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Reinsurance Dialogue

between

Christopher J. Robey *

and

David E. Wilmot

May 24, 1994

Re: 1. Automobile accident benefits commutation clauses

2. The arbitration clause

Dear Mr. Wilmot,

Automobile accident benefits commutation

This is certainly a current subject you have raised, and one we shall be living with for the next few years. And there is no doubt that the variety of wordings in use since 1990 will tend to complicate the process rather than help it. However, like you, I feel confident that equitable agreements will be reached in the vast majority of cases.

As you point out, there are valid reasons for commuting the long term accident benefits claims, although no valid reason for making it the only way to deal with them. Long term claims are handled without problem by the life companies and will have to be handled, like it or not, by insurers, so it is difficult to see why most reinsurers should find them so difficult to contemplate.

It is equally disappointing that so many reinsurers found present value the only way to handle the reinsurance,

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although their clients will be handling the original claims on a full value basis. That purchase of an annuity would permit them to convert the loss to a present value basis is no argument for forcing them to do so.

It seems a harsh judgment on reinsurers, let alone the intermediary you have in mind, to hold the intermediary responsible for the failure of some reinsurers to distinguish between present value and full value. I think it more likely that the impression that some full value covers were priced as present value covers results form the wide variety in pricing which was evident, and perhaps inevitable, with the introduction of a new exposure. Given the number of reinsurers it takes to complete most programs, it is unlikely that all participating reinsurers would have made the same mistake.

It is quite possible that not all reinsurers had the same level of understanding of the variations of cover being offered. Not all specialise in automobile, indeed not all specialise in Canadian business. But it is not as if Ontario is the only place where this type of exposure exists. American workers' compensation is probably the closest similar exposure and, since most Canadian reinsurers have American sister operations, a simple phone call could have unlocked many of the mysteries for them, if indeed mysteries there were.

However what disturbs me most about your letter is the absoluteness of the positions you advocate, as if each is the only possible choice.

I have already referred to the lack of choice for insurers between present and full value and between commutation and full service of the claim. There is no technical or administrative bar to either full value covers or full service of the claim, only an unwillingness on the part of most reinsurers to consider them. Some reinsurers were willing, as you say, to write full value covers and I cannot believe it was solely because they did not understand what they were doing. Rather, they saw it as a manageable alternative which ceding companies were entitled to request. Full value was only rarely used ultimately not because

of the difficulties it caused (not enough experience was available for such a basis for a decision (but because too few reinsurers were willing to offer it. Reinsurers are fortunate that they do not work in the regulated environment of their ceding companies, which do not have the option of withdrawing a product their clients want.

The same is true of commutation, whether it be in conjunction with a present value cover or of a reinsurer's full value share of a claim. There is nothing in the full service of a claim which poses an insurmountable problem. Certainly reinsurers will not want to be producing cheques every two weeks to reimburse claims payments, but it takes little imagination to come up with alternatives. Commutation is a valid option and many ceding companies would adopt it, even if it not forced. But they are forced, because too few reinsurers would do what is a normal practice in the life field and done regularly by their sister life companies. Are property/casualty reinsurers so much less able to cope with such things?

And I do not agree that the size of the limit needed is a bar to full value covers on Bill 164 benefits. By their insistence on present value covers, reinsurers show they are fully aware of the time value of money. Why then cannot they authorise the full value equivalent of the limit they would authorise on a present value basis?

But we must all work with what is available in the market, so present value commuted covers are the only choice, at least for the time being. And I agree that we should be able to sort out the true intent in the variety of clauses in use to find the settlement which is equitable to both parties. If we cannot, there is the arbitration clause to turn to, so I suggest we give that clause a closer look.

Arbitration clause

A few years ago, there was a move, certainly in Canada and London and no doubt elsewhere, to take the arbitration clause out of the contract and make it an independent

contract itself. The purpose was to allow the arbitration clause to be invoked when one of the parties sought to cancel the contract ab initio. If there was no contract, then an arbitration clause within the contract could not be used, but one outside it could. At the time it seemed to me a good idea, but I have come to feel since then that we put too much faith in arbitration, or at least the arbitration clause.

