The Insurance and Reinsurance Law Review
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This article was first published in The Insurance and Reinsurance Law Review - Edition 3
(published in April 2015 – editor Peter Rogan).

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The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

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JORQUIERA & ROZAS ABOGADOS
KIM & CHANG
LC RODRIGO ABOGADOS
LEE AND LI, ATTORNEYS-AT-LAW
MAPLES AND CALDER
Acknowledgements

NADER, HAYAUX & GOEBEL
NISHIMURA & ASAHI
ROSE-MARIE LUNDSTRÖM ADVOKAT AB
SEDGWICK LLP
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EDITOR’S PREFACE

It is hard to overstate the importance of insurance in personal and commercial life. It is the key means by which individuals and businesses are able to reduce the financial impact of a risk occurring. Reinsurance is equally significant; it protects insurers against very large claims and helps to obtain an international spread of risk. Insurance and reinsurance play an important role in the world economy. It is an increasingly global industry, with the emerging markets of Brazil, Russia, India and China developing apace. Given the expanding reach of the industry, there is a need for a source of reference that analyses recent developments in the key jurisdictions on a comparative basis. This volume, to which leading insurance and reinsurance practitioners around the world have made valuable contributions, seeks to fulfil that need. I would like to thank all of the contributors for their work in compiling this volume.

Looking back on 2014, Aon Benfield’s Annual Global Climate and Catastrophe Report (of 13 January 2015) reveals that 258 global natural disasters occurred worldwide. The two costliest insured loss events of 2014 were both as a result of severe thunderstorms, in the USA in May and Europe in June, although the September floods in northern India and Pakistan resulted in the largest economic loss of the year. The combined total insured loss for 2014 was US$39 billion, 38 per cent below the 10-year average of US$63 billion and the lowest annual insured loss total since 2009. However, we should not of course forget the cost in human terms: the deadliest event of 2014 was a stretch of flooding and landslides that killed an estimated 2,600 people in Afghanistan. Events such as these test not only insurers and reinsurers but also the rigour of the law. Insurance and reinsurance disputes provide a never-ending array of complex legal issues and new points for the courts and arbitral tribunals to consider. I hope that you find this third edition of The Insurance and Reinsurance Law Review of use in seeking to understand them and I would like once again to thank all the contributors.

Peter Rogan
Ince & Co
London
April 2015
I INTRODUCTION

The Scope of the United States Insurance and Reinsurance Market

The United States insurance market is one of the largest financial markets in the world. In 2013, US insurers underwrote approximately $1.26 trillion in life and non-life direct premiums, accounting for just over 27 per cent of the global insurance industry. To put that number in perspective, the $1.26 trillion in underwriting amounted to roughly 7.5 per cent of the total United States gross domestic product. Yet even these premiums fail to capture the full scale of the US insurance market. In 2013, the total cash and invested assets of US insurers reached $5 trillion. As such, the US insurance market plays a significant role in the global economy.

In 2013, the US insurance market included $560 billion in life insurance premiums, including annuities. This dynamic and highly competitive segment of the marketplace includes more than 1,000 insurance companies competing to underwrite a wide variety of products.

1 Michael T Carolan is a counsel and Paul W Kalish and William C O’Neill are partners and Rachel P Raphael is an associate at Crowell & Moring LLP.
5 Id.
6 Id.
The 2013 US insurance market also wrote $481 billion in premiums in the property/casualty and specialty markets, including, among others, comprehensive general liability, directors and officers insurance, errors and omissions insurance, and workers compensation coverages.\footnote{Id.} Competition within the highly fragmented property and casualty market is significant, with over 2,600 different insurance companies competing for business.\footnote{Id.}

The underwriting of US reinsurance is also robust, with net premiums written to unaffiliated reinsurers totalling approximately $29.1 billion in 2013.\footnote{Reinsurance Association of America, Reinsurance Underwriting Review: A Financial Review of US Reinsurers, 2013 Industry Results, at 1, 10 (2014) (based on results of US reinsurance organisations with over $10 million of unaffiliated reinsurance premium and $50 million of policyholder surplus).} Reflecting the heightened complexity of reinsurance offerings, lower demand for reinsurance products, and intense international competition, this market is concentrated in substantially fewer companies than the direct-side market.\footnote{Id. at 10.} In addition to US-based reinsurers, the US market cedes approximately $65.7 billion of net written premiums to reinsurers located in jurisdictions outside the United States, including cessions to affiliated reinsurers.\footnote{Reinsurance Association of America, Offshore Reinsurance in the US Market: 2013 Data, at 2 (2014).}

Given the scope of the US market, it should come as no surprise that legal advisors specialising in insurance and reinsurance law span a broad range of specialties including insurance litigation and counselling; claims handling; regulatory compliance; professional and management liability; insurer liquidation and insolvency; and reinsurance disputes. The following sections provide a basic introduction to the language and practice of insurance law within the United States market.

