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Mock Reinsurance Arbitration

Track: Reinsurance

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Panel: RONALD J. KLEIN
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Summary: Arbitration clauses have been included in reinsurance agreements for a number of years now. Most direct underwriters, however, have never been involved in an arbitration hearing. The session includes a mock arbitration to resolve a problem of current interest. At the close of this session, attendees have a better understanding of how the structure of an arbitration proceeding in reinsurance contracts works in practice and what companies can do to resolve a dispute prior to going to arbitration.

MR. MELVILLE J. YOUNG: My name is Mel Young. Some of you may have been at other mock arbitrations in the past. Our panel includes Jack Scott, who is going to serve as the umpire for the arbitration. Jack has served as reinsurance counsel for Gen Re, Life Re and Cigna Re and is now counsel to White & Williams.

To his right is Ron Klein. Ron spent 12 years with Mutual of New York as an actuary in agent compensation and reinsurance, and he has spent the last 10 years with Life Re, which then became Swiss Re. He's the global head of pricing.

To my left is Joe Kolodney. Joe began his career at the Phoenix. He has 16 and a half years at General Re; he's spent five years as president of Presidential Life in Nyack, N.Y. For the last 13 years, Joe has been with Aon or its predecessor organizations, acting as a reinsurance intermediary and running its worldwide life

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reinsurance operation.

Ronnie and Joe will be acting as the other two arbitrators.

To my right is Ozzie Scofield, He has worked for Swiss Re as an underwriter, for Gen Re for a lot of years, and then for Transamerica and GE. He currently serves as president of Scottish Re.

Jack Scott is going to begin the program by giving you a brief introduction to the subject of arbitrations. We do this periodically just so there's something in the record just in case anybody ever has a question about arbitrations.

MR. SCOTT: I am with White & Williams in Philadelphia. It's a law firm. I usually hang around places where there are many lawyers, and I'm very much in the minority these couple of days. It's very refreshing, and it's interesting.

When I told them I was going to do this, the firm told me to make sure that I said to everyone that any views that are expressed here are clearly not the views of the firm or any of its clients, necessarily.

General Introduction to Arbitrations.
Mel and Ozzie asked me to do a little bit of a general introduction because arbitrations, unfortunately for us lawyers, are not as commonplace on the life side as they seem to be on the property/casualty side of life.

My job is to give a general overview of the process. To do that I thought it might be a good idea to use the ACLI model language.

Is everybody familiar with the fact that this summer the ACLI put out a model working for life reinsurance contracts? They did a nice job. I have no vested interest at all in it; but for what it's worth, they did a good job. They'll be the second to tell you (I'll be the first to tell you) that you shouldn't take their language and just say, "Well, this is my boilerplate agreement to adopt." The intention here is to give you good, solid language that addresses all these areas. But every agreement really needs to be negotiated, and the terms of the agreement itself should match what the deal is between the parties. In fact, no provision should be considered boilerplate. You should get counsel to look at it. You should probably use a firm whose name you might be familiar with.

At any rate, I took the arbitration article of the ACLI paper, which is a particularly good one, and said to myself that this would be a good way to go through and talk about the process in general.

Honorable Engagement. Below is the first sentence of your so-called honorable engagement-type language

- *It is the intention of the Reinsurer and the Ceding Company that the customs and practices of the life insurance and reinsurance industry will be given full effect in the operation and interpretation of this Agreement.*

In the old days, we would say that reinsurance was a gentleman's agreement, but we don't say that any more. The gist is that it's an honorable engagement; it's not necessarily governed by the strict rule of law. What this means is that the panel is free to disregard rules of evidence and even rules of law, if it's appropriate to do so, and instead apply customs and practices of the industry.

If it doesn't say, for example, something like, "Follow the fortunes" in your agreement, does that mean, because it's part of the customs and practices, that every life reinsurance agreement is a "follow the fortune"? And does it mean that whatever "follow the fortunes" means, well, that's part of the agreement? I don't know. That's an area that really is very different in the property/casualty world than it is in the life world. Life reinsurance folks who've adopted the concept said to me one time, "That's a concept we really don't care very much for."

For what it's worth, when I'm representing a ceding company, I tend to encourage them to try to get that kind of language in there; if nothing else, it gets the issue on the table when it encourages people to talk. So, at least at the end of the day, the agreement does match what the parties' agreement is.

Good Faith. The parties act in utmost good faith.

MR. SCOTT: You'll see this query a lot, does it mean anything? Every contract has good faith as a covenant that's an understood covenant:

- *However, if the Reinsurer and the Ceding Company cannot mutually resolve a dispute that arises out of or relates to this Agreement, and the dispute cannot be resolved through the dispute resolution process described in Article 18, the dispute will be decided through arbitration as a precedent to any right of action hereunder.*

Is it different because it's reinsurance? Is it a fiduciary standard? SC case law says a fiduciary standard is even a greater standard than utmost good faith.

Sometimes it's just theoretical lawyer talk, but sometimes you actually end up fighting because of terms like this. If you're going to put that it's utmost good faith, the parties ought to have some idea of what they really mean by that.

Mediation. If you read this provision, you'll get the reference to Article 18. Apparently, when the ACLI put this language together, its intention was to capture mediation. It actually put it as a precondition to proceeding to arbitration. Mediation is a different kind of dispute resolution mechanism, whereby the two parties get a mediator, and they tell their story to the mediator. Basically the

mediator tries to resolve the dispute by kind of talking to the other side and telling the other side all the strong points of the first side's story in an effort to scare them: "You better settle; you better settle." The idea is, at the end of the day, maybe that's the way you resolve the dispute and settle it. But it's a nonbinding practice. Even when you hire a mediator and go through this process, at the end of the day, both parties can walk away and say, "I don't think so."

Is this a waste of time, or is it a good idea? I don't know. Personally, I often tend not to draft mediation provisions as a precondition or encourage my clients to do so unless they really want to—unless they have thought it through. Then those provisions are a part of the terms and conditions.

Disputes. The other thing I would point to is that this provision talks about disputes that arise out of or relate to this agreement. That's interesting. That's pretty broad language, and you would think that would cover disputes regarding interpretation of the language, breach of the agreement, etc. Does it, however?

Does it cover a fight about the validity of the formation? If the parties are fighting, if what they're saying is that a disagreement doesn't exist, it never came into play in the first instance, you could expect one party to say, "And I don't even have to arbitrate that. Because if there's no agreement, I never agreed to an arbitration clause; so I'll litigate that."

The ACLI language doesn't include words like "formation" and "validity," and I think that's an issue. If the parties want to have questions—all questions, including questions of formation—decided by an arbitrator rather than a court, then they ought to say that in the agreement. That's just another issue.

Notification. The notification is similar to the complaint . There's an answer within 15 days.

- *To initiate arbitration, either the Ceding Company or the Reinsurer will notify the other party in writing of its desire to arbitrate, stating the nature of its dispute and the remedy sought. The party to which the notice is sent will respond to the notification in writing within fifteen (15) days of its receipt.*

In this particular language, they talk in terms of stating the nature of the dispute and the remedy sought. If the party has basically sought a specific remedy, is the panel nevertheless free to resolve the decision and grant a different remedy? If the complaining party has sought rescission of the agreement, is the panel limited to say, "I'm either going to rescind it or order no rescission?" Or is the panel free to say, "Well, really the fair way to do this is to grant not rescission, but damages, to one party"?
Panels seem to think they have the right to do that no matter what the agreement says. I guess my point is that I'd rather see it spelled out in the agreement so you avoid an argument such as, "Wait a minute, this panel acted beyond the scope of

its authority when it did that." It talks about the remedy sought, etc. That's something to think of.

Selection of Arbitrators. This is pretty good language. Now we're getting to who the arbitrators are, what their qualifications are. You'll see typical language along these lines—"Current or former officers."

- *There will be three arbitrators who will be current or former officers of life insurance or life reinsurance companies other than the parties to this Agreement, their affiliates or subsidiaries.*

It doesn't always appear. Sometimes you'll see language that will say, "Retired" or "Active or Retired." That is, I think, problematic. A lot of people in this industry serve as officers of companies, and then they decide to leave those positions and become consultants. And then maybe later on they retire and want to go into arbitration.

If you have somebody like that and you want to appoint them as an arbitrator and the language says, "Retired," the other side is going to potentially raise an argument—"He doesn't qualify. He's not a retired officer; he's a retired consultant. He never retired as an officer." I encourage you to get lawyers in the picture, especially from a firm that you're familiar with—that's the type of thing that I think you need to watch.

Ex-parte Communications. This talks about the process of appointing. This is an opportunity for me to talk a little bit about ex-parte communications.

