The Insurance Receiver

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Promoting Professionalism and Ethics in the Administration of Insurance Receiverships

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To my fellow members:

In a summer punctuated by the continuing economic crisis, the advent of health reform, an apocalyptic oil spill, growing unrest on the Korean peninsula, increasing difficulty in Persian relations, and all manner of other mischief around the globe - not to mention the World Cup - developments at IAIR may not seem as momentous. Your Association, however, is in the midst of several initiatives to enhance the value of membership and, more importantly, to fulfill its fundamental role as an integral and productive part of the community it serves.

Patrick Cantilo

Before I delve a bit into these initiatives, I am compelled to climb onto my soapbox with a message of paramount importance to our future success. IAIR decidedly retains the potential of achieving unique status as the preeminent organization for professionals dealing with troubled insurers in all aspects of their activities and their journey through the land of financial challenge. But we can fulfill that potential only to the extent that our members devote their invaluable time and resources to this mission. Unlike many other professional organizations, IAIR cannot boast a compensated staff of specialists to develop and publish informative and thought provoking discussions of the issues that affect our work. Nor do we have a "development" staff to procure financial support. What we have is an Executive Director, aided by a very small staff, and a membership comprised of some of the most talented men and women in the world.

While IAIR is the only organization dedicated exclusively to the management of troubled insurers, we cannot say that all professionals engaged in such activities are drawn from our ranks. A disappointing number of accountants, actuaries, bankers, barristers, consultants, insolvency practitioners, lawyers, solicitors, and turnaround specialists who play significant roles in the management of troubled insurers are not IAIR members. It should be a key goal of our current membership to swell our ranks through the addition of these other professionals who, rightfully, should wear our colors. Moreover, there is much IAIR can do to better the way in which troubled and insolvent insurers are managed, but it can do so only to the extent that its members devote their time and attention to its undertakings. I step off the soapbox

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KNOWING WHEN TO STEP BACK
FOR THE RIGHT PERSPECTIVE

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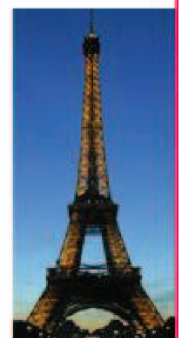


Insurance and reinsurance transactions, acquisitions, insolvency, rehabilitation, runoffs, and regulatory affairs.

IAIR's President's Message (Continued)

with this simple request: please become active in our work (join AND participate in our committees and subcommittees), and help us bring our "missing" members into the fold.

"Simple?" you ask. "What is simple about getting new members?" Permit me to illustrate one or two effective techniques for drafting new members.

1. You sit at the neighborhood Friday evening happy hour with your friends and siblings. The good looking and affluent actuary next door (an unabashed non-member) is regaling you with a long and exquisitely detailed account of a multi-billion P&C rehabilitation of which he is a key part. Suddenly his wandering eye rests on your sister. "Wow!" he exclaims, "She's hot! Did she used to work for Citibank? Think she would go out with me?" Without hesitation, you explain that she ONLY dates active IAIR members.
2. On your way home after a long work day, you stroll past the lagoon in your village when you spot somebody yelling for help from the middle of the water, apparently drowning. Resourceful as is your reputation, in seconds you fashion the leaves of a nearby tree into a solid rescue canoe and from its branches you sculpt two solid oars. But before putting in, you yell back: "How long have you been an IAIR member?"

In short, with a little resourcefulness, we can bring in those who belong but simply have forgotten to sign up. And don't forget to offer them a unique opportunity to become corporate sponsors as well.

Now, as to IAIR's newer initiatives, there is much in the works. Though they are described more fully inside the pages of this elite intellectual periodical, permit me to offer a brief preview. We already have our Job Board up and running. Use the tab at the top of our home page to locate that long sought employee or find a better job. And remember, it provides access to a global audience far larger than our membership.

Being a strong adherent to the old adage "If it ain't fixed don't mess with Texas" (or something like that), your President set out shortly after his election to overhaul our committee structure. After much work and debate, the Board has adopted a new organization described more fully in the pages that follow. We hope thereby to increase our efficiency and effectiveness. PLEASE PARTICIPATE!

Ever since those days long ago when Paul Revere rode though the streets and alleys of Austin on his borrowed steed, Brown Beauty, we all continue to repeat his cry with terror: "The meetings are coming, the meetings are coming!" For reasons we cannot discuss here, the NAIC has reduced (for now at least) the number of its annual national meetings to three. IAIR is not shy! We will plug the gap. We are working on a program scheduled for November 5-6 to launch a new Technical Development Series. More inside. We are also developing more of our exceptional issues forums (fora, fori, forex, forum plus?) to be held in conjunction with NAIC meetings.

In addition, we are working on another of our exceptional Insolvency Workshops. This one will be held in New Orleans beginning January 19, 2011 so MARK YOUR CALENDAR!.

Another goal is to enhance our international role and presence. As a first step, the Board has begun a collection to buy me a one-way ticket to Mogadishu with instructions to impose order on the industry in that seaside resort without taking any flak from the locals.

Another hare-brained scheme of this new president (called a "scheme of derangement" in the old country) was to broaden the purposes and mission statement of the Association to encompass some of the current alternatives to traditional receiverships. It would have been possible to incite greater passion among the members with other proposals, but not if they did not entail some heinous crimes. In any event, this issue will be brought to a close at the August meeting. Having collected the views of those who chose to express them, a special committee of the board will propose alternatives for member approval in conjunction with the next NAIC meeting in Seattle.

We also continue our campaign to improve our website and operating procedures. In short, we are working hard to make IAIR the best that it can be. PLEASE HELP US. We need: people, money, and a nuclear program strictly for peaceful purposes (no, you can't see it!).

I close with thank you, arigato, bedankt, danke, dankie, efkaristo, gracias, grazie, kamsa hamaida, mahalo, merci, obrigado, spasiba, sukran, tack, terima kasih, tesekkurler, toda, and xie xie for all you do for IAIR.

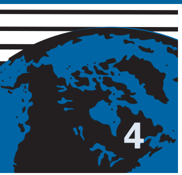
Patrick

Board Talk: Paula Keyes, CPCU, ARe, AIR, CPIW, DAE

By Michelle Avery

The subject of this issue's Board Talk has dedicated a significant amount of her time to the IAIR organization and is a familiar face at every event. Paula Keyes brings a unique perspective, having previously been IAIR's Executive Director and now a Board member. I caught up with Paula to find out more about her and her involvement with IAIR.

