The Insurance Receiver

Promoting Professionalism and Ethics in the Administration of Insurance Receiverships

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As the holidays approach, clearly the joys of the season are being dampened by the uncertainty of the world economy, the rising fear of failures in the financial services sector (especially the insurance industry), and yet there is still so much to be thankful for. First and foremost, be thankful for your families, your good health, your friends and colleagues. Now more than ever, our networks keep us going. As we move into 2009, it is inevitable that the insurance industry will experience a continuing negative trend and insolvencies will be inevitable. It is so important for IAIR to move forward in redefining its role and carry out its mission – to be the premier educational source for our members, regulators and the industry, so we are prepared to face the challenges ahead.

Francine L. Semaya, Esq.

As President of IAIR, I have so much to be thankful for – a dynamic Board of Directors, a "roll-up you sleeves and work" Executive Committee, worker bee Committee Chairs and members, and an Executive Management team that has more energy and creative ideas to make IAIR a better home for all its members. To each and every one of you, my personal recognition and thanks for making IAIR the professional organization that it is. This has been a year of transition and during any such period there will be successes and set-backs. Our website is up and running – it's not perfect – but our goal is to make it user-friendly and timely. We still need members to step-up to the plate and chair vital committees or just become more involved. But putting all that aside, our strength is our education programs and this year has been better than ever, and wait till you see what's in store for 2009!

Over the past year, IAIR has engaged in an aggressive educational undertaking – the programs this year have been timely, meaningful and brought new faces to IAIR. We just returned from the successful Joint Insolvency Conference with the NCIGF, "Tipping Points Exploring the Insolvency Decision Making Process." Thanks to the untiring work of Lynn Cantin (NCIGF) and Maria Sclafani (The Beaumont Group), we had 125 attendees, with a conference that ran ever so smoothly. Holly Bakke and Steve Durish, with their committee, put together an informative, innovative and timely program – I thank them for their hard work and dedication to both associations. Not to be outdone, our quarterly meetings have attracted increased attendance, thanks to the creative and hardworking Chair of our Issues Forum, Phil Curley. This year we have been on the cutting-edge with new topics, new speakers

IAIR's President's Message (Continued)

and a new look. Phil, my personal thanks for a job superbly done. In December, we will have yet another successful Issues Forum and our reinstated Think Tank.

And now we must look forward. The 2009 Post-Inaugural Insolvency Workshop is scheduled for January 21-23, 2009 in Tampa, Florida. If you've ever wanted to play Family Feud, now's your chance. Speakers and panelists come from far and near and will present the most up-to-date insolvency program to date.

We place a great deal of emphasis on our educational programs – the greatest benefit to IAIR membership. We must continue to grow – both in terms of carrying out IAIR's mission but also in terms of membership. In the Fall 2008 edition, I challenged each of us to bring in just one new member. I have recruited several – how about you? As the 2nd year of my term begins, let's work together to strengthen IAIR, to provide enhanced educational programs, and greater opportunities for advancement in the industry, and to be the premier source of guidance and assistance to regulators as they face increasing numbers of troubled companies.

2009 IAIR Insolvency Workshop
January 21-23, 2009
Sheraton Tampa Riverwalk Hotel,
Tampa, FL

On behalf of myself, the IAIR Board and our Management team, I wish you and your families a healthy, safe, and peaceful holiday season and a prosperous new year.

Board Talk

By Michelle Bolter & Jamie Saylor

Since a trip across the pond wasn't in the Publications Committee budget for this issue's Board Talk feature, the authors settled for a phone interview with our British board member, Dorothy Cory-Wright.

Dorothy Cory-Wright

Dorothy has been an IAIR member since the early days of the organization in 1992, at which time she was recruited by last quarter's Board Talk featured member, Karen Weldin Stewart. Karen encouraged Dorothy to get involved because of her relevant experience with insurance restructurings in England.

Dorothy began her career as a Barrister at the English Bar. Since 1989, Dorothy has practiced as a Solicitor and is a partner in the London office of Sidley Austin, LLP where she heads up Sidley's Insurance and Reinsurance Litigation practice. Dorothy has focused on commercial litigation and dispute resolution for over 23 years, particularly in the insurance and reinsurance arenas. Dorothy's experience includes counseling multiple insurance insolvencies and restructurings. Some of her relevant case work includes involvement with HS Weavers, the PCW syndicates, Bermuda Fire and Marine, English & American and Independent Insurance, as well as advising on issues arising on insolvent Schemes of Arrangement and Part VII transfers.

Dorothy sits on IAIR's International Committee as well as the Publications Committee. The International Committee helps to ensure that the international views of IAIR are properly represented at IAIR's annual workshops and seminars, actively pursues contributions from international members, and targets increasing IAIR's international membership. Dorothy's first term on IAIR's Board expires this December, but she hopes to gain re-election to a second term on the Board.

Dorothy believes that IAIR has always been a valuable professional forum for the

Board Talk (Continued)

identification of common principles and the exchange of issues and experiences among members of the insurance industry concerning international receivership events. She thinks it is inevitable that, as a result of the recent events in the U.S. and international economies, "there will be a renewed vitality in the organization and a need for the many benefits and opportunities it provides." Dorothy believes IAIR must now primarily focus on increasing its membership, keeping the organization relevant and creating a legacy for new members joining the organization. She also feels that widening the scope of IAIR from a receivership focus to include more general run-off, restructuring and troubled company issues is an important area of growth for IAIR.

And now for the truly interesting details about Dorothy that you can't read about in her bio.

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?

Roger Federer, winner of 13 Grand Slam tennis titles and currently world ranked No. 2 player for his aesthetic qualities as well as some tennis tips. Warren Buffett, CEO of Berkshire Hathaway. As one of the most successful investors of modern time, Dorothy wouldn't mind some sound investment advice. Queen Elizabeth I of England for saying "I have but the body of a weak and feeble woman, but I have the heart and stomach of a king."

What is your favorite NAIC/IAIR conference location?

San Diego, California. Dorothy particularly enjoyed the local Mexican market, margaritas and warm sunshine in December - as well as the interesting debates at the meetings, of course.

What is the last fictional book you read that you would recommend?

A Thousand Splendid Suns, by Khaled Hosseini. Dorothy enjoyed this more than *The Kite Runner* and found it to be very well written and thought provoking.

What is your favorite leisure activity?

Reading and Bridge - and on seeing that in print thinks that she should add that she also enjoys going to parties so not to be as dull as she might otherwise appear!

What is your favorite sport or sports team?

Scotland and anyone who is playing England.

Where is the last place you vacationed?

Bermuda for a house swap with a local insurance insolvency practitioner. This enabled Dorothy to enjoy/mediate a three generation holiday with her teenage daughters Ella (17) and Poppy (15) and her mother.

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

Hugh Grant is a very old friend. They met long before he was famous. Make sure you get Dorothy to give you the scoop on that friendship at the next IAIR cocktail reception.

Proudest professional achievement?

The exciting challenge of the move to Sidley Austin LLP and the success of the new practice group.

Thanks to Dorothy for her time and cooperation on this article.

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 advise.

