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These Clouds Have Silver Linings

by R. Michael Cass, J.D., CPCU

R. Michael Cass, J.D., CPCU, is president and principal consultant for R.M. Cass Associates, an independent consulting firm located in Chicago. Formed in 1987, the practice emphasizes reinsurance and related matters. A graduate of Penn State University and Temple University School of Law, Cass is a member of the New York Bar; the American Arbitration Association's Panel of Neutrals; and a certified arbitrator for ARIAS–U.S. He is past chairman of the CPCU Society's Risk Management Section Committee; a former member of the Excess/Surplus/Specialty Lines Section Committee; and currently serves as chairman of the Reinsurance Section Committee.

The Reinsurance Section recently conducted our annual symposium and "Reinsurance Fundamentals" workshop in Phoenix. The theme of this year's symposium was "Reinsurance Ripped from the Headlines!" As we are too aware, all of the headlines are not positive. Broker placement and commission issues, accounting for finite reinsurance transactions, and Congress's reluctance to rubber stamp a renewal of TRIA legislation are a few of the difficult issues facing our industry.

A progressive management style normally reflects on existing organization practices to determine if change is required and how established practices might be improved. The publicity and turmoil created by some of the revelations over the past year as to how our industry conducts business did not allow much time for reflection, but certainly did highlight the need for improvement.

The immediate results of some of the negative events were predictable. Organization consolidation and restructuring has occurred in some of the affected entities. However, most industry professionals as well as outside observers realize that companies staffed with capable professionals can overcome the indiscretions of a few, regroup, and move forward.

What has happened over the longer term is that many companies in our industry have given considerable effort to reviewing the best practices used in conducting business. Further, boards of directors have evaluated corporate governance procedures in order to better understand and direct the affairs of the organizations for which they are responsible.

For its part, your CPCU Society's Reinsurance Section Committee remains dedicated to offering educational forums where the current important issues of our industry can be presented and discussed. We welcome your comments and suggestions as to how we might better serve Reinsurance Section members and our industry at large. ■

2005 Reinsurance Section Symposium—

Education, Networking, and Gorgeous Weather!

The 2005 Reinsurance Section symposium—conducted in Phoenix on April 12 and 13—featured a diverse group of industry professionals who discussed reinsurance issues currently in the headlines. The symposium began with a "View from the Top" panel, where senior industry executives presented viewpoints from the perspectives of reinsurers, ceding companies, and brokers. The panelists offered their thoughts and opinions on the subject of "industry cycles." Other symposium speakers addressed topics currently receiving attention in the industry, including occurrence definitions; brokerage commissions; the Terrorism Risk Insurance Act (TRIA); finite reinsurance; evolving loss disputes that create "reinsurance tensions"; and catastrophe modeling. The following summaries were written by members of your Reinsurance Section Committee. If you were not fortunate enough to be in attendance, their recaps will be the "next best thing." Stay tuned for details of the 2006 edition of the Reinsurance Section symposium . . . ***we hope to see you there!*** ■

Reinsurance—View from the Top

by David B. Grant, J.D., CPCU

At the Reinsurance Section symposium on April 12, 2005, four executives participated in a panel discussion moderated by **R. Michael Cass, J.D., CPCU,** of R.M. Cass Associates and chairman of the CPCU Society Reinsurance Section Committee. The panelists were **John Zicarelli,** vice president and chief actuary, Scottsdale Insurance Company; **Ken Brandt,** president, Americas & Asia, Pacific, GE Insurance Solutions; **Joseph O'Brien,** vice president, Treaty, American Re, San Francisco; and **Urban Koagedal,** managing director, Guy Carpenter, San Francisco.