- *Each of the parties will appoint one of the arbitrators and these two arbitrators will select the third.*

How free should you be in talking about the case with somebody that you're thinking about appointing as an arbitrator, or somebody that you're thinking about putting on your list of potential umpire candidates? How freely do you talk? Are there different standards of what you tell one party? Does this standard change over the life of the dispute?

I'll tell you what my practice is and that of others at White & Williams in Philadelphia: Generally, when we discuss a case with somebody that is potentially a party-appointed arbitrator, we will try to present a pretty fair, balanced description of what the dispute is—both sides—so that they have a good feel for what to expect.

In terms of the umpire, we do not do that. When we already have an appointed arbitrator, as we're trying to figure out who is going to be our umpire, our practice is to tell that potential candidate the minimum necessary just to make sure the person doesn't have a conflict and can, in fact, assume it.

So we would tell the person who the parties are and just very generally what the nature of the dispute is. This is because you really don't want to have a fight later on down the line that the umpire was somehow biased, or the candidates were somehow biased, by getting an advance preconception of what the case was or how the case was going to shake down. You can avoid all that.

As far as your own party-appointed candidate—we'll get into a little bit later how it typically works—usually once the organizational meeting takes place, the panel then decides on procedural matters such as ex-parte conversations. Usually at that point in time, the panel will say, "From this point forward there either will or will not be any further conversations between you and your party-appointed arbitrator." That's what typically happens. Up until that point in time, however, there is no restriction on talking to your arbitrator, and there's really nothing inherently wrong with sharing your thoughts and your insights about the case.

Arbitrator's Role. Maybe now is a good time to talk a little bit about the role of the arbitrator.

The arbitrator has a difficult job sometimes. You would think it was balancing his role of being an advocate and being an arbitrator. Really, at the end of the day you want your panel to do the right thing and come up with the fair and equitable decision, because they're part of an arbitration panel.

But on top of that you have a party-appointed arbitrator that you've appointed, and at least there's a little bit of the feeling that, "Well, gee, I've explained my case to him, he sounded like he was enthusiastic. Then I kind of want him to be my advocate when he goes in there." This is a difficult one. Here's the way I typically handle it, the way our firm typically would do it.

We like to go to our party-appointed arbitrator and say, "Look, we expect you to, at the end of the day, vote your conscience and do the right thing, even if, in some situations, that means ultimately going against us and giving a ruling adverse to us. We wouldn't be pleased if that happens, but if that's what happens consistent with voting your conscience, we understand that. Having said that, you are a party-appointed arbitrator, and as this case progresses, we will be, in fact, making points. And because you're our appointed arbitrator, we expect something of you. Number one, we expect you to certainly understand the point that we're making. And we expect something more one step beyond that: We expect you to make sure that the umpire understands the point. That's not to say that we're directing you to convince the umpire that he has to believe it, but if there's a doubt in your mind that he doesn't understand the point you're making, we expect you to get over that hump and make sure that he understands it."

I think that's a good way of coaching your arbitrator. The message you're getting, too, I think is the accurate one. Ultimately, at the end of the day we want justice. We want fairness. We want the proper decision, but we certainly don't want any

misunderstandings along the way and confusion because our arbitrator didn't take this necessary step and dispel this confusion.

More Appointment Advice. Appointing the second arbitrator sometimes is a critical decision. It's one deadline you don't want to miss, because that could be the whole case.

- *If the two arbitrators do not agree on a third arbitrator within thirty (30) days of the appointment of the second arbitrator, then the appointment of the third arbitrator will be left to the American Arbitration Association.*

The appointment of the umpire is also absolutely critical. The ACLI has seen fit to leave it to the AAA, and I don't personally like that provision. There are a lot of other alternatives. The reason I don't like it is because AAA has good arbitrators for resolving general commercial disputes, but they're not necessarily reinsurance specialists; they're not necessarily people who understand the customs and the practice of the reinsurance industry. I think that's the whole point in going to arbitration.

You should know there are alternatives. You see language like this. There's an organization called ARIAS-U.S.; it has a good set of procedures for the process. At the end of the day, you're kind of in a random selection anyway—a coin toss, typically. At least there are certain safeguards built-in along the way that you end up with. There are other ways rather than turning it over to the AAA to get that accomplished.

Arbitration Site. Again, these are decisions that are made by the arbitrators, and the procedures are set up. Typically, you'll have organizational meetings. You'll have rulings on discovery, depositions and a briefing. These are things that the panel sets, and they are not set by law. Then there's usually a hearing and sometimes post-hearing briefs. Again, these are left to the panel to decide. There's our procedure clause

- *Once chosen, the arbitrators are empowered to select the site of the arbitration and decide all substantive and procedural issues by a majority of votes.*

The ACLI was a little bit redundant. They're talking again about the same provision that they made in the first sentence about the panel governing their decision by the customs and practices of the industry.

This is one of the basic, critical distinctions between resolving things by arbitration and by litigation. An arbitration decision is not subject to appeal. That's wonderful if you win, but it's not so great if you lose. Very often, you need to explain this to your client, because the first question you get when that adverse ruling is made is, "Well, can we appeal this?" And the answer is, "No, you can't."

There is something called a motion to vacate, but I will tell you upfront, these motions are not granted. It's not similar to an appeal at all. These are granted only in rare occasions, and you have to be talking either some fraudulent situation or some outrageous conduct along the way to justify that kind of motion. We should all think of arbitration rulings as final, not subject to appeal.

Enforcement. This is nothing more than how you get it enforced. You'll see a provision like this in the agreement. At the end of the day, it is just a ruling of three panel members. If you need to enforce it, then you take the opinion to a court, and the court does nothing more than basically give you the mechanism so that you have the force of a court order to get your money, if that's where the resolution has been.

- *Either party to the arbitration may petition any court having jurisdiction over the parties to reduce the decision to judgment.*

Expenses. Expenses are typically shared in accordance with a provision like this. What to look for in a provision like this: Sometimes the parties want to be very specific as to whether the panel is empowered to grant interest and attorney's fees, should they come up; and punitive damages.

There's no right or wrong here. I think it all boils down to what the parties wish to be the agreement. Sometimes the front end, before there's a dispute, is a perfect time to sit down and weigh, "What do we want? What do we want to empower this panel to do in the event that we have a dispute?" You'll see the survival clause that is in this. It's more common in most agreements I've seen to have a general survival clause that's not specific to the arbitration provision.

MR. YOUNG: Thank you, Jack. Oz is just going to give you a brief overview of the case. We will be introducing five witnesses. They will not only be interrogated by the three arbitrators, but consider yourselves as part of the panel. Ozzie will be floating with a microphone so you will all have an opportunity to interrogate these five witnesses.

Following the cross-examination of the witnesses, we're going to give you another opportunity to sort of state your opinion of the case. Then you'll be able to watch the panel basically go through their process to come to some conclusion.

MR. OSCAR SCOFIELD: Thanks, Mel.

I would like to get some idea of your familiarity with arbitration. How many of your companies, to your knowledge, have been involved in an arbitration? Quite a few. How many of you have had to be at that arbitration for evidence or any other reason? Fewer. How many of you have been an arbitrator or an umpire? That's great, we have some pretty good representation.

By way of introduction, let's assume that the treaty with the kind of language Jack just talked about is in place here, and it's between the reinsurance company and a ceding company. A dispute exists, which could not be remedied by Article 18 or whatever else was in the treaty. Mediation didn't work; discussion didn't work. So the parties have gone back and forth for a couple of years with their dispute, and finally, one of the parties is tired and is now making the demand for arbitration.

The reinsurer is claiming that the ceding company agreed to follow guidelines in a certain underwriting manual, and that that agreement induced this reinsurer to offer automatic reinsurance and to take a 30 percent quota share. All of this information is in those letters that you have. But the ceding company agreed to use the High Standard Re manual. Although that was not the manual of this immediate reinsurance company, it is a well-respected manual, and it was what was going to be used to underwrite the cases.

It is the reinsurer's contention that a replacement manual was put in place— we'll hear why that was done later from the ceding company—and that as a result, that manual differed significantly from the High Standard Re manual. Also, the reinsurer starts having very early mortality losses.

The reinsurer is maintaining that the losses came from that unacceptable manual. In accordance with the terms of our treaty, we are demanding that an arbitrator be appointed to settle the dispute. In that letter they appoint their arbitrator and wave the organizational meeting; so the actual arbitration can be held today in Boston at the Society of Actuaries meeting.

All right, there's the demand for arbitration. They're losing money, somebody did something that the reinsurer didn't think was acceptable, and they're asking for damages and a rescission of the treaty.

