

BEFORE THE INSURANCE COMMISSIONER  
OF THE  
COMMONWEALTH OF PENNSYLVANIA

|                                  |   |  |
|----------------------------------|---|--|
| IN RE:                           | : | Pursuant to Sections 1401, 1402 and 1403       |
|                                  | : | of the Insurance Holding Companies Act,        |
| Application of Randall & Quilter | : | Article XIV of the Insurance Company           |
| Investment Holdings Limited in   | : | Law of 1921, Act of May 17, 1921, P.L.         |
| Support of the Request for       | : | 682, <u>as amended</u> , 40 P.S. §§ 991.1401 - |
| Approval to Acquire Control of   | : | 991.1403 and Chapter 25 of Title 31 of the     |
| ACE American Reinsurance         | : | Pennsylvania Code, 31 Pa. Code §§ 25.1 -       |
| Company                          | : | 25.23  |
|                                  | : |  |
|                                  | : | Order No. ID-RC-06-11                          |

**DECISION AND ORDER**

AND NOW, this 3<sup>rd</sup> day of July, 2006, M. Diane Koken, Insurance Commissioner of the Commonwealth of Pennsylvania (the "Commissioner"), hereby makes the following Decision and Order:

Pursuant to the Insurance Holding Companies Act and in consideration of the information, presentations, reports, documents and comments received, as well as other inquiries, audits, investigations, materials and studies as permitted by law, the Commissioner hereby makes the following Findings of Fact and Conclusions of Law:

**FINDINGS OF FACT**

**Identity of Entities Involved**

**Identity of Applicant**

1. Randall & Quilter Investment Holdings Limited ("R&Q") is a limited liability corporation functioning as a holding and investment company organized under the laws of England and Wales with its principal place of business in London, England.

2. Kenneth E. Randall ("Randall") is an individual with his principal place of business in London, England. Randall owns 86.67% of the voting securities of R&Q.

3. Alan K. Quilter ("Quilter") is an individual with his principal place of business in London, England. Quilter owns 13.33% of the voting securities of R&Q.

4. Cavell America Inc. ("Cavell") is a business corporation organized under the laws of the state of Delaware with its principal place of business in Cambridge, Massachusetts. Cavell is a wholly-owned subsidiary of R&Q.

#### **Identity of Seller**

5. ACE Limited ("ACE") is a holding company organized under the laws of the Cayman Islands with its principal place of business in Hamilton, Bermuda.

6. The stock of ACE is publicly traded on the New York Stock Exchange.

7. ACE Group Holdings Inc. ("ACE Group") is an investment holding company organized under the laws of the State of Delaware with its principal place of business in New York, New York. ACE Group is a wholly-owned subsidiary of ACE.

8. ACE INA Holdings, Inc. ("ACE INA") is an investment holding company organized under the laws of the State of Delaware with its principal place of business in Philadelphia, Pennsylvania. ACE Group owns 80% of the issued and outstanding voting securities of ACE INA. ACE owns the remaining 20%.

9. INA Corporation ("INA Corporation") is an investment holding company organized under the laws of the Commonwealth of Pennsylvania with its principal place of business in Philadelphia, Pennsylvania. INA Corporation is a wholly-owned subsidiary of ACE INA.

10. INA Financial Corporation ("INA Financial") is an investment holding company organized under the laws of the State of Delaware with its principal place of business in Wilmington, Delaware. INA Financial is a wholly-owned subsidiary of INA Corporation.

11. Brandywine Holdings Corporation ("BHC") is a holding company organized under the laws of the State of Delaware with its principal place of business in Wilmington, Delaware. BHC is a wholly-owned subsidiary of INA Financial.

12. Century Indemnity Company ("Century" or "Seller") is a domestic stock property insurance company organized under the laws of the Commonwealth of Pennsylvania with its principal place of business in Philadelphia, Pennsylvania. Century is a wholly-owned subsidiary of BHC.

#### **Identity of the Pennsylvania Domiciled Insurer to be Acquired**

13. ACE American Reinsurance Company ("AARe") is a domestic stock casualty reinsurance company organized under the laws of the Commonwealth of Pennsylvania with its principal place of business in Philadelphia, Pennsylvania. AARe is a wholly-owned subsidiary of Century.

#### **Identity of Affiliates Involved in Related Transactions**

14. ACE INA International Holdings, Ltd. ("AII") is a holding company organized under the laws of the State of Delaware with its principal place of business in Wilmington, Delaware. AII is a wholly-owned subsidiary of INA Corporation.

15. Brandywine Reinsurance Company (UK) Ltd. ("BRUK") is a reinsurance company organized under the laws of the United Kingdom with its principal place of business in London, England. BRUK is a wholly-owned subsidiary of AII.

16. Century International Reinsurance Company Ltd. ("CIRC") is a stock insurance and reinsurance company organized under the laws of Bermuda with its principal place of business in Hamilton, Bermuda. CIRC is a wholly-owned subsidiary of BHC.

17. Brandywine Reinsurance Company S.A.N.V. ("SANV") is a stock reinsurance company organized under the laws of Belgium with its principal place of business in Brussels, Belgium. SANV is a subsidiary of AARE. Century owns 1 share of the stock of SANV out of 16,500 issued and outstanding shares. AARE owns the remaining issued and outstanding shares of the stock of SANV.

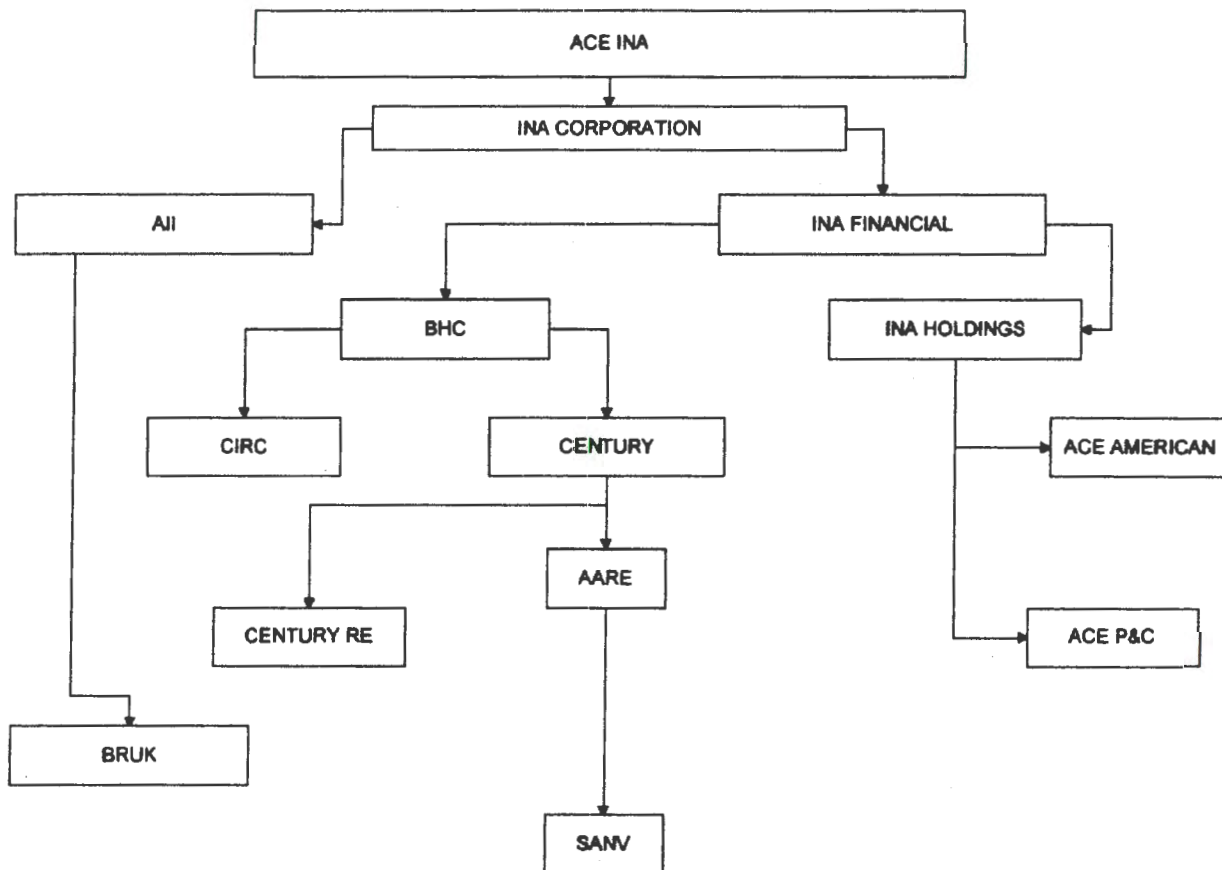
18. Century Reinsurance Company ("Century Re") is a domestic stock casualty reinsurance company organized under the laws of the Commonwealth of Pennsylvania with its principal place of business in Philadelphia, Pennsylvania. Century Re is a wholly-owned subsidiary of Century.

19. INA Holdings Corporation ("INA Holdings") is a holding company organized under the laws of the State of Delaware with its principal place of business in Wilmington, Delaware. INA Holdings is a wholly-owned subsidiary of INA Financial.

20. ACE American Insurance Company ("ACE American") is a domestic stock casualty insurance company organized under the laws of the Commonwealth of Pennsylvania with its principal place of business in Philadelphia, Pennsylvania. ACE American is a wholly-owned subsidiary of INA Holdings.

21. ACE Property and Casualty Insurance Company ("ACE P&C") is a domestic stock property and casualty insurance company organized under the laws of the Commonwealth of Pennsylvania with its principal place of business in Philadelphia, Pennsylvania. ACE P&C is a wholly-owned subsidiary of INA Holdings.

22. A chart depicting the corporate relationships of the ACE-related entities is set forth below:



## Background

### 1996 Restructuring

23. On October 2, 1995, INA Financial filed a Plan of Restructure for approval by the former Insurance Commissioner of the Commonwealth of Pennsylvania, Linda S. Kaiser.

24. The Plan of Restructure provided for the reorganization of the CIGNA Corporation ("Cigna Corporation") property and casualty insurance and reinsurance companies into active operations and inactive runoff operations. The active companies became subsidiaries

of INA Holdings, and the inactive runoff companies became subsidiaries of BHC. The restructuring is referenced hereinafter as the "1996 Restructuring."

25. On February 7, 1996, former Insurance Commissioner Kaiser approved the Plan of Restructure. The approval is referenced hereinafter as the "1996 Decision and Order."

26. The 1996 Decision and Order provided that no change could be made to the holding company structure of INA Holdings and BHC and no divestiture of any of their subsidiaries could take place without the prior written approval of the Commissioner.

27. In connection with the 1996 Restructuring, AARE became a subsidiary of Century and was re-domesticated in Pennsylvania.

28. AARE's assets and liabilities were not divided as part of the 1996 Restructuring. AARE existed as a separate corporate entity with its own assets and liabilities prior to the 1996 Restructuring and has retained that separate existence up to the present.