Paula originally joined the organization in 1993 to explore the many networking opportunities IAIR had to offer. In 1999, Paula began her first term as a Board member - but it was short lived. In June of that same year, Paula resigned her board position and was named the Executive Director of the organization, a role she maintained until April of 2008. She wasted no time, picking up right where she left off, and once again ran for a Board seat in 2009 and was elected to a three year term. Under the recently revised committee structure, Paula is the chair of the Member Services Committee, which has oversight responsibilities for the International, Membership and Education subcommittees.



Paula began her career in the insurance industry as a reinsurance accountant and, after several years, she became involved with insolvencies through the Ohio Liquidation Office. From there she moved to a consulting firm doing reinsurance collections and after 30 years of "living on the road," she decided to it was time for a change. Twelve years ago, in what she describes as the biggest accomplishment of her professional career, Paula started her own firm, Paula Keyes and Associates LLC, through which she provides reinsurance consulting to insurance departments and companies on both insolvent and active insurance companies. Additionally, Paula continues to be involved in association management work with the Society of Financial Examiners organization.

When asked what the number one challenge facing IAIR is, she focused on an area over which we all have control – membership. Paula believes membership retention is an issue facing many organizations, not just IAIR, because of the downturn in the economy. However, she also notes the decrease in insurance company insolvencies has no doubt contributed to membership retention challenges. Nonetheless, with fewer insolvencies, there is still a significant role and contribution IAIR can make to the industry and Paula believes it is important the organization and its members not lose sight of those opportunities.

Although there are fewer insolvencies, the recent economic environment has led to heightened scrutiny by the regulators. Those regulators need resources that are trained and have the necessary tools and processes to do their jobs competently and to assist in identifying risk factors that may lead to insolvencies. The IAIR membership is a population of resources that can be called upon and looked to by the industry for knowledge, training and experience. Further, Paula believes IAIR needs to expand its membership by expanding its mission statements to include troubled companies because "our experience can allow us to work with companies to help indentify and resolve problems – even companies that won't ever wind up in receivership or supervision. We have to broaden our mission statement because the knowledge and skills we have learned over the years by doing the work that we have done could be invaluable to [others] in the industry who need this assistance."

Paula took time to answer a few of the questions our readers have come to enjoy.

Q. What is your favorite sport?

A. Paula is an avid snow skier and with family in Denver there are plenty of chances to hit the slops in Colorado – her favorite ski destination.

Q. What is the last fiction book you read?

A. If an opportunity to sit back, relax and read presents itself, Paula prefers to use it as an opportunity to relax and escape. With that

as the goal, Paula looks to author Janet Evanovich for a light, humorous, murder mystery. Janet has a series of 16 books starring Stephanie Plum, "a bounty hunter with attitude" that Paula has read and recommends as an entertaining journey to another place.

Q. What is the last place you vacationed?

A. Paula tries to take advantage of occasional downtime with mini-vacations – squeezing in a long weekend when her schedule allows. Most recently she had a chance to take a quick trip from her Orlando-suburb home out to Cocoa Beach over spring break.

Q. What is your favorite leisure activity?

A. Although Paula enjoys reading as a form of escapism, her interest doesn't stop there. She feels there is an unwritten book inside her. Although she isn't sure what it is exactly, she recently began taking creative writing classes and she hopes to become Paula Keyes, the author in the not too distant future.

Q. What is your favorite NAIC/IAIR conference location?

A. New Orleans is Paula's destination of choice. Although Paula does make mention of the endless selection of bars and Bourbon street fun, she focuses more on the other wonderful things the Big Easy has to offer. During her past visits, she's managed to step off Bourbon Street and spend time taking in the historical sites, the beautiful garden district, the amazing cemeteries, lake access, campus life and wonderful restaurants with fabulous food selections. Paula is definitely a great spokesperson and advocate for the location of the upcoming IAIR Insolvency Workshop taking place in New Orleans in January 2012. I'm sure Paula could be a great tour guide if you decide to tack on a few extra days to your visit and no doubt, Paula will do the same.

Q. If you could have dinner with any three people in the world, dead or alive, fictional or non-fictional, who would they be and why?

A. Paula's selection of dinner guests span time and geography with an eye to the past.
Dalai Lama – While not a religious person, Paula describes herself as very spiritual and would like to speak with him about his philosophy and spirituality rooted views on life.
John F. Kennedy – Paula's interest in JFK has more to do with his death than his life. She is particularly intrigued with the mystery, speculation and uncertainty surrounding his death. She would like the opportunity to be one of the only people to know what really happened on that grassy knoll in November 1963.
Lastly, Paula has been influenced by her mother's interest in genealogy. She has a curiosity about where she came from and would like to have the opportunity to meet someone from a distant branch of her family tree. Although her mother's research has provided great insight into her family history, she believes providing a voice to bring those stories to life would allow her to truly understand the trials and tribulations of their life and times.

Q. Give us one piece of personal information that your business acquaintances might not know about you?

A. I honestly thought Paula was kidding when, without hesitation, she answered this question by saying that she has always been painfully shy and has struggled with shyness all her life. She is proud to say that she has overcome it and I'm sure for those of us who know Paula, we would agree that she has been very successful at conquering her fears.

Thank you, Paula, for your time and contributions to this article.

Michelle Avery, CPA is an Executive Vice President and Managing Director at Veris Consulting, Inc. within the firm's forensic accounting practice. Michelle has extensive experience assisting clients in causation and damage assessments related to failed property/casualty and life and health insurance companies. Michelle is a Board member of IAIR and a member of the AICPA's NAIC/AICPA Working Group Task Force. Michelle can be reached at mavery@verisconsulting.com.

To submit an article, please contact Maria Sclafani at mcs@iair.org.
The deadline for the Fall 2010 issue is September 10, 2010.

Recovering Reinsurance in Receivership – Is There a Crisis?

By Matthew Wulf

Many conversations in receivership circles include at least one anecdote involving difficulty in collecting reinsurance.

The upshot of these conversations is a large-scale, perceived crisis. In fact, the issue has risen to the level where the National Association of Insurance Commissioners ("NAIC") has given a charge to the Receivership and Insolvency Task Force ("RITF") to "identify and recommend possible solutions to address timing and collection concerns with reinsurance recoverables held by insurers in receivership."[1] However, anecdotes and trade association task force charges aside, the fundamental question remains – is there a pervasive problem requiring broad-reaching solutions? The treatment of reinsurance recoverables in receivership is an issue deserving attention and study, but a greater understanding of the overall circumstances is necessary before any action to implement "solutions" should be taken. While the subject of timing and collection of reinsurance recoverables in receivership may be crucial, it does not rise to the level of a crisis, and any future changes should be thoughtfully considered and not hastily implemented without fully understanding the matter at hand.

