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Session 21D
Where Is Your Reinsurance When You Need It?

Track: Reinsurance

Moderator: JOHN O. NIGH

Debaters: ERIC HAAB†
MONICA HAINER
JOSEPH F. KOLODNEY‡
JOHN E. TILLER JR.

Summary: Denials of reinsurance coverage are increasing, resulting in increased arbitrations between direct writers and reinsurers. A variety of reasons exist for the increase in frequency of denials, including contract termination and exclusion of specified claims. Join this lively debate as the point of view regarding the rights to deny claims is presented by a representative of both a direct writer and a reinsurer. Attendees learn the factors that have led to this increased level of arbitration and what can be done or what should have been done to avoid conflicts.

MR. JOHN O. NIGH: This is a debate, not a panel discussion.

I'm with Tillinghast in its New York office. I'm a managing principal of the firm and am responsible for the firm's mergers and acquisitions (M&A) practice for the Americas. As such, I have been involved in many related activities, reinsurance, and have been involved in a number of arbitration matters throughout my career at Tillinghast, including with members of the panel.

Speaking of members of the panel, we have Monica Hainer, an FSA, a Fellow of the Canadian Institute of Actuaries, as well as a member of the Academy. She's president at London Life in Blue Bell, Pa. She is active in the ACLI, including past

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chair of the Reinsurance Committee of the ACLI and past member of the board of the ACLI.

We have Eric Haab, who is not an actuary. He is an attorney. He is managing partner with Lovells in the Chicago office, and he has been deeply ingrained in reinsurance and reinsurance arbitration over at least the last 15 years. I have worked with Eric on one arbitration matter.

We have Joe Kolodney, a familiar face to most of you in the audience. He is managing director of the global life reinsurance practice of Aon Re Worldwide in Stamford.

John Tiller is an FSA, as well as a member of the Academy. He is senior vice president of research and development with ERC in Overland Park, Kan. He is co-author, along with his wife, Denise, of the seminal book on reinsurance entitled *Life, Health & Annuity Reinsurance*.

This is a debate. I will be moderating the debate. The format of the debate is that I will have a question. I will identify who is going to respond to that question initially. Then I will also identify, before I ask the question, who will either agree or disagree with that respondent, and then I'll allow, after those two comments are made, the other remaining panelists to give their view, if any. So, to begin, we will ask Monica to answer the first question, and Eric will respond to that question. Monica, is arbitration an appropriate means of resolving a dispute, and, if not, what are your options?

MS. MONICA HAINER: Thanks, John. When I started reading old articles and new articles on arbitration, I noticed that one of the issues with arbitration is that they're private, so it's rather difficult to examine the process with respect to efficiency and result, which makes the question sort of interesting. Is it an appropriate means? Well, do we really know? I left that question and went on to the options fairly quickly. I came across quite a few interesting options to arbitration.

There is mediation. What I found about mediation is that the earlier you try mediation, the more effective it is. The mediator doesn't decide the matter, but rather assists both sides to focus on strengths and weaknesses and to help with any obstacles in communication.

There's mini-trial. The parties, through counsel, present their case to a judge or an arbitrator. There's limited discovery and limited time allocated to this. The judge issues an advisory opinion outlining strengths and weaknesses of both sides. Negotiations can be renewed afterward in hopes of coming to a conclusion.

Neutral arbitrators, rather than our current system of having party-appointed arbitrators, have been presented as an alternative. There is litigation. The cost and time savings of arbitration may not be real. Again, it's hard to determine that.

Confidentiality may be a double-edged sword. You can't apply the results of an arbitration to another arbitration. The ruling can't be disclosed to rating agencies or to retros. It can't be relied upon by anyone. Litigation, of course, cuts through all of that.

The last one I came across quite recently was called multiple consolidation. That's taking arbitrations that arise from the same loss under separate reinsurance agreements and pulling them together for the obvious efficiencies that might entail. The significant difference is the forum selection. The choice of law might have to be worked through before the multiple consolidation can work. The courts have been less than willing to take this step to compel multiple consolidation, but it is another alternative to be considered.

MR. NIGH: Eric, I think she opened up the door for any opinion on appropriate means of resolving the dispute.

MR. ERIC HAAB: Thanks. One thing to bear in mind is that if you do have an arbitration clause in your treaties, that is going to be binding if one of the parties wants to bind it. It's a good question to think about theoretically, but on treaties that have been put in existence now with arbitration clauses, you don't have a whole lot of options. I happen to think that arbitration, although it is flawed, is the best option and has the best potential to resolve a dispute in a life reinsurance area. It's as good as the arbitrators that you've selected, and the parties need to pay attention and work at it to make it the best process it can be.

Versus litigation, it can be difficult to present a case, particularly if it's a complex technical subject or one that involves actuarial issues, to a court, whether it's a judge sitting or a jury. I think that there actually are cost savings and some efficiencies that you'll get in arbitration that might not always be apparent versus litigation. It may seem to those of you that have been involved in arbitrations that they go on forever, but you skip over long sections of the court litigation process, such as the summary of judgment, interrogatories and things that might take six months or a year in court. I do think that arbitration is probably the best alternative.

Mediation is something that isn't tried very often. There is a lot to be said for mediation, but it does require that both sides buy into the process. You have to have both sides wanting to do a meaningful mediation, picking someone whom they both respect, who's credible, who's going to understand the case, understand the dispute and who is going to tell it like it is to both sides. Like the mini-trial option, early on in a dispute you will force the parties—it often doesn't happen unless it's forced—to examine their own case and their own warts on their side. People fall in love with their side of a case. They think that the other side is just jerking them around. The best thing about mediation is that, even if it doesn't work, early on it forces both sides to see someone look them in the eye and say, "I don't buy that argument, and I don't think an arbitrator is going to if you don't settle." Mediation

often doesn't actually result in a settlement, but I think it does advance the settlement process.

MR. NIGH: John, you look like you wanted to say something.

MR. JOHN TILLER: Yes. John forgot the part of the disclaimer that the panelists are speaking from their own minds, and the opinions they represent are not necessarily those of their employers, the Society, the Academy or maybe even ourselves on occasion, for the purpose of debate.