## II REGULATION

Historically, US insurance and reinsurance companies were solely regulated at the state level. In 1944, however, a US Supreme Court decision raised doubts about state-level insurance regulation. In response, in 1945, the US Congress enacted the McCarran-Ferguson Act\footnote{15 U.S.C. §§ 1011 et seq.}, which declared ‘that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.’\footnote{Id. § 1011.}
Since passage of the McCarran-Ferguson Act, regulation of insurance and reinsurance companies is primarily performed at the state level. While the federal government has recently taken steps to increase its regulatory role, those steps have largely been at the edges of the insurance and reinsurance markets.

i State-by-state regulation

State insurance departments and commissioners

In the US, insurance companies obtain their charter from one domiciliary state, which is the primary regulator of the solvency of the insurance company. However, in general, an insurance company must also obtain a licence in each state in which it intends to issue policies. (An exception to that rule is for non-admitted or ‘surplus lines’ insurers, which are addressed below.) For these carriers, the company’s business practices, such as marketing, are regulated separately in each state in which it is licensed. The laws and rules regarding such business practices vary from state to state.

All 50 states have an insurance regulatory department, generally led by a chief insurance regulator. State insurance departments are generally funded by fees and taxes on insurance companies, including fees for licensing and examinations.

The National Association of Insurance Commissioners

The National Association of Insurance Commissioners (NAIC) operates to coordinate insurance regulatory efforts across the states. The NAIC is a private, voluntary association of chief insurance regulators from the 50 states, the District of Columbia, and five US territories. The NAIC is funded by assessing fees for its services and publications.

Although the NAIC lacks any actual regulatory authority, it is the leading voice with respect to the state-based insurance regulatory system in the US.

Issues subject to state regulation

In general, insurance regulation in the US is conducted in order to protect the public and consumers of insurance products by regulating the business practices of insurance companies while monitoring their solvency. The goal is twofold; first, to regulate the terms of insurance contracts to maintain fairness between the insurance company and

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14 This chapter does not address the US health insurance market. That market is primarily regulated by the federal government. For example, in 1965, the US Congress passed the comprehensive health insurance plans known as Medicare and Medicaid; in 1974, the US Congress passed the Employee Retirement Income Security Act, which placed employee benefit plans (including health plans) primarily under federal jurisdiction, and the HMO Act, which set standards for federally qualified health maintenance organisations; in 1996, the US Congress passed the Health Insurance Portability and Accountability Act, which established minimum federal standards for the availability and renewability of health insurance; and, in 2009, the US Congress passed the Affordable Care Act, a set of comprehensive health insurance market reforms.

15 Certain large states, such as California and New York, regulate the solvency of any insurance company selling policies in their state, regardless of its domicile.
the consumer, and, second, to assure that the insurance company will be available to pay
the valid claims of consumers when they are presented.

In practice, these goals are met through regulations on a variety of topics, outlined
below.

Company licensing
Insurance companies are generally required to obtain licences from state insurance
regulatory authorities before transacting insurance in a given state.\(^\text{16}\) Once granted, the
insurance licence specifies which lines of insurance the company is permitted to sell
within the state. Because licensing is done on a state-by-state basis, approval by one state
does not carry over into any other state. Licence applications submitted to states other
than an insurance company’s domicile generally are called ‘expansion applications’.

Typically, states require certain minimum levels of capital and policyholder
surplus in order to obtain a licence. The amount of capital and surplus will depend on
the type and volume of business the insurance company intends to write. In addition to
capital requirements, state regulators reviewing an insurance company licence applicant
evaluate the company’s management, business plan and market conduct.

Producer licensing
Individuals or companies that sell, solicit or negotiate insurance in the United States must
be licensed as a ‘producer’ in each state in which the individual or company operates.
This includes insurance agents and insurance brokers.

The requirements for licensing of producers vary from state to state and producers
typically have to meet separate licensing requirements for each state in which they sell
insurance. In most states, the producer licensing process includes an examination and a
background check. The process for licensing resident producers can be different from the
process for licensing non-resident producers.

Rate and product regulation
In the United States, individual states regulate both the types of products certain
insurance companies can offer and the rates those insurance companies can charge for
their products. The level and specificity of product and rate regulation varies from state
to state.

The general legal standard applicable for rates in all states is that rates may not
be inadequate, excessive, or unfairly discriminatory. On the whole, states do not set
mandatory rates. Instead, insurance companies choose the rates they intend to use in a
given state in which they are licensed and then inform the state of the chosen rates, with
justification.

For commercial lines within the property and casualty insurance market, states
take a variety of approaches to regulating insurance rates. Some states require that rates
be filed with the state and approved by the state prior to use. Other states require only
that rates be filed with the state. Finally, certain states have no filing requirements at all.

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\(^{16}\) The most important exception is for surplus lines.
With respect to insurance product regulation, state regulators often require pre-approval of certain life and property and casualty insurance products offered in their individual state in an effort to assure that offered products can be readily understood by consumers. That pre-approval process includes, among other things, a review of policy forms and marketing materials prior to the sale of such policies in their state.

**Market conduct regulation**
States also regulate the business of insurance by prohibiting insurance companies from engaging in unfair, deceptive or anti-competitive conduct. In order to enforce these regulations, states perform market conduct examinations of licensed or admitted carriers and producers. States also use enforcement actions to compel insurance companies to adhere to specific standards with respect to the interactions between the companies and consumers or policyholders. In some states, enforcement actions may also be brought by the state attorney general under laws outside of insurance-specific regulations.

**Solvency/accreditation**
All 50 states and the District of Columbia have adopted financial reporting laws that require insurance companies to file quarterly and annual financial statements on the forms authored by the NAIC. Likewise, insurance companies must calculate their risk-based capital in accordance with procedures set by the NAIC. These coordinated financial requirements are part of the NAIC’s accreditation program. Accreditation is a certification issued to a state insurance department once it has demonstrated that it has met and continues to meet a variety of legal, financial and organisational standards as determined by the NAIC. Accreditation is necessary so that when an insurance company is domiciled in an accredited state, the other states in which the insurance company is licensed, or writes business, or both, can be assured that the domiciliary state is adequately monitoring the financial solvency of that company. As of December 2014, all 50 states, plus the District of Columbia and Puerto Rico are accredited.

