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802.4

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February 3, 2011

BY E-MAIL

Mr. B. Michael Verne
Premerger Notification Office
Federal Trade Commission
Room 303
600 Pennsylvania Avenue, N.W.
Washington, D.C. 20580

Re: Treatment of Reinsurance Recoverables under Rule 801.21 and Rule 802.4

Dear Mike:

I am writing this letter to confirm oral advice you provided to the undersigned in a telephone conversation earlier today regarding the applicability to the following transaction of the notification requirements under the Hart-Scott-Rodino Antitrust Improvement Act of 1976 (the "Act") and the Federal Trade Commission's implementing regulations (the "Rules").

As we discussed, I believe that the transaction is exempt from the reporting requirements under the Act based upon the applicability of Rule 802.4. I have outlined the analysis we discussed below.

Structure of Proposed Transaction

My firm represents an insurance group (the "Seller") which is selling all of the voting securities of an insurer that in turn owns three other insurers (the "Target Companies"). All four of the Target Companies are property and casualty insurers domiciled in the US which are in "run-off" (i.e., not writing new policies but administering policies written in the past).

The purchase price for the voting securities of the target companies will be approximately $200 million (and the parties believe this to be the approximate fair market value of the voting securities of the target being sold). The size of the parties test is satisfied.

Assets of the Target Companies

Since the Target Companies are in run-off, a large portion of their assets consist of cash and securities and indemnification rights under reinsurance contracts. The consolidated assets (on a GAAP basis) of the Target Companies total $2,117 million. Approximately $888 million of the assets are investment assets (i.e., cash, securities, bonds and other obligations clearly exempt under Rule 801.21). Approximately $1,211 million of the assets consist of reinsurers' obligations under reinsurance contracts to indemnify the Target Companies for losses incurred under policies written by the Target Companies. Since these obligations represent amounts potentially payable by reinsurers under reinsurance contracts, they are often referred to as "reinsurance recoverables" in the industry. Finally, approximately $18 million of the assets consist of other assets of the Target Companies (such as infrastructure and other assets used to administer the run-off).

The total liabilities of the Target Companies are $2,166 million, the bulk of which consist of loss reserves of $1,736 million. Essentially, the purchaser is buying the target companies because it believes it can administer the run off of the Target Companies with actual net losses significantly lower than the amount currently reserved. There is no value ascribed to the Purchased Companies' goodwill or as a going concern, given that they are no longer writing any new business.

Based upon the foregoing, whether the proposed transaction is reportable under the Act will depend upon whether the "reinsurance recoverables" are exempt assets for purposes of Rule 802.4. If the "reinsurance recoverables" are exempt, then the fair market value of the remaining (non-exempt) assets held by the target companies is only $18 million, well below the threshold specified in Rule 802.4. If the "reinsurance recoverables" are not exempt, then the fair market value of the non-exempt assets will exceed the threshold specified in Rule 802.4.

Nature of Reinsurance Recoverables

As you are aware, it is common for insurance companies to reinsure the policies they write, thereby transferring the economic risk associated with the losses that arise under the policies to third parties. Reinsurance may be structured as indemnity reinsurance or assumption reinsurance. The reinsurance at issue for the Target Companies is all indemnity reinsurance.

In the case of indemnity reinsurance, the Target Companies continue to hold the policies they have written and bear the economic risk of losses that are incurred under the policies. Under the reinsurance agreement, the reinsurer is contractually obligated to indemnify the Target Company for all or a portion of the losses from claims arising under the reinsured policies. The holders of the original policies continue to assert their claims against the Target Company, and all claims are paid by the Target Companies. However, all or a portion of the economic burden of the losses arising from the claims is bourn by the reinsurer, as it will reimburse the Target Companies for all or a portion of the losses paid out on the policies.[1]

When the assets of the Target Companies are reported to state insurance regulators (i.e., prepared on a "statutory" basis), their balance sheets show a loss reserve as a liability. This represents the estimate of the liabilities that will be incurred to settle reported but unpaid claims, as well as claims that have been incurred but not yet reported, under the policies issued the Target Companies. On the Target Companies' balance sheets prepared on a statutory basis, the loss reserves reflected have been reduced for the estimated amount of reinsurance recoverables (i.e., reinsurers' indemnity obligations to the Target Companies under indemnity

[1] In the case of assumption reinsurance, the insurer transfer the policies they have written to the reinsurer in a novation arrangement. The policies are assumed by the reinsurer and become the reinsurer's direct contractual obligations. Under this arrangement, the holders of the original policies are directed to assert their claims against the reinsurer, and the original insurer is no longer involved in the claims process.

reinsurance contracts). Thus, on the Target Companies' statutory balance sheet, the reinsurance recoverables for unpaid losses are netted against the loss reserves rather than shown as an offsetting asset.

On the other hand, when the balance sheets of the Target Companies are prepared on a GAAP basis, the balance sheets show the full loss reserve as a liability, without any deduction or offset for the estimated amount of reinsurance recoverables associated with the policies. Instead, the reinsurance recoverables for unpaid claims are treated on the Target Companies' GAAP balance sheets as an asset because the Target Companies have a contractual right to receive reimbursement from the reinsurers for specified policy loss payments made by the Target Companies.[2]

Analysis of Rule 804.2

The obligations of reinsurers under reinsurance contracts to indemnify the target companies for losses (whether for potential contingent claims or for pending outstanding claims) would appear to qualify as "obligations which are not voting securities" under Section 7A(c)(2) of the Act. As noted above, "reinsurance recoverables" can be viewed (i) on a statutory basis as an offset to their loss reserves or (ii) on a GAAP basis as an asset because of the Target Companies' contractual right to recover from the reinsurer. Under either view, reinsurance recoverables do not appear to be voting securities.

Alternately, the "reinsurance recoverables" can be viewed as a financial asset of the Target Companies that represent a transfers of risk akin to a "swap" financial instrument, which we understand are viewed by the FTC staff as exempt assets (see e.g., Informal Staff Opinions 0511010, 0806008, 0705022 and 0412012).

Based upon our discussion, it is my understanding that you concur with the foregoing analysis. Please advise if my understanding is incorrect.

Very truly yours,

[redacted]

Agree
BV
2/7/11

[2] In contrast, when an insurer enters into any assumption reinsurance arrangements, there is no reinsurance recoverable reflected on either the statutory or GAAP balance sheet. Instead, the underlying loss reserve is simply removed from the balance sheet, since the reinsurer is now primarily responsible for payment of the claims and the original insurer is no longer acting as a conduit for the payments.