My experience with arbitration has been fairly negative. I don't see it as necessarily a very good tool. To me, a good tool should be something that has predictable, reliable and reproducible outcomes. I think that if you take the same set of facts to a different set of arbitrators or a different pair of companies, you'll often get different results.

What I have seen is that arbitration works fairly well between two somewhat equal-sized parties. However, if you have a large company, potentially the reinsurer, and a small company, potentially the ceding company, there seems to be a sympathy vote to try to help the poor, little ceding company that didn't know what it was doing find its way out of this in a way that keeps it whole.

My opinion is that arbitration may work in some circumstances with large companies, but I don't think it works very well in all circumstances. In the property and casualty (P&C) world, at least one large reinsurer, if not more, explicitly does not include arbitration clauses because they prefer to go to court, believing they can get a better, clearer settlement. I don't know exactly how it evolved, but on the life side we always have arbitration and on the P&C side we don't. I think it's something we need to think about going forward.

MR. NIGH: I'm going to ask Eric the question and ask Joe to respond. It's a simple question, but I think it's an eye-opening question. What do companies do wrong in the contracting process?

MR. HAAB: That's an open-ended question, obviously. There are all sorts of things that go wrong; we could talk about it for a long time. When you look at it, what is it that goes wrong when the contract is not put together in the way it should be? You're all in the business of making contracts for a living. When something happens in the performance of the contract that isn't expected, a good contract (a contract that is a product of the right kind of negotiation and is documented well) should allow the parties to go back, look at the document and look at their own files to have the issue resolved, either because it was addressed or if it wasn't addressed, because it was properly documented. If it's something that was ambiguous and it's not in the contract, you can look in the underwriting files or the placing files on the ceding side and see that the matter was raised and discussed. Things go wrong in all three of those phases.

The first is in the communication phase. We lawyers only see contracts that have gone bad. You'd be amazed at how often the stories are the same. You're under time pressure. There are deadlines. It might be year-end. Your reinsurers might be quoting on five or six different things at the same time. There are issues that just don't get explored. Both sides need to make sure that all of the things that might possibly be material get raised and discussed so that there's an actual meeting of the minds. There shouldn't be too many ambiguous, gray areas that don't get addressed. That's the first thing that can be done better, and that's just a matter of discipline. Make checklists or whatever you can do to prepare in advance on a systematic basis for trying to make sure that all of the material issues get addressed.

The second phase is the documentation process. There are too many occasions when standard treaty language is used when it's not necessarily appropriate for something that is not a standard arrangement. If there are particular wrinkles that have been raised, a certain set of exclusions or a certain set of assumptions based on whatever information was provided back and forth, then those need to get in the treaty if they possibly can. The people involved in negotiating the treaty need to spend the time with the people documenting it. There's a tendency to hand things off to some in-house counsel or a contract person who wasn't there and who doesn't have the same feeling for how things ought to be documented.

If I could leave you with one thing, the most important thing is that your files on the treaty negotiation process, the disclosures that were made and the discussions that took place need to be in the underwriting file or in the placement file. Here's what happens over and over again. It's three or four years down the line, if not longer. Some of the people involved have left the company. They might have been let go. They're not on good terms with the company on one side or the other. There are questions about something. Well, this must have been discussed. Shouldn't it have been discussed? The ceding company side says that they told them about that and they did the deal anyway or they factored that into their price. They told us they were going to do that.

If you're the reinsurer, you're saying that you asked those questions, and they absolutely misled you. You need to look into that file and see precisely what was discussed. The disputes that don't get resolved easily and that become expensive and acrimonious are the ones where the file is lacking. It's not there. I know you all do a very good job of peer reviewing the actuarial work and the pricing, but you ought to have someone do a peer review on the file afterward. Make sure it has everything in there that should be in there. Those are some of the big-picture things that sometimes go wrong and could go better.

MR. NIGH: Joe?

MR. KOLODNEY: I accept a lot of things that Eric has enunciated. However, I would like to point out that what goes wrong in the contracting process is the

question of focus. At the time the deal is negotiated, the focus is on the terms and not so much as on the following conditions. You have a product out there that's sent to several reinsurers. It's placed on certain terms. Companies want to get that bound and in place to be able to sell their business and move forward. The actual treaty terms are in some cases regarded as boilerplate, or there seems to be nothing extraordinary about them. As a result, perhaps ceding companies don't pay as much attention as they should to proper, upfront phraseology to make sure that these liabilities that they are passing on to the reinsurer are, in fact, going to be recognized and acknowledged.

I don't believe that ceding companies spend the quality of time necessary to fully understand to what obligations they're signing up. It's important to remember that a reinsurance agreement has a certain dynamic nature to it. Depending on the practices of the ceding company, there may be subtle or there may be overt changes to the business during the life of the treaty which no one is taking into account as far as the impact on pricing, impact on claim settlement, etc. It's incumbent on both the ceding company and the reinsurer to be as diligent in the treaty process *after* the deal is bound as they were to get the terms negotiated to the point where there is a treaty.

MR. NIGH: Anyone else on the panel?

MS. HAINER: I'll add to what Joe is saying. For instance, on the claim side, the treaty will define what business is being reinsured, but then the claim handler is not sure of the underwriter's view on what's reinsured and what isn't. Then the claim handler pays claims that aren't supposed to have been ceded under the treaty. Later on, that will become difficult to argue because you've been paying them for the last five years and now suddenly you're going to start denying them.

Another clause that's often not followed is audits. For instance, if there's a provision to allow you to audit and you never audit, or the audit is very ineffective, incomplete and cursory (more going out for lunch as opposed to really auditing), it's difficult to identify a problem. Then the problem continues for a long period of time, and it becomes more difficult to resolve because it's been done one way for a long time. Following up to what Joe is saying, make sure that contract is considered right through the pieces from the beginning, including the business you're taking, the claims and the audits.

MR. TILLER: I'd like to add an exclamation point. I've been involved in two to three dozen arbitrations or near-arbitrations in my career, either as a consultant, advisor, principal, expert witness or general manager of a company. I understand there are some issues around underwriting, but I've never had to get too involved in those. With one exception, every one of those two or three dozen could have been avoided with a clear contract. In other words, over 90 percent of the arbitrations I've been involved in were the result of a bad contract.

