts and shareholders understand the value of run-off and accord share value to intelligent run-off, the sooner managers will address run-off in an intelligent way. Some companies, however, persist in defining run-off as failure and try to sweep that failure under the rug, at least as long as they have the capital to do so.

But this is the way of the past. I can cite examples of companies that enjoy consistently strong share value and good support from the analyst community that have taken a proactive approach to dealing with their liabilities. Those companies will be rewarded.

**O. Horbelt:** European companies have learned a great deal from their counterparts in the US, who have for a much longer time been emphasizing effective management of their in-force business. A clear sign of that is the development of bank-like work-outs found in pretty much every sophisticated insurance and reinsurance company, both in Europe and the US.

**P. Scarpato:** Is run-off a people business or is it more a financial-results business?

**O. Horbelt:** It has to be both, not either/or. It's the people who are going to create those financial results, but the key qualifications of people you want to employ in a run-off might have changed over the years. Today

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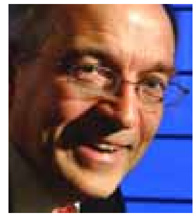
**Feature Article**

# Panel Discussion Special: London Market Update


Mike Palmer


Mike Walker


Philip Grant


Peter Sharp


Julian Ward

*In New York recently Helix UK Limited in conjunction with AIRROC played host to a panel discussion looking at the latest trends and developments in the London run-off market. Some of London's leading experts gave an insight into the key issues of 2007 and beyond. A picture of consolidation, two tier service standards, price hikes and a breakdown of traditional processes were hot on the topical agenda. This article first appeared in JTW News.*

**M. Palmer (Moderator):** We have seen a significant increase in the number of business portfolio transfers under Part VII FSMA over the last year or two and a corresponding interest in challenging such transfers. What ways are there for a US Cedant to challenge a proposed Part VII transfer?

> The Court is unlikely to reject an independent expert's opinion unless it is fundamentally wrong. – Sharp

**P. Sharp:** Although there has been a slight reduction in transfers so far this year compared to 2006, I am aware that there are a number under development. As far as challenging transfers is concerned, I would start by observing that it will be difficult to challenge an independent expert's opinion. The Court is unlikely to reject an independent expert's opinion unless it is fundamentally wrong."

However, that should not stop cedants raising objections to any aspect of a proposed transfer if they disagree with it. If, for example the transferor is an AA-rated reinsurer and the transferee is an un-rated company, a challenge could be worthwhile on the basis that the cedant will be disadvantaged by a diminution in the quality of its security.

**M. Walker:** To give some statistics, there have, to date, been approximately one hundred Part VII transfers sanctioned, split fifty/fifty between life and non-life business. It is worth noting that most transfers have been concerned more with internal restructuring than with sale transactions.

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### *The Panel*

- Mike Palmer (Moderator) Helix UK Ltd
- Mike Walker KPMG LLP
- Philip Grant Chairman of ARC
- Peter Sharp LeBoeuf, Lamb, Greene & MacRae
- Julian Ward JTW Reinsurance Consultants

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**M. Palmer:** Turning now to Solvent Schemes, another favourite topic: is there still a significant and useful mechanism following the setback of the BAIC judgment and will the WFUM case now before the English High Court effectively kill off the solvent scheme as a viable mechanism for companies in run-off?

> Whilst I would agree that solvent schemes have certainly given rise to passionate debate, in terms of business volumes affected they have not, so far, been of great importance… – Walker

**M. Walker:** It was recently suggested that the introduction of solvent schemes was one of the most significant events in the reinsurance market in the last twenty-five years.

Whilst I would agree that solvent schemes have certainly given rise to passionate debate, in terms of business volumes affected they have not, so far, been of great importance, with only some £107 of balance sheet liabilities schemed up to the end of 2003.

Although this number has probably now grown to somewhere in excess of £500 million, it is still small when compared to the nearly £40 billion of run-off liabilities in the UK run-off market.

As most will be aware, the WFUM scheme Sanction hearing is now awaited in September this year. The sanction hearing may be opposed and, if so, we can expect more substantive commentary from the Courts on Schemes. However, it is worth noting that since the BAIC ruling, some forty solvent schemes have been sanctioned and it is clear that judges are looking at each case on its merits rather than deducing any general principle. There have been some changes to scheme design in the light of the BAIC judgment, with a greater explanation of estimation methodology in scheme documents, longer time limits and the increasing use of independent vote assessors and chairpersons, which have had the effect of addressing judicial and creditor concerns.

All things considered, I believe that solvent schemes remain a useful tool in appropriate cases and are certainly not dead in the water as some have suggested.

Art Coleman, Citadel: What impact will the Equitas/Berkshire Hathaway deal have on recoveries from the London market going forward and will it affect the ability to effect commutations or successfully conclude solvent schemes?

**M. Walker:** Equitas has been pretty supportive of schemes in the past once it has become comfortable with the numbers and has obviously been keen to commute. Clearly, Berkshire has historically had a different approach to both commutations and schemes and so it assumed that it will not be so supportive going forward. Berkshire will need to be convinced that the Scheme makes economic sense to them. However, it is worth bearing in mind that Equitas is not as major a creditor as it once was, because of its success in implementing its commutation programme over recent years, so the impact of any change in policy may be limited.

**M. Palmer:** There is a perception that there are fewer major reinsurance disputes being fought in London recently. Is that a correct perception and will that state of affairs continue?

**J. Ward:** I believe that there are fewer disputes in London – and internationally. That may be because a number of major areas of dispute, such as the PA spiral, World Trade Centre and Film Finance are reducing in scale, but I think it is also in part because of recent good results in the business. I also foresee further activity in two areas. First, the outsourced service provider sector, which has recently seen the acquisition by Capita of CMGL, formerly the largest specialist London market service provider. As the compliance burden grows and margins shrink in this sector, consolidation, especially amongst small and medium size players, seems inevitable. Second, the increasing demands on capital from regulators – as exemplified by the Solvency II proposals in Europe – and from rating agencies, mean that risk carriers will look to shed under-performing portfolios of business in order to free up capital. This will in time lead to a major market for acquisition of 'non-distressed' liabilities.