#### **1999 Acquisition**

29. On February 11, 1999, ACE, ACE Group and ACE INA filed an Acquisition Agreement seeking approval by the Commissioner to acquire the United States domiciled and international property and casualty business of CIGNA Corporation through the acquisition of its subsidiary, INA Corporation. The business to be acquired included the active insurance and reinsurance company subsidiaries of INA Holdings, and inactive runoff insurance and reinsurance subsidiaries of BHC and certain international insurance subsidiaries. The acquisition is referenced hereinafter as the "1999 Acquisition."

30. On June 16, 1999, the Commissioner approved the Acquisition Agreement. The approval is referenced hereinafter as the "1999 Decision and Order."



## **The Acquisition Filing**

### **February 2005 Form A Filing**

31. On January 5, 2005, AII, Century and R&Q executed a stock purchase agreement (which together with all amendments received subsequently is collectively referenced as the “Stock Purchase Agreement”) under which R&Q would acquire control of AARe.

32. On February 3, 2005, the Insurance Department of the Commonwealth of Pennsylvania (the “Department”) received an initial application (which together with all materials and amendments received subsequently is collectively referenced as the “Application”) from R&Q for approval to acquire control of AARe.

33. The Insurance Holding Companies Act, Article XIV of the Insurance Company Law of 1921, Act of May 17, 1921, P.L. 682, as amended, 40 P.S. §§ 991.1401 et seq. (“Insurance Holding Companies Act”), provides that all changes in control of domestic insurers must be filed with the Commissioner for approval or disapproval.

34. Chapter 25 of Title 31 of the Pennsylvania Code, 31 Pa. Code §§ 25.1 - 25.23, requires the filing of an application known as a “Form A” filing to seek approval of a change in control of a domestic insurer.

## **Description of Proposed Acquisition and the Related Transactions**

### **Proposed Acquisition of AARe by R&Q**

35. As described in the Application as originally filed, R&Q, or an affiliate of R&Q, proposes to acquire from Century all of the issued and outstanding shares of AARe, consisting of 4,250 shares of common stock (the “Shares”), pursuant to the terms of the Stock Purchase Agreement. (Paragraphs 35 through 76 of this Decision and Order discuss the transaction as originally proposed).

36. The aggregate purchase price payable by R&Q for the Shares under the Stock Purchase Agreement is \$1.00 in cash plus the issuance to Century of a Preference A share in AARe at the closing.

37. The Preference A share would entitle Century to 50% of any remaining dividend, distribution or surplus after the completion of the runoff of AARe up to a limit of \$5 million. R&Q would retain any remaining surplus.

38. As described in the Application, Century is required to cause the surplus of AARe at the closing to be \$25 million.

39. The surplus of AARe is to be initially established based on AARe's estimate of various balance sheet line items including an estimate of AARe's reserve position.

40. After closing, R&Q and Century are required to determine AARe's surplus on a definitive, as opposed to an estimated, basis and to make a post-closing purchase price adjustment if the actual surplus is above or below \$25 million.

41. As described in the Stock Purchase Agreement, the reserve position of AARe must be calculated based on an independent actuarial review conducted by an internationally recognized actuarial firm.

42. To determine the estimated surplus in accordance with the Stock Purchase Agreement, ACE retained Towers Perrin-Tillinghast ("Tillinghast") to perform an independent actuarial analysis of the loss and allocated loss adjustment expense ("ALAE") liabilities of AARe as of December 31, 2003 and to prepare a roll-forward to estimate indicated liabilities as of December 31, 2004.

43. Tillinghast was asked to separate indicated liabilities into two components: the business written by AARe and the business originated from Insurance Company of North



America (“INA”) and ACE P&C. (See May 20, 2005 Analysis of Loss and Allocated Loss Adjustment Expense Liabilities as of December 31, 2003 and December 31, 2004 (the “May 20, 2005 Tillinghast Report”)).

44. Tillinghast issued a report on May 20, 2005.

45. Tillinghast issued a revised report on September 26, 2005, to reflect a correction to the allocation of business between INA and ACE P&C, on the one hand, and AARE, on the other hand. The September 26, 2005 revised report submitted by Tillinghast summarizes its analysis of the business originated by AARE as well as the appropriate amount of reserves.

#### **Related Transactions**

46. As described in the Application, a number of additional transactions are to occur prior to or contemporaneous with the closing of the sale of AARE to R&Q.

47. In addition to its acquisition of AARE, R&Q would also acquire from AII all of the issued and outstanding capital stock of BRUK and, from Century, the share Century owns in SANV.

48. The acquisition of BRUK and SANV by R&Q do not involve the acquisition of a domestic insurer and, thus, do not require the approval of the Department.

49. The acquisition of BRUK is subject to the approval of the Financial Services Authority (“FSA”) of the United Kingdom.

50. On February 27, 2006, the FSA issued a Notice of Approval of Change in Control of BRUK.

51. The other pre-closing transactions described in the Application are intended to disengage AARE, BRUK and SANV from various intercompany arrangements.

52. These pre-closing transactions can be grouped into five general categories:

(a) Capital contributions and intercompany note repayments;

- (b) Alignment of legal entity and business assumed reinsurance operations;
- (c) Other “clean-up” transactions;
- (d) Distributions to AARE and Century; and
- (e) Repayment of \$100 million Century Surplus Note.

53. Under the “capital contributions and intercompany note repayments” category, CIRC currently holds notes payable by BHC and BRUK. BHC and BRUK (through its parent AII) would receive capital contributions sufficient to allow them to repay the notes to CIRC in cash. This repayment would provide CIRC with sufficient liquid assets to engage in various commutations of reinsurance assumed from affiliates, described below.

54. Under the “alignment of legal entity” category, AARE, BRUK and SANV are parties to various intercompany reinsurance agreements that will need to be commuted or novated to separate those companies from the ACE family of companies prior to the acquisition by R&Q.

55. AARE has assumed reinsurance from several affiliates, including Century and ACE P&C. AARE has also ceded reinsurance to Century, Century Re, CIRC and various subsidiaries of INA Holdings. CIRC also reinsures SANV and BRUK and is itself reinsured by Century.

56. As described in the Application, each of these intercompany reinsurance agreements is to be commuted or novated at fair value, except the reinsurance of CIRC by Century, discussed more fully below.

57. According to the Application, the disengagement of AARE will make it stronger, relative to its current position as a cedent of CIRC, an unrated company, and Century, which is rated CCC+ by Standard & Poor’s, because the cash it will receive in the commutations is better

protection for AARe's reinsureds than reinsurance agreements that may provide benefits only years from now.

58. The Application also represents that the commutation and novation transactions would strengthen Century.

59. As described in the Application, CIRC would pay a net amount of approximately \$300 million to commute reinsurance agreements with AARe, BRUK and SANV, thus reducing ceded losses from CIRC to Century. Century, however, would not be required to pay CIRC any consideration.

60. Through CIRC's commutations, the liabilities subject to Century's Aggregate Excess of Loss Agreement would decrease by approximately \$175 million and Century's surplus would increase to \$25 million even though no consideration was to be paid by Century to CIRC.

61. The substantial reduction of liabilities ceded by CIRC to Century would increase Century's claim-paying ability by approximately \$200 million. This, in essence, would have the effect of CIRC providing a dividend to BHC and BHC providing a capital contribution to Century.

62. As described in the Application, the "other 'clean-up' transactions" include the transfer of reinsurance recoverables on paid losses from AARe to Century for cash at fair value net of the recorded provision for bad debts and the payment of intercompany receivables and payables in cash at the recorded book value.

63. These "other 'clean-up' transactions" would have no material impact on the financial position of any of the companies involved.

64. As described in the Application, the “distributions to AARe and Century” entail declaring certain dividends so that AARe will have a \$25 million surplus at the time of the closing.

65. Following the commutations, novations and other proposed pre-closing transactions described above, AARe’s surplus would exceed \$25 million primarily due to the surplus of its subsidiary, SANV.

66. As described in the Application, SANV would dividend approximately \$70 million to its parent AARe which would, in turn, dividend \$75 million to its parent, Century.

67. After the dividends, AARe would be left with a \$25 million surplus.

68. As described in the Application, the last pre-closing transaction involves Century repaying ACE INA on a \$100 million Surplus Note that was made in late 2004, when Century faced insolvency due to an increase in asbestos and environmental (“A&E”) liabilities.

69. To restore Century to solvent status, ACE INA contributed \$100 million in return for a Surplus Note in that amount.

70. ACE INA contributed that amount to Century in contemplation of this proposed transaction and has stated that it will not provide any additional capital to Century if there are further increases in A&E reserves. (See October 21, 2005 letter from Messrs. Sweet and Olsan to the Commissioner, p. 3; Transcript of the July 12, 2005, Public Informational Hearing, pp. 165-169).

71. The Application contended that the repayment of the Surplus Note was appropriate since the proposed transaction would improve Century’s financial position by approximately \$300 million (due to the increased claim-paying capabilities as well as the

dividend from AARe). Even after repayment of the \$100 million Surplus Note, Century's financial position would improve by approximately \$200 million as a result of the transaction.

#### **The Cavell Management Agreement**

72. As described in the Application, R&Q intends to employ its subsidiary, Cavell, to actively manage AARe's claims payments and commutations, along with its current manager National Indemnity Company ("NICO").

73. R&Q provided a proposed management agreement to the Department for its review.

74. The proposed management agreement with Cavell charges a level of fees designed to cover the costs of administering the runoff of AARe, without any profit to Cavell.

75. R&Q provided information about Cavell's experience in managing insurance companies in runoff and explained that Cavell would take a more active role in commuting and/or settling liabilities than NICO has done in the past.

76. R&Q contends that its approach will create more favorable results for AARe because its liabilities will be resolved more efficiently. R&Q also claims that a number of AARe's reinsureds have already expressed interest in negotiating commutation agreements, suggesting that the reinsureds would also benefit from the more proactive management of AARe.

#### **January 2006 Amended Form A Filing**

77. In January 2006, R&Q and ACE amended the Application and several of the proposed pre-closing transactions.

78. As described in the amendment, in addition to the \$25 million surplus that would be retained by AARe at the closing of the transaction, AARe would obtain \$35 million of reinsurance from an affiliate of AII or other reinsurer with a financial strength rating of "A" or better.



79. Under the proposed reinsurance slip provided to the Department, effective as of the closing, AARE will be reinsured for "70% of AARE's net losses in excess of its net reserves at closing up to \$35 million."

80. The reinsurance coverage would be triggered if and to the extent that AARE's surplus drops below \$25 million.

81. The premium for the reinsurance coverage is \$10 million, payable by AARE at closing.

82. R&Q agreed to pay half the cost of the reinsurance premium by issuing a \$5 million promissory note to AARE, payable over five years beginning in 2009. (The promissory note is intended to be part of AARE's dividend to Century at the closing of the transaction.)

