

# Receivership and Insolvency Task Force

## Timing and Collection Concerns with Reinsurance Recoverables

### June 2009

The NAIC has requested input regarding "timing and collection concerns with reinsurance recoverables held by insurers in receivership". This narrative identifies key concerns and offers suggestions where regulatory support may be helpful. In so doing, we provide examples of the conduct, issues and problems encountered by receivers that lead to severe delays in the collection of reinsurance recoverables.

Simply stated, reinsurance collections are a difficult and lengthy process in receivership. Issues and delays attributable to reinsurer conduct arise on a daily basis. In almost all cases, time frames for responses and payments from reinsurers lengthen considerably for companies in liquidation. While there are some reinsurers who deal with receivers in a professional, responsive manner; the majority do not fall into this category. Clearly, this creates a great deal of frustration for receivership staff and hinders efforts to achieve timely collections.

Unfortunately, reinsurers tend to regard insolvent cedants with a degree of concern or even suspicion, particularly when they participate on treaties that have incurred less than ideal results. Reinsurers, similar to all insurance companies, constantly seek to achieve as much certainty as possible and this becomes extremely difficult in the case of large insolvent cedants who wrote multiple lines of business over many years. These factors clearly influence the general approach reinsurers take and the way they review claims.

It seems that some reinsurers have business models which effectively call for them to serially question the claim presentation over extended time periods in order to delay payment wherever possible. Regardless of whether it's their official business model or not, many reinsurers require much more documentation (significantly more than prior to liquidation and often more than is contractually required) and then respond with many questions in a series of inquiries, before even stating their payment position on the billings. Reinsurers often repeat requests for the same information on the premise that they have not received it, which is another tactic used to delay payment. In addition, suddenly reinsurers will question coverage for the first time after having a file with documentation for many years. They will require a legal opinion from the cedant on most claim files, claiming they have retrocession problems which prohibit them from paying. In the London market, reinsurers increasingly do not want claim files presented to them in person, but rather ask the cedant or intermediary to leave the file for review in their own time. In some cases their own time is a very long time, and we have to continually follow up until they eventually respond. Following market reinsurers no longer follow the claim evaluation

process and determination of the lead underwriter but must review and evaluate the claims independently, again in their own time.

Frequently, the reinsurer's financial accounting area has the right of review before claim payments are released to an insolvent cedant. Inherently this leads to a delay in payment. In addition, the payment requests sometimes get 'lost' in the process. This often necessitates someone acting as a 'go between' with the reinsurer's claims area (who have the loss as 'paid' in their part of the system and cannot understand why we are still following up for payment) and the reinsurer's financial area (who have not yet released the approved payment). This is a time consuming and frustrating process as both units of the reinsurer assert that 'their hands are tied.'

A cedant's insolvent status itself is often a reason given for non payment or slow payment. Notwithstanding that every major reinsurer has been dealing with various insolvent cedants for decades, they will assert a general lack of understanding of the insurance company receivership process or the process as it relates to a particular state, as a basis of delaying payment. Nevertheless, they manage to articulate specific concerns over offset rights, arbitration rights (i.e. being forced to litigate in NY and Ohio), claim handling continuity and acceleration issues that show a comprehensive knowledge of the process. Some reinsurers believe that the standard insolvency clause contained in every reinsurance agreement doesn't apply to them or certainly can't mean that they would have to pay more than the receiver actually pays for a claim. These reinsurers actually state that they do not have to pay insolvent cedants because such cedants are not paying claims. These issues are typically addressed through lengthy and painstaking education processes and subsequent re-education processes whenever reinsurer personnel changes. Still, on occasion receivers must expend the costs of litigation or arbitration to enforce its rights under a basic insolvency clause.

Frequently, offset issues or the offset process itself, is cited as a reason for non payment. This is because reinsurers are more concerned with minimizing their overall net position and are looking more closely for potential offsets. Reinsurers fear that if they pay and then discover they had a valid offset, then a receiver would not reimburse them for their overpayment. Consequently, reinsurers often agree to balances subject to offset but when asked to support their offset position, they either cannot be bothered or try to avoid doing so. Most often, the reinsurer's assertion of potential offsets is not supported by proper documentation (certainly not close to the same level of documentation which they request of the claims ceded to them). Also with regards to offset, mutuality remains a major sticking point for a number of markets that want the benefit of impermissible Group to Group offsets. That being said, an agreement on mutuality will not necessarily unlock claims issues, which will still be considered on their merits. We have noticed that these problems arise, in particular, in the London and Foreign Markets. Initially too, there were some misunderstandings

in these markets about the liquidation process itself and that in the US, individual States have jurisdiction over the process.

Also, the level of service an insolvent cedant receives from both reinsurers and intermediaries is poor. Upon a cedant becoming insolvent, reinsurers and brokers change the status of the account to “inactive” and the insolvent company then receives very low priority attention. The account is often handled by an underskilled and understaffed run-off unit, and it takes some time until this unit becomes familiar with accounts, claims, etc. Some major intermediaries do not continue to forward accounts, billings or reserve notices to reinsurers as contractually required or do so only after several months delay. Poor servicing by intermediaries often leads to serious information shortfalls from the reinsurers’ perspective, which increases the delays and possibility of disputes. Then the responsibility to bring the reinsurers’ records up to date becomes a major task which the receiver must address. This is why receivers often consider cutting out the intermediary completely, where possible, and dealing directly with the reinsurers or contracting with a third party to provide broker replacement services. Until reinsurers feel confident in the numbers and the supporting claims data, payments will not be forthcoming.

