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What does a Claims Control Clause really say?

The Scope and Extent of Claims Control Clauses — A review under English law of the practice of the London Market

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For more than 20 years, many in the London reinsurance market have assumed that a claims control clause in a reinsurance policy gives reinsurers complete control over all aspects of the underlying claims process.

Where a claims control clause is present, reinsurers, on notification of a claim, will (if they so wish) appoint loss adjusters and/or solicitors to handle the claim. Typically, they will arrange and attend meetings with the original insured, investigators, witnesses, police, and claimants, as required, and report back to the reinsurers. The reinsurers will make all decisions regarding coverage, quantum and claims handling. If legal proceedings are commenced by the insured against insurers, reinsurers will decide whether to defend them and, if so, will select and appoint lawyers and make any decisions regarding settlement of the claim. The cedant's role is often marginal and it may or may not be asked to attend meetings and be kept informed of developments.

However, some claims control clauses in use in the London market do not grant reinsurers complete control over all aspects of the underlying claim. On a closer analysis, their scope appears limited and there is little case law on the meaning of the words used in a reinsurance context.

Claims control, claims co-operation and follow the settlements clauses

A claims control clause frequently appears in reinsurance policies where */ continued page 2*

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Claims Control Clause

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the cedant has retained little or no risk, as in a fronting arrangement. Often the insured and the cedant are in a foreign jurisdiction. For this reason, the reinsurers, who ultimately will pay all or almost all of any valid claim under the policy, wish to ensure that they have full control.

In contrast, a claims co-operation clause gives the cedant the power to manage claims but requires it promptly to provide the reinsurers with information about any claim, to cooperate with reinsurers in relation to the claim, and not to settle claims without the approval of reinsurers. A claims co-operation clause will generally be found in reinsurance policies where the cedant has retained a more substantial proportion of the risk.

At the other end of the scale is the follow the settlements clause. This permits the cedant to settle any claim as it sees fit and, essentially, provided the settlement is proper and business-like and the claim is covered under the terms of the reinsurance, the reinsurer must reimburse the cedant for all payments made to the insured, whether it agreed to them or not.

Following the ruling in Scor[1], if a reinsurance contract contains both a follow the settlements clause and a claims co-operation clause, the follow the settlements clause is qualified by the claims co-operation clause: the reinsured cannot automatically recover a settlement reached without the reinsurers' consent and will have to prove his loss.

The Scor clause

The Scor (UK) clause 011 4/83 is regarded as the standard and most favourable to reinsurers of the available claims control clauses. It provides as follows:

"Notwithstanding anything contained in the Reinsurance Agreement and/or the policy wording to the contrary, it is a condition precedent to any liability under this policy that:

a) The Reinsured shall, upon knowledge of any circumstance which may give rise to a claim against this Policy, advise the Reinsurers thereof [by cable][2] immediately and in any event no later than [7][3] working days;

b) The Reinsured shall furnish Reinsurers with all information respecting any claim or claims;

c) The Reinsurers shall have the right to appoint adjusters and/or representatives acting on their behalf to control all negotiations, adjustments and settlements in connection with such claim or claims."

Some claims control clauses in use in the London market do not grant reinsurers complete control over all aspects of the underlying claim.

The meaning of sections a) and b) is clear and established, although they are subject to the reasonableness requirement discussed below. It is the meaning of section c) that is open to debate: for many years, many reinsurers in the London market have assumed that this wording gives them control over all aspects of the claims handling process.

The standard Scor clause is stated to be a condition precedent to liability. Therefore, under English law, any breach of the clause will prevent recovery by the reinsured, regardless of its liability under the insurance policy. Where, with a different wording, it is unclear whether the claims control clause is intended to be a condition precedent to liability, the courts will usually construe any ambiguity against the reinsurer. If a claims control clause is not a condition precedent, its breach does not

1 Insurance Company of Africa v Scor (UK) Reinsurance Ltd [1985] 1 Lloyd's Rep. 312

2 A more modern form of communication should now be included.

3 The number of days is often changed to 14 or 21 days.

relieve the reinsurers of liability for a claim. If the reinsured can prove its loss, the reinsurers will be liable under the reinsurance contract and their remedy for breach of the clause will be the same as for breach of any other contract term.

