The Insurance Receiver

PROMOTING PROFESSIONALISM AND ETHICS IN THE ADMINISTRATION OF INSURANCE RECEIVERSHIPS

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Feature Articles

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President's Message - Fall 2005

Trish Getty, AIR, Reinsurance

IAIR's most popular education venue remains our quarterly Roundtables, so my message will begin there, and quite enthusiastically.

High drama at the June IAIR conference! The Roundtable presenters, Frankie Bliss, Henry David, Debra Hall, Doug Hertlein, Cecelia (Sue) Kempler (Chair of the IAIR Smart Committee), and Ed Wallis discussed "How Smart is SMART ?" from their respective perspectives. SMART and IRMA were compared. Audience participation was lively. The real fun began when, in a friendly spirit, Frankie Bliss and Debra Hall had a shootout on the merits and deficiencies of each proposed law. Not surprisingly, Frankie took the position that receivers were the representatives of policyholders because other creditors could fend for themselves. Debra emphasized that if the interests of reinsurers were not protected, the entire insurance industry would suffer. It was an informative session for all. The entire panel worked extremely hard on preparation for this meeting. IAIR leadership thanks them all, particularly Sue whose endless energy inspired her co-presenters.

Considering Doug Hertlein is our Chair of the MARG Committee, you can expect another very informative Roundtable in December. The obvious subject is MARG and its ramifications on the day-to-day handling of receiverships.

The Education Committee worked diligently and successfully to present a staff training workshop, for the first time in a few years, "From Troubled Company to Receivership – What You Want to Know," in San Francisco on May 12. Feedback included comments to the effect that the topics were interesting and informative, but popular request was to expand on reinsurance training! We thank Barry Weissman (Event Chair), Bill Barbagallo, Joe DeVito, Linda Holman, Jenny Jeffers, Dick Pluschau and Francine Semaya, whose dedication to education is evident. Others who gave their time and input include IAIR Education Chair, Kristine Johnson, Bob Fernandez and Susanne Twomey. We already have demands for other workshops in the Midwest as well as the east coast. Great job everyone!

IAIR received notice from NASBA (National Association of State Boards of Accountancy) on June 13 that we have been approved as a registered sponsor of continuing professional education on the National Registry of CPE Sponsors. We anticipate that CPE credits will be granted for at least all IAIR Roundtables. IAIR Executive Director, Paula Keyes, is responsible for gaining this accreditation for us. Thank you, Paula, for your time, effort and paper up to your neck to achieve this very significant recognition for IAIR. Excellent progress!

Patrick Cantilo, 2006 IAIR Annual Insolvency Workshop Chair & Member of the IAIR Board of Directors, promises yet another exemplary workshop for us. He has generously offered his firm's research support and recommendations for a desirable location for our meeting, perhaps a venue for the next two or three years. Cantilo & Bennett further offered their services as our event coordinator. Patrick, your generosity is appreciated, another furtherance in preserving IAIR funds.

Vivien Tyrell, IAIR International Committee Chair, hosted the London Market seminar on May 24th whose registrants included Paula Keyes and seventy-five others. Excellent job again, Vivien! IAIR is grateful for your dedication to international coordination and strive for commonality of our insolvency community.

Alan Gamse, Chair of our Website Committee, is currently reviewing RFP responses for website enhancements. IAIR will present a fresh appearance in 2006!

We are pleased to have negotiated a substantial discount off of registration fees across the board for the IAIR membership with both Mealey's and The American Conference Institute. I hope that you enjoy

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this advantage of reduced fees for further education.

We hope that you appreciate the welcome changes to our 2005 Membership Directory which now includes IAIR resources. Our many thanks to the multiple, supportive sponsors of IAIR who made this valuable resource booklet available to our members.

Susanne Twomey has resigned from the IAIR Board of Directors. Susanne, the IAIR members are very appreciative of time and shared experiences you have provided to our board.

IAIR welcomes Bill Barbagallo, AIR, Navigant Consulting, to the IAIR Board of Directors. Congratulations, Bill!

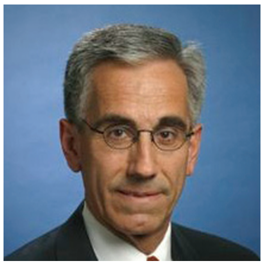
Upon Holly Bakke's resignation from the IAIR Board of Directors, we extend our welcome to Lowell Miller, North Carolina Life & Health Ins. Guaranty Association to the IAIR Board. Congratulations, Lowell!

I am grateful for the time, energy and focus of our Board of Directors and committee chairs who expend considerable time to bring value to our membership. This is your association so please give us feedback and any suggestions to ensure that we are meeting your expectations.

View from Washington

by Charlie Richardson

SMART Train Leaving the Station, Baker Says to Get on Board



The House Financial Services Capital Markets, Insurance, and Government Sponsored Enterprises Subcommittee held a hearing June 16 to examine SMART insurance reform. Subcommittee Chairman Richard Baker (R-LA) said he will introduce a "centrist bill" with state uniformity as the primary goal. Former insurance commissioners were largely supportive of Congress legislating more uniformity to state insurance regulation, but many wanted to see the final draft before endorsing SMART. NAIC President Diane Koken was critical of SMART's "unacceptable levels of federal preemption" that would create problems for the insurance industry and consumers. Representative Paul Kanjorski (D-PA), Ranking Democrat on the Subcommittee, said Congress should give first priority to renewing TRIA the 2002 "Terrorism Risk Insurance Act" (P.L. 107-297), which is set to expire at the end of 2005 instead of focusing on SMART.

