

AIRROC matters

LEVERAGING LEGACY LIABILITY



**Where in
the world is
my money?**

**BARBAGALLO, HORBELT & ROTHSEID LOOK INTO THE CRYSTAL BALL • THOU SHALL
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“Keep ‘Em Coming”

Peter A. Scarpato

The success of our magazine depends upon the unbounded generosity and prolific offerings of our authors and interviewees. Lest it seem to go unnoticed, we thank you all for your work. And yes, “keep ‘em coming.”

We begin with John West’s *Where in the World is My Money?*, an investigative, quantitative report on the geographic spread (or lack thereof) of reinsurance balances due U.S. cedants. His results, surprising to some, reveal that most collection roads lead to or through London. Next, in *A Young Person’s Perspective on the Blessing and Curse of the Paperless Insurer*, we get a refreshing view from Cara Anne Milione on the double-edged sword of electronic progress. To steal a phrase from the presidential campaign, Cara asks “are we better off today than we were years ago” before the advent of the paperless office? Robert Bear, Vice Chair of AIRROC’s Actuarial Committee, presents a “Summary of Survey Results on the Mandatory Commutation Clause,” identifying, among other findings, that AIRROC’s Dispute Resolution Procedure can greatly shorten the time and expense of actuarial arbitrations. *Farewell to AIRROC* is Trish’s goodbye to the beloved “child” she nurtured and grew over her very productive tenure with us. Having worked directly with Trish since 2005, I can, like so many

others, personally attest to her drive, integrity and charm. She is more a friend than a colleague, and I will miss her – but we all stand securely on the firm foundation she so carefully and effectively laid. Thank you Trish, and Godspeed.

Leah Spivey offers her interview of Carolyn Fahey, in *Future Plans for AIRROC*, giving us further insight into the background and objectives of our new Executive Director. In response to Leah’s probing questions, Carolyn presents her AIRROC “to-do” list, including expansion in membership, education and the use of technology.

Our Toolbox is brimming with useful info. Through quotes from session attendees and summary articles by Andrew Shapiro, Peter Matthews and Key Coleman, we get a glimpse into the success and substance of AIRROC’s June 2012 Regional Educational Sessions in Chicago. Topics covered include the many uses for Schedule F, a “how-to” on commutations and a mock arbitration. Not to be outdone, Bill Barbagallo, Bina Dagar and Joe Monahan penned summaries of the three Educational Sessions during the July 2012 membership meeting in New York, covering the insurance/reinsurance of sexual molestation claims, the state of tobacco litigation in Canada, and last but certainly not least, cutting edge claims for hydrofracking, nanotechnology, climate change and GMO’s (and if you don’t know what

that is, all the more reason to read the article).

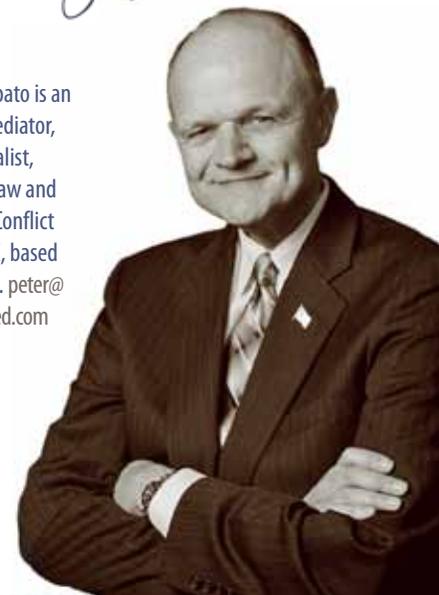
As you know, we are fond of roundtable interviews. For this issue, Connie O’Mara and I were fortunate enough to sit down and discuss the future of run-off and legacy business with Bill Barbagallo, Oliver Horbelt and Andrew Rothseid in the Who’s Talking segment, *What Lies Ahead?* Quick and candid with their informed observations, our interviewees used lenses forged in the flames of past mistakes to peer into the realm of future possibilities.

Include Nigel’s Present Value and you have yourself a magazine.

Let us hear from you. ●



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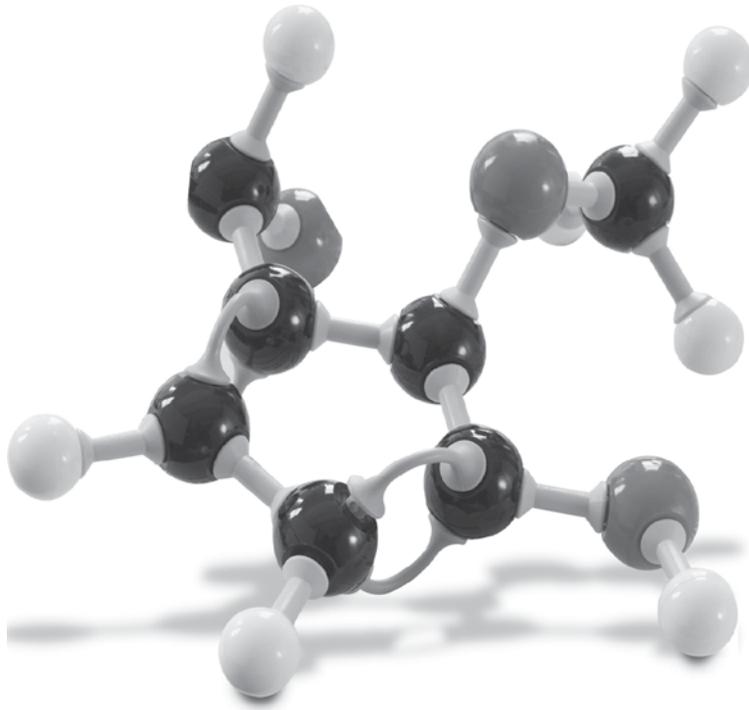
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Legacy/Run-off Business

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Where in the world is my money?



In the every day challenge of collecting reinsurance balances, there is usually never enough time to sit back and put it all in perspective. Typically, emphasis is placed on the balance due – not necessarily where in the world it will be coming from. But in fact, it is very interesting to take a look at how responsive markets around the world are to collection efforts from the U.S. cedents. Where in the world is your money? When it comes to reinsurance recoverables, chances are that it is in London!

A single cedent in the U.S. can face collecting from hundreds of reinsurance markets in the world. London being the fourth reinsurance market in size, it is only natural that a large portion of U.S. cedents' reinsurance recoverables are due from London players. In addition to amounts due from UK domiciled reinsurers, large reinsurance balances are also brokered through London or otherwise ultimately administered in London on behalf of non-UK domiciled reinsurers. This is a reality we all suffer. What makes it interesting, is the fact that the *oldest* recoverables are due from UK reinsurers.

In 2010 the *aged* balances which were due totaled \$2.5 Billion overall and the 2011 aged balances totaled \$2.4 Billion overall.

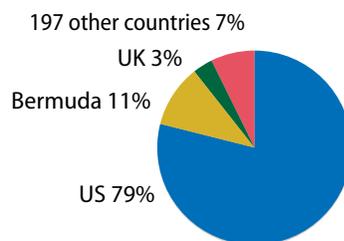
At the end of 2010, the annual statement data which is collected by the NAIC (National Association of Insurance Commissioners) reflected that over \$26 Billion was due in reinsurance recoverables from markets domiciled around the world to ceding companies domiciled in the United States. By the end of 2011, that gross outstanding number had increased to \$30.2 Billion. The pie charts show how these balances were distributed geographically.

Of those amounts due and outstanding, in 2010 the *aged* balances (amounts

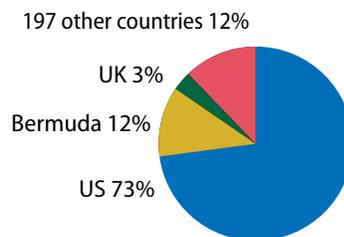
due which have been collectable and outstanding on a paid basis for greater than 90 days) which were due totaled \$2.5 Billion overall and the 2011 aged balances totaled \$2.4 Billion overall.

On the face of it, those relative balances don't seem extraordinary and in fact seem to show that aged recoverables decreased from one year to the next. The more intriguing point, and one which deserves some consideration, is the geographic distribution of those aged balances (see bar chart on page 9).

2010 recoverables



2011 recoverables



There is no other country that comes close to the UK in relative volume to comprise the same percentage of aged balances against total outstanding. If one looks straight at the bottom line of aged balances against overall balances (around the world), the average dollar amount against the overall was 10% in 2010 and 8% in 2011. There are currently about 200 countries in the world. \$29.2B (or 97%) of the total amount due in reinsurance at the end of 2011 was shown to be due from the

top 5 countries. Correspondingly, 93% of the aged balances were due from those same five countries. By far, the UK demonstrates the greatest lag time in payment, or processing of reinsurance recoverables.

In 2010, the aged balances due to U.S. cedents from reinsurers were as follows:

- U.S. reinsurers owed \$1.7 Billion (which is part of the overall balance of \$20 Billion – or 8%).
- Bermuda reinsurers owed \$165 Million part of their overall of \$2.8 Billion – or 6%.
- UK reinsurers owed \$438 Million part of their \$887 Million – or 50%.

In 2011, the aged balances stay consistent:

- U.S. reinsurers owed \$1.1 Billion (which is part of the overall balance of \$22 Billion – or 5%).
- Bermuda reinsurers owed \$172 Million part of their overall of \$3.6 Billion – or 5%.
- UK reinsurers owed \$350 Million part of their \$866 Million – or 41%.

The obvious question begging to be answered is, *“Why is the UK lagging so far behind the rest of the world when it comes to indemnification of those companies in the U.S. (and presumably elsewhere) where they provide reinsurance?”*

By far, the UK demonstrates the greatest lag time in payment, or processing of reinsurance recoverables.

Possible reasons for this situation:

- 1) Brokerage through London to non-UK domiciled reinsurers and
- 2) Reinsurance balances administered by offices located in the UK on behalf of non-UK domiciled companies. In other words, direct collections, brokered activity and collections on reinsurance administered in London all combine to affect a bottleneck of activity in an extremely concentrated and complicated environment which exists within a couple of square miles in downtown London. Even though a U.S. cedent



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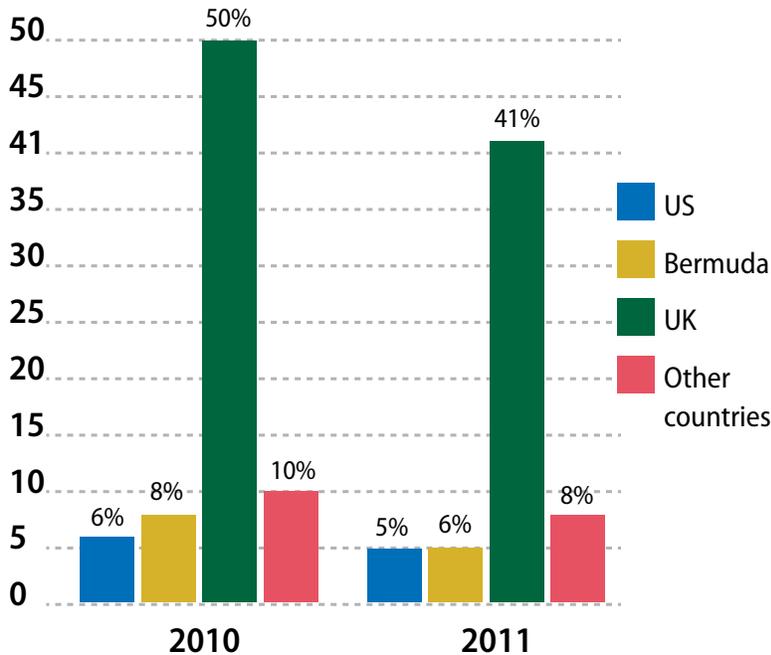
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Where in the World is My Money? (continued)

Over 90-day debt position per country over total outstanding



might have a collection due from a company domiciled in Japan, effectively, that balance could be administered and ultimately paid out of their London office.

