

BASIC PROVISIONS IN PROPERTY AND CASUALTY REINSURANCE AGREEMENTS

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Outline

- I. Basic Contract Clauses and their Operation*
- II. What is Covered*
- III. Rights & Obligations of the Parties*
- IV. Optional Provisions*
- V. How are Disputes Resolved*
- VI. Rights/Obligations Affected by Insolvency*
- VII. Hot Topics*

I. Basic Contract Clauses and their Operation

- Interests and Liabilities
- Parties to the Agreement
- Intermediary Clause
- Commencement
- Attachment
- Basis of Termination
- Taxes
- Currency

Interests & Liabilities Page

- Specifies who has an interest in the contract
- The percentage of liability to be assumed by the “Subscribing Reinsurer”
- Liability several and not joint

Parties to the Agreement

- Contract to indemnify the Company
- No third party rights

Intermediary Clause

- All communications to the Company or Reinsurer to be transmitted through the Intermediary
- Credit Risk on the Reinsurer
- Intermediary the agent of Company for all other purposes

Commencement

- Time and location important depending on business covered
- Various options include:
 - 12:01 A.M., Eastern Standard Time
 - 12:01 A.M., Local Standard Time
 - 12:01 A.M., Local Standard Time at the location of the risk

Attachment

- Most common attachment basis:
 - Losses occurring
 - Risks attaching (policies attaching)
 - Losses occurring on risks attaching
- Important that premium and termination are consistent with attachment basis

Basis of Termination

- Cutoff termination: reinsurer not liable for losses occurring or risks attaching after termination
- Runoff termination: reinsurer liable for losses occurring under policies in force at termination or for losses under policies attaching on or before termination. Often limited in time, e.g., 12 months plus odd time not to exceed 18 months in all
- Termination option may affect premium terms

Taxes

- If alien reinsurers participating then reference to their liability for Federal Excise Tax should be addressed

Currency

- Identifies the currencies to be used for payments of premium and loss and the methodology for conversion

II. What is Covered?

- Business Covered
- Limit and Retention
- Reinstatement
- Territory
- Exclusions
- Special Acceptance
- Net Retained Lines
- Other/Inuring Reinsurance

Business Covered

- States specifically what business of the Company is reinsured under the contract
- Indicates whether insurance and/or reinsurance contracts are covered

Limit and Retention

- Stipulates retention and limit in an excess agreement
- Lists maximum cession and minimum retention in surplus share
- May not appear at all in quota share
- Coverage can be stated on basis of “per policy”, “per occurrence”, “per risk” or in combination

Reinstatement

- Allows reinstatement of limits upon exhaustion
 - common in Catastrophe contracts
 - acts as an aggregate limit
- Additional Premium
 - can be free; or
 - additional premium pro rated

Territory

- Defines geographic scope of the treaty

Exclusions

- Specifies lines of business which are not afforded coverage
- Standard Exclusions
- Incidental Exposure Exception
- Accidental Exposure Exception
- Judicial Invalidation Exception

Special Acceptance

- Allows the Reinsurer to extend coverage to risks or policies that do not fit within Business Covered Clause or are specifically excluded under the agreement
- Typically requires written request and response within reasonable time period

Net Retained Lines

- Clarifies which portion of the Company's business will be subject to the contract
- Specifically states uncollectibility of other reinsurance does not increase the reinsurer's liability

Other/Inuring Reinsurance

- Clarifies priority of recovery
- Indicates if there is “common account” protection
- States if “inuring reinsurance”
 - inures to the benefit of the Company
 - inures to the benefit of the Agreement (e.g., the Reinsurer)

III. What are the Rights and Obligations of the Parties?

- Premium
- Commissions
- Ultimate Net Loss
- Loss Adjustment Expenses
- Loss Notice & Settlements
- Access to Records
- Confidentiality
- Errors & Omissions
- Follow the Fortunes
- Original Conditions

Premium

- Proportional treaty
 - Portion of original premium
 - Less returned premiums and cost of inuring reinsurance
 - Inforce vs. new & renewal
 - Earned vs. written basis

Premium

- Excess of Loss
 - Rate charged to cover exposures assumed under treaty
 - Minimum premium charged for reinsurer's capacity
 - Fixed vs. variable rate
 - Excess cessions treaty

Commissions

- Intent
- Ceding Commission
 - Proportional treaty
 - Occasionally on excess of loss