In *Trans-Pacific*[4], the Australian court held that a claims co-operation clause is an innominate term. This means that a breach can be serious or minor and the legal consequences of breach will vary accordingly. If a breach is sufficiently serious in its effect, a reinsurer may have the right to terminate the contract, but it is more likely that the appropriate remedy will be damages for any loss suffered by the reinsurers. This analysis should also apply to claims control clauses, unless stated to be a condition precedent.

The reasonableness limitation

There are two lines of English authority on the nature of the reinsured's duties under a claims control or claims co-operation clause. Various cases on timeliness in reporting claims (section (a) of the Scor clause) have held that the reinsured's duty is absolute.

However, another line of authority, from *Welch v Royal Exchange Assurance*[5] to *Napier v UNUM Ltd*[6], has held that the reinsured's duty to provide information to the reinsurers is subject to a reasonableness limitation. Reinsurers do not have the right to demand information where those demands are capricious and unfounded. This is relevant to section (b) of the Scor claims control clause. The reinsured's duty to furnish information is not absolute.

Meaning of "negotiations, adjustments and settlements"

These are the words used in the all-important section (c) of the Scor claims control clause, set out above. Claims control clauses will typically use a combination of these or similar words. For example, the claims control clause in *Eagle Star v Cresswell*[7] stated that "The Underwriters hereon shall control the negotiations and settlements of any claims under this Policy". The AVN 25 (NMA 2751) clause makes it a condition precedent that "*Reinsurers shall have the right to appoint adjusters, assessors and/or surveyors **and** to control all negotiations, adjustments and settlements in connection with such loss or losses*" [emphasis added]. The introduction of the word "and" in this clause means that reinsurers themselves can control underlying negotiations, adjustments or settlements. In the standard Scor clause, it is the adjusters and/or representatives (acting on behalf of the reinsurer) who have the right to control.

In common usage, 'negotiations' mean discussions with a view to reaching an agreement on a disputed matter. 'Adjustments' is defined in Stroud's judicial dictionary as being the settlement among parties of their several shares in respect of claims, liabilities or payments. It is defined in relation to insurance as being the determination of the amount payable in the settlement of a claim. 'Settlement' is the conclusive resolution of a matter, i.e., the full and final settlement of a claim. Thus, all of these words relate to the same thing: the resolution of a claim by means of discussion between the relevant parties. There is no mention of litigation, arbitration, coverage decisions, day to day claims handling or other claims-related processes.

Reinsurers often assert that the phrase "negotiations, adjustments and settlements" refers to all aspects of the claims handling process. However, that is not what the words actually mean. Frequently, the claims control clause is relied on by reinsurers as affording them the right to control the defence of underlying litigation, both third party claims against the insured and claims by the insured against the cedant. Does the control of "negotiations, adjustments and settlements" extend to control of the defence of litigation or arbitration?

A reinsurer who wants to interpret, for example, the Scor claims control clause in this way would have to show that the clause *means* all aspects of the claims process when it *says* "negotiation, adjustment and settlement". A court, especially a court in a foreign jurisdiction, could ask why the reinsurers did not ensure that their policy was clearer on this point. The selection of the words "negotiations, adjustments and settlements" arguably limits the scope of the clause to these three things, all relating to a similar stage in the claims handling process. A judge may be unsympathetic to the arguments of commercial reinsurers, professionally advised, that those words should be taken to mean more than they actually mean in common parlance.

It would be simple for a claims control clause specifically to grant reinsurers the right to control "all aspects of the claim" or to "take absolute control over any / continued page 4

4 (1990) 6 ANZ Insurance Cases 60-949

5 [1939] 1 KB 294

6 [1996] 2 Lloyd's Rep. 550

7 Eagle Star Insurance Company Limited –v- J.N. Cresswell & Others [2004] 2 All ER (Comm) 244

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claim", and indeed there are some that do. A claims clause confers rights on reinsurers (or their representatives), not obligations, so there is no reason why it should not be couched in the broadest possible terms, giving reinsurers the right to pick and choose how and to what extent they become involved.

Market understanding

A cedant accused of breaching a claims control clause, for example by failing to invite reinsurers to an initial meeting with the reinsured, might seek to argue that the clause is limited to control over the final stages of the claims process. Reinsurers could certainly argue that this interpretation goes against London reinsurance market understanding. However, although reinsurers may share a common understanding of what is meant by the clause, that may not be enough if the cedant disagrees.