In addition to accreditation, since 2008, the NAIC has undertaken a Solvency Modernization Initiative intended to assure that the US insurance regulatory system remains in sync with evolving international standards of prudential insurance regulation.

**Financial examinations**
Each of the 50 states and the District of Columbia subject insurance companies operating within their state or territory to a full financial examination at least once every five

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17 State control of the regulation of insurance companies was confirmed by the Insurance Capital and Standards Clarification Act of 2014, which was signed into law on 18 December 2014. The Act makes clear that if an insurer’s activities are regulated by state insurance regulators, it is not subject to the minimum capital requirements for depository institution holding companies and nonbank financial companies laid out in the Dodd-Frank Act (discussed below).
years. These examinations are designed to verify the financial statements discussed in the preceding section of this chapter.

Uniform standards, including the NAIC Model Law on Examinations and the NAIC’s *Financial Condition Examiners Handbook*, apply to financial examinations by almost all 50 states. These standards specify both when a financial examination is to be conducted and the guidelines and procedures to be used by the state in its conduct of the financial examination. Generally, states use a risk-focused approach to financial examinations. Insurance companies that operate in multiple states are subject to financial examination by each state. These multiple financial examinations, however, are coordinated to some extent for group examinations.

**Credit for reinsurance/collateral requirements**

Historically, most US states required that in order for ceding insurers to get full financial statement credit for reinsurance placements with unauthorised reinsurers (reinsurers not licensed or accredited in a ceding insurer’s domicile), the unauthorised reinsurers must post 100 per cent collateral for the reinsured liabilities. This allowed state-based insurance regulators to indirectly regulate transactions with reinsurers outside of its jurisdiction. In recent years, such indirect regulation has come under criticism.

In response to this criticism, a number of states have reduced collateral requirements for certain approved non-admitted reinsurers. As of autumn 2014, 23 states have adopted revised reinsurance collateral provisions focused on the solvency risk of reinsurers as opposed to their admitted status.18

**Insurance insolvency**

In the United States, insurance company insolvencies are exempt from federal bankruptcy law. Instead, the rehabilitation and liquidation of insurance companies has been specifically delegated to the states. Thus, domiciliary state laws establish the process for the receivership or liquidation of an insolvent insurance company.

Notably, the insolvency clause standard in almost all US reinsurance contracts may require the reinsurer to indemnify an insolvent insurer’s estate for the full amount of any covered claim allowed in the proceeding, despite the fact that the estate in liquidation may actually pay only a fraction of the allowed amount to its policyholder.

**ii  Federal regulation of insurance**

Although the primary source of insurance regulation is by the states, the US federal government does play a role with respect to certain regulatory issues.

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18 As of December 2014, the NAIC has approved seven countries as Qualified Jurisdictions: Bermuda, Germany, Switzerland, United Kingdom, France, Ireland and Japan. Reinsurers that are licensed and domiciled in these jurisdictions are eligible for reduced reinsurance collateral requirements.
Direct federal programmes
In a number of hard-to-place insurance markets, the US federal government has stepped in to provide direct insurance or reinsurance support. Under these programmes, federal regulation either pre-empts or directly supports private insurance, supplanting the states’ regulatory role for the specific insurance market.\(^\text{19}\) Examples of direct federal insurance involvement include terrorism risk insurance;\(^\text{20}\) flood insurance;\(^\text{21}\) and crop insurance.\(^\text{22}\)

Liability Risk Retention Act
In 1986, the US Congress enacted the Liability Risk Retention Act of 1986 (LRRA). The LRRA allowed for the formation of risk retention groups (RRGs), which are entities through which similar businesses with similar risk exposures create their own insurance company in order to self-insure their liability (but not property) risks. RRGs are only required to be licensed as an insurance company in one domiciliary state. Once so licensed, an RRG is exempted from most insurance regulations for any other state in which the RRG operates.

Dodd-Frank Act
In response to the 2008–2009 financial crisis, in 2010 the US Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The Dodd-Frank Act increased the federal government’s regulatory role with respect to insurance and reinsurance in a number of ways.

\(^\text{19}\) The examples cited herein of direct US federal government participation in insurance markets are illustrative and not exhaustive.

\(^\text{20}\) Initially enacted in 2002, the Terrorism Risk Insurance Act of 2002 (TRIA), Pub. L. 107–297, 116 Stat. 2322, was reauthorised in 2007 and expired on 31 December 2014. On 12 January 2015, HR 26, the ‘Terrorism Risk Insurance Program Reauthorization Act of 2015’ was signed into law. This legislation will, among other things, extend the federal terrorism reinsurance program established by the TRIA for six years and raise the trigger for reinsurance coverage from $100 million to $200 million beginning in 2016.


