

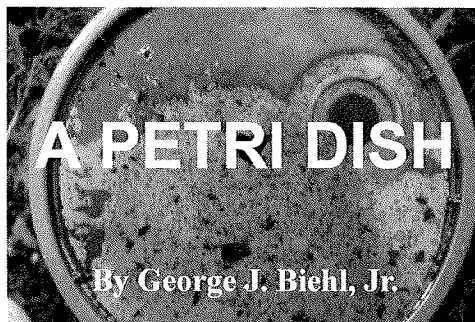
THE RHA REVIEW

ROUTE TO:

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REINSURANCE: A PETRI DISH FOR DISPUTES



Reinsurance is a multifaceted offshoot of insurance, and before delving into the possible pitfalls or any negative aspects, I will provide a brief review of the functions, including the following:

1. Financing – most typically surplus relief
2. Capacity – enables larger lines capability
3. Stabilization – varies but can control or ameliorate expense ratios and loss ratios
4. Catastrophe Protection – multiple-loss or large-loss protection

Additionally, it is important to differentiate between facultative reinsurance and treaty reinsurance, although the lines sometimes get blurred. Treaty reinsurance typically covers a ceding insurance company for a book of business and has a formal contract spelling out terms and conditions. Facultative reinsurance, on the other hand, addresses protection on an individual risk or segment of a policy. Some consider the two types analogous to wholesale versus retail.

An additional wrinkle to the overall picture is provided by the bifurcated way an insurance company can purchase reinsurance. There are reinsurance intermediaries (brokers) that have access to many domestic and

international reinsurers. On the other side of the aisle, there are so-called direct reinsurers that generally accept reinsurance only on a direct basis from a ceding insurance company. I will not complicate this brief overview but will point out that these methods have also been known to get blurred.

I will try to limit my focus here to the duties of reinsurance brokers and the ways disputes over reinsurance placements can involve them, rightly or wrongly. Unfortunately, in 1976 the insolvency of a large reinsurance intermediary (Pritchard & Baird) resulted in multimillion-dollar losses for ceding companies and reinsurers. The good news is that this insolvency led to statutory regulations that have brought much more codification of the obligations and responsibilities of a reinsurance broker. The New York Insurance Department set in stone Regulation 98, which is the keystone for setting out responsibilities. The National Association of Insurance Commissioners later passed the Intermediary Model Act, which further helped define intermediaries' role. Included in the areas of responsibilities are the following:

1. Licensure: the intermediary must be licensed (ideally in

New York state)

2. Written Authorization: the broker must have written authorization from the client
3. Fiduciary responsibilities along with premium and loss accounts
4. Books and Records: The intermediary must maintain detailed records of its activities for at least 10 years after the expiration of a reinsurance contract

The ceding company has the right to audit and copy all accounts and records maintained by the intermediary related to the ceding company's reinsurance.

I began my insurance career as a trainee in the home office Special Accounts department of one of the most prestigious insurance companies back when Eisenhower was president and I had not yet reached voting age. I was fortunate enough to get involved with many of the major Fortune-500 type

(PETRI DISH, continued inside)

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(PETRI DISH, continued from cover)
accounts during my tenure in that unit.

My employer was one of the first to use manuscript commercial casualty policies, and I spent many a day working on language acceptable to the producer, the insured, my company, and many times to reinsurers. These accounts also brought me into constant contact with our loss control unit as well as claims departments. Because of this contact, I had the benefit of literally reviewing thousands of large claims files with senior home office claims supervisors to get a handle on where and why claims were occurring and a better perspective on their ultimate outcome than was available from a computer run.

I give you this mundane information to demonstrate that not all reinsurance people were dropped into their chairs by the reinsurance stork. While still an underwriter, I came to meet with many reinsurance types, both intermediaries and so-called direct writers.

Thus when I began my next thirty years as a reinsurance broker, I had some appreciation for the basics of

reinsurance and why it was used. My next statement is not meant as a broad indictment of the reinsurance community but rather as my initial surprise as a rookie in that field. It was soon apparent that although many reinsurance people had backgrounds similar to

“A reinsurance intermediary has obligations and responsibilities similar to those of an insurance broker. He or she represents the ceding insurance company and does not have a contract or agency agreement with the reinsurance markets that quote on and/or accept a reinsurance proposal.”

mine, there were quite a few that had little or no insurance background. I found that to be particularly true of brokers and to some extent treaty underwriters.

obligations and responsibilities similar to those of an insurance broker. He or she represents the ceding insurance company and does not have a contract or agency agreement with the reinsurance markets that quote on and/or accept a reinsurance proposal. Nonetheless, it behooves an intermediary to present the very best data available from a ceding company to the reinsurers. By the same token, it may require the broker to “educate” the ceding company on how to compile, record and present data to the reinsurers.