MR. KOLODNEY: I'd like to make one more comment. I referred earlier to the fact that a reinsurance treaty is dynamic in some respects, but it's also something where the ceding company and the reinsurer sign on to an agreement. The only thing that changes is the action of the ceding company going forward. The liabilities and the obligations are spelled out in that agreement, and the reinsurer can act only under two circumstances. The first is under the audit procedure that Monica alluded to earlier, and the second is as a reaction to an event that has been called to their attention by the ceding company, whether it's a request to pay a claim, some reinstatement or something else. However, I think that the onus of performance rests on the ceding company because a reinsurer becomes somewhat passive as far as the ongoing business ceded to it and then reacts when they're called upon to discharge liabilities according to the way the contract is written.

MR. NIGH: There's a question from the floor regarding whether Monica was representing a reinsurer or a direct writer. We did try very diligently to get a direct writer, but, to a person, all the direct writers indicated that they felt uncomfortable making any statements, whether they were individual statements or not, that might be construed out of context. That's some indication of the importance of this issue.

MS. HAINER: It's a real issue. Sitting as an arbitrator on a panel, you realize quite rapidly you're just sitting there making enemies. Yet the arbitration process requires industry professionals to take part in that and be arbitrators. There are a lot of issues here.

MR. NIGH: The next question is for Joe, and I've asked John to respond. This is obviously directed at Joe in his role as a reinsurance broker. As a reinsurance broker, what changes have you seen in the relationship between the ceding company and the reinsurer that seemingly have increased the level of arbitration or have stimulated arbitrations?

MR. KOLODNEY: Fortunately, I haven't had as much experience in arbitrations as some of my colleagues here on the bench, but my view would be that what stimulates arbitration generally rests on a deficiency of proper interpretation of the treaty or an action on the part of the ceding company or the reinsurer as respects our friend, the claim. To go back to what companies do wrong in the contracting process, it's what they do wrong in the contracting process that stimulates the arbitration at the other end. This would include such things as being casual about underwriting or about timely notice to reinsurers as to a change in practice, a misunderstanding or miscommunication between departments within companies so that they're not adequately communicating a change that the reinsurer needs to know about, or perhaps miscommunication within the reinsurer, where a field representative out visiting the company writes a report that the underwriters are now being more aggressive on certain impairments, and nobody back at the reinsurer's head office looks at the impact of that on the pricing that they originally predicated their offer on.

There are a lot of issues that emerge just because of the reality of the day-to-day business. Once the treaty is set, I think few companies or even reinsurers refer back to the original agreements. Problems come up down the road that now have to be looked at in a completely new light, and, therefore, there is not an amicable settlement. We understand that there's now one reinsurer looking at a certain level of claims and finding that they were bound on claims that fell within the jumbo limit, and they weren't aware of it until the claim hit. That's going to be an interesting arbitration.

MR. TILLER: In response, I'd like to take you on a history lesson. I want to go back about 25 to 30 years, before a number of you were in this business, but you have to understand the context in which our treaties and our practices evolved. At that point, a ceding company would typically have two reinsurers. They would keep their full retention. They'd split their first excess between two reinsurers. Let's say that they were Lincoln and Connecticut General. That was quite typical. Then they'd have a second excess above that that the rest of us would fight over. Both of those companies have now disappeared into the Swiss Re, which was the third one that might have been in there. Typical reinsurance today is that a ceding company doesn't keep its full retention. It keeps 10 percent and lays off 90 percent to a pool of four to eight reinsurers. They change those four to eight reinsurers every nine to 18 months when they bring out a new product.

Let's talk about profit margins. When I got in this business with Transamerica, we had a treaty dating back to the 1940s and 1950s where we were retrocessionaire for one of those companies. We took out a dollar per thousand profit charge, and then gave half the remaining profit back as an experience refund. Our share of the experience refund was greater than our dollar per thousand. We were looking at profits of four dollars to five dollars a thousand on these things. Now you don't get that sort of premium.

In that era, it was fairly easy. There was a lot of loyalty. Ceding companies bent over backward. They didn't care as much about price as long as it was a fair price. They bent over backward to keep their loyalty to their ceding companies and make sure that those one, two or three companies were always involved. The ceding and the reinsurers would take care of them. They had margins. They could say, "Okay, we'll help you out with this claim. We'll take an extra underwriting risk on this case." There's not a margin to do that today. One extra claim can turn an account from reasonably profitable to a loss. I think one of the biggest changes is that we've moved from a profitable, partnership relationship where both parties cared about each other, to a price-driven relationship on the side of the ceding companies and a market-share relationship on the side of the reinsurers. If this changes, you no longer have the so-called gentleman's agreement where I'll help you out and you'll make it up to me, because you don't know if he's going to be the one to make it up to you next year or not. Everybody has to look at this quarter's profits and what this deal is going to do to them. The way the business has been done recently, there's no room for error and there's no room for partnership. That's the

biggest change that I've seen.

MR. KOLODNEY: Going back to John's history lesson, a lot of reinsurance treaties were written in an era where the transaction of the business itself was a lot less formal. Now these same agreements are being looked at in the light of a contemporary view. There's no wonder why there are spaces missing and issues that haven't been explicitly defined. At the time those early agreements were done, there was no apparent need to be that explicit. Everybody used to say, "We're not drafting a contract here. We're drafting a gentleman's agreement." But now, every year that goes by, contractual language is becoming more subject to review by counsel and outside counsel. There's a lot less flexibility for interpretation. As a result, issues are being much more narrowed. Specific responsibilities are being much more heavily enunciated in these agreements. It becomes incumbent on both the reinsurer and the ceding company to be acutely aware of their mutual responsibilities. I did a study for the Society a couple of years ago on reinsurance arbitrations. There were some companies that never responded because they didn't want to promote the fact that they were involved in one or two or 10 different arbitrations. I think this is true today. As Monica pointed out, arbitrations are generally confidential. People subscribe to the fact that they won't discuss them afterward. I don't know that the industry has a good view of how rampant this is. I can think of three possible arbitrations right now that haven't been announced, but I'm sure they will go forward.

