A View From The “Other Side”: Making The Underwriting Connection

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Getting Into “The Zone” ... (1)

“It is a dimension as vast as space and as timeless as infinity. It is the middle ground between light and shadow, between science and superstition, and it lies between the pit of man’s fears and the summit of his knowledge.

This is the dimension of imagination. It is an area which we call the Twilight Zone.”

-- Rod Serling (1959 – 1964 series)
Getting Into “The Zone” ... (2)

- A “dimension of imagination” almost as rarified as the vaunted Twilight Zone.
Overview

I. Reinsurance Disputes

II. Observations on Wording

III. Special Acceptances

IV. The Marketplace
Reinsurance Disputes (1)
Reinsurance Disputes (2)

- Treaties containing arbitration clauses.
- From a **1956** general liability XOL Treaty:

1. It is understood and agreed between the parties hereto that this agreement shall be regarded as an honorable engagement rather than as a mere legal obligation, and in the event of any difference arising between the contracting parties it shall be submitted to arbitration, the arbitrators to be chosen from the managers or officers of casualty companies or reinsurance companies other than the NORTH AMERICAN or the INDUSTRIAL as follows:
Reinsurance Disputes (3)

- From a **2015** Property Cat XOL Treaty:

Resolution of Disputes – Any dispute not resolved by **mediation** between the Company and the Reinsurer arising out of the provisions of this Agreement or concerning its interpretation or validity, whether arising before or after termination of this Agreement, shall be submitted to arbitration in the manner hereinafter set forth.
Reinsurance Disputes (4)

- The anatomical features of a reinsurance arbitration:
  - Three arbitrators with industry experience.
  - Each side appoints one arbitrator. The third arbitrator (or umpire) is “neutral”.
  - Confidential proceeding (almost always).
  - More svelte and informal than Court process.
  - Principles of fairness, equity, and industry custom & practice: Utmost Good Faith; Follow the Fortunes/Settlements; Honorable Engagement.
Reinsurance Disputes (5)

- The **identity** of the **umpire** is important.
Reinsurance Disputes (6)

▪ **Underwriters** often play important **role** in reinsurance disputes.

▪ They can be **key witnesses** who testify about the **intentions** animating disputed or allegedly ambiguous wording.
  
  – For example, what was the underwriting discourse concerning **aggregation** under the Treaty?

▪ Underwriting witnesses can also provide **atmospheric intelligence** concerning the cedent-reinsurer relationship, market conditions, etc.
Reinsurance Disputes (7)

- Underwriters often get involved *before* a formal dispute arises.
  - When a claim is under investigation, *claim handlers* and brokers frequently seek underwriter involvement.
  - *Brokers* can be “aggressive”. They exert pressure and leverage to “do their job” -- *i.e.* elicit payment.

- Take caution with communications -- especially *emails* discussing coverage issues.
  - They are discoverable, if not *privileged*.

  - Cases can rise and fall based on statements made in an underwriter’s email.
Reinsurance Disputes (8)

- **Email** is aptly called:
  
  - “Evidence mail”.
  
  - “Electronic truth serum”.
  
  - “The corporate equivalent of **DNA evidence**...In theory you can explain it away, but good luck trying.”

Reinsurance Disputes (9)

Sample Bad Email

From: Jayhawk Re Underwriter
To: Jayhawk Re Claims Handler
Re: Allocation

I reviewed the cedent’s allocation. I wouldn’t call it unreasonable, but I’ve attached some models that are more reasonable from my perspective and will cut our reinsurance exposure in half. I defer to Claims to decide which models to adopt.
Reinsurance Disputes (10)

Sample Bad Email

From: Patriot Re Underwriter
To: Reinsurance Broker
Re: Two Things

Hey -- we appreciate you steering the renewal our way. Thank you.

Per your request, I took a look at Cedent’s claim, and I agree that the contract wording is a little unclear as applied to this scenario. I’ll talk to our claims guy and see what I can do.
Observations On Wording (1)

- We’ve been involved in cases -- where there is no contract wording.

- Or, where the “contract” consists of a confusing mélange of slips and/or competing draft wordings.