Insurance Trades Lobby Senate for Optional Federal Charter

On June 14, the Optional Federal Charter Coalition, a coalition of eight trade associations, sent Senate Banking Committee members a letter urging support of Optional Federal Charter for insurers and insurance agents. The Coalition stresses that an OFC would not supplant state regulation, but simply provide an alternative. "The burden of having to comply with rules from fifty-six separate insurance regulators is too inefficient for companies, agents and consumers to manage, especially those whose interests are national in scope," the letter says. "Individual state regulators cannot speak to our national or global interests with the same scope and effectiveness as a strong, federal entity," such as the Treasury Department or the Federal Reserve. Coalition members include Agents for Change, ABA, ABIA, ACLI, AIA, CIAB, The Financial Services Forum and The Financial Services Roundtable.

Treasury Tags TRIA with Yellow Flag

On June 30, the U.S. Treasury sent its long-awaited report on the effectiveness of TRIA to Congress. The Federal reinsurance program expires at the end of 2005. To the surprise of some who remembered that the Bush Administration was instrumental in pushing Congress to approve TRIA in the first place, Treasury is now critical and recommends an extension, only with much tougher terms. Based on the report, House Financial Services Committee Chairman Mike Oxley (R-OH) said TRIA has likely inhibited a long term solution to terrorism insurance and "a simple extension of [TRIA] is not in the best interest of American consumers or the economy." Senate Banking Committee Chairman Richard Shelby (R-AL), who held a hearing July 14 on TRIA, has said TRIA has created "market dysfunction" and did not support the program when first enacted in 2002.

Data Privacy: Making it a Federal Case

With the latest of several data breach announcements over the past several weeks -- one by MasterCard involving compromise of data on up to 40 million credit cards -- the Congressional interest in taking action on data privacy is quickly rising. Senators are preparing bills with a variety of approaches including toughening current standards which apply to banks, imposing Federal data breach notification requirements, and creating a Federal "data security" czar. The Senate Commerce Committee as well as other House and Senate committees will be active on the issue.

Too Hot for Insurers?

Senator Arlen Specter's (R-PA) asbestos bill, S. 852, was reported out

View from Washington

Charlie Richardson

of the Judiciary Committee on May 26 by a vote of 13 to 5. But several insurance companies and manufacturers oppose the payment mechanism for the proposed $140 billion federal trust fund to compensate victims of asbestos exposure. Insurers favor medical criteria to determine who may be sick from asbestos exposure. Majority Leader Bill Frist (R-TN) has said he intends to bring the bill to the Senate floor for a vote, but his Democratic counterpart, Minority Leader Harry Reid (D-NV), has promised to filibuster the bill.

Debate Continues Over NAIC and SOX 404 Requirement

The NAIC/AICPA Joint Working Group at its June Boston meeting received a detailed presentation from the National Association of Mutual Insurance Companies describing the projected financial hardship for small carriers if the internal governance requirements of Section 404 of the Sarbanes-Oxley Act of 2002 (P.L. 107-204) were imposed upon non-public insurers through the NAIC's adoption of changes to the Model Audit Law. The issue of whether non-public insurance companies should be held to many of the more rigorous standards of Sarbanes-Oxley has been vigorously debated at the NAIC for more than two years. The NAIC/AICPA Joint Working Group appears to be convinced that Sarbanes-Oxley-like requirements should be imposed on insurers and continues in its efforts to move the proposed amendments up the NAIC chain for approval.

Solvency II: Turning Anticipation to Action

By David Lightfoot, Managing Director, Guy Carpenter & Company, Inc.

Solvency II is coming, bringing a sea of change in the way European Union insurance companies will defend their capital adequacy and risk management capabilities to regulators. The new regulations will usher in a consistent, EU-wide insurance regulatory platform that represents a significant advance over the predecessor platform, Solvency I. Indeed, Solvency II could well prompt evolutionary change in other parts of the world, which is why even those unaffected by its implementation are well served by gaining a familiarity with its likely requirements.

The current regulatory regime, Solvency I, became effective in EU member countries in 2004. It established minimum insurer capital requirements and represented relatively modest changes to the existing regulations. While the final Solvency II directives remain on the drawing board, there has been widespread speculation about the new regulatory framework and recognition that the coming changes are likely to be far more profound than any that have come before. While the first draft of a framework directive is not expected until sometime in 2006, there is already general consensus on some key issues.

The Anticipated Framework

At the most basic level, Solvency II will likely require all EU-domiciled insurance companies to assume greater responsibility for understanding their risk profile and demonstrating sound risk management and mitigation strategies that align both with their capital structure and business plans. Note that while Solvency II will extend to all insurers in the EU, the following discussion focuses on the considerations and consequences of Solvency II for non-life insurers in particular.

The Solvency II directives are expected to be based partly on the same principles followed recently by banking regulators in evolving the Basel II Accord. Like Basel II, Solvency II is expected to reflect a "three-pillar" approach:

Pillar I, which consists of quantitative requirements to assure capital adequacy. These requirements will likely aim to quantify both the minimum level of capital a company must maintain and Solvency Capital Requirements (SCR), which reflect

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the amount of capital the company needs to respond to large, unexpected loss events. This pillar will most likely also encapsulate quantification of insurance reserves and investment rules.

Pillar II, which addresses internal risk management processes and supervisory intervention. This pillar encompasses both internal controls and the supervisory review of risk management and capital quantification processes.