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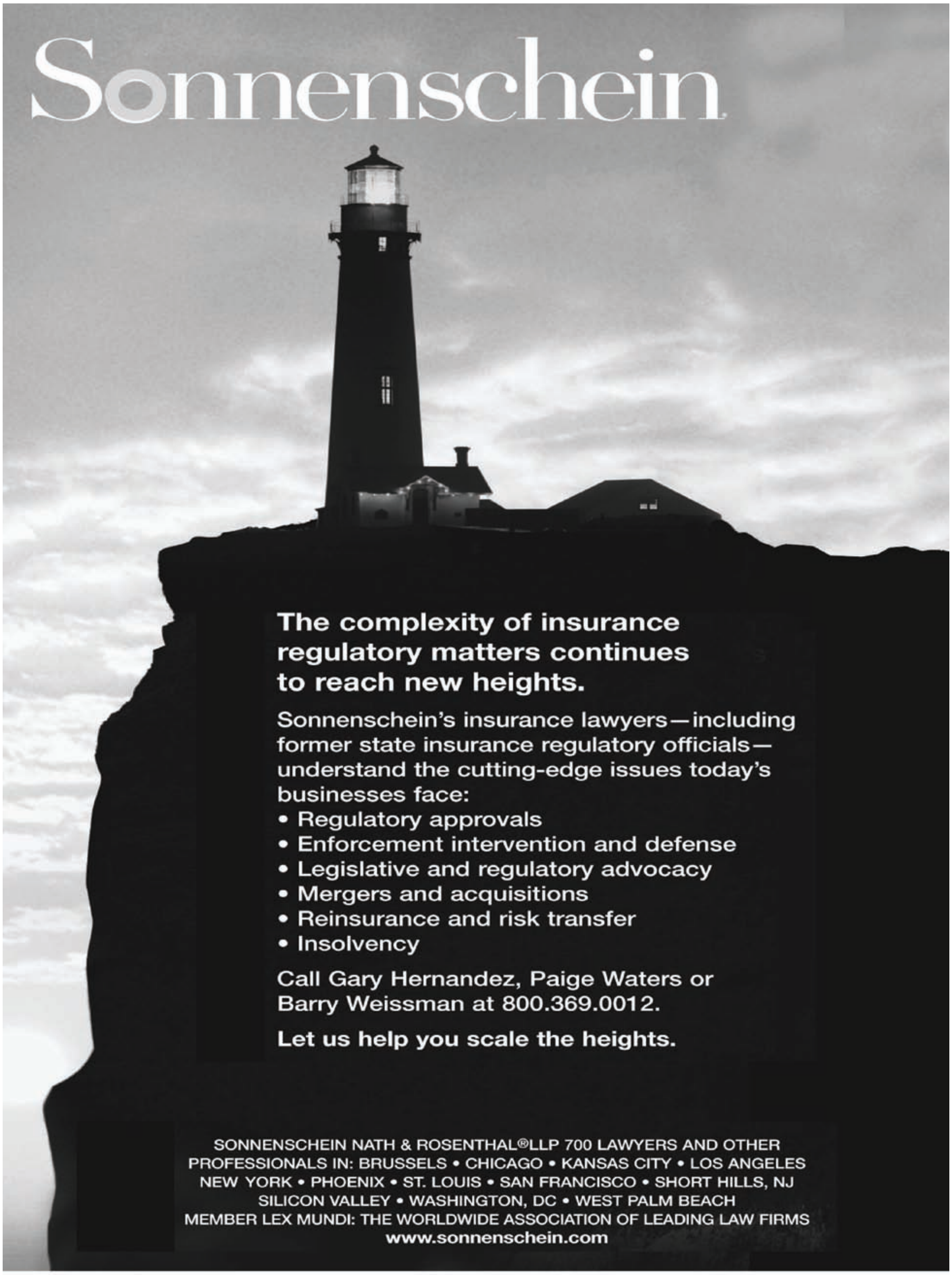
Maria Sclafani and Susan Barros, Executive Directors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Guaranty Fund Strategic Planning On Track, Moving Ahead with Purpose

By Roger H. Schmelzer

"You should examine yourself daily," wrote author Israel Zangwill. "If you find faults, you should correct them. When you find none, you should try even harder."

Zangwill's words could offer a good summation of the National Conference of Insurance Guaranty Funds' ("NCIGF") strategic initiative to provide an overall assessment of the NCIGF and guaranty fund system.

Created by the NCIGF Board of Directors in January 2006, the effort evolved into the most ambitious, comprehensive and in-depth self-examination of the organization and guaranty fund system in its nearly 40-year history.

The intent of the effort was to analyze the challenges facing the property and casualty guaranty funds, the challenges the guaranty funds will face in the future, and how the NCIGF could work more effectively and efficiently to help its members fulfill the core mission of "paying the claims of insolvent insurers."

The initiative will provide the foundation for the future of the property and casualty guaranty fund system, and help chart the future of the system and the NCIGF.

> *The initiative will provide the foundation for the future of the property and casualty guaranty fund system.*

From Arizona, to Orlando, to "self-knowledge"

The initiative traces its origins to the NCIGF's Fall Workshop in Scottsdale, Arizona in November 2005. There the NCIGF board began taking suggestions from guaranty fund managers, industry and trade representatives, insurance department representatives and others about how to improve the NCIGF and guaranty fund system. Comments at the meeting ranged widely, offering many perspectives on how the system and organization could work more efficiently to fulfill the mission of protecting policyholders.

A general consensus among those working on the effort was that the guaranty fund system had functioned well for nearly 40 years. Nevertheless, there was also broad agreement that much had changed in the insurance environment over the years, some of which had complicated insolvencies. The thought was that these changes brought a need for an objective assessment of the guaranty fund system and new recommendations for its improvement.

The overall charge of the strategic planning initiative was to undertake a comprehensive review of the guaranty fund system, with a view to determining necessary changes that would enable the system to continue bringing the greatest good to policyholders and claimants.

As a first step, the NCIGF board formed the Strategic Planning Committee ("SPC"). The SPC began building on the information solicited by the NCIGF board from those who work throughout the insolvency community. The input solicited centered on key issues facing the NCIGF and guaranty fund system.

The SPC's charge was to take the board's fact-finding to the next level, through a formal and systematic process of self-examination. The board asked the SPC – a group of 13 volunteers from the insurance industry and the guaranty funds – to spearhead research that would provide data for future strategic planning and chart the future of the NCIGF and guaranty fund system.

Consultants join effort

To ensure that the rigorous assessment reflected best practices in surveying, data collection and tabulation, the NCIGF retained Dr. Terri Vaughan and Dr. Robert Cooper, faculty members from Drake University, as consultants. Both brought to the effort proven research skills and a solid grounding in the insurance industry. Vaughan, a former Iowa Insurance Commissioner, had served as president of the

Guaranty Fund Strategic Planning On Track, Moving Ahead with Purpose (Continued)

National Association of Insurance Commissioners (NAIC).

Vaughan and Cooper prepared surveys and interview questions as a first step in conducting an objective assessment of the NCIGF, its services and current roles, and of the guaranty fund system. They gathered input from the guaranty funds' stakeholders. Input included suggestions about how the NCIGF and guaranty fund system could best meet future challenges. They also identified factors viewed by stakeholders as inhibiting the efficiency of the guaranty fund system and the NCIGF.

"We wanted to take a good look at the overall guaranty fund system and NCIGF and gather feedback on how the funds and others assess the system's effectiveness and value"

Study casts wide net

The data collection process was broad-based, eliciting input from a host of respondents. These included regulators, receivers and their staffs, guaranty association board members, managers and staffs, insurance producers, agents and brokers, insurers, trade association and other industry representatives, NCIGF management and staff, and consumer representatives.

The surveys probed virtually all key aspects of the guaranty funds. Questions invited input on everything from state guaranty fund laws to the make-up of the NCIGF board.

Feedback was sought on runoffs, net worth, resource-sharing, consolidation of fund operations and a broad range of receiver-related questions. Overall, the surveys, which safeguarded the anonymity of participants, probed deeply into the guaranty fund system. The fact-finding process focused on obtaining as much information as possible about what participants thought worked well– and what didn't work as well.

"We wanted to take a good look at the overall guaranty fund system and NCIGF and gather feedback on how the funds and others assess the system's effectiveness and value," said Debra Wozniak, co-chair of the SPC.

"Our consultants reported that the overall response rate for the surveys and interviews was very good. The report provided a good 'feel' for how the various stakeholders view the guaranty fund system and NCIGF."

In order to obtain the optimum feedback on key issues, the surveys included a core group of questions for all participants, as well as unique questions tailored to the specific stakeholder groups.

From September through November 2006, Drs. Vaughan and Cooper administered surveys and interviews with over 600 individuals from the various stakeholder groups. Among the many topics about which they questioned the insolvency community's stakeholders were those related to how well the guaranty funds and the NCIGF work. They asked for suggestions on how the funds could work better in the insolvency system to meet the responsibilities of paying policyholder claims, and how to best meet the challenges of the future. The surveys and interviews probed key aspects of guaranty fund operations and practices.

Initial results are tabulated

By December 2006, Vaughan and Cooper had received and tabulated most of the study's data. The team met with the SPC in December 2006 and January 2007 to discuss their preliminary findings.

In January 2007, the SPC, Vaughan and Cooper presented the report's results to the NCIGF board. Among the findings were seven identified key areas for improvement. At the board's direction, the SPC formed seven working groups corresponding to the key areas; these groups drew on a broad cross-section of representatives from guaranty associations, industry and other key groups.

Armed with the SPC report, the groups examined the issues and developed strategies for improve ment – including suggested best practices – for presentation to the NCIGF board last year.

