Life Reinsurance Treaty Construction

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1 Executive Summary

Reinsurance treaty negotiations can be a long process that may lead to lengthy, unwieldy documents and negative experiences for the direct writer and/or reinsurer. While there are resources that provide sample treaty language and/or insights on purposes of most reinsurance treaty clauses, it is difficult to find information on historical construction of treaties.

The report's purpose is to increase awareness of the importance of many reinsurance treaty terms/provisions, identify common treaty structures, practices, and/or solutions in reinsurance treaty construction and negotiation and illustrate how treaty terms have evolved over time. Lessons can be learned from ceding companies' and reinsurers' viewpoints and objectives on key treaty provisions and by considering obstacles, conflicts, compromises and solutions during and subsequent to the treaty construction and negotiation process.

This report is based on questionnaire responses, telephone interviews, participant research assignments, follow-up email correspondence and an in-person roundtable discussion. This report documents participant's points, counterpoints, counter-counterpoints and insights.

Shared knowledge may facilitate the success of future reinsurance treaty negotiations to the mutual benefit of reinsurers and direct companies and may contribute to a more rigorous treaty development process and reduce the odds of negative reinsurance treaty negotiation experiences and the likelihood of avoidable arbitrations and/or other legal actions. Lessons shared may enable both sides to reach better solutions more efficiently. Potential benefits include assisting individuals involved in reinsurance treaty negotiations, utilizing resources in future reinsurance treaty development more effectively, enhancing current processes and treaty language, reducing the length of time needed to complete negotiations and improving the administration and execution of treaties.

Participant comments provided through the questionnaire and interviews were useful and insightful and allowed participants to see the thought process of other treaty negotiators. However, the rich exploration of issues was only possible through engaging dialogue and debate. A nonpressure, nonnegotiation setting allowed participants to share and listen to other perspectives without the need to compromise, negotiate or persuade. The roundtable discussions alternated between describing, explaining, debating, clarifying, expounding, disagreeing, defending, developing, supporting, brainstorming and laughing. The authors used a documentary approach to capture these dynamics. Some issues provoked strong disagreements on the nature and intent of the provision. Throughout the roundtable, these differences were constructive and met with professional respect.

In this summary, we present underlying themes followed by highlights on contentious provisions and issues including cedants cherry picking recaptures, reinsurers raising premium rates, cedant's administrative and reporting weaknesses impacting reinsurer's financial statements, the intent and scope of errors and omissions (E&O), reinsurers denying coverage on claims, and both cedants and reinsurers exceeding tolerance risk limits.

The Business of Treaties

Treaties are long term and are bequeathed to their creator's successor's successors. People, relationships, intents, contexts and business environment may not be the same in the future when provision terms are applicable, questioned or enforced as when the treaty was constructed. Forces of change—including unanticipated events, interpretations, actions, regulations, accounting, products, market, competition, capital needs, capacity, administration, technology, disputes, underwriting and risks such as financial, market, legal and operational risks—all provide forward-looking challenges.

The reinsurance business and treaty construction have changed irrevocably. The consensus view was that today the business of reinsurance and treaty construction is different than in the past. An indication is that over the past 20 years, treaty page count has increased from single digits to as many as 100 pages. Increased page counts are a reflection of changing business drivers, objectives, relationships and complexity. In addition to length, treaty provisions have undergone a significant transformation.

There was a spectrum of views on the nature and degree of the reasons for changes. Both direct writers and reinsurers opined the gentlemen's agreement and trust era was in the past.

Some participant comments:

- "I trust you but I might not trust your successor."
- "I trust your company but I do not trust all companies."

There was general agreement that there have been bad apples on both sides and lessons learned necessitated protecting their own interests. As a result, all companies suffer collateral damage as protection is increased against future adverse actions.

The financial crisis, decreasing business volume, increased capital needs and earnings pressure have all resulted in recent changes in the landscape and treaty provisions. One such example is the insolvency clause. As another example, provisions have been evolving and reinsurance arrangements are increasing in complexity. The consequence has been an increase in operational risk. A result has been diverging viewpoints by ceding companies and reinsurers on existing errors and omission clauses.