With my underwriting background, I always attempted to pre-underwrite these placements as well as I could to make my job and that of the reinsurance underwriter as smooth as possible. At the same time, I was conscious that my job was not to protect the reinsurance underwriters from themselves. DO NOT interpret that comment to mean that a broker should hide or fail to clarify data for the reinsurance underwriter. In fact, on rare occasions, reinsurance underwriters have been known to take umbrage when an intermediary appears to be

A reinsurance intermediary has (PETRI DISH, continued opposite)

FROM NEAR AND FAR



London – According to a report published in the November 4 edition of *Business Insurance*, the windstorm that crashed through parts of the United Kingdom and continental Europe in late October caused up to \$1 billion in damage. Insured losses could reach \$300 million.



New Jersey – The Property Claim Services unit of the Insurance Services Office said that catastrophe losses through September totaled about \$3.7 billion.



Tennessee – During the night of November 11-12, a band of severe storms spawned dozens of tornadoes throughout the southeastern and midwestern United States. As of Monday, November 12, at least 35 deaths had been confirmed. Tennessee and Alabama were the hardest hit. At press time, more than 75 people were still unaccounted for in Morgan County, Tennessee.

(PETRI DISH, continued)

pre-underwriting a submission or "leading the witness," so to speak.

On facultative placements the data provided can amount to much of the same information used by the primary ceding underwriter. It is possible that reinsurers sometimes fail

"It is possible that reinsurers sometimes fail to recognize certain exposures or ask a question that perhaps would have provided a better overview. It is not NECESSARILY the role of a broker to point this out."

to recognize certain exposures or ask a question that perhaps would have provided a better overview. It is not NECESSARILY the role of a broker to point this out. Again, having said that, I do not mean that a broker should ever hide data available, especially if it could lead to potential disputes over coverage or adequacy of limits. I suppose the analogy can be made to a plaintiff's attorney versus a defendant's attorney. Certainly neither one is going to remind the other they may have missed asking a relevant question. Fortunately, most facultative underwriters are very savvy types, and many have primary insurance backgrounds. However, facultative placements have amounted to many costly claims that allege that a broker provided incomplete or erroneous data. Always recognizing that I might have to defend my professional actions in litigation, I

went to great lengths to tie up all loose ends and urged those working with me to follow suit. On the hundreds of placements I arranged, this strategy seems to have worked.

Treaty placements can be equally fraught with potential for disputes. Like the old Cole Porter line, "You say tomato and I say tomahto," there can be differences in interpretation of just what is ceded and covered. Obviously, if the broker has no insurance background, it is possible that the broker may not know just what to ask the ceding company to compile or pass along to the reinsurers. Reinsurers are not bashful about requesting an intermediary to get more information or clarifications for them.

Typically the broker may need to obtain the following data for treaty placements:


1. Company history
2. Financials – NAII test results, convention statements, etc.
3. Area of operations
4. Sources of business and costs to operate
5. Underwriting guides, rates and policy forms
6. CVs of pertinent personnel
7. Premium and loss history

If the broker is able to provide this data to reinsurers and has competency in writing the formal cover notes and contract wordings, it goes a long way in eliminating, or at the very least reducing, disputes that can lead to E&O claims. Basically, you need to explain what the ceding company does, where they do it and how they do it. It sounds simple, but it is amazing how often disputes arise. Sadly, the broker could find itself being sued by both the

ceding company and the reinsurers. Talk about double jeopardy!

Again, I am grateful for my insurance background in constructing manuscript policies. This helped considerably when drafting treaty wordings. An additional element is introduced when a U.S. intermediary has to utilize a London broker to assist

"Here in the United States, the reinsurance intermediaries and their reinsurers have worked together diligently to develop some standardized reinsurance contract wordings."

in a London market or Lloyd's placement. We can be two countries separated by a common language. Here in the United States, the reinsurance intermediaries and their reinsurers have worked together diligently to develop some standardized reinsurance contract wordings. These are the BRMA clauses and wordings that are used to write most treaty contracts. The more uniformity in constructing contracts, the less chance there is for misunderstandings or misinterpretation. 

George J. Biehl, Jr., is an associate consultant with Robert Hughes Associates, Inc. He has more than 40 years of reinsurance and insurance industry experience. His expertise covers a broad spectrum, from underwriting major casualty programs to spending almost 30 years as a reinsurance broker.

ADDRESS SERVICE REQUESTED

508 TWILIGHT TRAIL, SUITE 200
RICHARDSON, TEXAS 75080
(972) 980-0088 FAX (972) 233-1548

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Publisher Robert N. Hughes
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For more information, contact
John R. Oakley, Editor
508 Twilight Trail, Suite 200
Richardson, TX 75080
Tel. (972) 980-0088.

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