83. The reinsurance treaty as proposed in January 2006 contained a "Commutation / No Claims Bonus" provision that allowed either party to elect to commute the reinsurance in its entirety after ten years for \$2.5 million if no loss had been incurred and the reinsurer had not been advised of any covered losses by the date of the election.

84. On April 6, 2006, R&Q and ACE again revised the Application to reflect that any commutation of the \$35 million reinsurance treaty would require the Department's prior approval, in accordance with the insurance laws applicable at that time.

85. Several other modifications were made in the January 2006 amendments. The amount of dividend AARE anticipated making to Century while retaining a \$25 million surplus at the closing of the transaction increased from \$75 million to \$86 million, including the \$5 million note from R&Q.

86. In the January 2006 amendments, ACE withdrew its request that Century be permitted to repay the \$100 million Surplus Note.



87. There is no request pending before the Department to allow Century to repay the Surplus Note, and it is not anticipated that any such request will be made in the near future. If a request is made in the future, it will be addressed by the Department under the then-applicable statutes and regulations.

88. As described in the amendments, certain benefits to Century provided in the original Application have been reduced. As revised, the Application no longer provides that CIRC will commute the BRUK and SANV liabilities without consideration from Century.

89. CIRC will continue to commute its reinsurance from AARE for no consideration from Century. The resulting benefit to Century is a \$92 million reduction in the discounted, statutory basis usage of the limit of liability under the Aggregate Excess of Loss Agreement (\$137 million, undiscounted), as opposed to the approximately \$175 million reduction in the transaction as originally proposed.

90. Century will still have greater claim-paying capacity under the Aggregate Excess of Loss Agreement, but the benefit to Century from the commutations by CIRC is less than it was under the transaction as initially proposed.

#### **Final Results of the Proposed Transactions**

91. As described in the Application and Amendments, the following would be the planned result of the proposed transaction:

- a. AARE would operate as a stand-alone company owned and controlled by R&Q or one of its affiliates and managed by Cavell in conjunction with NICO;
- b. AARE would not write any new insurance and would continue its runoff operations, including, but not limited to, paying amounts due in the ordinary course or commuting its obligations by agreement with its reinsureds;

- c. Century, AARE's by-then former parent company, would remain an indirect subsidiary of ACE INA;
- d. Century would receive various financial benefits, including the payment of an extraordinary dividend and increased claim-paying ability, as a result of the transaction; and
- e. Century would not write any new insurance and would continue its runoff operations, including, but not limited to, paying amounts due in the ordinary course or commuting its obligations by agreement with policyholders.

#### **Department Procedures Relating to the Application**

92. Immediately after the Application and related documents were filed by R&Q and ACE on February 3, 2005, the Department began reviewing the information submitted and implemented several procedures.

93. Those procedures included maintaining a public file that may be reviewed by the public, publishing notices relating to the filing and subsequent activity, allowing for comments from interested persons, conducting a public informational hearing, and seeking additional information and documents from the applicants.

#### **The Public File**

94. A public file has been maintained by the Department at its Harrisburg office and has been available to any interested person for inspection and copying.

95. The contents of the public file have also been available upon request by any interested person for copying by the Department at the Commonwealth of Pennsylvania's copying rate of \$0.25 per page plus tax and for shipping or mailing.

96. The public file is comprised of all documents filed with the Department by R&Q and its representatives and ACE and its representatives except those documents which were

designated as confidential by R&Q or ACE and for which the Department determined that confidential treatment was appropriate.

97. The public file also contains all comments and documents received by the Department from interested persons, responses to those comments received by the Department from R&Q or ACE, various non-confidential final actuarial reports, correspondence between the Department and R&Q or ACE, and the transcript of the public informational hearing that was conducted.

98. All materials in the public file have been indexed in a composite document, in part to aid interested persons who wish to obtain copies of any of the public documents. The index was posted on the Department's website and was routinely updated as new documents became available for public inspection.

99. The Department at various times sent emails to interested persons who had previously requested documents from the public file, or who attended the public informational hearing discussed below, to advise them that additional documents had been received by the Department and were available.

100. Several documents relating to the transaction that are included in the public file were also scanned and made available directly from the Department's website without the need for any copying request.

101. As of June 26, 2006, the public file consisted of 393 documents amounting to 7,807 pages.

#### **Notice and Comments**

102. On February 19, 2005, the Department published notice in the *Pennsylvania Bulletin* and on the Department's website that the Application had been received.



103. The published notice invited interested persons to submit comments to the Department regarding the Application during a specified Comment Period.

104. There was no page limitation on the written comments.

105. In response to the published notice, the Department received numerous comments, documents and other inquiries by mail and email from, or on behalf of, a variety of interested persons ("interested persons" or "commenters").

106. All comment letters, with the exception of requests for documents from the public file index, were forwarded to R&Q for response.

107. R&Q shared comment letters with ACE for response, as necessary.

108. The Department reviewed and considered all comments from interested persons as well as R&Q's and ACE's responses to those comments.

109. The Department published notice on its website on February 14, 2006 that the Comment Period would close on March 10, 2006.

110. The Department received and considered several comment letters that were received after the March 10, 2006, closing of the Comment Period. The Department also reopened the comment period in June 2006 to allow interested persons to address additional information received regarding Cavell's management of two insurance companies in Rhode Island.

111. The Department reviewed and considered all comment letters received including those that were received after the close of the Comment Period.

#### **The Department's Retention of Consultants and Advisors**

112. Section 1402 of the Insurance Holding Companies Act provides that the Commissioner may retain, at the acquiring person's expense, any attorneys, actuaries,

accountants and other experts not otherwise a part of the Department's staff as may be reasonably necessary to assist the Department in reviewing the proposed acquisition of control.

113. The Department retained Wolf, Block, Schorr and Solis-Cohen LLP ("Wolf Block") to act as its legal advisor in connection with matters relating to the Department's examination of R&Q's proposed acquisition of AARE.

114. On March 25, 2005, the Department engaged INS Consultants, Inc. ("INS") to provide actuarial support to the Department in its review of the Application. (See March 25, 2005 letter to INS (the "Engagement Letter")).

115. In the Engagement Letter, the Department requested that INS perform an independent analysis and provide an estimate of gross and net loss and ALAE reserves of AARE as of December 31, 2004. INS' analysis would include a review of Tillinghast's actuarial analysis of AARE's liabilities as of December 31, 2003. The INS analysis would also include a review of Tillinghast's roll-forward analysis of AARE's ultimate liabilities as of December 31, 2004.

116. In the Engagement Letter, the Department also requested that INS review the post-closing, *pro forma* balance sheet of AARE as of December 31, 2004 and provide an opinion on the appropriateness of the balance sheet adjustments resulting from the transactions set forth in the Application.

#### **Public Informational Hearing**

117. Section 1402 of the Insurance Holding Companies Act provides that the Commissioner shall conduct a hearing if either the acquiring party or the party to be acquired requests a hearing within ten days of the filing of the Application. A hearing may also be held if the Commissioner, in her discretion, elects to conduct a hearing as part of her review and analysis of a Form A filing.

118. Neither R&Q nor AARe requested a hearing on the Application.

119. Because the parties to the Application did not request a hearing, the decision whether to conduct a hearing was within the Commissioner's discretion under Section 1402 of the Insurance Holding Companies Act.

120. After consideration of all documents, presentations and reports received, as well as other inquiries and studies as permitted by law, the Commissioner exercised her discretion to hold a public informational hearing on the Application.

121. The Commissioner's decision to hold a public informational hearing was an appropriate exercise of her discretion under Section 1402 of the Insurance Holding Companies Act.

122. On May 28, 2005, the Department published notice in the *Pennsylvania Bulletin* that a public informational hearing would be held on July 12, 2005, with regard to the Application. The published notice advised that the public informational hearing would provide an opportunity for AARe's reinsureds and other interested persons to present oral comments relevant to the Application. The notice also stated that, in the alternative, written comments could be mailed to the Department or sent via email.

123. The notice was also posted on the Department's website, and the Department sent an email to all interested persons who had previously submitted written comments regarding the proposed acquisition, specifically advising them of the public informational hearing.

124. On July 12, 2005, the Commissioner held a public informational hearing with regard to the Application as provided for in Section 1402 of the Insurance Holding Companies Act.



125. A public informational hearing is in the nature of a town meeting or a legislative hearing.

126. Approximately 56 persons attended all or part of the public informational hearing, including representatives of the Department, ACE, R&Q, several of AARE's reinsureds and other interested persons.

127. The Commissioner presided over the public informational hearing and received oral comments.

128. During the public informational hearing, among other things, the Department described its review process.

129. ACE representatives provided an overview of the transactions, the regulatory approvals needed, and the work of Tillinghast in the review of AARE's loss and ALAE liabilities.

130. R&Q representatives discussed the background of R&Q and R&Q's plans for the management of AARE.

131. INS representatives described the work that they were retained to perform as consultants to the Department and announced the anticipated August 15, 2005 delivery of their final report.

132. During the public informational hearing, a number of interested persons, all of whom had previously submitted written comments, presented their positions and, in some cases, responded to questions posed by the Commissioner.

133. The public informational hearing was transcribed by a stenographer. The transcript of the public informational hearing is 183 pages long.

134. At the conclusion of the public informational hearing, the Department announced that the public actuarial report prepared by INS would be posted on the Department's website and a notice of its availability would be sent to all hearing attendees.

135. On August 26, 2005, the Department posted the INS report on the Department's website and sent an email to all public informational hearing attendees providing notice of its availability.

#### **Actuarial Analysis**

136. On August 24, 2005, INS issued its report to the Department addressing the issues set forth in the Engagement Letter.

137. On October 20, 2005, in response to Tillinghast revising its report, INS issued a revised report.

138. In its reports, INS concluded that, except for one minor discrepancy, each of the *pro forma* balance sheet adjustments was accurately stated.

139. INS concluded that the AARE net loss and ALAE reserves were fairly stated in accordance with the Tillinghast estimate.

140. INS concluded that the high-end reasonable range of reserves was significantly higher than Tillinghast's projection.

141. On October 21, 2005, the Department issued a comment letter to R&Q concerning whether the proposed \$25 million surplus to be retained by AARE at the closing of the transaction was sufficient to adequately protect the interests of AARE's reinsureds.

142. The Department also requested that ACE and R&Q provide additional support for their position that the \$25 million surplus would be sufficient even if A&E liabilities exceeded AARE's current expectations.

143. ACE provided additional actuarial support, both from internal ACE actuaries as well as from Tillinghast, for the sufficiency of the \$25 million surplus to cover adverse developments in the A&E liabilities.

144. ACE conceded, however, that it was unlikely that the \$25 million surplus would be sufficient if the A&E liabilities developed consistent with INS' high end reasonable estimate.

145. ACE and R&Q subsequently amended the proposed transaction to provide AARE with additional coverage in the form of a \$35 million reinsurance treaty.

146. ACE contended that AARE would have sufficient reserves and surplus under both the original and amended Applications, and that the \$35 million reinsurance treaty would further increase AARE's financial strength.