In March of 2009, the RITF presented a memo to the NAIC Financial Condition (E) Committee outlining summary statistics on reinsurance recoverables held by insurers in receivership. The memo indicated that over 85% of current reinsurance recoverables in receivership were over 90 days past due – roughly $2.2 billion. The summary statistics were based on the responses of 37 states. No further information or analysis related to the data has been distributed since that time. While the summary statistics may have sufficed to provide support for the E Committee's charge to the RITF, they do not provide adequate information to analyze the nature and scope of the reinsurance recoverables in receivership issue or to develop balanced recommendations. At a minimum, it will be necessary to quantify the amount of recoverables due to each responding receivership estate as well as a per estate breakdown of reasons for recoverables over 90 days past due. A more thorough examination of the data is necessary to determine if overdue reinsurance recoverables are pervasive within the receivership community, as opposed to large concentrations in a small number of estates.

Also, while 2.2 billion is certainly a large number, it would benefit from some context. An examination of the NAIC's own data over the past 14 years shows 200 open receivership estates with a total of $18.8 billion in reinsurance recoverables (net recoverables after offsets were $17.4 billion). Such an analysis indicates that $15.2 billion has been paid by reinsurers to insolvent estates. Thus the 85% overdue figure gives a misleading picture of reinsurers' overall contribution to receivership estate assets.

The desire to examine reinsurance recoverables in the receivership context is easily understood – generally, the largest portion of the assets of an insolvent property/casualty insurer is its reinsurance recoverables. In a receivership, the Commissioner of Insurance is vested by operation of law with title to all property, contracts, and rights of action of the insurer as of the date of the order directing rehabilitation or liquidation. As a result, the Commissioner, as the receiver of an insurance company, is said to "stand in the shoes" of the insolvent insurer, taking all the rights and obligations under the pre-receivership contracts entered into by the insolvent insurer.

For example, the Commissioner has the right to collect, according to the terms and conditions of the contract, reinsurance recoverables under the insolvent insurer's pre-liquidation reinsurance agreements. Receivers use these reinsurance monies to pay a receivership's administrative expenses, claims of policyholders against the estate, and sums needed by the state guaranty associations. Thus, an insolvent estate's reinsurance recoverables are vital to the operation of the receivership, and a receiver is incentivized to collect reinsurance recoverables as quickly as possible. Because reinsurers have

no ongoing business relationship with insolvent estates, and no possibility of future premium, they are likewise incentivized to settle claims quickly. But the inevitable data and personnel disarray that typically accompanies insolvent estates often creates a delay in the timely notice of claims to reinsurers. Thus, in the usual receivership scenario, the flow of information makes it is nearly impossible for reinsurance to be paid within 90 days.

In addition, the desire to settle quickly does not obviate the reinsurer's obligation to pay only valid, covered claims. In some receiverships, billings can arrive with little to no supporting information. Reinsurers understandably ask questions when coverage obligations are not clear. This suggests a different measure of "overdue" may be necessary in the receivership context. Providing a more realistic time-period before classifying a recoverable as "overdue" would assist in identifying the truly overdue reinsurance recoverables and provide receivers with a more reasonable time-period after which additional, extraordinary measures might be appropriately employed.

It is also necessary to examine the many factors that can account for overdue reinsurance recoverables, from valid disputes and commutation negotiations to lack of necessary claim information and deliberate slow-pay practices. Receivers should reasonably expect reinsurers of receivership estates to pay valid claims in a timely manner just as reinsurers should expect notice and proof of claim information to contain all the detail necessary to evaluate if a loss is covered by the reinsurance contract. Industry and regulators alike should work to discourage deliberate and unnecessary slow-pay practices without vitiating important stakeholder rights or legitimate business practices.

The issue of timing is one of importance to all parties and deserves to be studied. However, to label the timing and collection of reinsurance recoverables in receivership a crisis is to shortcut a thorough examination of the state of affairs. A crisis implies the necessity of a strong and immediate response. Given the importance of reinsurance recoverables to receivership estates, policymakers should take care not to overreact before understanding the true nature and scope of the issue. Undertaking to make the practices and procedures surrounding recovering reinsurance in receiverships more efficient is a laudable goal, but will only be successful if all stakeholders are working from the same page.

Is there a crisis? No. And there should be some comfort in having one less crisis to address.

1 It is interesting to note that a similar exercise was undertaken by the NAIC a number of years ago and was quickly abandoned when, after an abbreviated hearing, it became apparent that the past due numbers for reinsurance recoverables presented at the time were not nearly what they seemed. Once a more detailed analysis of the data began, many of the questions raised by the initial data were easily answered.

Matthew Wulf is Vice President, State Relations and Assistant General Counsel at the Reinsurance Association of America. Mr. Wulf is an active advocate for reinsurance interests before state regulators and legislators and has been involved extensively in receivership law revision efforts at the National Association of Insurance Commissioners.

Visit the IAIR website at www.iair.org for updates and current Association information.

IAIR was founded in 1991 to provide an association to individuals involved with insurance receiverships in order to receive education, promote information exchange, and enhance the standards followed by those who work in this position.