The first question posed to the panel was: "Where are we in the underwriting cycle?" Brandt observed that we have entered a downturn. Property reinsurance rates were down slightly at January 1. Reductions would have been more significant, but the Florida hurricanes served to flatten the reductions that otherwise might have been given. Casualty rates were more stable, but softening can be expected in the near future. Koagedal agreed, noting his office saw a modest reduction in reinsurance property pricing of about 3 percent at January 1. He believed more actions were taken to modify terms and conditions, such as an expanded "hours" clause, rather than rate adjustments, at January 1. O'Brien did not see the changes mentioned by Koagedal, but did see rate reductions on property business. He hoped many board of directors would be prudent with original rates, as the industry has still not fully recovered from the loss of capital suffered in the 2000–2002 years. Zicarelli said his company had been very profitable for

reinsurers in recent years, but margins have begun to shrink. Scottsdale, which is an E&S insurer, usually experiences rate changes faster than traditional insurers, as it must deal with more difficult risks. Property rates have begun to decline, but are still more than adequate.

Cass then posed "Will we see more consolidations in the near future?" Zicarelli hopes more consolidations will occur in the reinsurance market, as his company sees no advantage to take risk off its balance sheet to give to reinsurers with lower ratings and less capital. His company currently requires an "A" rating and $500 million capital as its minimum acceptable criteria. O'Brien did not expect consolidations, but noted the reinsurance industry "subsidized" the insurance industry over the 1997–2001 period, so capital movement between the two sectors is still needed to rebuild the strength of reinsurers. Urban did not expect consolidations, but thought some of the weaker players might simply close their doors, as others have done in recent years. Brandt recalled a recent review of RAA statistics, where the current number of reporting reinsurers is down to about 25 companies, from around 40 just a few years ago. Further, "old" Bermuda companies have already gone through consolidation, so it is not unreasonable to expect a similar reaction by the "new" Bermudans in the next few years.

One of the more provocative questions asked was "What role do brokers have in the reinsurance cycle?" Urban, as the sole broker representative, said "none!" in his opening remarks. A broker must collect information and assist client companies to anticipate market actions, but underwriters must manage the cycle. O'Brien disagreed, saying there is a role for all in the distribution channel to help manage the cycle. While brokers do not control prices, they help establish expectations that influence market cycles. Zicarelli sided with Koagedal, saying that he did not think brokers played a part in the cycle, as pricing is an underwriting function. Finally, Brandt opined brokers need to continually improve the quality of information collected from clients and delivered to reinsurers, as the improved data should help ameliorate the impact of the cycle on the market.

Of course, no panel discussion is complete without questions regarding financial ratings. One question posed was "How does a company recover its lost rating?" Brandt opened by saying that ratings really reflect a focus on the past, and the only way to recover a lost rating caused by poor performance is through better relations with the rating agencies, coupled with a strong capital management plan. Zicarelli said he believed there are just two rates today: "acceptable" and "unacceptable." He did not think rating agencies are ready to give improved ratings, but he agreed with Brandt that relationships with the rating agencies may help save the existing rating a company has received. O'Brien added that he thought performance, and not capital, was the key element rating agencies need to consider when performing their analyses. ■

Reinsurance Occurrence Definitions Update

by Thomas M. Pavelko, J.D., CPCU, ARe

At the 2005 edition of the Reinsurance Section symposium, a trio of distinguished reinsurance contract attorneys presented an informative session on April 13 entitled "Reinsurance Occurrence Definitions Update." The panel consisted of **Julie Pollack**, associate general counsel for Swiss Re America Corporation; **Scott Van Koughnett**, senior vice president of Guy Carpenter & Company, and **Thomas Pavelko, J.D., CPCU, ARe,** contracts and regulatory attorney for American Agricultural Insurance Company, who also served as the session's moderator.

As the discussion began, the panel acknowledged that various events and market forces lead to revisions in reinsurance treaties—for example, increased government regulation may require the parties to include new terms and conditions, while changing market conditions (whether softening or hardening) can lead to an easing or tightening of contract terms. The effect of these, however, has been minimal compared to the great impact that catastrophic events, such as September 11 and the continuing threat of terrorism; earthquakes; California wildfires; and hurricanes (including the four that struck Florida in 2004) have had on the evolution of contract wording. This impact, the panel agreed, has been especially profound upon the occurrence definition in property catastrophe treaties.