Commissions

- Types
 - Flat
 - Contingent commission
 - Sliding Scale
- Issues to consider:
 - Incurred losses only or IBNR included?
 - Settlement date
 - Length of deficit/credit carry forward
 - Definition of experience period

Ultimate Net Loss

- Defines losses for purposes of an excess of loss treaty
- Loss Adjustment Expenses (LAE) can be either within or in addition to limit
- Extra Contractual Obligations (ECO) and Excess of Policy Limits (XPL) can be either within or in addition to limit

Ultimate Net Loss

- Loss payment by company followed by repayment to company as salvage or subrogation
- Share of insolvent reinsurers does not increase reinsurer's limit

Loss Adjustment Expenses

- Allocated (ALAE) vs. Unallocated (ULAE)
- Categories of LAE can include:
 - Court costs
 - Costs of supersedeas and appeal bonds
 - Post-judgment interest
 - Pre-judgment interest when not included in treaty's indemnity coverage
 - Expenses of employees as respects field adjustment of losses
 - Declaratory judgment expenses

Loss Notice & Settlements

- Loss Notice:
 - Proportional vs. Excess of loss
 - Timeliness of notice
 - Subsequent development must be advised to reinsurers
 - Monetary criteria or injury criteria

Loss Notice & Settlements

- Loss Settlements:
 - Reinsurer's right to associate in defense
 - Prompt payment upon satisfactory proof
 - Follow reasonable compromises and settlements
 - Ex-gratia payments

Loss Notice & Settlements

- Proportional treaty
 - Claims reported on bordereau basis (monthly or quarterly)
 - Net balance due either party within certain time frame
 - Usually a provision for notifying reinsurers of a large loss

Access to Records

- Purpose of clause
 - Evaluate risks its assuming
 - Track performance of treaty
 - Confirm cedent complying with T&C's of contract
 - Determine adequacy of loss reserves
 - Determine skills of underwriting and claims personnel
- Access to all relevant records
- Includes records in possession or access to

Access to Records

- Access at any reasonable time
- Access beyond term of treaty
- Confidentiality
- Current issue: access to “privileged” records

Confidentiality

- Used with increasing frequency
 - avoid potential for compromising attorney–client privilege in litigation between the insured and a claimant
 - Potential for disclosure of customer lists and competitive information by the Reinsurer to an affiliate that competes with the Cedent
 - Records in Possession of a Managing General Agent

Confidentiality

- Acceptable disclosures:
 - Retrocessionnaires of reinsurer
 - Outside auditors
 - Arbitrators involved in arbitration under this treaty
 - Disclosure required by subpoena or court order

Errors & Omissions

- Coverage or an inadvertent error
- Type of error (i.e., administrative oversight vs. gross negligence)
- Does not encompass claims handling errors
- Limits not affected or increased

Follow the Fortunes

- Application of the doctrine
- Follow the settlements vs. follow the fortunes
- Follow the fortunes appropriate in pro rata agreements but not intended to apply to excess of loss agreements
- Ex-gratia payments never covered

Original Conditions

- Requires the Reinsurer to “share the fate of the Cedent” with respect to judicial or regulatory interpretations of policy provisions
- Pro rata concept, not appropriate in excess of loss agreements.
- Limits ability of Reinsurer to second guess claims handling decisions

IV. Optional Provisions

- Commutation
- ECO and XPL
- Entire Agreement
- Governing Law
- Remittance/Late Payment
- Salvage and Subrogation
- Warranty

Commutation

- allows claims to be closed
- determines present value of outstanding losses (known and unknown)
- may be mandatory or optional
- clauses usually provide a full and final release from liability
- found in “long-tail” covers, especially Workers’ Compensation and Auto PIP (no-fault)
- also when one party is financially troubled or insolvent

Commutation

- Can cover all losses, claims or only certain ones (be careful if only certain ones)
- If to be done, then should be clear when
- Describe methodology, i.e., one party determines or to be agreed.
- If no agreement or dispute, include a process for determination (e.g., actuary arbitration)

ECO and XPL

- Intended to protect company against faulty claims handling
- Ancillary coverage, not intended to be substitute for traditional Errors & Omissions policy
- Coverage varies (e.g., 80%-100%) depending on line of business and need to provide incentive for responsible claims handling