- Cedents and brokers may seek to push questionable claims through any fissure in otherwise lucid contract wording.

- **Best practices**: Identify “final” wording; document agreement to it; where advantageous, state the intended purpose of a particular provision.
Observations On Wording (2)

- We’ve handled Swiss Re matters governed by contracts underwritten from the 1950s to the present.
  - In general, contract wordings have become more detailed and (in some cases) more definitive over time, which is a double-edged sword -- anything not specified by an otherwise detailed wording is replete with opportunities for exploitation.

- In our experience, underwriting files have also become more detailed over time.
  - Especially since the advent of the email age, when daily communications became indelible.
Observations On Wording (3)

- A few general recommendations concerning 7 core contract provisions.

- In a “soft” market, cedents tend to enjoy bargaining leverage with respect to contract language -- so, this list is both pragmatic and aspirational.
Observations On Wording (4)

- **Aggregation** (Property Cat Treaty):

  The term “loss occurrence” shall mean the sum of all individual losses directly occasioned by any one disaster, accident or loss or series of disasters, accidents or losses arising out of one event which occurs within the area of one state of the United States or province of Canada and states or provinces contiguous thereto and to one another.

  However, the duration and extent of any one “loss occurrence” shall be limited to all individual losses sustained by the Company occurring during any period of 168 consecutive hours arising out of and directly occasioned by the same event, except that the term “loss occurrence” shall be further defined as follows...

- **“Event”** aggregation wording is narrower -- and more reinsurer-friendly -- than other aggregating principles proposed by brokers, including “cause”, “causative agency”, or “common origin”.

  - Historically limited **spatially** and **temporally**.

- **Connectors** also matter: “following on”, “arising out of”, “directly occasioned by”.
Observations On Wording (5)

- **Follow the Settlements:**

  The Reinsurer agrees to abide by the loss settlements of the Company, such settlements to be considered as satisfactory proofs of loss, and amounts falling to the share of the Reinsurer **shall be payable** to the Company within 15 days by them upon reasonable evidence of the amount paid or to be paid by the Company being presented to the Reinsurer by the Company.

- **Best practice:** Add **reasonableness** or **good faith** qualifiers.
  
  - **E.g.:** “The Reinsurer agrees to abide by the **reasonable** loss settlements of the Company”.
  
  - **E.g.:** “Notwithstanding anything to contrary, the Reinsured is required to act **reasonably** and with **utmost good faith**.”
Access to Records:

The Reinsurer or its duly authorized representatives shall have the right to examine, at the offices of the Company at a reasonable time, during the currency of this Agreement or anytime thereafter, all books and records of the Company relating to the business which is the subject of this Agreement.

- **Best practice**: Consider wording that expressly permits review of the cedent’s **privileged** and work product-protected records.

- Absent a specific arrogation of that right, most courts (and arbitration panels) bar access to these documents -- which tend to be the most informative/consequential (e.g. coverage opinions).

  - **E.g.,** Gulf Ins. Co. v. Transatlantic Reinsurance Co., (N.Y. App. Div. 1st Dep’t 2004) (“Access to records provisions in standard reinsurance agreements, no matter how broadly phrased, are not intended to act as a per se waiver of the attorney-client or attorney work product privileges.”)

- **Best practice**: Prerogative to take copies.
Observations On Wording (7)

Notice:

The Company shall **promptly** notify the Reinsurer of each Loss Occurrence which, **in the opinion of the Company**, may involve the reinsurance provided hereunder and all subsequent developments relating thereto, stating the amount claimed and the estimate of the Company’s Ultimate Net Loss and Loss Adjustment Expenses.

Best practice:

- (1) Continue to specify **timely** notice -- i.e. “promptly”, “immediately”, or “as soon as practicable”.

- (2) Remove **subjective qualifiers** -- “in the opinion of the Company” -- which create uncertainty.

- (3) Add a set of **safety net** conditions -- i.e. notice is mandatory when ______ (certain types of loss, injuries, ______ or other contingencies appertain -- as a matter of objective fact).

  Example: Truck accident in California.
Observations On Wording (8)

▪ Expenses In Excess Of Facultative Certificate Limits?