The panel then compared a standard BRMA occurrence definition clause with those that they are currently drafting or that are being requested by other parties to the reinsurance agreement. Among the more recent additions they noted are the introduction of "time and radius" definitions for wildfires; increases in windstorm and related storm definitions from 72 hours to 96 hours or separate definitions for hurricanes and typhoons that use the 96 hour benchmark; increases in riot and related civil commotion definitions from 72 hours to 168 hours. There have been attempts to define "winter storm" better, but the panel generally felt that these attempts still need additional work.

When asked if the industry would be ready with appropriate wording if the Terrorism Risk Insurance Act of 2002 (TRIA) is extended and if the industry would be ready if the act is not extended, the panel acknowledged that new wording is already being discussed and negotiated in the marketplace. Ultimately, however, they unanimously agreed that the extension or expiration of TRIA will create a firestorm of activity in each of their offices. ■

Finite Re Panel Discussion

by Diane Houghton, CPCU, ARe

At the Reinsurance Section symposium on April 13, 2005, in a topic literally ripped from the headlines the week of the symposium, five distinguished experts in the field of finite reinsurance discussed the issues surrounding these transactions.

The panel discussion started with a short formal presentation explaining the types of transactions that fall into the category of finite re by **Mike Goldman,** a senior partner in the Chicago office of Sidley, Austin, Brown and Wood LLP. His practice focuses on the corporate representation of insurance companies and other insurance entities; insurance company investment practices, including the use of derivative instruments and strategies; and the structure and regulation of alternative risk financing mechanisms and complex reinsurance arrangements.

Goldman explained that there are two basic categories, retroactive and prospective, and gave the following examples:

Retroactive Arrangements

- loss portfolio transfers
- adverse loss development coverage
- hybrid retroactive/prospective agreements

Prospective Arrangements

- aggregate stop loss
- finite risk quota share
- spread-loss coverage
- hybrids

As Goldman explained, these transactions can be entered into for many different reasons, including the need to budget for risk and the desire to purchase risk protection at the lowest possible cost. SFAS No. 113 guides the accounting treatment of these transactions for GAAP reporting and SSAP 62 guides the accounting treatment for SAP reporting. These guidelines are generally consistent, except for the reporting of reinsurance recoverables and prospective reinsurance premium and the treatment of gain on retroactive reinsurance. The main issue in deciding how these transactions should be reported is deciding if the arrangement transfers risk. For these transactions to be treated as reinsurance (versus deposits) they must transfer both underwriting and timing risk. In practice, the 10/10 Rule has been used, which is a 10 percent chance of recognizing 10 percent loss on the subject treaty.[1]

These issues have come under the scrutiny of various insurance departments, as well as state attorney generals and have begun to engender the issuance of various

Continued on page 4

Finite Re Panel Discussion

Continued from page 3

directives and clarifications by the New York Insurance Department, Standard and Poor's, and the NAIC.

The second part of the presentation focused on the panel members' discussion of the issues surrounding Finite Re transactions. Joining Goldman on the panel was **Dan Malloy,** executive vice president, Financial Solutions, Benfield Group. Malloy is based in Benfield's NYC office. Before joining Benfield Group in 2003, Malloy was president and board member of Stockton Reinsurance Ltd. in Bermuda, and prior to that, he also served as president of Centre Re Bermuda. He was also joined by **Christopher DeAngelis,** executive vice president of Aon Re Inc., who leads the Custom Solutions practice at Aon Re out of the Chicago office; and **John Beckman,** president of ReAdvisory Services, which is the consulting arm of Carvill America Inc., also based in the Chicago office. Beckman is responsible for leading ReAdvisory's capabilities in actuarial analysis, financial modeling, catastrophe modeling, and new product development.