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About IAIR
IAIR was founded in 1991 to provide an association to individuals involved with insurance receiverships in order to receive education, promote information exchange, and enhance the standards followed by those who work in this position.
IAIR Mission Statement
To promote the highest standards in the administration of insurance receiverships and the prompt and efficient closing of receiverships;
To promote a uniform code of professional standards for insurance receivers;
To promote a uniform code of ethical standards for insurance receivers;
To develop educational and training programs to enhance the qualifications of persons working in the field of insurance receiverships and provide a forum for discussion of subjects of common interest to them;
To inform the public of the value of highly-trained and professional insurance receivers who are granted permission to use the Society's designations, thereby to cause insurance receivers to aspire to the highest standards;
To provide benefits usually available to organizations whose members have common interests; and
To perform such other acts and carry on such other lawful activities as may be incidental to, or as may be necessary or convenient to effectuate, the foregoing purposes and objectives.
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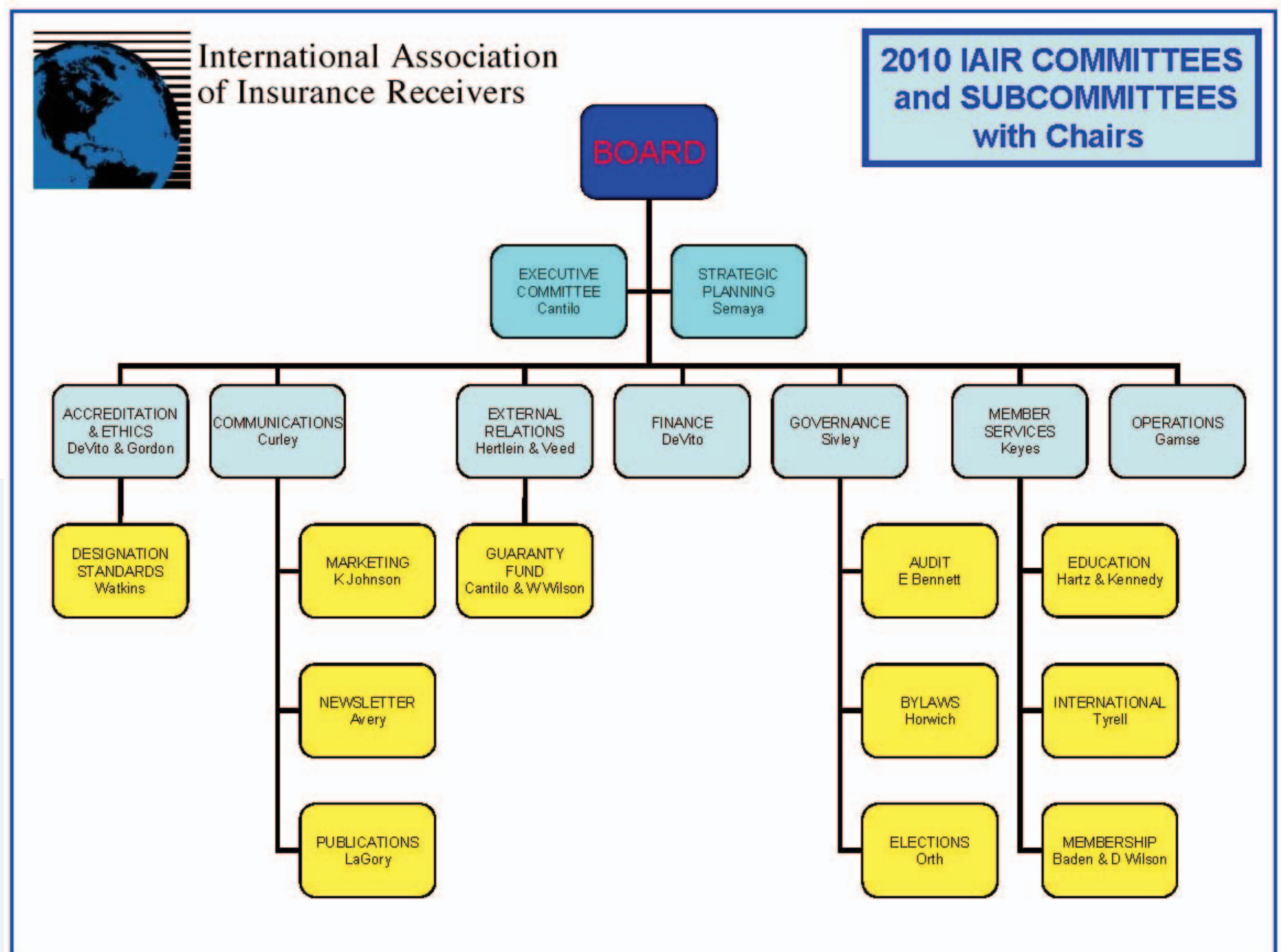
The Board at Work

By Patrick Cantilo

Since the last issue of this august publication, the Board has endeavored to adopt a slightly new approach to management of the organization. Rather than performing all tasks, large and small, at the Board level, much of the operation is now being managed at the level of the Executive Director, committees and subcommittees. As the new committee structure is fully implemented, it is important that our members become actively involved in our affairs by participating in these committee and subcommittee activities. This chart depicts the new structure and the chairs of the new committees and subcommittees:

Please contact the chairs and join the committees or subcommittees in which you are interested.

The Board met in conjunction with the April, 2010, Insolvency Workshop in Miami Beach. (Unfortunately your reporter was trapped in Paris by an Icelandic ash-hole and could only participate by telephone - téléphone in French).



The Board at Work (Continued)

We addressed:

1. Our financial situation (we need more members and money);
2. Anticipated results of the Workshop (better than expected given the poor economy);
3. Sponsorships (we need more, PLEASE);
4. Membership (we have gained a number of new members, but overall, down a bit);
5. Special Bylaws Committee (see below)
6. Strategic Alliances (getting this new initiative under way); and
7. Our normal planning matters.

Since then, the Board has met only once, by telephone, to plan for two exciting programs in our future. The Board has authorized the Member Services Committee and its Education Subcommittee to proceed with the first in a new series of Technical Development programs. This one, a one-day event (spread over two days to facilitate travel) which focuses on asset management and marshaling issues, will be held in Las Vegas. Mark your calendars for NOVEMBER 5-6 and watch for more information.

We are also working on the 2011 Workshop. Still much to do and too early to talk details but mark you calendar for January 19-21, 2011. It promises to be exciting and rewarding on many fronts.

In addition, we have re-energized our state training program with sessions already scheduled for Madison, WI, and Austin, TX, and more in the works.

The Board is also determined to continue improving and adding to the value of member services. Our Job Board is up and running, the website continues to improve and offer more resources, and the number and quality of our programs continue to be the focus of much attention.

The efforts of your president to broaden our constituency and professional focus, which led to a lively debate at our last meeting, are coming to a close with a member vote in Seattle at our August meeting. A special committee chaired by Dennis LaGory, has polled the members and prepared a report and a ballot upon which the members can determine the final revisions to the existing mission statement, incorporated as purposes in our bylaws.

In the main, the items dominating the Board's attention are the need to improve the state of our finances and expanding services for members. The adverse developments of the last few years have left us more vulnerable than at any time in recent years. The key to recovering the robust financial health we enjoyed not so long ago will lie, in part, in continuing to expand our membership and in part in a successful implementation of the new sponsorship program. The assistance of our members with both endeavors is indispensable to our success. While we continue to design a number of new benefits for members, many will require some financial commitment we are loath to make until our fiscal footing becomes a bit firmer.

As usual, we have a full agenda planned for the August NAIC meeting in Seattle. We look forward to another exceptional Issues Forum and a lively Think Tank, as well as great committee and subcommittee meetings and a fun reception. For this meeting we will be implementing the newly adopted Members-only policy for these events. But feel free to bring as guests to the reception those who should be IAIR members.

I look forward to seeing you, one and all, in Seattle.