This principle was applied in *Baker v Black Sea*[2] where it was there held that "what was needed was evidence of a universal and acknowledged practice of the market". The key is whether the practice is universally accepted and followed. Reinsurers' practice in relation to claims control clauses is important, but it must also be shown that the cedant would have 'unhesitatingly' agreed that the claims control clause was referring to all aspects of the claims process when it entered into the reinsurance contract. By definition, if a dispute has arisen then the cedant will be disagreeing with this assumption and arguing for a more limited interpretation.

It only takes the evidence of one person to counter an argument for universal established usage. Therefore, if a cedant does not agree with its reinsurer's view and a judge decides to give the clause a narrow interpretation, the reinsurer's case might well be lost.

Reinsurers' practice in relation to claims control clauses is important, but it must also be shown that the cedant would have 'unhesitatingly' agreed that the claims control clause was referring to all aspects of the claims process when it entered into the reinsurance contract.

If a cedant decided to question the reinsurer's position on the meaning of the claims control clause, the legal dispute may come down to the question of whether a term should be implied into the reinsurance that the claims control clause extends to the entire claims process and not just to "negotiations, adjustments and settlements".

The principal authority on this subject is the speech of Lord Wilberforce in the case of *Liverpool City Council v Irwin*[1]:

> "Where there is, on the face of it, a complete, bilateral contract, the courts are sometimes willing to add terms to it, as implied terms: this is very common in mercantile contracts where there is an **established usage**: in that case the courts are spelling out what both parties know and would, if asked, **unhesitatingly agree** to be part of the bargain." [emphasis added]

[1] [1977] AC 239 at 253

Impact of law and jurisdiction

If this is the case under English law, then the position in foreign jurisdictions may be more unfavourable to reinsurers.

If the reinsurance policy is subject to local law and jurisdiction, either explicitly or by implication, and the reinsured is based overseas, then the claims control clause will be interpreted in the local court. The local judge will analyse the clause based on local law and the plain English reading of the claims control clause. It may or may not give any weight to the London reinsurance market's views as to its meaning. Reinsurers should thus be aware that a local law and jurisdiction clause may render their claims control clause impotent.

Conclusion

English case law concerning claims control and claims co-operation clauses has generally focused on the failure of the reinsured

[2] Baker v Black Sea & Baltic Gen Ins Co Ltd [1998] HL

to provide information to reinsurers, the wrongful settlement of the claim, or the relationship between claims clauses and follow the settlements clauses. The English courts have thus far not examined what is meant by the words "all negotiations, adjustments and settlements in connection with" the claim commonly found in standard London market claims control clauses. It seems unlikely that this question will be resolved without a case going to trial. In the meantime, both parties to the reinsurance contract should consider their policy wordings and give serious thought to whether their claims clauses really do say what they want them to say.

Credit crunch: "Insurers are not banks"

by Patrick Devine, London, pdevine@chadbourne.com

The focus of attention in the credit crisis has been upon the banking community, the causes of the crisis and the creation of a new regulatory environment. Comparatively little attention has been given to the impact of the crisis upon the insurance industry.

Regardless of how the recession may play out, there is one important lesson to be drawn from the credit crisis that has so far not received enough attention, namely, that insurers are markedly different from banks and that their distinct business models expose them to lower liquidity risk.

Supported by a number of recommendations intended to improve the regulation of insurers and financial services generally, a submission by the Comité Européen des Assurances — the European Association of Insurers — to the leaders of the G20 members countries emphasises the Association's concern that banks and insurers are being treated the same under the global regulatory architecture emerging in response to the financial crisis, a process which the CEA describes as "regulatory contamination".

Anatomy of the credit crisis

"Insurers are not banks" is a simple statement with far reaching implications for the economic system and policy making. This must be reflected in different regulation and capital requirements for both industries in the future and must not be overlooked in the desire to find and implement solutions quickly.

These are some of the conclusions drawn in "Anatomy of the Credit Crisis"[3] an in-depth report published by the Geneva Association — an influential Swiss based think tank whose membership comprises 80 CEOs of the world's leading insurers and reinsurers — providing an insight into the credit crisis from an insurance point of view and examining the lessons learned for the insurance sector and concerns which remain.