There are certainly many disputes between ceding company and reinsurer which, if unresolvable by negotiation, can best be settled in a less formal setting than a courtroom, using people more familiar with the insurance world than a judge. But I do not think that the existence of the contract itself is such a dispute. Something so basic should, I think, come under stricter scrutiny than the somewhat informal arbitration procedure.

I also have some concerns about the automatic application of the arbitration clause in other disputes, not least the extent to which arbitrations to-day are following the format of a court hearing, albeit in a less formal manner. Certainly no party would go to an arbitration to-day without its lawyer and the lawyers invariably draw up the written cases submitted by each party. Expert witnesses are introduced and cross-examined not by the arbitrators but by the legal counsel, and this even though the two arbitrators have been chosen more for their role as advocate for the party appointing them than to hear each side objectively and take an independent position.

I doubt that this was the intention when the arbitration clause was first introduced. Indeed, much of what goes on in an arbitration to-day is not set out in the procedural rules in the arbitration clause anyway, but an umpire needs more than a little independence to go against any procedural demands put forward by the counsels of the two parties.

It is almost a cliché to talk of the numbers of dollars involved nowadays being so much greater that things cannot be like they used to, and experience in disagreements shows this to be the case, yet we are still using the same clause to settle

disputes as we did in supposedly simpler times. Those who attended the first Monte Carlo rendezvous speak of everyone knowing everyone else and the ability to work out problems amongst old friends. Those days certainly are gone. Many ceding companies never get to meet all their reinsurers and, with reinsurance so much more international, many reinsurers do not meet all their ceding companies. The "club" where disputes could be settled amicably amongst people who have worked together for several years has been dissolved. Reinsurance is very much a business, and a big business.

I think therefore it is time our contracts be treated as the commercial contracts they are. We have put up with poorly drafted contracts for too long, hiding behind the idea that the intent is more important than the words. And what other business dealing in so many dollars will wait until months after the contract came into existence to formalise it in writing?

I am not proposing that we hand over the drafting of reinsurance contracts to lawyers, since I have no reason to believe that they would do a better job than we can. There is no evidence that a contract drawn up by a lawyer is any less likely to be disputed than the existing reinsurance contracts drawn up by reinsurance professionals, and it does not seem likely that lawyers would make the contracts any easier to understand.

But greater scrutiny by the courts should make us take more care in the wording of our contracts and, since more and more of them are turning up in court to-day, despite the arbitration clause, it is not before time. I also suspect that the first thing the losing party in an arbitration asks his lawyer is what grounds they have to go to court to have the decision overturned.

Unfortunately, many of the cases getting to court involve companies in liquidation, often as a result of insolvency, so the disputes do not always relate to companies continuing in operation. A base of court interpretations, however painful to achieve, would nonetheless help in the preparation of better contracts over time.

For this and the reasons mentioned before concerning procedure, I question the advantage of automatically including an arbitration clause in the contract. Not only does it seek to prevent access to the courts, but it tends to become the only route for resolving disputes, once ordinary negotiation has failed. I suspect that when the arbitration clause was first brought in, it operated more as a form of mediation than the quasi-judicial process we have to-day and I think there is room for mediation in reinsurance disputes before moving on to a more formal and binding method of resolving them.

One could argue that the reinsurance broker is a mediator, so if negotiations have failed then mediation has already been tried and failed. However the broker, though sometimes referred to as an intermediary, is in practice more the agent of the ceding company than a true intermediary and it is too much to expect an agent to act as a true mediator between its principal and another party. However there is a wealth of reinsurance experience available to act as mediator in disputes, if asked.

If mediation fails, there is always time for binding arbitration, if the two parties agree. But there may be times when it is preferable to go straight to court. For example, there is often no provision in the arbitration clause for the process to involve more than one reinsurer, even though the dispute could be with more than one of them. A court action would also make it possible to bring in a third party on which liability may ultimately fall, for example a reinsurance broker. If the parties are forced to use arbitration, the losing party would still be forced to go to court to press a case against a third party, resulting in a second trial. Worse, if the court disagrees with the arbitration decision, the innocent party could be left with no means of recovery.

Absence of an arbitration clause does not prevent arbitration being used, if both parties agree to it. It would however encourage them to try other methods first and leaves

them the option to go straight to court if that is the best way to resolve the conflict. Little is lost while alternatives are gained.

Yours sincerely,

Christopher J. Robey