Pillar III, which requires greater transparency. The call for heightened transparency is expected to be particularly evident in the disclosure requirements of regulators and financial markets and should go hand in hand with advances made by the International Accounting Standards Board (IASB).

Solvency II's pillars – and the synergies between them – are intended to provide all of an insurance company's constituents with the best possible assurance of adequate capital and sound risk management practices.

Solvency II is also being drafted with a focus on ease of implementation and a recognition of the importance of balancing practical flexibility with the need to ensure substantial uniformity in the application of regulations throughout EU member states.

The Regulatory Forefront

Solvency II represents the forefront of regulatory thinking. Like the already existing advanced insurance regulatory and rating agency systems, Solvency II is expected to use a risk-based capital approach to determine capital adequacy. Unlike many others, Solvency II is anticipated to go beyond the externally prescribed formulaic approach in assessing capital adequacy. Solvency II's risk assessment methodologies will likely introduce the usage of both standard as well as internal models. This internal modeling component is new – and represents a marked departure from most existing systems.

Additionally, Solvency II will consider the adequacy of the solvency capital only as one component of the entire supervisory process. The framework will also address, in an in-depth manner, a company's risk management and internal controls, governance and transparency issues.

A Closer Connection to Best Risk Management Practices

What sets Solvency II furthest ahead of existing regulatory schemes is Pillar II, the risk management pillar. Indeed, this pillar recognizes that companies with stronger risk management capabilities are less likely to default on insurance obligations and thus need comparably less financial capital than companies without similar capabilities. Accordingly, the anticipated regulations are encouraging each company to critically analyze risk environment to a degree it may not have in the past and to link risk to its business plans and ultimately its capital base. For example, in a Solvency II environment, before a company can underwrite additional business, it would be expected to determine whether it has adequate capital to do so. As such, the regulations will attempt to foster an environment where proactive, comprehensive risk management is the industry norm by bringing new, supervisory oversight to these processes.

Solvency II is anticipated to also broaden the risk categories to be considered, requiring a company to take into account not only insurance risk that covers underwriting risk, reserve deterioration and accumulation (catastrophe) risk, but also other categories of risk, such as asset risk (including credit, market fluctuation and asset/liability matching), or operational risk. Thus, in order to comply with Solvency II, a company will likely need to have a better understanding of its enterprise risks.

The Reinsurance Ramifications

As Solvency II heightens the need to evaluate the various means of meeting capital adequacy requirements, it

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will likely change the way companies assess and utilize reinsurance.

Reinsurance can affect risk based capital, which is always net of reinsurance, in numerous positive ways. Reinsurance allows companies to leverage down the risk of the balance sheet and can provide a multi-year benefit that matches the run-off of insurance reserves. Fundamentally, reinsurance is a trade between decreasing insurance risk and often increasing credit risk (through adding reinsurance recoverables to the balance sheet). As regulators generally believe that insurance risk brings with it a higher stress on capital than credit risk, reinsurance, used effectively, serves to reduce the regulatory capital requirements of an insurance company.

Hence, Solvency II creates more opportunities for companies to use reinsurance efficiently. It is also likely to make reinsurance decisions more critical and complex as there are now additional issues to consider.

First and foremost, viewed in light of Solvency II, reinsurance is not simply a risk mitigation tool but also a means to achieve solvency capital relief and may therefore be viewed as a capital surrogate.

Companies will be expected to consider how much capital relief reinsurance can provide, how reinsurance can support business plans and strategies, and how much this support will cost. As a form of capital, companies will likely be weighing reinsurance against alternative sources of capital, such as traditional shareholder capital and its incumbent expected return on invested capital, or capital provided by debt instruments.

In addition, the new "holistic" risk management of Solvency II will make companies more mindful than ever of the credit risk they are accumulating with reinsurance, and conscious of the amount of reinsurance recoverable assets being concentrated with any single reinsurer. The end result may likely be the selection of a broader slate of reinsurers.

Lingering Questions

While there is consensus on many aspects of Solvency II, many questions remain unanswered. One pertains to the level of internal modeling versus external, factor-based modeling that will be expected under Solvency II. It is also unclear how Solvency II will account for the varied insurance and legal environments of EU countries. For example, the risk of a company underwriting casualty business will vary dramatically, depending on the local litigation environment. What accommodations will be made for this?

In addition, while the intent is to ensure Solvency II's compatibility with international accounting standards, it remains to be seen how new International Financial Reporting Standards (IFRS) pertaining to the fair value of balances arising from insurance contracts, if implemented, will align with the new directives. Another variable is accumulation (or catastrophe) risk: how will this be treated within the Solvency II framework and within various countries? Will it be stress tested?

Most pressing of all are questions surrounding the feasibility of certain quantitative aspects of Solvency II. Certain perils in certain EU countries have yet to be modeled in credible ways. For example, many models in Germany are still driven at the CRESTA zone level. This is substantially limiting as compared to modeling with data based on latitude/longitude addresses or even postal codes, which is standard practice elsewhere. In many cases in the EU, however, robust data is simply not yet available.

Fortunately, modeling capabilities in the EU are becoming more and more sophisticated. Those companies that are successful in collecting fine-level data will be rewarded under Solvency II. They will have a better understanding of their risk profile and more vigorous internal modeling.

No Time to Wait

While uncertainties remain, it is

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certain that Solvency II is fast approaching. Following release of the EU concept paper, each member country will have one to two years to translate the framework into local law, and the new regulations are expected to be implemented EU-wide in 2009 or 2010.