Supported by a detailed timeline of the development of the crisis, the report was prompted by anxiety that regulators, in creating a new domestic, and possibly global, regulatory environment for financial services, will adopt a "one size fits all" approach to the detriment of the insurance industry.

The premise of the 150 page review is that if regulation is based on the inaccurate assumption that banks and insurers offer similar services and pose similar threats to financial stability, the insurance industry faces the danger of collateral regulatory damage.

There are no indications that insurers have contributed to the market problems that many banks are facing today. Indeed the insurance sector can be said to have acted as a stabilising factor at a time of considerable stress in the global financial system.

Whilst the banking and insurance sectors have grown increasingly similar with respect to product offerings, distribution, regulation and supervision, the authors emphasise that, in spite of this convergence, differences remain in the basic function of business models of banks and insurers. The credit crisis has not questioned the basic business model of the industry i.e. insurance risk underwriting. There is no shortage of cover for life and non-life insurance, and capacity appears to be abundant even though prices may have started to harden in certain business lines.

Why were insurance companies less affected than banks?

One reason why insurers have been less impacted by the crisis than banks is that insurers are not subject to the same liquidity risks affecting banks. Insurers are pre-funded by a relatively stable flow of premiums and generally do not / continued page 6

3 Available at www.genevaassociation.org published February 2010.

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rely on short term market funding. Another key difference is that insurers are not as prone to systemic risk. Insurance hazards are typically uncorrelated and the failure of one insurer does not necessarily predict failure of others. In contrast, as bank risks are correlated across the sector, if one bank fails in a market characterised by tight liquidity, customers may suspect other banks are close to insolvency and will seek to withdraw their deposits.

Solvency II: insurance regulation re-visited

Whilst the credit crisis has revealed the need to reconsider the rules for bank capital and leverage ratios, Solvency II, the regulatory framework to be implemented in the European Union by 2011, goes a long way towards addressing the capital requirements of insurers. The Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) considers that Solvency II offers the best possible regulatory framework to implement the lessons learned from the crisis and to ensure the sector's long term viability.[1]

Solvency II introduces a holistic view for all the business, investment and operational risks of an insurance company focusing on the quality of internal risk management and giving credit for the diversification of benefits which arise from a portfolio diversified across geographies and lines of business. It provides for the supervision of insurance groups and, of particular relevance for insurance companies with cross border activities, recognises the supervisory practices of non-EU countries provided their standards meet the new EU solvency requirements.

A similarly holistic approach is applied to insurers' exposures to special purpose vehicles, securitisations and other off-balance sheet techniques in order to provide supervisors with a consolidated perspective of the risk to which policyholders may be exposed. Where insurers employ complex holding structures, possibly involving non regulated entities, supervisory powers should also include monitoring, data collection and intervention at the holding company level.

Whilst in its view Solvency II offers the best possible regulatory framework to implement the lessons learned from the crisis, CEIOPS launched a project in Autumn 2008 analysing different aspects of the crisis relating to the insurance sector and identifying potential areas for improvement to ensure that Solvency II can operate in both normal and stressed times. The recent credit crisis has prompted CEIOPS to re-visit the following key areas of the proposed Solvency II regime.

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Credit, market and operational risk

Recognising from banking experience that the markets decided that not all capital (not even all Tier 1 capital) is the same quality, the crisis has shown that capital quality matters. The calculation of the Solvency Capital Requirement aims at quantifying risks and allocating a capital charge to them consistent with a confidence level of 99.5%, intended to create a 1 in 200 year risk of insurance company failure.

As a result of the crisis, the risks reviewed included credit risk, market risk and operational risk.

Affecting both the asset and liability side of insurers' balance sheets, the main credit risk issue to be re-considered is linked to the need to guarantee that effective risk transfer has occurred. There is clear room for Alternative Risk Transfer mechanisms in Solvency II but the transfer of risk has to be an effective one. Further refinement of Solvency II's approach to

[1] See also: The implications of Solvency II for US Insurance Regulation: www.networksfinancialinstitute.org.

market risk is also required. The crisis has shown that the treatment of some assets, for example asset backed securities, was not prudent enough. CEIOPS is working to ensure that this is correlated, consistent with the 99.5% confidence level required by Solvency II.

Operational risk (the risk of failure of systems and/or people) has been identified by many as the main risk causing the current crisis, and Solvency II provisions were considered not to provide sufficient incentives for insurers to improve in this core area.