**M. Palmer:** Considering the hunger of investors to buy up distressed run-off portfolios, what effect has this had on pricing?

**P. Grant:** In the early days, we were seeing deals done at a significant discount to net asset value (NAV), but

*continued on next page*

the increased number of players in the market, allied to the tendency for sellers to put portfolios out to tender, has driven prices up to the point where it is rumoured that some buyers have paid as much as 100% of NAV. Against a background of greater difficulty in executing the finality mechanisms on which these deals are usually predicated, it would be fair to characterise the current market as overheated, which will, in time, correct itself, which has meant that there is more money available to settle disputes out of court. It is also possible that risk carriers are now more confident about taking responsibility for settling their disputes rather than abdicating entirely to their legal advisers. Lawyers should be on tap, not on top.

**P. Sharp:** I agree with Julian, although I should add that we are continually being approached for advice on disputed matters by clients, although in many cases they decide not to proceed with litigation or arbitration.

**M. Palmer:** There is a great deal of talk about potential new M&A activity in London, but what has actually happened in the last six to twelve months?

**P. Grant:** Obviously, the largest and most significant deal has been the Equitas/Berkshire Hathaway transaction, which we have talked about already, but we have also seen acquisition activity elsewhere in the distressed business space, with Bear Stearns buying the Minster (possibly a 'toe in the water' for further acquisitions) and Tawa acquiring the Continental business.

> That is why so many cedants are now considering broker replacement services: the 'run-off broker' is now a reality. – Ward

**M. Palmer:** Let us move on to tackle the subject of the London market's performance in settling claims. How does the US perceive London's service in this area?

**J. Ward:** London, to some extent, gets an unfair press, as many cedants there have tried and trusted settlement routines in place, but a lot of the delay problems revolve around broker service. Certainly the larger brokers are operating a tiered service, where if you are a cedant with no current live relationship with the broker, you will receive the lowest tier of service. That is why so many cedants are now considering broker replacement services: the 'run-off broker' is now a reality.

**P. Grant:** It is also worth pointing out that reinsurers take a different view of claims when the cedant is in run-off: ex gratia payments no longer happen and much more attention is paid to contract wordings. This caused some controversy in London when Tawa was perceived as slowing down claims payments on its CNA Re acquisition, CX Re: Tawa maintained that it was not deliberately slowing down claims payments, but merely paying proper attention to the wording of the policies.

**J. Ward:** Especially within the run-off environment, the subscription market is no longer the 'one-stop shop' it used to be, either, with the lead changing hands frequently and each slip participant wishing to take its own decision and treating the lead/follow conventions largely as a matter of convenience.

**Andrew Maneval:** The situation concerning follow markets is confusing for many in the US: what is the current situation?

**M. Palmer:** The process that once served London well is now almost dead: companies want to adjust claims themselves even if they do not have the ability or resources to do so. In addition, many of the leading underwriters have disappeared, so the follow market has been forced to take on the adjusting role.

Let's discuss London broker legacy issues: almost a year ago we saw Aon outsource almost all of its back office function to Xchanging. How has that gone and what effect if any has it had on US run-off cedants?

**J. Ward:** The perception is that Xchanging are struggling with the workload and that service levels may have dropped over the last nine months. A two-tier service level appears to exist depending on the current business relationship the cedant enjoys with Aon.

## Questions and comments from the floor

**Art Coleman (Citadel Risk Management):** Can we revert slightly to an earlier topic and consider arbitrations: is the cost of arbitrating deterring cedants from bringing arbitration proceedings?

**P. Sharp:** Costs are certainly rising, which has meant

*continued on page 22*

Message from CEO and Executive Director

## AIRROC Makes a Difference continued from page 1

others' company and dancing the night away.

My heart soared as I observed 400 delegates moving from one meeting to another working through their commutation efforts, issue resolutions, reinsurance collections and networking. AIRROC's goal to bring significant value to its members is obviously fulfilled by providing a quarterly forum for both topical education and business closure. And this effort is getting noticed. Our event was covered by Business Insurance, The Insider, Run-Off and Restructuring Magazine and Global Reinsurance Magazine.

Our members elected Frank Kehrwald of Swiss Re and Kathy Barker of Mitsui Sumitomo to AIRROC's Board of Directors on October 15. Re-elected to the board were Keith Kaplan of Reliance Ins. Co., Mike Fitzgerald of CNA, John Parker of TIG and Marianne Petillo of ROM. Congratulations to all!

Effective January 1, 2008, AIRROC welcomes Jonathan Rosen of The Home as Chair and Ali Rifai of Centre and Art Coleman of Citadel Re as Co-Vice-Chairs of AIRROC's Board of Directors. All were elected by the 2008 AIRROC Board on October 15. We are eternally grateful to our retiring Chair, Andrew Maneval of Horizon/Hartford, and Vice Chair, Terry Kelaher of Allstate. Their dedication and vision have been key to the creation and growth of AIRROC.

***Mark your calendars (all meeting dates/details accessed at www.airroc.org):***

- ☞ March 5, 2008 – AIRROC/Cavell Commutation Day at the LeParker Meridien, NYC
- ☞ March 6, 2008 – AIRROC Membership meeting at the Dewey & LeBoeuf offices
- ☞ October 20-22, 2008 – AIRROC/Cavell Commutation & Networking Event at the Sheraton Meadowlands in New Jersey

AIRROC's Education Committee met on October 16 to plan education sessions for each of our membership meetings in 2008. We have an awesome program on claims auditing planned for March 6th, one not to miss. The AIRROC board is dedicated to presenting our members with educational topics that could affect their run-off.

Encourage other run-off companies who can benefit from AIRROC membership to join us. The input from our multiple members will help all identify ways to improve their run-off. The greatest value is establishing or growing relationships. If you don't need them today, you will probably need them in the future. Join because **we seek solutions!** ■

*Ms. Getty has been active in the insurance and reinsurance industry for over forty years, specializing in reinsurance claims. She has significant experience evaluating liability and reserve adequacy and planning and implementing claims and operational audits. In 1996, Trish expanded her focus to include sales and marketing of reinsurance services. In addition to active business, Trish has provided consulting services to regulators for the reinsurance administration of troubled and liquidated companies. She can be reached at trishgetty@bellsouth.net.*

***Captions***

***Row 1:***
(1) Brian Snover, Run-Off Person of the Year and Trish Getty, CEO & Executive Director of AIRROC.
(2) Navneet Dhalival, Klas Kune, Andrea Lerch.
(3) Julie Ponsford, Wendy Fitch, Bryina Starks.