A lively discussion followed as the panel members discussed the issues that have surrounded the writing of finite re since it was first commonly used in the 1970s. These issues have gained notoriety today due to the scrutiny of the regulators and rating agencies as well as media attention.

The panel talked about the differences between finite re and financial re. It was pointed out that these transactions are as diverse as the people and companies who write the coverage, and therefore are hard to categorize.

The panel finished the presentation by discussing some of the issues surrounding the current regulatory examination. ■

Endnote

1. CPCU Society Reinsurance Section, Reinsurance Fundamentals Workshop, Finite Re—What's all the Fuss About" PowerPoint Presentation, presented by Michael P. Goldman, April 13, 2005.

Evolving Loss Disputes—Creating Reinsurance Tensions

by Andrew S. Boris, J.D.

With a goal of providing both some historic background and a lively discussion, the panel titled "Evolving Loss Disputes—Creating Reinsurance Tensions," addressed a wide variety of claims-related issues at the 2005 Reinsurance Section symposium in Phoenix. The panel was moderated by **Andrew S. Boris, J.D.,** of Tressler Soderstrom Maloney & Priess with the following additional speakers: **John R. Welch** of Allstate Insurance Company, **Paul J. McGee** of Buxbaum, Loggia and Associates, and **Michael Steinlage** of Larson King.

Years ago, it was relatively unusual for there to be serious disputes between reinsurers and cedents, but the panel agreed we have seen an increasing number of disputes in the reinsurance industry. In turn, there has also been a corresponding increase in the number of disputes that result in litigation and arbitration. While no consensus was reached as to exactly why there are more disagreements, the panelists agreed that relationships between many companies have eroded with changes in personnel and increased business pressures requiring faster action on outstanding billings. Of interest, the panel also agreed that many people are incorrect when they believe that the number of reinsurance disputes is simply the result of the activities of run-off companies acting as reinsurers. The panel agreed that certain well-publicized run-off companies and their actions might be presenting an inaccurate picture for those who monitor reinsurance claims activities.

The panel turned to some specific issues causing tension in the industry. One problem area involves a reinsurer's claimed right to review a cedent's files. Whether it was via the language of the specific contract or based upon the custom and practice of the industry, the panel recognized that a reinsurer is entitled to review a cedent's files before paying a claim. The panel members were also troubled by the practice of some cedents where an arbitration demand is filed at or near the time a billing is sent to the reinsurer. In those instances, it is common for the cedent to refuse access to its records outside of the arbitration process. Many on the panel agreed that such an approach was contrary to an enhancement of the cedent-reinsurer relationship and simply increased costs for all involved. In addition, the panel also tackled the question as to whether a cedent should be entitled to shield any documents relating to the cession that were created by the cedent's inside or outside counsel. In such situations, cedents contend that production to a reinsurer of any documents created by the cedent's attorneys may constitute a waiver of the attorney-client privilege. Reinsurers often contend that they are entitled to a review of the documents based upon the language of the reinsurance contract, custom, and practice in the industry, and the special relationship that exists between a cedent and reinsurer. All agreed that such an issue was difficult, but that every effort should be made by the parties to facilitate a compromise so that the billings may be handled in an efficient and expeditious manner.

The panel also took the opportunity to briefly discuss the "follow the fortunes" and "follow the settlements" doctrines. The panel explained that the doctrines enhanced the business goals of all involved in that they promoted quick resolution of underlying claims and allowed a cedent to settle with little fear that all of its claims decisions will be subject to close scrutiny by a reinsurer. There has been case law questioning whether a reinsurer may challenge the allocation analysis employed by a cedent in its handling of a long-tail claim. The panel universally agreed that it is still common practice for a reinsurer to at least inquire as to the foundational analysis employed by the cedent in arriving at its allocation. While some in the industry have called the utility of such doctrines into question where two sophisticated entities are engaged in a commercial relationship, the panel seemed to find merit in including such terms in reinsurance contracts.