The Texas Department of Insurance has issued a Request for Qualifications (RFQ) for Special Deputy Receivers. Applicants who meet the qualifications of the RFQ may become eligible to submit bids on insurance receiverships in Texas that are opened during the term of the RFQ. The RFQ and application forms are published at http://www.tdi.state.tx.us/lorc/sdrcontractadmn.html.

View from Washington

By Charlie Richardson

We've talked a lot in the past about the path in Washington toward financial services modernization. That path is now about to end in final legislation – which may start a new path!

After the House's passage in December (223-202) of a financial reform bill, the Senate finally got moving in March, with a new Dodd bill on March 15 and a party line Senate Banking Committee vote a week later. Senate floor debate started a month afterwards. On May 20, the full Senate adopted its version of financial services reform by a vote of 59-39.

Forty-three conferees – 31 from the House and 12 from the Senate – took up the final debate in June over how to reconcile the House and Senate bills on financial regulatory reform. After a few wild weeks and a 20 hour marathon session that ended at 5:39 a.m. on Friday, June 25th, House and Senate conferees agreed (27-16) on sweeping legislation that will change the way banks and other financial companies are regulated. On June 29, the conferees reconvened to strip out a $19 billion bank tax to win some Republican votes.

The Dodd-Frank Wall Street Reform and Consumer Protection Act then got to the President's desk on July 21 after final votes by the House and the Senate. It creates a new system for regulating large, interconnected bank holding companies and nonbank financial companies whose financial distress or failure could threaten the financial stability of the United States.

Oversight and Resolution Authority

Large, interconnected financial companies that are systemically significant will be identified by a Financial Stability Oversight Council chaired by the Treasury Secretary. (This could include insurance companies and insurance holding companies, although most observers contend that few – if any – insurers are systemically significant.) Once identified, these large financial companies will be subject to stringent regulation by the Federal Reserve Board.

The legislation also creates a new mechanism for liquidating systemically significant financial companies whose failure could destabilize the economy. While the FDIC will be appointed receiver of and liquidate most types of financial companies, insolvent insurers (including any that are systemically significant) will remain subject to state receivership and guaranty association processes. The only exception would be if the domestic state fails to act quickly enough and the FDIC's "backup authority" kicks in. The domestic state would have 60 days to act. In a late breaking turn of events, the conferees gave the newly-formed Federal Insurance Office (rather than state insurance regulators) a vote in triggering authority for orderly liquidation when a financial company or its largest subsidiary is an insurance company.

Resolution of systemically significant financial companies will be funded by a post-liquidation resolution fund. If any insurers are tapped to contribute to such fund, they will get a credit for guaranty fund assessments already paid. This resolution fund is separate from the $19 billion tax that the legislation originally levied on large financial institutions, including insurers, with assets under management of more than $50 billion; as I said, that was stripped out of the bill on June 29.

All in all, insurance receivers and guaranty funds/associations fare pretty well under the new legislation.

Federal Insurance Office

The legislation also establishes a Federal Insurance Office ("FIO") in the Department of the Treasury with limited authority over all lines of insurance other than health insurance. It will give a new federal focus to all things insurance. Among other responsibilities, the FIO will monitor the insurance industry for regulatory gaps that could lead to systemic risk.

The FIO will also recommend to the Financial Stability Oversight Council those insurance companies that FIO believes should be subject to regulation as nonbank financial companies by the Federal Reserve Board. Both the director of the FIO and a state insurance commissioner will have non-voting seats on the Council. The FIO will be authorized to gather (or in some cases, subpoena)

View from Washington (Continued)

data from insurers and their affiliates for these and other purposes, but only after coordinating with federal agencies and state regulators and determining that the information may not be obtained from those or other publicly available sources.

The legislation requires the FIO Director to conduct a study on how to improve and modernize insurance regulation, the results of which will be reported to Congress no later than January 2012. As part of the study, the FIO is charged with examining the potential consequences of subjecting insurance companies to a federal resolution authority, including the effects of any federal resolution authority on: the operation of state insurance guaranty fund systems, including the loss of guaranty fund coverage if an insurance company is subject to a federal resolution authority; and policyholder protection, including the loss of the priority status of policyholder claims over other unsecured general creditor claims.

So when it comes to insurance company receiverships, the financial reform legislation maintains the status quo, but opens the door for big changes in the future as the federal microscope potentially gets focused on the guaranty function in the study to come.

What's In Store?

That second wave of insurance examination as a part of a new insurance presence in the federal government is where our receiver and guaranty fund/association risks may be greatest. The spotlight will be on you like never before when that office is up and running and looking for things to examine. Many of you will be asked, maybe even compelled, to give input, I have no doubt. The federal camel's nose and humps will be under the heretofore state-regulated insurance tent, no doubt about it. You will be investigated – because Congress has now said it wants that done.

Charlie Richardson is a Partner at the law firm Baker & Daniels in Washington, D.C. where he chairs the insurance and financial services practice group. Charlie assists insurance companies and others with all types of corporate, federal legislative, regulatory, public policy and compliance matters. He practices in the area of insurance company rehabilitations and liquidations.

The Perfect Receiver

By Patrick Cantilo

"Captain: The Romulons are turning and are preparing to fire!""Fire two photon torpedoes, fore and aft!" I replied. Shazaam! Two direct hits and problem solved.

Having thus eliminated the current crisis, I tuned my attention to my youthful Tactical Planning Officer who posed this interesting question.

"Captain: Suppose I am appointed receiver of Borg Resistance Life Insurance Company and I quickly discover that management has not been completely candid with the reinsurers about the company's financial condition. What should I do?"

"Well Gertrude" I replied helpfully, "approach the issue systematically. First, have someone determine exactly what the reporting obligations are under the contracts AND what has been the custom and practice in the relationship. Second, determine in what respects the reports have been incomplete and inaccurate. Be attentive in particular to whether the problems have affected the reinsurers' risk in any way (i.e., did they induce renewals or additional cover?). Try also to determine whether and for how long the reinsurers may have known about the problems. Third, set a meeting with the reinsurers' representatives with a complete agenda (balances, possible commutation, modus operandi in receivership, and past reporting issues, etc.). Try to arrive at a working relationship based on candor and transparency. Experience teaches that trying to hide the problems is seldom a fruitful strategy. On the other hand, most of the time they really will turn out not to be as much of a defense to reinsurer liability as might have been feared."

"That's great Captain" she replied. "But what if the records are in disarray and company staff is unhelpful?" "In that case, Grasshopper, candor is again in order. At the meeting with reinsurers explain that you are reconstructing records and cannot yet make any comments about the quality of past reports. However, tell them you would appreciate any relevant information they can offer. Above all, try to establish a productive relationship."

