Contract "Uncertainty" in the Nordic Market?

by Søren Vasehus Madsen

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The old insurance industry practice of "deal now – details later" is no longer acceptable in today's business climate. Although reforms have been made, there are some instances of slip-wordings being debated after the date of policy inception.

As a result, Nordic and Continental insurers and reinsurers would do well to proactively work for reforms that would require contract certainty – rather than waiting for their domestic regulators to mandate it.

When I started my career in the insurance industry nearly 20 years ago, I was shocked at how many big decisions were made without any semblance of contract certainty.

Working in those days as an underwriter in the facultative department of a reinsurance company, I frequently saw multi-million dollar deals agreed with "Terms TBA" (Terms To Be Agreed). This worked for risks running the gamut from large single-risk property policies to standard engineering projects as well as product liability policies for exposures outside the United States.

At the end of the renewal season – when time was particularly tight – it was common to see decisions made over the telephone and later confirmed in a short telex.

When I questioned this practice, I was told this is a "gentleman's business" and, if you did not live up to and fulfill your promises, your reputation would be shattered; your customers would disappear. I was shocked, but I admit, the system appeared to work. Certainly with improvements in IT communication over the years, the level of information for underwriting decisions also strongly improved.

Twenty years have passed since I entered this industry and, although many improvements have been made in recent years, it is *still* possible to see multi-million dollar deals written and signed without all terms being finalized. In addition, months after an inception date for a liability program, some leaders have not issued final wordings.

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With such a prevalence of these practices, it is only a matter of time before we will see a big class action claim filed when the leader of a reinsurance program and following reinsurers have not yet agreed a material term of the contract.

With the complexity and volatility of modern insurance risks, we do our clients and shareholders a disservice when we fail to insist on contract certainty at inception. In a cutthroat business environment, a "gentleman's agreement" opens the door to expensive and lengthy arguments in the courtroom.

Just look at the dramatic example of the World Trade Center: the wordings were still being decided when the terrorist attacks occurred on September 11. It is amazing that the industry has not yet learned its lesson – it still binds and exposes millions of dollars without having final agreement of all terms at inception.

The U.K. example

Through hundreds of years, the London market – similar to many global markets – has followed a "deal-now, details-later" business practice. But there is a growing understanding that a "gentleman's agreement" can easily fall apart, for example, when an underwriter has moved to another company or retired and his or her successor only wants to comply with *written* agreements. When millions of dollars are involved, even long-standing business relationships can become strained – without clear, undisputable contract language.

As a result, the U.K. Financial Services Authority (FSA) in December 2004 challenged all players in the U.K. insurance market to find a market-driven solution to the issue of contract certainty within two years. The stated purpose of the initiative is to maintain the public's confidence in the insurance market and to reduce the risks to all parties in the insurance chain. .

Each UK regulated entity is individually responsible for finding a solution to contract certainty. Failure to do so may result in capital allocation penalties, actions against approved persons as well as other regulatory sanctions. This is on top of the reputation and brand damage that would likely result. The FSA will complete its review of the industry's improvements by the end of the first quarter. Failure to achieve this aim may result in regulatory intervention.

"Contract certainty is achieved by the complete and final agreement of all terms (including signed lines) between the insured and insurers before inception," according to the Market Reform Group, which is a cross-market body that represents Lloyd's, the company market and brokers that transact London market insurance and reinsurance business. The Market Reform Group regularly discusses its work with the FSA.

As a result of the initiative, the Market Reform Group has set a group of targets:

- By the end of 2005, U.K. companies were asked to achieve contract certainty for 30% of monthly volume;
- By the end June 2006, U.K. companies must achieve contract certainty for 60% of monthly volume;
- By the end of 2006, U.K. companies must achieve contract certainty for 85% of monthly volumes.

The Market Reform Group lists six contract certainty attributes for the London market:

1. Is the submission clear and unambiguous?
2. Is the law and jurisdiction and arbitration clearly referenced and complete?
3. Are all terms clear and unambiguous?
4. Are all duties clearly allocated, including processing of contract changes, document production and claims processing?
5. Is any supporting information clearly referenced?

6. Is the submission compliant with regulatory requirements?

The FSA will be able to monitor aggregate market progress via reports received from the Market Reform Group, which will collect data from brokers on a monthly basis.

Challenge all industry norms

Many companies operating in Continental and/or Nordic markets have started insisting on contract certainty. Indeed, in the renewal season just passed, most broker business achieved certainty by the time of inception. This was the case for most business, but not all ...

As a result, the Nordic and Continental European marketplace needs to push for its own reforms. It needs to challenge industry norms, instead of accepting long-standing business practices that no longer are effective or could even damage a company's bottom line. Further, many Nordic companies insure and reinsure into the London market, so the U.K. reforms will have to be incorporated. What better time for our marketplace to make its own changes?

Last year GE Insurance Solutions promoted an initiative called "CAIN" (Challenge All Industry Norms) for the purpose of improving the way we do business in this industry. It has created an internal process where employees are encouraged to assess actions, protocols and policies that may lead to unanticipated risks.

Certainly, "contract uncertainty" is a risk the industry can no longer afford to condone and a practice that must be challenged. It would benefit the image of our businesses if Nordic and Continental European insurers and reinsurers took a proactive stance to develop similar reforms to those being developed in the United Kingdom. Better to take control now than be forced to by our regulators or after an expensive loss when there is a falling out between "gentlemen."