147. In a report dated May 2, 2006, INS reviewed ACE's amended proposal and concluded that the additional reinsurance coverage, in addition to the \$25 million surplus, was sufficient to protect AARE's reinsureds from adverse developments resulting in liabilities up to INS' high-end reasonable range of reserves.

#### **Other Investigation and Submissions by R&Q and ACE**

148. Throughout the Application process, the Department reviewed and analyzed the information and materials provided by R&Q in support of the proposed acquisition as well as the comments from interested persons.

149. At various times throughout the Application process, the Department requested that R&Q and/or ACE provide additional information or documentation.

150. R&Q and ACE continued to provide information and documents in support of the Application and relating to the proposed pre-closing transactions from February 2005 through June 2006.

151. On June 16, 2005, ACE submitted a revised Pre-Closing Transactions Memorandum to address certain changes to the amounts that would be paid in connection with the various pre-closing transactions due to revised financial information.

152. On September 27, 2005, ACE submitted an update to the report of its outside actuarial firm, Tillinghast, dated September 26, 2005, regarding the appropriate level of reserves for AARE.

153. On January 26, 2006, R&Q submitted an amendment to the Application, entitled "Change 2 to Form A" and a Second Revised Pre-Closing Transactions Memorandum.

154. Throughout the process, in response to requests from the Department as well as comments submitted by interested persons, R&Q and ACE provided a significant volume of additional documents that further explain the proposed acquisition, the future management and control of AARE after the acquisition, and the financial transactions involved in the proposed acquisition. Many of these documents have been made part of the public record.

#### **Standards for Review**

155. Section 1402(f)(1) of the Insurance Holding Companies Act establishes the standards for approval of an application for change in control of a domestic insurer.

156. Under 40 P.S. § 991.1402(f)(1), the Department "shall approve any merger or other acquisition of control referred to in subsection (a) unless it finds any of the following:

(i) After the change of control, the domestic insurer referred to in subsection (a) would not be able to satisfy the requirements for the issuance of a license to write the line or lines of insurance for which it is presently licensed.

(ii) The effect of the merger or other acquisition of control would be to substantially lessen competition in insurance in this Commonwealth or tend to create a monopoly therein. In applying the competitive standard in this subparagraph:

(A) the informational requirements of section 1403(c)(2) and the standards of section 1403(d)(2) shall apply;

(B) the merger or other acquisition shall not be disapproved if the department finds that any of the situations meeting the criteria provided by section 1403(d)(3) exist; and

(C) the department may condition the approval of the merger or other acquisition on the removal of the basis of disapproval within a specified period of time.

(iii) The financial condition of any acquiring party is such as might jeopardize the financial stability of the insurer or prejudice the interest of its policyholders.

(iv) The plans or proposals which the acquiring party has to liquidate the insurer, sell its assets or consolidate or merge it with any person, or to make any other material change in its business or corporate structure or management, are unfair and unreasonable to policyholders of the insurer and not in the public interest.

(v) The competence, experience and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders of the insurer and of the public to permit the merger or other acquisition of control.

(vi) The acquisition is likely to be hazardous or prejudicial to the insurance buying public.

(vii) The merger or other acquisition of control is not in compliance with the laws of this Commonwealth, including Article VIII-A.

157. The Department has carefully considered the compliance of the proposed transaction with all of the requirements under the statutory standards as follows:

**Inability to Satisfy Requirements for Licensure -- 40 P.S. § 991.1402(f)(1)(i)**

158. When analyzing an application for change in control under Section 1402 of the Insurance Holding Companies Act, the Commissioner reviews the requirements for continued licensure of the domestic insurers being acquired.

159. The line or lines of insurance for which an insurance company may be incorporated and become licensed to write are set out in Section 202 of the Insurance Company Law, 40 P.S. §382.



160. The minimum paid-up capital stock and paid-in surplus required of a stock insurer for each line of insurance is set out in Section 206 of the Insurance Company Law, 40 P.S. §386.

161. In accordance with Section 206 of the Insurance Company Law, 40 P.S. §386, AARE is required to maintain a minimum paid-up capital stock of \$2,350,000 to write the lines of insurance for which AARE is presently licensed.

162. In accordance with Section 206 of the Insurance Company Law, 40 P.S. §386, AARE is required to maintain a minimum paid-in surplus of \$1,175,000 to write the lines of insurance for which AARE is presently licensed.

163. AARE currently has sufficient paid-up capital and paid-in surplus to satisfy the requirements to write the lines of insurance for which AARE is licensed.

164. Upon completion of the transaction, AARE will continue to have paid-up capital in an amount that will satisfy the statutory minimum required of a property or casualty insurance company licensed to write the lines of insurance currently held by AARE.

165. Upon completion of the transaction, AARE will continue to have paid-in surplus in an amount that will satisfy the statutory minimum required of a property or casualty insurance company licensed to write the lines of insurance currently held by AARE.

166. To the extent this prong of the test relates to a company's financial strength and ability to perform its business functions, those concerns are addressed more fully below under other prongs of the test.

167. The Department has analyzed the adequacy of AARE's surplus to satisfy its obligations to its reinsureds even assuming adverse developments – *i.e.*, the Department fully considered whether AARE would be able, after the closing of the transaction, to perform the business in which it is engaged. The Department also reviewed the business plan R&Q



submitted to determine if it provides an appropriate approach to the management of AARe's runoff business.

168. The Department also reviewed AARe's Risk-Based Capital ("RBC"). RBC is determined through a formula developed by the National Association of Insurance Commissioners ("NAIC"). Certain requirements relating to the RBC level of insurance companies have been codified by the Commonwealth of Pennsylvania in 40 P.S. §§ 221.1-A, *et seq.* The specific RBC report, level and any RBC plan of a company is strictly confidential. See 40 P.S. § 221.12-A.

169. In connection with the Application, the Department reviewed AARe's current RBC as well as the *pro forma* RBC that would result after the closing of the transaction.

170. Based on all relevant facts of record including the foregoing, the Commissioner concludes that the approval of the Application would not result in AARe's inability to satisfy requirements for licensure or require it to lose its license.

**Substantial Lessening of Competition -- 40 P.S. § 991.1402 (f)(1)(ii)**

171. The acquisition of control of AARe is subject to review and analysis under Section 1403 of the Insurance Holding Companies Act to determine whether the effect of the acquisition of control would be to substantially lessen competition or tend to create a monopoly in the Commonwealth ("Competitive Standard").

172. The Competitive Standard analysis requires a comparison of the market share of the "involved insurers," including all insurers being acquired, acquiring, or affiliated with an acquirer.

173. As described in the Application, AARe is in runoff and has no market share in the Commonwealth of Pennsylvania.

174. Transport Insurance Company (“Transport”), the only insurance company subsidiary of R&Q that is licensed to write insurance in the Commonwealth, is also in runoff and has no market share.

175. Based on all relevant facts of record including the foregoing, the Commissioner concludes that the Competitive Standard will not be violated by the transaction because neither AARE nor R&Q has a market share in the Commonwealth of Pennsylvania and the acquisition of control of AARE by R&Q will not lessen competition or tend to create a monopoly.

**Financial Condition of the Acquiring Party -- 40 P.S. § 991.1402 (f)(1)(iii)**

176. When analyzing an application for change in control under Section 1402 of the Insurance Holding Companies Act, the Commissioner reviews whether the financial condition of the acquiring party is such as might jeopardize the financial stability of the insurer or prejudice the interest of its policyholders.

177. Without deciding this issue, the Commissioner has considered the reinsureds of AARE to be “policyholders” under 40 P.S. § 991.1402(f)(1).

178. The Department reviewed the financial condition of R&Q and its principals.

179. In particular, the Department reviewed financial statements submitted by R&Q for the previous five fiscal years through December 31, 2004.

180. R&Q’s audited financial statements, reconciled to United States Generally Accepted Accounting Principles (“US GAAP”), reported the following net income for the years 2000 to 2004:

| YEAR | NET INCOME    |
|------|---------------|
| 2000 | \$ 5,023,000  |
| 2001 | \$ 256,000    |
| 2002 | (\$ 522,000)  |
| 2003 | \$ 750,000    |
| 2004 | \$ 11,518,000 |

181. R&Q's reported 2004 net income includes an extraordinary gain associated with its acquisition of Transport.

182. R&Q's audited financial statements, reconciled to US GAAP, reported the following shareholders' equity for the years 2000 to 2004:

| <b>YEAR</b> | <b>SHAREHOLDERS' EQUITY</b> |
|-------------|-----------------------------|
| 2000        | \$ 8,331,000                |
| 2001        | \$ 8,425,000                |
| 2002        | \$ 7,810,000                |
| 2003        | \$ 8,692,000                |
| 2004        | \$ 20,630,000               |

183. R&Q's reported 2004 shareholders' equity reflects assets and liabilities associated with its acquisition of Transport.

184. The Department also reviewed financial statements submitted by R&Q's principals, Randall and Quilter, as of April 30, 2005.

185. R&Q and its principals are financially stable and do not represent a risk to the financial stability of AARe.

186. R&Q has acknowledged that it does not intend to contribute additional capital to AARe or the other insurance companies it will acquire in the proposed transaction (other than the \$5 million note it agreed to issue in connection with the \$35 million reinsurance agreement under the amendment and a \$2.5 million contribution to BRUK).

187. This does not distinguish R&Q from Century or, for that matter, ACE. ACE has specifically stated that it will not contribute, and is not legally obligated to contribute, any additional funds to AARe if this transaction is not approved.

188. The reinsureds who contracted with AARE did not obtain a guarantee from any parent company of AARE.

189. Based in part on these facts, R&Q's financial condition and R&Q's stated unwillingness to contribute additional capital to AARE does not adversely affect AARE's reinsureds and does not weigh against approval of the transaction.

190. In addition, based on the amendments to the proposed acquisition, AARE should be sufficiently capitalized and reinsured to minimize the risk of insolvency or inability to pay its liabilities.

191. Based on all relevant facts of record including the foregoing, the Commissioner concludes that the financial condition of R&Q and its principals, Randall and Quilter, would not pose any impediments to the change in control of AARE nor jeopardize the financial stability of AARE or prejudice the interests of its policyholders.

**The Plans or Proposals of the Acquiring Party to Manage AARE – 40 P.S.  
§ 991.1402(f)(1)(iv)**

192. When analyzing an application for change in control under Section 1402 of the Insurance Holding Companies Act, the Commissioner reviews whether the plans or proposals of the acquiring party, R&Q, to manage the insurer, AARE, are unfair or unreasonable to its policyholders and not in the public interest.

193. R&Q has stated in the Application that it has no plans to cause AARE to declare an extraordinary dividend, to liquidate or dissolve AARE, to sell any of the assets of AARE or to cause AARE to merge with any person or persons. R&Q has also confirmed that it does not plan to cause any other material change in the business operations or corporate structure of AARE.



194. In managing AARE, R&Q plans to take a more proactive approach to handling claims by offering, negotiating, and entering into commutations with reinsureds and retrocessionaires where it believes the commutation process will be beneficial to all.