The youngster looked down thoughtfully, obviously uneasy, and finally asked, "But what if our outside counsel is my boyfriend?" Smiling I answered, "In that case, sue everybody!"

At that moment my science officer warned "Captain, a Vulcan Man-of-war is uncloaking to starboard!" and my attention was drawn elsewhere.

This is the second in a new series of practical tips. Nothing herein is intended as legal advice.

IAIR Welcomes New Members

The following members were approved at the March 2010 Denver IAIR Board of Directors Meeting:

J. Kevin Baldwin is the Chief Operating Officer & Deputy General Counsel for the Office of the Special Deputy Receiver. Kevin directs the OSD's Receivership Operation, Estate Management, and Claim Departments, and serves as Deputy General Counsel on certain receivership estates and OSD corporate matters.

Daniel D. Haug, CPA is Chief Financial Officer of his own accounting firm. His services include all financial functions; an integral resource to executive management for decision-making; preparing IPO's; effective liaison to auditors, examiners, and tax personnel; and, creating strategic alliances with outside partners to maximize cash flow.

Margaret "Peg" Ising is a Regulatory Consultant with the law firm Nelson Levine de Luca & Horst. She provides regulatory consulting services to the firm's Insurance Regulatory and Transactional Practice Group.

Jeffrey C. Johnston is the President of the insurance regulatory consulting firm of Rector & Associates, Inc. ("R&A"). R&A assists insurance companies, insurance regulators, law firms, and others with respect to a wide variety of regulatory issues. For 13 years, Jeff held various senior positions with the National Association of Insurance Commissioners ("NAIC"), including Chief Financial Officer and Director of Financial Regulatory Services. Jeff serves as a team member with respect to the NAIC's Financial Regulation Standards and Accreditation Program.

Bill Lane is a CPA with his own accounting firm BFL Consulting, LLC. BFL Consulting is located in New Waverly, Texas and provides client services in the area of financial analysis.

Fred Marziano brings 40 years of leadership and experience in the property and casualty insurance and reinsurance business to his role as Principal at CIM, Inc. His consulting practice emphasizes arbitration, expert witness and general consulting to the financial services industry, specializing in M&A and Strategic Planning.

Nick Pearson is a Partner in the Insurance and Reinsurance Department of Edwards Angell Palmer and Dodge's New Your office. He has represented US and foreign insurers, reinsurers and producers and served as outside General Counsel to licensed to excess surplus lines insurers.

Michael J. Rothman is a shareholder with Winthrop & Weinstine, PA in Minneapolis, MN. He has extensive experience in the areas of insurance & financial services, legislative & regulatory matters, business & commercial litigation, insurance litigation and ethics, campaign finance & election law.

Elizabeth Wheal is a Senior Associate in the Insurance Restructuring and Insolvency team at the London law firm of Reynolds Porter Chamberlain LLP. Elizabeth advises both UK and foreign insurance and reinsurance clients operating in the London Market.

Donald Wustrow is President & Chief Operating Officer of Chiltington International, Inc. located in Holmdel, New Jersey. He is responsible for corporate marketing, project coordination and supervision and management of technical assignments.

The Insurance Receiver is intended to provide readers with information on and provide a forum for opinions and discussions of insurance insolvency topics. The views expressed by the authors in the Insurance Receiver are their own and not necessarily those of the IAIR Board, Publications Committee or IAIR Executive Director. No article or other feature should be considered as legal advice.

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Private Run-Offs: Alternatives to Government Administration of Troubled Insurance Companies

By Bernhardt Nadell, William D. Latza, and Robert M. Fettman

Every state in the United States has a regulatory framework – dictated by state law – that sets forth the process to be followed when an insurance company is, or may become, impaired or insolvent.

Typically, the insurance commissioner in the company's domiciliary state initiates the process by instituting expanded supervisory authority over the insurance company (with or without a court order, depending on the applicable statute) and if supervision proves insufficient, by filing petitions with the appropriate state court seeking the right to seize the assets of the impaired or insolvent company, to operate it pending the rehabilitation and, if rehabilitation fails, to liquidate the company.

If granted, the rehabilitation or liquidation order appoints the state insurance commissioner to act as a receiver in orchestrating such rehabilitation or the winding down and ultimate liquidation of the impaired or insolvent insurer. In most states, the receivership is contracted out to private sector specialists.

This process worked relatively well in the past, when insurance company insolvencies tended to be smaller and less complex. More recently, however, with insurance insolvencies involving significantly larger and more complex companies inextricably tied to volatile financial markets, resulting in strain on state agencies, some have questioned the efficacy of the traditional receivership model. These critics argue that the traditional process, which is responsive on a day-to-day basis to public officials who are necessarily concerned with balancing competing interests (including, oftentimes, political interests), is not necessarily the best means to wind down the operations of an impaired insurer and to achieve the optimal resolution of a complex financial situation.

In response to these concerns, new structures, in which companies engage in voluntary, private run-offs as an alternative to a formal receivership proceeding, are gaining acceptance, both from insurance companies and regulators. This article examines the key elements of three private run-off transactions, the nexus between private run-offs and M&A activity putting private capital at risk, and the implications of private run-off alternatives for both the private and the public sectors.

Private Run-offs

Overview

Formal delinquency proceedings are governed and shaped by a detailed set of laws and regulations – a legislative "cookbook" that has worked well in the situations for which it was intended, but which limits flexibility to respond to situations and issues not considered when the statutes were enacted. Government rightly responds to exogenous concerns, while private run-offs respond to those concerns under insurance department oversight intended to protect the public interest while also keeping the strict financial circumstances of the company clearly in mind.

When is it appropriate to permit a private run-off? Conventional wisdom says when (1) the insurer's stakeholders have substantive interests that are in opposition to one another; (2) the capital structure of the insurer is complicated and its liabilities are multifaceted, complex and difficult to administer (as distinguished from complex characteristics of the underlying risks insured); (3) resolution requires a restructuring, rather than merely "working the files"; and (4) the size of the insurer justifies the effort. Private investors, lenders and active affiliates of candidates for run-off should be aware that regulators increasingly recognize that public-private collaboration in running off troubled insurance companies can result in cost savings and greater efficiency than the traditional receivership model.

Private run-offs may be attractive to both the government and the private sector for several reasons; perhaps most important is the potential

for a quicker resolution. Private run-offs, because they are not subject to detailed statutory prescriptions and proscriptions, also afford interested parties greater flexibility in negotiating tailor-made solutions best suited for the affected company.