Soliciting input and participation from through out the insolvency community has been key to the success of the effort, says Steve Durish, chairman of the Strategic Planning Oversight Committee ("SPOC"), the group that now oversees the strategic planning effort.

"The guaranty fund system has provided a broad and reliable safety net for policy holders for nearly 40 years," said Durish. "Self-


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Guaranty Fund Strategic Planning On Track, Moving Ahead with Purpose (Continued)

assessment is not always easy, but our hope is that this unprecedented effort to gather a wide range of input from our community and stakeholders will be the best-possible way to ensure that the guaranty funds are well-positioned to meet the challenges ahead."

Implementation begins

Following the initial work of surveying, interviewing and compiling results, the SPC committee convened in December 2006 to begin the strategic planning phase of the project. The consensus of the group was that focusing on seven key areas provided the best and most efficient means of examining, evaluating and making recommendations in important areas of potential improvement. The areas were:

- Communications/public relations/education
- Preparing guaranty funds for change
- Operations and support
- Board of directors issues
- Uniformity
- Gaining a consensus on the primary guaranty fund mission
- Coordination and cooperation.

Following review of the results of the Vaughan and Cooper study at the 2007 NCIGF Annual Meeting, seven working groups were created to examine issues the SPC identified related to key areas that emerged:

- Gaining a consensus on the primary guaranty fund mission
- Operations and support
- Coordination and cooperation
- Uniformity
- Communications/public relations/education
- Board of directors issues
- Preparing guaranty funds for change.

The working groups included representatives from guaranty associations and the insurance industry. All NCIGF member guaranty funds were invited to participate in this critical planning stage and to provide thoughtful recommendations in the key areas identified from the survey results.

In total, the workgroups conducted more than 30 meetings. Drawing from issues identified by the Final Report in their respective areas, the groups conducted wide-ranging discussions on issues and offered recommendations for improving performance in these areas.

Following the meetings, the workgroups compiled working group reports. These reports, which chronicle the discussions about issues and document related recommendations, provided a window into the thinking and strategic direction of the workgroups.

Taken together, the working group reports provide a roadmap for the NCIGF and the state-based property and casualty guaranty funds to move forward into an efficient and effective system of state guaranty funds.

An Excellent Time for Self-assessment

This has proven to be an excellent time for undertaking the self-assessment. The strategic initiative began as the shock waves from the massive insolvencies of the early part of this decade were dying down. The effort resulted in development of a full-scale strategic plan introduced to all guaranty association managers in January 2008.

Some key points about the undertaking:

- The Strategic Plan consists of 78 tactics
- 14 tactics were designated as priority by the NCIGF board in January
- Many of the 78 tactics are incorporated into 14 priority tactics by committees
- A project calendar has been created for monitoring progress.

The original Strategic Planning Committee has given way to a Strategic Plan Oversight Committee chaired by Steve Durish (Texas Property & Casualty Insurance Guaranty Association) with Vice Chair Deb Wozniak (State Farm Insurance). Members include John Barret (Rockingham Group), Charles Breitstadt (Nationwide Insurance), Jack Falkenbach (Delaware Insurance Guaranty Association), Larry Fitch (Oklahoma Property & Casualty Insurance Guaranty Association), Bruce Gilbert (Nevada Insurance Guaranty Association), Chuck Renn (Missouri Property & Casualty Insurance Guaranty Association), Christopher Roe (CUNA Mutual Group), Randy Seiner (American International Group) and Michael Surguine (Arizona Property & Casualty Insurance Guaranty Fund).

The strategic plan is focused on meeting three primary goals. These are listed below, along with the key areas of emphasis that will define success for each goal.

Guaranty Fund Strategic Planning On Track, Moving Ahead with Purpose (Continued)

Operations and Insolvency Management

The state guaranty fund system will manage property and casualty claims in a professional, timely, efficient and cost-effective manner. The NCIGF supports member guaranty funds in meeting their immediate and future obligations to policyholders.

- Performance and Cooperation
- Coordinating Committee Protocols
- Receivership Outreach
- Best Practices among Guaranty Funds
- Expertise Sharing.

Public Policy Management

The state guaranty fund system seeks to strengthen service to policyholders and claimants through sound public policies that form the foundation of the property and casualty guaranty fund system. When necessary, seek renewal of the system's statutory foundation to meet future challenges on behalf of policyholders and claimants.

- Alternative Mechanisms
- Emerging Issues
- Capacity Solutions.

Outreach, Communications and Education. Educate and inform the public, industry, policymakers and other stakeholders about the property and casualty guaranty fund system to assist the state guaranty funds and the NCIGF in execution of their respective missions. Drive cooperation and consensus building among guaranty funds through member-focused communication and education.

- Stewardship and Governance
- Education Programs.

Volunteers and NCIGF staff are working every day on the tactics that make up the strategic plan.

By taking on this analysis and choosing a process of continuous improvement, NCIGF members are demonstrating their commitment to provide the best and most efficient service possible to the policyholders and claimants they serve.

Insolvency activity has diminished in recent years. The relative quiet should not be mistaken for the ability to rest; the need to complete the plan has never been more important.

Washington, D.C. has been bubbling lately. Momentum has begun to build toward some sort of a federal system of insurance regulation. So far, no one in Congress has seriously raised the prospect of a federal safety net, but it is not out of the question that such a call could come in the future.

Given the federal government's eagerness to take on some of the other urgent issues in the financial markets and their willingness to use the U.S. Treasury as a backstop, it is extremely unlikely that the Feds will want to do the same thing for insurance consumers UNLESS they have a reason to do so.

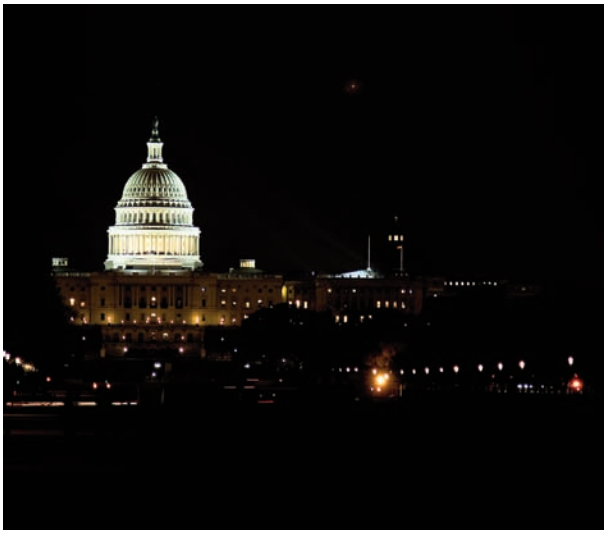
By facing the tough issues that confront the property and casualty guaranty funds, NCIGF members have demonstrated remarkable foresight: they have shown, without a doubt, that they take their public service responsibilities seriously. While no one hopes for an insolvency, and few think about guaranty funds when activity is low, our colleagues, through the strategic planning initiative, have dedicated themselves to a renewed and vibrant "firehouse," that will continue to perform with a single-minded purpose when and if the need arises.

Roger H. Schmelzer is president and CEO of the National Conference of Insurance Guaranty Funds.

View from Washington

By Charlie Richardson

This has been the most turbulent time in Wall Street's 200 year history, and with good reason. We've witnessed the demise of Bear Stearns, the bailout of Fannie Mae and Freddie Mac,



the bankruptcy of Lehman Brothers, the sale of Merrill Lynch, a $50 billion support for money market funds, the $85 billion federal loan to AIG, the conversion of Goldman Sachs and Morgan Stanley to bank holding companies/commercial banks, the failure of WaMu and the piece de resistance, the Treasury's plan to purchase $700 billion in securities from troubled financial firms. This report will only touch on a couple of the recent staggering financial services developments. My intent is not to relate details, which are well explained in the financial press, but to highlight open policy questions and important consequences.