The "Evolving Loss Disputes—Creating Reinsurance Tensions" panel provided an excellent summary and discussion of many emerging claims issues confronting the reinsurance industry today. ■

Transactional Audits

by Joseph E. Carney

Joseph E. Carney, an ARIAS-US certified arbitrator, has spent 34 years in the reinsurance industry, with most of the last four years focusing on insurance and reinsurance arbitrations. He is founder and president of JEC Consultants, LLC, which focuses on providing reinsurance underwriting expertise and technical insight to insurance companies, reinsurance companies, and law firms.

He has held senior positions at Swiss Re; Gerling Global Reinsurance; North Star Reinsurance; Folksamerica Reinsurance; and Prudential Reinsurance. His responsibilities ranged from building qualified underwriting units to the production of desirable portfolios of business.

Carney holds a B.A. in philosophy from St. Bonaventure University; attended the Kellogg School's Advanced Executive Program; and was a three-time panelist at the Reinsurance and Advanced Reinsurance Reasoning Seminars held at the University of Dallas' Graduate School of Management. Further details on JEC Consultants, LLC can be found at www.jecconsultants.com.

Underwriting is a process whereby a series of risk exposure identifications, assessments, evaluations, and decisions are made by an individual or group in determining the desirability and viability of the business being offered for coverage. Though my perspective is that of a reinsurance underwriter, this concept holds true whether you are a primary company underwriter or a reinsurance underwriter.

Key to the profitability of any risk or program is the technical ability and market intelligence of the individuals doing the underwriting. Good, old-fashioned common sense is a nice adjunct to these qualities as well. It is, however, the competent underwriter who is able to blend and balance these qualities.

This process can only work if there is, in place, a realistic business plan, detailed underwriting guidelines and procedures, authority levels, oversight, and, above all, accountability. Someone has to be responsible for the results, and that takes talent and due diligence. The underwriter is the one who has the ultimate responsibility for the profitability of an account and, to accomplish that challenge, needs to have a comfort level with the experience numbers being evaluated. That is where transactional audits play an important role in the reinsurance underwriting process, providing reliability to the numbers being assessed and analyzed.

The transactional audit, however, is often ignored or pushed to the side as an unnecessary expense. Yet, the purpose of this type of review is to verify that the business being ceded is the intended business to be covered and that the appropriate premium and losses are also being ceded. This, therefore, benefits both the ceding company and the reinsurer, as both entities would be making decisions based on audited numbers. From my perspective, transactional audits are a part of the underwriting process because an account isn't written just once a year and then put aside until renewal time. It is, rather, a process that entails continuous monitoring and evaluation. Having a comfort level with the numbers is a very important part of this ongoing analysis.

Underwriting Responsibilities

An underwriter has an obligation to analyze risk and to write the business that falls within the boundaries of the corporate business plan. This would, naturally, include operating in accordance with the adopted underwriting guidelines and procedures. This may sound a bit confining, but the assets of a company need to be protected. There has to be a sensible framework around which the business of underwriting can be conducted. There's a great deal of discussion today about compliance in the financial arenas, but a company's risk begins at the underwriting desk. Unless there are guiding principles under which an underwriter operates, the company assets can be in grave danger. Too often, underwriting compliance is an afterthought, usually when a large loss occurs or a book of business goes bad, rather than something that should be ongoing and continuous. Underwriting compliance has to be a "proactive," not a "reactive," function. This concept makes it necessary for the underwriters to know their authority. Underwriters will be accountable for their actions and need to recognize the importance of documenting their thought process. An underwriting file is not a personal object; it is supposed to be a written record of the underwriter's decisional sequence to write the business and monitor its progress. The file is also supposed to be constructed in a way that is understandable by anyone who reads it.