	XPL	ECO
Allegations by the Plaintiff	Faulty handling or defense of a claim	Faulty handling or defense of a claim
Judgment	Against the insured by a third party	Against the primary insurer by the original insured
Relationship to Policy Limits	In excess of the primary insurer's policy limits	No relationship to policy limits
Coverage for the Original Claim	Covered under the original policy	Outside the coverage of the original policy

Entire Agreement

- Required by State Regulation
 - Texas, South Carolina, New York and Illinois
 - Note: no statutory authority exists
- Referred to in “Nine Month Rule”
- Confusion with Integration Clause
 - Introduction of parole evidence
 - e.g., reassuring fax or verbal statement, but is it a part of the terms of the agreement.

Governing Law

- Required in Texas, Illinois, Alaska, South Carolina and Texas.
- Must have some relationship to the parties

Remittance/Late Payment

- Financial penalty for late payment of premium or losses
- Initially a response to the NAIC 90-day rule (aging of reinsurance recoverables)
- Can be used as a sword as well as a shield
- Important Elements:
 - Apply mutually to payment of premiums and losses
 - Interest must be reasonable and tied to an objective index
 - Tolling provision to permit additional review and verification of claims

Salvage and Subrogation

- Allows the Reinsurer to share in:
 - Share in recoveries made by the Cedent from other responsible tortfeasors
 - Share in amounts received by the Cedent where damaged items are salvaged
 - Assume responsibility to pursue subrogation if Cedent unable or unwilling

Warranty

- Promise regarding insured business (e.g., maximum policy limits issued)
- Breach of warranty permits rescission but parties usually choose reformation
- Deemer wording often used to avoid rescission

V. How are Disputes Resolved?

- Mediation
- Arbitration
- Litigation

Mediation

- Condition precedent to arbitration
- Disputes decided by single disinterested party
- Non-binding

Arbitration

- Scope of arbitration
- Demand for arbitration
- Disputes decided by disinterested industry executives knowledgeable about the business
- Umpire selection by lot or third party
- Panel guided by terms of contract, intent of parties as reasonably ascertainable, and custom and practice in the industry

Arbitration

- Consolidation
- Decision must be in writing but typically no explanation or reasoning required
- Awards and remedies
- Limited right to appeal

Litigation

- Although inconsistent with original intent of reinsurance becoming more frequent option
- Option preserved without specific clause
- Common law and statutory contract principles apply as well as rules of evidence

VI. Rights and Obligations Affected by Insolvency

- Loss Funding/Service of Suit
- Insolvency
- Offset

Loss Funding/Service of Suit

- Applies to unauthorized reinsurers
- Intended to protect credit and solvency of the company
- LOCs, trust funds and funds withheld comprise the typical security required
- IBNR negotiated
- Provides for jurisdiction over “alien” reinsurers

Insolvency

- Compliance with state law as condition for credit (e.g., New York)
- Reinsurance proceeds are not diminished due to insolvency
- Payable directly to liquidator
- Exception for cut-throughs recognized
- Liquidator must give notice of a claim
- Reinsurer has right to associate

Offset

- Right to set-off amounts payable to and receivable from other party (“net accounting”)
- Applies to “mutual debts and credits”
- Common law and statutory right to broad offset (i.e., all agreements)
 - Only way to restrict right to broad offset is to contractually agree to narrow offset rights
 - Narrow offset rights not in the best interests of either party in insolvency

VII. Hot Topics

- **TRIA & TRIAE**
- **Security/Special Termination**
- **Contract Certainty Initiative**

TRIA & TRIAE

- **What is TRIA/TRIAE?**
- **Integration into contract:**
 - **Determine if TRIA applies to contract**
 - **If applies does TRIA inure to reinsurers or company?**
 - **If TRIA inures to company's benefit than excess recoveries language is required**
 - **How are NCB perils treated?**

Security/Special Termination

- Bilateral (applies to both parties) or Unilateral (applies to one of the parties)
- Notice provision
- Allows termination of the agreement prior to its renewal or expiration based upon certain triggers including:
 - Insolvency
 - Loss of license
 - Other triggers as negotiated