How do they respond? "We find your demand without merit." The responder goes on to say, "You guys had to know that High Standard Re was acquired by somebody, they stopped supporting their manual, and that was common

knowledge. So why are you coming back to us and asking us to use a manual that's no longer being supported?"

Actually, there's no specific mention in the treaty and no provision that Aggressive Life has to give notice or get approval from the reinsurer to change the manual.

Moreover, the ceding company is objecting to the reinsurer characterizing the third-party administrator (TPA) as their TPA. This is a situation in which a TPA was used to do the underwriting process and the policies, put them on the books and keep track of them. So we'll hear a little bit of a dispute as to whose TPA was that.

They're more than willing to respond for the arbitration, which they're doing here today (their arbitrator is here, as well), and they're hoping that the reinsurer after that arbitration will honor the terms of the treaty, take the business and pay the claims as they come in.

You also have a copy of the appointment of the umpire letter. The two arbitrators, Mr. Kolodney and Mr. Klein, appointed an umpire, Mr. Jack Scott, and they agreed to meet in Boston at two o'clock on the 28th of October.

We're going to turn the arbitration over to the arbitrators, and we're going to introduce the facts as Mel wants to, or as you make them up.

MR. YOUNG: We have five witnesses. There will be five sets of facts that the five witnesses will be reporting on. Mr. Wilson has this set of facts. In 1998, Aggressive Life performed an audit of the TPA but missed the fact that there was the change of manual. I open up the panel to question Mr. Wilson. I think we're going to begin with Mr. Klein.

MR. RONALD L. KLEIN: Mr. Wilson, I learned that you're no longer working for Aggressive Life, is that true?

MR. WILSON: No, I'm not. I'm in employment and public accounting now.

MR. KLEIN: So when you performed your audit of the TPA for Aggressive Life, what was the scope of the audit? What were you looking for?

MR. WILSON: We were really looking to see that the premiums due Aggressive Life, and then correspondingly to the reinsurer, were paid on time and that the commissions for those policies were paid. We also were looking to make sure that no bad claims were being processed for that TPA.

MR. KLEIN: And at any time, were you worried about what the actual prices were set for? Were you worried about, let's say, suicide clauses? Were you worried about the underwriting that was done? Anything like that?

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MR. WILSON: We weren't really concerned with the underlying reinsurance agreements or underwriting manuals. They weren't overly important to us.

MR. KLEIN: So it was an administrative audit?

MR. WILSON: No, it was more of an accounting audit to make sure that stuff was flowing through and being booked properly.

MR. KOLODNEY: Basically, during the course of your audit of Aggressive Life's internal TPA business, did you find nothing extraordinary in how that business was being underwritten or processed? In other words, when you came out with your audit—even though the details of the underlying agreement governing this were supposedly not important to you—you did do your due diligence with respect to the fact that they did get the premiums, that they paid only the commissions, and that they did not get claims on bad business, is that correct?

MR. WILSON: That is correct.

MR. KOLODNEY: Now, how did you determine whether or not they got claims on bad business? Wouldn't there have to be have been some kind of a pattern of claim that would call attention to the fact that perhaps there were too many claims? Did you find any inordinate amount of claims when you were looking there?

MR. WILSON: We didn't see any pattern of claims, say, coming from one specific agent.

MR. KOLODNEY: But in your role as internal auditor, you had an obligation to the company to disclose whether or not there was something not quite right, perhaps, with what was being done at the TPA. And apparently that was never an issue. You satisfied yourself that the TPA was doing what you were told to audit in its way of handling premiums and claims, yes?

MR. WILSON: That's correct.

MR. KLEIN: One more quick question, Mr. Wilson. When you were looking at the claims, how many years' worth of claims did you look at?

MR. WILSON: Typically we covered the audit period we were looking at, which would be one year.

MR. KLEIN: Just one year. So you didn't look at any pattern of claims from year to year. For example, you didn't look at the number or amount or severity of claims from 1996, '97 and '98. You just looked at one year?

MR. WILSON: That's correct.

MR. KLEIN: So what kind of pattern were you looking for in one year's worth of claims?

MR. WILSON: If they were coming from one specific agent, that might lead us to think that something's not right in terms of that business.

MR. KLEIN: Did you actually leave under your own accord?

MR. WILSON: Yes, I did.

MR. KLEIN: Mr. Wilson, when you did the audit—I shouldn't assume anything— did you, in fact, read the reinsurance agreement under which the audit was conducted?

MR. WILSON: No, I did not.

MR. KLEIN: So you were employed to do an audit of a TPA to inspect reinsured business, but you didn't bother to read the reinsurance agreement?

MR. WILSON: We didn't think those details were important.

MR. YOUNG: Any other interrogation of this witness?

MR. KLEIN: Did you use the term "clean bill of health" in your audit report?

MR. WILSON: Yes, we did.

FROM THE FLOOR: Did you read the administrative agreement before you did your audit? They didn't ask any questions about that. I think they just asked about the reinsurance.

MR. WILSON: We did not look at the administrative agreement, but we did look at the accounting forms related to the reinsurance treaty.

MR. YOUNG: Our next witness is Mr. Ronald Colligan. Deep Pockets participates in other pools that had used High Standard Re's manual and replaced it with the same replacement manual. Deep Pockets Re is aware of the use of the replacement manual in that pool.

MR. KLEIN: Mr. Colligan… (He's an underwriter for a competitor–Aggressive Life.) Do you know the marketing and pricing structure of all the reinsurance company partners that you use?
MR. COLLIGAN: Yes, sir.

MR. KLEIN: So, let's take, for instance, Deep Pockets Re. Are you familiar with their regional approach to pricing, that there are four different regions, and each one of them deals with the clients separately?

MR. COLLIGAN: Absolutely.

MR. KLEIN: And are you also aware that there's another pool that's mentioned here where the replacement manual is being used? Are you aware also that that occurs with a company that's a different region from Aggressive Life?

MR. COLLIGAN: As the underwriting executive, that's not my responsibility to be aware of that with another.

MR. KLEIN: But because you know everything about reinsurance, you wouldn't be surprised that one region doesn't know what the other region is doing?

MR. COLLIGAN: Absolutely, that's correct.

MR. KOLODNEY: Now, you're an underwriter for a competitor of Aggressive Life?

MR. COLLIGAN: That's correct.

MR. KOLODNEY: So that means as a competitor of Aggressive Life, you're writing approximately the same kind of business with the same clientele, more or less the same product design and the same kind of distribution system. And you have a lot of years of underwriting experience. Now, your company used the High Standard Re manual, but replaced it with the manual now being used by Aggressive Life.

MR. COLLIGAN: That's correct. The original manual was discontinued.

MR. KOLODNEY: Would you say that Aggressive Life, as a competitor, has consistently won more business than you did and put you in an inferior role? Do you feel you give them a good run on a competitive basis for the quality of underwriting product, distribution, etc.?

MR. COLLIGAN: Absolutely. They're one of the companies that we use to benchmark our progress in several different areas, and underwriting competitiveness is one of them.

MR. KOLODNEY: So in other words, if they were really doing something screwy, it would probably surface pretty quickly—you would notice that. And that hasn't happened?

MR. COLLIGAN: It hasn't happened. We have some of the same fiduciaries, and we would know very quickly if we were getting beat on most of the business they submitted to both of them.

MR. KOLODNEY: So basically the fact that you're using the manual that Deep Pockets really condemned Aggressive Life for using has had no relevant impact on

the results of your business, right?

MR. COLLIGAN: It's had no material impact.

MR. KOLODNEY: Have you had a good relationship with Deep Pockets Re?

MR. COLLIGAN: Oh, I think so.

MR. KOLODNEY: And they haven't had any complaints of the quality of your underwriting?

MR. COLLIGAN: No, they routinely do audits every other year.

MR. KOLODNEY: Thank you.

MR. KLEIN: I'm confused. You're saying that since you moved to the new, more aggressive underwriting manual, your mortality has not deteriorated at all?

MR. COLLIGAN: Well, I think you're the one that characterized it as more aggressive. I didn't think it was more aggressive.

MR. KLEIN: So you don't think that the new underwriting manual is more aggressive?

MR. COLLIGAN: Certainly not, because we use our underwriting as a guide for our mortality assumptions, and we try to mesh the two. And I would not put my company on the risk for something that I didn't think met our mortality assumptions.

MR. KLEIN: You're not an actuary, are you?

MR. COLLIGAN: No, I'm not.

MR. KLEIN: So if I told you that the mortality studies done over the last three years showed that there was a 22 percent increase in mortality on this underwriting standard compared to the other one, would you not believe that? Have you ever underwritten a case before?

