



Reinsurance Section Encounter

RISE

Volume 21

Number 3

November 2003

Time to Move On

by Gordon J. Lahti, CPCU, ARe

This will be my last column as chairman of the Reinsurance Section, as my term concludes following this year's Annual Meeting and Seminars in New Orleans, LA. I am delighted to announce that **R. Michael Cass, J.D., CPCU**, president of R.M. Cass & Associates, will be succeeding me as our section's leader. Mike is an extremely talented professional, and I have no doubt that he will do an outstanding job in leading our section.

As I conclude my term and reflect on the past three years, it has certainly been a period marked by significant challenges and change for both our nation and our industry, primarily as a result of September 11, 2001. Looking ahead, I have no doubt that we can successfully meet these challenges.

It has been a great honor to serve as the chairman of the Reinsurance Section. Before I conclude, I would like to express thanks and appreciation to some people.

First, I would like to thank my employer

Swiss Re, for its strong support of both CPCU as well as my participation on the Reinsurance Section Committee (even though I am stepping down as chairman, I will continue to serve on the committee).

Second, I want to express my sincere appreciation to everyone who has served with me on the committee for all of their dedication and hard work. Extra special thanks go to our RISE editor, **Bruce D. Evans, CPCU, ARe, ARM**, who is indeed a "scholar and a gentleman" in every sense of those words.

Next, a very special thank you to **John Kelly, CPCU**, and the Society staff in Malvern. John's professionalism and warm demeanor have certainly made my job a lot easier over the past three years.

And finally, I would like to recognize my best friend and lovely wife Betty, who reminds me every day just how wonderful life can be.

My best wishes to all of you for health and success in your future endeavors. ■

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2004 Reinsurance Section
Symposium and ARe Ceremony



2004 Annual Meeting
Seminars developed
by your Reinsurance
Section

Reinsurance Underwriting Results

Reinsurers Moving in the Right Direction: Will It Last?

by Bradley L. Kading, CPCU

■ **Bradley L. Kading, CPCU**, is senior vice president and director of state relations for the Reinsurance Association of America.

In 2002, U.S. reinsurers focused on growing surplus, increasing premiums, and documenting larger amounts of retrocessional recoverables. These are three important themes gathered from a review of the *Reinsurance Association of America's Reinsurance Underwriting Review: 2002 Industry Results*.

For nearly a quarter of a century now, the RAA has published an annual review of the underwriting results of U.S. insurers specializing in reinsurance. This year's report covers the experience of 50 organizations. It was a recovery year for U.S. reinsurers—that is recovering from the worst ever loss of 2001 reflected in the nearly 140 percent combined ratio. Those that had expected a profit recovery, though, were disappointed in the 2002 numbers. Deteriorating asbestos and workers compensation reserves, overall reserving adjustments tied to under pricing of the market in the late 1990s, and lost investment opportunities have been documented by other analysts as the causes of the disappointing 2002 results. The RAA report does not attempt to document the cause.

Analysts have noted that insurance and reinsurance underwriters need to learn how to price business to achieve an underwriting profit. Since investment markets are not projected to afford great opportunities to offset underwriting losses, pressure is on the underwriters to build the bottom-line profit. That's quite a challenge. In the 20-plus years the RAA has been reporting on industry underwriting results, the industry has never in the aggregate reported an underwriting profit as measured by the combined ratio. The best year was 1997 when a combined ratio of 101.5 percent was reported; other "good years": 1996, 1986, and 1987. First-quarter results from 2003 reveal substantial improvement, so at this point we could argue there is

always the first time!¹ But Standard and Poor's recently noted in its *Industry Report Card: North American Reinsurers* that the "ease of entry for new players and increased competition in the market have dampened the ability of existing players to recover." Market observers are likely taking a skeptical wait-and-see attitude about that possibility of an aggregate underwriting profit in 2003.

Statistics show an improving surplus picture, significant premium growth, and increasing premium to surplus ratios. Inclusion of National Indemnity will skew some of these statistics, so the RAA report provides comparison data including and excluding National Indemnity. Notably, though, with National Indemnity excluded, the industry failed to earn a positive return on equity in 2002.

Investment yields improved a full percent from 2001, thanks largely to growth in bond values.