I was helping my son untangle some fishing line the other night and it felt like I was trying to explain the London Reinsurance Market. If one was to draw lines to represent the movement of reinsurance placement from one country to another and one company to another, it would look like a ball of yarn being pulled through the eye of a needle. In fact, when the market was trying to unravel the LMX spiral in the 1990's, that is exactly what had to be done. There were so many primary contracts, reinsurance contracts, brokered events, circular placements that an incredible loss was impacting the market which should never have even existed! As an example, there was one specific loss which impacted primary policies for about \$12M. However, as that claim circulated through the LMX spiral, the amount which impacted the market became closer to \$60 M!

In London, there is a distinct sense of hands-on dealing when it comes to the actuality of the business at hand. There is a profound feeling of ownership and pride in making sure that client's claims are paid in accordance with contractual terms. The combination of transactional volume, focus on detail and a very concentrated environment lends itself to a natural lag on processing which can be accommodated most effectively by a very pro-active, interpersonal interaction which is the way business has been done in London for over 300 years. The most effective way of resolving one's reinsurance issues is through direct contact between relevant parties. This would be true whether those parties include the Lloyds market, whether there is a direct cedent to reinsurer relationship or whether one of the parties is a broker and is dealing either with the cedent or the reinsurer. Walking around the city with an oversized pouch containing the required documents is the best and most effective way on a daily basis to collect reinsurance funds which are due. It literally moves the

collection for a certain cedent to the front of the line.

In London, there is a distinct sense of hands-on dealing when it comes to the actuality of the business at hand.

What can be done to decrease the time lag? Properly used – communication, relationships and documentation are the tools needed to reduce turnaround time to bring it in line with the rest of the world. Companies can also mitigate the known causes of the lag:

- 1) Replace ineffective brokers with one which is equipped to handle legacy issues. Consolidate many brokers into one. Having a single point of contact reduces time and energy previously spent on communication, record transfer and reporting mechanisms.
- 2) Use a third party who can tap into the social aspect of how the London market works. To have someone on the ground in London who knows the right people, the processes and the reality of turnaround time will make a big impact on your ability to forecast, manage your expectations and control your costs. Also, having a representative constantly working your balances creates an efficiency in collections going forward. The markets are more acutely aware that you are pursuing your recoverable balances vigorously.
- 3) Be conscious of the financial health of your reinsurers and develop a plan (through commutations, or other) to collect as much of your current and future exposure as possible. ●



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From the Mouths of Babes...

A Young Person's Perspective on the Blessing and Curse of the Paperless Insurer



Illustration / Rafael Edwards

By design, computers and e-technology improve efficiency and effectiveness, nowhere more evident than in the paperless insurance office. What before took reams of paper, countless hours and endless phone calls, now flashes by in the click of a mouse. But are these impersonal efficiencies improving the business? In this article, an aspiring college student spending the summer at Munich Re prepping documents for e-scanning, ponders how IT advances have helped and hindered the business of insurance.

I am a third year college student with a summer job at Munich Re, whose major project consists of preparing hard copy documents for electronic scanning. Specifically, my work entails sifting through hundreds of file folders, which contain copies of insurance and reinsurance contracts from the 50's, 60's and 70's. I then organize the documents with unique bar-coded sheets, recording the corresponding information onto a master list. Ultimately, the goal is to establish an online coverage inventory of documents contained in hard copy folders as part of a larger paperless environment initiative. This coverage inventory will provide Munich Re

employees with increased efficiency and easy accessibility to documents which have been collected from various sources over many years.

While doing my daily work, it is fascinating to think back to when these documents were first created, before we had the benefit of computers. Even though computers have been around as long as I have been alive, they continue to transform the way companies function and do business. Although my summer project is rooted in new technology, each day I have to literally walk back and forth to a colossal bank of filing cabinets approximately 30 yards away, where the hard copy folders are

housed, back to the flat screened PC in a modern cubical to which I have been assigned. In the midst of all this paper and furniture, I realized the remarkable impact that technology has on our lives and in the workplace.

Thinking about the time that my father started in the business decades ago, when underwriters and claims professionals would have to cope with an overwhelming mountain of paper, I marvel at the amount of time that was required to find a particular file or document. Even with the benefit of alphabetical and numeric filing systems, there was no capacity to conduct an electronic search among a sea of thousands of documents. This transition to no paper and less storage furniture and space is probably no more dramatic than moving from scribed documents to the printing press.

Although the documents in my project are not yet fully available via an electronic system, the implications for the future are great. Employees will be able to locate their desired documents with an electronic search feature. The convenience and time saved will be considerable. Few would dispute that electronic systems expedite processes significantly. In addition, electronic document storage improves accessibility. For example, if an employee needs to forward a document to someone else, he or she no longer needs to retrieve and manually photocopy it. Instead, he or she may just send a link or make an electronic copy and e-mail it.

In addition, electronic storage permits many different people to view a given document simultaneously. In the past, people would have to wait for a document or folder to be returned and checked in. Those days are gone. Moreover, manual filing systems created opportunities for misplacing documents and folders. Electronic document

storage ensures consistent organization. Traditional filing cabinets of the past were sometimes left in a messy clutter of papers as soon as the drawer opened. The improved use of technology also reduces the degree of human error.

Although we want to enjoy the strategic benefits of technology, we must be careful to avoid losing the human interpersonal dimensions which are building blocks upon which many successful organizations are founded.

Many companies are embracing a nearly paperless work environment, and this is only just beginning to change the way that companies operate. As companies around the globe transition to paperless environments, we see many benefits from an eco-friendly system, like space saving and more efficient and effective use of square footage. Also, an increasing number of employees are being given the opportunity to do their work from remote locations (e.g., from home). The overall cost savings are tremendous.

As a matter of fact, due to this and other expense initiatives, Munich Re America is able to repurpose one of its four buildings at its Princeton location. Instead of office and file storage space, the building will house a conference and fitness center. This change will enhance the workplace experience of employees who take full advantage of the facilities provided. In addition, there will be a savings due to the decreased need to rent offsite facilities for large meetings.

A paperless document system is just one way that insurers like Munich Re

can improve the environment. Beyond simply reducing its use of paper, Munich Re has also taken bigger strides in technological advancements, like a solar panel installation project recently begun in the building's main parking lot. Upon completion, the solar panels will provide a source of renewable energy, further emphasizing Munich Re's environmental awareness. The solar panels also remind us that new technology is everywhere, not confined to one place in the office.

While technology certainly has its advantages including improved efficiency and accessibility, it is not without some possible shortcomings. As our world moves toward computers and electronics, does this limit the value and importance of human interaction? Many of us would prefer to work from home. But how will this affect our ability to form important business relationships and leverage our strengths through teamwork? Although we want to enjoy the strategic benefits of technology, we must be careful to avoid losing the human interpersonal dimensions which are building blocks upon which many successful organizations are founded.

In this small way, we can be true to the credo that makes great companies great: paying homage to the old tradition of person-to-person connections (my writing and your reading this article); while at the same time enjoying the advantages of enhanced use of technology in the traditional business of reinsurance. ●

Cara Anne Milione is a junior at Vanderbilt University's College of Arts & Sciences majoring in Political Science/Financial Economics. She is a Dean's List student and is studying in Florence, Italy this Fall Semester.



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Thou Shall Commute...Or Not?

Robert Bear

Summary of Survey Results on the Mandatory Commutation Clause

In late 2011, Betty Barrow and Steve Herman led the Actuarial Committee in its effort to conduct a survey regarding mandatory commutations. Respondents were given the following instructions:

“This is a questionnaire about mandatory commutation clauses, which we are defining as reinsurance contracts (ceded or assumed) with active liabilities where either side has the right to require a commutation, and where the contract contains either a preset formula, or procedure such as an actuarial valuation panel. For any of the questions below with percentages, please give us your best ballpark estimate, on a per contract basis....”

While twenty-two responses were received, only a small number of the respondents had experience with actuarial arbitrations. Below is a summary of major results:

1. The clause is usually invoked because the contract requires it – usually because

the contract calls for commutation after a certain number of years.

2. For contracts with mandatory commutation clauses:

- a) Commutation is required on a per claim basis at least 10% of the time,
- b) About 50% of contracts allow inclusion of IBNR, and
- c) There is a wide range for these percentages, depending on the book of business.

3. IBNR is usually estimated based on a formula in the contract, or actuarial arbitration if the parties don't agree.

4. Very few of the respondents had experience with actuarial arbitrations, but those who did reported that the process can take from 6 months to over 2 years, and that the process could be improved by shortening it. The Actuarial Committee concluded that the use of actuaries identified on the AIRROC Arbitrator List within its

Dispute Resolution Process may be able to expedite the actuarial arbitration process.

A Power Point presentation with graphical responses to the questions is available upon request to the email address below.

Our next survey on Sources of Actuarial Information will be conducted later this year and summarized in a future edition of AIRROC Matters. ●



Robert Bear is a Consulting Actuary and ARIAS-US Certified Arbitrator in the firm he has established, RAB Actuarial Solutions LLC. He currently serves as Vice Chair of the AIRROC Actuarial Committee. rabsolutions@gmail.com



Call for Authors

If you like the new look and focused content of AIRROC Matters, why not be a part of the message by submitting your own article? We are constantly “spanning the globe” for current issues and knowledgeable authors to address them for our growing, international audience, many of whom could be your current or future client. Articles range from 1200 to 1800 words in length, accompanied by your headshot, brief bio and email address. If you are interested, please contact Peter Scarpato, peter@conflictresolved.com, and/or Maryann Taylor, mtaylor@bswb.com. We will be happy to discuss your ideas and get you on the road to submitting an article for our readers. Let us hear from you.

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Farewell to AIRROC

Trish Getty



Trish has consistently demonstrated strong positive leadership, a can-do-it attitude and a great sense of humor—all of which helped to grow and strengthen AIRROC.