The related service issue on the reinsurer side is attributable to frequent changes in the contact person at a reinsurer, resulting in the new file handler having to become familiar with the file, which can take considerable time. Continuity has been lost because individuals who knew and worked with the cedant in the past have either moved on or now have other preoccupations. The market is also subject to a greater level of scrutiny from investors and other stakeholders than it was in the past. This often makes for a less flexible approach, meaning that accommodations or compromises are less easy to reach.

Moreover, reinsurers (like everyone now) have limited resources. As a result, attempts to get claims adjusters to focus on insolvent cedants, given their remaining workload, can be difficult. This is particularly true when it comes to those claims with a relatively small value. The reality is that the smaller the value, the more difficult it is to focus attention. Fundamentally, the biggest single challenge is maintaining reinsurers’ attention and interest. Many markets prevaricate and delay, not always in a planned mode, but due to other business pressures.

Some reinsurers have themselves become financially impaired and payments have slowed down considerably. Due to their own financial difficulties, such reinsurers can only pay on a particular schedule (i.e. reinsurer pays quarterly after putting submitted claims through a 6 – 9 month vetting cycle), if at all. Such companies have minimal incentive to pay claims. Additionally, older reinsurers in run-off or liquidation can be difficult to track down, particularly those

from the 1970's and 1980's where much reinsurance was placed through pools and underwriting agencies.

Commutation discussions are often used as a delay tactic in the payment of balances owed to insolvent cedants, even if the discussions are in the very early stages or non-existent. Many reinsurers state that they are not paying receivables because they claim they are commuting, when in fact they are not.

Reinsurers often make repeated requests to audit, taking the position that they will not pay until they do so. Then it requires several months to schedule the audit. After they finally complete the audit, it takes several more months for the reinsurer to "review its findings". When reinsurers ultimately advise the cedant of their position, it becomes clear that the audits are being used by the reinsurers to inflate perceived or minor discrepancies, which provide reinsurers with a contrived basis for delay, forced compromise, commutation settlement or for trying to avoid liability altogether. Thus the result of many audits is arbitration, which further delays collection and adds substantial expense.

The net result of all of these tactics to a receivership is greater costs of collection and administrative expenses, additional costs of litigation and arbitration, and lost investment income. Ultimately, this causes delays in making distributions to claimants and to guaranty associations through early access and extends the timeframe for closing the estate.

After considering the issues and tactics of the reinsurers, there are several possible solutions available to address the problems. Some of the solutions fall outside the regulatory realm, some take advantage of existing regulatory schemes, and some require modification of current regulatory practices.

Proper staffing and aggressive collection procedures with management oversight is an absolute requirement for collections in a receivership environment. Defined response timeframes and dedicated follow through are very important. Nevertheless, some reinsurers choose to delay payment until threatened with legal action. As far as possible, it is best to try to work with reinsurers to address their needs while making an effort to not allow them to unreasonably delay payments. If this attempt at compromise ceases to work then a more forceful approach is sometimes necessary. In such cases, arbitration or litigation is deemed necessary and has been found to be successful, for the most part. Receivers should not delay initiating the legal process when the delay or positions expressed are unreasonable. Unfortunately, it is an expensive, extensive and time consuming process.

On the regulatory front, receivers may need to be more aggressive in appealing to the domiciliary state regulators to consider requesting an official inquiry and response from reinsurers on the issue, terminating the reinsurer's

right to conduct business or to consider placing the reinsurer under supervision, depending on the circumstances. In turn, the domiciliary state regulators will need to be open to consider this type of action. Receivers should also be more aggressive in seeking review and rescission of any accredited rating for that reinsurer, and such regulator needs to be willing to seriously consider such action.

Perhaps the single most effective regulatory change would be amending Fair Claim Settlement Practices Regulations to include reinsurance claims. Nearly every practice used by reinsurers to delay payment would be a clear violation of such acts if committed by a primary company in dealing with its insureds or claimants.

In a related manner, Commercial Deceptive Trade Practice laws should be amended as needed to allow for private action of cedants against reinsurers. States such as Massachusetts that already allow this legal recourse, give cedants a powerful tool to combat reinsurer misconduct.

While we believe receivers already have the authority, the regulatory scheme could be enhanced by explicitly allowing receivers the power (if not the obligation) to refund overpayments of reinsurance as a Class A expense. This would clearly alleviate reinsurer's offset and overpayment concerns.

Finally, increasing or enhancing collateral requirements would virtually end payment delays. It is important to note that delay tactics are also successfully deployed by accredited reinsurers who do not post collateral or markets such as Lloyds, whose trust fund can only be accessed after obtaining a non-appealable final judgment, which is a lengthy and expensive process. The effectiveness of this potential solution is obvious and proven in the real world: reinsurers that are required to provide collateral to the cedant have the best payment records because collateral is immediately available to draw upon when disputes reach the appropriate stage. When collateral is available, inordinate delays are minimized and usually only realistic, supportable objection positions are taken by reinsurers.

Respectfully Submitted,