MR. COLLIGAN: Well, I'd like to know if that was one company or a group of companies that that experience proved to be the case in, because it's more than an underwriting manual that can determine whether or not the mortality objectives of the company are met.

MR. KLEIN: So what you're saying is that not only the underwriting manual, but the company—for example, Aggressive Life—might not be interpreting it the correct way. Is that what you're saying?

MR. COLLIGAN: I don't know enough about Aggressive Life to make that judgment.

MR. KLEIN: But that could be a cause for worse mortality experience?

MR. COLLIGAN: As could probably 20 other things.

MR. KLEIN: Can you name one or two of the 20?

MR. COLLIGAN: It could be the nature of production source, product, market or clientele.

MR. KLEIN: And are all these things similar in your company and in Aggressive Life?

MR. COLLIGAN: As a benchmarking entity, yes. We look at all of those.

MR. KLEIN: OK. Go ahead.

MR. KOLODNEY: I just want to know one thing: When you turned over the new manual to Deep Pockets Re, they obviously knew it was a new and different manual.

MR. COLLIGAN: Yes, they did.

MR. KOLODNEY: And did they object in any way?

MR. COLLIGAN: No, they did not at all.

MR. KOLODNEY: OK, thanks.

MR. KLEIN: Did they ask for a price increase?

MR. COLLIGAN: No, they did not.

MR. KLEIN: As the underwriting officer, would you know whether or not they asked for a price increase?
MR. COLLIGAN: Yes, I sit on the Risk Committee, and the Risk Committee makes those determinations.

MR. KLEIN: The Risk Committee makes the price, and they didn't ask for an increase.

MR. COLLIGAN: Yes, absolutely.

MR. KLEIN: And is there any other business that Deep Pockets Re has with your company, or is this the only pool that they're on?

MR. COLLIGAN: This is the only pool that they're on.

MR. KOLODNEY: Were you aware that Aggressive Life's underwriting was being conducted by a TPA?

MR. COLLIGAN: Yes, there had been a lot of talk about that when they first started that underwriting method.

MR. KOLODNEY: And were you aware that that TPA had specifically been recommended to Aggressive Life by Deep Pockets Re?

MR. COLLIGAN: Absolutely. They tried to get us involved with the same TPA.

MR. KOLODNEY: OK, thank you.

MR. YOUNG: Any questions from the group?

MR. CHRIS NOYES: What's the nature of the reinsurance agreement you have? Is it automatic co-insurance, YRT, excess?

MR. COLLIGAN: Automatic co-insurance.

MR. NOYES: And what percent of the pool is...

MR. COLLIGAN: First dollar total share. We were paying 10 percent.

MR. NOYES: And what percent of the pool does Deep Pockets Re get?

MR. COLLIGAN: They'll either have half or the 90 percent.

FROM THE FLOOR: Mr. Colligan, I assume that even in your role as chief underwriter you're familiar with the reinsurance pricing for your company?

MR. COLLIGAN: Absolutely.

FROM THE FLOOR: Are you equally familiar with the reinsurance pricing for Aggressive Life?

MR. COLLIGAN: No, I'm not.

FROM THE FLOOR: Is there any possibility that one company may have been priced more aggressively than others and that a change in your manual may have less impact and there may be some extra margins there that would allow the

reinsurer to be comfortable?

MR. COLLIGAN: I can't comment on that, but that's generally the way it works.

FROM THE FLOOR: OK, thanks.

MR. YOUNG: Any other questions?

MR. DAVID WILLIAM COOK: When you changed underwriting manuals, were you aware of any change in the distribution of risks that you started accepting?

MR. COLLIGAN: No, you see, we didn't change underwriting manuals. The company went out of business, and we had to select another underwriting manual. We selected this one. We did not notice any change in distribution.

MR. KLEIN: I'm sorry, just one more question: Are you familiar with all the reinsurance deals—in other words, financial reinsurance, bigger deals, block deals, maybe purchases of some of your foreign entities? Are you familiar with those deals as well?

MR. COLLIGAN: That my company does? Yes.

MR. KLEIN: All of them. And you don't remember the deal that I have a copy of the contract, that was done with Deep Pockets Re on an administrative basis, in which the reinsured bought one of your entities and did the administration also. You're not aware of that deal?

MR. COLLIGAN: I'm familiar with that. It came to the Risk Committee.

MR. KLEIN: Oh, it did. I just wanted to make sure you knew about that one.

MR. YOUNG: Mr. Kopel is our next witness. In 1996, Aggressive Life—through a different TPA—negotiated a reinsurance agreement with a different reinsurer and ceded business to that reinsurer using the replacement manual. That reinsurer applied a different rate due to higher mortality assumptions.

Mr. Kopel, you're a consulting actuary with over 30 years of experience, right?

MR. KOPEL: Right.

MR. YOUNG: He has experience in various aspects of reinsurance, and he is here as an expert to answer your questions.

MR. KLEIN: Mr. Kopel, you heard the testimony from Mr. Colligan. Were you sitting here when he was saying that?

MR. KOPEL: Yes, I was.

MR. KLEIN: Does he have any idea what he's talking about? Did you see pricing that was just drastically different from this underwriting manual?

MR. KOPEL: I think he changed the facts slightly, but I did more than 100 hours of study. I compared not only the ratings from the manual, but the rates themselves that were charged by the other reinsurer and Deep Pockets Re.

I concluded that the other reinsurer got a lot more money.

MR. KLEIN: So the change in underwriting manual, you would say, definitely had an effect on the mortality?

MR. KOPEL: I think so. I'm not an expert on underwriting, but the replacement manual had lots of nice little pictures and diseases, and it was very interesting. And I think it led to some higher prices.

MR. KLEIN: OK, thank you.

MR. KOLODNEY: However, the fact that this particular transaction may have led to higher prices and perhaps a larger margin of profit to the new reinsurer doesn't necessarily mean that the business written by Aggressive Life under the new manual was a loser. It could have been just a narrower profit margin.

MR. KOPEL: It's possible, but I think the level of difference between the Deep Pockets Re and the new reinsurer precludes that. It would be my stated opinion that the new manual contributed to the higher profits of the new reinsurer.

MR. KOLODNEY: Yes, I don't think anybody would disagree with that; but I guess the point that I'm making is that the previous witness testified that from his view, he didn't see anything that Aggressive Life was doing by way of result that gave him cause for concern that he was not being as competitive as he normally would be, especially since he said on several occasions that he used Aggressive Life as a benchmark for their own performance. And if he's satisfied with his economic results, apparently Aggressive Life's economic results were not unacceptable.

FROM THE FLOOR: Badgering the witness....

MR. KOPEL: I'm not quite sure where he got his facts.

MR. KLEIN: Let's just get it straight. The change in underwriting manual, no matter how small or how big, caused a different mortality pattern that was worse than it was with High Standard Re's manual. Is that your stated opinion?

MR. KOPEL: No. I didn't do a mortality study. What I did was compare the

premium that was received by the new reinsurer to the premium that was received by the old reinsurer under similar cases, which was the scope of my assignment.

MR. KLEIN: So the premium received under the new manual was higher?

MR. KOPEL: Much higher.

MR. KLEIN: Can you make an actuarial judgment conclusion on why the premium would go up when they changed the underwriting manual? Let me restate that question. Since the premiums were higher right at the same time as the underwriting manual changed, would you conclude that the mortality coming in was higher, so the premium needed to be higher with the new manual? The new manual created worse mortality and higher premium.

MR. KOPEL: Assuming reinsurers were equally adept at pricing, I would reach that conclusion.

MR. KLEIN: Thank you.

UNKNOWN SPEAKER: Let me just see if I can figure this out. Aggressive seems to believe that the replacement manual would not and should not have been unacceptable. In your expert opinion, what is your comment on that?

MR. KOPEL: It would be my opinion that the replacement manual would have generated a new quote from Deep Pockets Re, which would have changed the allowances, even though I thought it was a YRT.

UNKNOWN SPEAKER: But, as has been indicated previously, Aggressive Life had no obligation to inform Deep Pockets Re that there was a change in manual. And the only reason that a change in manual occurred was because High Standard Re went out of business and was acquired.

MR. KOPEL: I can't comment on the legal aspects.

MR. KLEIN: Good. You're not an expert on the treaty, are you? You looked at the pricing.

MR. KOPEL: Absolutely. Let's accept for a moment that your statement is technically correct. However, so far there has been no evidence that Deep Pockets Re has been injured in the quality of the claims that have come through. The auditor said that he tracked bad claims, and that was all right. The underwriter from the other company said that he didn't see anything untoward in Aggressive Life's performance from a market competitive point of view.