Corporate governance

As in the financial sector at large, governance, risk management and internal controls in the insurance sector need to be strengthened. One of the main drivers of the current crisis has been directly linked to the combination of the lack of disclosure and inappropriate valuation of complex products. The principle of not buying or selling assets which no one can value or understand was hitherto left aside. CEIOPS observed that insurers invested in structured products that they did not sufficiently understand, relying upon external ratings by rating agencies rather than their own judgement. Effective risk management requires a strong emphasis on own risk assessment rather than reliance upon third parties.

Valuation

CEIOPS considers that the economic valuation of assets and liability should be considered as valid and necessary for a project like Solvency II. It indicates that additional work needs to be done on valuation by the International Accounting Standards' Board and would like solutions to be adopted to bring consistency within the financial sector at large.

Should insurers be more rigorously regulated?

The report concludes that for core insurance activities, current regulation has proved adequate and effective. The industry nonetheless faces the danger of collateral damage if regulation is based on the inaccurate assumption that banks and insurers are offering similar services and pose similar threats to financial stability even though the nature of the services provided and the underlying business models and the risks associated with them differ considerably. This must be reflected in different regulation and capital requirements for both industries.

Companies that have suffered most in the insurance arena as a consequence of the credit crisis are chiefly those that combined insurance and banking operations. This is where regulators and supervisors should focus in the future.

International co-operation

The crisis has also revealed gaps in the capabilities of regulators to supervise market relevant developments not just within but also beyond their borders. Critical information did not appear to flow in a timely manner to the appropriate institutions or to be shared with all relevant domestic or foreign counterparts.

One answer to remedy the problems relating to regulatory fragmentation is increased international co-operation and agreements on information sharing between national bodies and across borders.

Whilst Europe seems to be at the centre of attention, triggered by the adoption of Solvency II which will have a major impact, not just in Europe, but internationally over time. Many emerging markets, including China and India, have indicated that they plan to adopt Solvency II or something similar, if it proves workable.

The report concludes that if the insurance industry is meant to be the reliable bearer of (long term) risks for its clients, then the regulatory framework needs to facilitate this. Legal systems which do not provide a stable judicial environment and legal certainty over time, regulatory impositions which hold back risk transfer where it should occur and financial reporting which discourages long term strategies, are all to be avoided. Too often, important regulatory reforms are the product of pressured compromises on a technical level and are politicalised in an (as now) crisis driven environment.

In May this year the European Commissioner responsible for financial services, Michel Barnier, announced the introduction of Solvency II would be delayed by two months from October 2012 to 31 December 2012 to align the new rules with the commencement of the financial year for most European insurance companies. The new rules will be tested by insurers in the Autumn of this year in CEIOPS Fifth quantitative impact study, known as Q1S5, leaving two years for necessary fine tuning and further debate. ◎

Credit for reinsurance update: Florida leads the way for alien reinsurers

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XL Re follows Hannover Re in becoming second "eligible reinsurer" in Florida with reduced collateral requirement.

In most United States jurisdictions, alien reinsurers[1] are generally required to provide 100% collateral in order for cedents to receive credit for the reinsurance on their financial statements, while generally domestic U.S. reinsurers do not have to post any collateral for their cedents to take credit. Many alien reinsurers view the 100% collateral requirement as an impediment to entry into the United States market because of the extra financial burden this requirement places on them.

On June 17, 2010, Bermuda reinsurer XL Re Ltd ("XL Re") received approval from the Florida Office of Insurance Regulation to reduce the 100% collateral requirement. XL Re is now classified as an "eligible reinsurer" under Florida law and does not have to post 100% collateral in order for its cedents to receive credit. XL Re is only the second alien reinsurer to take advantage of Section 624.610(3)(e) of the Florida Statutes, which was enacted during the 2007 Property Insurance Special Session, and accompanying Rule 69O-144.007 of the Florida Administrative Code, approved by the Florida Cabinet in September 2008.[2]

German reinsurer Hannover Ruckversicherung AG (Hannover Re) was the first alien reinsurer to reach an agreement with the Office of Insurance Regulation just earlier this year on February 24, 2010. Hannover Re only had to post 20% collateral in order for its cedents to receive credit.[3]

The aforementioned Florida statute and regulation establish lower collateral requirements on a sliding scale for alien reinsurers that are highly-rated and financially sound. They allow alien reinsurers to make an application to the Office of Insurance Regulation to become an "eligible reinsurer." Section 624.610(3)(e) of the Florida Statutes provides some general guidance, allowing the commissioner of the Office of Insurance Regulation to give credit for reinsurance "if the assuming insurer holds surplus in excess of $100 million and has a secure financial strength rating from at least two nationally recognized statistical rating organizations." Among other considerations, the commissioner is also to take into account the standards of regulation the alien reinsurer is subject to in its home country and that country's regulator's willingness to cooperate with United States regulators.