For example, decisions on whether to run off components of a business, to utilize reinsurance, to engage in assumption transfers and loss portfolio transfers, or to negotiate settlements or commute existing policies, are easier to implement in a private run-off. This flexibility may, in turn, make potential acquirers more willing to purchase companies going into run-off and to put capital at risk. Moreover, as private run-offs typically cost less than the expenses of receivers and liquidators, which enjoy the highest priority in the distribution of assets composing the estate of the insurer, more assets may be preserved to pay policyholders and claimants.

To be sure, a successful private run-off plan must also provide regulators with procedural oversight and certain assurances – such as ensuring that all similarly situated claimants will be treated in a like manner, the interest of policyholders and claimants will be properly accounted for and well served under the plan, and the right of judicial review and intervention will be preserved. At the end of the day, however, private run-offs can prove beneficial not only to the policyholders and creditors of the troubled insurance company, but also to insurance regulators, to active businesses excluded from the run-off and to investors.

The proof, of course, is in whether private run-off transactions have been successfully consummated. The following is an overview of several recent innovative restructurings and acquisitions and divestitures of insurance companies in run-off. In the examples that follow, state involvement was through insurance regulators, with no involvement by court appointed receivers.

ACA Financial Guaranty – Settlement and Entry into Run-off Operations (2008)

In November 2007, A-rated ACA Financial Guaranty Corporation (ACA), a Maryland domiciled financial guaranty corporation that primarily guaranteed or credit enhanced municipal bonds, was put on credit watch with negative implications. ACA had begun writing guarantees on structured finance products in 2002, whereby it guaranteed the performance of credit default swaps written by special purpose vehicles on collateralized debt obligations (CDOs) (which in some instances were backed by bundles of subprime mortgages).

Certain of these guarantees included provisions permitting the counterparties to the transactions guaranteed by ACA to require the posting of collateral in the event that ACA's financial strength rating was downgraded below certain levels. A ratings downgrade would have required ACA to post approximately $1.7 billion in collateral for CDOs, for which it did not have sufficient assets available had they been demanded.

ACA proposed entering into short-term forbearance agreements with its counterparties under which the counterparties agreed not to demand that ACA post collateral or otherwise terminate their contacts with ACA in the event of a downgrade. The forbearance agreements provided breathing room for the parties and regulators to devise a long-term solution to ACA's financial difficulties.

The Maryland Insurance Commissioner and ACA entered into a Consent Order granting the Commissioner the right to commence rehabilitation or liquidation proceedings if in his sole judgment a downgrade resulted in insufficient protection to ACA's policyholders and other creditors or to the general public. In December 2007, ACA and the Maryland Insurance Administration entered into a further agreement subjecting the insurer to significantly increased oversight by the Administration. Under the agreement with the Administration, ACA was allowed to negotiate a settlement with its CDO counterparties. During this time, the Commissioner contracted experts in restructuring, receivership, modeling, tax and finance to monitor settlement negotiations and develop a run-off business model.

As a result of negotiations with its counterparties and certain policyholders and creditors, ACA proposed a restructuring transaction to the Commissioner whereby ACA would settle many of its obligations prior to closing the transaction and thereafter operate as

a run-off company. ACA's remaining insurance obligations consisted primarily of traditional financial guaranty insurance written on municipal obligations. An essential component of the transaction was the development of a run-off business model designed to determine the amount of financial resources, using conservative assumptions, for ACA to operate as a run-off company and pay all insurance claims and administrative expenses until its last remaining policy on municipal obligations expired in the year 2045. After settlement negotiations were finalized, the Commissioner reviewed the terms of settlement and the negotiation process and deemed the settlement fair, reasonable and in the best interest of the relevant parties and the public.

As part of the settlement, and in release of future claims, ACA made a cash payment and issued $1 billion principal in surplus notes to the former counterparties. The surplus notes were subordinate to policyholder claims, claimant and beneficiary claims and all other classes of creditors except common and preferred shareholders. The note covenants provided that noteholder approval was required for certain transactions, including selling assets, merging, acquiring assets, entering into affiliate transactions, paying dividends or distributions and changing organizational documents. ACA Capital, the parent company of ACA, disclaimed control over ACA in light of the controlling rights that the note covenants and various governance rights conferred on the noteholders. The disclaimer was intended to exempt ACA Capital from holding company reporting requirements under Maryland's holding company statutes.

Another element of the transaction involved ACA Capital's restructuring of its holding company system to permit ACA to no longer be consolidated with ACA Capital for federal income tax purposes. This restructuring involved the transfer of certain shares of ACA common stock between wholly owned subsidiaries of ACA Capital. ACA Capital created a Cayman Islands holding company, which bought 23.4% of ACA's common stock from an affiliate.

The sale did not constitute an acquisition of control of ACA by the Cayman Islands holding company. Although after the sale ACA remained an indirect, wholly-owned subsidiary of ACA Capital, because ACA Capital disclaimed control, the Cayman Islands holding company was not deemed to control ACA.

In addition to the settlement, ACA entered into several inter-affiliate agreements to settle intercompany obligations and provide ongoing support. ACA also provided the Commissioner with a plan of operations, which it was not allowed to materially alter or amend without the prior written approval of the Commissioner. Further, approval was required for transactions such as transferring assets from ACA to another entity, creating new subsidiaries, acquiring subsidiaries, merging or liquidating subsidiaries, making distributions to the noteholders, reinsuring all or a portion of its book of business, executing any lease, incurring any debt, pledging any assets, and hiring outside entities to perform operational functions for ACA.

Conseco – Stock Transfer to an Independent Trust (2008)

Another recent innovative deal was the transfer by Conseco of its Senior Health Care business to an independent trust to run-off the long-term health-care policy business, written primarily by Senior Health Insurance Company, of one of Conseco's affiliates. In order to effect the transfer of Senior Health Insurance Company's stock to the independent trust, Conseco first created a transition trust into which Conseco transferred the stock of Senior Health Insurance Company. Following approval by the Pennsylvania Insurance Department (which did not hold a hearing) and transfer of Senior Health Insurance Company stock to the transition trust, the transition trust merged into the independent trust. An independent board of trustees was appointed to manage the independent trust, and the remainder of the trust is required to be distributed to charitable institutions whose objectives focus on senior health.