So, it's the era we're living in—price-driven and market-share driven. Being casually addressed by either party as to what their obligations are is a cause of concern. I don't believe it's going to get any better. The last comment I'll make is that another part of the problem is that, as Jimmy Durante once said, "Everybody's got to get into the act." Everybody has their own treaty version. It makes it very difficult for a ceding company to have consistency in how it views its obligations to the reinsurer and for a reinsurer to have consistency in how it views its obligation to the ceding company. There's enough language out there from multiple reinsurers that somehow we ought to get beyond the proprietary nature of "my version is the only version" to something that the industry can accept as a reasonable standard for dealing with these issues.

MR. HAAB: I agree completely with that analysis. It should be no surprise that with greater amounts being ceded, you have a greater number of disputes. Greater amounts and changing relationships will automatically cause disputes. The very same phenomenon was seen in the P&C world starting in the 1980s when you had all the product liability in asbestos long tail through unexpected liability arising. You had a lot of people getting out of the business, buying books of business and focusing on running those off. That's where all the disputes started arising. When you have huge amounts at stake, when people sit down at the table and there's a $70 million gulf between them, they're not as able to be gentlemen and work it out because there's too much at stake. It's hard to see how it's going to change in that environment.

MR. NIGH: John, your response in large part is a response to the next question, but I'll go ahead and state the question to see if you have anything more to add to it, and then I'll ask Monica to respond. Has the focus on profitability somehow impacted service and/or the relationship between the direct writer and reinsurer? Have those two events, the postulate that service has somehow deteriorated and/or that the relationship has somehow deteriorated, contributed to the increase in arbitration?

MR. TILLER: Yes, I think they have. I'd like to focus on a couple of points, both of which have been alluded to or touched on earlier. One is the consolidation of reinsurers. A number of you were in the session this morning where we talked about reinsurance creditworthiness. By my count, something like 14 or15 reinsurers have disappeared from the U.S. marketplace, via consolidation or exit of some sort, in the past 15 years. We've had effectively one replacement that's still in the marketplace. That has changed a lot.

As Eric said, you have companies that are buying other blocks of business. They don't have the long-term relationship, and they're buying off on a tighter financial platform than they've had in the past. You've had a number of these companies exiting because they couldn't get the right kind of return for capital, so the companies that are still in it have to get the return on capital. The reinsurance selling and consolidation has certainly changed relationships, and disrupted and disturbed them.

I think Joe mentioned mutual obligations earlier. We always talk about the reinsurer's obligations. The reinsurer has the obligation to pay off, to live up to their promise, but the ceding companies have operational obligations to do the administration in a timely, accurate fashion and to underwrite appropriately. We're seeing an emergence of more and more arbitrations around: Was this business underwritten properly? There are a number of ceding companies out there that I am convinced are not following the underwriting guidelines that they should be. When you get less and less of the business on your books, it's pretty easy to make that easy call or that call in favor of the agent to issue something. I think we're going to see more and more arbitration resulting from underwriting issues. I think you're going to see more and more reinsurers standing up and saying, "No, this is what we priced for, and you should have underwritten to that standard. If you didn't, you're not covered." That all goes back to the other things we talked about.

MS. HAINER: Both from the point of view that this is a debate, so it's my obligation to take the opposite side, but also from the point of view that I don't want to be part of a panel that is strictly doom and gloom, I think, yes, the focus on profitability is real, but I think perhaps this focus on profitability should extend to the arbitration process. It is very important for us, in the event of a dispute, to review our position honestly and realistically and perhaps take it forward to trying to come to a solution without going to arbitration. I don't know what the dollars are now, but I don't think that you even get into an arbitration for under $1 million at

this point in time. Those are the kind of numbers I hear bandied about. It's all very well to say you wish you had underwritten the policy this way, but if you didn't, you didn't. Maybe save your company the $1 million or $2 million or $3 million that it's going to cost and try to come up with a settlement with the other side. That might be a valid thing to do. Maybe that's too rosy a picture, but I don't like the total gloom and doom that we're portraying up here.

MR. TILLER: Let me come back. I apologize for spreading doom and gloom. I've been told that I tend to take the negative to the extreme sometimes in my analysis. I think Monica is absolutely right, and we can make this a very rosy picture for everybody if in our future contracts and negotiations we make clear what's going on and we clearly document what's happening. That's the message that I'd like to send out today. Let's work together to solve the issues and to deal with them upfront. I was once a part of an organization and fairly new, and I saw a quote going out on some reinsurance. I said, "Well, what about this issue and this issue?" "Well, we don't like to bring that up. We'll do that when we get into further negotiation." Why? Why not just bring it all out in the open so everybody knows what they're dealing with from day one? This is an issue that applies to both reinsurers and ceding companies. By the way, a lot of my negative experience in arbitration was involved with two sister companies that got sold separately. Those are the worst ones.

MR. KOLODNEY: There's an old Chinese proverb that says, "Be careful for what you wish." The end of that is because, obviously, you may get it, and maybe not the anticipated result. In the focus on profitability, there's definitely been a horse race for the last five or six years in the U.S. marketplace as to which reinsurer can get to the finish line ahead of everybody else as far as terms and conditions go. Now we've seen in the last year or so that this is starting to turn. One of the guys who works with me was talking to a prospect about a deal, and the prospect said, "We have this problem with our reinsurer. Why can't they do us a favor like they used to do?" Basically, the answer is that there isn't enough economic margin left in the business to allow reinsurers to do the kind of favors that they have done in the past. That's both the culpability of the aggressive negotiation on the part of the ceding company and the aggressive pricing on the part of the reinsurer, where the fixation is on today's numbers and not what happens 10, 15 or 20 years down the road.

Our business is a long-term business. We take on liabilities that could run 50 years, and while as reinsurance brokers we're very much a client advocate as to getting appropriate terms and conditions for our ceding companies, at the end of the day our feeling is that it has to be a win-win situation on a long-term basis. The spate of arbitrations that are coming up now is, I think, in part a direct result of this rush to cheap and marginless business that reinsurers have gone out to get and ceding companies have been willing to provide.

MR. NIGH: Joe, you used the word "culpability" in your response there, and I think

that makes a good segue to the next question. This question is for you, and I would like Eric to respond. Do you have a view on future trends with respect to arbitrations versus jury trials?