***Row 2:***
(1) Larry Schiffer, Henry McGrier, Bill Littel.
(2) Mike Walker.
(3) Art Coleman, Richard Mueller, Charles Thomas.

***Row 3:***
(1) Brian Snover, Kathy Barker, Nick Pearson.
(2) Tom Norsroorthy, Trish Getty, Louis Pietroluongo, Norm Taplin, Rudy Dimmling, Mike Zeller.

***Row 4:***
(1) Jonathan Rosen, Trish Getty, Andrew Maneval.
(2) Mike Zeller.
(3) George Mitchell.

# AIRROC'S Commutation and Negotiation Event

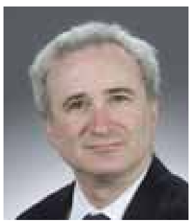
## October 15-17, 2007, New York City

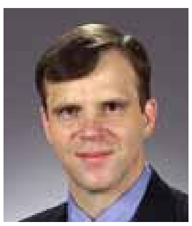
Feature Article

# BAIC and SCOTTISH LION DECISIONS:

## A Wake-Up Call for U.S. Creditors to Challenge Fairness of U.K. Solvent Schemes


Joseph J. Schiavone


Jeffrey S. Leonard


Christopher P. Anton

*By Joseph J. Schiavone, Jeffrey S. Leonard, Christopher P. Anton and Leslie J. Davis (not pictured)*

## Preface

This is a condensed version of an article that appeared in the February 16, 2006 edition of *Mealey's Litigation Report: Reinsurance.* In the year-and-a-half since then, several cases have addressed some of the fairness issues that were the focus of the *BAIC* and *Scottish Lion* decisions. On June 9, 2006, the High Court of Justice held in *Sovereign Marine & General Insurance Company, Ltd., et al.* [2006] EWHC 1335 (Ch), that it was inappropriate under the circumstances of the case to include IBNR creditors in the same class as all other creditors.

In *In re NRG London Reinsurance Company Limited* [2006] FCA 872, the Federal Court of Australia distinguished *BAIC* and approved the convening of a meeting of a single class of creditors with accrued and IBNR claims. Unlike BAIC, the business at issue consisted solely of reinsurance.

Joseph J. Schiavone, Esq. and Jeffrey S. Leonard, Esq. are shareholders of Budd Larner, P.C. and are members of the firm's Reinsurance Department, which is chaired by Mr. Schiavone. Christopher P. Anton, Esq. is counsel with the firm. Leslie J. Davis, Esq. is Vice President and Assistant General Counsel with General Reinsurance Corporation. The views expressed herein do not necessarily reflect those of Budd Larner, P.C. or its clients, or of General Reinsurance Corporation.

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## Introduction

Foreign insurers and reinsurers with long-tail risks in the United States have increasingly used solvent schemes of arrangement as an alternative to liquidation or protracted run-off. These schemes, implemented under §425 of the United Kingdom's Companies Act 1985, have been an efficient and reliable means of finalizing all or part of a company's portfolio of business and returning capital to shareholders. If the necessary majority creditor approval is obtained and the scheme is sanctioned by the U.K. court, it becomes binding on all creditors. Claims submitted by a date certain, including IBNR estimates, if allowed, are paid at present value. All other claims are forever extinguished.

> **There may be good cause to question the reasonableness of such schemes where the scheme company is fully able to pay its obligations as they mature, but does not want to do so.**

Some solvent schemes seek to fairly adjust debts and distribute the assets of a company that is in questionable financial condition. Other solvent schemes, however, are proposed by companies whose financial strength is undoubted. There may be good cause to question the reasonableness of such schemes where the scheme company is fully able to pay its obligations as they mature, but does not want to do so.

Solvent schemes should be of particular concern to U.S. policyholders and reinsureds, who lose the bargained-for protection of coverage for future claims in exchange for payment based on an estimate of what

*continued on next page*

those claims may be, assuming that they have the loss history and resources to submit a sufficiently documented IBNR claim to be allowed any payment at all.

Until recently, with the decision of the High Court of Justice in *Matter of British Aviation Insurance Company Limited* ("*BAIC*") [2005] EWHC 1621 (Ch), and the unpublished decision of the Scottish Court of Sessions involving the solvent scheme proposed by Scottish Lion Insurance Company Ltd. ("*Scottish Lion*"), the proponents of solvent schemes of arrangement have enjoyed uninterrupted success in obtaining court approval.

## Disincentives to Creditor Participation

There are a number of explanations for the lack of strong creditor opposition to solvent schemes in the years leading up to the *BAIC* and *Scottish Lion* decisions. A U.S. creditor may learn of a pending solvent scheme, if at all, through notice received by mail from the scheme proponent or printed in an industry publication. Because these notices do not identify specific contracts or claims, and the accompanying scheme documents are lengthy and filled with jargon and unfamiliar terms, the reaction of many U.S. creditors understandably is one of bewilderment. The potential impact, if any, of the scheme on a particular creditor may be difficult to discern, and there is very little time in which to consider whether and how to respond to the scheme in a foreign jurisdiction. Secrecy concerning the identity of creditors has made it difficult for creditors to exchange information, pool litigation resources, and maximize their leverage in negotiations with the scheme proponent.

**In the wake of BAIC, U.S. creditors should recognize that some solvent schemes may not be in their best interest and that there may be grounds to successfully challenge them.**

## BAIC: Fairness Comes to the Fore

The *BAIC* decision marked the first time that creditors successfully opposed a solvent scheme proposed by an insurance company. The court held that creditors with IBNR claims constitute a separate class of creditors and that it was improper for the scheme proponent to convene a single meeting of all creditors. *BAIC* [2005] EWHC 1621 at ¶97 (Ch). The court also noted that it would "be unfair to require the manufacturers who have bought insurance policies designed to cast the risk of exposure to asbestos claims on insurers to have that risk compulsorily retransferred to them." *BAIC* [2005] EWHC 1621 at ¶143 (Ch).