Trish is a generous mentor to many folks in the industry including me.

What I learned from Trish — the personal approach matters and stay positive — never take no for an answer!

*Katherine Barker
Co-Vice Chair of AIRROC,
Excalibur Re*

My tenure with AIRROC since June 2, 2004 has been one of the most rewarding experiences of my career. My forty seven years in the insurance industry was primarily driven as a reinsurer but I also stood in the shoes of a ceding company, an intermediary, primary claims agent, liquidation reinsurance administrator then marketing director for an acquisition party.

I know of no single individual with a deeper commitment to integrity and professionalism in our industry than Trish Getty. AIRROC's promotion of these values in the run-off space is a living, lasting tribute to Trish, as its founder.

*Paul Dassenko
Past Runoff Person of the Year*

When I was asked by the RAA to form AIRROC, I thought that, given my industry experience, this was the perfect place for me since I could relate to virtually any interested party.

Our twenty-seven founding members were clear in their desire to establish a venue where risk bearing entities could meet principal to principal to discuss their issues in managing their legacy books. In our early days we established committees and members agreed to participate on the various committees. In January of 2005, I observed counterparties entering committee meetings rather looking each other up and down. Six months later they greeted each other in a cordial manner! What I hoped for happened as I observed members quietly setting aside time to meet face to face to discuss their issues which made my heart sing! We were making a difference.

The initial board of directors was comprised of not only companies in run-off but ongoing writers and receivers so nobody was speaking to the choir. Input from various perspectives was essential to a thriving association. Why did AIRROC succeed? That's easy, it was the right time. I expect that AIRROC membership will continue to grow as more companies with legacy run-off books and related issues learn about our association that has so many values, particularly as they appreciate the value of networking with counterparties. I urge all of you to reach out to writers who would benefit from AIRROC membership. I recall a member who told me that their membership gave them the ability to know their counterparties and thereby avoided at least a dozen arbitrations. Think about the expense that saved them as well as it did for other members.

The people I have come to know through my work at AIRROC have become so very special to me. You will all be tremendously missed. However, it is time to focus on my family and other personal interests as I enter into retirement. Keep AIRROC healthy and growing! Farewell. ●

With strength of mind and spirit Trish spawned AIRROC from a fledgling organization into a market leader. She was a guiding light whose dedication will be sorely missed.

*Jonathan Rosen
Past Chair and Current Board
Member of AIRROC
The Home in Liquidation*



Trish and Tom Getty



From left: Leah Spivey, Karen Amos, Marianne Petillo, Trish Getty and Kathy Barker

Spivey Interviews Fahey

Future Plans for AIRROC

During the July Membership Meeting, Carolyn Fahey, AIRROC's new Executive Director, had reserved a conference room to accommodate various committee meetings and individual appointments. I happened to overhear Carolyn letting participants know that she could be found in room 3604 if not in the hallway or main meeting room. So, following a scheduled meeting, Carolyn and I stole an opportunity to sit down in Room 3604 to have a candid discussion about Carolyn and AIRROC.

Leah: *While most of AIRROC's constituency knows you, Carolyn, many do not know about your background. Would you please give us a rundown of your past experience?*

Carolyn: I started in the industry with the RAA, the Reinsurance Association of America where I spent 14 years and learned a great deal about association management. I was initially responsible for the RAA's ReLaw publications – the Digest, Compendium, Contract Clauses, Arbitrators Directory and ReArb.com – so some may know my name from those resources. I was also very involved with the Claims, Law and Underwriting committees and the RAA's ReEd programs. I also attended and worked with several industry-wide groups, including Excess/Surplus Lines, the IUA of London, the Insurance and Reinsurance Arbitration Task Force, Mealey's – those all helped me to get to know many leading industry professionals. On a non-industry note, during my time at the RAA, I also became a member of ASAE, the American Society of Association Executives and the ASTD, the American Society of Training Developers. Those organizations provide me terrific



photo / Jean-Marc Grambert

Carolyn Fahey, Executive Director of AIRROC

networking and resources that will help me in my role at AIRROC.

I also spent some time at the EEAC, the Equal Employment Advisory Council, as its first Director of Training and Development. I was responsible for instituting professional training programs within a human resource focused organization. It was there that I was most involved with issues of management and diversity requirements, EEO and affirmative action programs, and internal investigations. I developed programs to educate HR professionals from the EEAC's members.

I then moved to HB, formerly Mealey's, with responsibility for all insurance and

reinsurance training programs for the industry. Most notable for AIRROC was the Scottsdale Insurance and Reinsurance Insolvency Roundtable, which many AIRROC members would regularly attend. Two years ago HB partnered with AIRROC so I provided the educational session of that year's October Commutation Event.

Leah: *With all of that experience and background, what about AIRROC attracted you to accept its leadership position of Executive Director?*

Carolyn: Good question, Leah. I have known the organization since its infancy and have a relationship with

the original board members and Debra Hall and Frank Nutter. I also informally consulted with Trish Getty in her role as the founding Executive Director of AIRROC. I have always been impressed with how well AIRRROC developed and maintained its presence in the industry. As a matter of fact, I always wondered if it was a good decision to establish AIRROC as a separate entity from the RAA. I suppose in the long run it was, especially given my present circumstances.

Truthfully, after leaving the RAA, I really missed the association world, specifically committee work, board governance, and member relations. I truly believed that my past experience was one of the gifts I could bring to AIRROC. So, when I heard of the opportunity, I felt strongly that I should apply. The selection process left me with a good feeling of synergy. Ultimately, I agreed to offer my talents to this worthwhile endeavor, a new and exciting chapter in the life of AIRROC.

Leah: *Now that you have been with AIRROC for a whole 2 months, what have you identified as your top priorities as its new Executive Director?*

Carolyn: Short term my top priority is some additional structure around the organization. Operationally we will be implementing a new AMS, or Association Management System, to provide a database structure to enhance the AIRROC website, communications and member interaction. Think of this like a company intranet – I know that many of our members are used to working within those at their companies. A key feature is that it will allow for much more flexible interactive use by members, the Board of Directors and committees.

There appears to be a need to solidify the strategy that the Board implemented a couple of years ago, that some working groups explored and made recommendations to follow. I also have some ideas on initiatives but need to gather more data and information on the present state of affairs before finalizing my transition plan. I also need to assure

that the quality of our planned programs remains high with continued participant satisfaction before recommending any changes. We may just need to change how we do things not change the things we do.

We are enhancing our tracking of marketing efforts and will be clarifying our message and implementing an overarching marketing and membership growth plan by year's end.

I have started working with all of the committees and the Board of Directors on our immediate plans for the Commutation Event in October and the September and October Educational Programs as well as outreach to existing and potential new members. We are enhancing our tracking of marketing efforts and will be clarifying our message and implementing an overarching marketing and membership growth plan by year's end.

Leah: *Do you see any challenges or obstacles to AIRROC reaching its full*

potential as a leading industry resource for education and networking?

Carolyn: The greatest challenge is the busy schedules of the Board of Directors themselves as many of them chair committees and are responsible for much of the day-to-day activities of AIRROC. I see my major responsibility as making their high level of input into the organization easier in any way that I can. Again, putting more structure around the organization with something as simple as an AMS will be a great start. Working with the Executive Board Members, Board, and on all Committees will also go a long way in assuring that these volunteers are most productive for AIRROC.

Another challenge but also a great need is constant and clear communications between directors, committees and membership. This is the only way we will increase member engagement. I am committed to making sure that we fully utilize the robust communication capacity of our new AMS. I am also always reaching out to individuals involved in projects, programs and plans to make sure that I have the latest information to share with all.

AIRROC has grown and changed since its inception and we now need





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Future Plans for AIRROC...Interview with Carolyn Fahey (continued)

to revisit and clarify our Mission and align our Strategy. This is the challenge that we have ahead of us and that I have personally taken on in the role of Executive Director.

Leah: *What would you like to see accomplished by AIRROC over the next couple of years?*

Carolyn: I would like to see several successes and I will list them:

- Substantially expanded membership
- More engagement of current and new members through committee work
- Better use of technology
- Expansion of the Regional Educational Programs
- More virtual learning events
- Outreach abroad
- Joint ventures with the CPCU

- Possible cross association affiliations
- Closer relations with selected Risk Management Schools
- Creation of CROP (Certified Run Off Professional)

Leah: *Thank you so much, Carolyn. Before we conclude, is there anything that you would ask of the Board of Directors or Membership at this time?*

Carolyn: My virtual door is always open to ALL involved in AIRROC! Your ideas are always welcome and while I am continuing to assess the next steps for our organization I want to hear from you! I am blessed to have the support of such a fantastic Board and set of volunteers and look forward to working with all of you as we take AIRROC into the next generation. Stay tuned and stay involved.

.....

After putting her first very successful AIRROC Membership Meeting behind her, Carolyn returns to her home in Virginia – just outside of Washington DC – where she lives with her husband, two daughters (14 and 4), one son (13), 5 fish and a hound dog. And, room 3604 at our new legal counsel, Chadbourne & Parke’s Rockefeller Center Office will never be the same... ●



Leah Spivey is Senior Vice President and Head of the Environmental/Mass Tort Claims Department of Munich Re. ispivey@munichreamerica.com



Bring Out the Vote!