All sides agreed on the importance of building and nurturing their relationships. There is a small population of reinsurers. Business volume of ceded amounts has and continues to decrease. The reinsurance community is generally aware of the business conduct by the other side. As a relationship business, the power of suppliers and the power of buyers are both considerable. Thus, when a company burns one bridge, it is likely burning many bridges. However, when the word "partner" was mentioned, one participant noted that the opposite side was not their partner. This became a source of ongoing humor as the word "partner" was uttered numerous times by both sides throughout the in-person roundtable discussion.

Principles and Guidelines Versus Rules and Legal Definitions

Treaty construction reflects current business objectives as well as the efficacy of previous treaties in meeting past, current and anticipated objectives. Treaty language, original intent, current interpretations and operations including business practices and execution of treaty requirements all influence negotiations and the construction process. Treaties are also constructed with one eye toward the future. Most treaties are entered into with the intent to enter into future treaties, that is, to maintain or even grow the existing business relationship. It is not typically a one-and-done deal. A provision that proves one-sided will be remembered again and again during future negotiations. In *Getting Past No*, William Ury advises, "Next to knowing when to seize an advantage, the next most important thing is knowing when to forgo an advantage," and "to aim for mutual satisfaction, not victory." However, even if your company has good practices, it may be adversely impacted by the practices of other companies.

Treaty construction attempts to anticipate what might happen 10, 20 or 40 years from now. The pendulum swings back and forth between guidelines and rules based on developing experiences. Precise legal language can provide clarity to protect one's interests. Guidelines can provide flexibility when rules do not anticipate or address the instance precisely. Precision can imbue clarity while removing ambiguity when the "letter" of the contract rather than the "intent" is enforced. Not every issue can be anticipated in advance. If the rules approach does not address the instance precisely, then each party decides exactly what it means. These interpretations likely do not coincide. One interviewee said, "You want to be loose and flexible but then it is difficult to figure out how it applies to a specific case or dispute, so you want to tighten that up."

Contention can occur during the negotiation process or long after the treaty's consummation. Some provisions are not contentious during the negotiation process; however, they become contentious later (e.g., facultative reinsurance, and reductions, terminations and changes). Some provisions are contentious now and later (e.g., errors and omissions). Some contentious issues have everything to do with treaty language. Provisions framed in the gentlemen's agreement era were based on intent and understanding. Treaty language subsequently permitted actions deemed contrary to intent and unfair to one side or the other. Some contentious issues have everything to do with business operations and practices. Construction of language is inextricably intertwined with business, operational and administrative practices. Regarding treaty evolution, one participant commented, "It's not as if we've been brilliant with foresight in anticipating future issues; we mostly react to bad situations."

If reinsurers are not standardized on an issue, in general, it causes a lengthier negotiation process for the direct companies. New and emerging issues take time to become standardized. Both sides desire consistency across their treaties. Reinsurers enter into thousands of treaties over a short time span. Inconsistent language between cedants, across countries and from year to year creates administrative and operational challenges. Mid-size to large domestic and/or global direct writers face similar challenges. Evolving and new products, coverages and regulatory and business conditions produce an entropy effect. Language might not be immediately updated, resulting in provisions that do not satisfactorily address new needs or situations. For example, pro rata treaties initially retained excess treaty language regarding recaptures related to retention increases. If language becomes standardized but ends up not working, the construction becomes contentious to address the shortcomings.

All roads may lead to Rome; however, all treaty provisions lead to errors and omission. The basic question is, does E&O narrowly apply to specific types of errors under certain conditions with limitations (the preferred reinsurer interpretation) or is it all inclusive (the preferred direct writer interpretation)? During the interviews and the roundtable, discussion on numerous articles and provisions led to a digression on E&O. Both sides are passionately firm in both their business interests and in their positions. Both sides acknowledge various points of the other side but remain opposed on the intent, scope and application of E&O.

Perspectives: Highlights

Participant comments and authors' observations are documented in Section 5, Perspectives: Treaty Provisions. Below, we provide highlights on these contentious issues.

Facultative Reinsurance

Most facultative reinsurance issues arise after the death of the policyholder due to operational risks. If the reinsurer's offer was never formally accepted and the reinsurer never received premium on a policy, is the reinsurer bound on a death claim? On an existing but unknown error, the direct writer believes it has ceded the mortality risk when in fact it has not. Thus the direct writer has an operational risk exposure.