\(^\text{22}\) The Federal Crop Insurance Corporation was initially created by the United States Congress in 1938 (codified at 7 U.S.C. § 1501) in response to the economic difficulties brought to the US farming industry by the Great Depression. In 1980, the programme was expanded through the Federal Crop Insurance Act, Pub. L. 96-365. Of note, the Federal Agriculture Reform and Risk Management Act of 2013, signed into law on 7 February 2014, includes, among other things, expanded crop insurance subsidies paid by the US government over the next 10 years.
Federal Insurance Office

The Dodd-Frank Act established the Federal Insurance Office (FIO), a new organisation within the US Treasury Department. The primary function of the FIO is to monitor all aspects of the insurance industry in order to identify issues or gaps in the regulation of insurance companies that could lead to a systemic crisis in the insurance industry or the US financial system. The FIO does not, however, currently have any express regulatory authority over the insurance industry.

The FIO monitors all lines of insurance, except for health insurance, long-term care insurance, and crop insurance. The FIO also has certain responsibilities relevant to the insurance industry and the US financial system, including, among others: acting to pre-empt state regulations that conflict with international insurance agreements, monitoring whether traditionally underserved communities have access to affordable insurance products, and reporting to the US Congress, including annual reports on acts to pre-empt state law due to international insurance agreements, a report on modernisation of insurance regulation, and reports on the US and global reinsurance markets.

Financial Stability Oversight Council

In 2010, the Dodd-Frank Act also created the Financial Stability Oversight Counsel (FSOC). Tasked with identifying and responding to risks to the financial stability of the United States, the FSOC may subject a ‘nonbank financial company’ (NBFC), including an insurance company, to supervision by the Federal Reserve if it determines that the company is a ‘systemically important financial institution’ (SIFI) through a multi-stage determination process. In making its determination, the FSOC considers factors such as size, leverage, interconnectedness and current regulatory scrutiny. By statute, the FSOC may only designate a NBFC as a SIFI if the company’s material financial distress, or its size, scope, nature, scale, interconnectedness, concentration or mix of activities, pose a threat to the financial stability of the US. Once a company is identified as a SIFI, it is subject to direct supervision by the US Federal Reserve Board and enhanced prudential standards, including specific reporting requirements, risk-based capital requirements, liquidity requirements, risk management requirements, leverage limits, and credit exposure limits. Once a company has been designated, the FSOC is required by statute to re-evaluate each year, and considers whether material changes at the company warrant a rescission of the SIFI designation. Aside from the annual re-evaluations, a designated company can request a re-evaluation if it has undergone a change that materially reduces the threat that it might pose to US financial stability.

24 Id.
NRRA – surplus lines
Additionally, the Dodd-Frank Act included the Nonadmitted and Reinsurance Reform Act (NRRA). The NRRA, which became effective in July 2011, addresses two important issues, including surplus lines insurance.

In the US, all 50 states allow issuance of surplus lines business by unlicensed or non-admitted insurance carriers. Generally, consumers must use a specially-licensed insurance broker and demonstrate they are unable to find the specified coverage through the admitted market. Once the exceptional need is demonstrated, the risk can be placed with non-admitted carriers.

In situations where the risk placed with a surplus lines carrier is located in multiple states, the surplus lines broker is sometimes faced with conflicting state requirements for surplus lines placement, including allocation of the tax payments. The NRRA first addresses these conflicts by investing exclusive taxing authority with respect to surplus lines and non-admitted insurance policies in a policyholder’s ‘home state’. The NRRA also encourages (but does not mandate) the formation of interstate compacts to manage the reporting, payment, collection, and allocation of premium taxes remitted on surplus lines policies covering multistate risks. In addition, the NRRA provides that surplus lines insurance is subject only to the regulatory requirements of the policyholder’s home state (except for workers’ compensation business). Finally, the NRRA permits large commercial insurance purchasers that meet certain conditions to directly access the surplus lines market.

NRRA – reinsurance
The NRRA also addresses certain issues of regulatory redundancy with respect to reinsurance. Under the NRRA, if an insurer’s domicile recognizes credit for reinsurance for the insurer’s ceded risk, then no other state may deny such credit for reinsurance, so long as the domiciliary state is NAIC-accredited, or has solvency requirements substantially similar to those required for NAIC accreditation. The NRRA also pre-empts the laws and regulations of non-domiciliary states, to the extent that such laws or regulations: restrict or eliminate the right to resolve reinsurance disputes pursuant to reinsurance contractual arbitration provisions; require that a certain state’s law shall govern the reinsurance contract; or attempt to enforce a reinsurance contract on terms different than those set forth in the reinsurance contract itself. Finally, the NRRA invests exclusive authority to regulate the financial solvency of a reinsurer in the reinsurer’s domiciliary state.

III INSURANCE AND REINSURANCE LAW
i Sources of law
As discussed above, pursuant to the McCarran-Ferguson Act, the US Congress has declared that states will be the primary regulators of the insurance and reinsurance markets.

In the US, each state has both statutory and common law applicable to insurance issues. State common law is a significant source of law for the purpose of resolving disputes. In broad terms, it applies to issues such as: legal duties, the interpretation of contracts, procedure, and damages. Individual state statutes applicable to insurance,
though they vary in breadth and focus, generally regulate insurance companies operating within the state. Common state statutes include provisions requiring companies to be licensed or barring insurers from acting or marketing its products in a deceptive manner.