Insurers cannot yet get their arms around the full detail and implications of the final directives. Nevertheless, they can and should be actively preparing for the future regime – particularly its quantitative capital adequacy and internal risk management requirements.

Preparing For Solvency II

What should companies be doing now to prepare for Solvency II?

First, companies should keep abreast of the proposed regulations in the EU and in their individual countries. Some member countries, including the UK, have introduced new regulations in advance of Solvency II.

Companies should begin working to understand their own insurance, asset and operational risk environments and develop and implement systems and strategies for mitigating these risks.

Companies should analyze how their economic capital will likely be viewed under Solvency II methodology. While Solvency II continues to evolve, existing regulatory capital benchmarks, including the UK's Enhanced Capital Requirement, Australia's Minimum Capital Requirement and US' Risk Based Capital, can provide benchmarks. Importantly, existing regulatory and rating agency frameworks can help a company analyze not only its current capital structure, but how this structure aligns with business strategies.

Companies should begin mining data and developing internal models to evaluate capital and SCR.

Companies should work to make informed reinsurance purchasing decisions that consider the coming requirements and anticipated capital adequacy requirements.

A new day is dawning on the EU insurance industry, and its impact may well reverberate around the globe. It will be a day marked by deeper capital assessments, holistic risk management processes and enhanced transparency in interactions with policyholders, shareholders, regulators, and rating agencies. Those companies with the foresight to embrace this new day will be better positioned for success in the years ahead.

SCRUTINY OF THE BOUNTY: STEERING THE SHIP THROUGH A U.S. SOLVENT RUNOFF

by Pamela H. Woldow, Esq.
Practice Leader, Forensic Accounting and Litigation Services - Smart and Associates, LLP

Imagine a huge treasure ship, sort of a Spanish galleon. Stacked on deck is an abundant bounty, a vast variety of riches -- cash, barrels of reserves, treasure chests full of premium payments, investment proceeds, and reinsurance treaties.

This treasure ship symbolizes the diverse financial stakes in a solvent runoff -- the present and potential assets involved, the collection and allocation of large amounts of money, and the rewards that come from retaining or acquiring part of that bounteous treasure. Depending on one's management, economic, regulatory and personal vantage point, a solvent runoff can come to look very much like a battle for treasure. And for executive management, the stakes are particularly high.

Business as Unusual

One point is paramount: for executive management, the decision to undertake a solvent runoff cannot be a routine business-as-usual decision, like moving the headquarters to Chicago or investing in new computers. A solvent runoff of an unprofitable insurance line -- or even of an entire company -- triggers a radical business transition that puts extraordinary strategic, tactical, operational and fiduciary pressures on management. It signals the start of an intense competition, played out in various skirmishes for various portions of the booty.

Underestimating the significance and complexity of a shift to an active runoff mode is one of the biggest and most common misjudgments an insurance company can make. In effect, management must shift to an entirely different conception of the company and its future. Nick Eddery-Joel, Director of Axiom Consulting, has likened a solvent runoff to "crossing over to a parallel universe." This is a universe with lots of interested players, including existing management, policyholders, shareholders, insurance company staff, brokers, TPA's, vendors, contractors, and, to some degree, regulators, competitors, potential buyers, business analysts, lawyers, lobbyists, lessors and politicians.

The Menu of Runoff Strategies

When contemplating a solvent runoff, management confronts a variety of possible exit options: portfolio transfer, sale to a third party, policy buybacks, reinsurance collection/commutation strategies and even running off the business to its eventual conclusion. Management may want to close up shop as quickly as possible and consider reacquiring as many policies as possible in order to lower the number of outstanding policyholders, and they may also consider buying out any future claims using cash in hand. With a portfolio transfer or outright sale, management can get out quickly, but the value of the bounty takes a beating, and most of the crew goes down with the ship. Alternatively, the company can finance a runoff through reinsurance commutation and aggressive collections and still wind things up pretty quickly. Or management can decide on a long-tail runoff, which preserves jobs and provides continued executive control for the longer-run. If the company operates in

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England or Rhode Island, it also can consider various schemes of arrangement. Every option affects whether the ship floats or sinks, how fast or slow it sails, and whether it journeys safely in deep water or struggles to stay off the shoals.

Managing External Forces and Constituencies

There are, of course, constraints on management's options and the timing of the runoff. In terms of fiduciary responsibility, the company's executives must fundamentally change the way they manage the discontinued business to ensure -- first and foremost -- that existing value is preserved and that steps are taken to enhance value during the runoff; management must turn its gaze away from developing business and relationships and instead focus on asset collection and preservation.

As long as the company remains solvent, regulators have only broad oversight authority and not the plenary powers state insurance departments assume in liquidations. But because protecting the interests of claimants and policyholders is regulators' paramount priority, regulators will keep a hard eye on solvency. Management's initial priority therefore must be to protect the bounty: to review the asset mix, review the adequacy of reinsurance, categorize claims and liabilities realistically and get aggressive with asset recoveries.

While self-interest might tempt management to prolong the runoff process, thereby prolonging its own employment tenure, shareholders and other stakeholders are unlikely to accept such a strategy passively. To keep them satisfied, runoff strategy must create strong incentives for all players to bring the runoff to an efficient and expeditious conclusion without encouraging a rush for the lifeboats, or a feeding frenzy. Vendors, lenders and contractors also are likely to be highly evident and highly vocal. When it comes to collections or extending credit, they may suddenly develop a pronounced near-sightedness because the distant horizon just isn't relevant anymore.