In the wake of *BAIC*, U.S. creditors should recognize that some solvent schemes may not be in their best interest and that there may be grounds to successfully challenge them. Many of these grounds concern issues of basic fairness, both of the process for obtaining scheme approval and of the scheme itself.

## Procedural Fairness

Scheme proponents rely on the ill-defined concept of "creditor democracy" to obtain approval of schemes. But a process that allows the will of a majority of creditors to control the fate of the minority is sustainable only if the system of creditor voting is fair.

Inadequate notice may lead to inequitable results. The scheme proponent's efforts to identify and locate creditors, as well as the sufficiency of publication notice, should be scrutinized. Low voter turnout may result in a scheme being approved by a small minority of creditors (who nevertheless comprise a majority of *voting* creditors) or by an unrepresentative sample of creditors.

The timing of schemes gives their proponents an unfair advantage over creditors. A solvent scheme typically is the result of many months of planning, drafting and negotiation. In comparison, creditors have scant time in which to evaluate the scheme, identify their contracts with the scheme company, analyze the scheme's potential impact, determine whether the scheme proponent's decision as to the number and nature of creditor classes is proper, attempt to organize themselves, and raise any objection.

*BAIC* underscores the importance of proper classification of creditors in achieving fair results. In a solvent scheme, the holders of accrued claims are paid no more and no less than what they otherwise would receive: full payment of their claims in accordance with the terms of the pertinent insurance policies or reinsurance contracts. IBNR creditors, however, are treated differently. In a solvent scheme, they are not paid the contractual

*continued on next page*

indemnity to which they otherwise would be entitled. Instead, IBNR creditors are paid based on an estimate of what their claims against the scheme company may be in the future.

**The September 2005 Scottish Lion decision scored a victory for creditors concerned about procedural fairness in the scheme process.**

Adequacy of information about the proposed scheme and the scheme process also raises fairness concerns. The flow of information relating to a proposed scheme is largely controlled by the scheme proponent. Creditors may be unable to determine the effect of the proposed scheme on their claims or, for that matter, whether their claims would even be subject to the scheme in the first place.

Negotiations between scheme proponent and creditors who support the scheme are kept secret. At the same time, the scheme proponent usually does not disclose creditors lists or voting records. Such secrecy makes it virtually impossible for creditors to consult one another, pool resources, prepare for the creditors' meeting, and determine whether the creditors' vote at that meeting was equitable.

The September 2005 *Scottish Lion* decision scored a victory for creditors concerned about procedural fairness in the scheme process.

In its decision, the Scottish Court of Session granted a creditor's application to require disclosure of the creditors list and additional financial information and ordered that such information be provided to *all* scheme creditors. The court adjourned the creditors' meeting and ordered the company to post both the creditors list and the additional financial information on its website. Scottish Lion responded by petitioning to withdraw its scheme, rather than providing the additional information.

## Substantive Fairness

Although a solvent scheme obviously benefits the scheme company and its shareholders, the same cannot be said in all instances for its creditors, especially with respect to IBNR losses. The liabilities of a scheme company's creditors are unaffected by the scheme. But deprived by the solvent scheme of the protection that they purchased from the scheme company, both policyholders and reinsureds will have to bear those future liabilities entirely on their own. Under a solvent scheme, the risks that the scheme company was paid to assume are involuntarily transferred back to its policyholders and reinsureds.

IBNR creditors can argue that this compulsory abrogation of their contractual rights is unfair. One need look no further than to the extremely volatile fluctuations in projections of the insurance industry's ultimate exposure to asbestos and pollution losses to recognize that IBNR cannot be accurately projected. Creditors can argue that there is no reason why a solvent company that is able to pay its debts as they become due should be relieved of its contractual obligations simply in order to release capital for the pursuit of other business ventures or return to shareholders.

**The opportunity for U.S. creditor involvement in the scheme process may extend beyond the shores of the United Kingdom.**

Some solvent schemes may be unfair to creditors for other reasons, as well. Schemes usually deprive creditors of access to the court system, including their right to a jury trial and appeal. They also abrogate all contractual rights to arbitrate disputes. Instead, claim disputes typically are resolved by a scheme adjudicator selected by the scheme proponent.

## U.S. Proceedings

The opportunity for U.S. creditor involvement in the scheme process may extend beyond the shores of the United Kingdom.

Bankruptcy Courts have routinely granted ancillary relief in connection with § 425 solvent schemes, usually without creditor opposition. The scheme proponent's need to petition the U.S. Bankruptcy Courts for ancillary relief does not necessarily give U.S. creditors another "bite at the apple." Considerations of comity may weigh in favor of recognition, even if the scheme and the scheme approval process do not precisely comport with American notions of fairness.

A bankruptcy court may refuse to enforce a foreign order irrespective of considerations of comity where the relief sought is beyond the scope of the Bankruptcy

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Feature Article

## BAIC and SCOTTISH LION Decisions continued from previous page

Code. For example, in *In re Rose ex rel. London & Scottish Assurance Corp.*, 318 B.R. 771 (Bankr. S.D.N.Y. 2004), a bankruptcy judge refused to grant ancillary relief in connection with an insurance business transfer scheme under Part VII of the United Kingdom Financial Services and Markets Act ("FSMA"). The court held that because the scheme lacked the characteristics of a bankruptcy reorganization, as distinguished from a corporate consolidation or merger, it fell outside the Code's definition of "foreign proceeding" and was not entitled to § 304 relief. *Id*.

In conjunction with the enactment of Chapter 15 (which replaced § 304), the definition of "foreign proceeding" has been amended and is expressly limited to certain types of proceedings "under a law relating to insolvency or adjustment of debt." 11 U.S.C. § 101(23). Therefore, it may be assumed that *Rose* would have been decided no differently had the petition been filed under Chapter 15.

