MReBA Cover Notes --
A Publication of the Massachusetts Reinsurance Bar Association

Summer 2012

In This Issue

Welcome!

By Alexander Henlin,
Edwards Wildman Palmer LLP

Summer is upon us! In honor of this too-brief season, the Massachusetts Reinsurance Bar Association has altered its regular meeting calendar. Please note that our **next meeting** is scheduled to take place at **12:00 noon** in Boston on **Wednesday, July 25**.

The **Mintz Levin** firm will be our kind hosts for a special educational program on insurance and reinsurance issues emerging from cyber risk and data protection covers. Leading the discussion will be Julian Miller and Hans Allnutt of the DAC Beachcroft firm in London. If you plan to attend, please send your RSVP to Kathleen Doherty at kmdoherty@mintz.com. As always, the lunch and program are free of charge. Thereafter, **there will be no August meeting**. Our next regular meeting will be held after Labor Day, on Wednesday, September 12.

Rest assured, the lack of formal meetings does not mean that our business has taken a summer vacation. As the articles in this newsletter can attest, MReBA's members have been busy. As **Rhonda Rittenberg** details below, preparations are well underway for the Fourth Annual Symposium, to be held in early October. We look forward to sharing many more details in our next issue; in the meantime, we hope that you will visit our website - www.mreba.org - for the latest information.

Our Newsletter Committee has also been keeping up with developments in the world of reinsurance. In this issue, **Robert Whitney** offers a double-feature on reinsurance regulation. **Nick Cramb** and **Adam Doherty**, too, offer case notes on two recent decisions of interest to the reinsurance community. We are, as always, indebted to our authors for making this newsletter possible.

Finally, please let me take this opportunity to invite you to consider appearing in *Cover Notes*. Our Industry Spotlight feature highlights active

MReBA
Massachusetts Reinsurance Bar Association

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MReBA Calendar

MReBA Meeting:

July 25, 2012 at 12:00 noon
Mintz Levin
One Financial Center
Boston, MA

MReBA Meeting:
No August Meeting

MReBA Meeting:
September 12, 2012 at 12:30 p.m.
Location TBD

MReBA Symposium - *A FRESH PERSPECTIVE...*
October 11, 2012
Harvard Club
374 Commonwealth Ave.
Boston, MA

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people in the insurance and reinsurance space, and we are always looking for article ideas. If you would like to write an article in an upcoming issue, craft an Industry Spotlight, or be the subject of either, I would be glad to hear from you.

We hope you enjoy the summer, and this issue of *Cover Notes*.

Alexander Henlin is the chair of MReBA's Newsletter Committee. He may be reached at ahenlin@edwardswildman.com.

Don't Miss Out! Register Now For The Fourth Annual Symposium: *A Fresh Perspective...*

On behalf of the Symposium Committee, it is my pleasure to invite you to our upcoming program: *A FRESH PERSPECTIVE*..., the Fourth Annual Symposium sponsored by the Massachusetts Reinsurance Bar Association. The day-long conference will be held on **Thursday, October 11, 2012**, at the **Harvard Club, 374 Commonwealth Avenue**, in Boston, Massachusetts.

Consistent with our goal to offer you a fresh perspective on timely industry topics, we are pleased to announce that Melissa Salton, Chief Risk Officer and Senior Vice President of Munich Reinsurance America, Inc., will be our keynote speaker and will share her insights on Enterprise Risk Management, a significant topic being addressed by boardrooms in corporate America and beyond.

Additionally, this year's program will explore current reinsurance audit, regulatory, and arbitration issues. We have assembled a team of top-notch insurance executives, audit and claims professionals, arbitrators and outside attorneys who will showcase, through a series of panels and an interactive workshop, a variety of practical and topical issues that matter to the industry. Whether you are with a ceding company or a reinsurer, a claims or other industry professional, or in-house or outside counsel, this program will offer you new vantage points and valuable take-aways.

For further details concerning the symposium and online registration, please visit our website at www.mreba.org. We look forward to seeing you this fall for a program that promises to be informative, interactive and lively.