Some participant comments:

- "Direct writers say they simply don't have the ability to always accept the cases in writing, they don't have sophisticated enough procedures. The biggest issue is that at claim time, if the reinsurer doesn't have premium and doesn't have a name, can you come back and claim E&O to force the coverage?"
- "We're told, 'You are our partner.' We get arguments that there are no conditions on E&O."
- "It would help if management saw this report and the need for improved administration in facultative offers and acceptances. Everyone can do better and apply more resources."

A suggested solution is the direct company providing notification of acceptance or rejection on every facultative request and the reinsurer providing notice that an expired facultative offer has been withdrawn. Since errors can occur, a review policy and/or diagnostic tools to discover missed cases should be established.

Reinsured Risk Amount

Issues stem from errors that occur because the administration differs from the treaty language requirements. Many times, policies cannot be administered per the treaty language. As with facultative reinsurance, problems arise due to administrative errors. If a cedant and reinsurer are aware that practice does not follow the treaty language, an amendment to close the operational risk exposure is in the best interest of both parties. The treaty negotiation team should communicate with the reinsurance administration team to ensure administration can be executed per the treaty requirements prior to signing the treaty.

Late Reporting

Prior to 2000, treaties did not include time limits for late reporting. Systemic administrative errors have resulted in millions of dollars of premium adjustments. Late reporting of issued policies may cause the reinsurer or retro to exceed their risk exposures. Reinsurers are and have been attempting to place time limits or shorten existing time limits on late reporting.

Some participant comments:

- "This was a source of extreme contention when we pushed it a few years ago. Resulting treaty language provides limited protection against the effects of poor cedant reporting."
- "It's those systemic errors that are surprises that affect your blue book you need to be concerned about."
- "Does E&O last forever—10, 20, 30 years?"
- "There is an end date for certain things. You should have done your job."
- "Life insurance and reinsurance is a long-tail business. We are very averse to having hard-stop limits."
- "There's no point at which a ceding company would ever commit to getting things right contractually?"
- "In negotiations there has been an effort by reinsurers to narrow the timeframe to five or three years."
  "And three years is really narrow?"
  "But in my example you might not know for two years that there is a problem."
  "Is that OK? In the SOX [Sarbanes–Oxley Act of 2002] era? Really? That's a way to run a company?"
- "I guarantee that if your agents were getting mispaid for three years, you'd figure out a way to fix it."
- "We feel differently when a company knows they have problems but refuses to fix them."
  "It is not usually that we refuse to fix them but rather we have three problems and we have decided to fix one after the other two and not instead. Furthermore, reinsurance was always last on the list for my company."
- "I was stunned by the fact that the ceding companies are unwilling to commit to anything."

Errors place undo strain on the relationship between the ceding company and their reinsurers. Contention then arises over the use of E&O due to the impact on financials. Are known problems errors or practices? Are premium billing mistakes covered indefinitely? Some companies have deferred addressing problems. Relying on reinsurer reviews is insufficient. A review requires complete information on a block of policies, information that the reinsurers lack. Reinsurers view administration as the direct writer's job and responsibility to see the job is done correctly. A suggested solution is to invest in appropriate administrative resources and/or to perform self-audits or to engage third-party audit specialists on a periodic basis. Reinsurers have responded by seeking protection and mitigating risk through treaty language.

Claims
Direct companies want certainty of coverage and do not want to lose sleep at night regarding the risk that a claim is not covered. The differences between direct companies and reinsurers are not because of the treaty language. The major change in claims is the evolution of "follow the fortunes." Reinsurers will follow the fortunes as long as all requirements of the follow the fortunes concept have been met. The requirements of follow the fortunes can be found in research and case law applicable to the appropriate jurisdiction and fact pattern. Both sides agreed employee agent misconduct and intentional underwriting deviations do not fall into follow the fortunes.

Claim issues also include extra contractual obligations and reinsurer consultation and involvement on contestable or litigated claims. Reinsurers are no longer willing to provide an opinion on a death claim and reinsurers do not want to be tied to the direct company's decision pertaining to extra contractual obligations.