Notwithstanding the McCarran-Ferguson Act, federal law also addresses insurance issues. Under the US Constitution, federal statutes may pre-empt state statutes and laws where they overlap. Thus, a federal statute such as the NRRA (discussed above) may pre-empt inconsistent state laws. Federal common law, while fairly narrow in scope, impacts insurance and reinsurance companies indirectly. One example is federal common law relating to the application of the Federal Arbitration Act, which guides decisions on whether policyholders or cedents are bound to arbitrate a dispute with insurers or reinsurers.

ii Making the contract
The requirements for the creation of an enforceable insurance or reinsurance contract mirror those of most written contracts – offer, acceptance, consideration, legal capacity and legal purpose. In practical terms, an application or submission and the tender of the initial premium represent the offer to contract. Acceptance is generally demonstrated through execution of the policy or agreement. Without an offer and acceptance, there is no meeting of the minds and no contract.

Insurance and reinsurance contracts are negotiated and placed both directly and through intermediaries. In either case, prospective insureds or cedents provide the information requested by the insurance carrier or reinsurer for the placement. If necessary, the insurance carrier or reinsurer’s underwriter can (but is not necessarily required to) seek more information. At all times, the prospective insured or reinsured generally is under an obligation to disclose all material information relating to the risk being covered.

Following the agreement on terms, the insurance or reinsurance contract is documented. In most individual consumer insurance markets, the insurance policy is initially crafted by the insurance company. In other instances, a manuscript policy may be negotiated.

iii Interpreting the contract
Because of variations among state laws, there are no overarching rules of insurance contract interpretation. In general, the rules of interpretation applicable to commercial contracts apply to insurance policies. State or federal courts that interpret contract provisions typically try to determine the objective intent of the parties. Unambiguous insurance policy provisions are generally enforceable. While these principles apply generally to reinsurance agreements as well, it is important to note that reinsurance disputes are typically viewed through the prism of industry custom and practice. Indeed, in reinsurance arbitrations the arbitrators’ charge is often to view the parties’ agreement as an ‘honourable engagement’ and they are often directed to interpret the contract without a need to follow strict rules of law and with a view to effecting the purpose of the contract in reaching their decision.
iv  **Intermediaries and the role of the broker**

Insurance intermediaries, including agents and brokers, play a key role in the US insurance and reinsurance markets. Currently, there are more than 2 million individuals and more than 500,000 businesses licensed to provide insurance services in the US.

There are a number of types of agents and brokers. Broadly speaking, a general insurance agent contractually represents the insurance company and is authorised to accept risks and issue policies, a soliciting agent has authority to seek insurance applicants, but has no authority to bind an insurance company, and a broker is a licensed, independent contractor who represents insurance applicants and ceding insurers in the negotiation and purchase of insurance or reinsurance.25

The conduct of insurance intermediaries is regulated through state statutes and laws. Typically, an agent or broker has a duty to faithfully carry out the instructions of its client. Depending upon the circumstances, a heightened ‘fiduciary duty’ may also apply.

v  **Claims**

The laws regarding insurance and reinsurance claims issues vary from state to state. The key issues include: notice, good faith and dispute resolution.

With respect to notice, both insurance and reinsurance claims generally require that a policyholder or insured provide reasonably timely notice of claims or other information. For insurance claims, timely notice is considered a condition precedent to coverage in many states and, in the absence of reasonably timely notice, a claim may not be covered. For reinsurance claims, in some jurisdictions, unless timely notice is stated to be a condition precedent in the reinsurance contract, a reinsurer seeking to avoid a claim on account of late notice must prove that it was economically prejudiced.

Both insurance and reinsurance claims may involve issues of good faith and fair dealing. Insurance companies, for their part, must respond to the claims of their policyholders consistent with contractual good faith and fair dealing requirements. If the insurance company fails to do so, it opens itself up to a potential breach claim by the policyholder. In reinsurance, the duty of utmost good faith applies to both cedents and reinsurers. Thus, while cedents must fully disclose all material information about the ceded risk, for most lines of business reinsurers have a concomitant duty to ‘follow the fortunes’ of their cedents, which requires indemnifying cedents for all businesslike, good faith, reasonable claim payments.

In the US, many casualty insurance policies contain arbitration clauses. In some states, however, such clauses are not permitted and disputes are required to be resolved through litigation in state or federal courts. On the other hand, most reinsurance contracts contain dispute resolution clauses mandating confidential arbitration.

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25 Depending upon the facts, a broker may also act for the insurance company or reinsurer.
IV DISPUTE RESOLUTION

i Jurisdiction, choice of law and arbitration clauses

A few key issues relating to insurance and reinsurance dispute resolution are the forum in which a suit can or must be brought, the law that will govern the dispute and the dispute resolution process. In that regard, some insurance policies and most reinsurance contracts contain provisions relating to jurisdiction, choice of law, and/or arbitration, either separately or together within a single dispute resolution clause. A typical forum clause, for example, requires any lawsuit related to the policy or contract to be filed in a given state or federal court. Similarly, a typical choice of law clause dictates which jurisdiction’s laws ‘shall’ apply to disputes arising out of the contract. Finally, a typical arbitration clause states that all disputes regarding the contract shall be resolved by arbitration and, in most instances, spell out certain procedures applicable to the arbitration process.

Where those issues are not spelled out in the applicable contract, state and federal courts use a variety of legal rules for determining whether the chosen forum for a lawsuit is appropriate and choosing which state’s law will apply. Arbitration, however, is a matter of contract or agreement; thus, a party that did not or has not agreed in its contract to arbitrate a dispute typically cannot be forced to do so.

ii Litigation

The judicial system in the United States is made up of two different court systems: the federal court system and the state court systems.

