

The challenge of agreeing to contracts at placement

Charles Higham, chief administration officer for Guy Carpenter, examines the 'quiet revolution' of established practices taking place



Charles Higham: the key to success is to continue the momentum for change.

A quiet revolution is underway in North America as cedents and assumers of reinsurance risk reverse a business process that has existed for decades. The traditional approach to reinsurance contracts was 'deal now, details later', but the obvious debacle of the World Trade Centre litigation reminded the industry that 'details' are often the subject of million-dollar disputes. The parties involved in the reinsurance transaction — insurers, brokers and reinsurers — have recognised that the status quo is no longer an option. They have now committed themselves to a process whereby the details develop simultaneously with the deal.

Outside the US, this process was further spurred by regulators, notably the Financial Services Authority (FSA) in the UK and the Australian Prudential Regulation Authority (APRA). In the US and Canada, the industry is focusing on fully agreed contracts ready for signature at placement. To reach this point, it was necessary to revamp completely the slip/contract process that existed for decades.

In practice, the process begins with the cedent approving a placement package and full contract wording. The second step involves securing full wording agreement from reinsurers as part of the placement authorisations, including incumbents and potential new markets. Since the terms and conditions tend to be fixed over many years for most placements, the process plays out in an 80/20 fashion. Most time and effort is spent on a few difficult contract terms or in negotiations with a small number of reinsurers.

While contract at placement initiatives began in earnest during 2005, the January 2006 renewal season was clearly the largest and most important test thus far. This was a tough test for a new process because of the great turmoil in the market following the record losses and overall business impacts of the storms of 2005. However, our own data, supplemented by market sources, indicate that a clear majority of contracts at January 2006 renewals were agreed at placement. With these successes, momentum is building in the industry, encouraging more insurers to participate.

At Guy Carpenter, we are reviewing our experience to identify where the process can be improved. So far, we have discovered that some reinsurers found


it difficult to respond in the required time frame because the documents were sent to them very late in the process. We believe that most of these delays were one-off events. For many players, this was their first time to participate. We have conducted some preliminary analyses of these delays and, to date, have not identified any systemic factor at work. Our sense is that with the next renewal cycle, these bottlenecks will be addressed, leading to a smoother and more punctual process.

Aside from the newness of the process and difficult market conditions, we did find a few situations where delays resulted from changes that were requested by some of the parties after final agreement. If the parties believe that they can have another bite of the apple, the integrity of the overall initiative will be threatened. Specifically, others are likely to shy away from studying and agreeing to terms that can be negated later in the process. We hope that with time, cedents and reinsurers will see that it is in their own best interest to have contracts with full agreement on all key terms at placement and therefore will avoid seeking revisions later.

> Revolutionising the process is certainly not easy, considering that the industry has been accustomed to operating in a certain way for so long.

Like the UK's FSA contract certainty requirements, the North American initiative on contract at placement mandates agreement to the language of the contract clauses at placement, as well as requiring signing the full contract document at that time.

Revolutionising the process is certainly not easy, considering the industry has been accustomed to operating in a certain way for so long. Completing the contract during the placement affects the entire calendar of reinsurance treaty renewals because it requires a shift in when and how contracts are drafted. The process of negotiating contract wording will have to start many months earlier than it did previously. The resources and capabilities of some cedents, brokers and reinsurers will be strained until permanent adjustments in staffing and processing structures are completed. However, the positive results of this initiative cannot be denied. The key to the long-term success of this initiative is to continue to build on the growing momentum for change.

We are optimistic that the industry in North America will continue to build on its own success, and that the benefits of contract at placement will spread to reinsurance markets worldwide. 

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