Reductions, Terminations and Changes
This provision is often not contentious during treaty construction. The issue is not the language but the execution of the requirements. The treaty requirements can prove to be contentious later if not executed properly. There are companies that are not administering reductions, terminations and changes correctly either due to system limitations or operational deficiencies.

Some participant comments:

- "We sometimes find that in reality, policies are not being administered in accordance with the terms of the treaty.
- "Some companies administer it manually because they want to minimize their reinsurance [to keep the mortality profits]."
- "Reinsurers enforce correct retention upon death."

If a company cannot execute existing requirements, we recommend addressing deficiencies and/or modifying language on new treaties and amending existing treaties to requirements the company can execute correctly.

Changes of Plan (or Conversions, Exchanges and Replacements)
Language changes have attempted to clarify definitions but the issue remains that both insurers and reinsurers frequently continue to use the words "conversion" (contractual policy changes) and "replacement" (noncontractual policy changes) interchangeably when the distinctions are important. Conversions are commonly treated as new issues within a company's reinsurance administration because of administration system limitations. Conversions should remain in the

same treaty with the same mortality risk as the original policy. Replacements should be treated as a new policy.

The industry does not have a standardized approach to handling plan changes that has demonstrated effectiveness in treaty construction and operations. Language should be *s*pecific regarding which treaty covers the converted policy and conversion reinsurance premium rates should be included in the treaty. Treaties should be flexible enough to support the business needs of both sides. Language should reflect system capabilities and company operations.

Premium Accounting

Reinsurers' language is not consistent. The primary issue with premium accounting surrounds premium rate guarantees and the ability to increase reinsurance premiums. Cedants do not construe the lack of rate guarantees as a re-pricing vehicle. Explicit premium guarantees at current rates would likely result in the reinsurer setting up deficiency reserves.

Some participant comments:

- "Reinsurers usually want short guarantee period (e.g., one year) then an unrestricted ability to increase rates."
- "We insist on meaningful premium guarantees terms in YRT [yearly renewable term] treaties."
- "If a reinsurer increases the rates, you have the right to recapture. But do you want to recapture?"
- "Recapture is not an answer to raising rates because I need the coverage."
- "The intent is to not change the rates. No one enters into a deal knowing they underpriced but intend to jack up prices at a later date."
- "The intent to never increase rates was often expressed verbally, that it was merely included for reserve purposes."
- "Intent means nothing if it is not in the contract. We've gone from gentlemen's agreements to huge legalese treaties. "

Treaty language is not standardized across the industry and the many variations increase the interpretation difficulties. Language has evolved (or rather transitioned) along several paths to protect the ceding company and limit the reinsurer's optionality. The premium provision is one that epitomizes the passing of the guard from a gentlemen's agreement to a legal contract. The provision has yet to evolve to an industry standard satisfactory to both sides and remains a source of contention. The treatment of existing treaties that provided limited protection to ceding companies is a source of concern and acerbates contention in current negotiations not only in this provision but collaterally affects other provisions. The mirror image of the premium provision is the recapture provision.

Recapture

One recapture issue is the mirror image to premium accounting with the cedant/reinsurer optionality reversed. A second issue occurs when a direct company recaptures policies due to a rating trigger that the reinsurer has retroceded to another company.

Some observations:

- "Companies wish to redeploy capital and hence recapture. Others are grabbing back old business as new business dries up. We need to prevent cherry picking."
- "Old language lacks clarity as to the extent of a recapture."

Similar to the premium accounting treaty, language for the recapture provision is not standard across the industry and many variations exist. This provision is an example of guidelines and flexibility versus rules and precision. Historically, treaty language did not anticipate future conditions and lacked the necessary guidelines or precision, thus leaving gaps allowing broad and divergent interpretations. Treaties have evolved to address ambiguity.

Change in Legal Control
Issues exist when there is ambiguity on the conditions and rights upon a change in control. As a two-sided option, the inclusion of a recapture option upon a change in legal control could result in benefitting the reinsurer or the direct company. If the direct company has a change in legal control, the reinsurer may be allowed to force a recapture of ceded business. If a block of business proves to be unprofitable, the reinsurer will exercise this option. Likewise, if the reinsurer has a change in control, the direct company may use their option to recapture profitable business. The inclusion of this clause should weigh into the evaluation when acquiring companies.