MR. KOPEL: I was told when I accepted this assignment that the level of claims that Deep Pockets was getting was much higher than anticipated and that they

were losing money.

UNKNOWN SPEAKER: Mr. Kopel, did you read the reinsurance standard?

MR. KOPEL: Yes, I did.

UNKNOWN SPEAKER: And did you read the underwriting standards contained in that?

MR. KOPEL: I read what it said, but I'm not a lawyer and I don't think I can comment on whether they had any obligation to tell about a replacement manual.

UNKNOWN SPEAKER: That's fair.

MR. KLEIN: Obviously, it didn't have any wording that said they had to tell about a change in the underwriting manual. But it did have the typical wording that said that the direct company, Aggressive Life, would have to follow its normal pattern of underwriting.

MR. KOPEL: Yes, normal underwriting standards.

MR. KLEIN: Right.

FROM THE FLOOR: You mentioned that when the manual was changed it would have caused higher prices from other insurers.

MR. KOPEL: That was my opinion.

FROM THE FLOOR: And did you see actual price increases given by other insurers with the switch of the manual?

MR. KOPEL: The net premium that went to the second reinsurer was higher. Again, they can come out with a different rating, but if the premium is different—higher or lower—you can't conclude unless you do the entire calculation.

FROM THE FLOOR: There were a number of other reinsurers that increased their price at the same time.

MR. KOPEL: I don't think I knew that.

FROM THE FLOOR: Do you know if any other price has been modified because of a change in the manual?

MR. KOPEL: That I don't know.

FROM THE FLOOR: I guess that's it.

FROM THE FLOOR: Along a similar line of reasoning, clearly Aggressive Life must have gone to the reinsurance market soliciting quotes; and therefore, more than one quote would have been provided?

MR. KOPEL: When? Are you talking about initially?

FROM THE FLOOR: No, in 1996.

MR. KOPEL: For the second re? I would assume so.

FROM THE FLOOR: So for you to have selected the terms that you did, it would have been a competitive rate?

MR. KOPEL: I don't know Aggressive. I was just comparing the two actual reinsurers.

FROM THE FLOOR: What is your knowledge of the life reinsurance market?

MR. KOPEL: Extremely high.

FROM THE FLOOR: And that being the case then Aggressive Life would have selected a competitive reinsurance rate and have gone to more than one reinsurer?

MR. KOPEL: One would think so.

MR. YOUNG: Other questions?

UNKNOWN SPEAKER: Did you hear the second witness say that his company was not asked for a rate increase when they switched underwriting manuals?

UNKNOWN SPEAKER: I have no knowledge of that.

FROM THE FLOOR: Was Deep Pockets Re asked to quote in 1996 on this other product, or were they not contacted? Was Deep Pockets asked to quote on this product that went to this different reinsurer back in 1996?

MR. KOPEL: I don't know. I would assume they were, but it's possible they weren't.

MR. KLEIN: I reserve the right to call him back again.

MR. YOUNG: Next witness is Johanna Becker. Aggressive Life told the TPA to notify Deep Pockets Re of the new manual, but the message never got delivered to Deep Pockets Re.

MR. KLEIN: I think this will be easy, Johanna. Why would you tell the reinsurance company of a change in the underwriting manual if it's not required in your treaty?

MS. JOHANNA BECKER: I didn't tell the reinsurance company. I told the TPA.

MR. KLEIN: You told the TPA to tell the reinsurance company. So why would you ask the TPA to tell Deep Pockets Re about a change in the underwriting manual?

MS. BECKER: I didn't tell them to tell the reinsurer. I told them that they had to make a change because the manual was no longer being supported.

MR. KLEIN: You instructed the TPA to advise Deep Pockets Re about this change?

MS. BECKER: No, I instructed the TPA to switch from the High Standard Re manual, because the reinsurer that we had been using, Standard Re, was no longer supporting the manual.

MR. KLEIN: So you told the TPA, but you didn't tell the TPA to advise Deep Pockets Re of the change in underwriting manual?

MS. BECKER: No, I did not, because I normally don't deal with underwriting. I administer reinsurance and pay reinsurance premiums and collect claims.

MR. KLEIN: This is your witness.

MR. KOLODNEY: We accept the fact that you informed the TPA that a switch from the High Standard Re manual was necessary because that reinsurer no longer supported the manual. As a matter of fact, that reinsurer was out of business, so they had no manual to support.

Now if you search your recollection carefully, would it be possible that you instructed the TPA to advise Deep Pockets about this change because of the relationship that the TPA had with Deep Pockets Re, which brought them to Aggressive Life with its endorsement as a TPA underwriter?

MR. KLEIN: Is that a question?

MR. KOLODNEY: Absolutely.

MS. BECKER: Yes, I did. I'm sorry, I got confused. I get very nervous up here when I'm in front of an audience like this, and I did ask the TPA to tell Deep Pockets.

MR. KOLODNEY: And the reason why was?

MS. BECKER: It was because of the manual change.

MR. KOLODNEY: And also, were you aware that Deep Pockets Re had introduced the TPA to Aggressive Life and endorsed them as an entity in which they could rely?

MS. BECKER: That's my impression; that's what I've heard.

MR. KLEIN: Let's go back to that first question again. Why would you ask the TPA to tell the reinsurer that you changed the manual? Why would you do that?

MS. BECKER: Tell the TPA...

MR. KLEIN: Tell the TPA to tell Deep Pockets Re. You just said you told the TPA to advise Deep Pockets Re of the change in the underwriting manual. Why?

MS. BECKER: Because it was an underwriting issue, and the TPA is handling the underwriting.

MR. KLEIN: But you asked them to tell the reinsurance company.

MS. BECKER: Yes.

MR. KLEIN: Why? Just because it's an underwriting issue, why would they need to know this? Why would Deep Pockets Re need to know that there was a new underwriting manual?

MS. BECKER: Well, because the old company didn't exist. Standard Re didn't exist.

UNKNOWN SPEAKER: I'm certain Mr. Klein is not suggesting that the reinsurer only receives information that it needs to know. I'm certain that he doesn't understand that the utmost good faith relationship between reinsurers and ceding companies is that limited. So I'm certain that's what Mr. Klein meant by that.

MR. KLEIN: In the years that you have been a reinsurance administrator with Aggressive Life, did you ever have any personnel changes? Did anybody leave, or do you have 100 percent persistency with your company? Do people just leave and quit, and you hire new people?

MS. BECKER: In the administrative area?

MR. KLEIN: Yes.

MS. BECKER: Well, people certainly change over time. They retire; some go on to new jobs.

MR. KLEIN: Did you tell the TPA to tell the reinsurance company when anybody ever comes or leaves or has a birthday or comes in late? You know, typical stuff?

MS. BECKER: No.

UNKNOWN SPEAKER: Were you familiar with this TPA before Deep Pockets Re presented them to you?

MS. BECKER: No, I was not.

UNKNOWN SPEAKER: So you had never come across them in the marketplace before?

MS. BECKER: Well, we weren't doing business with them, and normally, it's not my role to determine what TPAs might be out there in the marketplace.

MR. KOLODNEY: But you knew that they had been introduced to Aggressive Life by Deep Pockets Re?

MS. BECKER: That was my understanding.

MR. KOLODNEY: Could we conclude that in addition to the fact that underwriting wasn't your particular responsibility—but administration was—that you asked the TPA to notify Deep Pockets Re because you felt that they were a reliable conduit simply because they had this relationship with Deep Pockets Re prior to even joining Aggressive Life?

MS. BECKER: Yes, and the reinsurance arrangement had been in place for less than a year. So it was a new association with the TPA.

MR. KOLODNEY: ... who was brought to Aggressive Life by Deep Pockets Re?
MS. BECKER: Yes, as I understand.

UNKNOWN SPEAKER: When you say that the reinsurer never heard—in other words, the TPA never did what you asked the TPA to do—what did you do? Did you get angry? Did you have a discussion with the TPA?

MS. BECKER: Well, I didn't know about it until this arbitration came up.

UNKNOWN SPEAKER: Are you angry now?

MS. BECKER: Well, I'm certainly very frustrated that it has reached this state of arbitration.

MR. KLEIN: Just to make one thing clear legally, is there any legal relationship that you know of between the TPA and Deep Pockets Re? Are they a legal entity? Does one own the other or something like that?

MS. BECKER: I don't know.

MR. KLEIN: But it wouldn't surprise you to know that they're two completely different companies that have nothing to do with each other?

MS. BECKER: But it could be equally the other way, since it's my understanding that Deep Pockets introduced us to the TPA.

MR. KLEIN: But the facts are that they are two separate companies. So it wouldn't surprise you to know that they are two separate companies?