MR. KOLODNEY: I'm an arbitration kind of guy. I respect lawyers, but I don't like to see them involved in our business. I think that if you're professionals and you're immersed in the business, and you know what you're doing, it's nice to have legal counsel review terms and treaties, but at the end of the day it's the managers that should be making the operating decisions. They're the ones that get paid for it, and they should do it. I like arbitrations, and I'm sympathetic with Eric on this because I think that it serves the industry better. You're not going to get 12 peers in a jury trial that are accredited people in any society, and I don't know how they could effectively judge the merits of a fairly complex or even interpretative reinsurance claim.

I think we just have to work a little harder at making sure that by the time you get to arbitration, both parties feel that they at least have a cause of action that's worth fighting for. I intervened at the request of one client in a matter of arbitration, and I was talking to the two CEOs. I said to each of them independently, "Now, so-and-so feels that they have a great case here, and before you step forward on this thing, you need to go back over your own files again and make sure that you feel as strongly about your position." Unfortunately, both of them came back and said that they felt equally strong. That arbitration is now in process.

MR. HAAB: There are pluses and minuses to arbitration, and I don't see a huge trend toward parties opting out of arbitration clauses and deciding to go to litigation, for a number of reasons. One is that management and companies are risk-averse. They're actuaries, right? When someone makes a decision to scrap arbitration, that person is going to be accountable for that. With the first piece of litigation that goes horribly bad, everyone is going to look back and ask why they did this. Why didn't we want our industry people helping us resolve this problem? It may be that in a lot of cases you can get a better resolution in litigation, but by and large, there's a comfort level with arbitration, and that's why it's going to be the primary means of resolving disputes in the industry. Certainly there are some kinds of cases that are going to be better off in court, and that is often going to be where there's quite clear contract language. It's not so much a matter of the unexpected situation that arose, where you need the expertise of arbitrators to ask how this would have been resolved if it had been discussed or how do you put the parties back in a position that reflects the intent of the parties. A court is not going to be able to do that the same way as arbitrators, but on a very clear case where both sides are just debating about some contract language, you might get a better result in litigation.

MS. HAINER: According to a recent article in *Best's*, apparently tort costs in the United States in 2002 totaled $233 billion. That's $809 per person, or a 5 percent

tax on wages. Those are startling numbers. Last year—I think they were talking about 2002 still—the American Arbitration Association settled disputes worth more than $1 billion. There are 8,000 arbitrators listed on arbitrator listings worldwide, so arbitration is here, and it's probably here to stay.

There was also a report by the National Arbitration Forum done in 2004, so it's very recent. This was interesting to me. Keep in mind that this is not specifically about reinsurance. Consumers prevailed 20 percent more often in arbitrations than in court, and arbitration was 36 percent faster than lawsuits and generally considered less expensive. However, the benefits are lost if the arbitration is agreed to after a legal dispute to go to arbitration. A lot of money gets spent on that first argument. I thought those were some interesting facts that you might want to know about.

There's another interesting thing about arbitration versus a jury trial that I'm not sure people are aware of, and I wanted to make sure it came out somewhere in this panel. Generally, vacating an arbitration award is very, very difficult. Probably Eric can talk to this better than I can, but what I was reading said that an award will only be vacated if the arbitrators are guilty of refusing to postpone the hearing when sufficient cause has been shown that a postponement should be given, if the arbitrators have refused to hear evidence pertinent to the arbitration and material to the controversy, or if there is some other misbehavior that clearly infringes upon the rights of one of the parties and prejudices their position. Beyond that, the courts are loath to override an arbitration ruling. An arbitration, once you enter into it, will tend to be binding.

The follow-up to that that I was reading up on just recently was, what about a liquidator? Can a liquidator go in and disavow an arbitration agreement? Can a liquidator say that we don't want to arbitrate and we'd rather take this to court, or will the arbitration clause stand? Previously, the courts have always held that the liquidator stands in the shoes of the insolvent company, and, therefore, if there is an arbitration clause in the agreement, the liquidator will have to abide by that and also arbitrate the situation. However, there was a recent court case on employee contracts, not reinsurance, but I thought with insolvencies around this is something worth thinking about.

In this case the court held that the employees had signed the agreement, not the liquidator, and because the liquidator can either affirm or disavow contracts in the event of an insolvency, the court ruled that requiring arbitration would be contrary to public policy and, therefore, the liquidator was free to opt for a trial rather than an arbitration. When I was reading that, I wondered what the implications of that were for a reinsurance agreement in the event of an insolvency. I know we've been there before, and the case went to arbitration, but I don't know whether this is a new trend that we should all be aware of.

MR. HAAB: I have two quick comments. One is that Monica is absolutely right on trying to vacate an arbitration award. It is virtually impossible. It almost never

happens unless there's some sort of fraud in the arbitration process, such as bribery or corruption of some sort. The one benefit of arbitration that you shouldn't overlook is that you might not be happy with the way the arbitration is resolved, but it's done. Both parties save a year or two years of appellate litigation costs and just having that dispute still alive and distracting everyone in the company.

The second thing that you all should be thinking about is that, as I said earlier, arbitration is as good as the arbitrators, and in the life reinsurance world, there is a dearth of people who are very knowledgeable about the business who also have a lot of experience as arbitrators. Arbitrators get better at it over time. In other parts of the reinsurance world, in P&C and in accident and medical insurance, because they've had more disputes longer, there is a much larger group of people in whom the companies have confidence, both for their knowledge and for their experience in arbitration. The life reinsurance arbitration world is a less mature industry in a way. You don't have professional life reinsurance arbitrators like you do in the P&C world. It would actually help if there were more people who know the business who would decide to learn about the arbitration side of it as well.

MS. HAINER: The ACLI has a registry of life arbitrators, people who are willing to be arbitrators in life reinsurance disputes. If you do need an arbitrator, that might be a place to go to get a list of names.

MR. NIGH: I'm going to exercise my option as the moderator of this debate to give a personal story, regarding arbitration versus jury trial. In arbitration, you do have people familiar with the industry that you've chosen because they do understand the issues. There's not an educational process. I was involved in a jury trial. I was an expert. It had to do with valuation of a company. During my testimony, the judge called for a break. The judge called the lawyers up to the bench to have some sort of sidebar. If you've been in a courtroom, you know that nothing is really quiet in there—it echoes throughout the room. The judge clearly showed her unwillingness to understand the issues and her impatience to get on with my testimony by making the comment that this was really boring. I said to myself that my client did not have a chance to win this case. My client did end up winning on one part but losing on the other. However, I did conclude then that as troubled and as controversial as arbitration might be, it seems a lot fairer to both parties than a jury trial.