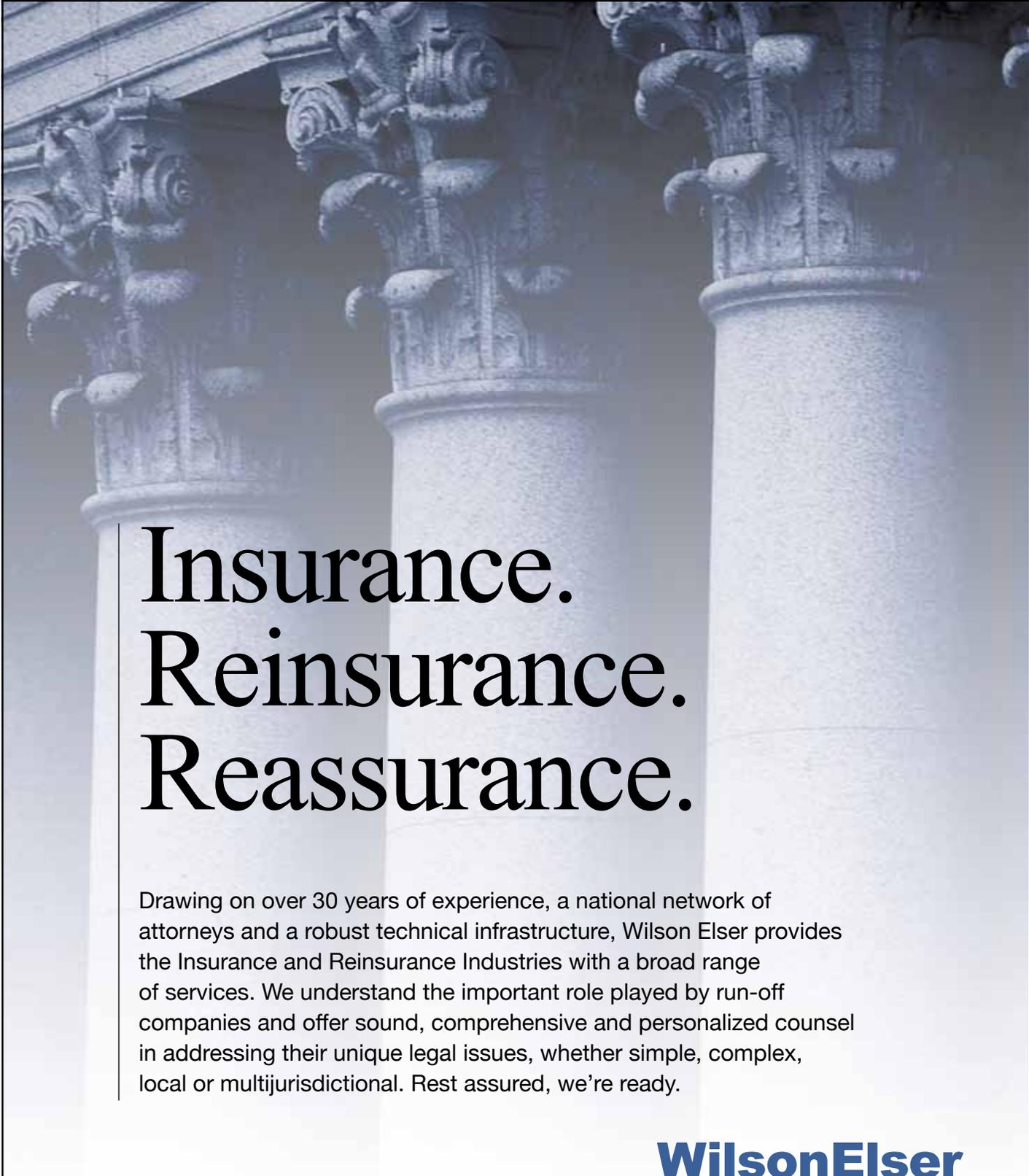
It is time for the AIRROC Board of Directors elections – remember to go to the AIRROC website (www.airroc.org) and cast your vote. We have five directors who are up for election this year with terms expiring at the end of 2012. New Board members will be announced at the Annual Meeting of Members at the October Commutation and Networking Event.

Make sure you register for the event! AIRROC members get one free registration – a terrific benefit of membership...see you there!

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A Day to Converge, Communicate & Commute

AIRROC Commutation Day, Chadbourne & Parke, New York City, July 18, 2012



photos / Jean-Marc Grambert

AIRROC Educational Session Summaries / Chicago

What they are saying....

Materials presented in a way that connected with the entire group

Greatly increased knowledge of the subjects presented and had fun during the process

Matthew Moore, Inpoint

...

Phenomenal job on the workshop & stunning success

Great networking tool

Look forward to future workshops

Sue Riehman, Allstate

...

Well thought-out, well-organized, well delivered

Very beneficial to attendees in building knowledge and sharpening skills

Met new interesting people

Ed Gibney, CNA

AIRROC is on the road! We conducted a regional educational session at the AON Center in Chicago on June 11, 2012, fulfilling our commitment to bring educational programming to everyone in our member organizations involved in legacy and run-off business. Three of the sessions are summarized in this section.

The Snapshot Speaks a Thousand Words

An Overview of Schedule F

Summarized by Andrew Shapiro

A distinguished panel of industry professionals presented the program's opening session: "Schedule F: An Overview and Who Uses It and How." With Mitchell Orpett of Tribler Orpett & Meyer, P.C. moderating, panelists Evan Bennett, Timothy Corley, Michael Cosentino and Joseph Scognamiglio provided thought-provoking insights into the real-world use of Schedule F, evoking audience participation and discussion throughout the presentation.

As Senior Manager — Reinsurance of the Office of the Special Deputy Receiver, Michael Cosentino began the session by offering a rare opportunity to hear how regulators and rating agencies use Schedule F in their unique oversight roles. Noting that those groups serve different constituents—regulators look out for policyholders, while rating agencies serve corporate investors—Cosentino confirmed that the groups often focus on different aspects of Schedule F than company management. Cosentino explained that in using Schedule F to assess a company's solvency protections, regulators are

likely to focus on information regarding the company's uncollectable reinsurance. Cosentino contrasted that viewpoint with that of rating agencies, which use Schedule F to assess the company's financial strength. He suggested that rating agencies will use Schedule F to determine who is reinsuring the company so that they can assess the financial strength of the company's reinsurers and apply appropriate risk charges. Cosentino further explained that the risk-based capital model used by regulators typically does not strongly differentiate between the creditworthiness of different reinsurers.

A different perspective was offered by Evan Bennett, Director, Reinsurance Consulting with Blackman Kallick LLP, who identified some of the issues that an auditor focuses on when using Schedule F. Generally, explained Bennett, auditors are most interested in determining whether controls are in place to ensure that data is "accurate and reliable." Bennett noted, however, that auditors also typically assess the adequacy of the company's reinsurance protection, asking whether the company has a system in place to ensure that its reinsurance is collectable. In Bennett's view, many audit clients expect their brokers to monitor their reinsurers' financial stability. It is becoming more common, however, for cedents to more closely scrutinize the security provided by their reinsurers and to consider whether the reinsurers will be around to pay claims down the road. Joseph Scognamiglio, President of Quantum Consulting, Inc., opined that the identity of the company's reinsurers was the most important piece of information set forth in Schedule F, and careful consideration of the reinsurers' financial strength is important when determining the collectability the company's reinsurance.

Timothy Corley, Senior Solutions Executive of Inpoint, Inc., provided a broker's perspective of Schedule F. Corley explained that, historically, the broker uses Schedule F to gain

market intelligence and to find business opportunities. For instance, Corley said, if the schedule shows that a company is paying a large penalty, the broker may be able to offer the company a plan that will save the company money by reducing the penalty. Corley also noted that the broker may focus on overdue reinsurance to determine whether the company has a collectability problem.

The balance of the session included discussions about what is necessary to formally classify something as a dispute in Schedule F and the role outside counsel can play to assist parties before an arbitration demand is filed. Mitchell Orpett suggested that using in-house or outside counsel early in the process is critical to developing a successful strategy and to reducing the company's long-term legal expenses.

Overall, the session provided a unique view of how different industry players actually use Schedule F on a day-to-day basis to achieve their goals. ●

Andrew Shapiro is a Partner at Butler Ruben Saltarelli & Boyd LLP. ashapiro@butlerrubin.com

How and When to Cut the Cord

Commutations Panel

Summarized by Peter Matthews

I was one of four panelists on the Commutations Panel. Our Moderator was Catherine Isley (a partner at Butler Ruben) and the entire event was organised by Barbara Murray (SVP, Lumbermens Mutual).

Both Catherine and Barbara did a great job in making this industry event one of the most engaging, informative and interactive that I have attended.

I was the only individual from the UK for the event and greatly enjoyed our panel discussion. My fellow panel

members were Sheila Chapman (Vice President, Zurich), Matt Moore (Senior Solutions Specialist, Inpoint), and Alan Hines (Managing Director, PwC), all of whom have a great understanding of the world of commutations and were able to approach the topic from their respective and diverse skill sets.

Matt drew on his wealth of claims and reinsurance expertise gained at Travelers, Nationwide and Ace.

Alan's deep understanding of the Actuarial world was insightful and Sheila's reinsurance career, in particular her role at Zurich, meant she was able to apply her expertise and practical application to the world of commutations.

Yours truly has negotiated many commutations over the past 15 years varying greatly in size from as little as \$15,000 to as much as \$10,000,000.

For the benefit of the audience Catherine defined what a commutation actually is. Sheila then went on to detail the motivations for a company seeking commutation with a counterparty including the need for liquidity, dispute resolution (including slow/non-payment activity), reduction of administration costs, elimination of risk from an assumed book, exiting the market or a particular line of business due to run-off or insolvency. Additional commutation triggers were identified or expanded upon such as solvency risk (where a real danger is present that a reinsurer could no longer be in business before the year is out) and the sale of a book of business or portfolio to a third party which then drives a proactive commutation strategy in where the acquirer seeks to extract value from the acquisition as quickly as possible.

We then moved on to discuss the chronology of a commutation. Once a company has decided to look at commutation, a team of professionals from both inside and outside the company then become involved. Whilst each company will have its own formal/informal procedures for managing the commutation process there will be a

Content well organized

Variety of presenters with experience from various perspectives

Topic time allowance perfect and facility quite good

Breakout session was a great experience

Able to touch base with peers

Laura Prescott, Swiss Re

...

Enjoyable, productive, informative

Breakout groups conducting mock commutation negotiation really added value, a first time experience for some

Met excellent new contacts and strengthened relationships with others

Peter Matthews,
Global Re Group

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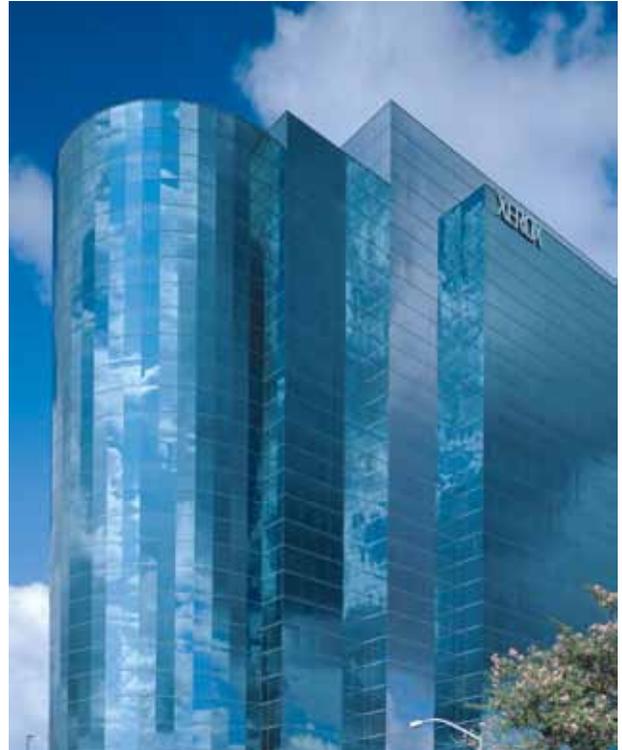
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AIRROC Educational Session Summaries / Chicago (continued)

typical chronology to work through. Sheila outlined this chronology but commented that all commutations will be approached slightly differently depending on whether they are more actuarially or claims driven, for example.

With Alan and Matt being the Actuarial and Claims experts respectively, each detailed their roles in the pre-negotiation commutation process which highlighted the coordination needed between these key areas.