MS. BECKER: No.

FROM THE FLOOR: Since you thought it was important for Deep Pockets Re to know about the manual, and since you were the only company with a contractual relationship to Deep Pockets Re, did you think it was a duty of yours either to tell them directly or to verify that the TPA had in fact told them?

MS. BECKER: I did not feel that it was my duty to tell them directly, because we were dealing with a TPA. And I felt that by telling the party that was responsible for the underwriting to tell the reinsurer—in case there were any questions of an underwriting nature that I could not answer—that it was appropriate to have the TPA provide the information.

FROM THE FLOOR: Since you chose to let the TPA convey that message—and yet you agree that you wanted Deep Pockets to know—do you think that you had any responsibility to follow up with the TPA to ensure that the message had been conveyed?

MS. BECKER: Not necessarily, because we certainly from time to time ask the TPA to do other things, and they carry out our instructions; so it seemed reasonable that they would do so in this situation. And as the evidence proves, they did so a month later, because I requested this in August and in September the manual was changed.

FROM THE FLOOR: You said they did so in September, I thought we heard testimony...

MS. BECKER: I meant that they changed the manual, not necessarily that they had notified Deep Pockets, but that the procedure had been changed. So the assumption was that they had carried out all of the necessary communication.

FROM THE FLOOR: Your contractual obligation with the TPA is with Aggressive Life, not with the reinsurer, is that correct?

MS. BECKER: Yes.

FROM THE FLOOR: And I assume since you entered into that, you fulfilled your fiduciary responsibility by doing due diligence on the TPA?

MS. BECKER: Again, you must realize that my role is reinsurance administration. I was not responsible for due diligence or any of the other facets that brought the parties together.

FROM THE FLOOR: Did your company perform due diligence on the TPA?

MS. BECKER: I cannot answer that; I do not know.

MR. YOUNG: Do you want to ask that of Mr. Wilson?

FROM THE FLOOR: Mr. Wilson, did your company perform the due diligence on the TPA?

MR. WILSON: Yes, they did.

FROM THE FLOOR: Have you notified other reinsurers since the change of the manual?

MS. BECKER: This is the only reinsurance arrangement that we have at the moment.

FROM THE FLOOR: But at the time when the High Standard Re manual was in place, was it used on all these transactions?

MS. BECKER: Yes.

FROM THE FLOOR: And for other transactions, did you use some other manual?

MS. BECKER: We were retaining the rest of the business, the other products.

FROM THE FLOOR: So it depends on what other reinsurance deal that you have?

MS. BECKER: Yes.

FROM THE FLOOR: The underwriting was done using the High Standard Re manual?

MS. BECKER: Yes.

FROM THE FLOOR: What did you tell the other reinsurer at the other 50 percent of the same pool?

MS. BECKER: I don't have anything on here about retention.

MR. KLEIN: Yes, it's a pool; that's why they call it a pool. On this one we have 30 percent.

MR. KOLODNEY: How interesting. And the other reinsurers obviously had made no complaint about the results of the business, correct?

FROM THE FLOOR: Have they been told that there was a change in the manual—the other reinsurers?

MR. KOLODNEY: I'm an arbitrator, I'm not a witness.

MS. BECKER: One thing that I would clarify when you asked do we have any other reinsurance arrangements—we have no other first-dollar arrangements. We have some facultative arrangements.

FROM THE FLOOR: There is no other insurance in the same pool that the TPA was in?

MR. YOUNG: Well, I think you might want to ask Mr. Kopel this line of reasoning.

MS. BECKER: Can I go back given the facts now that this was 90 percent reinsured—I apologize—and change my answers?

MR. KOLODNEY: You're just refreshing your recollection.

MS. BECKER: That's right, yes. So there are other reinsurers in the pool.

FROM THE FLOOR: And what have you told them?

MS. BECKER: Oh, we went through the TPA as well.

FROM THE FLOOR: Same TPA?

MS. BECKER: Yes, because they're handling all of the direct business.

FROM THE FLOOR: And you have notified other reinsurers with the same TPA?

MS. BECKER: We have not had any communications from the other reinsurers.

FROM THE FLOOR: The other reinsurers could not have endorsed the TPA, and yet they were notified, and Deep Pockets really was not.

MR. YOUNG: I think the facts of the case are that we know that one reinsurer did not receive notification. The facts of the case don't have any information about the other reinsurers of whether they were notified or not. It's fine for Ms. Becker to

respond based on that, but it's sort of your information, Ms. Becker, as to what you think or know has transpired.

FROM THE FLOOR: Basically the fact is that they informed all of the insurers of the change in the manual; they informed all the insurers except for Deep Pockets.

MR. KLEIN: It was an oversight.

FROM THE FLOOR: What was the reaction of the other reinsurers when they found out the change in the manual?

MS. BECKER: I did not know because they went through the TPA.

MR. YOUNG: Again, there is no information in the case as to whether or not the TPA has ever notified anyone.

FROM THE FLOOR: They did notify...

MR. YOUNG: All she knows is that she has informed the TPA to notify and apparently we know—at least as it relates to this one reinsurer—they didn't. The other reinsurers are not pursuing arbitration and are not part of the case.

FROM THE FLOOR: Not pursuing arbitration yet.

MR. KOLODNEY: To your knowledge, as reinsurance administrator, the only reinsurer that was complaining about the TPA's results was Deep Pockets Re?

MS. BECKER: Correct.

MR. KOLODNEY: And the other reinsurers appear to be perfectly content with the terms they negotiated in the use of the Aggressive Life new underwriting manual?

MS. BECKER: We have not heard anything.

MR. KLEIN: And are you aware of all the pricing in the pool of each of the different reinsurance companies?

MS. BECKER: I know the rates because I administer the business.

MR. KLEIN: So are the rates the same for each different company?

MS. BECKER: No, they're different.

MR. KLEIN: Different from the pool, thank you.

MR. KOLODNEY: Would you say that the difference in those rates was

substantively different, or you would say within an average range?

MS. BECKER: There's a couple of points' difference in them. They're all fairly in the same ballpark.

MR. KOLODNEY: But they're different.

MR. YOUNG: Any other questions before we excuse the witness? All right, Mr. Yanko, are you sure you want to put yourself through this?

Aggressive Life has ceded to another reinsurer 90 percent of Aggressive Life's retention under the treaty with Deep Pockets Re. Mr. Yanko, you're a retired chief actuary of Marvelous Re, and you have 40 years of experience in the business.

MR. KLEIN: I'm not really sure I understand why this guy is here. So you're aware that Aggressive Life first set up a pool and ceded 90 percent of the business of the business to a pool?

MR. YANKO: I just learned that today.

MR. KLEIN: Good, so did I. And now you're aware that Aggressive Life wanted to leave itself with virtually 1 percent of the business and have 99 percent of the business reinsured.

MR. YANKO: We are now aware of that, yes.

MR. KLEIN: Just from your experience—would you think that that is a good risk management or good risk position for the reinsurance companies in this situation?

MR. YANKO: I would have to say that is not a good risk sharing for the reinsurers.

MR. KLEIN: OK , thank you.

MR. KOLODNEY: Mr. Yanko, you would think that this other reinsurer that accepted 90 percent of Aggressive Life's retained business knew that there was reinsurance above that. Would that be a correct statement?

MR. YANKO: That would be a good assumption, but I don't recall.

MR. KOLODNEY: Good assumption, all right. But apparently this other reinsurer that took this 90 percent of Aggressive Life's retained business seemed to be sufficiently happy about that transaction. So the fact that Aggressive Life only retained at the end of the day 1 percent, did not seem to be an item that concerned that reinsurer.

MR. YANKO: At that time, that is a correct statement.

MR. KOLODNEY: And the reason why Aggressive Life may have decided to cede that much could have been for a variety of reasons?

MR. YANKO: Good observation, yes.

MR. KOLODNEY: It did not necessarily mean that they were uncomfortable with the mortality results or anything else?

MR. YANKO: I would not be aware of that.

UNKNOWN SPEAKER: Mr. Yanko, did you read the reinsurance treaty?

MR. YANKO: I did not.

UNKNOWN SPEAKER: So you don't know whether there was an actual provision that would have been a warranty of retention in the agreement one way or another?

MR. YANKO: I did not. But again, they should have done that. If you recall, back when I started this type of business, a gentleman's agreement would be the understanding, so they could follow through in this fashion.

UNKNOWN SPEAKER: So whether or not there's a provision in the agreement that specifically addresses retention, what's your feeling on what the ceding company should or shouldn't have done regarding its retention?

MR. YANKO: The ceding company can sort of do as they wish, but they should share with the other reinsurers whatever the circumstances may be. Full disclosure would be appropriate.