Given that the transaction ultimately created an independent entity responsible for Senior Health Insurance Company's run-off operations, capital adequacy was the greatest concern for the Pennsylvania Insurance Department. Conseco made capital contributions in an aggregate amount of $175 million to the transition trust and Senior Health Insurance Company. Conseco

contributed $125 million in the form of a senior note, $11 million in cash to the trust to provide working capital to fund future operating expenses, and $39 million through the forgiveness of accrued and unpaid dividends on Senior Health Insurance Company preferred shares. As the subject business is long-term, and the transaction is comparatively recent, time will tell whether these enhancements were, in the aggregate, adequate.

As part of the transaction, Conseco (and related entities) agreed to assign to Senior Health Insurance Company various contracts and other assets primarily related to the run-off business, subject to receipt of any necessary third party consents. The parties also agreed to use commercially reasonable efforts to implement various separation transactions between Senior Health and Conseco, including amending various reinsurance agreements in order that the rights and obligations under those agreements relating to the portion of the business retained by Senior Health could be divided and allocated between Conseco Insurance Company and Senior Health, as appropriate.

Conseco (and related entities) also assumed responsibility for certain existing litigation relating to the run-off business, but at the closing, Senior Health transferred an amount equal to the reserves relating to such litigation to Conseco. Further, Conseco and the independent trust agreed to use commercially reasonable efforts following the closing to obtain consents to novate or assign certain contracts, licenses and other obligations for which Senior Health and Conseco (and related entities) were jointly or severally liable to either Senior Health or one of the Conseco parties, as agreed under the Transfer Agreement.

The Pennsylvania Insurance Department played a significant role in structuring the transaction, imposing numerous conditions and ongoing restrictions on the transaction and maintaining a significant amount of control over the independent trust. For example, the Department's approval is required for amending the trust's governing documents, amending an Operating Principles and Guidelines Agreement (which governs Senior Health Insurance Company's day-to-day operations) and other agreements entered into in connection with the acquisition transaction, appointing any new or replacement trustees, and paying any dividends. Furthermore, all future contracts between the trust and Senior Health Insurance Company are subject to Department approval.

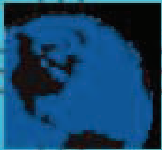
Randall & Quilter Purchase of Brandywine from ACE (2005)

In 2005, Randall & Quilter purchased ACE American Reinsurance Company, Brandywine Reinsurance Co. (UK) Ltd. and Brandywine Reinsurance Company S.A.–N.V., three run-off reinsurance subsidiaries of ACE Ltd. The transaction was subject to prior approval by the Pennsylvania Department of Insurance (because of the change of control of ACE American Reinsurance Company) and the U.K. Financial Services Authority. The transaction was likely subject to heightened scrutiny due to Brandywine's history.

In 1995, the Brandywine entities were formed to house the asbestos and environmental run-off operations of certain INA Financial (Cigna) entities created in a restructuring of INA Financial's active and inactive operating entities. The restructuring was effectuated under a Pennsylvania division statute. As part of that original restructuring, INA Financial was required to make a capital contribution of approximately $375 million (which was allocated to the run-off entities), provide a $50 million revolving working capital fund, and obtain an $800 million aggregate excess of loss reinsurance agreement for the run-off entities.

In 1999, ACE Ltd. acquired the Brandywine entities. As a condition to obtaining regulatory approval in 1999, the Pennsylvania Insurance Department required that all conditions of a 1996 order allowing the original restructuring remain in full force and effect. The Department's review of the 2005 transaction also focused heavily on capital adequacy, similar to the 1996 and 1999 orders. The Pennsylvania Insurance Department approved the sale of ACE American Reinsurance on July 3, 2006 and the Financial Services Authority of the United Kingdom approved the sale of Brandywine Reinsurance on February 27, 2006.

Prior to closing of the 2005 transaction, the ACE entities entered into four types of transactions: 1) capital contributions and intercompany note



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repayment; 2) alignment of legal entity and business assumed reinsurance operations; 3) other "clean-up" transactions; and 4) distributions to ACE American and Century Indemnity Company. Intercompany notes held by certain of the Brandywine entities were repaid to enable non-Brandywine entities to commute reinsurance agreements assumed from affiliates. Various intercompany reinsurance agreements were commuted or novated to separate the Brandywine entities from the ACE family of companies. In addition, reinsurance recoverables on paid losses were transferred from ACE American to a non-Brandywine entity, and dividends were declared so that ACE American would have a $25 million surplus at closing.

As part of its review, and in addition to holding a public hearing, the Department retained legal counsel and a consulting firm to provide actuarial support in the Department's review. As a result of the actuarial review, the parties amended their filing to provide additional coverage in the form of a $35 million reinsurance treaty. Similar to the transactions discussed above, and in addition the terms of prior orders relating to the Brandywine entities, the 2005 transaction was subject to a number of conditions. These included that ACE American was subject to certain reporting requirements exceeding those statutorily required under Pennsylvania law, and that it could not, without prior approval of the Department, acquire certain types of investment assets, write new business, pay dividends or other distributions, or effect any transfers of assets outside the ordinary course of business.

Conclusion

Capital adequacy is, of course, the paramount concern to regulators in reviewing proposed transactions involving run-off companies. Regulators want assurance that the run-off is based on a fully developed and comprehensive financial plan. Each of the transactions discussed in this article involved either the regulator hiring independent actuaries to review capital adequacy and/or requiring the parties to devote additional capital to the run-off entities. In Conseco, the former parent provided cash, notes and forgave indebtedness. In the original Brandywine deal, INA Financial provided cash, a revolving working capital fund, and an aggregate excess of loss reinsurance treaty to the run-off insurers to ensure that capital was adequate for the run-off operations. In the 2005 Brandywine transaction, Randall & Quilter obtained an additional reinsurance cover to bolster capital adequacy.

Another key aspect of a successful transaction includes an ongoing, active dialogue with regulators, commencing as early as possible during the process of developing a transaction structure. In addition to capital adequacy, regulators typically will look for assurances that (i) contractual obligations to policyholders will be honored, (ii) meaningful and timely notices are provided to policyholders, creditors and guaranty funds, (iii) statutory liquidation priority schemes are adhered to, and (iv) policy commutations or restructuring are entered into voluntarily (no cram-downs). In the ACA restructuring, for example, the Maryland Insurance Administration was involved from the beginning of the forbearance process, helping to achieve an "approvable" transaction. This open dialogue should continue during the run-off.

Lastly, maintaining flexibility in the approach to the transaction structure is vitally important, as the regulatory review process will result in extensive give and take among the regulators and the involved parties. Each of the transactions discussed above went through various incarnations, as transactions were negotiated among the parties and scrutinized by the regulators. Being proactive in soliciting the views of the regulators throughout the process will increase the likelihood of developing a viable and approvable structure.

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