Once the runoff starts, relationships with reinsurers are going to change fundamentally. Management's strategic focus may concentrate on collecting what typically is the largest asset of the company -- reinsurance. As soon as reinsurers learn that there will be no more flow of business, they know there will be no continuing long term relationship to foster and respect. Understandably, they will likely place a stronger emphasis on their own short term financial interests, and relationships between insurer and reinsurer may become strained unless management exercises an adroit whip-hand when attempting to access the bounty of the reinsurance treaties.

Looking Inward at People and Processes

Effective runoff management also must focus on internal processes and on the people who must implement them. As Paul Dassenko, Chief Operating Officer of Cobalt, has put it, "The initial process of this transition must involve establishing robust internal checks and balances -- executed by a management team that has the correct incentives -- effectively creating the tightly-run operation that should have existed from the earliest, euphoric days of underwriting. Transitioning to runoff becomes an after-the-fact implementation of practices and procedures which ensure corporate governance and the creation of a culture where the entire team is laser-focused on balance sheet management until every liability is settled."

In order to bring the runoff to a satisfactory conclusion, management must constantly balance the need to control costs against the maintenance of adequate resources. A company's liquidity ratio begins to deteriorate the moment it goes into runoff, so it is critical that management ensure that all available funds are invested in a way that both maximizes returns and allows the liquidity needed to settle and pay claims. Asset recoveries must be managed aggressively and must be converted to cash as quickly as possible. In addition to cash collection, management has to pursue set-off, debt sale

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and assignment strategies, as well. Runoff strategy will include a strong focus on commutation, and management must come up with powerful incentives for commuting the most volatile reserves.

Managing Information and Controlling Costs

In a runoff, costs are unlikely to diminish as quickly as revenues, so it is essential that management take all possible steps to minimize claims settlement costs. To keep a control on costs, management must assure that its information remains timely and accurate, yet management often underappreciates the need for sophisticated information management. The runoff process requires intense reliance on IT systems and capabilities, and this is the time to make sure information technology, processes and procedures are optimized. Poor quality data, including poor legacy or historical data, seriously impacts the efficiency of a runoff. Crucial underwriting information must be preserved to maintain an historical frame of reference. Outdated systems may provide feedback that is stale or cast in irrelevant terms. New procedures must be implemented to compel TPA's to provide timely and accurate information about their claims processing; otherwise, dramatic "friction losses" may occur outside the immediate supervision of internal managers. Management may be reluctant to make such an investment in both technology and vigilant new control processes when things are going to wind down anyway, but scrimping on technology and information management at this point is a false economy.

The People Perspective: Capabilities and Incentives

Competent, motivated employees are a treasure during a solvent runoff, and the "worker bees" cannot be taken for granted either during the commencement or duration of a runoff. A major issue in maintaining teamwork is ensuring that there still is a team. At the outset, management must immediately assess which players have the most critical knowledge and experience. This is no time to plug inexperienced players into critical roles. Retention is likely to be a major issue; in the face of the uncertainty a runoff creates, trust and morale issues loom large. Human resources experts must be included in strategic and tactical planning, because as never before, HR planning and policy are essential keys to employee motivation, career planning, training and development in order to retain critical employees. From senior management on down, new performance goals and objectives keyed specifically to implementing an effective, efficient runoff must be developed, and compensation must be keyed tightly to those measures.

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Employee retention is particularly important in the claims area; rewards and incentives must be structured to motivate claims staff to achieve results that release capital in the shortest possible amount of time.

Smooth Sailing...or Stormy Seas?

In summary, while a solvent runoff is not a hurricane like liquidation, it is not automatically smooth sailing, either, and many a ship laden with bounty ends up at the bottom. The treasure ships' captains face many simultaneous challenges. They must be masters and commanders of runoff strategy. They must keep a vigilant eye on the barometer of investments and cash flows. They have to do an excellent job at claims management. They need to keep the ship's IT systems and performance infrastructure shipshape. They have to keep the crew happy or risk mutiny. And, of course, they must sustain a delicate working balance with their reinsurers. The stakes are high, and the risks of ineffective planning and management higher still.

INSOL INTERNATIONAL CONFERENCE DIARY

Scottsdale is located in central Arizona in the heart of the lush Sonoran Desert.

Scottsdale 2006 will be held at the AAA Five-Diamond Fairmont Scottsdale Princess which reflects the dynamic environment that surrounds it – where sun-washed stone and bright green cottonwoods rise up to meet the pale-blue sky and majestic purple mountains. The hotel is one of the ‘Leading Hotels of the World’.

What better venue could we have chosen for our Annual Regional Americas conference.

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Cape Town image courtesy of South African Tourism

INSOL 2009 sees Vancouver as our host city, situated on British Columbia’s beautiful coastline. Vancouver is one of the most scenic cities in the world. The Congress will be held at the Vancouver Convention & Exhibition Centre, which has a spectacular waterfront location. Our two Congress hotels will be the Pan Pacific Hotel and the Fairmont Waterfront both superb hotels to stay at and both connected to the Convention Centre.

Vancouver has quite a mild climate but the coastal mountains that form the backdrop to the city allow for skiing and hiking on Grouse Mountain most of the year so you can ski in the morning and go to the beaches in the afternoon.

Make sure you have the dates for Scottsdale 2006 in your diary.