Other key component areas involved in the commutation process are Accounting, Management, Legal, the Broker and, if appointed, the Consultant.

Once the scope of the commutation has been defined (i.e. single contract, multi contract, or global) then the negotiation can begin.

Negotiating the commutation itself is key and should be conducted by those individuals within the organisation who possess sufficient expertise in handling this process and also have the necessary authority to conclude the deal when appropriate.

Every commutation negotiation is different but many of the same approaches usually manifest themselves such as the 'Start High, Counter Low, Meet in the Middle' scenario. However, you should always be in a position to justify your IBNR number to the other party.

The successful finalisation of a commutation may not always run smoothly and certainly if parties become entrenched in their positions they will never reach a mutually agreeable number.

Other ways that a commutation can fall apart is where the receiving party is too slow to accept what their reinsurer is telling them such as their lack of financial ability to pay. In this instance the reinsurer then goes into liquidation or 141 procedure before the commutation is concluded and a substantial or major portion of the previously available commutation funds are then lost.

Our panel was also due to address the special concerns in relation to negotiating commutations with foreign companies but unfortunately we did not have enough time to cover this topic in any real detail. (Perhaps a subject for a future AIRROC Educational Session!)

The panel concluded with the members advising their top tips when dealing with commutations. Comments such as 'Making sure you involve all the internal processes at the start' and 'Being careful when negotiating a global deal' were made.

The Mock Commutation Negotiation between Matt Moore and myself was a lot of fun and provided an excellent base for the workshops that then took place in the afternoon.

All in all a great panel to be a part of – I learnt a lot and hopefully the audience gained some further insight into the wonderful world that is Commutations. ●

Peter Matthews is a CEO of Global Re Group which amongst other areas of consulting expertise specialises in the successful conclusion and negotiation of commutations for its worldwide client base.
Peter@globalre-group.com

The Great Debate

"What the great ones do, the less prattle of..." William Shakespeare

Summarized by Key Coleman

The reinsurance greats and runoff kingpins were out in force on when AIRROC came to Chicago. They were welcomed with a sizeable crowd and great enthusiasm.

After a morning of reviewing the 'nuts and bolts' of the statutory annual statement's infamous Schedule F, Messrs. DiGiovanni and Hermes (Nick & Bob) put our knowledge to the test with a rousing mock arbitration.

Our fact pattern included two companies that had each reinsured

Great program as well as interaction with other attendees

Appreciated other perspectives and approaches

Environment provided easy communication with others

Ursula Merten,
Lumbermens Mutual
Group

...

Be sure to tailor the topics to the experience level of the attendees for best and efficient use of time

Continue this sort of regional education

Sufficient time to network

Michael Baschwitz, Zurich
Insurance Group

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- A former Insurance Commissioner
- A former counsel to the Pennsylvania Insurance Department
- Experienced litigators in reinsurance, class action and coverage issues
- Former counsel to a national surety company
- In-house claim departments experience

The Issues

- Regulatory matters before state and federal agencies
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- Class actions
- Coverage matters
- Expert testimony
- Corporate insurance company transactions



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AIRROC Educational Session Summaries / Chicago (continued)

each other on two separate fronting arrangements.

The first company, Luck Be a Lady Tonight (Luck) had wisely signed onto a reinsurance contract covering a \$1 billion book of Residual Value Aircraft Policies (will they ever learn) from the second company, Help Me Help You (Help). As Luck would have it, Help was needed to reconcile Schedule F balances between the two companies.

On the flip-side, Help had reinsured Luck's prize book of workers comp business under a cleverly constructed "carve-out reinsurance agreement" (smile when you say that – it's the gift that keeps giving). Help does not allocate IBNR by program, so there is no way to tell if they match up to Luck on Schedule F.

Little or no contract documentation could be found, and about the only thing the companies agreed upon is that they will continue to deny each other's claims.

With this backdrop, Nick & Bob duked it out on two tantalizing arguments:

1. Luck's motion to stay litigation and compel arbitration, and
2. Help's motion to compel Luck to provide additional collateral and Luck's corresponding motion to allow set off or off set.

With regard to the first argument, Nick was quick to point out the fact that one could expect different treatment in litigation versus arbitration on certain issues such as:

1. Expenses in addition to limits, and
2. Follow the settlements.

He went on to argue the benefits of arbitration include the fact that it is a long-standing tradition in the reinsurance industry, it is confidential, and it is better equipped to handle a situation like this (where contracts have been lost) due to the fact that experienced reinsurance professionals can find their own way in the dark.

Nick, always on his game, jumped out front, not only to frame the case, but also to name its key witnesses, Ms. Lina Lina Pants-on-Fire and Mr. I. M. Truthful. Relying on the Truthful affidavit, Nick argued that, even though there were no contract wordings available, the parties should be compelled to arbitrate because the custom and practice in the industry was to arbitrate and because the parties had previously arbitrated other disputes between them.

Bob bolstered Help's side of the argument stating that if no agreement exists regarding the parties intentions to arbitrate, then the court should summarily conclude there was no intention to do so. Bob cited Luck's VP of Reinsurance Claims, who, in an affidavit, stated that the CEO had told the ceded reinsurance department to stop issuing certificates that included arbitration clauses.

When it came to the set off argument, Nick claimed Luck should be able to set off \$50 million in paid losses it is owed by Help from the \$150 million Help is claiming from Luck. Nick claimed that collateral should be reduced by \$50 million.

Conclusion

Once arguments were made, the esteemed audience was given the chance to draw their own conclusions on the issues. Their consensus opinion was that:

1. No parties are bound to arbitrate without such an agreement in writing, and
2. The right of offset is well established.

AIRROC members and attendees were, indeed, lucky to have Help of this calibre in wrestling with issues of this magnitude. ●

Key Coleman is Managing Director at Grant Thornton LLP. key.coleman@us.gt.com

Huge success!

Pat Van Wert, Inpoint 2

...

*Very good overall program
informative, educational
and engaging*

*Presenters kept our
attention while discussing
the topics and provided
various views or positions
on the topic*

*Benefits as to providing
information and meeting
others in the insurance
field and various views of
the same topic*

*Engaged in conversation
with other company
representatives to enable
future commutation
discussions*

Vickie Montgomery,
Liberty Mutual

AIRROC Educational Session Summaries / New York



Greg Caruso of Munich Re, Andrew Lewner of Stroock & Stroock & Lavan, Julie Secor of Eastpoint, William Barbagallo of PricewaterhouseCoopers, and Michael Goldstein of Mound Cotton Wollan & Greengrass

AIRROC hits the Big Apple! On July 19, 2012, an AIRROC Membership meeting was held at the New York City offices of our new general counsel, David Raim, Esq. of Chadbourne & Parke. This section summarizes the topical, thought-provoking educational sessions presented at the meeting.

A Complex Conundrum

Sexual Molestation Claims Panel Summary

Summarized by Bill Barbagallo

Bill Barbagallo moderated a panel to discuss coverage issues associated with Sexual Molestation cases. The panel, consisting of Julie Secor with Eastpoint, Greg Caruso with Munich Re, Andy Lewner with Stroock & Stroock & Lavan, and Michael Goldstein with Mound Cotton, assumed cedant and reinsurer roles as a fact pattern was presented.

A discussion ensued surrounding the definitions of an insured and occurrence, liability and damages, as well as loss and expense allocation. Although it is agreed, as in most cases, coverage determinations and reinsurance contract applicability are made based on both the facts of the loss, the policy language and contract wording, there was agreement amongst the panelists that these losses are some of the most difficult to evaluate due to the inflammatory element of the act itself.

Many of the losses reported involve allegations against the employer of the perpetrator for negligent hiring, negligent supervision, vicarious liability, and “respond eat superior”. Oftentimes the cases involve multiple acts of molestation over multiple years and may also involve multiple employees and multiple victims. The employees responsible for the acts of molestation are not considered “insured” under a General Liability policy due to the intentional nature of the act. The number of occurrences is determined by the acts of molestation, and the total years of loss is most commonly calculated based on the beginning and ending dates of loss.

The evaluation of the plaintiffs claim is extraordinarily variable and is deter-

mined by a variety of factors including the number of times the individual was molested, the frequency of medical care, lifestyle impact, and the action taken by the employer once they became aware that the act had occurred, if any. Cases rarely reach trial due to the monetary implications. Most plaintiffs seek the highest settlement they can obtain. To effectively achieve that goal, they must not only prove that the acts committed by the employee were horrible but that the employer consciously disregarded the safety of the victim and was grossly negligent and reckless in either their hiring or supervising practices. If this is successfully proven, the insurance carrier can more strongly assert that the actions of not only the employee but the employer were intentional and therefore not covered. Without the insurance proceeds, there is less money available for victim compensation. For this reason, settlements are compromised with contributions from both the employer and carrier. As a result, there is no guidance to help quantify the average settlement value of these claims.

Once a settlement is reached, the amount of the carrier’s loss and expense contribution is then allocated amongst the year(s) of loss. The carrier then

bills the reinsurer for their share of the contribution based on the impact to the affected policies. Although this explanation is arguably straight forward, panelists offered that disputes have often occurred when the carrier's reinsurance submission contains a different allocation amongst impacted policies presumably for the purpose of maximizing their reinsurance recovery. Although the reinsurer acknowledges their duty to participate in the loss per the terms of the contract, the allocation to impacted policies should be

consistent with how the settlement with the policyholder was allocated.

Given the fact specific nature of these losses as well as the volatility associated with potentially large jury awards, these sensitive cases remain challenging for both the insurers and reinsurers to evaluate and resolve. ●

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Smoke Signals from the North

Tobacco Litigation in Canada

Summarized by Bina Dagar

According to Roderic McLauchlan, Partner, Clyde & Co (Canada) LLP, the history of tobacco litigation in Canada goes back 20 years. Individual claims started appearing in the 1980s and 1990s and were unsuccessful. Class actions by smokers followed in the 1990s, of which many, such as Caputo in Ontario, stumbled at the stage of certification. The court did leave the door open to

narrower classes, and there are several class actions pending nationwide. There are generally two types of classes: 1) addiction to cigarettes; 2) injury caused by tobacco through inhalation.

All eyes currently are on Quebec, which has the biggest class action case pending, Letourneau/Blais/ Quebec Counsel on Tobacco and Health. Trial started in March 2012 and will continue into 2013. This case consolidated two class action claims, for addiction (Letourneau) and for illness caused by tobacco (Yvan Blais). Quebec is unique among Canadian provinces in being a civil law jurisdiction. And it is one of the most lenient in terms of certification in North America.



Roderic McLauchlan of Clyde & Co (Canada)

Although non-pecuniary damages are capped in Canada, they represent big sums. For Letourneau, claimed damages total about \$17 billion, and for Blais/ Quebec Counsel, about \$10 billion. Tobacco companies' response to this class action is that they followed government guidance, the public knew all along of the risk, and this is just an "opportunistic cash grab" on the part of the plaintiffs. The biggest hurdle for the plaintiffs is to prove specific causation and damages.