As rating agencies continue to have the industry under watch with a negative outlook, it is worthy of noting that the RAA report documents increasing leverage ratios for reinsurers. Without including National Indemnity, the net leverage ratio for 2000 was reported at

Table 1

Year	Combined Ratio
2002	117.5%
2001	139.3%
2000	112.8%
1999	114.0%
1998	105.9%
1997	101.5%
1996	102.9%
1995	108.7%
1994	108.7%
1993	106.0%
1992	118.3%
1991	107.1%
1990	106.3%
1989	106.9%
1988	102.6%
1987	103.3%
1986	104.7%
1985	121.4%
1984	128.2%
1983	116.4%
1982	111.6%
1981	110.2%

Continued on page 4

Table 2

Underwriting Gain (Loss)

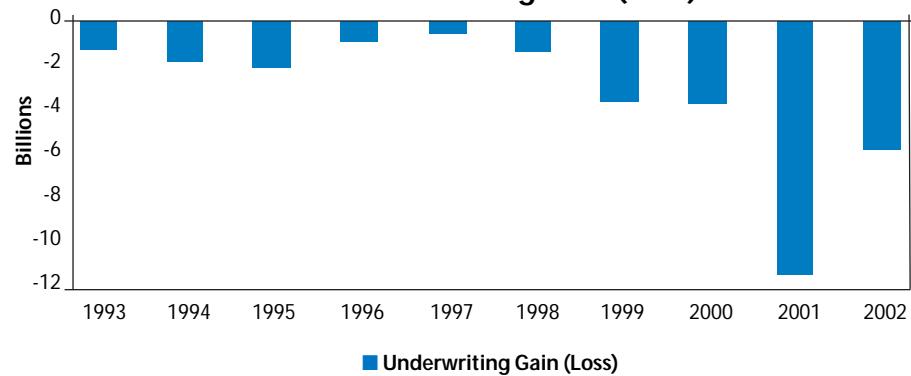


Table 3
Net Leverage (w/o National Indemnity)

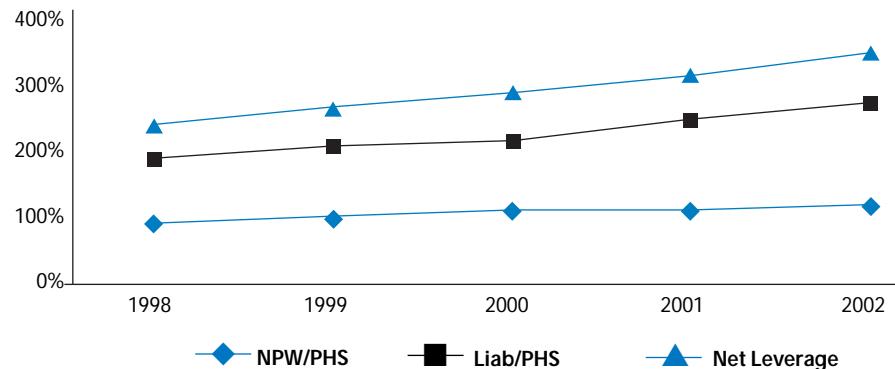


Table 4

Year	ROE	Retention	NPW/PHS	Liab/PHS	Net Lvg.	Investment Yield	Reinsurance Exposure to PHS
1998	10.4%	86.3%	33.0%	102.5%	135.5%	4.2	15.5%
1999	2.9%	81.7%	37.4%	113.2%	150.6%	3.9	20.6%
2000	5.4%	82.5%	45.6%	136.0%	181.6%	4.1	23.6%
2001	-5.6%	71.9%	56.6%	205.9%	262.5%	4.2	43.6%
2002	3.0%	64.2%	66.0%	226.0%	290.9%	5.3	49.4%

Table 5

Year	Reinsurer	Rank	GWP, Billions
2001	Employers Re	1	\$6.15
	General Re Group	2	\$4.3
	American Re	3	\$4.14
	Swiss Re America	4	\$3.19
	Transatlantic/Putnam	5	\$2.15
	XL Re America	6	\$1.43

Reinsurance Underwriting Results

Continued from page 3

Table 6

Year	Reinsurer	Rank	GWP, Premiums
2002	Employers Re	1	\$6.7
	American Re	2	\$4.88
	General Re Corp.*	3	\$3.8
	Swiss Re	4	\$3.66
	XL Re America	5	\$3.43
	National Indemnity	6	\$2.87

*In 2002, General Re Group gross premium written was \$4.7 billion.

about 200 percent; by 2002 this number had grown to 250 percent. On the positive side, policyholder surplus grew by about \$5 billion or just over 10 percent.