Rule 69O-144.007 of the Florida Administrative Code provides that if an alien reinsurer has the highest possible financial strength rating (AAA or the equivalent) from at least two financial rating agencies, the reinsurer will not be required to post any collateral in order for the ceding company to take credit for the reinsurance. The implementation rule specifically states that the relevant rating agencies are Standard & Poor's, Moody's Investors Service, Fitch Ratings, and A.M. Best Company. Companies with lower credit ratings will still be required to post collateral in an amount proportional to their financial strength as follows:

- AAA:No collateral requirement
- AA:10% collateral requirement
- A:20% collateral requirement
- BBB:75% collateral requirement
- BB:100% collateral requirement

The implementation rule also requires that the alien reinsurer's reinsurance agreements include an insolvency clause, a service of process clause, and a submission to jurisdiction clause.

The ceding insurer also has obligations under the new scheme. It must immediately notify the Office of Insurance Regulation and increase its reserves for reinsurance recoverables if the "eligible reinsurer" fails to pay an undisputed claim

1 A "foreign reinsurer" is a U.S. reinsurer conducting business in a state other than its domiciliary, whereas an "alien reinsurer" is a reinsurer domiciled outside the U.S. and not admitted in any state. See Robert W. Strain, Reinsurance 765-766 (1997).

2 Press Release, XL Re, *XL Re Ltd Becomes First Bermuda Company to Qualify as an Eligible Reinsurer in Florida* (June 17, 2010). Although the consent order has not been made publicly available yet, as of March 2, 2010, XL Re had an A rating, which would correspond to a 20% collateral requirement under the Florida statute and regulation.

3 In re Hannover Ruckversicherung AG, Florida Office of Insurance Regulation Case No. 108275-09-CO, Consent Order (Feb. 24, 2010); Press Release, Florida Office of Insurance Regulation, *Florida Office of Insurance Regulation Reaches Agreement with Hannover Re to be the First to Qualify as an Eligible Reinsurer Under New Terms* (Feb. 24, 2010).

after ninety (90) days or if there is any indication that the reinsurer is not substantially complying with the solvency requirements of its home country.

The NAIC Credit for Reinsurance Models and proposed amendments

The majority of states in the United States, including Florida,[4] base their requirements regarding credit for reinsurance on the National Association of Insurance Commissioners' (NAIC) Credit for Reinsurance Model Law of 1996 and the Credit for Reinsurance Model Regulation of 2007. Pursuant to the NAIC models, a ceding insurer may take credit for reinsurance if the reinsurer is:

- Licensed in the ceding insurance company's domiciliary state;
- Accredited in the ceding insurance company's domiciliary state; or
- Provides 100% collateral of their U.S. reinsurance obligations in the form of a multi-beneficiary trust or provides letters of credit or other acceptable collateral securing their obligations to an individual ceding insurance company.

For a number of years, the NAIC has been discussing proposed amendments to the U.S. reinsurance collateral requirements. In December 2005, the NAIC issued its U.S. Reinsurance Collateral White Paper to summarize all of the arguments for and against amending the collateral requirements. In 2006, the Reinsurance Task Force of the NAIC was charged with reconsidering the collateral requirements for all reinsurers.[5] The task force presented the Reinsurance Evaluation Office Proposal Procedure to Grant Credit for Ceded Reinsurance. This proposed that the amount of collateral required to be posted by each reinsurer would be on a sliding scale, based on the reinsurer's financial rating and included a mechanism to rate the financial strength of reinsurers regardless of country of domicile.

Florida's "eligible reinsurer" law and implementation rule were developed contemporaneously with the NAIC's activities and share some common elements with this 2006 NAIC Task Force proposal. In particular, they both provide for rating alien reinsurers based upon ratings set by recognized statistical rating organizations, information sharing with the alien reinsurer's home regulator, and evaluation of the alien reinsurer's home regulator.