MR. SCOTT: Thank you, Mr. Yanko.

MR. KLEIN: I'd like to call Bob Barker, the pricing actuary. This is for Deep Pockets Re. I just have a couple of questions. Mr. Barker, you're the pricing actuary for Deep Pockets Re?

MR. BARKER: That's correct.

MR. KLEIN: Now, can you just explain the structure of the company as far as the regions of pricing actuaries—just a couple of minutes of how you guys have no clue what each other is doing in the regions.

MR. BARKER: Yes, we have four agents, and we've merged with a few different reinsurance companies over the years. We have no clue what they're doing in other regions.

MR. KLEIN: That's what I said. Now if you were just pricing two separate deals—one with High Standard Re, now defunct, plus an underwriting manual and the new underwriting manual introduced in this agreement—how would your pricing differ from both of those?

MR. BARKER: About 15-20 percent higher.

MR. KLEIN: For the new manual, for the different manual, that's what you would do. You are familiar with that other pool that Deep Pockets is in where they changed the manual?

MR. BARKER: Yes, I am familiar with it.

MR. KLEIN: And the price didn't change on that one when they changed the manual?

MR. BARKER: Well, they should have changed the price, but there were other considerations. We did a couple of good administrative redeals with them, so we kind of did them a favor by giving them a pricing break.

MR. KLEIN: And the business that you had in that pool was much lower than the large business that you had at a good price?

MR. BARKER: Yes.

MR. KLEIN: I'm done.

MR. KOLODNEY: It's very interesting that on the latter example you indicated that some concessions were made because of ancillary transactions. Is that correct?

MR. BARKER: Yes.

MR. KOLODNEY: Now, is it also correct that you could draw a similar analogy to the fact that if it were not for Deep Pockets Re introducing the TPA to Aggressive Life, Deep Pockets Re wouldn't have been the beneficiary of so much of the reinsurance business that flowed as a result?

MR. BARKER: No, we just helped the client out. They didn't have a clue at the time, so we just gave them the TPA so they could finally start administering that insurance. They were not able to reinsure any business before at all, and they were in a dire need to find someone who could help them out.

MR. KOLODNEY: So you would say that the TPA that you brought to them was held in high regard by your company?

MR. BARKER: At the time, we thought it was a good fit.

MR. KOLODNEY: It was a good fit. So you had an expectation that if something were amiss, your buddies at the TPA who you brought to Aggressive Life would have informed you, yes? Especially since Ms. Becker said that all of those types of communications relating to underwriting changes came through the TPA?

MR. BARKER: No, we expected that TPA would perform its duties and perform its contractual obligations.

MR. KOLODNEY: The TPA that you brought to Aggressive Life. Thank you.

FROM THE FLOOR: Mr. Barker, do you have underwriting back there?

MR. BARKER: No.

FROM THE FLOOR: How do you determine that the use of the Aggressive Life manual, the Deep Pockets Re manual, necessitated a new price?

MR. BARKER: We have a life mortality system.

MR. YOUNG: This is the point of the program where we're going to give you all an opportunity to sort of evaluate the case yourselves by stepping up to the microphone and giving your opinions of the facts as they've been presented.

MR. KLEIN: When you say opinion you mean that the people should say, "I think this side should win because..."

MR. YOUNG: Well, whatever. Their opinion of the facts.

FROM THE FLOOR: The bottom line is the contractual obligation with the ceding company is with the TPA. They are the ones who instructed the TPA to change the underwriting manual.

The practice in the insurance industry and reinsurance is to notify when there is a change in underwriting manual; that did not occur. That is the obligation of the ceding company, not the TPA. The bottom line is that there is a change; they did not notify them of the change, plain and simple, at that point in time. Therefore, it is the obligation of the ceding company and I would rule in favor of the reinsurer.

MR. YOUNG: We haven't talked about what the consequences are. It's pretty much open to the arbitration panel—from one end, rescission, price change and status quo. So you can assume that the full range of options is open to the panel. Would anybody else like to state an opinion of the facts of the case?

FROM THE FLOOR: Anybody in favor of the ceding company?

UNKNOWN SPEAKER: Just for clarification, you rule in favor of the reinsurer. Would you grant rescission? That is what the reinsurer asks for?

FROM THE FLOOR: I would grant rescission effective on the change in the underwriting manual date. At that point, they would keep the business prior to that on the previous manual. You would reverse any transactions since that point in time.

MR. YOUNG: Any opposing points of view?

FROM THE FLOOR: I was surprised, in one sense, that the reinsuring company did not discontinue accepting business under the reinsurance treaty; they continued during this discussion even leading up to the arbitration. They could have stopped doing business.

I was also surprised by the wide-ranging questioning by the panel—it didn't really seem to focus specifically on the issues of the obligations to notify.

UNKNOWN SPEAKER: I just want to go back to the second set of facts that we introduced, Larry, just so you recall them. Deep Pockets Re participated in a different pool that used the old High Standard Re manual and replaced it with the same replacement manual. Deep Pockets Re was aware of the use of the replacement manual, and apparently didn't react.

FROM THE FLOOR: That's precisely the point I wanted to make.

While the ceding company certainly does have an affirmative obligation to inform the reinsurer of this, it strikes me that the reinsurer waited almost seven years before saying anything. In that sense, they're sort of cherry-picking. I can't imagine the reinsurer saying anything had the experience turned out to be better than they had expected.

Therefore, I would find for the reinsurer. But in terms of damages I would split it somehow—maybe cover half the losses or cover rescission for the policies sold after or before a certain point in time, sort of midway in between the change in the manual and the current time.

FROM THE FLOOR: I'll present you another opinion.

Aggressive committed to underwrite the business. They did it with the manual that was well-approved by the market at the strike. Once that manual was no longer available, they just switched manuals. They didn't start waiving underwriting requirements. They just underwrote the business with a manual that Deep Pockets knew of and accepted. I can realize that better lines of communication might have been welcome in this situation, but I don't see any need for rescission. Deep

Pockets has to support the risks, period.

FROM THE FLOOR: Regarding the 90 percent cession, that seems almost like a financial reinsurance deal of the retention.

MR. YOUNG: This was a risk transaction.

FROM THE FLOOR: It doesn't strike me as too odd to raise surplus, even on a transfer of coinsurance basis.

MR. YOUNG: So where does that take you?

FROM THE FLOOR: The allegations being that they are down to a very small percentage on the risk...

Mr. KLEIN: You're not disturbed by the fact that 99 percent of the risk is being ceded out, the underwriting is being ceded out, the claims administration is being ceded out? Everything is being ceded out. But Aggressive Life gets to choose which underwriting manual is being adhered to and gets to give the rules on claims and all that kind of stuff that binds other companies to 99 percent of the risk. That doesn't bother you?

FROM THE FLOOR: I'm not in underwriting.

MR. KOLODNEY: I think Mel has a point. It may well be disturbing, but Deep Pockets Re had the option of putting in the treaty a clause that mandated a minimum retention by Aggressive Life. And it chose not to do that.

MR. KLEIN: One thing is that there are state laws about minimum retention. The second thing is, I laugh a lot about these unilateral rights. I don't understand what that means that Deep Pockets could put it in the treaty. What if Aggressive Life said no?

FROM THE FLOOR: Then they could have chosen not to enter into the agreement.

MR. KLEIN: No, I understand that. The whole situation is that if a company then decided to hold less retention than it said it was holding, that that's something that the reinsurer should be notified about. You don't think that the reinsurer should be notified? That's not a material change in the agreement?

UNKNOWN SPEAKER: No, I don't think those were the facts.

MR. KLEIN: No, it's on new business.

UNKNOWN SPEAKER: Because if I cede to another reinsurer 90 percent of

Aggressive Life's retention under the treaty, it's going forward.

MR. KLEIN: I see what you're saying—you can read it both ways.

MR. YOUNG: The intention of the wording was that it was going forward on new business.

UNKNOWN SPEAKER: The fact that Aggressive Life ceded 90 percent of its retention to another reinsurer, I don't think demonstrates anything. And as far as naïve capacity goes, I don't think it existed in this particular instance. Both of these reinsurers were sophisticated enough to make their own decisions.

MR. KLEIN: I don't even think this comes into a case, so I won't dispute that at all. Mr. Umpire, I'd like to just quickly make my case. It's a very simple case. I don't even have to make it because Jim did such a good job. It's exactly what I wrote down here. It's a very simple case.

Mr. Kolodney here will obviously pound the table, because he doesn't have the facts or the law on his side; so it's very clear. You have to tell of a material change in underwriting. There's a material change in underwriting that Deep Pockets was not told.