195. Commutations are a normal part of managing reinsurance liabilities.

196. Commutation is also a matter of agreement. R&Q cannot compel any reinsureds to commute their reinsurance treaties if the reinsureds do not consent.

197. There is no basis to conclude that R&Q has engaged in improper or coercive tactics to obtain commutations in the past or to suggest that it will do so in the future in managing AARE.

198. Several interested persons have raised a concern that R&Q will attempt to redomesticate AARE to Rhode Island so that it can implement a solvent scheme of arrangement which would, in essence, force commutations.

199. R&Q, however, has repeatedly represented that it has no intent to redomesticate AARE.

200. Even if R&Q later determines that it would like to redomesticate AARE, it would require the approval of the Department and of the insurance department for the proposed new state of domicile before any redomestication could occur.

201. R&Q would be required, at a minimum, to seek permission from the Department and establish that redomestication is appropriate under all applicable statutes.

202. The risk that AARE's reinsureds will feel pressured to enter into commutations by the threat of an undercapitalized AARE should be addressed by the amendment to the Application which provides AARE with \$35 million in reinsurance in addition to the \$25 million surplus it will retain.

203. INS has concluded that the reinsurance, in addition to the surplus, provides sufficient capital to AARe to satisfy A&E liabilities up to INS' high-end range of reasonable reserves.

204. After the closing, R&Q intends to retain NICO, which currently provides day-to-day claims management and reinsurance recovery management to AARe, in accordance with a Memorandum of Understanding among Century, NICO and AARe.

205. R&Q intends to have AARe enter into a management agreement with Cavell, a subsidiary of R&Q, which manages insurance and reinsurance companies in runoff in the United States. Cavell will perform management services for AARe at cost, with no profit.

206. The management agreement between AARe and Cavell must satisfy the standards of the Insurance Holding Companies Act, 40 P.S. § 991.1405.

207. Based on all relevant facts of record including the foregoing, the Commissioner concludes that R&Q's plans to manage AARe are not unfair or unreasonable to its policyholders or contrary to the public interest.

**Competence, Experience and Integrity of Those Who Would Control the Operation -- 40 P.S. § 991.1402 (f)(1)(v)**

208. When analyzing an application for change in control under Section 1402 of the Insurance Holding Companies Act, the Commissioner reviews the competence, experience and integrity of the persons who will control the operations of the acquired insurers.

209. As described in the Application, R&Q has significant experience in the runoff of long term A&E liabilities comparable to the kinds of risk included in AARe's book of business.

210. R&Q's principals, Randall and Quilter, collectively have over 60 years of experience in the property and casualty insurance business, including more than 28 years of experience in the business of running-off insurance and reinsurance portfolios.



211. Biographical affidavits for all directors and executive officers of R&Q were provided as part of the Application, and the Department reviewed all affidavits that were submitted.

212. R&Q was formed in 1991 to provide services to the international insurance and reinsurance markets.

213. The business of R&Q includes owning and managing insurance companies in runoff, advising vendors and purchasers of insurance and reinsurance entities, and providing consulting services to others engaged in the insurance industry.

214. R&Q and its affiliates have received approvals and authorizations from the states of Ohio, Washington and Rhode Island, as well as from the United Kingdom and Belgium for owning insurance companies and/or managing significant liabilities for insurance companies in runoff.

215. R&Q, along with Cavell Management Services Limited and Cavell, has particular expertise in claims handling for A&E claims, reinsurance collections, liquidity management and commutations.

216. For example, in 1992, R&Q commenced management of the Gooda Walker Syndicates at Lloyd's of London, with approximately \$4.5 billion in gross claims.

217. In 1992, R&Q acquired Ludgate Insurance Company, a United Kingdom domiciled insurance company in runoff with A&E liabilities.

218. Between 1996 and 2000, R&Q subsidiaries managed up to 150 syndicates of Equitas, a United Kingdom based reinsurer of pre-1993 liabilities of Lloyd's of London with significant A&E exposures.

219. In 1996, R&Q participated in the formation of Dukes Place, a private equity fund that acquired solvent insurance companies in runoff.
220. Between 1999 and 2006, R&Q managed Seaton Insurance Company ("Seaton") on behalf of Dukes Place.
221. Between 2000 and 2006, R&Q managed Stonewall Insurance Company ("Stonewall") on behalf of Dukes Place.
222. The liabilities of Seaton and Stonewall arise from both direct and assumed business and are mainly A&E.
223. Both Seaton and Stonewall purchased retroactive loss portfolio transfer reinsurance policies from NICO in connection with their acquisition by Dukes Place.
224. Between 1998 and 2006, R&Q managed other non-United States domiciled insurance companies on behalf of Dukes Place.
225. In 2000, R&Q acquired La Metropole, a Belgium domiciled insurance company in runoff.
226. In 2004, R&Q acquired Transport, an Ohio domiciled insurance company in runoff.
227. In 2004, R&Q was awarded a contract to manage the runoff of the Goshawk syndicates at Lloyd's of London.
228. The Goshawk contract requires R&Q to manage substantial United States liabilities.
229. The United States domiciled insurance companies owned or managed by R&Q up to 2006, collectively, have A&E liabilities that are somewhat smaller than those of AARE.

230. The United Kingdom domiciled insurance companies owned or managed by R&Q up to 2006, collectively, have A&E liabilities that are similar in magnitude to those of AARE.

231. As of 2005, R&Q employed 180 people in both the United States and the United Kingdom.

232. Based on the foregoing, R&Q has significant experience in owning and managing runoff insurance companies with substantial A&E exposures in both the United Kingdom and the United States.

233. In April 2006, it was publicly announced that Cavell would no longer serve as runoff manager of Seaton and Stonewall. Subsequently, one of the interested persons who had previously commented on this transaction submitted several emails to the Department that the interested person said had been received anonymously. The emails suggested that there was certain impropriety in R&Q and Cavell's management of Seaton and Stonewall.

234. The emails were between an unidentified person who appeared to have inside information about the operations at Cavell and an official from the Rhode Island Insurance Division, which is regulator for both Seaton and Stonewall.

235. The emails were sent to the Rhode Island Insurance Division in the summer of 2005.

236. From 2005 through 2006, the Rhode Island Insurance Division performed an examination of the financial condition of the two companies as of year end 2004.

237. The Rhode Island Insurance Division was assisted in its examination by Mercer Oliver Wyman Consulting Actuaries, Inc. ("Mercer").

238. Mercer checked the reasonableness of the actuarial report prepared by the companies' independent actuary, Ernst & Young ("E&Y"), reviewed E&Y's calculations for

accuracy, estimation methods and judgmental selection of ultimate values and performed on-site individual claim reviews.

239. The Rhode Island Insurance Division released the examination reports of Seaton and Stonewall to the public on June 19, 2006.

240. The final examination reports for both Seaton and Stonewall recommended an adjustment to both companies' reserves and surplus. The 2004 Seaton Examination Report concluded that Seaton's year-end 2004 surplus, after all examination adjustments, was \$32,554,208. The 2004 Stonewall Examination Report concluded that Stonewall's year-end 2004 surplus, after all examination adjustments, was \$45,935,811.

241. The 2004 Seaton and Stonewall Examination Reports make no adverse findings regarding the competence and integrity of R&Q or Cavell.

242. In particular, the 2004 Seaton and Stonewall Examination Reports do not attribute the adjustments in Seaton and Stonewall's reserves to R&Q's or Cavell's runoff management.

243. Both Examination Reports state that "Cavell provides the attention required to manage the runoff of business, while understanding the issues facing the Company and the Industry." (Seaton Examination Report, p. 9; Stonewall Examination Report, p. 8).

244. The Examination Reports further state: "We have applied verification procedures to the data contained in this report using both subjective and statistical sampling techniques as deemed appropriate. While sampling techniques do not give complete assurance that all errors and irregularities will be detected, *those that were detected during the course of this examination have been disclosed in this report.*" (Seaton Examination Report, p. 34; Stonewall Examination Report, p. 32) (emphasis added).

245. Pennsylvania law authorizes the Commissioner to rely on the examinations of other insurance departments. For instance, 40 P.S. § 710-15 provides: “In lieu of an examination, the commissioner may accept the report of an examination conducted by the insurance supervisory official of another state under the laws of that state.”

246. Well before the Rhode Island Insurance Division issued its examination reports and well before the Department received the anonymous emails forwarded by the interested person in this matter, the Department had already independently investigated and questioned R&Q about the termination of Cavell’s management of Seaton and Stonewall as well as the substance of the allegations made in the anonymous emails.

247. The Department also reviewed the financial statements of Seaton, Stonewall and Transport for the years that R&Q or Cavell owned and/or managed those companies.

248. R&Q provided the Department with information about Cavell’s termination as runoff manager and about assertions made by a former Cavell employee. Because of the confidential nature of much of the information relevant to the allegations, certain of R&Q’s responses were maintained as confidential by the Department.

249. R&Q further responded to the allegations in its response to the anonymous emails which was made part of the public record. (See May 26, 2006 letter from Mr. Randall to Ms. Daubert).

250. The Commissioner is satisfied that the termination of Cavell’s management agreements with Seaton and Stonewall and Cavell’s management of those companies does not support a finding that R&Q, its principals or Cavell lack competence, experience or integrity.

251. Based on all relevant facts of record including the foregoing, the Commissioner concludes that the competence, experience and integrity of the persons who would control the



operations of AARe are such that the interests of policyholders and the public would not be jeopardized.

**Hazard or Prejudice to the Insurance Buying Public – 40 P.S.  
§ 991.1402(f)(1)(vi)**

252. When analyzing an application for change in control under Section 1402 of the Insurance Holding Companies Act, the Commissioner reviews whether the proposed acquisition would likely be hazardous or prejudicial to the insurance buying public.

253. ACE and R&Q have explicitly announced that if the transaction is approved, ACE will have no responsibility for any obligations of AARe, and that R&Q has no intention of contributing any further capital to AARe should AARe's financial resources prove insufficient to meet its obligations.

254. Therefore, the Department undertook a thorough analysis of the adequacy of the proposed capital structure of AARe when all of the proposed transactions are concluded.

255. AARe's projected liabilities were subjected to a rigorous analysis by the Department's outside actuarial consultant, INS.

256. The assessment of the adequacy of the capital structure of AARe is a difficult task, since its most important component is a prediction of the future course of development of losses, both as to the total liability and the speed of payout that will be incurred by AARe's reinsureds in the areas of A&E liability.

257. Those areas of liability have been difficult to predict over the past several decades in the insurance industry, but it is not credible or responsible to declare that because it is difficult to assess those risks, one should not even try to do so with the appropriate expertise brought to bear on the issue.

258. ACE and R&Q, supported by the report prepared by Tillinghast, contend that the assessment of AARE's post-closing liabilities demonstrates that \$25 million is an adequate surplus. They make this assessment based on supposing three possible scenarios, one based on projected losses less than expected, one for the most likely outcome, and one for higher than expected liabilities. Even if the high estimates were realized, ACE contends, the \$25 million surplus would be sufficient.