The other notable private law claim is for "light" cigarettes where the Knight case has been certified in British Columbia (BC) as a statutory claim under the Trade Practices Act of 1996 seeking damages and refund by Imperial of all sums paid (unqualified) by class members for light cigarettes.

Of even greater consequence is the cascade of government healthcare cost reimbursement claims, led by BC. In Canada, about 90% of health costs are borne by government. BC's Tobacco



AIRROC Educational Session Summaries / New York (continued)

Damages and Health Care Costs Recovery Act of 2000 allows the government “a direct and distinct action” to “recover cost of health care benefits caused or contributed to by a tobacco related wrong.” (BC Act s. 2 (1)). While the government must prove breach of duty to persons under common law, statute or equity, the act reverses burdens of proof, permits epidemiological evidence, and apportions damages based on market share. Its constitutionality was upheld in 2005. Limitation periods are waived. Nearly all provinces have followed suit, and the estimated provincial healthcare costs claimed to date are in excess of \$130 billion.

With such high stakes, tobacco companies are launching constitutional and jurisdictional challenges. Faced with rejection, they say they will fight all the way.

Insurance coverage will raise many old and new issues: fortuity, whether the losses are named perils, and aggregation. Given that over 50 years of policies might be in play, exclusions will differ significantly. With uncertainty regarding liability, these matters may wait to be tested only after litigation is over. ●

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From left: Mark Travers, Jeremy Dongilli, Timothy Krippner, David Wallis, David Raim, Karen Amos

Claims on the Cutting Edge

Hydrofracking, Nanotechnology, Climate Change & Genetically Modified Organisms

Jeremy Dongilli, Senior Complex Director of Mass Tort Claims for Chartis, Timothy Krippner from Segal, McCambridge, Singer & Mahoney, Ltd., Mark Travers, principal at ENVIRON, and David Wallis, partner with Chadbourne & Parke, LLP presented

an engaging panel discussion entitled Emerging Issues: Hydrofracking, Nanotechnology, Climate Change and Genetically Modified Organisms. This article provides just a useful summary of the many covered topics.

Mr. Dongilli first defined “nanotechnology” as “the understanding and control of matter at dimensions between approximately 1 and 100 nanometers, where unique phenomena enable novel applications.” He put this in perspective by noting that if Big Ben were reduced to a nanometer, the UK would be about the size of a red blood cell. He next gave a few examples of how the technology is commonly used today, including the automotive industry, cosmetics, band aids and sunscreens. The technology is popular and widely used in the health and fitness area because silver nanoparticles have anti-microbial properties. Mr. Dongilli also explained that as research progresses, nano-technology might be used to develop far less invasive and more targeted drugs to combat disease by, for example, delivering medicine directly to a particular cell.

Mr. Dongilli’s turned to a consideration of nanotechnology risks. Though not presently known, several studies have shown some potential health risks, including a mesothelioma-like cancer, similar to the result of exposure to asbestos, and potential DNA damage caused by exposure to



Members of the audience



nano-particles. Other studies suggested possible environmental impacts from the escape of silver nano-particles from clothing in wash water. As Mr. Dongilli closed, however, he noted that presently no one knows which nano-particles are hazardous to humans, and if they are hazardous, at what level of concentration the particles must be found to cause harm.

Mark Travers next discussed hydraulic fracturing or “hyrdofracking”, a technique used in drilling for oil and natural gas deposits trapped in source rock. The technology creates fractures in rock into which particles and chemicals are forced to free the deposits. While the industry could not economically access these deposits until relatively recently, hydrofracking and advancements in directional drilling afford access to these deposits. Mr. Travers explained that while more “green” chemicals are now used in hyrdofracking, the process nevertheless raises significant environmental issues because the wastewater from the wells contains chemicals, metals and potentially radioactive materials. Other potential issues include the increased amount of methane migrating from drilling zone to groundwater, potential silica exposure at the sites, and at least a potential for earthquakes caused when fracking destabilizes the ground.

Tim Krippner followed, speaking of climate change litigation. He emphasized

that in defending such actions, it is difficult to prove a causal connection between an extreme weather event, for instance, and human influence. While the scientific community is close to agreeing that human causes contribute to global warming, good challenges can still be made to a plaintiff’s causation theory. He explained that while data from the Environmental Protection Agency may give enough support for a general causation argument, it may not be enough for specific causation of a particular weather event, for example. He closed by noting that even if a plaintiff cannot prove causation, where a defense obligation exists, these suits are still very expensive to defend.

David Wallis was last, speaking about genetically modified organisms or “GMOs”. He opened by noting that GMOs have been around for a long time, marked by farmers’ harvesting seeds based on their yields, their hardiness, etc. and the selective breeding of plants and animals. Now, however, more DNA modification and transplanting of genes across species have occurred. He discussed three particular fields where GMOs are prevalent: medical, industrial, and agricultural, the last of which is responsible for the most litigation over the past ten years. Mr. Wallis gave as an example of agricultural GMOs the creation of herbicide resistant crops, and noted that 94% of soy beans are GMO.

As part of the “first generation” GMO litigation, Mr. Wallis explained that some suits involved neighboring farm properties, with one farm growing GMO crops and the other attempting to grow organic crops. Due to the inevitable migration of seeds across the boundary line, the organic farm might inadvertently produce GMO crops, leading to potential loss of the farm’s organic certification, ability to meet contractual production obligations, and ability to market its crops at premiums associated with organic product. Such suits have arisen against the GMO farm for nuisance, trespass or negligence. Other suits have been filed against neighboring non-GMO farms for intellectual property infringement by virtue of their growing and selling GMO product sold to the neighboring GMO farm. Mr. Wallis spoke of the “second generation” of GMO liability, claims for failure to label or disclose the use of GMO products in something otherwise called “natural”. These suits are often based on consumer fraud statutes, which sanction treble damages and attorney fees for the plaintiff. They have also given rise to class actions, leading to, as Mr. Wallis noted, “gigantic monetary obligations,” another form of “GMO.” ●

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Rahul Mehta and Kathy Barker



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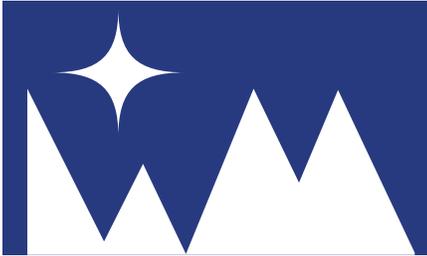
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News & Events

White Mountains on acquisition spree



White Mountains Solutions, the wholly owned subsidiary of Bermuda-based White Mountains Insurance Group, has announced two further acquisitions.

The specialist runoff unit is to acquire Physicians Insurance of Ohio and Citation Insurance Company from PICO Holdings. Both companies ceased underwriting in the mid-1990s and have been in run-off since.

Under the terms of the agreement, White Mountains Solutions will pay approximately \$17 million subject to certain targeted pre-closing dividends. Expected to be completed in the third quarter of 2012, the transaction and related dividends are subject to Department of Insurance approvals in both California and Ohio.

In a separate acquisition, White Mountains Solutions has announced it will buy American General Indemnity Company and American General Property Insurance Company from American International Group, Inc. The \$35 million transaction is expected to close during the third quarter of 2012, subject to customary closing conditions and regulatory approval from the Departments of Insurance in Illinois and Tennessee.

RiverStone buys Brit run-off

RiverStone, the run-off subsidiary of Canada's Fairfax Financial Holdings, has agreed to purchase Brit Insurance Limited ("BIL") of London, which

wrote UK domestic, as well as some international, insurance and reinsurance before being placed into runoff earlier this year. The transaction, subject to regulatory approval, is expected to close in the fourth quarter of 2012.

At March 31, 2012, BIL's gross and net reserves were approximately \$1.9 billion and \$1.3 billion, respectively, its cash and invested assets were approximately \$1.9 billion, and its book value was approximately \$530 million.

RiverStone will purchase BIL at a discount to its book value, adjusted for certain pre-closing dividends. The purchase price for BIL is expected to be approximately \$300 million, subject to certain adjustments at closing. The acquisition is expected to be financed using internal resources at RiverStone.

The renewal rights, operations and assets of BIL's UK regional operations were sold to QBE Insurance (Europe) in April 2012.

Catalina acquires legacy businesses from HSBC

Catalina Holdings (Bermuda) Ltd. has signed a definitive agreement to acquire two legacy businesses from HSBC Holdings plc.; HSBC Reinsurance Limited and HSBC Insurance (Ireland) Limited.

With assets of approximately \$273 million as of March 31, 2012, the two HSBC units predominantly wrote creditor, property, travel and motor business. HSBC Reinsurance Limited was placed into run-off in June 2010 and HSBC Insurance (Ireland) Limited was placed into run-off in June 2009.

Established in 2005, Catalina has made six acquisitions to date with average consideration in excess of \$100 million, including Overseas Partners, Quanta Capital, Alea Holdings UK, Western General Insurance, Glacier Reinsurance and Residential Loss Control Holdings.



PEOPLE



Brian O'Hara is planning a return to the market with a new run-off facility, three years after retiring as chairman and chief executive of XL Group. Speaking at the Insurance Day Summit Bermuda in June, he told delegates that he was working to build a new model for run-off of discontinued lines, focusing on a different legal approach in Bermuda. ●

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 Nigel Curtis at the Publications Committee at ncurtis@fastmail.us.

What Lies Ahead?

Barbagallo, Horbelt and Rothseid Muse on the Future of Legacy/Run-off Business



No one has THE crystal ball...if they did, the future would be boring. But our three distinguished panelists, Bill Barbagallo, Oliver Horbelt and Andy Rothseid, explore the possibilities that lie over the mountain in an insightful, candid discussion with Connie O'Mara and Peter Scarpato.

Connie O'Mara: *What is the current state of the runoff business and is there a trend if you see one?*

Andy Rothseid: The runoff business continues to prosper and opportunities to increase financial performance are motivating opportunities in the marketplace.

We are seeing an increased focus on companies looking for balance sheet relief, rationalizing their financial performance, removing volatility from their books of business and legitimate devices to access trapped capital. There are more reinsurance and acquisition

transactions involving discontinued blocks of business and an increased concentration and effort by runoff acquirers to look beyond traditional runoff blocks of business and examine asset-rich, active underwriting platforms. These ongoing platforms provide runoff acquirers with opportunities to leverage their existing balance sheets.

Connie: *Andy, can you give me an example of a way in which a runoff company might leverage an existing balance sheet strength?*

Andy: We are in an extended period of low investment yield returns.

When a company is yielding 3 or 3.5% on investments and seeing reserve deterioration, conservatively, of a minimum of 5%, there must be a way it can increase its financial performance and return to shareholders. This comes from the volume of assets under management.