U.S. creditors also may be able to challenge enforcement in the U.S. of §425 solvent schemes and Part VII business transfers by invoking the "reverse pre-emption" rule of the McCarran–Ferguson Act, 15 U.S.C. §1012; *Barnett Bank of Marion County, N.A. v. Nelson*, 517 U.S. 25 (1996) (Bankruptcy Code subject to McCarran-Ferguson). For example, a U.K. insurance business transfer scheme (such as the scheme at issue in *Rose*) that purports to effect a mass novation of insurance contracts outside of the applicable state regulatory framework may trigger reverse pre-emption.

### Conclusion

For years, proponents of solvent schemes operated in an environment free of significant creditor resistance. *BAIC* and *Scottish Lion* serve as a wake-up call for scheme creditors to challenge U.K. solvent schemes in appropriate cases. ■

Feature Article

## Panel Discussion Special: London Market Update continued from page 15

> Costs are certainly rising, which has meant that the level at which a dispute is not commercially worth fighting has risen too.

that the level at which a dispute is not commercially worth fighting has risen too.

**Gregg Frederick (Legion Insurance Company – in liquidation):** It may be true that arbitrations are not entered into by live companies as frequently as they were in the past, but for distressed or liquidated companies it remains a powerful tool when no leverage exists. Reinsurance used to be a trust business; those days are now gone.

**Jim Veach (Mound Cotton Wollan & Greengrass):** Would you say that the US market for run-off lags behind the London market?

**P. Grant:** London is currently more advanced in its thinking when it comes to seeking imaginative solutions to its problems, but it has had to deal with those problems because of their sheer volume and the danger they posed to London's reputation and economic well-being.

The US market is beginning to seek its own answers to similar problems – and AIRROC's work is evidence of that – and will quickly develop. ■

Feature Article

# Mealey's Educational Sessions

By Bina Dagar

*For those who were unable to attend the Educational segment (as well as for those who did but wouldn't mind a refresher), the following is a summary of the topics discussed at the panel sessions of the Commutation and Networking Rendezvous in October 2007. This portion of the Event was developed by Mealey's.*

## Consolidation and Run Off

The educational portion began with "Consolidation and Run Off," presented by a panel consisting of David Alberts of Lovells, Paul Eddy of Travelers Special Services, Susan Grondine of Cavell America, Inc., and Andrew Rothseid of PricewaterhouseCoopers LLP, and moderated by Andrew Stuehrk of Navigant Consulting. Noting the US market's growing appetite for run off, the panel centered its comments around the past year's five prominent, and representative, yet unique, run off transactions: sale of ACE Brandywine Run Off Companies to R & Q, sale of Converium Re North America to Berkshire Hathaway (National Indemnity), Royal Sun Alliance's MBO, sale of PXRe Reinsurance Company to Argonaut Group, Inc., and the merger of The St. Paul Companies and Travelers Property & Casualty Corp. In the panel's view, the ACE transaction was the longest, most controversial and high profile of the four, requiring the PA Insurance Department to work with ACE to alleviate myriad concerns of large direct policyholders. Perhaps the most unique was the Royal Sun Alliance deal, since it involved the decision of responsible management from a foreign insurer to exit the US market using a highly publicized MBO that expressly addressed the need for policyholder protection in the regulatory order. The Converium Re NA sale was the most straight forward and least controversial transaction, and was approved by the Connecticut Insurance Department in only two months. Two notable aspects of this deal were that not one party objected to the transaction, and that 18 potential buyers expressed serious interest. The PX Re sale differed from the others in two material respects: it was a reverse merger — the surviving entity PX Re actually was acquired by Argonaut; and it was a property CAT reinsurer, hit by Katrina losses, with a book that had no real market. Ultimately the sale was not done to maximize the value of its run off, but to deploy the existing capital for on going business in another company. Considered the most "traditional, old school run off," the St. Paul/Travelers merger created a $9bln run off requiring the work of a combined dedicated management team and shared resources from the rest of the company. Given the strength and long established history of both companies, the regulatory approval process did not focus on run off issues.

Noting the US market's growing appetite for run off, the panel centered its comments around the past year's five prominent, and representative, yet unique, run off transactions…

Two notable aspects of this deal were that not one party objected to the transaction, and that 18 potential buyers expressed serious interest.

In their analysis of these transactions, the panel first discussed the level and nature of regulators' involvement, whether reactive and traditional or proactive and creative, and the resulting impact on run off deals, past, present and future. One view was that the very multistate structure of US insurance regulation impedes creative solutions to run off problems, alleviated somewhat by regulators' ability to outsource certain actuarial and operational functions. Next, the panel addressed capital market investments in run off, expressing an overall consensus that CMs will continue to invest, provided their ROR exceeds current rates. Indeed, depending on when and at what price they come in, and on when and at what level their reinsurance exhausts, CMs may still make money in the transactions. In the final analysis,

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the panel felt that it was too soon to judge whether these five transactions — unique in many ways — will fully accomplish their stated goals.

## Impacts of Commutation to a Run Off Company

The panel on the topic of commutation in the run off context was chaired by Ali Rifai of Centre Solutions, with John Nonna of Dewey & LeBoeuf LLP, Mark Adams of Deloite & Touche LLP, and Nick Pearson of Edwards Angell Palmer & Dodge LLP participating as panel members. The discussion was centered on the special challenges of commuting business in the run off context. The panelists pointed out that these could include gaps in record keeping, inflexibility due to the lack of an ongoing business relationship, and the need to ensure that an appropriate team of professionals is focused on the process. It was suggested that entities in run off focus first on the "low hanging fruit" to crystallize liabilities quickly. Other points made by the panel which relate to commutations generally are the need to be as fully informed as possible before entering into commutation negotiations and the necessity of accurately documenting what has been agreed upon, including clear descriptions of the parties and the business commuted.

## Pools

The panel on Pools, consisting of Nigel Montgomery of Sidley Austin as moderator, Paige Waters of Sonnenschein Nath & Rosenthal, James Bolton of KPMG and Henry Sopher of ISIS Consulting covered a lot of ground in a short period of time. Among the salient issues they touched upon were the unique problems associated with pools and the changing regulatory environment.