Stitching the TARP Together

The massive financial asset bailout request by Treasury and the Federal Reserve was hashed out behind Congressional leadership doors over a 10-day period. Nicknamed TARP (Troubled Asset Recovery Program), it will have far-reaching effects on the financial and financial services markets for years to come. The legislation may be short and spare and leave several key questions to the next administration and regulation writers. Some key issues:

- To what financial institutions will TARP be available in addition to banks - insurance companies, finance companies? We know from the debate over who can own industrial loan banks that defining what is and is not a financial services company can be very difficult.
- What assets will be purchased, and at what price – book value, actual value, or something in the middle? The idea is that troubled mortgage assets are the target, but how broad will the definitions be?
- How can the borrower rework a bad loan – the troubled assets may not typically be whole mortgages, but bundles of tranches of individual loans, often junior to the principal debt. If the whole loan is reformed, or if there is foreclosure relief, how is that reflected through to the junior debt holder of a small piece of the loan? How is that reform valued?
- Treasury will now have the power to regulate wages, at least the wages of senior management of companies shopping assets to Treasury. What will the standards be, and how much litigation will that generate?
- Goldman Sachs and Morgan Stanley are now bank holding companies and the banks within them will be intensely regulated. How much more vigilant will federal and state regulators be in determining how troubled assets may be transferred among holding company units, either for liquidity purposes, or to facilitate sale to TARP? Will liberalized Fed rules on non-banks that are holding bank interests encourage more?

More to come. Much, much more.

AIG – The Good, the Bad and the Ugly

AIG's regulated insurance operations did not bring the company down. Similar to many bank failures, the problems were in the less regulated financial services subsidiaries and the holding company, not in the highly regulated insurance carriers. AIG has now formally agreed to draw up to $85 billion from the Federal Reserve window for 80 percent of its equity in the form of warrants. Repayment will require some asset sales, likely to include some of AIG's insurance operations. Insurers may learn to love regulation again. The NAIC and state regulators are heavily involved in the whole process and have been since AIG's slide into the abyss began. At the NAIC meeting in Washington in September, there were multiple regulator meetings – some public, some not – as the regulator community prepared for a sale and reorganization process touching the many insurance companies in the AIG family.

Optional Federal Charter – Less Optional Now?

Regardless of political party or candidate, inadequate federal regulation is being blamed as one cause of today's financial crisis. Whether or not SEC Commissioner Cox should be fired, the next Congress will want to do something and will likely try making federal financial services regulation more consistent across the different types of financial institutions. In the past, inconsistent state regulation was often cited as the reason for optional federal regulation. But now, the principal reason will be the investment of hundreds of billions of taxpayer dollars in an industry sector where the taxpayer will demand greater accountability and a pledge that it will not happen again.

Fannie and Freddie and Mortgages

Washington will not provide any quick solution to reforming individual mortgages.

Almost forgotten was one of Treasury's early rides to the rescue of Fannie and Freddie, the government sponsored (now more owned) housing finance companies. This crisis started with housing finance, but the difficulties in the mortgage market will continue to affect Wall Street and Main Street. Whether because of (i) naïve or greedy borrowers betting on a constant housing value up-tick, (ii) overly-aggressive mortgage brokers underwriting poor loans, or (iii) a secondary market too hungry for mortgage securitizations, Washington will not provide any quick solution to reforming individual mortgages. A large part of the problem is that securitized mortgages are sliced and diced so thoroughly that most institutions, which are holding a lot of very small pieces of non-performing loans, have no power to reform the terms of those loans. In fact, the 7th Circuit just reversed and disallowed a class action against Chevy Chase Bank, alleging inadequate and poor disclosure of mortgage terms. *Andrews v. Chevy Chase Bank, No. 07-1326 (7th Cir. Sept. 24, 2008).*

To submit an article, please contact Maria Sclafani at mcs@iair.org.
Deadlines for 2009 submissions are as follows:
February 1, May 1, August 1 and October 31.

Meet The Receivers
Patrick Hughes, Illinois Special Deputy Receiver

By Francis C. Flood

Patrick Hughes was appointed Special Deputy Receiver in February 2008, after five years with the State of Illinois, most recently as Chief Legal Counsel to the Office of the Governor,

Patrick Hughes

and before that as General Counsel to the Illinois Department of Financial and Professional Regulation. He had been a practicing attorney with experience in both corporate transactions and commercial litigation before entering government employment.

Mr. Hughes and his wife Ann live in Wilmette, Illinois and have four children, ranging in ages from 4 to 11 years. He enjoys reading (especially Lincolnalia), theatre, and cooking, when not working or just enjoying family time.

Mr. Hughes was kind enough to take time from his schedule to answer our questions:

Please explain how the Illinois Office of the Special Deputy Receiver works and how it interacts with the Illinois Division of Insurance.

The Office of the Special Deputy Receiver ("OSD") provides the staff and facilities for the Illinois Director of Insurance when he or she is affirmed as statutory conservator, rehabilitator, or liquidator of an Illinois domestic insurer. OSD staff accordingly work closely with, and at the direction of, the Illinois Director in fulfilling these responsibilities, subject to the supervision of the applicable receivership court. The OSD also works closely with staff at the Division of Insurance. We work on receiverships on the Director's behalf, so there is regular interaction.

How many open insolvency cases does Illinois have? What are your most important, or interesting, cases?

Illinois currently has 25 open receiverships. Needless to say, every receivership case, and every claim within that case, is important. To an individual claimant that file is the most important, so it's important to us. One of our business principles is that we regard ourselves as "estate-owned," which means that everything we do must be for the benefit of the estate and its claimants, and every success or failure is judged by that standard. That seems like an obvious observation, but when you really concentrate on making it the driving force of every decision, the benefits to the estate are enormous.

That said, the significance of any given case can be assessed in a variety of different ways: remedying market conduct problems, availability or non-availability of guaranty fund coverage, size of the insolvency, lines of business, and complexity of asset recovery.

If a troubled company had significant market conduct issues prior to receivership, a receivership that triggers guaranty fund coverage to take care of policyholders becomes very important.

The availability of guaranty fund coverage is always a critical issue. Estates that have limited or no guaranty fund coverage require special attention because the receivership estate will be the only resource available for protecting the policyholders and creditors.

Receiverships involving personal lines and healthcare also take on significant importance because of the adverse impact on consumers, who, in turn, typically lack access to professional advisors that can explain the impact the receivership will have on them. We keep those individual people in mind every day.

Do you use staff or contractors on insolvency cases?

I have been appointed the Special Deputy Receiver for each Illinois receivership, as had my predecessors. In that sense, Illinois does not utilize contractors. However, where the estate will benefit from the application of additional outside resources, we are open to contracting for those services.

Meet The Receivers
Patrick Hughes, Illinois Special Deputy Receiver

Who are the key staff personnel that work on insolvency cases?

The OSD provides full staffing for each receivership file, and some dedicated, longstanding employees of this Office have supported me in my role. My first year would have been an abject failure without the likes of Dan Barr, Mike Gleeson, Rick Bingham, and Cathy Travis.

The OSD employs a team-oriented approach to insolvency cases that includes OSD's general counsel, chief financial officer, director of claims and director of receivership operations. I've repeated it ad nauseum: I want us to be crawling all over each other to get things done. I want a high-energy, interactive environment.

What are your biggest challenges as to insurance insolvencies?

Today, of course, most standing receivership operations face the challenge of a decrease in receivership volume. That is a good thing for the Illinois and national economy, needless to say, but lower volume presents obvious resource dedication challenges. Our office needs to be both nimble and strong enough to make economic and operational sense in any environment. Capital and human resource investments become tough decisions. But planning and deciding is in my job description.

Another of our big challenges is measuring the insolvency and ascertaining the payouts at the various distribution priorities. This generally takes time, can require the devotion of significant resources, and will vary significantly, depending on the lines of business, and the complexity of the asset recovery. of multi-line insurers also significantly increase the complexity of this task, as well as the variability in timeline for resolving different types of claims. At the heart of the challenge is the obvious goal of ensuring timely and fair distributions to the estate's policyholders and creditors. The dilemma is that we don't want to do needless, costly work assessing a priority level that ends up not getting paid out; on the other hand if you end up reaching that level (a good thing), there is information decay associated with having waited. If anyone has a perfect formula for resolving that one I hope they will send it over. We just exercise our best judgment in each case.

From an insolvency viewpoint, what branch of the industry receives most of your attention, P&C, life or health companies?

Illinois has encountered P&C, life and health, and HMO receiverships. Recently property & casualty receiverships have received the most attention. I have to say that we are still dealing with a broad range of issues across various kinds of estates.

Over the past three years, has your Office had any insurer under "confidential supervision"?

We have not.

Is there anything on your insurance insolvency "wish list"?

Insolvencies need to be faster and less expensive, and as creditor-centric as possible. Every effort needs to be geared toward those goals. Other than that, if I knew what the world needed from us tomorrow I could more easily manage today, but that's life in any business – we manage with the information we have and adjust to the situation as it develops.