Existing underwriting platforms, while perhaps not profitable as ongoing ventures, frequently lack the

Pictured above from left: Bill Barbagallo of PricewaterhouseCoopers LLP, Oliver Horbelt of Munich Re, and Andy Rothseid of RunOff Re.Solve LLC

loss characteristics and loss reserve development that plague traditional runoff businesses. Runoff acquirers seeking platforms in the active market are looking for asset rich portfolios with limited downside liability risks to increase their return to shareholders.

Connie: *Essentially a company that has studiously reserved would be asset rich with little downside because it planned for losses, to the extent that's possible given volatility in some lines of business?*

Andy: It's being both studiously reserved, and less exposed to the more volatile risks, asbestos, pollution and health hazard risks, that are the common denominators among legacy books of business. The absence of these types of liabilities allows runoff acquirers to find these ongoing platforms attractive.

Bill Barbagallo: We're also seeing a trend towards a different group of exposures that companies are looking at for runoff, the primary one being worker's compensation. More companies are looking at old worker's compensation losses still on their books. Many self-insured corporations have these old worker's compensation losses still on their books.

They represent substantial reserves but when you're talking about volatility, they're pretty low because many old cases are now life pension cases. Decisions have already been rendered. It's known, but for a pure actuarial exercise using the latest mortality tables, granted medical costs can still be unknown, but once again, when you're dealing with older worker's comp losses even medical is somewhat known and stable.

So, there's a trend right now in expanding beyond traditional toxic tort, asbestos, environmental and health hazard books, to worker's compensation.

Oliver Horbelt: I wouldn't say that we see a trend in the current market that hasn't been in the market over the past few years. As to finality, there are still too many buyers chasing even fewer deals. Also, sellers' motivations are fairly stable, centering on corporate restructuring,

and capital repatriation and efficiency. Obviously, when the ten year Treasury yields less than 1.5%, the margin for cheating has basically disappeared and the pressure towards balance sheet workouts has increased.

...there is plenty of capital on stand-by to support transactions like runoff acquisitions and insurance buyouts and restructurings, well beyond the pure concept of runoff deals.

— Horbelt

As to valuation and balance sheet leverage, carrying substantial long-term liabilities is absorbing capital, limiting the underwriting of potentially profitable future business. At the same time, those reserves are tying-up risky assets, which many European insurers face after investing in presumably risk-free assets, which turned out to be anything but risk free, and so many companies are getting squeezed on both sides of the balance sheet. Many Loss Portfolio Transfer inquiries in Europe today are probably driven as much by the asset side as by the liability side.

Peter Scarpato: *What is the impact of current financial market conditions like interest rates and availability of financing on acquisitions?*

Oliver: Interest rates are low for most developed economies. Interest rates as well as credit default swaps are not so low in certain peripheral economies within Europe. As to financing availability, there is plenty of capital on stand-by to support transactions like runoff acquisitions and insurance buyouts and restructurings, well beyond the pure concept of runoff deals. If the market is trading at around 80% book value, it might be attractive to target a going concern, if one can buy it at a sufficient discount to book value and

operate it as a runoff platform. What does this say about a market that negatively values the franchise values of many enterprises?

This all happens during a time when supervision and regulatory frameworks become more stringent. We experienced something similar in the banking industry which introduced heightened capital requirements amidst major turmoil in the macroeconomic environment and the adjustment process is prolonged and ongoing.

Andy: There have been many runoff acquisitions in the last two or three years. The acquirers have either their own internal financial resources or a track record that allows them to attract additional capital.

There is a tremendous amount of capital looking to be deployed in the market and it is the *financial* investor, not the insurance or reinsurance *strategic* investor, who wants to enter the market, but perhaps with unrealistic return expectations based upon their experience with other businesses. For the market to move more efficiently and for these businesses to be transferred more expeditiously than we have seen in even the last 12 to 18 months, financial investors will hopefully realize that value exists within these balance sheets and that the traditional range of expected investment returns does not necessarily uniformly apply to all books of business.

Connie: *Regarding this increase in the sales of books of business over the past few years, what is the relative concentration of legacy versus pure runoff being sold? Is more segregated within companies or actually transferred to either companies that specialize in that business or to third party administrators?*

Bill: You're seeing all of that. If I were to pick, I would say we are seeing less of an entire company going into runoff but rather a certain lines of business or exposures being placed in runoff or sold to companies that specialize in

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What Lies Ahead? (continued)

that business. Companies are making decisions to segregate that portion of the business going into runoff and then conducting an internal expense exercise to determine whether it can be completed internally and staffed with competent individuals, or should be outsourced.

I am not aware of any studies that determined which is best. It depends upon the specifics of a particular company.

Andy: It differs among marketplace and regulations. In the United States, most reserves in runoff are not within standalone runoff companies. The majority of property and casualty reserves, excluding the financial guarantee marketplace, are in companies with discontinued liabilities written within the same legal entity where they continue to write active business. The household names of major property and casualty companies all have those exposures.

Even these companies are more likely to rationalize balance sheets, improve financial performance, and remove volatility by, for example, segregating where possible the handling and disposing of owned or inherited legacy business to a different legal entity. We are restricted in the United States without Part VII transfer legislation, which is prevalent in the UK. Through the European reinsurance directive, this transfer mechanism can apply over various stages to Continental Europe, allowing a company to distance itself transparently from legacy liabilities, providing value to shareholders and security to policyholders by transferring the business to a well-capitalized partner.

United States' assumption and novation regulations are often more restrictive than those available elsewhere. This regulatory environment limits the options available to owners of the runoff companies to responsibly and transparently pay their obligations to their policyholders or cedents and terminate their exposure to prospective liability. As a consequence, capital is trapped and not deployed for more beneficial purposes. Consequently,

we are seeing all manner of classes of business subject to sale transactions

Oliver: There's a third category beyond pure legacy and runoff. In Continental Europe and the Middle East, there is "the going concern business," in many cases the core business where insurers have written significant business that, depending upon the tail, continues to absorb risk capital.

In my experience, the majority of operations set up to handle runoff initially were woefully inadequate because most companies wanted to avoid the costs required to put together an effective run-off management system.

—Barbagallo

The past 18 months have shown an increasing tendency to cede those loss reserves using retroactive reinsurance to deleverage the balance sheet. Interestingly, this is mostly the companies' bread and butter business which they would not normally cede through a quota share or similar prospective reinsurance. But the capital relief from transferring loss reserves is now understood, increasing the tendency to offload reserves or to accelerate the balance sheet to release risk capital tied to existing reserves and corresponding assets. From a solvency and capital efficiency perspective, it is often more favorable to cede one dollar of liabilities than one dollar of premium – for the same underlying business.

Connie: *Since we've been discussing the expertise of managing runoff, could someone talk a little bit about how you judge the expertise of managing runoff? What metrics are used to see if a company is handling those assets efficiently?*

Bill: To manage a runoff, just from an operational level, is a complex decision involving systems, strengths of personnel and on the other side of the house, what Andy and Oliver were discussing relative to the assets and how those assets will be managed and invested.

From an operational standpoint, the determination whether you have the proper systems and personnel to handle the business and the evaluation of whether a third party is better suited to handle the business at a reasonable cost that allows the desired rate of return on your investments is a company to company exercise.

In my experience, the majority of operations set up to handle runoff initially were woefully inadequate because most companies wanted to avoid the costs required to put together an effective run-off management system. Runoff becomes the stepchild, with more concentration given to ongoing business than runoff, even though runoff may represent a significant liability to the company that must be addressed. Only after that liability continues to be a significant drain on the active company do they step up and incur the costs necessary to put together an effective system and staff to manage the runoff.

Whether companies that only deal in runoff are the best companies to handle runoff remains to be seen. You're as good as your people and your systems. I have seen very effective runoffs of certain lines of business occur within companies that have segregated rather than outsourced the business. .

Andy: Bill's general statements are completely correct. Even after the transition into runoff, large property and casualty writers are trying to manage legacy and live liabilities side-by-side with dedicated staff that are not properly incented or motivated to achieve optimal financial performance, something ignored by chief financial officers and chief executive officers of many companies. Even companies that outsource their runoff or their



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What Lies Ahead? (continued)

runoff management regularly do so to third parties that are not incented to achieve finality. Frequently these managers are not compensated based upon the improved financial results of the company they have been hired to manage.

We are going to see increased failures of companies to end their runoff exposures properly until they address the need to achieve finality of runoff exposures in a manner that allows them to maintain business relationships with existing and previous clients, maintain their reputation within the market as companies that honor their claim obligations in an open and transparent manner, and achieve finality and motivate their employees to focus on bringing about finality rather than simply maintaining their position for the runoff duration, which can be 25, 35, 40 years or longer.

Companies often do not fully appreciate the financial impact of discontinued business. It's a management and financial distraction, mired in reserve volatility with reserves that rarely, if ever, improve as they progress.

Bill is correct that worker's compensation liabilities have become attractive to runoff acquirers because the underlying liabilities are more easily modeled than asbestos and pollution risks. For the worker's compensation liabilities, the only end in sight is the longevity of the underlying claimant. If the company becomes financially impaired, there is no cap on guarantee fund exposure for the worker's compensation liabilities.

Companies that transition into runoff must determine where they are in the progression of their runoff liabilities' life cycle and what they can do quickly to achieve finality which will allow them to be more capital efficient and improve their performance for shareholders, while honoring obligations to policyholders.

Oliver: We agree that managing runoff in a going concern is mostly an afterthought, only given the attention needed when things start to develop

unfavorably. However, I am not sure that an outside solution is necessarily more effective. How many of the approximately 15 or so buyers of runoff liabilities are really equipped and have the scale to manage the business so that value can be maximized while safeguarding policyholders' interests?

Heightened transparency of an insurer's capital intensities will lead to a more integrated view of how it optimizes in-force business vis-à-vis new premium volume.

—Horbelt

Andy: The question turns to how one defines maximizing value. If you are looking at management fees and earnings achieved from those management fees to satisfy shareholder concerns, perhaps that is maximizing value. Another perspective is that maximizing value is mitigating your reserve exposure, controlling your expenses, eliminating volatility and maximizing the return received from your outward reinsurance protection.

Perhaps one or two acquirers of discontinued books really focus on these types of metrics. For the most part, however, acquirers appear to be focused on assembling and leveraging assets, removing volatility where they can, but generating other forms of earnings to satisfy shareholders.

Peter: *We've talked a little bit about how the regulatory climate has tightened and become more restrictive. How will companies in this increasingly restrictive regulatory environment stay profitable or become more profitable?*

Oliver: Regulation is focusing on transparency and a fair value view of insurance assets and liabilities. An insurer's capacity to write is a function

of the difference between its Tier 1 capital base and the modeled capital requirements of its current business plus the entire business written in the past to the extent that losses are not fully settled. The sum of premium, reserve and market risk explain over 85% of the Solvency II capital requirements.