SWISS REINSURANCE AMERICA CORPORATION

Does Hereby Reinsure: XYZ Cedent (herein called the Company) with respect to the Company's policy hereinafter described, in consideration of the payment of the reinsurance premium and subject to the terms, conditions and amount of liability set forth herein as follows:

▪ and

This Certificate is an Agreement of Facultative Reinsurance under which the Reinsurer, in consideration of the payment of the reinsurance premium and subject to the terms, conditions and limits stated herein, indemnifies the Company with respect to its insurance liability for payments made by the Company on the policy reinsured hereunder.
Observations On Wording (9)

▪ Expenses In Excess Of Limits (Continued):

▪ Cases enforcing reinsurance limits:

<table>
<thead>
<tr>
<th>Case</th>
<th>Outcome</th>
<th>Key Contract Language</th>
<th>Other Rulings/Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Bellefonte Reins. v. Aetna (2d Cir. 1990)</td>
<td>Reinsurer not liable for expenses</td>
<td>Reinsurance “subject to the terms, conditions and amount of liability”.</td>
<td>• “Follow” doesn’t expand cover to override “subject to limits” language.</td>
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<tr>
<td></td>
<td>above limits.</td>
<td></td>
<td>• “In addition thereto” only differentiates loss and expense; it doesn’t indicate that</td>
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<td></td>
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<td>either is outside limits.</td>
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<td>2 Unigard v. North River (2d Cir. 1993)</td>
<td>Reinsurer not liable for expenses</td>
<td>Reinsurance “subject to the terms, conditions, limits of liability, and Certificate</td>
<td>• “Follow the form” doesn’t expand cover to override “subject to limits” language.</td>
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<td></td>
<td>above limits.</td>
<td>provisions”.</td>
<td>• Arbitration Order to pay costs doesn’t override “subject to limits” language.</td>
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<td>3 Excess Ins. v. Factory Mut. (N.Y. 2004)</td>
<td>• Reinsurer not liable for expenses</td>
<td>Limit stated without “subject to” language.</td>
<td>• Followed Bellefonte even absent “subject to” language.</td>
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<td></td>
<td>above limits.</td>
<td></td>
<td>• Rejected limitation of Bellefonte to liability (rather than property) policies.</td>
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Observations On Wording (10)

▪ Expenses In Excess Of Limits (Continued):

▪ More recent cases conclude that facultative certificates are **ambiguous**, as applied to expenses in excess of limits:

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<td>4. Utica Mut. v. Munich Reins. (2d Cir. 2014)</td>
<td>Certificate was ambiguous.</td>
<td>“Losses or damages” <strong>(not expense)</strong> “subject to the reinsurance limits”.</td>
<td>• Distinguished contract language from Bellefonte and Unigard that “expressly made all of the reinsurers’ obligations ‘subject to’ the limit of liability.”</td>
</tr>
<tr>
<td>5. Utica Mut. v. R&amp;Q Reins. (N.D.N.Y. 2015)</td>
<td>Certificate was ambiguous.</td>
<td>Reinsurance <strong>subject to</strong> the terms hereon and the general conditions” of the Certificate.</td>
<td>• Distinguished contract language in Bellefonte and Unigard that rendered the reinsurance “expressly ‘subject to’ the limits of liability.”</td>
</tr>
<tr>
<td>6. Century v. OneBeacon (Pa. Super. 2017)</td>
<td>Certificate was ambiguous.</td>
<td>Reinsurance “subject to the general conditions” of Certificate.</td>
<td>• Absent “subject to” wording directed to reinsurance limits, reinsurer must “follow” underlying policies covering expense in addition to limits.</td>
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<td></td>
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<td></td>
<td>• Certificate required reinsurer to pay its proportion of expenses “in addition” to its proportion of settlements.</td>
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Observations On Wording (11)

▪ **Expenses In Excess Of Limits (Continued):**

▪ **Best practice:** We recommend **addressing the issue** directly with the cedent during the underwriting process.

  – If expense exceeding the reinsurance limit is covered, then underwriters can price it.