New York Court Refuses Reinsurer's Request For Leave To Sue Midland Liquidator

By Dennis G. LaGory

On January 14, 2008, the Supreme Court of New York issued a number of rulings that ultimately rejected the efforts of Everest Reinsurance Company ("Everest") to modify the permanent injunction against suits to allow it to proceed against the Liquidator of Midland Insurance Company ("Midland").1 The following article briefly recounts the rather convoluted history of the case, summarizes the decision and attempts to evaluate its significance.

History of the Case

Midland was a multi-line carrier that wrote excess coverage for a number of Fortune 500 companies. These companies faced significant environmental,

New York Court Refuses Reinsurer's Request For Leave To Sue Midland Liquidator (Continued)

asbestos, and product liability claims, including HIV-tainted blood factor litigation. In 1986, Midland was adjudged insolvent and placed in liquidation. The Order of Liquidation contained the usual language, providing that all persons "who have claims against Midland are permanently enjoined and restrained from bringing or further prosecuting any action at law, suit in equity, special or other proceeding against the... estate."

Everest assumed risk from Midland under various reinsurance treaties, covering the period from 1974 to 1983, and facultative certificates, to 1986. As in virtually every liquidation, reinsurance constituted Midland's most significant reported asset.

Since 1997, the Liquidator made recommendations for payments from the estate pursuant to claims allowance procedures approved by the Liquidation Court. By October 2005, the Liquidator believed that a distribution of assets on allowed claims could be made to class 2 creditors, (i.e. policyholders and claims of a security fund, guaranty association or the equivalent). In July 2006, the Liquidation Court permitted the Liquidator and major policyholders whose claims were disallowed, in whole or in part, to address common legal issues that would have been determined piecemeal before the Special Referee appointed to hear policyholders' objections. The Court also permitted the reinsurers to submit briefs on the common legal issues.

It was at this point that Everest filed its motion to lift the injunction barring actions against Midland, based on various alleged breaches of the reinsurance agreements and alleged deficiencies in the Liquidator's claims-handling practices. The Liquidation Court thereafter issued an interim decision and order requiring the Liquidator and Everest to submit supplemental briefs, and granting Midland's policyholders an opportunity to be heard by the court.

Motions before the Court

By January 2008, there were three motions pending before Judge Michael D. Stallman of the Liquidation Court: (i) Everest's motion to vacate the court's interim decision and order; (ii) the motion of a Midland policyholder, Baxter International, Inc. ("Baxter") for leave to submit papers in response to Everest's motion to lift the injunction; and (iii) Everest's motion to lift the injunction. The court noted that these motions required it to reexamine "well-established principles, procedures and assumptions of insurance liquidation insofar as they affect contract rights of reinsurers."[2]

The Direct Policyholders Weigh In

Judge Stallman first addressed Everest's motion to vacate the court's interim decision and order and Baxter's motion for leave to submit papers in response to Everest's motion to lift the injunction. These motions raised related issues because the court's interim decision and order had granted Midland's policyholders an opportunity to submit papers in the proceedings on Everest's motion to lift the injunction. One of these policyholders was Baxter, which sought to admit evidence that Everest had settled HIV-contaminated blood factor claims with its own policyholders on the same principles that it now claimed were improperly followed by the Liquidator.

Everest questioned the court's authority to grant such a right to Midland's policyholders, claiming that because the policyholders were not parties to the reinsurance agreements, their rights were not implicated by the motion to lift the stay. According to Everest, Baxter and the other policyholders were merely attempting "to inject themselves" into a contractual dispute between Everest and the Liquidator.

Judge Stallman acknowledged that "the reinsurer has no privity with, and is generally not liable to, the original purchaser of the underlying policy." Moreover, because the Liquidator is charged with protecting the interests of policyholders, there is "generally no need for the policyholders to speak on their own behalf."[3] Notwithstanding these well established principles, Everest's motion raised unique issues that required input from Midland's policyholders:

> Everest has alleged that the Liquidator has mishandled claims. If proven, this might suggest that the Liquidator acted in a fashion that was contrary to protecting the policyholders' interests.... Everest's motion to permit the proposed action against Midland raises important questions about the role that reinsurers may play, not only in the liquidation proceeding, but also in the day-to-day affairs of the Liquidator.... If Everest demonstrates that its breach of contract claims against Midland have a likelihood of success on the merits, then modifications to the claims allowance procedures could follow. Although the impetus for considering changes to the allowance procedures arose from a contractual dispute, changes to the allowance procedures would affect all of Midland's policyholders.[4]

Weighing these factors in light of the Liquidation Act's purpose "to protect the interest of persons who purchased insurance policies from a company which has become insolvent,"[5] the court exercised its discretion to allow the policyholders the opportunity to speak on their own behalf and accepted the papers proffered by Baxter.[6] To conserve the estate's scarce resources, the court held that Everest should bear the costs of any notices to policyholders that were necessitated by Everest's motion.

Everest's Motion To Lift The Injunction

Judge Stallman then turned to Everest's motion to lift the injunction. In support of that motion, Everest argued that it was not obligated to indemnify the estate because the Liquidator had breached Midland's reinsurance agreements with Everest. As a result of

New York Court Refuses Reinsurer's Request For Leave To Sue Midland Liquidator (Continued)

these breaches, Everest was deprived of the following contractual rights: (i) its right to timely notice of a claims; (ii) its right to associate with Midland and to cooperate in the defense and control of any claim that may involve Everest's reinsurance; (iii) its right of access to Midland's books and records; (iv) its right to investigate claims; and (v) its interposition rights under the "Insolvency Clause" of the agreements to assert defenses to claims in the liquidation proceedings.[7]

Everest argued that it was entitled to a permanent injunction restraining the Liquidator from engaging in any settlement negotiations. Specifically, Everest focused on several claims that the Liquidator allegedly mishandled, including the claims arising from HIV-contaminated blood factor (discussed above). Everest argued that because the Liquidator waited more than fifteen years after the submission of major policyholders' claims to advise it of the losses, Everest lost retrocessional recoveries that would have been available had Everest received timely notice of the claims.[8]

In ruling on Everest's motion, the court noted that the purpose of a permanent injunction barring actions against an insolvent insurer is to "preserve the assets for the benefit of creditors, and to protect policyholders, which is the overall purpose of Article 74 of the Insurance Law."[9] With this purpose in mind, the court applied the generally recognized standards for vacating or modifying an injunction: i.e. (i) likelihood of success on the merits, (ii) irreparable harm absent the relief or lack of an adequate remedy at law, and (iii) the balancing of the equities in the movant's favor.[10]

Likelihood of Success

The court first determined that Everest failed to meet its burden of demonstrating a likelihood of success on the merits of its breach of contract claims. According to the court, Everest had not clearly demonstrated by a preponderance of the evidence that the facts showed a likelihood that its reinsurance contracts were breached and that it suffered actual injury.

Judge Stallman rejected Everest's interpretation of the reinsurance agreements, holding that the various contractual provisions Everest cited did not support the extensive role it wished to play in the liquidation proceeding:

> Contrary to Everest's and the reinsurers' arguments, Everest's contractual rights-a right to notice, to inspect books and records, to associate and cooperate in the defense, and to investigate a claim and to interpose defenses in the liquidation proceeding-are discrete rights that neither give rise to, nor should be confused with, an all-encompassing right to be involved in the Liquidator's internal process of adjusting claims. Everest itself points out that it has no privity with Midland's policyholders, so the reinsurance contract should not be interpreted in a manner as to permit Everest effectively to stand in the shoes of Midland or the Liquidator.[11]

The court found that Everest had not met its burden of demonstrating a likelihood that it suffered prejudice with respect to all claims for which the notice was untimely. It found that Everest had not demonstrated a likelihood of success proving that the Liquidator had denied Everest access at reasonable times to Midland's books and records. It found that Everest had not met its burden of showing that the Liquidator interfered with Everest's right of investigation.[12]

Nor was the court persuaded by Everest's contention that the Liquidator had breached its interposition rights under the Insolvency Clause by refusing to allow Everest to participate in the allowance, disallowance and settlement of claims:

> Permitting a reinsurer to allow, to disallow, or to settle claims under the guise of exercising interposition rights wrests away from the Superintendent his clear, exclusive fiduciary powers over handling claims.... Unlike the Liquidator, reinsurers would have no corresponding fiduciary duty tempering any incentive to deny or delay payment of claims. Allowing reinsurers to adjust claims in lieu of the Liquidator might create an incentive for reinsurers to adjust claims in a manner so as to reduce their liability as reinsurers.... It does not necessarily follow that the right to interpose defenses entitles Everest, or any other reinsurer, the right to control the claims handling process or to be involved with the settlement of claims, given that Article 74 of the Insurance Law vests the Liquidator with exclusive management of the liquidation.[13]

Irreparable Harm

The court found that Everest would not suffer irreparable harm if its motion was denied. The suit Everest proposed against the Liquidator and Midland was for declaratory relief, not compensatory damages. The court found that Everest did "not have to incur any out-of-pocket loss with respect to a claim until Everest had been called upon to pay out on claims that the Liquidator allows and that the Court has approved."[14] According to the court, Everest's damages were "at best inchoate; at worst, Everest is speculating as to its injury."[15] Indeed, if Everest and the other reinsurers were permitted to litigate as Everest wished, the Midland estate, the Liquidator and the public interest would be irreparably harmed.