Rhonda L. Rittenberg, ASLI

MReBA Symposium Chair
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The Regulation of Reinsurance: Where We Have Been & Where We Are Going

By Robert A. Whitney

The following is drawn from remarks delivered to the Massachusetts Reinsurance Bar Association at its annual cocktail reception on April 24,

Benjamin Hincks
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2012.

Good afternoon. My name is Robert Whitney, and I am the Deputy Commissioner and General Counsel of the Massachusetts Division of Insurance. I greatly appreciate the opportunity to speak with you today. Of course, anyone would find it very difficult to top the remarks given by last year's speaker at this event - the Commissioner of Insurance, Joseph Murphy, who spoke about the ongoing activity of the Division of Insurance - so I will not even try!

Instead, I'd like to spend a few minutes talking to you about a topic that has been of utmost interest to reinsurers, cedents and others in the reinsurance industry for quite some time: namely, the regulation of reinsurance.

Introduction

After many years of relative quiet, unprecedented levels of exposure have rocked the insurance industry during the past decade, beginning with the September 11, 2001, terrorist attacks in New York City. The attacks were soon followed by a rash of natural and man-made disasters that seemed to build in severity from one year to the next: the devastating 2004 Atlantic windstorm season; Hurricanes Katrina, Rita and Wilma in 2005; and the greatest financial turmoil in generations during 2008-2009.

Since then, insured losses from additional natural and man-made disasters around the globe and in the U.S. - including the nuclear reactor meltdown in Japan, the offshore oil spills in Australia's Great Barrier Reef and in the Gulf of Mexico, as well as the unending parade of tornados, hurricanes, tropical storms, and extensive flooding throughout the U.S. and even here in New England - has further challenged a now global insurance industry.

Throughout this period, insurer insolvencies have been negligible. Other than the well-reported case of AIG accepting funds from the Troubled Asset Relief Program, only two other insurers - Allstate and Lincoln National - ultimately received any relief funds whatsoever. On the whole, the financial condition of the industry has proved to be strong and resilient. At no point did any insurance activity result in any significant impact to the reinsurance market, let alone the larger economy.

Nevertheless, the decade has been witness to sustained calls for reform of U.S. insurance regulation. Many of the complaints have centered on the fact that the insurance sector is alone among financial services in being subject primarily to a state-based regulatory system. Under such a system, it is presumed that that efficiency, fairness, economic growth, and transparency have not been maximized as they could have been under a single, national system of regulation. Also, the complainants point to other developed countries in the world that have national insurance regulatory frameworks in place, and many - such as those in the European Union - have moved to a single regulatory paradigm across national boundaries.

The primary goal of reinsurance regulation is to ensure that reinsurers are able to meet their obligations for losses paid by ceding companies. Like a primary insurer, a reinsurer licensed in a state is subject to that state's solvency requirements. These requirements (*e.g.*, minimum capital levels) vary among the states. However, unlike a primary insurer, a reinsurer does not have to be licensed in each state in which it operates. An individual state is unable to directly impose its solvency standards on reinsurers in other states or countries. As such, each state is able to focus only on the regulation of those ceding insurers and reinsurers within its own jurisdiction.

In an attempt to deal with this situation, the National Association of Insurance Commissioners ("NAIC")developed a model law in 1984 with minimum standards to encourage uniform reinsurance regulation within the country. The model law was amended in 1989 to increase the standards.

While some states have adopted the model law, most have not followed the NAIC's guidance.

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The Southern District Of New York Clarifies When Reserve Information Is Discoverable In Reinsurance Disputes Where Bad Faith Is At Issue

By Adam R. Doherty,
Prince Lobel Tye LLP

In a case that the reinsurance industry knows well, *Unigard Sec. Ins. Co. v. N. River Ins. Co.*, 4 F.3d 1049 (2d Cir. 1993), the Second Circuit held that a reinsurer need not show prejudice to establish a lack of notice defense, if it demonstrates that the cedent acted in bad faith by failing to provide timely notice. The court reasoned that, because the ceding insurer is in virtually exclusive possession of information concerning the underlying risk, it is required to exercise a high level of good faith to ensure that material information is fully and promptly communicated to its reinsurers. *Id*. at 1069. The court held that the minimum standard for bad faith is "gross negligence or recklessness," and explained that a ceding insurer that establishes routine practices and controls to ensure notification to reinsurers does not act in bad faith if inadvertence causes a lapse in notification.