Errors and Omissions (E&O)
Historically, the E&O provision was fairly short and open. Treaty language issues on E&O include defining what an error is and what corrective actions and results are permitted or required. Direct companies have taken a broad and liberal approach and application of the E&O clause as an all-inclusive provision. Reinsurers have been attempting to narrow the scope.

Some treaties written since 2000 state the E&O provision is specifically for administration errors and not underwriting errors. Recent treaties have introduced limits on how many years a company can go back to collect premium overpayments or relinquish the reinsurer from the mortality risk on repetitive errors. Language has been introduced in the late reporting provision to set time limitations on reporting. Reinsurers are introducing this language as a means to reduce operational risk.

Some participant comments:

- "What kind of errors needs to be defined—it should be limited to administrative errors."
- "If language is detailed and too precise then it's not covered in E&O. If language is vague, you can negotiate."
- "Repetitive errors are not considered E&O."
- "What does repetitive mean?"
- "Direct writers want make whole language. Reinsurers push to exclude certain types of errors—repetitive, just not doing a good job at admin. …"
- "We don't buy reinsurance to get into a debate with you on how our policy should be interpreted, how our underwriting guidelines should be interpreted or how our claims-

handling guidelines should be interpreted. We are buying reinsurance so that you are bound unless you can show we have no basis on how we handled the policy."

- "Because it is a time-consuming process, most cases will not be reviewed. As a result, most errors will not be uncovered and therefore no premium reimbursement is applied on these policies."
- [Direct writer] "This is not a good partnership."
- "The reinsurer is only reinsuring mortality risk and not operational risk."

E&O language has a myriad of variations and varies from company to company and even from treaty to treaty. From a reinsurer's perspective, an E&O clause introduces operational risk. Over the past 10 to 15 years, direct companies have requested large recoveries from reinsurers under E&O. In response, reinsurers have taken steps to eliminate or lessen the impact of specific errors through the introduction of new treaty language, a trend that is expected to continue. E&O will evolve into several distinct categories each with appropriate treatment.

At least one reinsurer had a difficult time understanding why, with the technology available today, direct companies had so much difficulty with reinsurance administration. Reinsurers feel some direct companies treat E&O as a reason not to address operational gaps. Above a threshold, contention arises over nonisolated errors, the use of E&O, if and when known problems become practices not errors, and whether mistakes are covered indefinitely. Trust remains a fundamental element regarding errors, practices and business decisions. As with late reporting, a suggested solution is for the cedant to invest in appropriate administrative resources and/or to perform more thorough and effective audit reviews on a periodic basis.

Reinsurers espouse that after a period of time, known errors are deemed to be a business practice and thus fall outside E&O. The reinsurers are evolving toward a shorter and shorter timeframe and a stricter application of this precept. Some direct writers have been slow to accept this evolution and/or institute necessary changes to backfill operational gaps. This is another example where a few companies to some degree collaterally impact the entire industry and treaty construction.

Change in Ratings/Financials

This provision became more prevalent in treaties after the 2008 financial crisis but there is still no standard provision or starting point. Requests are typically reviewed on a case-by-case basis and involve much compromise. This provision provides for recapture optionality and reduces counterparty risk for the cedant but creates additional liquidity risk for the reinsurer. Risk-based capital (RBC) triggers are preferred over rating downgrades by reinsurers since the former is in their control but the latter is not.

Plans Covered and Binding Limits

Because there is no central repository to monitor the insurance available to a prospective policyholder, there are times when the jumbo limit is breached. On these occasions, there is disagreement on how much, if any, reinsurance coverage a cedant has. The automatic binding limit and jumbo limit have evolved in the last 10 years to provide more clarity on the limits.

Treaties are now stating both the maximum share a ceding company is allowed to cede to a reinsurer under the treaty and the total death benefit permitted to a policyholder under the treaty. Treaty clarity should help minimize automatic binding limit errors going forward because the ceding company should have knowledge of their own block of business.