Security/Special Termination

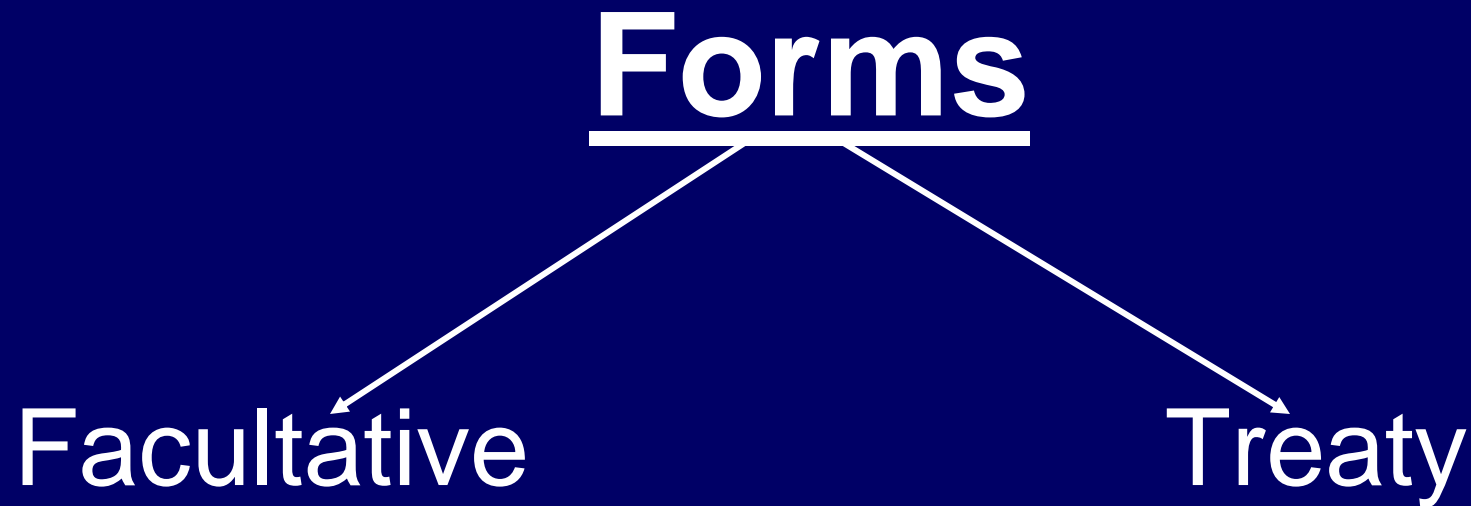
- Outlines the basis of termination (run-off or cut-off)
- Premium handling in the event of special termination
- May address funding option
- May address commutation

Contract Certainty Initiative

- Discussion topic during afternoon session
- Documentation of brokerage when intermediary involved
- Negotiation of “template” clauses and wordings between reinsurers, brokers & cedents (e.g., BRMA database)

The End

Forms and Types of Reinsurance



Forms and Types of Reinsurance

Facultative

```
graph TD; A[Facultative] --> B[Certificates]; A --> C[Automatic or Semi-Automatic];
```

Certificates

Automatic or
Semi-Automatic

Forms and Types of Reinsurance

Treaty

```
graph TD; Treaty[Treaty] --> ProRata[Pro Rata]; Treaty --> ExcessLoss[Excess of Loss];
```