Retention has been declining as reinsurers retrocede more business and as a result exposure to recoverables has been growing as a percent of policyholder surplus. Retrocessional exposure, as measured as a percentage of policyholder surplus, has grown from 23.6 percent in 2000 to 49.4 percent in 2002. As previously reported, liabilities to policyholder surplus increased 51 percent in 2001 compared to 2000, and now we can document the trend with a continued increase in this ratio in 2002.

Moving from the underwriting results to the market-share picture, we find continued movement. The market-share statistics have jumbled slightly in 2002 versus 2001. It is clear several players are taking advantage of better market conditions to expand their market shares. Big movers year over year include XL Re America and National Indemnity. In an environment where reinsurers continue to see substantial premium growth from rate increases and additional business, General Re appears to have pulled back a little compared to its peers.

The RAA's *Reinsurance Underwriting Review: 2002 Industry Results* is available for purchase at www.reinsurance.org or by calling (800) 259-0199.² You can also subscribe to the *Quarterly Reinsurance*

Underwriting Results. The *Quarterly Reinsurance Underwriting Reports* include a slightly different set of reporting companies. The RUR always includes a bigger universe of U.S. reinsurers, which accounts for differences in the quarterly versus the annual underwriting reports. This year the RUR includes tables and graphs on: key financial ratios; underwriting and investment income; five-year trend analyses of operating results; and individual underwriting results for all reporting companies. New tables and analyses of ceded reinsurance, invested assets, and loss reserve development are included for the first time in this year's report. ■

Endnotes

1. Review *Quarterly Reinsurance Underwriting Reports* on the RAA web site at www.reinsurance.org.
2. The Reinsurance Association of America publishes: the *Quarterly Reinsurance Underwriting Results*, the annual *Reinsurance Underwriting Review*, the annual *P/C Industry Market Share Reports* and the annual *Reinsurer Market Share Reports*, the biennial *Loss Development Study*, the *World Trade Center and Natural Catastrophe Loss Development Study*, and the *Alien Reinsurance in the U.S. Market report*. All of these can be previewed at www.reinsurance.org.

The Elusive Complexity of Reinsurance Arbitrations

by Andrew S. Boris, Esq.

■ **Andrew S. Boris, Esq.** is a partner in the Chicago office of Tressler, Soderstrom, Maloney & Priess. His practice is focused on litigation of complex insurance coverage matters throughout the country, including general coverage, reinsurance, and bad-faith cases.

Before attending law school, Boris worked for a major insurance company. He remains licensed as an insurance provider and has extensive experience in interpreting insurance policies and the coverage they provide. In addition, he has authored and spoken on a variety of topics including general insurance coverage, reinsurance, bad faith, and general litigation issues. Boris has served as an Adjunct Professor at the DePaul University College of Law having taught both litigation and legal writing classes.

Boris received his undergraduate degree from Boston College and his law degree, with honors, from DePaul University College of Law where he served on the law review and was a member of the Order of the Coif.

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It was not long ago that there were only a limited number of reinsurance disputes, and the reinsurance professional was able to remain detached from the arbitration process. With an increase in the number of reinsurance disputes, there has also been a corresponding increase in the number of judicial opinions addressing the arbitration process. This article seeks to briefly address recent decisions highlighting this trend with opinions concerning arbitrator substitution, consolidated arbitrations, and identification of party arbitrators. Importantly, all of the issues addressed by these recent cases provide significant guidance to those involved in the reinsurance dispute process.

Substitution of Arbitrator During Arbitration

In a recent case, a court was presented with the question of whether an entirely new arbitration panel should be appointed and the arbitration restarted when one member of a three-member panel resigned during the arbitration. *National Am. Ins. Co. v Transamerica Accidental Life Ins. Co.*, 328 F.3d 462 (8th Cir. 2003).

The original reinsurance arbitration between the parties began in 1999. Each party designated an arbitrator, who together named a third arbitrator. Over a year after the arbitration panel was named (during which the parties had engaged in extensive discovery and the panel had issued several orders), the reinsurer's arbitrator resigned due to health reasons. The cedent initially requested that the reinsurer appoint a new arbitrator to fill the vacancy, but the reinsurer declined to do so and requested that the entire arbitration panel be replaced. In turn, the cedent requested that the district court name a new arbitrator for the reinsurer, relying upon Section 5 of the Federal Arbitration Act. The district court appointed a substitute arbitrator and the reinsurer appealed. On appeal, the Eighth Circuit held that



where the parties cannot agree on a replacement process, a party may apply to the federal district court to appoint a substitute arbitrator.