Some participant comments:

- "The industry needs to get on the same page. Is binding limit for the specific reinsurer or for the total pool? Does the binding limit include or exclude ceding company retention?"
- "The NAIC [National Association of Insurance Commissioners] has model laws. The Treaty Sourcebook falls short. Can't the SOA [Society of Actuaries] or ACLI [American Council of Life Insurers] have models?"

Improving treaty clarity helps but there is still the problem of ascertaining the correct amount of insurance in force for the policyholder. If a policyholder omits current insurance on their application then, unless the underwriter discovers the additional insurance by other means, the issuance of a policy could result in exceeding the jumbo limit as stated in the reinsurance treaty. Reinstatements can also result in limits being breached. A central repository was discussed as a suggested solution and considered to be highly beneficial.

Some participant comments:

- "The only way to solve is to have some company that maintains applied-for and placed amounts. If the [SOA] wants to take away anything from this session, that should be the charge: To get this industry back on its feet where there is a repository that is reporting amounts by carrier that an underwriter can access just like the medical information."

Two challenges of a central repository are that participation is voluntary and participants would fund the costs. Although a repository was deemed to be the appropriate solution to an industry problem, a repository was deemed unlikely to come to fruition.

Conclusion

A reinsurance treaty's long-term nature challenges both parties during the construction process to negotiate intent and then translate and formulate intent into language that pulls together rules, clarity, guidelines and flexibility to pass the test of time. The business climate and quality of business practices, administration and operations may change favorably or unfavorably.

Reinsurance treaties are more complicated today than they were 20 years ago and will continue to evolve as new problems emerge. Twenty years ago, reinsurers did not necessarily anticipate the operational risk created from business and administrative practices. Such risk has manifested itself in reinsurers paying millions in premium reimbursements or death claim payments on policies they had not received notification. Likewise, direct writers have paid millions in denied claims on coverage they thought they had or intended to have.

Gen. Donald Rumsfeld said, "There are also unknown unknowns—the ones we don't know we don't know." If intent, language, interpretations, time, practices and known errors cost companies on both sides millions, what about the unknowns? Treaty provisions have evolved as a means to address the known and the unknowns.

Each side agreed there was room for improvement regarding operations and business practices as well as meeting/serving industry needs. Suggestions included facultative notification, more effective audit reviews to address and fix back office and administrative errors, consistency between treaty language and requirements with business practice, a repository to address autobind and jumbo limit compliance, and E&O categories.

The direct company/reinsurer/retro relationship may not be a partnership but there is no denying the three sides have built strong business relationships. The friendships and the respect each side has for each other was evident prior to and during the in-person roundtable discussion. It is because of the respect and friendships the three sides have for each other that we have no doubt reinsurance treaties will evolve to the mutual benefit of the life insurance industry.

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Although the report captures a multitude of perspective from many companies, the comments and views expressed may not be representative of the full industry. Also, the observations and sample treaty language may not be applicable to certain situations.

3 Introduction

Reinsurance treaty negotiations can be a long process that may lead to lengthy, unwieldy documents and negative experiences for the direct writer and/or reinsurer. While the 2008 Life Reinsurance Treaty Sourcebook of the American Council of Life Insurers (ACLI) provides sample treaty language and the 1994 Guidance and Commentary on Life Reinsurance Treaties provides insight on the purposes of most reinsurance treaty clauses, it is difficult to find information on historical construction of treaties, including the current prevalence of treaty terms and the impact treaty language has on the reinsurance transactions, the ceding company and/or the reinsurer. Having this additional information on historical treaty construction may contribute to a more rigorous treaty development process and reduce the odds of negative reinsurance treaty negotiation experiences and the likelihood of avoidable arbitrations and/or other legal actions.

The report's purpose is to increase awareness of the importance of many reinsurance treaty terms/provisions, identify common treaty structures, practices and/or solutions in reinsurance treaty construction and negotiation, and illustrate how treaty terms have evolved over time. Lessons can be learned by examining key treaty provisions, by surveying ceding company and reinsurers' viewpoints on business objectives and reasons specific provisions are of particular importance, by identifying how current practice has evolved from the past, and by considering obstacles, compromises, conflicts and solutions during and subsequent to the treaty construction and negotiation process.