I can't tell you the number of times I reviewed underwriting files over the years, but it was a significant number, where I had to instruct the underwriter to go back and update the file to include underwriting intentions, as well as addressing items that were left unresolved. It seems that it is only until an underwriter has that large, unexpected loss or has to defend his or her actions in arbitration that the importance of a well-documented file will be recognized. Part of that documentation should be that the business ceded and its corresponding experience is correct and in line with what was expected. The purpose of a transactional audit is to do exactly that, but it also has the side effect of providing a compliance mechanism under the Sarbanes-Oxley Act. An example of this would be validating a quota share treaty. Wherein the past it was customary to have premium and loss bordereaux for these types of treaties, such is not the case today. It is more of a summary report and basically a good-faith transaction, something with which the outside auditors will not be comfortable, nor should the underwriter who has account responsibility.

Relying on the Process

The underwriting process is really a multi-disciplined approach to understanding risk exposure, providing the appropriate coverage, and charging the right price. An underwriter relies on the input of claims personnel with regard to loss trends, the actuarial department as regards expected ultimate losses, the legal department as regards the nuances of contract language,

Continued on page 6

Transactional Audits

Continued from page 5

the IT department for needed reports, the accounting department to make sure that the premiums and losses are being paid, and, finally, an audit team to verify the numbers.

Over the course of my 34 years in the reinsurance business, while conducting my underwriting reviews, I made it a practice to determine, as part of the review, whether or not the primary company underwriters were obtaining audited premium for risks that would normally be rated on a fluctuating base, such as payroll or revenues. This action was taken because the terms and conditions of the reinsurance coverage depended on the appropriate business being ceded and the accuracy of the stated premiums and losses.

Human error, as well as system error, can lead to premiums and losses being assigned to the wrong reinsurance programs. Preventing this from happening is a matter of making sure that the upfront data is correctly booked and that the cessions made on the subject business are in sync with the respective contract terms. Even though the contract language spells out what premium and losses are to be reported, an underwriter needs to have confidence in the data he or she receives. In a transactional audit, verification of coverage is made along with the tracking of premium and losses in order to determine whether such information is properly recorded and assigned to the appropriate reinsurance coverage. This audit function is beneficial to both the ceding company and the reinsurer because it can increase each party's comfort level that the information on which decisions are made is correct. On the other hand, faulty data can easily hamper contract negotiations as well as business relationships.

Transactional audits have varying degrees of difficulty, depending on the number of entities reporting data into the company, such as agents, third-party administrators, or even branch offices. A ceding company could have multiple contracts with multiple reinsurers, further complicating the booking process. The end result of such audits is to have the best data on which to make evaluations and informed business decisions.

Prior to the actual on-site audit, a significant amount of preliminary work is required, including an understanding of the coverage being afforded, a review of underwriting and claim reports for issues that need to be addressed, a review of the policy register (along with defined prefixes for identification purposes), and a review of the claims run.

Conducting an Audit

During a reinsurance transactional audit, various tests are conducted to assure that the correct policies, premium, and losses are ceded to the appropriate reinsurance programs. If the contract calls for a commission, a breakdown of costs is also reviewed. With regard to workflow, a review is made of the types of systems and accounting structures that are in place as well as an assessment of the relational database between premium and claims systems. There is also a review of the company controls in place to assure that premiums and losses go to the correct reinsurance program. This usually entails determining whether the design of the database incorporates system edits. In other words, does the system prevent entry of erroneous information, such as entering a policy that has an effective date outside the coverage period? Timeliness of reports and remittances is another facet of the audit, having an ultimate goal of tracking the numbers through the company's system and, thereby, balancing these results with the company's financial statements. Compliance issues relating to policy forms, rating, fines, and penalties are also an integral part of a transactional audit.

Contract terms will dictate how reinsurance coverage will be afforded. Therefore, a very important part of the audit process is determining whether the contract under review was written on a risks-attaching or losses-occurring basis. This knowledge is critical to the assignment of premiums and losses to the appropriate underwriting period. Policy or contract extensions will also affect the proper distribution of premiums and losses.