  – If not, then include an **express prohibition** in the Certificate:

    ○ **I.e.:** “**Notwithstanding anything** to the contrary in this Certificate, the Reinsurer shall not be liable for any expense exceeding the Certificate’s limits”.

▪ **Best practice:** “Subject to the ... **limits of liability** and Certificate provisions.”
Observations On Wording (12)

- Umpire Selection in Arbitration Clauses:

- The American Arbitration Association (AAA) is replete with rosters of retired judges with (little to) no reinsurance experience.
  
  - **Example:** Obamacare Panel.

- We also recommend omitting selection by the President of ARIAS, or any other individual identified only *by title*.

- **Best practices:** A detailed methodology predicated on: cross-strikes/coin flip; rankings; or, even court process (as a last resort).

- **Best Practice:** Avoid reference to a *trade group* without specifying a process (*i.e.* “ARIAS”).
Observations On Wording (13)

- **Honorable Engagement v. Choice of Law:**

  - An **honorable engagement** clause permits a Panel to resolve a dispute based on principles of fairness and industry practice.

  - **Choice of law** provisions specify the legal principles governing interpretation and enforcement of the Treaty -- by nation state or U.S. jurisdiction.

  - **In practice,** Panels generally resolve the **tension** by favoring the specified jurisdiction’s law, but otherwise receiving and considering all authorities on point.
Special Acceptances (1)
Special Acceptances (2)

- Special Acceptance Wording:

SPECIAL ACCEPTANCE

Reinsurance indemnity will be afforded under this Agreement for the following only under special acceptance by Jayhawk Reinsurance Corporation:

1. Pollution Legal Liability and “Select” policies with non-scheduled locations;
2. Policies with terms greater than 10 years;

- Or:

Risks which are beyond the terms, conditions or limitations of this Agreement may be submitted to the Reinsurer for special acceptance hereunder; and such risks, if accepted in writing by the Reinsurer, shall be subject to all of the terms, conditions and limitations of this Agreement, except as modified by the special acceptance. Premiums and losses derived from any special acceptance shall be included with other data for rating purposes under this Agreement.
Special Acceptances (3)

- Special Acceptance (Continued):
  - We represented a party in a $100M+ arbitration with a significant (still current) client involving special acceptances.
  
  - The parties disputed whether the Reinsurer had granted oral special acceptances with respect to 3 otherwise excluded policies with terms each exceeding 10 years.

  - We conducted a 2-week arbitration hearing in NYC -- several current and former underwriters testified.

  - The result favored the Reinsurer.
Special Acceptances (4)

- **Special Acceptance (Continued):**

- **Best practices:**
  - (1) Special acceptance requests and approvals must be in writing.
    - The writing requirement dispels confusion -- especially in the context of long-tail claims, when coverage questions often arise decades later.
  - (2) Reinsurer should confirm denials of requests for special acceptances in writing, so that all of our special acceptance discourse is written.
  - (3) To the extent that there are operative special acceptance criteria, they should be embedded in or attached to the contract.
Special Acceptances (5)

Sample Good Email

From: Jayhawk Re Underwriter
To: XYZ Cedent
Re: Denial Of Special Acceptance Request

This email responds to XYZ Cedent’s request for a special acceptance with respect to the policy issued to ABC Policyholder.

Jayhawk Re declines the request for a special acceptance, because the ABC risk is at odds with our underwriting objectives and guidelines. Accordingly, there is no coverage.
The Marketplace (1)

- I have always thought the actions of men the best interpreters of their thoughts.” John Locke (1632-1704).

- Reinsurance analogue to John Locke’s social contract:
  - Honesty and integrity.
  - Supporting employees who do the right thing.
  - Paying covered claims.
  - Selectively pursuing bona fide disputes.
  - Market and industry leadership.
The Marketplace (2)

- Act with integrity and take the “long view” of relationships.

- Values that pervade both “zones” -- the Underwriting and Claims Operations.

- Preservation & Growth imperatives:
  - Clarify wordings to your benefit -- where the “soft” market permits.
  - Honor the coverage bargain -- as of the time when the claimed cover was sold.
  - Selectively fight those losses Reinsurer may not have undertaken to cover.
• 8563681