For further information please contact Tina McGorman, Conference Manager, at tina@insol.ision.co.uk

1st Row: Francine L. Semaya, Kristine Johnson, CPA, Trish Getty, AIR, President, Daniel L. Watkins, CIR, I. George Gutfreund, CA, CIRP, CIR
2nd Row: Daniel A. Orth III, William Latza, Joseph DeVito, MBA, CPA, AIR, Patrick H. Cantilo, CIR, Edward B. Wallis, Francesca G. Bliss, Douglas L. Hertlein, Harry L. Sivley, Jr., CIR
Missing from photo: Vivien Tyrell and newly appointed Board Members; William Barbagallo, AIR and Lowell Miller.

IRMA Meets The Criteria

W. Franklin Martin, Project Director for the Pennsylvania Liquidation Office

In the May 2005, NOLHGA Journal, NOLHGA President Peter Gallanis described the criteria that he feels should be used to judge any proposed receivership law. Peter says that there are "first principles" that any proposal should meet. He then goes on to list and describe his nine first principles: 1) a receivership law should be part of a seamless web of regulation; 2) decision making within the "Zone of Insolvency"; 3) fundamental purpose of receivership; 4) the role of the receiver; 5) transparency; 6) openness and participation; 7) accountability; 8) efficiency and effectiveness and 9) clear "ex ante" rules. I totally agree with Peter's theory of the first principles and, to a very great degree, I agree with the principles he established. Peter makes it very clear that his article is not intended to measure any proposed receivership law against his principles; that process will come later.

For almost two years, I have been the chair of the NAIC's Receivership Model Act Revision Working Group (MARG). The product of our labors is the Insurers' Receivership Model Act (IRMA). IRMA is currently working through the NAIC hierarchy toward adoption as the model to replace the model which had been adopted in 1995. Asking me to judge IRMA is sort of like asking a new grandmother what she thinks of her first grandchild, but I will try to objectively apply Peter's first principles to the current draft of IRMA.

Peter's first principle is that a receivership law should be part of a seamless web of insurance regulation. Even though it is not a desired outcome, regulation should always take into consideration the possibility of the insolvency of the company and should prepare for it. While I agree that this should be the goal, it is largely outside the scope of a receivership law and should be addressed in the laws governing the active insurance industry. IRMA does provide some new tools to the regulators. One of IRMA's basic premises is that insurers should be placed into receivership before they are so far insolvent that claims against the estate are paid in pennies on the dollar. Two new grounds for receivership were added: "impairment" and "about to become insolvent". A company is impaired if its assets do not equal its liabilities plus its required capital and surplus. The regulators will not have to wait until the liabilities exceed the assets. A company is about to become insolvent if its liquid assets will not be sufficient to realistically meet its obligations for the next three months. Another new tool for the regulators is conservation. Conservation has been a part of the receivership models for a long time but IRMA puts meat on the bare bones. IRMA's conservation is a court process that places an insurer under the control of the Insurance Commissioner and requires the Commissioner to determine if the company can be rehabilitated or if it should be liquidated. Conservation should be a more attractive alternative for the owners and management of the troubled company, so that they should be more amenable to consenting to receivership, thereby getting the company under regulatory control sooner.

Peter next discusses decision making within the "zone of insolvency". Once it becomes apparent that a company is in serious financial difficulty, the primary efforts of management and regulators should be toward protecting the potential claimants against the company rather than protecting the company. Once again, while a valid objective, this is outside the scope of a receivership statute. As I stated above, IRMA's approach is early intervention; the sooner a troubled company is placed under regulatory control the better the results for the claimants.

The fundamental purpose of a receivership, according to Peter, is to protect the stakeholders in the receivership whether they are obligors or obligees. A receivership statute should strike a balance between parties owing money to the insurer and those seeking to collect from it. This principle guided the members of MARG from the very beginning of

IRMA Meets The Criteria

Frank Miller, Project Director for the Pennsylvania Liquidation Office

our efforts. Representatives of the various interested parties participated in all discussions and drafting sessions; as a result there are benefits for all constituencies in IRMA. Reinsurers received recognition of their contractual right to arbitrate disputes and an express statement that reinsurance collections could not be based on estimates of incurred but not reported claims. The guaranty associations received greatly expanded provisions requiring early access distributions by receivers and inclusion of their allocated loss adjustment expenses with their administrative expenses in a priority of distribution class above claims for policy benefits.

The next principle is recognition that the role of the receiver is not a stakeholder, but rather a quasi-fiduciary for all stakeholders. IRMA explicitly states that the receiver's constituents are not just the policyholders of the insolvent company. IRMA requires a receiver to petition the Receivership Court for authority prior to undertaking many actions that previously had been within the receiver's sole discretion. Further IRMA gives any interested party the right to challenge the petition and demonstrate that the requested action is not in the best interest of the estate. IRMA also requires a conservator or rehabilitator to consult with any potentially affected guaranty association throughout the period of rehabilitation or conservation, so that if the company must be liquidated, the guaranty associations have had adequate time to prepare to meet their statutory obligations. Many receivers who were not members of MARG and actively engaged in the drafting of IRMA have complained that IRMA goes too far toward protecting other interested parties to the detriment of the policyholder claimants. As I stated previously, throughout the drafting process, we attempted to balance the interests of all parties.