Shared knowledge will facilitate the success of future reinsurance treaty negotiations to the mutual benefit of reinsurers and direct companies. Lessons shared potentially will enable both sides to reach better solutions more efficiently. Potential benefits include assisting individuals involved in reinsurance treaty negotiations, utilizing resources in future reinsurance treaty development more effectively, enhancing current processes and treaty language, reducing the length of time needed to complete negotiations and improving the administration and execution of treaties.

4 Overview

The treaty construction process takes weeks to months and involves negotiation and buy-in from numerous people and departments from both the direct company and reinsurers. Not only do people from different companies disagree but team members within a company will agree or disagree due to different perspectives, objectives and concerns. It is well beyond the scope of this report to review negotiation topics. However, we point out that negotiations and the treaty construction process are people-centric. The process is much more than treaty language. Rather than seek or recommend one solution to an issue, we wished to capture and disseminate multiple viewpoints.

Our focus was on issues that created difficulty for one or both sides during or after the treaty negotiation and construction process. We did not seek out best practices but rather a multitude of perspectives and practices regarding the issues, interests, reasons, approaches, and what did or did not work. Universally accepted and long-standing best practices regarding a treaty provision that have worked would likely not cause or have caused difficulty during or after the construction process; however, future conditions could change. Difficult issues often arise not from the treaty language but in business practices often related to executing treaty requirements.

The various stages in developing this report entailed 1) participant selection, 2) a questionnaire identification and selection of issues, followed by 3) telephone interviews, 4) participant research assignments, 5) follow-up email correspondence, 6) a literature scan and, finally, by 7) an in-person round-table discussion with 10 participants. Comments provided through the questionnaire and interviews were useful and insightful and allowed participants to see the thought process of other treaty negotiators. However, the rich exploration of issues was only possible through engaging dialogue and debate. A nonpressure, nonnegotiation setting allowed participants to share and to listen to other perspectives without the need to compromise, negotiate or persuade.

4.1 Participant Selection

The Reinsurance Section solicited reinsurance treaty specialists—actuaries, lawyers or others who had first-hand knowledge and/or responsibility for drafting or reviewing life reinsurance treaties. Those who expressed interest were invited to participate in the study. The process resulted in fourteen dedicated individuals of varying backgrounds and perspectives who responded to the questionnaire, participated in telephone interviews, provided sample language, and/or participated in an in-person roundtable discussion.

4.2 Questionnaire

A questionnaire was distributed to identify difficult or contentious areas for one or both sides during or after the treaty negotiation and construction process or resulting in unsatisfactory outcomes. The questionnaire listed 32 provisions and nine exhibits that we derived from the 28 articles and nine exhibit categories in the ACLI 2008 Life Reinsurance Treaty Sourcebook. On a scale of 1-5, we asked participants to rate each provision/article and exhibit:

a) From your perspective, rate your degree of satisfaction with the outcome;
b) From your perception of your reinsurance partner, rate their degree of satisfaction with the outcome; and
c) Rate the degree of disagreement at the onset of and during the process.

Scale: 1 = highly satisfied or much agreement; 5 = highly dissatisfied or much disagreement. For each category that a participant rated parts a), b) or c) a 4 or 5, we asked for a brief description or specific examples that formed their opinion.

The following provisions received the most dissatisfied/disagreement ratings (4's and 5's):

1) errors and omissions,
2) recapture,
3) claims,
4) change in financial/capital ratios,
5) change in ratings,
6) change in legal control,
7) late reporting,
8) premium accounting, and
9) changes of plan (or conversions, exchanges and replacements).

Other provisions receiving a 4/5 were: credit for reinsurance (or credit for reserves), confidentiality, notice, commencement of liability, reductions, terminations and changes, reinsured risk amount, facultative reinsurance, funds withheld, definitions, offsets: netting provisions and other (compliance with law wording).

See Appendix 1 for the full questionnaire, average ratings and the number of 4's and 5's each article received.

The following 16 provisions and eight exhibits did not receive any 4's or 5's and the average rating was less than 2**:**

Provisions: preamble, definitions, automatic and facultative-obligatory reinsurance (or automatic reinsurance), reporting, retention limit changes, general provisions, deferred acquisition cost (DAC) tax election, good faith, insolvency, dispute resolution, arbitration, service of suit and consent to jurisdiction, notice, effective date, duration and termination of agreement (or duration of agreement), and execution.