259. INS subjected ACE's predictions to a rigorous review and independently assessed AARE's reserves. INS' analysis resulted in a "most likely" prediction of future liabilities that was essentially equivalent to Tillinghast's prediction. INS' low-end and high-end reasonable estimations, however, were significantly different from Tillinghast's due to the use of different assumptions.

260. INS concluded that AARE's proposed \$25 million surplus would be sufficient to cover the losses if the "most likely" scenario were achieved, but that the surplus would likely be insufficient if losses developed consistent with INS' high-end reasonable estimate.

261. Three risk factors could cause AARE's proposed \$25 million post-closing surplus to be inadequate: (1) Amount Risk, *i.e.*, AARE's reinsurance liabilities may exceed those projected as the most reasonable loss scenarios of either Tillinghast or INS; (2) Timing Risk, *i.e.*, even assuming the amount of loss does not exceed the projections, AARE's liabilities may mature sooner than expected; and (3) Interest Rate Risk, *i.e.*, AARE may not earn the projected rate on its investments, causing it to have insufficient funds to pay its liabilities as they mature.

262. After assessing the differing actuarial projections, the Commissioner adopted INS' analysis as the proper one and based her assessment of the adequacy of the capital structure on that analysis.

263. Although ACE contended that INS' analysis was overly conservative, adopting INS' analysis is appropriate to evaluate possible prejudice to AARE's reinsureds and their policyholders.

264. AARE must have sufficient claim-paying ability so that if adverse developments not now expected occur, AARE can pay the claims required when they come due and maintain sufficient surplus or coverage. If AARE lacks sufficient claim-paying ability, the reinsureds could be harmed, either by AARE's inability to pay claims in the ordinary course as they come due, or because the prospect that it may be unable to do so may lead to an artificially high degree of pressure, even without any action by R&Q, to accept terms of commutation they would not otherwise accept.

265. On the other hand, simply requiring a much larger surplus at the outset of the transaction would most likely produce a large remaining surplus when AARE finally ends its operations.

266. That would be inappropriate and would benefit R&Q to the detriment of AARE's parent, Century, and Century's policyholders. If AARE's surplus is more than adequate for its purposes, then Century will have been deprived by this transaction of the benefit of its ownership of AARE. Removing what may be excess capital from a subsidiary of Century, for that reason, would be unfair to Century and potentially harmful to Century's insureds.

267. As proposed, Century is achieving certain benefits from the transactions and is not entirely deprived of the benefit of AARE's current surplus in light of AARE's significant dividend to Century. The Preference A share issued to Century as part of the transaction compensation would pay part of any remaining surplus after completion of the runoff of AARE

to Century. However, the amount recovered by Century would be limited to a maximum of \$5 million, and R&Q would retain the benefit of the remainder.

268. In consideration of these competing interests (*i.e.*, INS' conclusion that the proposed \$25 million surplus would not be high enough to satisfy liabilities up to INS' high-end reasonable range of reserves and the desire not to allow Century to suffer by simply requiring additional surplus to remain in AARe at the closing), in January 2006, R&Q submitted its amended Application.

269. Under that amendment, AARe will receive \$35 million in reinsurance from a stable credit quality company in addition to the originally proposed \$25 million surplus.

270. INS reviewed the amended proposal and concluded that the \$35 million reinsurance in addition to the \$25 million surplus would be sufficient to cover additional liabilities up to INS' high end reasonable reserves under all reasonable risk scenarios.

271. Although the cost of the reinsurance to AARe (and, thus, Century) would be \$10 million, \$5 million of which is being contributed by a note from R&Q, it provides adequate additional claim-paying ability and protection for the reinsureds of AARe while not depriving Century of a significant extraordinary dividend and other benefits of the transaction.

272. In the event AARe is successfully wound up with a significant surplus, it may be the result, at least in part, of positive developments in the area of A&E liability. If that is so, it is also likely, although not certain, that those same developments will result in an improved financial outlook for Century and the related companies remaining part of the ACE family.

273. Weighing all the relevant factors, the Commissioner concludes that the terms of the amended Application properly protect the interests of all parties.



274. Based on all relevant facts of record including the foregoing, the Commissioner concludes that the proposed transaction is not likely to be hazardous or prejudicial to the insurance buying public.

**Compliance with the Laws of the Commonwealth – 40 P.S.  
§ 991.1402(f)(1)(vii)**

275. When analyzing an application for change in control under Section 1402 of the Insurance Holding Companies Act, the Commissioner reviews whether the proposed acquisition is in compliance with the laws of the Commonwealth.

276. Based on all relevant facts of record including the foregoing and for all the reasons stated above, the Commissioner concludes that the proposed transaction would be in compliance with the laws of the Commonwealth.

**The GAA Amendments**

277. The GAA Amendments Act of 1990, 15 P.S. §§ 21101, *et seq.*, does not apply to this proposed acquisition.

278. Even if it did apply, however, the Commissioner concludes that this transaction satisfies its requirements and specifically finds that the transaction is in accordance with law and not injurious to the interests of the policyholders and creditors.

**Review of the Public Comments**

279. A number of issues addressed above were raised both in comment letters and orally at the public informational hearing by representatives of AARe's reinsureds and other interested persons.

280. The Department has received many letters with comments or objections about the proposed acquisition of AARe by R&Q, but to a great degree they repeat common themes.

Rather than repeat at length the comments received from each of the interested persons, the recurring themes are addressed below:

**Theme One: The Proposed Transaction Will Limit the Entities and Assets Available to Satisfy AAre's Reinsureds**

281. A major theme of the interested persons that commented on the Application is that ACE or one or more other members of its corporate family is responsible for the liabilities of AAre, either legally or because of reputational risk, and that the sale of AAre should not be permitted because if it takes place, Century (and other ACE companies or ACE itself) will no longer be liable to stand behind AAre's obligations.

282. This theme seems to be based on one or more of three ideas:

a. That AAre is an entity whose current assets and liabilities resulted from its being allocated a portion of the assets and liabilities of other companies as a consequence of the 1996 Restructuring;

b. That AAre's corporate parents are legally responsible for AAre's liabilities because of their status as AAre's parents; and/or

c. That even if no other entity is legally responsible for the liabilities of AAre, if AAre is not sold, ACE would contribute capital necessary to ensure all of AAre's liabilities are paid to avoid the harm to ACE's reputation caused by any failure of its subsidiary.

283. The Commissioner has reviewed these issues but finds that they do not warrant disapproval of the Application.

284. AAre was not allocated any assets or liabilities under the 1996 Restructuring. (See, e.g., March 22, 2005 letter from Messrs. Harkins and Sweet to the Commissioner, p. 6). The assets and liabilities held by AAre are those that it alone contracted for. In particular, each of the reinsurance treaties on which AAre is obligated was specifically negotiated and executed by AAre individually, not by or on behalf of any other ACE entity.

285. Even assuming *arguendo* that a company whose assets or liabilities were allocated to or from other entities under the 1996 Restructuring would remain liable for all of the liabilities allocated to another company and/or would become liable for all the liabilities of companies whose assets were allocated to it, that question is not posed by this transaction.

286. Under general corporate law, absent some basis to “pierce the corporate veil,” a parent corporation is not liable for the debts or obligations of its subsidiary. The Commissioner does not find that AARe’s parents are liable for its debts.

287. The issue of whether reputational risk should preclude the approval of the Application involves a public policy assessment. Although it is possible that ACE may infuse capital into AARe to avoid suffering any reputational damage to ACE if AARe fails to satisfy its reinsurance obligations, this issue is unlikely to arise under the January 26, 2006 amendments to the Application, which provide AARe with a \$35 million reinsurance cover.

288. Although ACE recently provided \$100 million to its subsidiary Century in exchange for a Surplus Note to prevent Century from becoming insolvent, ACE has specifically denied that it will do so again. (See October 21, 2005 letter from Messrs. Sweet and Olsan to the Commissioner, p. 3 (“The objectors would have the Department believe that there is a third choice, which is that the ACE operating companies will simply infuse AARe with capital as it may be needed. *This will not happen, regardless of the speculations of the objectors about reputational risk and the like.*”) (emphasis added); Transcript from the July 12, 2005, Public Informational Hearing, pp. 165-69 (By Mr. Cusumano: “the obligations on the active ACE companies to these various runoff entities are fixed and finite. . . . It [the transaction] benefits [claimants against Century] to which they have \$200 million in additional claim-paying capacity

that didn't exist yesterday, unless you assume that the ACE group is simply going to finance that, *which we are not going to do.*") (emphasis added)).

289. Since the Commissioner has found that the surplus that will be retained in AARe (in addition to the \$35 million reinsurance obtained by AARe) is adequate to protect AARe's reinsureds against adverse development in its A&E liabilities up to INS' high-end reasonable range, this concern has been adequately addressed.

290. Even if that were not the case and the surplus and reinsurance prove to be inadequate, the reputational stake provides only illusory protection to the reinsureds and is an insufficient reason to reject the proposed transaction.

291. ACE has denied that it will provide any additional capital to AARe in the event that AARe's surplus is insufficient to satisfy its obligations. The mere chance that ACE would contribute to AARe (when presumably other related companies, including Century, would be similarly situated and experiencing difficulties if AARe's surplus proves insufficient) is not a sufficient reason to disapprove the transaction.

**Theme Two: R&Q's Business Plan Will Prejudice the Reinsureds of AARe**

292. Several interested persons also expressed concern that R&Q will utilize excessively aggressive tactics, like threatening the dissolution of or default by AARe on the reinsurance treaties, to compel reinsureds to accept commutations at less than fair value. In support, several of AARe's reinsureds emphasized that R&Q conducts commutation seminars with industry participants on a regular basis.

293. Interested persons have also suggested that R&Q will attempt to redomesticate AARe to Rhode Island or another state which would give it additional options to force commutations, such as a solvent scheme of arrangement.



294. As found above, R&Q emphasizes its experience and good reputation in operating runoff companies. R&Q states that it has worked with and even on behalf of many of the interested persons who submitted comments.

295. R&Q states, and the Commissioner agrees, that commutation is a standard industry practice requiring the agreement of both the insured and the insurer. There are a number of valid business reasons that parties to reinsurance treaties may elect to commute for fair value.

296. R&Q also denies that it forces commutations through inappropriate practices or that its seminars evidence any improper intent. According to R&Q, the seminars are voluntary and are well attended by insurers who enjoy the benefits of commuting their reinsurance policies for fair value. In fact, R&Q cites specific instances where the interested persons who raised this concern have participated in the commutation seminars. (See, e.g., May 13, 2005 letter from Mr. Alberts to the Commissioner, p. 8).

297. R&Q has also represented on multiple occasions that it has no intent to redomesticate AARE, and any effort to redomesticate AARE in the future would require separate Department approval. (See id. at 5 & 9).