Having said that, we'll move on to the next question, which is for John to answer and for Joe to respond. Once you get into an arbitration, what means are there to expedite the process?

MR. TILLER: In my experience, there's not a lot you can do to expedite the process. To the extent you *can* expedite the process, it's a matter of cooperation between the two parties. If one party is willing and the other isn't, you're probably not going to move ahead. However, there are things that can be done. Get a very clear understanding of the process, an agreed-upon process, including how you're

going to pick the arbitrators and the panelists, how quickly you could move ahead on that and the time deadlines. How much time are you going to allow for discovery/preparation and decision-making? You can contract all those time frames down if you have cooperative parties.

The other thing that you can do is to continue to keep your line of communication open. The reason that you usually can't make much progress is that you say, "Okay, we're going to quit discussion, and we're going to arbitration or to litigation." Everybody goes to their legal corners, and there's no further communication. Whatever glimmer you had of a settlement has now gone out the door because the lawyers take control, the management lets them, and they say that they're not going to talk to each other. Keep the communication open. As a manager, you have to force that. Keep communication open.

Then, what can you agree on? What do you disagree on? How clearly can you define it? Usually when you get into a dispute, you end up with 10 or 15 issues there, and everybody is trying to prove their side of it. There are certain things that you will end up agreeing on. Let's say there's a list of 15 issues. You'll probably find that you can agree on five to six of them, and there are five or six of them on which you violently disagree. Moving ahead and clarifying where the differences are, or how you interpret the agreements differently and the points where you agree, can help move it along.

Those are the things that I see that could move it along if you have two cooperative parties. If you don't, you're just in for it.

MR. KOLODNEY: I agree with John.

MS. HAINER: From my experiences, I agree with what John is saying. Try to agree on as much as you can upfront. Remember that to the extent that the parties don't agree, they're consenting to accept whatever rules the arbitrators are going to formulate, including rules of the hearing and other aspects. That should be kept in mind. Another thing to keep in mind is how to measure winning. Each company should think about that before they enter into the arbitration. Winning should perhaps be measured by how well the company manages the total economic and non-economic impact of disputes. Disputes are going to arise, and the specific arbitration is one in a bunch of things that are going to happen over a lifetime of a company. Minimizing the risk, the cost, the time spent, the resources expended (don't underestimate the resources expended) and preserving the business relationships all have to be considered in terms of winning.

It's very important for the companies to get their legal groups to understand the broader business issues that are facing the company, as opposed to just the specific single arbitration. The broader corporate planning processes and the broader business outcomes have to be considered. Don't forget that the entire time the arbitration is going on, there's ample opportunity for the parties to continue to

dialogue. The panel can invite the parties to dialogue or the parties can ask for time to try to discuss things and settle issues as the arbitration is going on. All of that can save you time and can help reach a resolution that's acceptable and, therefore, a win for both sides.

MR. HAAB: I agree with all of that.

MR. NIGH: The next question is related, but it has to do more with what companies do wrong. I'm going to ask Eric to respond to this question and Monica to give her response. What do companies do wrong once they get into the arbitration? We talked about what they can do to expedite or what they can do to possibly make it better, but what do they do to exacerbate it and make it worse than it should be?

MR. HAAB: There are a number of things that companies don't do as well as they should when they get into arbitration, and that's to make the process work the way it should. It's also to give yourself the best chance of winning, and, if it's a case that should settle or that you might lose, to make sure you get a settlement and you don't lose.

One of the most important things in arbitration is who the panel is. It's sort of self-evident. It seems like it should be obvious. However, parties don't put enough time into picking the right arbitrator. Having the right umpire makes all the difference. You might have a great case, but if you have an arbitrator who can't get along with the other two arbitrators, or who happens to be a lawyer when it might be a very technical actuarial issue or a financial issue and that person just doesn't quite understand it, or the umpire is a lawyer and it's a legal issue but it's not really the area of your arbitrator, so your arbitrator can't be as persuasive as he or she should be. You can't spend enough time on making sure you're very happy with who the panel is and doing whatever you can to get the right panel in place. That's the most important thing you can do, and it's probably more important than who your lawyers are, as well.

The second thing is that sometimes once a case goes into dispute, there's a tendency to put that in a different category of matters, and surprisingly, it doesn't always get the attention that it should get from the ongoing business people. It's put in a legal category or someone else is dealing with it. In order to get the best out of the process, companies need to invest in it and put the resources on it. Don't just have a few people dealing with the lawyers who don't really understand what happened. Management needs to assign people to it who are knowledgeable, who can help the lawyers get prepared and who treat it as seriously and the same as they do their new business and ongoing business opportunities. That will make a huge difference in getting the case prepared and handled well.

The third thing is that companies in the dispute, in arbitration, need to do their homework upfront, early and thoroughly. You shouldn't wait until you're a year into

the arbitration to figure out the strengths and weaknesses of your case. Don't wait until you get the other side's documents. Situations we've seen that have gone badly for one party occur when they have gotten into arbitration, they're happy to let it go on for a while for whatever reason, and they don't understand the warts in their own case. They just think they're right about it. No one has sat down, particularly the decision-makers at senior levels, to say, "Look, this is a problem. We think there's a real chance of losing this." Either they haven't thought about the other perspective or they haven't looked at it in an adequate way. I'm thinking of two situations in particular. In one, the case went on for two years, a lot of money was at stake, and on the eve of the arbitration one party finally realized it was wrong, after wasting all this money, and basically gave up.

In another case, we could not get the other side to ever focus on the problems that they had. They just got crushed. We understand that the opposing management still doesn't understand it. They just never really focused. If you look at your case early on, and both sides do that, you'll only benefit. You'll prepare your case as well as you can, but more likely, if both sides do that, it's going to bring the people to the table and you're going to be able to work something out. The process needs to be paid attention to once it's instigated.

MS. HAINER: Obviously, Eric's points are good about planning and getting the right panel, assigning the resources and assessing your case early on. Bringing to the table a genuine willingness to consider the merits of the other side's case is also very important because sometimes you get carried away with your own opinions and how right you are, and if you stopped, listened to the other side and considered its position, you might get a lot further a lot faster.