As far as any other pools or any other knowledge of this, the only reason that it took so long is because the experience had finally emerged that was worse, and then negotiations began. And it took a couple of years talking to this because Deep Pockets thought that Aggressive Life would grant some sort of increase, because the new underwriting manual is not inconsistent, it's just worse. So it's consistently worse, and you can price for it. We had the pricing actuary for Deep Pockets say it would be 15 percent. If Deep Pockets got a 15-percent increase, they would love to continue the business and then everything would be fine.

So I'm asking for rescission, but I'd like to keep the relationship going and keep in good faith the relationship at a 15-percent increase at the time. But it's just so clear—none of the other facts matter at all. Clearly here there was a breakdown of communication. Deep Pockets is not blaming Aggressive Life and understands there was a problem in communication. Had they found out right at the change, they would have said, "Could we see the new underwriting manual? Could we price for it?" Then the chief pricing actuary here would have priced for it, turned it into the model, and would have come up with a 15-percent increase. We would have asked for a 15-percent increase, and it either would have been yes or no. If Aggressive Life says no, we want rescission; if they say yes, we'll take the 15-percent increase. It's clear.

MR. YOUNG: So what you're proposing is a 15-percent increase on new business processed from the date of the change, and I assume plus some interest rate on those premiums to the current date.

MR. KLEIN: To show what good guys we are, we'll waive the interest rate.

MR. KOLODNEY: What a pal! I believe Deep Pockets' argument is specious and carries no credibility.

In the first place, Deep Pockets Re has made a total shambles of their allegations. This is a company that introduced the TPA to Aggressive Life. That is a de facto endorsement of the quality and nature of the operation, because they were prepared to accept TPA's underwriting throughout.

Also, here's a letter that Deep Pockets Re sent dated August 14, 2002, to Mr. Farquar, President of Aggressive Life, talking about the fact that Deep Pockets Re's chief underwriter discovered on September 1, 1995, that Aggressive Life's TPA, which was brought to them by Deep Pockets Re, discontinued using the High Standard Re manual and substituted another manual without notice to or approval by us.

Well, it took them seven years to figure that out. What happened between September 1, 1995 and August 14, 2002? Is it just because they started getting claims and woke up and said, "Well, we don't like to pay these claims, so maybe we'd better figure out a way to get out of this agreement entirely?" I believe that Deep Pockets' conduct in this whole issue was totally reprehensible and certainly violative of an obligation to perform an act in a reasonable and timely manner.

My remedy would be that Deep Pockets Re loses completely on the charges that it alleges, and they have a choice of terminating new business with Aggressive Life or renegotiating between the two of them a different set of terms on a mutual basis.

The other thing was that Ms. Becker told the TPA to notify Deep Pockets Re as part of her normal procedure in dealing with reinsurers on issues like that. And here you have the chief underwriter coming in September, discovering that the manual had been changed, and reporting it. Deep Pockets Re does nothing about it for seven years, so I think there's culpability on Deep Pockets Re's part. I believe that they're just frankly sore losers.

MR. KLEIN: Yes, he has to read the memo—I think you're correct. It's very simple. Go ahead, explain.

MR. KOLODNEY: It says during a routine underwriting audit recently conducted, it was discovered–I see. Ah-ha....

MR. KLEIN: So, we're back to the case again. It's very simple. The TPA has really nothing to do, there's no legal obligation. And yes, the TPA was introduced. You heard from the chief pricing officer here that that was just a neat space thing. It's just a TPA.

MR. YOUNG: Mr. Umpire.

MR. SCOTT: Very complicated case, guys, but I don't think it's as simple as saying that the ceding company had an obligation to tell the reinsurer, and it didn't tell the reinsurer, so the case is easily resolved. Does the ceding company have an obligation to tell the reinsurer something that the reinsurer already knows or ought to know? I think it's a little bit tougher than that.

The fact of a long delay in the reinsurer acting that I think Joe was sort of leading to is also something. This is not a rescission case. I think rescission is a tough remedy and one that is very rarely granted by panels. I think that probably it does make sense to grant some limited relief to basically reinforce this reinsurance agreement and have a ruling that the reinsurer must honor its obligations.

However, we will make it subject to a discounted rate for the business that's in existence, and I think the panel, after deep deliberations, will come up with a rate that will be between zero percent and the 15 percent offered by Mr. Klein. So we'll come up with a discount rate of 7.5 percent and that's our rule.

MR. KLEIN: Or an increase.

MR. SCOTT: That's what I mean. Once again, the lawyers split the baby—typical arbitration—they split the baby in half.

MR. YOUNG: I want to thank all of the participants. Are there any other questions?

FROM THE FLOOR: Just an observation. Mr. Scott, this is more for you. The nature of this arbitration panel has had one arbitrator selected by the reinsurer and one selected by the direct writing company, both of whom were strong advocates of the position of the companies that appointed them. So it seemed that the end result of the arbitration was they're each advocating the position of the company that appointed them, and the decision is now yours. Is that the way that it should be or should there be more of an attempt to have three more unbiased parties on the arbitration panel?

MR. YOUNG: For whatever reasons over the years, it started out sort of the way you would have liked it to be. My experience over the years is that it has tended very much to this kind of procedure.

I think Jack mentioned during his early remarks that you try to have people that are going to keep an open mind as much as possible. You don't normally have quite the level of advocacy that you see here, but there are people, very often today, that have been picked each by one side or the other and have been exposed to the facts and have expressed a sympathy with the side that's selecting them. So that's the way things are more often than not. I don't know if other people have other

experience, but that's been my experience in recent years. I would say a decade ago it was more unusual, and perhaps it's because these things have become more of a legal proceeding than they used to be.

MR. SCOTT: It's a fair question to ask whether that's the way it ought to be as opposed to the way it is.

Again, in an hour, we couldn't really give you a full, capsulized example of what they're like. In reality you'll have counsel for both sides making arguments to the panel, so you'll probably in reality see less blatant advocacy practiced by the panel and more practiced by counsel on behalf of each side. But what Mel is saying is true. There certainly is that element when the panel sits down to make a decision. You are going to have strong views by each party-appointed arbiter. That's typically what happens.

MR. YOUNG: I'll make one other comment about this case. We tried hard, we really did try hard, to come up with an interesting case for you.

Again, it's my experience that most arbitrations could have been avoided had the parties communicated more effectively from the start. And whenever we do one of these—we try to do one every two or three years—that's always the message. Whatever the case is, communication between reinsurer and ceding company can avoid many of these messy situations.

MR. SCOTT: That, and hire lawyers is the other message.

MS. JILL A. KIRK: My lawyers have been telling me that they are more comfortable with litigation. Could you comment on the pros and cons of arbitration versus using mediation maybe leading to...

MR. YOUNG: Lawyers will generally agree with that position.

Let me start with this. Ozzie and I, many years ago, several lifetimes back, were once negotiating a very large financial agreement with a company. During the negotiations they said, "We want you to take the arbitration provision out of the treaty." And I very innocently said, "Arbitration provisions are important, because if there's a dispute involving a lot of money you want to have educated people, who understand the business, come to the table and come up with a fair and proper resolution." The lawyer on the other side of the table from me said, "If this blows up, we're going to owe you a few hundred million dollars. Do you think we're just going to write a check? We're going to make you sue us."

We didn't do the agreement. But I think that again, handled properly, which I think most of these are, you have three people, knowledgeable about the insurance business. Hopefully, they can be as fair and open-minded as possible. That should be part of the process. Then you're going to get as close to the right conclusion as

you can.

If you go through litigation you're not going to have that situation. If you have a very weak case and you would rather not have knowledgeable people, then I agree.

FROM THE FLOOR: Ed Tomin, just one comment: To emphasize what Jack said earlier, I've only been involved in one arbitration case in my career, but it was an eye-opening experience and a profitable one.

You remarked early on that the normal process would be that where the arbitrators chosen by each side, while there may be some element of advocacy early on, there came a point in the case I was involved with when we were instructed, "Now you stop talking to your arbitrator." In other words, to get him to advocate your view.

There comes a point in time where they're left on their own. Again, I can't overemphasize the element of education. I think most of us would choose to have knowledgeable insurance people involved in coming up with a fair case. In this case, we didn't get everything that we wanted, but we were confident that the knowledgeable people that sat on the panel came up with a fair resolution.

MR. YOUNG: One of the things Jack said during his remarks was that each side tries to give all of the facts as best they can from this point of view to the person that they've appointed. But I'll tell you again from my experience, very often when you hear the other side's facts presented from their point of view, there's a different color to them. So even though you might think you might have a party arbitrator, the situation might change.