298. As also found above, the surplus and reinsurance that will be maintained by AARE at the closing of the proposed transaction should protect the reinsureds from being unduly pressured to accept commutations.

299. The Commissioner finds that these challenges to R&Q's business plan and practices do not support disapproval of the Application.

**Theme Three: Century Is Avoiding Liabilities While Keeping an Interest in AARE**

300. Several interested persons objected to the transaction on the ground that Century is eliminating potentially significant A&E liabilities but is nonetheless retaining the right to benefit if the A&E liabilities do not increase significantly (in the form of the Preference A Share). In that same vein, some of the interested persons also object to a provision of the Stock Purchase Agreement requiring that, if certain tort reform legislation is passed resulting in a reduction of AARE's reserves, then 50% of that reduction must be paid by AARE to Century.

301. None of these benefits to Century, however, harm AARE's reinsureds.

302. To the extent there is surplus retained by AARE after all of the reinsurance agreements have been extinguished (either through payment, commutation or otherwise), there would be no harm to the reinsureds who would have been paid appropriately before any dividends would be made to Century.

303. Similarly, if tort reform is passed that reduces AARE's liabilities, that reform would similarly lessen the liabilities of AARE's reinsureds. Thus, there should be no risk of prejudice to the reinsureds from this provision.

304. It is also not improper for Century to retain some potential benefit, as it would have been entitled to a dividend from its subsidiary AARE if surplus was available after all of AARE's liabilities were satisfied. (See May 20, 2005 letter from Messrs. Harkins and Sweet to the Commissioner, pp. 15-17).

305. The fact that Century or some other member of the ACE family may derive some economic benefit as a result of the proposed transaction is not a basis to disapprove the transaction.

#### **Theme Four: The Benefit to Century Is Doubtful**

306. At the same time they claim that it is unfair for Century to retain a benefit, several of the interested persons have also expressed concern that the proposed transaction does not provide enough of a benefit to Century.

307. Many of the interested persons voiced significant concerns about Century's proposed repayment to ACE INA of the \$100 million Surplus Note.

308. As found above, ACE INA withdrew its request for repayment by Century of the \$100 million Surplus Note in January 2006 in connection with the amendment to the Application.

309. Approval of the Application (along with the related pre-closing transactions) is not detrimental to Century and, in fact, provides certain benefits to Century, including an increase in Century's current claim-paying ability.

310. The Commissioner finds that the interests of Century do not provide a basis for disapproval of the Application..

**Theme Five: AARe Does Not Have Adequate Surplus After the Sale**

311. Many of AARe's reinsureds expressed concern that AARe would not have sufficient surplus after the close of the transaction to cover all of its liabilities. ACE and R&Q agreed that the adequacy of AARe's reserves is a matter of legitimate concern. (See May 20, 2005 letter from Messrs. Harkins and Sweet to the Commissioner, p. 3).

312. AARe will have less surplus as a result of the proposed transaction because of its substantial extraordinary dividend to Century. ACE contends that any detriment due to the reduction in surplus is more than overcome by the benefit of not having AARe's fortunes (and ability to pay claims) tied to Century's financial stability. (See, e.g., Transcript of the July 12, 2005, Public Informational Hearing, p. 169) (By Mr. Cusumano: "[I]t's also beneficial to the claimants of AARe by . . . eliminating its dependence on the financial viability of Century

Indemnity, which we frankly recognize, is not the most financially sound enterprise on the planet right now.”).

313. According to ACE, because AARE is commuting its reinsurance with Century at fair value for cash, AARE will be better able to pay its obligations to its reinsureds. (See October 21, 2005 letter from Messrs. Sweet and Olsan to the Commissioner, pp. 4-5) (“the obvious commercial reality is that cash is better and more secure than reinsurance from a CCC+ company.”).

314. ACE and R&Q also contend that the surplus that will remain at AARE at the time of the closing of the proposed transaction will provide more than sufficient protection to AARE’s reinsureds and that AARE will be able to fulfill its reinsurance obligations.

315. As found above, with the assistance and expertise of INS as its independent actuaries, the Department analyzed in detail the adequacy of AARE’s surplus and reserves after the transaction. Based on INS’ analysis and findings as well as concerns expressed by the interested persons and the Department, ACE and R&Q amended the transaction to provide AARE with a \$35 million reinsurance treaty in addition to the \$25 million surplus originally proposed.

316. INS’ analysis demonstrates that the reinsurance treaty provides AARE with sufficient claim-paying ability to cover reasonably anticipated upward adjustments in A&E liabilities, even to INS’ high-end reasonable range.

317. Based on the amendment to the transaction and INS’ assessment and conclusions, the concerns about the adequacy of AARE’s reserves and surplus have been properly addressed and resolved. The Commissioner finds that the comments do not provide a basis for disapproving the transaction as amended.

**Theme Six: This Transaction Violates the Letter or Spirit of the 1996 Decision and Order**

318. Some of the interested persons have suggested that the 1996 Decision and Order precluded the subsequent sale or other disposition of any of the companies involved in the 1996 Restructuring. The interested persons contend that this was important to the 1996 Decision and Order because, according to them, the various corporate entities retained liability for any default by other entities that assumed or were assigned liabilities in connection with the 1996 Restructuring.

319. ACE responded that the 1996 Decision and Order merely stated that any future sale of any of the companies involved required the approval of the Department. ACE claimed that it is in full compliance with both the letter and the spirit of the 1996 Decision and Order since it is doing exactly as required in seeking the Department's approval with the instant Application.

320. ACE also emphasized, as discussed above, that AARE did not assume any policies or other liabilities in connection with the 1996 Restructuring and that, therefore, the 1996 Decision and Order has no impact on the present transaction.

321. The Commissioner agrees that the 1996 Decision and Order is not an impediment to this transaction. Neither the 1996 Decision and Order nor the 1999 Decision and Order precludes ACE from seeking to dispose of AARE as long as the necessary approval from the Department is sought and obtained. As found above, AARE did not assume any policies or liabilities under the 1996 Restructuring. Therefore, any legal implications arising from transferring assets or liabilities from one entity to another in connection with the 1996 Restructuring are not present in this transaction.



322. The Commissioner finds that the 1996 Decision and Order does not preclude approval of the Application.

**Theme Seven: This Transaction Is a Test for ACE's Anticipated Future Sale of Century**

323. Many of the interested persons express significant concern about a potential future transaction resulting in the sale by ACE of Century. The comments relating to that potential future transaction suggest that ACE is using this transaction to test the waters to determine the likelihood of getting approval for a sale of Century.

324. ACE has suggested in the media that it does intend to divest itself of Century in the future. ACE's responses to the comments from the interested persons on this issue do not allay those concerns. ACE states that there is no current transaction involving Century, but it does not disavow any intent to enter into such a transaction in the future.

325. Any future transaction involving the potential sale of Century, however, would require separate approval from the Department. There would be another investigation, another opportunity for interested persons to comment (in that case, direct policyholders), most likely another public hearing, and another actuarial analysis.

326. That transaction would be scrutinized as closely as the instant one involving AARE. It should be clear to the interested persons and to ACE that nothing about this decision on the proposed sale of AARE would lessen the statutory requirements that would need to be satisfied before any potential future transaction could be approved. Moreover, nothing in this Decision and Order will bind the Department in connection with any analysis involving a different company with different policyholders and different liabilities, at a different time under different circumstances.

327. Thus, while the interested persons' concerns about a potential future transaction involving Century are legitimate, they do not warrant the denial of this transaction.

**Theme Eight: The Procedures Employed for the Review of this Transaction Are Insufficient**

328. Several interested persons have objected to the procedure employed by the Department in its review of the Application. In particular, the comments suggest that the information available from ACE and R&Q in the public record is insufficient and that they should have been given a greater opportunity to participate at the public informational hearing by, for example, presenting testimony from witnesses, cross-examining R&Q and ACE representatives and obtaining documents pursuant to requests that are akin to those served in the course of discovery in litigation.

329. R&Q and ACE provided a significant volume of information for the public record. In fact, the public record for this proposed transaction is among the most, if not the most, complete public record the Department has ever had for such a transaction.

330. The Department has reviewed the documents that are not part of the public record and determined that they are appropriately designated as trade secret, confidential and/or proprietary and that they should not be made publicly available in conjunction with this deliberation.

331. The disclosure of these non-public documents would cause significant hardship to ACE, AARE, and R&Q and would provide an unfair competitive advantage to others in the insurance industry.

332. The disclosure by the Department of the non-public information submitted in connection with this request could also cause a chilling effect on insurance companies'

interaction with the Department and could prevent companies from engaging in appropriate transactions for fear that proprietary business information will be revealed to competitors.

333. ACE was not required to provide proprietary, confidential and trade secret information to its competitors or the public at large.

334. The information that was made publicly available was sufficient to allow interested persons to fully analyze and comment on the proposed transaction, as evidenced by the numerous submissions made by interested persons addressing all of the integral aspects of the proposed acquisition of AARe by R&Q.

335. Many of the documents to which the interested persons requested access related only to the pre-closing transactions that are not part of the Application and are considered by the Department under different legal standards in a confidential context not subject to public review or comment.

336. For instance, the various commutations of inter-company reinsurance treaties are the subject of a Form D filing which does not provide for public comment or analysis. As evidenced by the different procedural requirements, the value of the commutations is left exclusively to the consideration of the Department which is certainly qualified to assess those transactions without public comment.

337. Had ACE sought to perform the pre-closing transactions before filing its Application, many of the pre-closing transactions would have been addressed by the Department confidentially and none of the interested persons would have received any information about those transactions. Because ACE revealed the pre-closing transactions in its public filings relating to its Application, the interested persons received more information and access to more documents than they would have otherwise had any right to receive.

338. The procedure for the public informational hearing and comment periods, as well as the access to information that was provided to interested persons, is consistent with and, in some ways, provides a greater opportunity for interested persons to be heard than was available in connection with the 1996 Restructuring.

339. The procedures used by the Department in connection with the 1996 Restructuring were found by the Pennsylvania Supreme Court to be sufficient to protect interested persons' due process rights.

340. For all of the reasons set forth in this subsection, among others, the Commissioner finds that the interested persons' due process rights have been satisfied by the Department's procedures.

**Theme Nine: The Modifications to the Application and Pre-Closing Transactions Are Insufficient**

341. The Department received only a few comments after the January 2006 amendment to the Application that, among other things, added the \$35 million reinsurance coverage for AARE and withdrew the request for Century to repay ACE INA on the Surplus Note.

342. Those comment letters acknowledged that the amendments made to the transaction addressed several of the concerns and were a "step in the right direction." (March 10, 2006 letter from Mr. Aronchick to the Commissioner, p. 1; March 10, 2006 letter from Mr. Gordon to Mr. Brackbill, p. 1). Nonetheless, the interested persons continued to raise several concerns.

343. The interested persons questioned the adequacy of the \$35 million reinsurance policy, particularly in light of the provision that either party could commute the policy for \$2.5 million after ten years under specific conditions.