The ease of entry into a market through a pool is not matched by ease of exit. Traditional exit strategies of sale, portfolio transfer or reinsurance are unlikely to bring finality to all pool participants. Underwriting agreements may not address pool members' responsibility for run off or run off fees. Paper records or systems may not be adequately kept by all members.

Seeking to modernize regulation in this sector, the NAIC Task Force proposals, if adopted, will require non-U.S. reinsurers to apply for accreditation by a port of entry regulator. Once accredited, the non-U.S. reinsurer will be rated based on a number of factors (including rating agency ratings) and assigned a Class rating between 1 and 5, which will determine the amount of collateral to be posted. Recalibration of collateral requirements could significantly impact the composition of future pools.

## Dispute Management

Moderator Marvin Mohn (Tawa Management) led a discussion that began with James Veach's (Mound Cotton Wollan & Greengrass) discussion of how the run off process itself may be affecting reinsurance arbitration (see, *Run Off Changing Everything, Including Reinsurance Arbitration*, Mealey's Reinsurance, October 5, 2007, and Workbook, pp. 57-62) and moved to Janet Kloenhamer's (Fireman's Fund) presentation (and "Final Examination," see Workbook, pp. 63-64) on reinsurance mediation as an arbitration alternative. Clive O'Connell (Barlow, Lyde & Gilbert) commented on the U.K. and U.S. consequences of bad behavior on the way to resolving reinsurance disputes and Kevin Walsh (Locke, Lord Bissell & Liddell) explored trends on both sides of the Atlantic with respect to pre-hearing security in arbitration. See K. Walsh & W. Foley, *U. S. and U.K. Approaches to Pre-Hearing Security at Arbitration: Two Countries Separated by a Common (Law) Language, Workbook, pp. 45-56).*

> **…James Veach's discussion of how the run off process itself may be affecting reinsurance arbitration…**

## Ceded Reinsurance and Managing the Run Off

This panel was moderated by Tim Stalker of Nelson Levin deLuca & Horst. Joining him on the podium were Brian Johnston of Reinsurance Solutions and Andrew Maneval of Horizon Management. The discussion revolved around ongoing and evolving issues regarding the cedant-reinsurer relationship and the collection of ceded reinsurer in today's global marketplace. The issues take on new meaning when the cedant or reinsurer is in run off or insolvent. This panel discussion highlighted some of the key issues that both cedants and reinsurers face. The speakers offered some

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practical day-to-day solutions regarding setoffs and the current regulatory environment surrounding insolvencies and book roll-overs such as New York Regulation 141 and Part VII transfers.

Brian Johnston gave a PowerPoint presentation on salient steps to managing an insolvent company starting from the time at which a bar date has to be estimated to the final payout.

The panel discussed Regulation 141 of Section 1321 of New York Insurance Law. Briefly, this regulation allows a company to perform a broad commutation. The panel effectively offered aspects that help to streamline a commutation plan providing the audience with the required elements of the plan. The time span from impairment to its final conclusion culminating in a commutation is key. This process takes several years, for e.g. Paladin Re went insolvent in December 31, 2003 and received the final approval of the executed commutation agreements on June 29, 2006.

**A recent notable example is the National Indemnity and Equitas deal. The policyholder is not involved and is merely notified.**

Transfers of insurance business under Part VII of the Financial Services and Markets Act 2000 essentially move insurance business from one insurer to another through a statutory novation, i.e. it sanctions a transfer of Scheme. A recent notable example is the National Indemnity and Equitas deal. The policyholder is not involved and is merely notified. There is no requirement for the reinsurer to agree to the novation. Not surprisingly, reinsurers' reaction to this hasn't been favorable. As to the future of Part VII transfers, this regulation has gained momentum; and it is here to stay in spite of the reinsurance market's unenthusiastic response. At the end of the day, reinsurers may get some say. Aside from that, the FSA has to highlight major arguments in favor of the transfer in its future submission to the court as opposed to just doing it.

Other related topics discussed: Schemes of Arrangement in the U.K. between an impaired company and its creditors take about two years to conclude. Of note is FSA's new guide, is sued July 2007, which outlines a process for reviewing Schemes.

The management of the offset provision requires historical as well as practical considerations. Where the agreement is silent, the issue is compounded further. Each court views these provisions differently.

## Ethical Pitfalls in Run Off Management

Jim Schaller of Jackson Campbell was the Ethics speaker of this Commutation Event. The American Bar Association (ABA) changed its Rules of Professional Conduct (Rules) in a substantial way. However, these changes were not sweeping, according to the speaker. The generality of the rules does not lend itself to the specific field of run off. Conflicts of interest still exist in large part due to the focus of the Rules, which provide little guidance in either the primary or the reinsurer run off situations. This is further compounded by the inexperience of the many lawyers attracted to this field.

Some examples of common ethical problems that show how the Rules might apply uniquely in the run off setting are:

1. Requisite in the duty to provide competent representation is a degree of knowledge and skill to navigate the complex and specialized run off management field;
2. The dilemma of the experienced lawyer facing an inexperienced opposing counsel, which begs the question of sole allegiance to ones client over all other duties, such as respect and courtesy, with the resultant use of offensive tactics to gain advantage over the opposing counsel; and
3. Some Rules, such as balancing decision-making responsibilities, telling the client what you think, use of conventions and elusive truths in negotiations, and transactions with third parties do not lend themselves to easy application by counsel to a run off client.

The run off industry today is larger and more focused than it ever was. Therefore, the Rules may not apply as precisely to this field. Ultimately, a lawyer knows what conduct is proper and must find the balance where the Rules reflect his understanding of the duty of fundamental fairness to the profession and to society. ■

**Feature Article**

# Present Value

## Run-Off News

**New Board & Officers at AIRROC:** On October 15, 2007, **Frank Kehrwald** of Swiss Re and **Kathy Barker** of PRO Insurance Solutions on behalf of Mitsui Sumitomo Marine were elected to the AIRROC Board of Directors.

In addition, the AIRROC Board elected **Jonathan Rosen** of the Home as Chair and **Ali Rifai** of Centre along with **Art Coleman** of Citadel Re as Co-Vice-Chairs. They replace departing Chair **Andrew Maneval** of the Hartford and Vice Chair **Terry Kelaher** of Allstate. The changes to the AIRROC Board are effective January 1, 2008.