In the federal system, there are three levels of courts: the District Courts, which are the federal trial courts; the interim appellate courts, called the Circuit Courts of Appeal; and the US Supreme Court, the final appellate court. Only two types of cases are heard in the federal system. The first is cases dealing with issues of federal law. The second is cases between citizens of two different states or between a US citizen and a foreign entity, provided the amount in dispute meets a minimum threshold. In total, there are 94 US district courts throughout the 50 states. There are 13 US circuit courts of appeal, each with separate jurisdictional coverage. There is one Supreme Court. Notably, the right to appeal to the Supreme Court typically is not automatic; the Supreme Court must agree to hear the case.

No two state court systems are exactly alike. Typically, state court systems are made up of two sets of trial courts: trial courts of limited jurisdiction (probate, family, traffic, etc.) and trial courts of general jurisdiction (main trial-level courts). Most states also have intermediate appellate courts. All states have one final appellate state court.

Each state has its own rules of evidence for cases tried in its courts. Each state likewise has its own rules of procedure for cases progressing through its court system. On the other hand, the federal district courts have a unified set of evidence rules and a unified set of rules of procedure.

Except in certain limited circumstances, the general rule in the US is that each party pays its own costs of litigation.
iii Arbitration
The most widely used alternative dispute resolution process in the US is arbitration. There are numerous types of insurance and reinsurance arbitrations. The differences between each type generally relate to the following: the number of arbitrators; arbitrator selection procedures; arbitrator neutrality; and arbitration hearing procedure.

In general, US insurance and reinsurance arbitrations are conducted before either one arbitrator or three arbitrators. The selection process truly varies; in some instances, there is a process managed by an independent third-party for selection of the entire panel, in other instances, the parties choose and organise the selection process. Two prominent and independent groups that certify arbitrators and in varying degrees organise insurance and reinsurance arbitrations in the US are the American Arbitration Association (AAA) and the AIDA Reinsurance and Insurance Arbitration Society (ARIA-US).

Typically, in the single-arbitrator process, the arbitrator is neutral and often has expertise in the particular type of dispute. Where the arbitration panel consists of three arbitrators, the general process is that arbitrators are either all neutral, or the parties each appoint a single arbitrator and follow a process for selection of a neutral umpire. In the latter process, it is common for both parties to be able to communicate with their appointed arbitrator prior to the hearing, but in the end, party-appointed arbitrators are expected to rule based on their view of the merits of the dispute. Although there are grounds to vacate or modify an arbitration award under the Federal Arbitration Act (or similar state statutes) and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (also known as the ‘New York Convention’), unless there is prior agreement otherwise, arbitration decisions are considered binding.

In most instances arbitrators are not bound by strict rules of evidence during the hearing. It is also common that witnesses appearing at an arbitration hearing will be questioned by each of: the presenting party’s attorney, the opposing party’s attorney, and the arbitration panel.

Finally, the general rule in the US is that each party pays its own costs for insurance and reinsurance arbitrations. However, insurance and reinsurance contracts may specify otherwise. Additionally, unless forbidden by the applicable contract, arbitration panels are generally empowered to order one party to pay the other party’s costs.

iv Alternative dispute resolution
A range of dispute resolution techniques are used in the US. Beyond arbitration and mediation, alternative dispute resolution procedures include early neutral evaluations, peer review, and mini-trials. A number of industries – including the construction, maritime, and securities industries – have adopted such procedures to handle intra-industry claims. Of course, the level of interest in these procedures can vary greatly by company or industry.

v Mediation
Beyond settlement conferences, most state and all federal courts have adopted mediation processes designed to encourage dispute resolution without a trial. In general, the process is voluntary and the mediator is an independent third-party without court affiliation. However, in a number of states, parties in commercial disputes are required to participate
in at least one mediation or settlement conference prior to moving forward with trial. In addition, parties to an insurance dispute will often agree to retain a private mediator to help resolve one or more issues.

V YEAR IN REVIEW

2014 was an eventful year for the US insurance industry, with significant industry, judicial, and regulatory developments. While a comprehensive review of developments in the industry far exceeds the scope of this article, the following is a sampling of the key emerging issues and events that will be on the minds of insurers throughout 2015.

i Designation of us insurers as systemically important

On 18 December 2014, FSOC formally designated MetLife, Inc. as a nonbank SIFI. MetLife represents the third insurance company labelled as a nonbank SIFI, following American International Group, Inc. (AIG) and Prudential Financial, Inc. in 2013. On 13 January 2015, MetLife filed suit in the US District Court for the District of Columbia looking to overturn this designation. While the Dodd-Frank Act allows a designated entity to seek judicial review of FSOC’s decision within 30 days, MetLife is the first nonbank financial firm to file such a challenge.

On 4 February 2014, the FSOC voted to adopt certain changes in an effort to improve the transparency of its process. Notably, these changes involve earlier notification to companies that come under the FSOC’s review, more publicly available information regarding the FSOC process, and more engagement between designated entities and the FSOC during the annual re-evaluation of SIFI designations. The FSOC’s announcement follows two reports released by the US Government Accountability

29 MetLife, supra note 26.
32 Id.
Office that identified data collection and communications problems with the existing FSOC process for designating companies as SIFIs.  