This decision is important in that it seemingly conflicts with a Second Circuit decision addressing the arbitration substitution issue. See, *Marine Products Export Corp. v M.T. Globe Galaxy*, 977 F.2d 66 (2d Cir. 1992) (finding that where one member of a three-person panel dies before rendering an award and the arbitration agreement does not anticipate a replacement process, the arbitration must begin anew with a full panel). The expense and delay that may be incurred should a panel member withdraw or be unable to proceed are considerable. Those involved in the arbitration process should be cognizant of this potential problem and determine whether the reinsurance contracts address it. Parties should proactively address this issue at the initial organizational meeting.

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The Elusive Complexity of Reinsurance Arbitrations

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Compelling Consolidated Arbitration

In a reinsurance dispute arising out of a cedent's alleged failure to pay its share of payments under five separate commutation agreements, the question presented to an appeals court was whether the district court could compel a consolidated arbitration. *Philadelphia Reinsurance Corp. v Employers Ins. of Wausau*, 2003 U.S. App. Lexis 6198 (3d Cir. 2003). In a prior forum, the parties had consolidated two disputed contracts into a single arbitration. In the current dispute, the cedent identified that the parties had an informal agreement to consolidate the current dispute in a footnote included in a brief addressing an unrelated issue. The reinsurer later petitioned to compel a consolidated arbitration, which was granted by the district court. Although the Third Circuit Court affirmed the order consolidating the arbitration, it explicitly rejected the lower court's holding that a consolidated arbitration would promote the interests of justice and judicial economy. Instead, the court affirmed the finding that cedent's reference to an informal agreement to consolidate was a judicial admission and modified the arbitration clauses within the reinsurance contracts. Thus, the Third Circuit did not depart from the generally accepted trend that arbitrations will not be consolidated absent contractual language to the contrary or extenuating circumstances (i.e. judicial admissions). The decision does give significant guidance for those who draft, or review, briefs submitted to the courts, as courts can bind a party to a position even when it is not fully addressed.

Arbitrator Selection Deadline

Reinforcing the finality of an arbitrator selection deadline in an arbitration clause, a New York state appellate court ruled that the plain terms of the contract controlled. *Everest Reinsurance Co. v ROM Reinsurance Co.*, 756 N.Y.S. 739

(App. Div. 1st Dept.). After missing the deadline for selecting its arbitrator, the reinsurer argued that it could not be held to the deadline because the reinsurance contract did not contain a "time is of the essence clause." The court concluded that the terms of the contract requiring an arbitrator designation were not ambiguous and the failure to do so violated the terms of the parties' agreement.

■ After missing the deadline for selecting its arbitrator, the reinsurer argued that it could not be held to the deadline because the reinsurance contract did not contain a "time is of the essence clause."

It is not entirely uncommon for a party to disregard the appointment deadline identified within the reinsurance contract. Often, parties are engaged in settlement discussions as the deadline approaches and the arbitrator selection deadline is disregarded. As the *ROM Reinsurance* case teaches reinsurance professionals, the appointment deadline is a serious matter. Strict adherence to the contract deadline provides the greatest flexibility for a reinsurer or cedent to participate in continued settlement negotiations and the reinsurance arbitration. The unsuspecting reinsurer or cedent that fails to name an arbitrator by the proper deadline could find itself with little leverage in the reinsurance dispute resolution process.

The complexity of reinsurance can be daunting without having to examine the intricacies of the reinsurance arbitration. However, courts continue to provide new guidance on the arbitration process. The three cases discussed above highlight the need for reinsurance professionals and their attorneys to be

proactive in addressing the problems potentially associated with arbitrator substitution, attempts to compel consolidated arbitrations, and identifying a party-appointed arbitrator within the time parameters identified within the reinsurance contracts. ■

Reinsurance Challenges and Opportunities in a Post-9/11 World

Editor's note: By the time you are reading this report, this Reinsurance Section seminar and the entire 2003 CPCU Society Annual Meeting and Seminars will be a fond memory! We hope you were able to attend the seminar in New Orleans, and we would welcome your comments.

A distinguished panel of industry experts discussed major challenges and opportunities that reinsurance buyers and sellers are facing in the post-9/11 environment.

Sandra LaFevre, CPCU, CPIW, ARe, of the Reinsurance Association of America moderated a panel that included **Robert Kingsley**, president and CEO of Financial Pacific Insurance Company; **Mark Lescault**, head of division underwriting, Swiss Re America; **Wayne**

Pagliari, chief underwriting officer, Chubb Re; **Joao Santos, CPCU**, vice president, Island Insurance Companies; and **Michael D. Schnur, CPA**, managing director, Guy Carpenter.