Although amendment of the collateral rule has been actively discussed by the NAIC, it does not appear that a revision of the current NAIC model laws will take place in the near future.

> Rule 69O-144.007 of the Florida Administrative Code provides that if an alien reinsurer has the highest possible financial strength rating (AAA or the equivalent) from at least two financial rating agencies, the reinsurer will not be required to post any collateral in order for the ceding company to take credit for the reinsurance.

New York credit for reinsurance reform not issued

Meanwhile, New York has yet to issue the regulation it proposed over two years ago to substitute a sliding scale of collateral requirements —depending on a reinsurer's ratings and surplus levels— in place of the requirement that all unauthorized reinsurers post 100% collateral.[6] Indeed, on the New York Insurance Department's formal regulatory agenda, the proposed regulation is not even mentioned in the New York Insurance Department's formal regulatory agenda for 2010.

Much like Florida's sliding scale, under New York's proposed amendments, alien reinsurers with the / continued page 10

4 Florida's new "eligible reinsurer" rules are superimposed on a state regulatory scheme which is still substantially based on the NAIC models and maintains the traditional requirements that credit is given only for reinsurance obtained from a licensed or accredited reinsurer or for a reinsurer which has posted 100% collateral.

5 NAIC Joint Meeting of Executive Committee - Plenary (March 5, 2006).

6 New York State Insurance Department Eleventh Amendment to Regulation 20 (20 NYCRR § 125) (proposed Oct. 18, 2007) (to be codified at § 125.1).

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highest possible financial strength rating (AAA or the equivalent) from at least two financial rating agencies would not be required to post any collateral in order for the ceding company to take credit for the reinsurance. Companies with lower credit ratings would still be required to post collateral, in an amount proportional to their financial strength. The proposed amendments also require the reinsurer to consent to the jurisdiction of U.S. courts for any dispute arising out of the reinsurance transaction and also to consent to New York governing law or the law of the domestic insurer's domiciliary state. The reinsurer must also be domiciled in a jurisdiction which has reciprocity with New York and which allows U.S. reinsurers to enter its markets on similar terms.

The proposed amendments also introduce new obligations in order for the ceding insurer to obtain credit for reinsurance under the auspices of "principles of prudent reinsurance risk management." These require ceding insurers (1) to act with "financial prudence" prior to entering into a reinsurance relationship; (2) to diversify their reinsurance programs; and (3) to notify the New York Insurance Department within thirty (30) days of a large reinsurance recoverable from a single reinsurer.

Federal credit for reinsurance proposed reform outlook

A vote on an overall package of financial reforms is pending which includes a requirement that the domiciliary state's rules for taking credit for reinsurance control. Under S. 3217 Restoring American Financial Stability Act of 2010, New York regulators would have to recognize that a ceding insurer domiciled in Florida and licensed in New York could take credit for reinsurance on its financial statement without any collateral being posted by a reinsurer which was neither admitted nor accredited in New York, but which did have "eligible reinsurer" status in Florida if Florida regulators did not require the collateral. ◎

Class action law passed in Poland — floodgates or ripple effect?

by Sylwester Pieckowski, Warsaw, spieckowski@chadbourne.com

Class actions have traditionally been associated with the American legal system and have been viewed somewhat suspiciously by the European legal establishment. They are associated in the popular consciousness with bloated lawyers' fees and spurious claims against multi-nationals.

However, in recent years more and more European countries have adopted legislation allowing class actions to proceed. Germany, Sweden and the Netherlands already allow collective actions. Earlier this year Italy approved a Bill allowing class actions by way of an amendment to their Consumer Code. England too has the group litigation order, which allows the court to consolidate related claims. However, the 'opt-in' approach favoured by European countries has had a restrictive effect on class actions, as has the requirement that a losing party pays the winner's costs. Now, Poland is following suit. The Polish parliament passed legislation permitting class actions on December 17, 2009, which will come into force on July 19, 2010.

So far, the impact of the new class action law on the business community is uncertain. According to a market survey conducted in December 2009, 45 business leaders were questioned and most knew little or nothing about the new law. One third of those surveyed acknowledged that they did not know about the changes. Only 29% had followed the progress of the legislation through Parliament, and only 3% were fully aware of the effect of the change in the law and had commenced an analysis of its possible impact on their companies. 22% of respondents thought that the market for legal services would develop. According to 44%, the number of consumer claims would increase but only one in four is of the opinion that there will be more claims from aggrieved parties.

