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Think Tank

Some Thoughts on the Pre-Hearing Security Freight Train in the Run-Off Context

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Introduction

The Significance of Pre-Hearing Security Awards for Run-Off Reinsurers

As many have noted, in the run-off context, where claims issues cannot be resolved by promises of new premium on wonderful (loss free!) new business, run-off reinsurers find themselves with more disputes, many of which end up in arbitration. Subsequently, pre-hearing security has become a threshold issue with the potential of significant adverse consequences for a run-off company.

Typically, cedents, contesting the adequacy of the reinsurers' reserves, assert there will be shortfall at the end of the day. They claim the reinsurer is in reality an extortionist seeking to force settlement with the insolvency card and frivolous defenses, and at the very start of the arbitration, ask the arbitrators to require the reinsurer to post security for the full amount in dispute *before* any consideration of the merits. The run-off reinsurer, in turn, asserts that it is simply taking a more objective, careful view of claims, and rather than simply paying quickly for reputation reasons, it is entitled to arbitrate legitimate disputes without elevating the cedent to preferred creditor status. With many reinsurance arbitrators being retired officers of insurers or reinsurers, who practiced in an era when run-off invariably meant a failed or likely to fail operation, there is a distinct possibility that the train will leave the station early, with a pre-hearing security order, leaving the reinsurer to ponder whether it can continue the fight. For a run-off reinsurer, a panel's grant of such relief can have disastrous consequences. As overall reserves get portioned off to elevate particular cedents to "secured creditor" status, the reinsurer's financials may take on a grim look and, in the most severe cases, a death spiral to insolvency results, as other cedents and/or regulators lose confidence in the run-off's ability to manage the book to a successful conclusion.

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Clearly, the run-off reinsurer must consider this possibility prior to initiation of any arbitration. This article: 1) focuses on the existing case law on pre-hearing security in the United States, the United Kingdom and Canada; and 2) offers a few suggestions on preparation for this issue in the run-off context.

I. The United States — Deference to Arbitration Results in a Loose Standard

The problem (from the reinsurer's point of view) with the cases on pre-hearing security in the U.S. is that the reported decisions arise in the context of courts deciding motions to vacate an arbitration award. Under the Federal Arbitration Act (9 U.S.C. § 1, et seq.) to prevail on a motion to vacate such order, the cedent need only show that the power of the arbitrators can be "rationally derived" from the reinsurance agreement. *Yasuda Fire & Marine Ins. Co. of Europe v. Continental Cas. Co.* 37 F. 3d 345, 350 (7th Cir. 1994). This has led to decisions

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What we do, every day, is about solving the very toughest problems. More often than not, those problems have been so large they wore down our own companies!

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The Association of Insurance and Reinsurance Run-Off Companies (AIRROC) was formed in 2004 to promote and represent the common business interests of risk bearing entities in run-off, risk bearing entities with books of discontinued insurance business, receivers and rehabilitators. AIRROC's objectives include improving professional and managerial standards and practices, and enhancing knowledge and communications within and outside of the run-off industry through regular meetings and educational activities. AIRROC provides a forum for members to meet several times annually to raise and discuss common issues and conducts a commutation event each Fall where members and non-members meet for networking opportunities and to facilitate collection and dispute resolutions.