I have a couple of personal observations from sitting on panels, listening to the lawyers present the cases and listening to the witnesses. This was all new to me as an arbitrator since I've never been in court. Personally, I feel the posturing is not very useful. It wastes a lot of time. It brings a lot of drama to the event, but it doesn't help you decide on the facts and the situation at all. I think advising the lawyers to focus on the issues and not the drama would be good. I also think that over-preparing witnesses makes them not credible. As soon as they start speaking like the lawyer, as a panel you just sit there and think that you're not sure you believe anything that witness is going to say. For instance, his definite "yes" and "no" answers to what he remembers from a conversation on a telephone five years ago—boy, he has a good memory—just discredits everything he's going to say. Clearly the lawyer has recalled that conversation for him and, to my mind, ruined him as a witness.

The free-ranging wide tactics, the overly broad discovery deposition sweeping in all kinds of court cases, doesn't add much to the arbitration but dollars. I'm not a lawyer. Maybe the lawyers on the panel love it, but the arbitration clause specifically says that I don't have to be ruled by the court rulings, and, therefore, hitting me with 50 cases that are on point does nothing but serve to confuse me.

I'd rather that you stuck with the issues and discussed the merits. Also, trying to bring in other reinsurance agreements that the parties have entered into at some previous time is just wasting time. Again, I'm a simple actuary; you're just confusing me.

The last one I'll throw out is—you can argue all of these because they're just my personal opinion—the overuse of experts. The expert opinion is very interesting and very important to the case. If you're talking on a technical deal, the experts bring some real value. However, if the expert makes a statement, and then the other side's expert makes a statement, and then they counter each other's statements, and then they counter the counters, they've lost their value to me as experts because they're just fighting with each other.

Those are some things that companies can do wrong in an arbitration that just extend the time and money that goes into the arbitration without helping it.

MR. HAAB: I would echo a lot of what Monica said. As a lawyer, your goal should be to play to your audience. It always should be. If it's a jury, it's a jury. If it's a judge, it's a judge. In arbitration, you should be presenting the case that the arbitrators want to hear. It's very interesting to hear what Monica has to say. It shouldn't be over-lawyerly. There shouldn't be a lot of discussion about court decisions if that's not what the arbitrators want to hear. Lawyers probably make those mistakes in life reinsurance arbitrations because their clients aren't involved enough in the case, and they're letting the lawyers tell them a little too much of what's supposed to happen.

In this particular field, we lawyers that are really trying want all the possible input we can get. The cases that have gone well have been ones where there were quite technical and complicated actuarial issues, but we had the time and the resources devoted to us to get us up to speed in understanding these issues. In one case, I spent the better part of a year learning all about pricing a closed block of business. By the time we presented the case to the panel of three actuaries, I felt like we (and they said afterward) had addressed the very issues that they were interested in. We didn't do it in a lawyerly fashion; we tried to do it in a way that addressed the business issues that were involved.

Repeating what I said earlier, don't just turn the case over to lawyers and tell them to arbitrate. You all know what the business is about, how it should run, how it should have worked and you would know how to argue this to the actuary or the businessperson that you work with down the hallway. That's what's going to be effective. Unless the lawyer has worked in a company, he or she is not going to have that same feel for it. You should stay involved and work with the lawyers. You know what's going to be persuasive, sometimes in ways that the lawyers don't.

MR. NIGH: Over time, the market has changed. We've acknowledged that. We've talked about the fact that there's not a discipline in the contracting process. There

is more aggressive pricing taking place, suggesting that there are fewer profits to go around to share. There are fewer profits for the direct writer, as well as the reinsurer. That certainly has somehow impacted what liabilities reinsurers are willing to accept. I'd ask Joe to comment on, as the market has changed, what liabilities are reinsurers not accepting? What liabilities are they continuing to accept? I'll ask John to have a response to that.

MR. KOLODNEY: The magic words "operational risk" have now crept into the vocabulary of the kind of liabilities that reinsurers don't want to accept. They've signed on to accept the mortality risk. They've signed to pick up other risks inherent in the life reinsurance treaty, but when it comes to the actions that the ceding company itself engages in which may lead to a liability, they're very loath to even step up to it. First, they can't afford it, and second, it's never really been part of the agreement. For a lot of reinsurers, in the United Kingdom, for example, to "follow the fortunes" is almost nonexistent. That's a clause that I haven't seen for a while in this country. Also, as far as errors and omissions, I think that's something that is going to be further refined. It's one thing for somebody to make a clerical error that can be rectified. It's something else to make wholesale errors and omissions that could have been remedied if the ceding company had been diligent about what it was doing.

I think the issue of operational risk is going to loom pretty large in future arbitrations, or somebody will say, "Well, you really owe us this money even though we forgot to send it to you." I think that reinsurers are getting very picky about the documentation. There's one reinsurer who has made very clear that if it gets a claim and that name is not on a seriatim listing that it was provided with as to reinsureds, it doesn't want to pay it. You can go cry "errors and omissions" or "follow the fortunes," but the reality is that at these prices, who can afford to pay the claim if it's not justified?

MR. TILLER: Mr. Kolodney and I agree at least twice today.

MS. HAINER: One of the issues that is coming up in some arbitrations and the law is allocations. Allocation methodologies can make a huge difference in the exposure. I think it's become a big difference in what reinsurers will accept and what they won't accept, in answer to your question. Especially if the cedant has entered into some kind of settlement with the policyholder, the old phrase that the reinsurer will "follow the fortunes" and just follow in with that settlement is one that's really being tested right now. I think sometimes the temptation *might* be to choose the allocation method that maximizes the reinsurance coverage, and the reinsurers aren't willing to allow that to happen anymore. They're very much asking, "Does this follow the contract? Am I responsible for this claim?"

We have a lot of new products and a lot of alternative risk transfer happening on the life side now. There's a lot of complexity that we didn't have even just a few years ago. One of the quotes that I took out of one of the articles I read that I liked

a lot said, "Stability brought with it a casualness of approach." I think that's true. We don't have that stability anymore—not in our economy, not in our environment and not in our life reinsurance business. With that, everyone is challenging what actually are the risks that got transferred and how that should be handled.