344. INS has analyzed the \$35 million reinsurance coverage provided under the amendment and determined that it provides sufficient coverage to address INS' high-end range of reserves.

345. After the interested persons raised their concerns, ACE revised the proposed reinsurance coverage. The proposed reinsurance treaty still provides for commutation by either party after ten years for \$2.5 million if certain conditions are satisfied. The modification, however, now makes clear that the commutation is contingent on prior Department approval. (See April 6, 2006 letter from Ms. Bregman to Mr. Johnson and enclosures).

346. Based on this modification (and INS' conclusion that the surplus and reinsurance are sufficient to cover its high-end range of reasonable reserves), the modification proposed by ACE and R&Q has adequately addressed the interested persons' legitimate concerns.

347. The interested persons also questioned whether, despite its elimination from the Pre-Closing Transactions Memorandum, ACE was still attempting to seek repayment of the \$100 million Surplus Note or will do so in the near future. In response, ACE unequivocally explained that it had withdrawn its request for repayment of the Surplus Note.

348. No such request is currently pending before the Department. If ACE renews its request in the future, the Department will analyze that request as appropriate, but ACE will be required to satisfy the statutory requirements for repayment of a surplus note. Any such repayment may only occur with the approval of the Department.

349. Therefore, any concerns about the future repayment by Century of the \$100 million Surplus Note are adequately addressed by the Department's requirements.

350. The interested persons further noted that, in conjunction with withdrawing its request for payment of the \$100 million Surplus Note, ACE has reduced the benefit to Century



that was to be provided by CIRC under the initial Application by approximately \$75 million. (See March 10, 2006 letter from Mr. Aronchick to the Commissioner, pp. 4-5). In essence, according to the interested persons, ACE INA is still obtaining a \$75 million benefit (as opposed to \$100 million from the repayment of the Surplus Note) at the expense of Century.

351. While this comment accurately describes part of the modification of the proposed transaction, it does not preclude its approval. CIRC was not required to commute the reinsurance obligations of SANV and BRUK at no cost to Century. It was doing so as part of the larger transaction to provide additional benefits to Century, in part to justify the repayment by Century of the Surplus Note. As discussed above, under the amendment, Century is no longer seeking approval to repay the Surplus Note.

352. CIRC is not obligated to provide the benefit to Century that was contemplated by the transaction as originally filed. Century's claim-paying ability is still improved by the transaction and AARE's reinsureds are not prejudiced as a result.

353. The commutations and novations contemplated by the pre-closing transactions are all being performed at fair value (except where CIRC is still providing a benefit to Century from the commutation of its reinsurance with AARE). INS has reviewed and confirmed that each of the transactions is reasonably stated on the *pro forma* balance sheet.

354. The Commissioner recognizes that Century could have received a greater benefit from the transaction as originally proposed if it were approved with only the repayment of the Surplus Note disallowed. On the whole, the transaction still benefits Century and does not prejudice the reinsureds of AARE.

355. The elimination of the benefit that was being provided to Century by CIRC under the previous proposal does not merit disapproval of the amended transaction.

356. If any of the above Findings of Fact is determined to be a Conclusion of Law, it shall be incorporated in the Conclusions of Law as if fully set forth therein.

### **CONCLUSIONS OF LAW**

1. Under Section 1401 of the Insurance Holding Companies Act, the Commissioner has jurisdiction to review and approve the proposed acquisition of control of domestic insurers.

2. The filing submitted by R&Q satisfies the requirements of all applicable laws and regulations.

3. Section 1402(f)(2) of the Insurance Holding Companies Act does not require that the Department conduct a hearing in review of an acquisition of control unless the persons or insurers involved in the filing so request, or the Commissioner, in her discretion, elects to hold a hearing.

4. The Commissioner's decision to conduct a public informational hearing under Section 1402 of the Insurance Holding Companies Act, even though the persons or insurers involved in the Application did not request a hearing, was a proper exercise of her discretionary authority.

5. The Commissioner was not required to hold a trial-type hearing before approving or disapproving the proposed acquisition.

6. The general public has no constitutional right to a trial-type hearing in connection with the Application.

7. The General Rules of Administrative Practice and Procedure, 1 Pa. Code §§ 31.1-35.251, do not control the conduct of public informational hearings by the Commissioner under Section 1402 of the Insurance Holding Companies Act.

8. The process afforded at the public informational hearing satisfied due process requirements.

9. The publication of the notices of the R&Q filings and the public informational hearing, as well as the content of those notices, in the *Pennsylvania Bulletin* satisfied due process requirements.

10. The public comment period satisfied due process requirements.

11. Section 1402 of the Insurance Holding Companies Act provides that the Department may retain outside consultants to assist the Department in its review of a proposed acquisition of control of a domestic insurer.

12. The Department's retention of Wolf Block and INS as legal counsel and actuarial consultant respectively was appropriate under Section 1402 of the Insurance Holding Companies Act.

13. Under Section 1402 of the Insurance Holding Companies Act, the Commissioner must approve an application for a change in control unless the Commissioner has found that:

a. The insurer will not be able to satisfy the requirements for the issuance of a license to operate the line or lines of business for which they are presently licensed;

b. The change in control will substantially lessen competition in insurance in this Commonwealth or tend to create a monopoly therein;

c. The financial condition of the acquiring company is such as might jeopardize the financial stability of the insurer or prejudice the interests of its policyholders;

d. Any plans to liquidate the insurer, sell its assets or consolidate or merge it with any person, or to make material changes in its business or corporate structure or management are unfair and unreasonable to policyholders of the insurer and not in the public interest;

e. The competence, experience and integrity of those persons who would control the operation of the insurer are such that it would not be in the interest of policyholders and the general public to permit the acquisition of control;

f. The acquisition is likely to be hazardous or prejudicial to the insurance buying public; or

g. The acquisition of control is not in compliance with the laws of this Commonwealth, including Article VIII-A, Insurance Company Mutual-to-Stock Conversion Act.

14. Under Section 1402 of the Insurance Holding Companies Act, the Commissioner has not found that any of the above conditions is present with respect to the change in control of AARE.

15. For purposes of this Decision and Order, the Commissioner assumes, without deciding, that the reinsureds of AARE fall within the category of persons referred to in Section 1402 of the Insurance Holding Companies Act as "policyholders."

16. The Application filed by R&Q, with amendments, complies with the requirements of 40 P.S. § 991.1402.

17. The 1996 Decision and Order imposes no additional requirements on the parties to the proposed acquisition of AARE or on the Commissioner in reviewing this transaction. The Commissioner does not here decide the legal effect of the 1996 Decision and Order on any future transaction involving any entity whose liabilities and assets were involved in the 1996 Restructuring.

18. Thus, the acquisition of AARE by R&Q is permitted under Pennsylvania law.

19. If any of the above Conclusions of Law is determined to be a Finding of Fact, it shall be incorporated in the Findings of Fact as if fully set forth therein.

BEFORE THE INSURANCE COMMISSIONER  
OF THE  
COMMONWEALTH OF PENNSYLVANIA

|                                  |   |  |
|----------------------------------|---|--|
| IN RE:                           | : | Pursuant to Sections 1401, 1402 and 1403       |
|                                  | : | of the Insurance Holding Companies Act,        |
| Application of Randall & Quilter | : | Article XIV of the Insurance Company           |
| Investment Holdings Limited in   | : | Law of 1921, Act of May 17, 1921, P.L.         |
| Support of the Request for       | : | 682, <u>as amended</u> , 40 P.S. §§ 991.1401 - |
| Approval to Acquire Control of   | : | 991.1403 and Chapter 25 of Title 31 of the     |
| ACE American Reinsurance         | : | Pennsylvania Code, 31 Pa. Code §§ 25.1 -       |
| Company                          | : | 25.23  |
|                                  | : |  |
|                                  | : | Order No. ID-RC-06-11                          |

**ORDER**

Upon consideration of the foregoing, the Insurance Commissioner of the Commonwealth of Pennsylvania ("Commissioner") hereby makes the following Order:

The application of Randall & Quilter Investment Holdings Limited ("R&Q") in support of the request for approval to acquire control of ACE American Reinsurance Company ("AARe"), as set forth in the application as amended, is hereby approved, subject to this Order and the following conditions:

1. All necessary regulatory filings and approvals are obtained prior to consummation of the transaction.
2. R&Q shall provide a list of closing documents within five (5) days after consummation of the subject transaction and shall maintain the listed documents and make them available to the Pennsylvania Insurance Department ("Department") for a period of not less than five (5) years from the date of consummation.
3. AARe shall not acquire investments except securities rated "1" or "2" by the National Association of Insurance Commissioner ("NAIC") Securities Valuation Office or as



otherwise authorized by prior written approval of the Commissioner; AARE may continue to hold all securities in the company's portfolio on the date of this Order until they reach maturity.

4. AARE shall not write any new business without prior written approval of the Commissioner except as required by law or contract.
5. AARE shall not file an application for voluntary dissolution within five (5) years of the effective date of this Order.
6. AARE shall not redomesticate without prior written approval of the Commissioner.
7. All intercompany balances due to AARE shall be settled within ninety (90) days of the end of each quarter, except for the reinsurance balances.
8. An independent actuary shall review and analyze the reserves of AARE, including but not limited to the adequacy of the reserves for reinsurance uncollectibles, at least once every two (2) years, beginning with the year ending December 31, 2007, and the selection of the actuary and scope of the review shall be subject to the prior written approval of the Commissioner. The Department may waive this requirement in any year during which the Department performs a financial examination of AARE.
9. AARE shall annually provide to the Department, on or before March 31, a stress test that will demonstrate the adequacy of the company to continue to runoff the business. The format of the annual stress test shall be approved by the Department in advance. The first stress test shall be filed on or before March 31, 2007.
10. AARE shall annually provide to the Department a two-year financial projection, updated annually. The first two-year financial projection shall be filed on or before March 31,

2007. All subsequent two-year financial projections shall be filed annually with the Department, on or before March 31.

11. AAre shall not establish security deposits with any other jurisdiction without the Commissioner's prior written approval except to the extent required by law.
12. AAre may discount reserves, as allowed by law, including but not limited to asbestos and environmental case reserves, but such discounting shall in no event be greater than six percent (6%).
13. AAre shall annually meet with the Department to review the operating results by the end of May of each year. AAre shall meet with the Department at other times upon reasonable advance notice by the Department.
14. AAre shall not engage in any transactions with affiliates or other entities owned by its officers and/or directors without prior written approval of the Department.
15. AAre shall make no dividends or other distributions without the prior written approval of the Department.
16. AAre shall not make any disbursements, payments or transfers of assets, except as otherwise provided herein, outside the normal and ordinary course of business, without the Department's prior written approval.
17. The request of R&Q to change the name of AAre to "R&Q Reinsurance Company" after the consummation of the subject transaction is hereby approved.

This Order is effective immediately and valid for one year, provided no material changes are made to the transaction prior to consummation.

  
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M. Diane Koken  
Insurance Commissioner  
Commonwealth of Pennsylvania