Effective October 1, 2007, **Dewey Ballantine LLP** and **LeBoeuf, Lamb, Greene & MacRae LLP** merged and are operating as **Dewey & LeBoeuf LLP**. Jeffrey Mace, AIRROC's acting counsel since its inception, says he is looking forward to the opportunities the new firm presents and to hosting the next AIRROC meeting in Dewey & LeBoeuf's new space which can accommodate the ever growing ranks of AIRROC's membership. Please note new name and email addresses. www.deweyleboeuf.com.

Effective October 2, 2007, **Locke Liddell & Sapp PLLC** and **Lord Bissell & Brook LLP** merged and are operating as **Locke Lord Bissell & Liddell LLP**. Please note new name and email addresses. www.lockelord.com.

Effective January 1, 2008, **Edwards Angell Palmer & Dodge LLP** and **Kendall Freeman** plan to merge. For further information visit www.kendallfreeman.com and www.eapdlaw.com.

The **UK Financial Services Authority (FSA)** issued a new document on July 31, 2007 on Schemes of Arrangement for insurance firms'. For full details, see the FSA website: ww.fsa.gov.uk/Pages/Library/Other_publications/Miscellaneous/index.shtml.

In August, **Whittington** announced the first successfully completed Solvent Scheme of Arrangement for a Singapore-based insurer, **Lion City Run-Off Private Limited** (formerly the Offshore Insurance Fund business of The Insurance Corporation of Singapore Ltd). www.whittingtoninsurance.com

## Mark Your Calendar

**February 26 - 27, 2008**: The 9$^{th}$ ARC Congress will be held at Merchant Taylors' Hall, London, England. www.arcrunoff.com

**March 5, 2008**: AIRROC/Cavell Commutation Day will be held at LeParker Meridien in New York City. This is a change to the previously published date due to a conflict with the ARC Congress.

**March 6, 2008**: AIRROC Membership Meeting will be held at the offices of Dewey & LeBoeuf in New York City. The agenda, including the full educational program, will be posted on AIRROC's website at www.airroc.org.

**June 2 -5, 2008**: The 12th Annual Cavell Rendez-Vous will be held in Norwich, England. www.commutations-rendezvous.com

**May 22, 2008:** AIRROC Membership Meeting will be held at the offices of Dewey & LeBoeuf in New York City.

**July 24, 2008:** AIRROC Membership Meeting will be held at the offices of Dewey & LeBoeuf in New York City.

**October 20-22, 2008**: AIRROC/Cavell Commutation & Networking Event will be held at the Sheraton Meadowlands in New Jersey.

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## People

**Brian Snover** of Berkshire Hathaway was named 2007 AIRROC Run Off Person of the Year at the **AIRROC/Cavell Commutation & Networking Event at the Sheraton Meadowlands, NJ** in October.

**Michael Knoerzer** was appointed a senior partner of Clyde & Co's US practice in October. Formerly one of the leading partners in the insurance and reinsurance litigation practice at the New York City offices of LeBoeuf Lamb Greene & MacRae, Mike has been a commercial litigator for over twenty years, focusing on the arbitration and litigation of insurance and reinsurance matters.

Asbestos, pollution and health hazard (APH) experts **Pervin Sivanathan**, **Kent Ulyatt** and **Dan Silverman** joined Tawa Management Ltd from Axiom Consulting in August 2007.

**Mike Walker** and **John Wardrop** of KPMG Restructuring's Insurance Solutions practice were appointed Joint Administrators of London market broker Park London Limited on Thursday 2nd August 2007. The appointment covers he business operations in London and its branch operations in the USA and Canada.

**Dan Schwarzmann** and **Mark Batten** from PricewaterhouseCoopers LLP were appointed joint administrators of Highlands Insurance Company (UK) Limited on 1 November 2007

**Kathy Barker**, formerly with The Hartford, has joined PRO's new US affiliate, PRO Insurance Solutions, Inc ("PRO US") as President. PRO US, a member of the Swiss Re Group, will operate out of New York and Boston offering full-service discontinued management, technical audit, commutation, asset recovery and reinsurance debt purchase solutions.

**Amanda Atkins**, former Chief Financial Officer of Alea Group Holdings, and **Nick Eddery-Joel**, former Director or Corporate Solutions at Axiom Consulting Limited, have launched a new run-off entity called Afinia. Seeking to acquire discontinued non-life re/insurance liabilities, Afinia is backed by Deutsche Bank and EOS Credit Opportunities.■

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

**Feature Article**

## "Why We Work in 'Run-Off'"

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overlooked qualities of Ginger Rogers with the high visibility panache of Fred Astaire:

*"Why, she could do **everything** he could do, except backwards, and in heels!"*

**That's our part in the risk-management world: Everything, except subject to constant suspicion and scrutiny…**

That's our part in the risk-management world: *Everything*, except subject to constant suspicion and scrutiny, for customers under maximum stress, relying on the work of worried employees, and frequently with tenuous access to capital, or worse!

Plus, we must accomplish our many difficult objectives, while regulated by strict laws and regulatory oversight, bringing together numerous professional disciplines with considerable technical expertise, **and** do all of these things with unwavering fealty to the highest principles of trust and integrity.