Pro Rata

Excess of Loss

Forms and Types of Reinsurance

Pro Rata

```
graph TD; A[Pro Rata] --> B[Quota Share]; A --> C[Surplus Share];
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Quota Share

Surplus Share

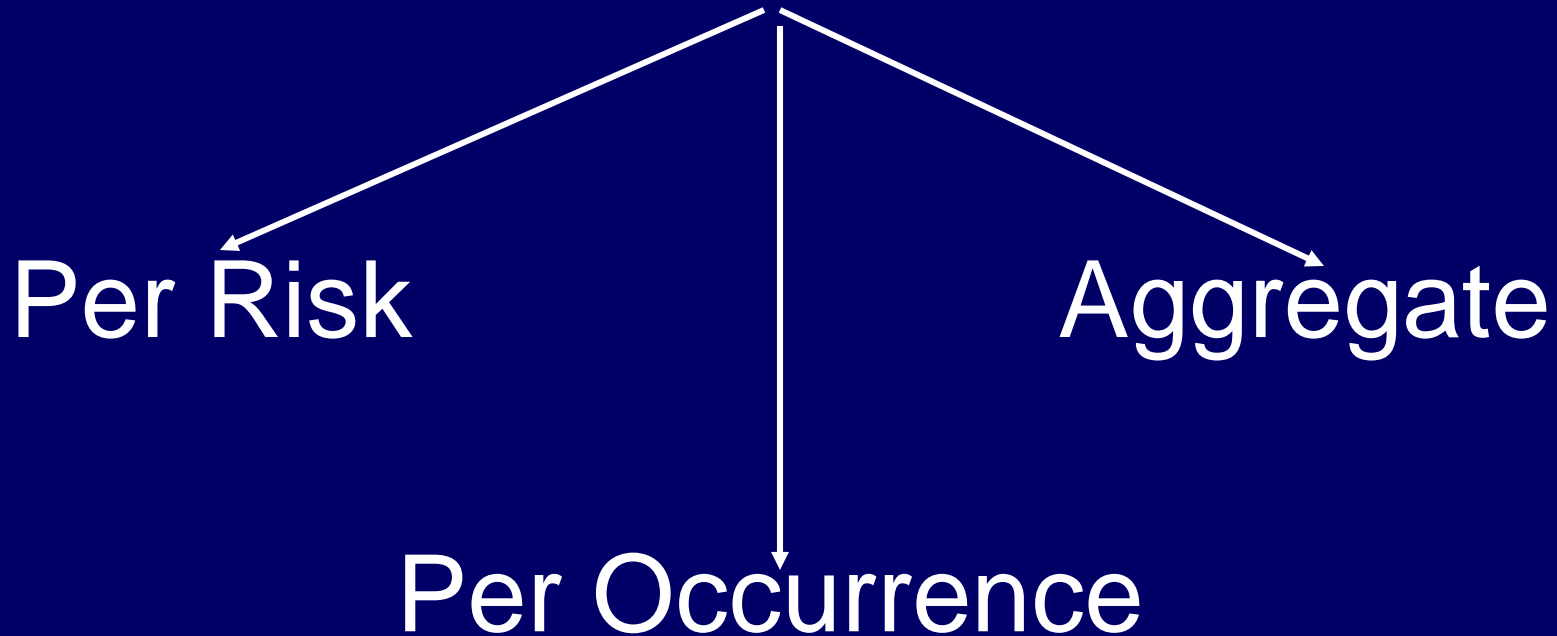
Forms and Types of Reinsurance

Excess of Loss

Per Risk

Aggregate

Per Occurrence



Evolution of Contract - Facultative

- Proposal/Submission
- Authorization
- Confirmation Risk was Written
- Reinsurance Binder
- Policy Documentation
- Certificate Issuance

Evolution of Contract - Treaty

- Proposal
- Authorization
- Covernote and Placement Slip
- Contract Documentation

How Does a Program Fit Together?

- Company has the following:
 - Quota Share:
50% of \$1,000,000 each risk
 - Per Risk Excess:
\$400,000 excess \$100,000 each risk
 - Catastrophe:
\$3,000,000 excess \$100,000 each occurrence

How Does a Program Fit Together?

- Company suffers four losses in one windstorm:

–Loss 1	\$ 25,000
–Loss 2	\$ 500,000
–Loss 3	\$ 750,000
–Loss 4	<u>\$1,000,000</u>
	\$2,275,000

How Does a Program Fit Together?

- 50% Quota Share recoveries

	<u>retained</u>	<u>recovered</u>
Loss 1	\$ 12,500	\$ 12,500
Loss 2	\$250,000	\$250,000
Loss 3	\$375,000	\$375,000
Loss 4	<u>\$500,000</u>	<u>\$500,000</u>
		\$1,137,500

How Does a Program Fit Together?

- Per Risk Excess recoveries

	<u>retained</u>	<u>recovered</u>
Loss 1	\$ 12,500	\$0
Loss 2	\$100,000	\$150,000
Loss 3	\$100,000	\$275,000
Loss 4	<u>\$100,000</u>	<u>\$400,000</u>
	\$312,500	\$825,000

How Does a Program Fit Together?

- Catastrophe Excess recoveries

	<u>retained</u>	<u>recovered</u>
Loss 1		
Loss 2	\$100,000	\$212,500
Loss 3		
Loss 4		

How Does a Program Fit Together?

- Total retention and recoveries

retained

\$100,000

QS

Risk XOL

Cat XOL

recovered

\$1,137,500

\$ 825,000

\$ 212,500

\$2,175,000

Questions?