In addition to a designation by the FSOC, US insurers may also be identified as global systemically important insurers (G-SIIs) according to a methodology released by the International Association of Insurance Supervisors (IAIS) in July 2013. Using this methodology the Financial Stability Board (FSB), an international body that works to ensure the stability of the global financial system, has identified its initial list of G-SIIs which included AIG, Prudential and MetLife. On 6 November 2014, the FSB announced that it would re-identify the G-SIIs identified in 2013 and postpone any decision on the G-SII status of reinsurers. By November 2015, the IAIS will revise the G-SII assessment methodology and this new methodology will be applied starting in 2016. Like a non-bank SIFI under the FSOC, a G-SII will be subject to enhanced regulatory supervision as well as certain capital requirements and risk management plans.

### New York High Court reverses itself on whether a carrier in breach of its duty to defend can rely on policy exclusions to escape its duty to indemnify

One of the more significant insurance cases from 2014 involved New York’s highest court reversing a decision it had issued only one year before.

In 2013, the Court of Appeals of New York concluded that an insurer which breaches its duty to defend is not allowed to later rely on potentially applicable policy exclusions to deny coverage for indemnification. That decision was subject to criticism by insurance companies operating in New York, who pointed out that it was a significant departure from established New York insurance law, which provided that even where an insurance carrier breaches its duty to defend, the carrier could still rely on policy exclusions to bar the policyholder’s claim for indemnity.

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33 The September 2014 Government Accountability Office (GAO) report, ‘Financial Stability Oversight Council: Status of Efforts to Improve Transparency, Accountability and Collaboration’, included suggestions for how FSOC could improve its transparency and accountability. Specifically, the GAO recommended, among other things, that the FSOC develop (1) a systematic approach for collecting and sharing key risk indicators to identify potential threats; (2) a strategy to improve communication with the public; and (3) a framework for evaluating the impact of its SIFI decisions. The November 2014 GAO report, ‘Financial Stability Oversight Council: Further Actions Could Improve the Nonbank Designation Process’, included additional suggestions for how the FSOC could make its process more systematic and transparent, such as detailed public documents on its decision rationale, and a tracking system for key data to monitor progress.


35 Id.


37 Id.


39 New York’s long-standing rule in this regard was first set out by the New York Court of Appeals in the 1985 case of Servidone Constr. Corp. v. Security Ins. Co. of Hartford, 64 N.Y.2d
Less than a year later, in *K2 Inv. Grp. LLC v. American Guar. & Liability Co.*, 22 N.Y.3d 578, 584 (2014), the New York Court of Appeals reversed itself, vacated its 2013 opinion and reverted to longstanding precedent, which provided that New York insurers which breach the duty to defend can still rely on policy exclusions to deny coverage for indemnification. 41 Pointing to the rule of *stare decisis*, the Court of Appeals explained that ‘[w]hen our Court decides a question of insurance law, insurers and insureds alike should ordinarily be entitled to assume that the decision will remain unchanged unless or until the Legislature decides otherwise.’ 42

Following the 2014 decision, the law in New York returned what it has been for decades: when an insurer breaches its duty to defend, the insured is entitled to recoup reasonable defence costs, but the breach does not abrogate the respective burdens of the parties regarding a claim for indemnity, meaning the insured must show it is entitled to coverage for indemnity and then the insurer must demonstrate that the loss at issue falls entirely within a policy exclusion. 43

iii Seventh Circuit rules foreign sovereign reinsurer immune from state law requiring prejudgment security

In November 2014, the US Court of Appeals for the Seventh Circuit addressed whether a foreign sovereign reinsurer had to comply with an Illinois state statute that required insurers not specifically authorised to do business in Illinois to post security sufficient to satisfy any final judgment before it files a responsive pleading.

The case, *Pine Top Receivables of Illinois, LLC v. Banco de Seguros del Estado*, 771 F.3d 980 (7th Cir. 2014), involved a foreign sovereign reinsurer who disputed amounts it owed to an insolvent insurer, which were being collected by a company established for collecting outstanding balances on behalf of the insolvent insurer. At the outset, the collection company filed suit against the foreign sovereign reinsurer seeking to compel arbitration, or alternatively, a judgment for breach of contract. 45 The foreign sovereign reinsurer thereafter filed its answer, but failed to comply with a provision of the state statute that required insurers not specifically authorised to do business in Illinois to post security before filing a responsive pleading. 46 When the collection company sought to strike the foreign sovereign reinsurer’s answer for the failure to post security, the US District Court for the Northern District of Illinois denied the motion and held that the foreign sovereign reinsurer did not have to post security. 47

40 22 N.Y.3d 578, 584 (2014).
41 Id. at 587.
42 Id.
43 *Servidone*, 64 N.Y.2d at 425.
44 771 F.3d 980 (7th Cir. 2014).
45 Id. at 981-82.
46 Id. at 982.
47 Id. at 981.
The US Court of Appeals for the Seventh Circuit affirmed the lower court's decision. In doing so, it relied on the Foreign Sovereign Immunities Act (FSIA) and concluded that the prejudgment security required by the Illinois state law was an impermissible ‘attachment’ of the foreign sovereign reinsurer's property. Thus, under the FSIA, the foreign sovereign reinsurer was exempt from having to post security before filing its answer in state litigation.

iv FIO report on importance of the global reinsurance market on insurance in the United States

On 31 December 2014, the FIO released its report on the ‘Breadth and Scope of the Global Reinsurance Market and the Critical Role Such Market Plays in Supporting Insurance in the United States’. This report, required by the Dodd-Frank Act, emphasises that global reinsurers ‘play a vital role’ to US insurers, and therefore, to the US economy as a whole. The FIO summarises the benefits of global reinsurers, such as:

- stabilising underwriting results;
- increasing underwriting capacity;
- supporting entry into and exit from insurance markets;
- promoting capital and allocation among affiliates; and
- achieving risk concentration or diversification.

