Catastrophe Reinsurance: Lessons for Claims Professionals

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Objectives for Today's Discussion

- Provide a brief overview of Reinsurance Basics.
- Discuss reinsurance contract issues arising after Natural (and other) Catastrophes.
- Help you get the most out of your relationship with your Reinsurers.
  - What information will Reinsurers require?
  - What services can a Reinsurer provide?
How reinsurers create value and manage risk.
Reinsurance: A contract between the insurer (cedent) and the reinsurer where the reinsurer agrees to accept a portion of the losses in exchange for a portion of the premium.

The benefits of reinsurance: To spread the risk so that no single entity finds itself saddled with a financial burden beyond its ability to pay.

- **Capacity** -- Assists in complying with regulations and rating agency surplus requirements for single risks and premium-to-surplus ratios.
- **Stabilization** – Reinsurance protects against wide swings in profit and loss margins inherent in the insurance business.
- **Catastrophe Protection** – Reinsurance can protect against a single large loss, such as a fire, or an event affecting many policyholders, such as an earthquake or storm.
- **Surplus Relief** – Reinsurance provides cedents with commissions to allow them to offset the expenses associated with writing business which are charged against the company's income. Unearned premium reserves can be transferred to the reinsurer, increasing the cedent's policyholder surplus.
- **Expertise, Market Insights, and Knowledge Transfer** – Underwriting and claims consultations can make an insurer aware of ways to improve its selection and pricing of risks and organizational processes.
The Contracts and Parties

- Insured
- Insurer/Cedent
- Treaty or Facultative Certificate
- Reinsurer
- Treaty
- Retrocessionaire

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Types of Reinsurance Contracts

- **Facultative:**
  
  *Insurer and Reinsurer agree to share losses for a single risk/policy.*

- **Treaty:**

  *Insurer and Reinsurer agree to share losses on an entire book of business or group of policies.*

  - Proportional (Pro Rata) – Prorates all premium, losses and expenses between the cedent and the reinsurer at an agreed percentage.

  - Excess of Loss -- Reinsurer agrees to take a percentage of the losses in excess of an agreed retention up to the limits of the treaty. The retention operates similarly to a policy deductible or SIR.

    e.g. 25% of $5 million xs $1 million.
Excess of Loss contracts we will focus on today . . .

- Catastrophe Excess of Loss

  *Reinsurer agrees to pay losses in excess of a retention for all claims arising from a single loss occurrence.*
  - The treaty very specifically defines a "loss occurrence" for various perils.

- Per Risk Excess of Loss

  *Reinsurer agrees to pay losses in excess of a retention for a claim arising from an occurrence at a single risk.*
  - The treaty includes a definition of "risk."
  - The treaty generally has an occurrence limit for all claims arising from a single "loss occurrence."
Reinsurance Contract Issues Arising after the Storm
Follow the Fortunes (Settlements)
Reinsurance Coverage

In order for there to be coverage under a reinsurance contract, there must be coverage under the cedent's policy . . .

Why?

- Reinsuring Clause or Business Covered Clause states:
  "The Reinsurer agrees to reinsure the excess liability which may accrue to the Company under their policies, contracts and binders of insurance..."
Does a Reinsurer Just Follow the Fortunes?

- Typical Follow the Fortunes language:

  *The liability of the Reinsurer shall follow that of the Cedent in every case and be subject in all respects to all the general and specific stipulations, clauses, waivers and modifications of the Cedent's policies and any endorsements thereon. However, in no event shall this be construed in any way to provide coverage outside the terms and conditions set forth in this Contract.*

- Clearly there must be coverage under the reinsured policy before the reinsurer has any liability.
What Happened After Sandy?

- State insurance departments declared homeowners deductibles would not apply.
- Wind v. water decisions, whether to invoke the ACC clause all had to be made quickly.
- Cedents moved quickly to handle claims in a pressure situation. They did not have time to think about reinsurance or notify reinsurers of coverage decisions made that could impact their reinsurance coverage.

Should reinsurers deny these claims because they were not covered under the primary policies?
Lessons Learned

- "While the follow the fortunes doctrine restricts the ability of a reinsurer to contest payment of a reinsurance claim it is generally recognized that, unless the reinsurance contract provides otherwise, a reinsurer will not be obligated to provide reinsurance for a payment by the cedent for a loss falling squarely outside the scope of the coverage afforded by the reinsured policy."