Balance of Hardships

Everest likewise failed to demonstrate that the "balance of equities" favored lifting the injunction against lawsuits. The court noted that if it were to allow Everest to sue Midland, there would be no reason why any other similarly situated reinsurer should not be permitted to do the same. The costs of having to defend against such suits would not only drain the financial resources from the estate and judicial resources from the Liquidation Court, but also interfere with the orderly liquidation of the estate.[16] Based on application of the foregoing factors, Judge Stallman denied Everest's motion to lift the permanent injunction.

New York Court Refuses Reinsurer's Request For Leave To Sue Midland Liquidator (Continued)

Everest Questions The Liquidator's Motives

Everest propounded one other argument in the proceedings that bears attention, even though it was not addressed in Judge Stallman's opinion. In its briefs and proposed complaint, Everest also took the truly novel position that the Liquidator's statutory obligations to Midland's policyholders were in conflict with his duties to Everest. According to Everest, Midland and its reinsurers shared a common interest in proper and efficient claims handling prior to Midland's insolvency.[17] However, once Midland was adjudicated insolvent and the Liquidator was appointed, the Liquidator sought to maximize the estate's assets for the benefit of the policyholders.[18] Indeed, the New York Liquidation Bureau's mission, as set forth in its website, is to "maximize assets and resolve liabilities."[19] Everest argued that because under the Insolvency Clause it is required to pay indemnity to the estate at one hundred cents on the dollar, even though Midland's policyholders may ultimately receive only a small fraction of the allowed amount of the claim in the distribution from the estate, the Liquidator has a perverse incentive to allow claims that might otherwise be questionable and then seek to force payment from Everest under the "follow-the-fortunes" doctrine.[20]

As noted above, these contentions were not addressed in Judge Stallman's opinion. One can only imagine the repercussions on the future insurance company insolvencies if a court were to accept the proposition that a liquidator's duty to act in the interest of policyholders is incompatible with the insolvent company's duty to deal with its reinsurers in utmost good faith.

Revising The Claims Settlement Procedures

Although it denied Everest's motion, the court recognized a need for Liquidators to devise new claim procedures. For example, the court rejected the Liquidator's argument that New York's Liquidation Act limits a reinsurer's contractual right to interpose defenses to the mere suggestion of defenses to the Liquidator:

> The adjudication of claims implies that the Court will rule on the merits of any interposed defenses; the Court does not render advisory opinions on "suggested" defenses. To interpose a defense therefore means that the defense may be raised and adjudicated, even if the Liquidator does not accept the defense in deciding whether or not to allow a claim.[21]

Because the claims allowance procedures established in 1997 conflict with the court's determination of the reinsurers' interposition rights, the court felt itself constrained to modify the procedures for judicial approval of allowed claims. The modification would entail allowing reinsurers to assert defenses available to Midland or the Liquidator with respect to any allowed claim that is either partially or wholly reinsured. The modified procedures should establish a process for adjudicating those defenses that would involve a hearing before a referee. The court initially directed the liquidator to review the claims allowance procedures, formulate changes, and report to the court within 120 days.[22] There have since been several extensions of time for these submissions, the latest being to August 20, after which a status conference was contemplated. It should also be noted that on November 3, the Liquidation Bureau announced that it had hired Milliman, Inc. to assist it in preparations for a possible sale of the carrier to private investors.

* * * * *

The Midland decision illustrates a number of trends that have become pronounced in recent insurance company insolvencies. The court's willingness to consider the views of Midland's direct policyholders on a dispute between the estate and its reinsurer is consistent with the increased sympathy liquidation courts have displayed to policyholders who seek direct access to their insolvent carrier's reinsurance.[23] Although Midland does not represent a major breach in the wall of privity, it is yet another crack.

Everest's strident criticism of the Liquidator's claims handling practices is emblematic of the increasingly aggressive approach many reinsurers in run-off have been taking in dealing with their ceding companies. In the current economic climate, where many reinsurers may, themselves, be trying to avoid insolvency, more of the same can be expected.

Dennis G. LaGory is a partner at Schiff Hardin's Chicago office. Mr. LaGory's experience encompasses a broad range of issues involving the insurance and health care industries, including regulatory compliance, ERISA litigation, reinsurance and coverage litigation and arbitrations, and international reinsurance insolvencies.

Mr. LaGory currently represents clients in connection with the liquidations of the Home Insurance Company, Legion Indemnity Company, Legion Insurance Company, and Reliance Insurance Company.

1 In the Matter of the Liquidation of Midland Ins. Co., 18 Misc. 3d 1117(A), 2008 WL 151786 (N.Y. Sup. Ct. Jan. 14, 2008).
2 Id. at *1.
3 Id. at *5.
4 Id.
5 Id. at 6.
6 Judge Stallman also held that admission of the settlement agreements did not violate Section 4547 of New York's Civil Practice Law and Rules ("CPLR"), which bars the use, of offers or discussion of settlement as evidence of liability in the same action. Here, the subject settlement agreements resolved other disputes and were are not being used for the purpose of establishing Everest's liability. Nor were they introduced to establish a dollar value of claim. Instead, they were being offered to refute Everest's allegations that the allocation principles and methodologies that the Liquidator used were improper.
7 Id. at * 11.
8 Id
9 Id. at *9 (Article 74 is New York's Liquidation Act).
10 Id.
11 Id. at *17.
12 Id. at **12, 13 & 15.
13 Id. at **20-21.
14 Id. at *22.
15 Id.
16 Id. at *23.
17 Complaint at ¶ 61.
18 Id. at ¶¶62 & 63; Liquidator's Response, citing Bean v. Stoddard, 207 A.D. 276, 279 (4th Dept. 1923).
19 Complaint at ¶ 67; Liquidator's Response, at 9.
20 Id at ¶ 64.
21 In the Matter of the Liquidation of Midland Ins. Co., 2008 WL 151786 at *20.
22 Id. at *25.
23 See, e.g., Koken v. Legion Ins. Co., 831 A.2d 1196, 1234 (Pa. Commw. Ct. 2003).

Underwriting the Persian Gulf
An overview of the Insurance industry in the Middle East region with a focus on the UAE

By Vishal Mehta

Breaking from tradition, the eighth bi-annual World Insurance Forum was held at the Dubai International Financial Center in March this year. The first Forum to be held outside Bermuda, it marked the growing significance of Dubai and the Middle East region to the changing global economic landscape. More importantly, it marked a show of recognition from the Insurance industry, reflecting the industry's high level of confidence in Dubai as a potential leading Insurance market.

Dubai is one of the seven emirates of the federation called United Arab Emirates ("UAE") formed in 1971 and is the second largest economy within the federation behind Abu Dhabi, the capital of the UAE. The other key economies of the Middle East region are Saudi Arabia, Kuwait, Qatar, Oman and Bahrain, which together with the UAE form the Gulf Cooperation Council ("GCC"). In the Middle East, the insurance sector remains relatively untapped, with annual premium turnover of $12 billion, less than half of one percent of the global annual premium of $4 trillion. The premium per capita is $25, representing only one percent of GDP in the entire Arab world. The UAE is the largest insurance market in the Middle East growing by 27 percent in nominal terms in 2006, with total premium volumes reaching $2.7 billion. Non-life insurance continues to dominate the region, with many markets featuring high levels of concentration on selected insurance retail lines and major commercial insurance contracts covering high-risk infrastructure projects, such as oil, gas and construction. The Middle East is thus poised for significant expansion and offers vast opportunities for regional and global providers.