Those surveyed considered that the business sectors most

exposed to group action claims are the banking and pharmaceutical sectors (risk assessment rate: 55%); second place went to real estate, insurance and tobacco products (40%), and third place to medical products (30%). When asked how the legislation would affect the activities of their companies, one in five thought that it would have no effect and 43% thought it would have only a small effect on their companies. Of those surveyed, 28% foresaw a risk to their business and 7% expect many class actions against their companies.[7]

From the above it can be seen that the business community does not see the new class action law as a revolutionary change to the business and legal landscape in Poland. On the contrary, most struggle to see how it will impact on their business. Indeed, it may take some years for its impact to be truly felt. On the other hand, the group action law in England has not created the flood of class action claims that some people feared. It may be that the Polish business community is right to be skeptical about the long-term effect of this new law.

The Polish Law facilitates the filing of class actions and increases the possibility of individuals collectively pursuing claims, whilst at the same time significantly reducing litigation costs for claimants in proceedings against manufacturers, pharmaceutical companies, insurers etc.

The new law has the following key aspects:

- A group action can be filed by a minimum of 10 claimants, either professionals or consumers. There is no upper limit on the number of claimants.
- All the claims must be of the same nature, based on the same facts, or based on the same legal basis and background circumstances.
- In the case of monetary claims, the group action should state the damages being claimed. This should be the same for all the claimants. In certain cases, sub-groups may be formed for this purpose so as to allow different quantum to be claimed by different sub-groups.
- Claims are to be filed by the representative of the group: either a group member or the district (municipal) consumers' ombudsman. If the latter, a lawyer is not required to represent the claimants. If the former, the group must be represented by a legal professional who will be allowed to agree on a proportional success fee. The fee agreement with the lawyer may set a maximum limit on fees and there is an upper limit of 20% of the amount awarded to the plaintiffs.

To prevent unfair actions and unjustified claims, a panel of three judges sitting in the district court will decide whether a class action should be recognized. The proposed defendant may contest the constitution of the class at this stage. The prospective defendant may be further protected by a deposit, which can be required by the court as security for litigation costs. The deposit is payable in cash and it amounts up to 20% of the dispute value.

The court may at any stage in the proceedings refer the parties to mediation or otherwise encourage settlement of the claim. This should serve to prevent unnecessary litigation.

The court fee for a class action will be 2% of the value of the dispute, but with a minimum fee of 30 zlotys and a maximum of 100,000.00 zlotys (EUR 24,800). This is far lower than the 5% required for most cases in Poland. This is an interesting decision by the government and will likely be seen, together with the success fee available to the legal representatives, as an incentive to claimants, who might otherwise be priced out of litigation, to pursue meritorious claims.

Once a group action claim has been recognized by the Polish court, potential claimants have the right to opt-in to the claim by a certain date set down by the court. Opting in after this deadline will not be possible. Any ruling by / continued page 12

7 M. Domagalski, *Companies are not afraid of class actions*, Rzeczpospolita, January 18, 2010.

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the Polish court on the instigation of group action litigation will be announced in the press so that potential claimants have the opportunity to participate.

There is also no opt-out possibility after the decision on the group composition has been made by the Polish court, so claimants cannot change their minds and withdraw from the group action. This means that any court decision is binding upon those who participate in the proceedings, although it has no effect whatsoever on any other individuals in the same or a similar position who did not opt-in originally. The decision of the court on the constitution of the group is appealable.

This opt-in proposal brings Poland in line with the rest of Europe rather than with the United States, which should act as a brake on any large-scale US style class actions. In US class actions all potential claimants are bound by the suit, unless they opt-out of the class. In Europe, the opposite is usually true. All claimants must apply to join the litigation, otherwise the ruling will not affect them.

The Polish Law facilitates the filing of class actions and increases the possibility of individuals collectively pursuing claims, whilst at the same time significantly reducing litigation costs for claimants in proceedings against manufacturers, pharmaceutical companies, insurers etc. This is also in keeping with the ongoing development of the law in Poland towards protecting consumers against unfair practices in the trading of complex financial instruments. ◎

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