In 2013, non-US reinsurers accounted for about $28.4 billion (over 62 per cent) of reinsurance premiums ceded by US-based insurers. In its report, the FIO explains that with this significant proportion of reinsurance premiums ceded to non-US reinsurers, uniformity of reinsurance supervision is all the more important. Because federal officials are well-positioned to make determinations regarding whether a foreign jurisdiction has sufficiently effective regulation, the Treasury and US Trade Representative are considering pre-empting inconsistent state laws governing reinsurance collateral. Ultimately, the FIO concludes that the global reinsurance market ‘provides an essential backstop and various risk and capital management mechanisms for insurance in the United States.’

48 Id. at 984.
49 Id. at 984.
52 Id. at 11–14.
53 Id. at 36. Notably, this figure only counts premiums ceded to unaffiliated non-US reinsurers.
54 Id. at 19–20.
55 Id. at 25.
56 Id. at 43.
v Cybersecurity remains a major concern going into 2015

Data breaches and cybercrime made for major headlines in 2014.\footnote{In 2014, cyber-attacks affected big-name business across a range of industries, including companies such as Target, eBay, Neiman Marcus, the University of Maryland, and JP Morgan Chase.} Cyber incidents such as privacy violations, inadvertent security breaches and cyber-attacks remain a significant source of liability for companies of all sizes. Courts continue to reach inconsistent decisions regarding whether standard commercial general liability (CGL) policies cover such losses.\footnote{See Hartford Cas. Ins. Co. v. Corcino & Assoc. et al., 2013 US Dist. LEXIS 152836, *15 (C.D. Cal. 7 October 2013) (dismissing suit by insurer of CGL policy seeking declaration that it did not have a duty to defend or indemnify policyholder for underlying lawsuits connected to the online publication of medical records.); but see Zurich American Ins. Co. v. Sony Corp. of Am., et al., No. 651982/2011 (N.Y. Sup. Ct. 21 February 2014) (finding insurers under CGL policies were not obligated to defend policyholder in relation to underlying putative class actions arising from unauthorised access to personal and credit card information of online game users).} Additionally, the Insurance Services Office, Inc. continues to try to address coverage for cyber liabilities, most recently by issuing new CGL policy endorsements, effective as of May 2014, which aim to broadly exclude data-related liability and losses resulting from access or disclosure of personal or confidential information.\footnote{A sample of ‘Exclusion – Access Or Disclosure Of Confidential Or Personal Information And Data-Related Liability’ is available at www.independentagent.com/Education/VU/SiteAssets/Insurance/Commercial-Lines/CGL/Endorsements/WilsonDataBreach/CG21060514.pdf.}

Due to the uncertainty in coverage offered by standard CGL policies, increased government scrutiny of cyber security measures, and related legislative developments, a growing number of companies are looking to specialised stand-alone cyber insurance policies.\footnote{Insurance Information Institute, ‘Cyber Risks: The Growing Threat’, at 25 (2014).} Insurance carriers, in turn, are expanding the types of specialised coverage offered in response to this demand.\footnote{Id.} Thus, cybersecurity will likely remain key issue in 2015, with insurance and reinsurance companies playing an important role.

VI OUTLOOK AND CONCLUSIONS

The growth of the size, scope, and complexity of the US insurance and reinsurance markets continued in 2014. Likewise, the numerous and varied laws and regulations applicable to insurance and reinsurance companies are evolving to keep pace with the industry. As this growth and evolution will no doubt continue in 2015 and beyond, industry executives, representatives, and practitioners will need to stay abreast of these changes in order to timely respond to new and emerging issues.
Appendix 1

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Michael T Carolan is a counsel in Crowell & Moring’s insurance/reinsurance group, where he focuses on litigating and arbitrating disputes concerning a variety of issues, including reinsurance, complex insurance coverage, and brokers’ liability. Michael has represented both company and intermediary clients in life, health and property/casualty disputes regarding issues such as policy and contract interpretation, notice, underwriting practices and claims management, allocation, follow the fortunes, rescission, fraud, misrepresentation, and sunset and commutation clauses. He has also written on reinsurance issues related to credit default swaps and financial products. Michael received his JD from George Washington University in 2006. Prior to joining Crowell & Moring, Michael represented a variety of domestic and offshore captive insurance companies owned US corporations, providing counseling on tax and health care issues, reinsurance and fronting arrangements, policy drafting, claims management, and commutation agreements.

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Paul W Kalish is co-chair of Crowell & Moring’s insurance/reinsurance group. He received his BA from Duke University in 1983, where he graduated magna cum laude, and his JD from Northwestern University School of Law in 1986 where he was an Editor of the Northwestern University Law Review and member of the Order of the Coif. Paul represents domestic and Bermuda-based clients in a variety of litigation and counseling matters, including: (1) serving as national coverage counsel for insurers with regard to various tort (implants, asbestos, pharmaceuticals), and environmental matters; (2) representing insurers and reinsurers in liquidation matters, such as the Midland Insurance Company and Home Insurance Company liquidation proceedings; (3)
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