  *North River Ins. Co. v. CIGNA Reins. Co., 52 F.3d 1194, 1999 (3d Cir. 1995)*

- Generally a reinsurer must indemnify for payments made:
  - in good faith and after a reasonable business-like investigation;
  - on claims arguably encompassed within the scope of the underlying insurance policy; and
  - to the extent the claims also are encompassed within the terms, conditions and limits of the reinsurance contract.
Loss Occurrence
Definition of Occurrence

Typical Language:

The term 'loss occurrence' shall mean the sum of all individual losses directly occasioned by any one disaster, accident or loss or series of disasters, accidents or losses arising out of one event which occurs within the area of one state of the United States or province of Canada and states or provinces contiguous thereto and to one another. However, the duration and extent of any one 'loss occurrence' shall be limited to all individual losses sustained by the Companies occurring during any period of 168 consecutive hours arising out of and directly occasioned by the same event, except that the term 'loss occurrence' shall be further defined as follows:

As regards to windstorm, hail, tornado, hurricane, cyclone, including ensuing collapse and water damage, all individual losses sustained by the Companies occurring during any period of 96 consecutive hours arising out of and directly occasioned by the same event. However, the event need not be limited to one state or province or states or provinces contiguous thereto.
Three Common Examples of Events That Raise Occurrence Issues

- The remnants of a hurricane combine with another front over the Midwest to re-strengthen.
- Hurricanes made landfall in more than one location, e.g., Florida and later made landfall in a Gulf state, or North Carolina and later in New Jersey.
- A winter storm dumps heavy snow on structures causing damage at the time of the storm, but also causing collapse or ice dam claims several days later.

Are these losses the result of a single occurrence under the treaty?
Lessons Learned

- Generally, reinsurers will look to meteorological data, the PCS or other recognized industry definitions of what constitutes "one event".

- Cedents need to understand how their coverage works, and anticipate the possibility of taking more than one retention.

- Good records should be kept to avoid controversy with your reinsurer.

- Whether or not a loss that occurs after the hours period ends, but was started during the hours period is covered is a grey area in CAT XOL contracts.
Definition of Risk
Definition of Risk

- This issue arises under both Property Per Risk or Multi-Line XOL reinsurance contracts.
- Preferred Language:

  *Article VI – Definition of Risk*

  *The Company shall be the sole judge of what constitutes one risk provided, however, that:*
  - A risk shall never be less than all insurable values within exterior walls and under one roof regardless of fire divisions, the number of Policies involved, and whether there is a single, multiple or unrelated named insureds involved in such risk.
  - When two or more buildings are situated at the same general location, the Company shall identify on its records at the time of acceptance by the Company, those individual buildings and all insurable values contained therein that are considered to constitute each risk. If such identification is not made, each building and all insurable values contained therein shall be considered to be a separate risk.
  - A risk shall be determined from the standpoint of the predominant peril and such peril shall be noted in the Company's records.

- This is what is usually in the reinsurance treaty:

  *The reinsured shall be the sole judge of what constitutes a risk.*
What Happened After Sandy?

- Several buildings at the WTC site were damaged.
- This is a common issue when a cedent insurers apartments, schools, or chain stores.

*Should the cedent have to take more than one retention, or can they cede as one risk?*
Lessons Learned

- "These clauses have not often been interpreted by United States courts. The English Court of Appeals, however, concluded that the 'sole judge' clause evidenced an intention by the parties to the reinsurance contract that the cedent have broad discretion, limited only by reasonableness 'to decide whether losses (or a series of losses) for which he had to accept liability as primary insurer arose out of a single event.'"


- Requires reasonableness:
  - Underwriting guidelines/underwriting file
  - Timing – what constitutes a risk should be determined before the loss. The cedent cannot decide on different definition after a loss.
Working with your Reinsurer
When should you talk to your Reinsurer about Nat Cats?

- Before the Event
- When the Event Occurs
- When you want to get paid . . .
Before the Event

- At the start of the reinsurance relationship:
  - Cat Modelling
  - Is there an adequate Nat Cat Response Plan in place?
  - If not, we can assist.

- When moving into a new line of business or new territory:
  - Are there unique exposures you should consider?
  - We have had experience with those exposures.
When the Event Occurs

- How can we help?
  - Facilities
  - Clerical Support
  - Coverage Consulting
  - Litigation Consulting
  - Event-specific Issues

- And we need to know:
  - Total loss estimates
  - Large risks that may impact the Per Risk Treaty
When you want to get paid . . .

- Discuss the terms of the contract and how the billings are calculated.

- Supporting documentation:
  - Do the losses you are ceding fall within the definition of loss occurrence?
  - How are you defining "risk" when multiple locations are damaged in the same event?

- Procedures for advance payments if needed.
Questions
Thank you