



FOLLOW THE FORTUNES

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Reinsurance Relationships



Gentlemen's Agreement

- Less formal
- “Hand Shake”

Contractual Agreements

- More formal
- Tighter, detailed treaty language



Duty of “Utmost good faith”

- Mutual trust and regard for the interest of the other party
- Disclosure of facts material to the reinsured risk
 - Conduct of business dealings that may affect the other’s legal liability
- Reinsurer relies on cedent to perform the actions that would be taken if it (the reinsurer) was placing the original coverage
- A reinsurer is not intimately involved in underwriting the ceded business or in handling claims subject to the reinsurance agreement
 - Reinsurer depends on cedent to underwrite the ceded business and handle reinsured claims

Insurer has duty to disclose to reinsurer all material facts about risk being reinsured

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- Disclosure Points
 - Cedent has duty to disclose material facts about the risk that the reinsurer is reinsuring
 - Ceding company must reveal all facts that materially affect the risk of which it is, or should be, aware
 - Place the [reinsurance] underwriter in the same position as himself [and to provide the same means and opportunity of judging the value of the risks]
 - Material Facts
 - Reinsurer would not have issued policy.
 - Reinsurer would have issued policy at higher premium.

Insurer has duty to disclose to reinsurer all material facts about risk being reinsured

- Material information in the underwriting process
 - The premium rate, volume or sufficiency
 - Prior significant losses or legal actions against the insured
 - The underwriting agent's role
 - The geographical spread of the underlying risks
 - The type of business ceded



Principle application

Application of utmost good faith extends to the entire reinsurance process

- Applies to actions during the entire course of the reinsurance relationship
- The cedent's duty to disclose all material facts extends to underwriting, claims handling, and general integrity
- Cedent must act honestly and follow all proper and businesslike steps in underwriting reinsured business and in settling claims.
- Failure to act in good faith in handling or resolving claims may excuse the reinsurer from following the fortunes or settlements of the cedent.

Principle application

Obligation to give notice of claim

- Cedent is obligated to notify reinsurers of potential claims
- Failure to provide prompt notice of a claim may entitle the reinsurer to refuse to perform

Example:

A reinsurer was relieved of its obligation to indemnify its reinsured where the reinsured failed to implement notification practices, procedures and controls, made no effort to determine what its duties were under the reinsurance agreement and failed to give timely notice of a significant claim in violation of the agreement's claims control clause.

Standard for determining whether cedent's payment was made in bad faith

- Reinsured acted in a grossly negligent or reckless manner in failing to implement practices and controls to ensure proper and timely notice of claims to the reinsurer.
- If a ceding insurer does not implement such practices and controls, then it has willfully disregarded the risk to reinsurers and is guilty of gross negligence.



“Follow the fortunes” doctrine

- Applied to reinsurance in the U.S. as early as 1800's
 - Not from English common law
 - Evolved from reinsurance contracts in France
 - Express provision binding the reinsurer to reimburse the reinsured for payment of loss, so long as the reinsured acted in good faith and could produce evidence of payment of the loss
- Reinsured obligated to exercise sound discretion when deciding whether to contest or pay a claim



“Follow the fortunes” vs. “Follow the settlements”



- Reinsurer will indemnify its cedent for any losses arguably **within the terms of the underlying policy**, as long as the cedent has not acted in bad faith
- Many U.S. court decisions fail to distinguish between following fortunes and following settlements.
- Meaningful distinction between the two concepts:
 - “Follow the Fortunes”
 - Reinsurers accept a reinsured’s good faith decision that a particular loss is covered by the terms of the underlying policy.
 - “Follow the Settlements”
 - Reinsurers abide by a reinsured’s good faith decision to settle a claim --rather than litigate.

“Follow the fortunes” vs. “Follow the settlements”

- “Follow the fortunes” more accurately describes the reinsurer’s obligation to follow the reinsured’s underwriting fortunes
 - Reinsurer indemnifies the cedent for all claims paid in good faith and reasonably within the coverage provided under the direct policy
 - Obligation is broad, but a reinsurer’s liability is limited to losses covered by the direct policy and not excluded by the reinsurance agreement
 - Does not override or alter express coverage limits in a reinsurance certificate
- “Follow the settlements” refers to the duty to follow the actions of the reinsured in adjusting and settling claims
 - Does not require the reinsurer to indemnify for ex gratia payments
 - Reinsurer obligated to reimburse a cedent for a settlement or judgment paid by the cedent in good faith
 - Court mixed regarding whether “Follow the Settlements” can or cannot be implied in a reinsurance agreement

Even under “Follow the fortunes” and “Follow the settlements,” the loss must come within both the original policy and the reinsurance agreement before the reinsurer’s indemnity obligation arises.



Points to consider when examining a case

Does “Follow the fortunes” apply in the event of agent gross negligence or intentional misconduct:

Facts:

- 69 year old male dies of natural causes
- Life claim of approximately 1.5 million
- Policy was issued 5/2001 client died 1/2011
- Company records showed policy was terminated 12/03
- Insured was misinformed by agent that the policy provisions would cover policy premium and ignored lapse notices

Is the claim payable ?

- Certainly if a claim was technically not payable, but the agent’s conduct waived the cedent’s defenses forcing the ceding company to pay the claim, the reinsurer may consider the claim to be ex-gratia, and outside the scope of coverage.

Consider:

Ceding Company mistakenly lapses a policy or lapse notices are not compliant with industry standard and elects required to pay a claim on a lapsed policy,

- Does “follow the fortunes” apply?
- Would the claim fail to meet the standard of “reasonably with the coverage provided by the policy,” required by the follow the fortunes doctrine?

Points to consider when examining a case

Relationship between the “Follow the fortunes” and the errors & omissions clause as it relates to administrative issues?

- 45-year old male dies of natural causes
- Life claim of approximately \$1 million
- Policy was issued 4/2002 client died 12/2008
- Company records showed lapsed policy was terminated 04/05
- Insurers lock- box vendor failed to follow through on request for address changes

Is the claim payable?

Consider:

Ceding Company corrected an administrative error in good faith to prohibit further business exposure.

- Relationship between current and future business may be hindered by the manner in which claims are paid.

Points to consider when examining a case

How does “Follow the fortunes” apply to underwriting errors?

Facts:

- 81-year old female dies of natural causes.
- Life claim of approximately \$400,000
- Policy was issued 8/2006 client died 6/2008
- Company records showed there was not an APS requested during underwriting for the insured, even though medication listed by the insured indicated the higher risk.

Is the claim payable ?

Consider:

Cedent required to act honestly and to follow all proper and businesslike steps in underwriting reinsured business and in settling claims.

[Am. Marine Ins. Group v. Neptunia Ins. Co., 775 F. Supp. 703, 705 (S.D.N.Y. 1991)]

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