Insurance Market Structure

In global terms, the insurance markets of the Middle East remain small: according to Swiss Re's Sigma report, the total premium income generated in the Middle East in 2006 represented around 0.2% of the world's insurance markets. In addition, the domestic insurance market remains relatively fragmented and highly competitive. Given the low level of insurance penetration and lack of awareness of insurance in many markets, it is perhaps not surprising that most Middle Eastern insurance markets are characterized by relatively high numbers of small, often specialized (by geography or business line) insurers. Large local groups such as Oman Insurance (part of the Mashreq Bank Group), Abu Dhabi National Insurance Company (partly government-owned), Salama, Arab Orient (part of the Al Futtaim Group) and Al Ain Ahlia hold strong general market positions, whilst many smaller players focus on niche product lines or distribution channels, with foreign companies initially focusing on the insurance needs of expatriate communities. In May 2008, the Emirates Insurance Association had 51 listed members, of which 24 were local and 27 were foreign companies. While close to 7% of the insurers are Arab-owned and 16% are international, most of the providers are joint ventures between nationals, Arab and foreign firms, and the top-three players control 40% of all gross written premiums. This gives rise to the

UAE Insurance Industry: Key Market Indicators

	2002	2003	2004	2005	2006	2007
Non-life Premiums ($mn)	$879	$1,070	$1,281	$1,798	$2,341	$3,228
Life Premiums ($mn)	190	223	282	326	446	716
Total Premiums ($mn)	1,069	1,293	1,562	2,124	2,787	3,944
Density ($ premium per capita)	276	310	375	456	518	N/A
Life Insurance Density	49	54	68	70	82	N/A
Nominal GDP ($mn)	72,990	86,642	103,219	131,219	161,954	197,216
Penetration (premiums as % GDP)	1.5%	1.5%	1.5%	1.6%	1.7%	2.0%

Source: UAE Ministry of Economy

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An overview of the Insurance industry in the Middle East region with a focus on the UAE (Continued)

remaining 48 companies competing aggressively for the residual 60% of the market.

The trend of increasing numbers of larger and higher profile insurers is expected to continue as insurance markets mature. Realistically, there is little chance for the market structure to change because many of the bigger players are part of larger conglomerates with secure businesses. In addition, the sector has moved toward greater consolidation, considering that the number of market players has come down from 126 to 51, and will continue to do so in the near future. The reduction was also encouraged by the regulator, who stopped issuing licenses in order to combat the increasing risk and instability.

Life segment

For a market the size of the UAE, the life insurance segment is clearly underdeveloped. Currently, life policies underperform largely due to cultural reasons and are mostly tailored to the expatriate community. While the life segment is growing, it accounts for only 16% of the total annual premiums. However, the effects of the soaring economy are spilling over into the industry and the numbers give proof that people are starting to take life insurance seriously. Consumers in the UAE are spending more on life insurance every year, and there is an increased awareness that long-term planning should include life coverage. In addition, individuals are increasingly becoming aware of the benefits that insurance can bring as their net wealth increases. Second, in many Middle Eastern countries, governments are gradually encouraging individuals to save for their own retirement, such that life and pensions markets are beginning to develop strongly. The density figures, which measure the average per-capita expenditure, increased by 22% and stood at \$100 in 2007. According to the Ministry of Economy, life premiums accounted for \$448.8 million and continue to grow rapidly. Not surprisingly, the foreign companies have a stronghold – 76% market share.

Non-Life segment

The non-life market continues to lead the insurance business in the UAE. The sector enjoyed high growth over the past five years, where the non-life premiums for 2006 stood at \$2.4 billion and more than doubled the levels of 2003. Local companies dominate the market, a trend that is expected to sustain over the coming years. Hence, while in 2002 the local insurers held 73% of the total non-life premiums, by 2006 they captured 76.5% of the industry. A closer look at the breakdown of the non-life segment reveals the drivers of the market in the UAE – policies for accident and liability account for more than half the total premiums collected. Surprisingly, this segment alone reported \$1.3 billion in premiums for 2006, which is a considerable 26% increase over 2005 figures. In turn, fire policies accounted for \$348.2 million in premiums, growing at 22% and were closely followed by the marine, aviation and transport segments, with a 22% jump worth \$331.8 million. Medical insurance also made an important contribution, which stood at \$285.6 million for 2006.

Motor segment

Although the dearth of official figures makes it rather difficult to assess the size of the market by motor premiums, it is a huge business. And given the fact that Dubai's car ownership rates are growing quickly, the market is expected to continue to expand rapidly in the foreseeable future. While authorities are investing heavily in the public transportation system, the UAE remains a private-car society. A car is no longer a luxury but a necessity in Dubai and Abu Dhabi and with the strong influx of expatriate workers, motor insurance enjoys the highest penetration rates in the insurance industry. On the other hand, the profit margins in this segment are very low – though this is in line with even the most developed markets, where insurers are burdened with frequent and expensive claims that take a heavy toll on profits. Official figures indicate that the gross loss ratio for accident and liability for the UAE in 2006 stood at 54.7% of premiums, which is, nonetheless, an improvement over the previous 65%, recorded two years before. However, it is estimated that for the motor segment alone the gross ratio stands at 70%. Motor insurance premiums in the UAE cost on average \$136 for third-party liability and close to 4% of the car value for fully comprehensive policies. It is a market with little differentiation across customers. Thus, careful drivers are not rewarded on the basis of price, and higher premiums are spread across the customer spectrum. For this reason, the industry has called for the establishment of a motor insurance credit bureau that can assess the driving quality of the customers. In this sense, by providing and sharing information with the companies like in many other developed markets, cheaper motor products could be offered.

Construction segment

With the rapidly growing private sector, demand for insurance coverage in the construction and real estate market is flourishing. Insurers predominantly provide coverage for contractor all-risk exposure,

Underwriting the Persian Gulf
An overview of the Insurance industry in the Middle East region with a focus on the UAE (Continued)

machinery, plants and other associated risks arising from large-scale construction projects, such as the loss of profits and third-party liability. A unique characteristic of this segment is that the domestic insurance companies retain only a small share of the total risk of the segment by reinsuring themselves abroad. This is the nature of the business in Dubai and the local firms have a disproportionate reliance on international brokers and reinsurers. The International Monetary Fund estimates that local players assume only 10% of the risk from their engineering and fire policies, while for other non-life segments, such as motor insurance, risk retention is close to 100%.

The insurance sector is calling for tougher construction safety standards in the emirate. Claims are on the rise due to relaxation of quality standards by contractors, in addition to excessive risk-taking with respect to fires, collapses, natural calamities and accidents due to negligence. To make matters worse, the Civil Defense Department – which incurs $68 per minute to put out a blaze - in an attempt to curb the increasing fire costs, has submitted a draft law to make insurance firms responsible for the civil defense bills. This move from the Ministry of Interior that excludes residential buildings is going to pass the responsibility of ensuring that companies are taking all the necessary precautions to insurers. By increasing the insurance costs for owners, the legislation seeks to create greater fire awareness within the public. The debate over fire prevention and liabilities intensified recently after a spate of serious fires across the UAE have wiped out the profits of some insurance companies, leading to talk of rates being raised, or consolidation in the segment.

Health care segment

The new health care regulations will make 2008 an important year for this non-life segment. After the introduction of compulsory health insurance for expatriates and their dependants in Abu Dhabi, there are expectations for great business opportunities.

"The Takaful Story"

The renaissance in Islamic banking and finance and demand for Shariah compliant investments has spurred the double-digit growth of the global demand for Takaful, or insurance based on principles of mutual assistance. Takaful insurance is a unique aspect of the Middle East Insurance industry and demands specific focus, since it is an integral part of the current market structure, as well as a key driver of future market growth.

The first Takaful company was established in 1979 and now, there are over 250 globally. The Takaful product family spans general, life, health and pensions business. The two main business models used in the Takaful industry are Mudarabah and Wakalah, with the latter being more prevalent. Under the Wakalah model, the Takaful operator acts as an agent (Wakeel) for the participants and manages the Takaful/-reTakaful fund in return for a defined fee.