No wonder we like what we do. Where else can you find such challenges — and opportunities — to be good and do good? Don't apologize at parties anymore. Also, you're not obliged to convince anyone else. ■

KPMG

# Policyholder Support Update — Alert No. 21

*KPMG's Restructuring Insurance Solutions practice has been providing e-alerts to the insurance industry regarding Schemes of Arrangement for many months. These e-alerts act as a reminder of forthcoming bar dates and Scheme creditor meetings. To subscribe to these alerts or access KPMG's online database of solvent and insolvent Schemes of Arrangement, please access their web site at **www.kpmg.co.uk/services/r/ins/forms/alerts_policy.cfm.***

## Solvent Schemes – Upcoming Key Dates

### AXA INSURANCE UK PLC; ECCLESIASTICAL INSURANCE OFFICE PLC; GLOBAL GENERAL AND REINSURANCE COMPANY LIMITED; MMA IARD ASSURANCES MUTUELLES; SWISS REINSURANCE COMPANY (IN RESPECT OF THE GLOBAL LONDON MARKET (GLM) POOL BUSINESS)

Schemes for the above companies were approved at the Meetings of Creditors on 28 February 2007. The Schemes became effective on 10 July 2007 and the bar dates have been set as 25 January 2008. Further information is available at **www.glmpool.com.**

### OSLO REINSURANCE COMPANY (UK) LIMITED; OSLO REINSURANCE COMPANY ASA

Schemes for the above companies were approved at the Meetings of Creditors on 12 February 2007. The bar dates have been set as 17 December 2007. Further information is available at **www.kpmg.co.uk/insurancesolutions.**

### SUNCORP METWAY INSURANCE LIMITED

By Order of the High Court of Justice of England and Wales, a Meeting of Scheme Creditors for the above company was held for the purpose of considering and, if thought fit, approving a Scheme of Arrangement on 7 September 2007. A date for the hearing to sanction the Scheme has yet to be set. Further information is available by e-mailing **suncorp.solventscheme@axiomcc.com.**

### WALTON INSURANCE LIMITED

The above company's Scheme was approved at the Meeting of Creditors on 21 June 2007 and was subsequently sanctioned by the Supreme Court of Bermuda on 20 July 2007 and became effective on 27 July 2007. The bar date has been set as 26 October 2007. Further information is available at **www.waltonscheme.com.**

### COMPAGNIE EUROPEENE D'ASSURANCES INDUSTRIELLES S.A.

The above company's scheme was approved at the Meeting of Creditors on 11 May 2007. The Scheme became effective on 27 September 2007 and the bar date has been set as 25 February 2008. Further information is available at **www.ceai.co.uk.**

### GREAT LAKES REINSURANCE (UK) PLC

The above company's scheme was approved at the Meeting of Creditors on 18 June 2007. The Scheme became effective on 5 July 2007 and the bar date has been set as 7 January 2008. Further information is available at **www.gluksolventscheme.co.uk.**

### WILLIS FABER (UNDERWRITING MANAGEMENT) (WFUM) POOLS

By Order of the High Court of Justice of England and Wales, Meetings of Creditors for the Scheme Companies who participated in the WFUM Pools were convened on 27 October 2006. The Schemes for the 14 WFUM Pools Scheme Companies for whom votes were taken were sanctioned by the Court on 17 September 2007. The Schemes became effective on 10 October 2007 and the

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bar date has been set as 7 April 2008. Further details are available at **www.kpmg.co.uk/insurancesolutions** and **www.wfumpools.com.**

### SPHERE DRAKE INSURANCE LIMITED

The Creditors Meetings for the Sphere Drake WFUM Pools Scheme, which were opened but adjourned on 27 October 2006, was reconvened on 19 October 2007. The outcome of the meeting is not yet known. Further details are available at **www.kpmg.co.uk/insurancesolutions** and **www.wfumpools.com.**

### LA SALLE RE LIMITED

The 30 August 2007 bar date for the above company's Scheme has now passed. Further information is available at **www.lasallerescheme.com.**

## Other Recent Developments

### CAVELL INSURANCE COMPANY LIMITED

The above company's Scheme was approved at the reconvened Meeting of Creditors on 25 April 2005. The Company has postponed their application to the High Court of Justice of England and Wales for the Scheme to be sanctioned the date of this application has yet to be announced. Further information is available by e-mailing Steve Aldous at steve.aldous@castlewood.co.uk.

### RIVERSTONE INSURANCE (UK) LIMITED; MITSUI SUMITOMO INSURANCE COMPANY (EUROPE) LIMITED; SIRIUS INTERNATIONAL INSURANCE CORPORATION (PUBL) (IN RESPECT OF THE ORION POOL BUSINESS)

The above companies expect to apply to the High Court of Justice of England and Wales for permission to convene Meetings of Creditors. The date of this application has yet to be announced. Further information is available at **www.rsml.co.uk/solvent.**

### WINTERTHUR SWISS INSURANCE COMPANY

The above company is proposing to implement a Solvent Scheme of Arrangement. A Practice Statement Letter was sent out to brokers and known policyholders on 7 September 2007. Further information is available at **www.winterthur-crdriver-scheme.co.uk.**

## Insolvent Estates

### WILLIS FABER (UNDERWRITING MANAGEMENT) (WFUM) POOLS (SOVEREIGN MARINE & GENERAL INSURANCE COMPANY LIMITED - INSOLVENT PARTICIPANT)

See Solvent Schemes. ■

*Please do not hesitate to contact Mike Walker at **mike.s.walker@kpmg.co.uk** should you require any further information or guidance in relation to insurance company Schemes and insolvencies.*

**Think Tank**

## Dassenko and Horbelt: Run-Off Past, Present and Future

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you might actually find some of your smartest and most dedicated people in the run-off area just because they understand the capital effectiveness of a decent run-off operation.

I think that profit center thinking in the run-off area has attracted new talents and has actually resulted in much more integrated thinking.

**P. Dassenko:** It has to be both, not either/or. People are extremely important, but people who understand the value of capital and capital efficiency are those who are really succeeding in the run-off arenas today.

**J. Veach:** Regarding Warren Buffet's thirst for buying these discontinued lines and placing big bets on entities like Equitas, is Equitas a high watermark of this kind for investment?

**P. Dassenko:** It may very well be in terms of size of transaction, but if companies start to treat run-off liabilities as the ordinary fallout of day-to-day business, we may see a series of much smaller transactions. These won't be headline grabbing, but I don't think we have seen the aggregate high watermark.

**O. Horbelt:** I think it goes back to the previous comment. It's interesting that there's only one organization out there with a business model that can take on deals like this, and that is Berkshire Hathaway.

Paul said it well, but it's interesting that business models exist that can actually deal with something as toxic as asbestos. Duplicating that business model, however, will not be easy.

**P. Scarpato:** Gentlemen, any expectations we had about this interview have been greatly exceeded. Jim and I thank you very much. ■