With regard to contracts written on a risks-attaching basis, reinsurance coverage is provided for those policies or programs that are written or bound during the underwriting period. As for contracts written on a losses-occurring basis, reinsurance coverage is provided for those policies or programs that sustain loss during the underwriting period, regardless of when the loss is reported. Verifying that these policy premiums and losses are recorded in the correct underwriting period is an essential part of the transactional audit process. Knowing whether the company records its data on a calendar year, accident year, or underwriting year basis is also important to the audit function. The ultimate goal is to track the data through the company accounting systems and reports in order to attest that such data is in accordance with contract stipulations.

Before leaving the company premises, it is customary to discuss the audit findings with the appropriate company personnel. The importance of doing this is to assure that there have not been any erroneous assumptions made on the part of the individual(s) performing the audit, as well as providing an opportunity for discussion relating to any problems observed during the audit itself. The purpose here then is to get all interested parties on the same page of understanding the audit results and create a buy-in so that problems can be rectified.

The report itself should summarize the findings of the audit, detail the actual preliminary and on-site work performed, provide a brief summary of the individuals met (along with their functions and authority), and conclude with findings and recommendations. Again, the purpose of this element of the underwriting process is to test the data for correctness so that informed business decisions can be made.

Transactional audits are just one of the tools an underwriter utilizes in evaluating business opportunities, but it is an integral part of the underwriting process that pays for itself over time. There are technical and marketing ramifications to conducting such audits, but, in reality, it comes down to plain, old, common sense. Underwriters have the task of protecting their company's assets and they need to know that the numbers on which decisions are based are trustworthy. The vehicle for that comfort level resides in transactional audits. ■

Where Is the Duty of Utmost Good Faith?

by Andrew S. Boris, J.D.

Andrew S. Boris is a partner in the Chicago office of Tressler Soderstrom Maloney & Priess. His practice is focused on litigation and arbitration of insurance coverage and reinsurance matters throughout the country, including general coverage, directors and officers liability, professional liability, environmental, and asbestos cases. Questions and responses to this article are welcome at aboris@tsmp.com.

Many believe that the duty of utmost good faith forms the foundation of every reinsurer-reinsured relationship. Nonetheless, others in the reinsurance industry question the utility of the doctrine where reinsurers and insurers are sophisticated corporate entities capable of contracting for all of their individual business needs. In general, the concept of utmost good faith applies to the entire reinsurance relationship, encompassing all aspects of the communications that take place between the reinsurer and cedent. In fact, "utmost good faith" or "uberrimae fides" is a defining characterization or quality of some (contractual) relationships, of which reinsurance is universally recognized to be. Among other differences from ordinary relationships, the nature of reinsurance transactions is dependent on mutual trust and a lively regard for the interests of the other party, even if inimical to one's own. **Robert W. Strain**, Reinsurance Contract Wording (1998). Of note, there are some who would maintain the duty of utmost good faith requires the highest standard for cedents without a concomitant high standard for reinsurers. With respect to underwriting, the reinsured is expected to disclose all material facts it possesses that the reinsurer would not otherwise be able to acquire. With respect to claims issues, the duty of utmost good faith requires competent and effective claims administration. The larger question that may face the reinsurance industry is to what extent the duty exists in every reinsurance contract regardless of the terms of the contract. At one time, the industry relied on the duty of utmost good faith to promote complete trust between the parties so as to facilitate long-term relationships and consistent business. Today, some believe that the duty of utmost good faith does not necessarily control every aspect of the reinsurance relationship.

