MINUTES OF THE MEETING OF THE REINSURANCE WORKING PARTY

HELD ON 20 SEPTEMBER 2007 IN CHRISTCHURCH, NEW ZEALAND

1 Introduction

Michael Gill opened the meeting.

2 Presentation by Tim Griffiths on the insolvency of HIH

There have long been insolvency provisions in the Corporations Act which were never really looked at, but these came to the fore in the HIH insolvency, which was the largest corporate failure in Australia running to over A$5 billion. The single biggest asset was the reinsurance recoveries, some A$650 million, and the recovery problem was to persuade reinsurers that inwards claims were being handled properly. This required establishing an open relationship with reinsurers and persuading them that the figures were reliable. In particular there was a need for the liquidators to enter into favourable commutations. There were a number of particular challenges.

(a) Proper law and jurisdiction of reinsurance agreements. In the absence of agreement, the test for the proper law is that of closest connection. Under Australian common law the proper law is generally that of the cedant. However, the Insurance Act 1902 (NSW), an old piece of consumerist legislation, has an impact here. The Act prohibits arbitration clauses in insurance (including reinsurance) contracts. In *HIH v Wallace* the cedant commenced proceedings in Australia, and the reinsuring underwriters unsuccessfully applied for a stay of the proceedings so that the matter could go to arbitration. The court held that the 1902 Act struck down the arbitration clause. See also the Trade Practices Act 1984, which contains a general prohibition on misrepresentation. The court in *ReAC v HIH* refused a stay of Australian proceedings on the ground that such a stay would prevent reliance on the 1984 Act.

(b) Limitation periods. The initial question is whether a limitation period is a substantive or procedural issue, ie, whether it is governed by the proper law or the law of the forum.

(c) Pay to be paid. The "ultimate net loss" clause provides that the reinsured can recover from reinsurers only where it has "actually paid". In England, in *Charter Re v Fagan* it was held that the phrase meant the amount of liability and not physical payment. This issue is to be determined by the Australian courts in *HIH v Wallace*, and it is not clear whether they will follow *Charter Re*.

(d) Arbitration. There are problems with determining the qualifications of arbitrators, although arbitration may be speedier and cheaper and, most importantly, is private.

3 Presentation by Mark Norman on the insolvency of HIH

HIH was a major liability insurer and a voracious acquirer of other companies, but it had few management controls. The liquidators' first task was to improve data confidence: all transactions with a reinsurance recovery were stamp-coded, and a map of the reinsurance contracts was built up. It was crucial to build up confidence with the reinsurers, and they were invited to give their views and to air their concerns.

The reinsurance asset divides more or less equally between Australia and the UK. As far as the UK is concerned, there is a process of agreeing commutations, with brokers playing a key role on behalf of the liquidators. There is an important issue concerning the right of a broker to set-off claims paid against premiums owed to it by HIH. There are about 600 reinsurers, 100 of whom represent 97% of the reinsurance asset and 20 of whom represent 60% of the reinsurance asset. Commutations have been entered into with a number of the reinsurers, and there are issues of transparency and agreeing issues. IBNR (incurred but not reported) losses are particularly contentious: Much business was written on a claims made basis; HIH has long-tail liabilities; and there has been a need to fix prudential margins with reinsurers.

The treaty wordings have Australian law and jurisdiction clauses, although the facultative contracts are silent on the point. As far as arbitration is concerned, there are problems with finding qualified arbitrators who are not conflicted out, and it has been found that arbitration is in fact more expensive that judicial proceedings.

Section 553(C) of the Corporations Act provides for set-off on the basis of mutuality. Reinsurance sold to Lloyd's Syndicates by HIH has been problematic, in that the membership of any syndicate will change from year to year, so it has been necessary to arrange set-off on a year-by-year basis in order to meet the mutuality requirement. Policyholders of HIH may have cut-through actions against reinsurers, cutting HIH out entirely.

Standstill agreements have been entered into with reinsurers in order to preserve HIH's claims under limitation laws, which bars claims after six years from accrual. There is a debate as to what this date may be.

"Pay as paid" has led to disputes as to whether *Charter Re v Fagan* applies so that actual payment by HIH is not required in order to recover from its reinsurers. This is a particular problem if the matter goes to arbitration, in that the arbitrators may not be required to apply strict law and there is no right of appeal.

4 Discussion

Colin Croly explained the origins of ARIAS (AIDA Reinsurance and Insurance Arbitration Service), with national organisations in the UK, the US, France and Germany. The UK ARIAS arbitration clause has now been adopted by the London market and now appears in most contracts. The new clause has removed the honourable engagement clause so that decisions are based on legal principles so that awards can be appealed, and it is no longer necessary for an arbitrator be a practising reinsurer (10 year qualification is enough).

Michael Gill raised the problem of HIH Re, which was the captive reinsurer of a number of HIH entities. Mark Norman explained that it was in some cases difficult to work out the allocation of debts within HIH.

Rob Merkin explained the problems of the pay to be paid clause.

5 Any other business

Colin Croly explained the operation of the Reinsurance Working Party, including its meetings and the publication of reports on questionnaires in order to develop international principles of reinsurance law. It was pointed out that the future of publication was under review, in particular the possibility of free availability on the AIDA website and the pending translation of the reports into Spanish. Colin also referred to the new organisation, AIDA Europe and its forthcoming joint conference with the International Bar Association in Hamburg in May 2007.