Peter's next two principles are so closely related and interrelated as to be one: transparency and openness and participation. Transparency suggests that those interested in a receivership will be able to find out what is transpiring in that proceeding. Openness and participation means that the stakeholders will have an opportunity for a meaningful role in the proceeding. IRMA goes far beyond any existing law to meet these principles. Receivers will be required to provide full financial information regarding the estate to the Receivership Court and to the NAIC. The reports to the NAIC will be part of the Global Receivership Information Database (GRID). GRID will be available via the internet to anyone interested in any receivership. IRMA allows anyone to have their name placed on a service list and thereby be advised of any motion filed by the receiver; it also requires the receiver to seek Receivership Court approval of expense payments and proposed transactions involving estate assets. Any party with a financial interest in the estate may ask the Receivership Court to designate them as a party in interest, thereby giving them the right to object to any proposed action by the receiver. IRMA explicitly recognizes contractual rights to demand arbitration of claims by the receiver.

The receiver and those persons engaged to assist in the receivership are and should be accountable for their actions. Under IRMA, the receiver and the Receivership Court must work much more closely to carry out the objectives of the receivership. The court will play a more active role in overseeing the receiver. There has been criticism that the immunity and indemnity provisions of IRMA are too broad and have been extended to cover contractors engaged by the receiver. No one would be willing to work in a litigious, contentious field like insurance receivership if their homes and savings are at risk; to get the best possible receivership staff we must assure them that their personal assets are not at risk. IRMA does that, but IRMA also assures accountability by expressly stating that the immunity given does not apply to suits by the receiver. If the receiver's contractor fails to properly perform its duties, there is nothing preventing the receiver from suing

IRMA Meets The Criteria

W. Franklin Martin, Project Director for the Pennsylvania Liquidation Office

the contractor.

A receivership process must be efficient and effective because every dollar expended by the receiver to meet receivership costs is one dollar less that is available for distribution to estate claimants. Under IRMA, payment of any expenses in excess of an amount established by the Receivership Court must be approved by the court after any interested parties are given an opportunity to object.

Finally, anyone dealing with an insurance company should know what to expect if the company is later placed into receivership. IRMA is a very strict expression of the rules for receivership. Any business partner or customer of the company can determine where they would fit into the receivership priority scheme and, with a moderate amount of due diligence, determine the financial health of the company. At that point, the potential partner or customer can make their decision on whether or not to do business with that company. A receivership is not business as usual. IRMA gives receivers the right to reject or accept the insurer's executory contracts and to recover funds paid by an insolvent company within 120 days of the receivership petition. Any potential contract partner must consider this risk in its decision making. The rights to reject contracts and recover preferential transfers are almost universal in any form of receivership or bankruptcy; they are not unique to IRMA.

IRMA Meets The Criteria

W. Franklin Martin, Project Director for the Pennsylvania Liquidation Office

I am one of IRMA's strongest supporters, but even I don't believe it is perfect. IRMA is a balanced statute that was drafted giving due consideration to the interests of every constituency. As a receiver, there are many things I would like to change, but I appreciate the legitimate concerns of the other interested parties. I truly believe that IRMA strikes the proper balance among all the parties and an impartial analysis of IRMA using any set of reasonable criteria will lead others to the same belief.

About The Author:

Frank Martin has been the Project Director for the Pennsylvania Liquidation Office since 1992. Since January 2004, Frank was the Chair of the NAIC's Model Act Revision Working Group; as Chair he was one of the leaders of the effort to redraft the receivership model.

Meet Your Colleagues

Joe DeVito

Rachel Ravasco Lopez

Rachel Ravasco Lopez is a manager in the Insurance and Reinsurance Practice of Smart & Associates LLP's Assurance and Advisory Business Services. She is part of the diverse New York team that specializes in providing management advisory and financial planning services, as well as accounting, tax and compliance services to insurers, regulators and receivers. She is a member of the Pennsylvania Institute of CPAs, IAIR, and the Society of Insurance Financial Management (SIFM).

During the course of her career at Smart, Ms. Lopez has been engaged to provide a wide range of services to a diverse array of insurance clients, including Reliance Insurance Company in Liquidation, the American International Group (AIG), and Arch Insurance. She gained valuable receivership experience working on various projects for the Reliance receivership. Some of the services provided include insurance and reinsurance accounting, reinsurance collections, Sarbanes-Oxley compliance, operational audits of managing general agents, financial audit of regional firms, litigation support, financial and operational analyses, and the processing and implementation of reinsurance internal controls.

Ms. Lopez serves on the Board of Directors of ICON Philadelphia, a non-profit organization that provides Asian Americans with a forum for networking, diversification and community service. She was born in the Philippines and moved to the United States in 1986. She is fluent in Filipino and proficient in Spanish. Currently, she resides on the Upper East Side of Manhattan with her husband, Frank, and their four-month-old son, Alexander. Frank is a resident physician specializing in Physical Medicine and Rehabilitation at NYU Hospital.

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Phil O'Connell

Phil O'Connell is a partner with the law firm of Sonnenschein Nath & Rosenthal LLP, a firm with more than 700 attorneys and offices in nine U.S. cities. Mr. O'Connell specializes in litigation and counseling involving insolvent insurers, reinsurance and the effect of bankruptcy on insurance relationships.

Mr. O'Connell serves on the Amicus Committee of the International Association of Insurance Receivers. He is also a member of ARIAS-U.S., INSOL International, and numerous legal professional associations. He spoke at the February 2003 IAIR Insolvency Workshop on "Jurisdiction Over Property Claimed By A Debtor And a Receiver Of An Insolvent Insurer."

Mr. O'Connell has been representing 18 insurers, reinsurers, and related entities in various proceedings involving the insolvency of the Superior National Insurance Group, including the defense of those 18 entities in a $250 million preference action brought by the liquidator of the Superior National Insurance Companies In Liquidation.