The panel examined the current state of the industry and the outlook for the future with a particular focus upon the following:

- How have underwriting and buying practices changed as a result of 9/11?
- Rating agency downgrades and the implications for both cedents and reinsurers
- Influence of the new Bermuda-based companies
- Is the industry likely to see further consolidation?

- Is there an increased interest in the use of captives and other alternative risk arrangements?
- Underwriting terrorism risk
- What is the outlook for TRIA? What is likely to happen when TRIA expires?
- What differentiates the best performing companies from the others?

If you were unable to attend the Annual Meeting and are interested in audio recordings of this and other seminars, please visit www.tsok.net or call (858) 635-5969. ■

Reinsurance Section Seminars at the 2003 Annual Meeting

The Reinsurance Section presented three seminars at the CPCU Society's Annual Meeting in New Orleans. Gordon Lahti, CPCU, our outgoing section committee chairman, headed a panel of four experts in a catastrophe modeling seminar that was co-hosted by the Underwriting and Reinsurance Sections. We provided two panel slots in that endeavor in addition to Gordon's excellent panel leadership. A concise recap of that educational opportunity is expected in our next *RISE* issue. Also appearing in the fourth quarter *RISE* will be a summary of our traditional state-of-the-art seminar ("Reinsurance Challenges and Opportunities in a Post-9/11 World") to be authored by Reinsurance Section Committee member Tom Pavelko, CPCU.

My seminar—"Evans on Reinsurance: A Primer for Insurance and Risk Management Professionals"—drew a full



■ **Bruce D. Evans, CPCU, ARe**

house of attendees. When asked, approximately 40 percent of the audience indicated serving in the reinsurance process of their respective firms. The majority of the seminar attendees sought the basics of reinsurance, and hopefully gained more than they expected. The learning objectives that shaped my design of this program were:

- Identify important "constants and changes" in both the U.S. culture and the reinsurance industry during the last four decades.

- Understand basics concepts related to the insurance marketplace and the role of reinsurance within the insurance mechanism.
- Identify the parties to the reinsurance contract and their respective roles and responsibilities.
- Understand the interactions within the reinsurance distribution system.
- Establish key distinctions between treaty and facultative reinsurance.
- Determine the methods of risk sharing in reinsurance.
- Ascertain important terms and conditions within reinsurance agreements.
- Identify key accounting standards and IRS rulings that affect the business of reinsurance.

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Reinsurance Section Seminars at the 2003 Annual Meeting

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■ Attendees take notes during "Evans on Reinsurance: A Primer for Insurance and Risk Management Professionals"

- Understand the role of and parties to the arbitration process.

Interspersed with the fundamentals of reinsurance were reflections on the constants and changes in this country's culture in order to establish parallels found within the reinsurance marketplace during my four-plus decades in the P&C industry. For instance, we still have the same number of national holidays, the same percentage of K through 12 students enrolled in private schools, the same percentage of Americans classified as below the poverty level (the level has changed, however) and the same ongoing percentage of new foreign-born population among U.S. residents. Among items that have changed substantially: higher percentages of urban versus rural residents, the number of cars per household, clothing fashions at the workplace, and longer life expectancies.

By contrast, the reinsurance industry still offers facultative versus treaty types, and also the same five product lines. The headings within reinsurance agreements of four decades ago are strikingly similar today, although the former "honorable undertaking" clause has disappeared over the years. What's different is the forging of financial reinsurance agreements, vastly more reinsurance submission data, the introduction of the Interests and Liabilities agreement, plus the rising tide of legal involvement.

After sharing several clues to my entrance year, three participants (about 40 participants revealed their estimates) identified the correct date. I rejected one guess (1858), but complimented everyone else who responded to that challenge. I hope the guess was in fact just a typo! The participants were also questioned whether the United States has more lawyers or more medical doctors as of the year 2002. (If you did not attend, which group is your choice?)

We hope you were able to be with us in New Orleans. Stay tuned for news regarding the 2004 Reinsurance Section symposium, and about Reinsurance Section seminars to be presented at the 2004 CPCU Society Annual Meeting and Seminars in Los Angeles. ■

Reinsurance Section Encounter

is published four times a year by and for the members of the Reinsurance Section of the CPCU Society.

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RISE

Volume 21

Number 3

November 2003

CPCU Society
720 Providence Road
Malvern, PA 19355-0709
www.cpcusociety.org

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