In late April, the U.S. District Court for the Southern District of New York rejected a cedent's attempt to limit the scope of the bad faith defense under *Unigard*,as well as the discoverability of information concerning the defense. In *Granite State Ins. Co. v. Clearwater Ins. Co.*, 2012 WL 1520851 (S.D.N.Y. April 30, 2012), the reinsurer (Clearwater) moved to compel the production of its cedent's asbestos loss reserve documents related to one of the reinsurer's affirmative defenses, which claimed that:

> Plaintiff failed to implement reasonable and adequate practices and procedures to ensure the proper reporting to Clearwater of notice and related claim information, including, but not limited to, information specifically requested by Clearwater about claims.

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Federal Court Rejects Reinsurer's Argument that Excess Insurer's Liability Was Contingent Upon Exhaustion by Full Payment of the Underlying Policy Limit

By Nicholas C. Cramb,
Mintz, Levin, Cohn, Ferris, Glovsky & Popeo, P.C.

In *Lexington Ins. Co. v. Tokio Marine & Nichido Fire Ins. Co. Ltd*., No. 11 Civ. 391, 2012 WL 1278005 (S.D.N.Y. March 28, 2012), the United States District Court for the Southern District of New York (Batts, J.) held that Lexington's excess coverage obligations, and thus the obligations of its reinsurer, Tokio Marine, were not contingent upon exhaustion by full payment of the underlying primary policy limit.

Lexington's insured, the Port Authority of New York and New Jersey, sustained over $1 billion of damage as a result of the September 11, 2001, terrorist attack on the World Trade Center - more than twice the total limits of its property insurance. In making a claim to recover some of that loss from its insurers, the Port Authority asserted that the attack constituted two occurrences.[1] The insurers initially paid only on a one-occurrence basis, however, limiting the Port Authority's recovery. Coverage litigation ensued.

The Port Authority's property insurance, so far as is relevant here, included a primary policy with a per-occurrence limit of $10 million issued by American Home and two excess policies issued by Lexington with: (i) a per occurrence limit of $11.5 million, which was part of a $40 million layer, excess of $10 million; and (ii) a per-occurrence limit of $9.5 million, which was part of a $50 million layer, excess of $50 million. Both of Lexington's excess policies were issued as part of a fronting arrangement with Tokio Marine, pursuant to which Tokio Marine agreed to fully (100%) reinsure Lexington's policies.

American Home and Lexington ultimately settled the coverage litigation with the Port Authority (concerning the second occurrence) for $11 million, allocated pro rata by limits among the American Home policy and the Lexington excess policies, with the Port Authority releasing all claims against American Home and Lexington.

Lexington billed Tokio Marine for its share of the amounts it paid toward each occurrence. Though Tokio Marine paid Lexington's claim for the amounts it paid toward the first occurrence in full, it rejected Lexington's bill for the settlement concerning the second occurrence. Tokio Marine asserted that, until the American Home policy limit was exhausted, Lexington (and, thus, Tokio Marine) had no coverage obligations.

Lexington filed suit and shortly thereafter moved for judgment on the pleadings. Lexington asserted that the law (in the Second Circuit) was well-settled: "An insured is entitled to coverage from an excess insurer even when the insured has not received payment from the primary insurer sufficient to exhaust the underlying primary limit, so long as the total loss exceeds the primary policy and ventures into the scope of the excess policy."[2]

Tokio Marine argued that Lexington's policies were not triggered unless American Home actually paid its full primary limits. Because American Home's $3.6 million settlement payment did not exhaust its $10 million limit, Tokio Marine argued, the remaining $6.4 million should be subtracted from the $7.4 million that Lexington paid under its excess policies before its indemnification obligation arose.

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[1] In a separate case, World Trade Center tenants asserted a similar two-occurrence position in litigation with their property insurers. A jury ultimately determined that the two September 11 attacks constituted two separate occurrences, and the Second Circuit affirmed the lower court's judgment.

[2] Lexington also argued that the settlement between the Port Authority, American Home and Lexington did, in fact, exhaust the American Home policy because, by the settlement's terms, the Port Authority forever released all claims against American Home and Lexington. The court found in favor of Lexington without reaching this argument.

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