Heightened transparency of an insurer's capital intensities will lead to a more integrated view of how it optimizes in-force business vis-à-vis new premium volume. The flip side for an acquirer of runoff liabilities is that – at least in a Solvency II or equivalent world – size and diversification matter. It will be bad business to write one asbestos deal every three years; scale and diversification will determine the sustainability of this business model and if it can be adequate for the risk-adjusted returns that must be generated.

Andy: There are two sides to the regulatory question.

Recently within the United States, we have seen proactive regulation regarding discontinued books of business that is not founded in any specific regulatory authority. Traditionally, United States' regulators monitor property and casualty insurance companies based upon their risk based capital levels. Recently financial regulators have allowed arguably insolvent companies to either continue in solvent runoff or be transferred to third parties, even though those companies are technically insolvent and should properly be placed into liquidation or rehabilitation.

We may see more instances where financial regulators continue to take a proactive role in the operations of financially impaired companies, rather than allowing them to go under.

Bill: I agree with Oliver and Andy. I have a different twist on this, the change in the regulatory climate will have an impact on corporations as a whole and we're talking about large corporations that are self-insured as well as insurance corporations and smaller companies that carry insurance. The Dodd-Frank Act will have significant implications to corporations



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What Lies Ahead? (continued)

because of the heightened legal liability that these companies now face as well as the increase in compliance costs. The increase in costs will require companies to start relieving some of their liabilities in an effort to free up more money to address the regulatory issues and become in compliance.

Although regulatory compliance issues are usually excluded from D&O and E&O policies there are some creative policies that extend some coverage for these potential costs but the expansion into whistleblower provisions of the act are leading many companies to seek insurance products that address those risks associated with these investigations. As a result, we are seeing an increase in claims filings with regards to the whistleblower activities, violations of privacy, network security issues regarding usage of social media and data leakage, and an increase in personal injury claims for defamation and slander.

What all of this means to runoff is that this whole change in the regulatory environment is adding additional stress on the company's financials which is a motivating factor in a company's decision to consider runoff as a future strategy.

Peter: *How, if at all, will recent consolidations in the broker and company markets impact the legacy and runoff management business?*

Andy: Broker records are historically difficult to obtain for runoff companies, a reflection of the commercial reality that the broker, though not necessarily disinterested in legacy business, is more forward, than retrospective, looking.

Broker records, for such matters as common account and other forms of inuring reinsurance are relied upon by runoff companies simply because there is no alternative. Dependent upon the broker's records since inception, the runoff company would rather continue to rely on the broker's information rather than re-create the allocation model themselves. Outward reinsurance allocations were often calculated by the broker and not by the ceding company.

Oliver: In the UK and Continental Europe, I see that consolidation obviously leads to an increased size and with that to a higher ability to absorb legacy issues. Obviously, some disagree with this theory, but we've seen that consolidation in the primary market has produced an increased ability and willingness to deal with runoff or legacy issues internally. This could obviously change as a result of solvency regimes that make the true economic costs of holding on to legacy business transparent.

Broker records are historically difficult to obtain for runoff companies, a reflection of the commercial reality that the broker, though not necessarily disinterested in legacy business, is more forward, than retrospective, looking.

— Rothseid

Bill: I hope that Oliver's experience makes its way here in the U.S. Unfortunately, I have not seen where that consolidation has been helpful in the runoff environment. Although the broker community has represented a greater commitment with the transmission of data to runoff entities, the experience is still one of runoffs sitting in the back of the bus and much of the change is still by way of lip service. Runoff organizations must still chase information. Information often is lost or misplaced, correspondence and emails often are either not responded to or delayed which affects collection activity.

Andy: In the last seven to ten years, broker replacement service entities have emerged and become successful in the marketplace, a reflection of companies' appreciation for the commercial reality that the broker, having earned

commission on the prospective business and looking for commission on the next book of active business, will naturally focus efforts on more commercially viable profit centers, not legacy liabilities.

Connie: *Do any of you have a sense of where we are in the curve of the remaining asbestos related runoff liabilities? People have studied this for years. There have been ups and downs. Where are we now in 2012?*

Andy: It's really two questions. One question is are we going to continue to see asbestos liabilities emerge within the active or discontinued insurance marketplace and the second question is how will companies manage these liabilities moving forward? Clearly the market believes that these liabilities have either plateaued or are on the downturn, at least within the United States. Whether that's the case in the United Kingdom or elsewhere remains to be seen.

Managing those exposures raises a completely different issue. From that perspective, asbestos liabilities are here to stay on company's balance sheets unless all stakeholders involved in those exposures – the insureds, insurers and their reinsurers – can accept the available transparent closure mechanisms that can conclude these liabilities by fairly assessing the value of the liabilities and insuring that there's money to pay the truly injured.

Connie: *What are those mechanisms?*

Andy: The scheme of arrangement, which has worked repeatedly within the United Kingdom and Bermuda marketplace. In Rhode Island, as we saw with GTE RE, the Commutation Plan process allows companies to end their runoff obligations cleanly and transparently while honoring their obligations in full to their cedents – even with a portfolio of assumed reinsurance that contained underlying asbestos, pollution and worker's compensation risks.

Bill: Asbestos was banned in the early 70's. The latency for mesothelioma is

What Lies Ahead? (continued)

anywhere between 25 and 50 years arising out of exposure. I believe the latest information is that the average age for diagnosis for mesothelioma is 62. So if you start to do the math, the peak occurred in the early 2000's, so just simply due to the time and the age, we are seeing it on a downhill scale.

Now as to whether or not there's light at the end of the tunnel for everyone is open to debate as it depends on who you are insuring, when the policies were written and a lot of other factors and certainly the disease type.

Is there anything like asbestos? I would say no. There are a lot of latent injuries out there, but nothing with that kind of magnitude. I do see that there are an increasing number of cases that are being dismissed every year, so even though there are still steady filings, the number of cases that are outstanding are decreasing.

Oliver: Just an observation. Looking at all concluded legacy deals, or at least the ones where we have sufficient information over the past 15 years - and this is not just asbestos but often includes APH and other lines - the valuations of those books are close to the trading levels of the broader going concern market, in terms of price to book multiples. So either the runoff market feels that the risk inherent in those latent exposures is somewhat contained, or the runoff market is sufficiently competitive that the price is really a question of supply of and demand for finality, somewhat detached from a technical evaluation of reserves. Multiples for runoff transactions have steadily approached industry valuation levels for active companies, which is surprising.

Peter: How should entities like AIRROC adjust to assist people in this community to be more efficient, improve their communications and share valuable information for all handling this type of business?

Andy: Although succeeding very well as a forum for discussion and leadership, it would be good to see a unified voice in the industry toward legislative change.

AIRROC's membership is diverse and reflects the existing marketplace. Hopefully, the industry will come to a point where they can speak with one voice, calling for legislation that allows companies to eliminate liabilities through various means on various transparent bases, addressing items discussed today, like rationalization of balance sheets, risk elimination, increased yield of investment returns, increased capital efficiency.

AIRROC should continue to provide, in their educational sessions, forward thinking topics to assist those handling runoff with more tools to handle the issues before them.

—Barbagallo

Oliver: Looking at the mission statement and considering that AIRROC combines about 60 companies throughout the entire spectrum, AIRROC found a common denominator and operated successfully since inception. I agree with Andy to a degree that more could be done on the regulatory side to better represent the particular interests of the runoff sector, both in the U.S. and maybe Europe. Secondly, I'd like to see the Life & Health market better represented as well.

Bill: I echo these comments. AIRROC should continue to provide, in their

educational sessions, forward thinking topics to assist those handling runoff with more tools to handle the issues before them. Some programs have addressed topics that many attendees deal with regularly, affording little benefit. Probably greater attention can be spent on developing different, creative programs that might address the future of runoff rather than the past.

I understand, especially being on the educational committee, and appreciate many of the sessions already presented, but AIRROC needs to adjust to meet those needs and if the changes mean that there are different types of exposures in runoff or we see an increase in worker's comp as the asbestos and health hazard losses are beginning to go down, we need to look at the members are dealing with and continuing to start to address those rather than just simply looking at the past.

Andy: The need for a US commutation forum, which had to be a motivation for AIRROC's formation, may not be as relevant today as it was at the outset, simply because of marketplace consolidation. The numbers and portfolios transferred to a small number of acquirers would probably lead to those types of productive sessions to be held among four or five different people rather than the general membership. I agree with Bill's and Oliver's suggestion to bring live market companies into AIRROC. Forward focused educational topics will serve the membership and the industry well. ●



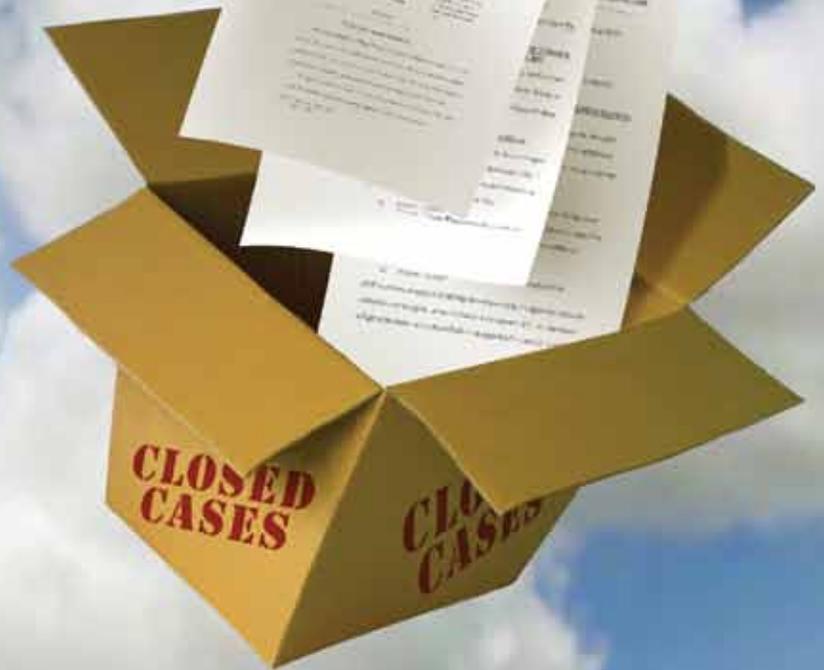
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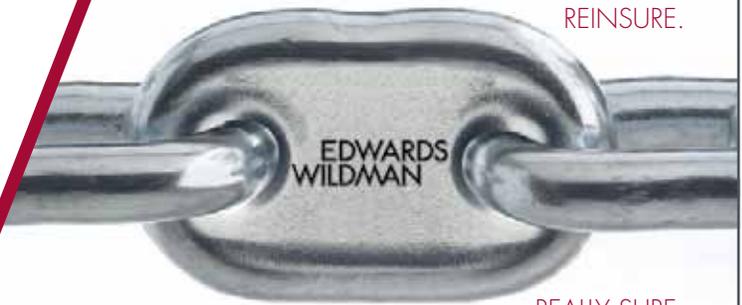


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