A case from last year highlights the increasing questions that surround the duty of utmost good faith. *PXRE Reinsurance Co. v Lumbermens Mutual Casualty Co.*, 2004 WL 1166631 (N.D.Ill. May 24, 2004), reconsideration denied, 330 F. Supp.2d 981 (N.D.Ill. August 10, 2004). In *PXRE*, the federal district court in the Northern District Court of Illinois had the opportunity to determine the reach of the duty of utmost good faith when presented with a discovery dispute involving a retrocessional contract. The question presented to the court was whether the duty of utmost good faith may be implied where a contract contains the following language, "there are no general or specific warranties, representations, or other agreements by or among the parties in connection with the entering into this Stop Loss Cover. . ." Having found that the parties were capably represented during the negotiation of the contract terms, the court reasoned that this was a situation where two sophisticated entities identified individual business needs that were later committed to a contract. Since the provision addressing the lack of any warranties was not contrary to public policy, it could not be overridden by the doctrine of utmost good faith. In turn, the court denied PXRE's motion to compel.

In addressing PXRE's motion for reconsideration, the court addressed what it perceived to be the limitations on the duty of utmost good faith.

> As PXRE's counsel would have it, uberrimae fidae plays the role of the 800 pound canary, able to sing whenever and wherever it wishes. That doctrine assertedly applies to every reinsurance relationship irrespective of its particular circumstances—irrespective of the contractual limitations that the parties may have chosen to impose in the course of entering into such a relationship.PXRE, 330 F.Supp. at 983.

In response, the court noted that PXRE had failed to identify any legal authority supporting the concept that the duty of utmost good faith operates as a powerful public policy doctrine trumping any limits that sophisticated parties agreed to place upon themselves in a contract. In summary fashion, the court denied PXRE's motion for reconsideration.

For many, the PXRE decision could be viewed as a rather straightforward legal opinion decided upon facts that involved specific contract language. However, the court's analysis does have some significance beyond the unique facts of the case. First, the decision does demonstrate some limitations for the duty of utmost good faith. Many seasoned reinsurance professionals believe that the duty of utmost good faith is a constant for all reinsurance contracts and the court's treatment of the doctrine fails to account for its importance in the reinsurance industry. Thus, some may believe the *PXRE* decision illustrates a trend by courts to closely scrutinize the application of principles not specifically identified within the reinsurance contract. See also, *North River Ins. Co. v Employers Reinsurance Corp.*, 197 F.Supp.2d 972 (S.D. Ohio 2002) (finding no sound basis for implying the "follow the settlements" clause as a matter of law). However, the Northern District of Illinois also recently predicted that the Texas Supreme Court would find a duty of utmost good faith, or at the very least, good faith exists between a reinsured and reinsurer in both the formation and performance of the reinsurance agreements in order to maintain an incentive for insurers to give full and prompt disclosure to reinsurers. See, *AXA Corporate Solutions v Underwriters Reinsurance Company*, 2004 WL 2534386 (N.D.Ill. Nov. 9, 2004) (requiring such a duty would maintain an incentive for cedents to give full and prompt disclosure to its reinsurers).

Continued on page 8

Where Is the Duty of Utmost Good Faith?

Continued from page 7

Second, the court opinion also highlights the treatment that certain reinsurance contracts are given in the courts. The judge in the *PXRE* case commented on the lack of legal authority supporting the application of the duty of utmost good faith. Some may question whether the duty of utmost good faith would have been addressed in the same summary fashion if the question had been presented to an arbitration panel comprised of three seasoned reinsurance professionals (it is not entirely clear from the text of the *PXRE* case, but it would appear the contract at issue did not contain an arbitration provision). Given the language used by the court in the *PXRE* case, it is critical that parties examine the language placed in the reinsurance contract to determine what limitations it may place on what some may consider to be well-established reinsurance concepts. Of course, all of the parties should clearly contemplate the contract language to determine if it captures all of the agreements of the parties. ■

What's in this Issue?

These Clouds Have Silver Linings 1

2005 Reinsurance Section Symposium—
Education, Networking, and Gorgeous Weather! 1

Reinsurance—View from the Top 2

Reinsurance Occurrence Definitions Update 3

Finite Re Panel Discussion 3

Evolving Loss Disputes—Creating Reinsurance Tensions 4

Transactional Audits 5

Where Is the Duty of Utmost Good Faith? 7

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