Mr. O'Connell was also lead trial counsel for General Accident Insurance Company of America in a month-long Chapter 11 plan confirmation trial in In re Western Asbestos Company, et al. (Bankruptcy Court, N.D. Cal.). The plan at issue in those proceedings involved debtors with alleged asbestos-related liabilities in excess of $5.8 billion.

Mr. O'Connell is a 1983 graduate of The Law School of The University of Chicago and is licensed to practice law in Massachusetts, California, Illinois and Nevada. He is also admitted to the bars of numerous federal courts.

Meet Your Colleagues

Joe DeVito

Peter Scarpato

Peter Scarpato joined IAIR this year as the President and owner of Conflict Resolved, LLC, a firm through which he provides arbitration, mediation and run-off services. Peter held the position of Chair of AIROC's Publications Committe, before setting up his company. He continues to serve on AIRROC's Publications Committee, as well as its Education and Commutation Events Committee.

Peter brings IAIR over 20 years of experience in alternative dispute resolution, run-off, legal, regulatory and insolvency-related practice. While serving as general counsel for American Centennial Insurance Company and later as Vice President-Counsel for AIG, he (a) sat on the Creditors Committees or actively represented his company in several major US and international insurance and reinsurance liquidations, receiverships and rehabilitations (b) managed audits, handled disputes and negotiated commutations and settlements with many guaranty funds, regulators, receivers and run-off companies (c) actively worked with US and Bermudan insurance departments to resolve run-off and insolvency related issues and (d) personally managed several multibillion dollar run-off portfolios of US and foreign business.

Peter is an active arbitrator and mediator in many alternative dispute resolution organizations, including ARIAS-US, National Association of Securities Dealers (NASD), New York Stock Exchange (NYSE), National Arbitration and Mediation (NAM), National Arbitration Forum, The Jansen Group, Inc., Reinsurance Association of America (RAA), New York Eastern District Federal Court, New York Supreme Court-Commercial Division, New Jersey Superior Court and Volunteer Lawyers for the Arts. He serves on the Certification and Forms and Procedures Committees of ARIAS and is a frequent speaker at insurance, reinsurance, ADR and solvency related seminars.

A graduate of Rutgers University and Rutgers School of Law, Peter currently lives in Yardley, PA with his wife, Paula Weiss, and two children, Rachel and Aaron. In addition to his business pursuits, Peter is a musician who sings baritone for the Bucks County Motet Singers, a Pennsylvania-based a cappella choir.

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Frank Miller

Frank Miller has over 25 years of in solvency expertise working primarily with insolvent financial institutions, both banking and insurance, and is an insolvency specialist for the Canadian Life and Health Insurance Compensation Corporation (CompCorp) in Toronto, Canada.

CompCorp is the industry funded program protecting Canadian life insurance policyholders against loss of benefits due to the financial failure of one of its member companies. Its membership of 108 includes large national and international insurers, regional companies and Canadian branches of foreign companies. CompCorp works with two primary solvency regulators, one for federal companies and one for Quebec registered companies, and with market conduct regulators in the 13 provinces and territories. Frank was one of CompCorp's team involved in dealing with Confederation Life Insurance Company, one of the largest international life insurance companies ever to fail. The liquidator of Confederation Life paid 100% to all policyholders in both the United States and Canada, and transferred

Meet Your Colleagues

Joe DeVito

policies in the UK, Bermuda, and Cuba.

Frank attended the University of Western Ontario, is a Chartered Accountant with a specialist designation as a Chartered Insolvency and Restructuring Professional (CA•CIRP) and a Bankruptcy Trustee. Frank's experience as a receiver and trustee include working on problem real estate, mines, retailers, leasing companies and manufacturers across Canada, and both individual and corporate bankruptcies and restructurings. Prior to joining CompCorp in 1996, he worked with the Canada Deposit Insurance Corporation (CDIC) - Canada's equivalent to the FDIC. At CDIC, Frank gained considerable experience with deposit-taking financial institutions during an era when the Canadian industry went through an adjustment just like the Savings and Loan industry did in the U.S.A.

Frank and his wife Cynthia live in Toronto and spend weekends between three children at university in London and Waterloo, supporting parents in Niagara, or at their cottage three hours north east of Toronto.

News from Headquarters

Paula Keyes, CPCU, ARe, AIR, CPIW, DAE
Executive Director

New IAIR Designations

Congratulations to the following members for earning IAIR designations:

Frederich J. Bingham, CIR-Multiple Lines

Jimmy D. Blissett, AIR- Claims/Guaranty Fund, Accounting /Financial Reporting and Asset Management

Robert Fernandez, AIR- Asset Management

Dana W. Rudmose, AIR-Accounting/Financial Reporting

Mary Cannon Veed, AIR-Legal

Save The Date!!!

IAIR is pleased to be a co-sponsor of the 8th annual NAIC Breakfast Symposium together with Stroock Stroock & Lavan, Reinsurance Solutions International and the Society of Financial Examiners.

This year's event will be on Sunday, December 4th from 8 - 10 a.m. at the Sheraton Chicago during the NAIC meetings. The topic is Extreme Catastrophes: Aftermath & Alternatives. Join us a regulators and professionals from the insurance and disaster planning industries discuss this topic.

You will receive an e-mailed invitation, with RSVP, soon. But do not forget to put this date on your calendar and plan to join us for this informative and timely event.