MR. TILLER: If I could pick up for a moment on the doom-and-gloom scenario, I'd like to point out that what we're talking about here is probably less than 5 percent of the business ceded or 5 percent of the business reinsured. Ninety-five percent of the business is still there. It's still solid. The reinsurers are going to pay off. However, if we're working around the fringes, that's where the problems are in general.

MR. NIGH: Are there any questions from the audience?

MR. DALE MENSIK: We talked a lot about "once we get into arbitration" and a little less on the contract upfront. If there was one provision that for both the direct members here as well as the reinsurers that we'd go back and look at within our contracts, if there's a gulf in interpretation potentially, what would each of you think that might be?

MR. HAAB: That's a tough one. I'm not sure if I can say that there's one provision because it's often the non-standard provisions, the things that are unusual, where the disputes arise. Not to duck the question, but if I could leave you with one thing, it's to make sure that the files are very well documented. That's going to be a better focus of your energies in trying to avoid disputes than looking at a particular language.

MR. KOLODNEY: The treaties are going to have provisions in there for accounting, timeliness of reporting, and so forth, and the parties should adhere to those. The one area that is probably the most subject to interpretation would be the basis on which the business has been accepted. If there is, in fact, an underwriting program attached, then it should be spelled out. They just don't have a set of rates and a plan code. "It is understood by the parties that the ceding company is engaged in this, and they will do this, this and the other thing." When you get into subjectivity of an area of a treaty that needs to be codified, if you will, these are the areas that you have to look at because these fall outside the normal methodology of administration, reporting, late payments and all that other stuff.

MS. HAINER: I'm with Eric. The underwriting file is what you want to look to, particularly the conversations you've had and the understandings the two parties have reached. As one lawyer said to me, "If nothing has been written down, there's nothing to work with." If one side has documented giving this information, talking about this, agreeing on this, and that's the only record that exists, then that's the record that's going to be used to determine the situation. Your underwriting file is *the* most important thing that you have working for you.

MR. TILLER: If I were to pick out a couple of clauses in particular to look at, I think there's going to be an emerging pressure on recapture clauses. Especially with quota share reinsurance, there tends to be a lot of murkiness about what "recapture" means. The position on one side is, "I can recapture whatever I want." The other side is, "There's no way you could ever recapture." Those are the two positions.

MR. CRAIG HANFORD: What I see as the most upcoming concern—something that will feed arbitration panels for years to come—is extra-contractual damages. When I negotiate reinsurance treaties, I always try to get set up so that the parties' interests are aligned. That's a real struggle on that issue. The reinsurers don't have the information that the ceding companies have to make their decisions. The ceding companies can't spare the time to bring the reinsurers up to date, and the documentations are attorney-client privilege. I'm interested in the perspectives of the panel on that issue.

MS. HAINER: You make a very good point. Maybe the lesson there is that on an ongoing basis keep the dialogue open between the ceding company and the reinsurer, with the reinsurer trying to keep on top of things and the ceding company trying to share the information. If something comes out of the dark, it's going to end up being a dispute.

MR. HAAB: There are never easy answers, but perhaps you can have limitations to the extent things aren't disclosed or have ongoing disclosure obligations even after the negotiation process has concluded, so that they have six months when there is more time to go back and disclose everything possibly relevant. There might be ways to protect yourself, but it's going to be a tough one.

MR. TILLER: I want to comment on another approach. I mentioned earlier the number of P&C reinsurance treaties that do not have an arbitration clause. I believe the primary reason is that they feel better control and better leverage around extra-contractual damages.

MS. MARY BROESCH: I am looking for pointers on coming up with a clean contract in order to avoid potential arbitration. The mention of recapture is one interesting thing. I'm struggling with the difference between adding a lot more language in the treaties, which takes a lot of time to negotiate, given we already have a backlog of unexecuted treaties, which is probably part of the problem, or just going to a clean approach of saying "if this scenario occurs, it will be determined upon mutually agreeable terms," which then just defers it to a later time.

MR. HAAB: I tend to think that the more things you can raise and address upfront, the better. I know it makes the process lengthier, but you can't always count on being able to address things and resolve things later, obviously, and particularly when things have gone badly, which usually they do when you're looking at these

things later. The ideal contract and the clean contract is one where everything that you possibly can consider within the realm of reason is raised and addressed, or provisions that sort of tell you how they're going to be dealt with or resolved in favor of one side or the other, even for issues that people haven't discussed or haven't addressed.

There's the administrative side, and there's the real-world, practical side of getting these contracts documented, which is the tough part. You don't have enough people; you don't have enough time; and you do have the backlog. That's when all of the theory about what you need to do sometimes comes in second to just what is possible in a person's job. Starting the process as early as you can and being as organized as possible with checklists of things to be thinking about will aid the process. I know it's a vague answer, but I hope it's somewhat helpful.

MR. TILLER: You're not alone with some of these issues on backlogs and such. Recapture is pretty simple. That's just a matter of everybody stepping up and asking, "What do we agree to?" You're never going to have a better time to agree than upfront. I don't know why as an industry we've run from those things and wanted to postpone them because they are just going to create problems. Treaty backlogs are a terrible issue. I was once called in to help with an arbitration as an expert witness. They had no signed agreement and had been operating for two years. I can't tell you how fast I said no. The last thing I want to do is get involved in trying to interpret something in a legal environment where they didn't have an agreement. As an industry, we have not put enough attention on getting the treaties done. I think we ought to live up to what we say. Treaties have to be signed in 90 days, and we do it.

I confess to guilt. In the last year and a half at ERC, we went through a very large number of backlogged treaties around the world. We got to the point where I finally said that if we get the documents out to them and they don't sign in 30 days, we're not doing any more business with them. We'll send a letter saying that the treaties aren't good. If you don't sign them within the period of time, we're not going to do business. Salespeople weren't getting bonuses. It's amazing what you can do if you put some resource and focus on it. It's an obligation to both you as a reinsurer and you as a ceding company because you don't want to get down the path where you have a dispute and you don't have an agreement. That's probably the only thing that's worse than having an unclear agreement.

MR. KOLODNEY: The reality is that, for some reason, people have no time to do things right, but they can make plenty of time to do them over.

MR. NIGH: I want to thank our panelists, the debaters, for their time, and thank you for coming.