According to the Standard & Poor's April 2007 report on Takaful, "the GCC Takaful market is currently growing at 40% per year and the opportunities for increased uptake of Takaful in the GCC markets are positive. The GCC insurance market has a potential size of $20 billion (currently $6 billion). Within the GCC insurance sector, the Takaful market has the potential to reach $4 billion at the current level of development (currently US$170 million)." Due to the ethical guidelines underpinning Shariah compliant financial services, the increasing transparency of customer terms and conditions, pricing structure, regular compliance monitoring by the relevant Shariah boards and supervisory regulators and the adequate disclosure of information and transparency to policyholders, such offerings tend to attract both Muslim and non-Muslim customers. Based on a 2007 Oliver Wyman report, up to 20% of Takaful revenues could emanate from non-Muslim customers.

However, to fuel growth and attain the potential premium targets, the nascent Takaful industry needs to enhance customer education and awareness, gain critical mass, provide an innovative array of products and superior quality service to customers, build worldwide brand recognition and to exceed performance standards set by the conventional insurance industry. Acceptance of Shariah compliant savings, education, marriage and retirement plans is gradually increasing among the affluent, but significant investment in customer education and training of financial planners and investment advisers is still necessary.

Key Challenges to Growth
Underdeveloped regulatory process

The capabilities of the insurance regulator are limited and underdeveloped in the UAE's existing regulatory framework and there is room for improvement in the supervision of the industry. As a result, authorities passed the new Insurance Law of February 28, 2007 that promotes a more independent Insurance

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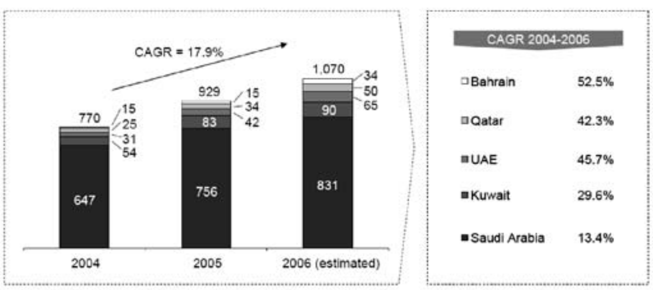
Commission. The commission formed under the aegis of the Minister of Economy, reports to a board of directors and is chaired by the minister, although it has not begun operations to date. There is also room for improving cooperation and organization within the various regulatory bodies in the UAE, including the Central Bank, the financial regulatory authorities, the Emirates Securities and Commodities Authority ("ESCA"), the Dubai Financial Services Authority ("DFSA"), and the Insurance Commission, which will result in better sharing of information and therefore more effective supervision of financial conglomerates.

The UAE has also created a special committee, the UAE Insurance Committee, to address regulatory issues further. The issues the group must address include requiring companies to follow solvency margins, rather than just meeting minimum capital requirements; obligations to invest in the local market; the lack of an insurance judicial authority; and the creation of a federal health insurance authority and limitations on the risk exposure of firms. As insurance companies rely heavily on investment income, their riskier investments have exposed them to the fluctuations of the capital markets.

Lack of skilled resources

While employment in the insurance sector has grown rapidly over the past few years, the sector has difficulty in attracting qualified locals and does not meet the Emiratisation quota established at 15%. Under the threat of fines and visa refusals for expatriates, the companies are currently making efforts to attract more nationals. The task has not been easy, due to a dearth of adequately trained nationals. With only 6% of the employees being Emiratis, the National Human Resource Development Committee and the Supreme Insurance Committee are developing training programs. However, these educational modules have been lenient to those seeking insurance exposure, to the point where a diploma from the Emirates Institute of Banking and Financial Studies can be obtained with only one year of study.

Gross Takaful Contributions in the GCC ($ million)



Source: World Takaful Report 2008

Future Outlook

Growth Drivers

According to Yassir Albaharna, CEO of Arab Insurance Group "…The insurance market in the region is $11.7 billion, of which $9.7 is on the non-life side. Insurance penetration in the MENA region is 1 percent, compared to 7.5 percent worldwide. Insurance density in the region is $41, compared to a global average of $555…." The drivers for growth in the insurance market in the region include buoyant economies, infrastructure spending, high disposable income, as well as very low likelihood of natural disasters. In addition, the industry is taking advantage of business-friendly taxes and government policies, and the low level of long term financial risk. Over the next five years, it is anticipated that both non-life and life premiums will grow by 20% annually. The key drivers of growth in the non-life segment will be the anticipated rise in nominal GDP from around $186 billion to $303 billion and an expected increase in non-life penetration from 1.3% of GDP to 2.0%. The key driver of growth in the life segment is an envisaged moderate rise in life density from about $100 per capita in 2007 to $150 per capita in 2012.

Reinsurance

Given that the construction segment defines much of the reinsurance market and that the local players reinsure approximately 90% of their risk overseas, statistics suggest that the reinsurance market in the emirate is nascent and only profitable for foreign firms, which can impose pricing guidelines based on their actuarial and risk management assessments. However, new players are awakening to the gains to be made from the reinsurance market and several new Arab joint ventures were announced in 2008. One of these, Gulf Reinsurance (Gulf Re), received an operating license from the DFSA in May 2008.

"This is a significant moment for the GCC insurance market as it moves to the next level of its development. As reinsurance markets become increasingly global, Dubai is seeking to become the leading centre for the Middle East and south Asian region," commented Wayne Jones, partner

Underwriting the Persian Gulf An overview of the Insurance industry in the Middle East region with a focus on the UAE (Continued)

at Clyde & Co, who advised on the deal. He continued, "Having a well-capitalised local reinsurer, with an excellent and experienced management team, whose primary focus is on the region, is a tremendous step in helping the market to move forward. The fact that it brings with its world class experience and expertise is great news for the Dubai International Financial Center (DIFC) and the region."

Recently, the DIFC announced that it intends to become a reinsurance centre along the lines of world-established destinations, such as Bermuda, the Isle of Man and Luxembourg. Thus, it is going to focus on supplying the growing demand for takaful insurance and become one of the leaders in the takaful and retakaful segments.

Captive insurance

Captive insurance, which consists of limited-purpose insurance companies established solely to finance risks for their parent corporations, may be gaining popularity elsewhere, but for Middle Eastern companies the concept is in its diapers. Despite the region's asset boom, which is creating large physical assets that command huge insurance premiums, captive insurance has not caught the fancy of many. Captives may be considered as a risk management tool and not really an insurance mechanism, alternatively, from another perspective, a captive is a legal accounting gimmick to save taxes. As a risk management tool, it's useful to transfer risk from the corporate body to an outside funding mechanism; however given the no tax regime in the UAE, the very basis for having a captive doesn't exist. But it does exist for places such as Iran and India, and for that Dubai is best-placed.

"Today, there are over 4,500 captives worldwide writing over $38 billion in premiums," says Abdulla al-Awar, the managing director of DIFC Authority. Bodies such as DIFC have reasons to believe that the growth of captives is just around the corner. Considering the recent economic turbulence and slow growth in Western Europe and North America, the world's insurance and reinsurance companies are now looking beyond their traditional markets. Centers such as DIFC are best placed to attract such companies. With that in mind, DIFC's regulatory body, the DFSA, has introduced specific legislation relating to captives. The result is that the DIFC now recognizes captive insurance companies while the UAE and many other jurisdictions do not. Bahrain and Qatar have also put in place regulatory captive insurance frameworks that would suit corporations based in the region. No taxes are imposed on insurance premiums, or on the profits of captive insurers whose parent company's premium payments are transferred to the captive, and whose captive's profits are 100 percent retained or repatriated.

The "Tail End" View

Insurance is considered as a sector with a lot of potential in the Middle East, thanks to the current low penetration levels, high growth in population, and supportive economies. This holds true for the UAE too, especially as it is one with a relatively higher per capita income. While the growth in the industry will continue into the future, it would be difficult for the domestic companies to repeat their performance in the past years, as the Ministry of Economy and Commerce has already submitted recommendations to allow new foreign insurance companies to operate in the UAE. In addition, the opening up of the market will challenge the current players to be more aggressive and innovative with their marketing strategies and products – or possibly lead to consolidation in the medium term.

Over the next decade, the Insurance industry in the Middle East is set for significant growth, spurred by a rapidly growing population, a steadily increasing GDP and supplemented by sound government policies, including deregulation of the industry.

Vishal Mehta is a Managing Director at Veris Consulting and provides internal audit and litigation support services to the firm's clients. Vishal has significant experience in internal audits, risk assessments, internal control enhancements, corporate governance and Sarbanes-Oxley advisory services. Prior to joining Veris, Vishal was partner of KPMG's internal audit practice in India.

Vishal is heading up Veris' expansion and business development in Dubai.

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