Exhibits: retention limits of ceding company, plans covered and binding limits, underwriting guidelines (or forms, manuals and issue rules), application for facultative reinsurance, premiums and allowances (or reinsurance premiums), DAC tax net consideration report, reporting requirements (or self-administered reporting) and ceding company data.

4.3 Telephone Interviews, E-mails and In-Person Roundtable Discussion

We conducted one-on-one telephone interviews with each participant covering the provisions they rated 4 or 5. We discussed the particular provisions, their perspectives on issues, drivers, and the evolution of the provisions in treaties and the nature of negotiations over time. We requested examples of sample language to illustrate the issues and the provision's evolution. In many cases, the provision was absent in older treaties.

An in-person roundtable discussion was conducted in December 2012 between five participants representing reinsurers/retrocessionaires and five participants representing direct writers. Prior to the roundtable, we circulated a summary of the issues and perspectives and sample language for each provision. The most difficult task in setting the roundtable agenda was choosing which provisions to exclude and allocating time to included provisions. Numerous participants commented during the telephone interviews that some of the provisions such as errors and omissions, recapture and premium accounting could each take a full day. We developed talking points for each provision to facilitate the in-person roundtable discussion.

5 Perspectives: Treaty Provisions

Provisions are organized into two sections: 1) participant comments and 2) author observations. Comments are a mix from the questionnaire responses, telephone interviews, e-mails and in-person roundtable discussion. Observations are the authors' spin on the multiple perspectives based not only on comments included in this report but also based on the collective body of comments and discussions that transpired during our research for this report.

The roundtable discussions alternated between describing, explaining, debating, clarifying, expounding, disagreeing, defending, supporting, brainstorming and laughing. Some issues provoked strong disagreements on the nature and intent of the provision. Throughout the roundtable, these differences were constructive and met with professional respect. Recurring humor peppered the discussions.

The comment section reflects the back-and-forth dialogue between participants. The authors' compiled notes encapsulate sometimes concurring, sometimes conflicting, sometimes divergent views on what the issues are, what does work and what does not work, and different suggestions on possible solutions. For clarity and brevity, we have edited and paraphrased our notes. However, in many cases we felt conciseness would not capture the vibrancy of the issues and opted for a documentary approach. The authors have attempted as much as possible to be faithful to participant's words and meanings. Any misrepresentation or misstatement is entirely the fault of the authors.

Since 1993, the Flaspöhler Research Group has conducted biennial surveys of life company attitudes about reinsurance and reinsurers. Rick Flaspöhler has published several articles on the surveys in *Reinsurance News*. The levels of being very satisfied steadily decreased over 10 years before plummeting to below 30 percent in 2004 before increasing during 2008-11. Many survey comments have reflected contentions. Three quotes in particular from the May 2005 issue are:

> "It seems that the 'gentlemen's agreement' approach to doing business is being quickly replaced with the new contractual provisions which seem to protect the reinsurer at the expense of the ceding company. This appears to be driven by a belief that the ceding company is no longer as trustworthy."
>
> "Seems to be less trust. The treaty historically was used as a final resort to settle disputes. Now it seems more iron-clad and restrictive ... less flexibility in regard to business practices, and much more control exerted over activities."
>
> "It would set a much better atmosphere if the reinsurers would explain why they are suddenly changing the wording, length of provisions and general tone of their agreements. Also, some of the new provisions are too one-sided. Finally, the reinsurers seem to feel that they are now able to dictate terms, as opposed to seeking compromises."

A similar survey of reinsurers might produce similar ratings and comments. This report provides explanations and insights from both sides.

5.1 Facultative Reinsurance

Most facultative reinsurance issues arise after the death of the policyholder due to operational risks. If the reinsurer's offer was never formally accepted and the reinsurer never received premium on a policy, is the reinsurer bound on a death claim? On an existing but unknown error, the direct writer believes it has ceded the mortality risk when in fact it has not. Thus, the direct writer has an operational risk exposure.

5.1.1 Participant Comments

- "A case is submitted for facultative underwriting and the reinsurer makes an offer. Sometimes the direct company fails to inform the reinsurer that they ceded the risk to the reinsurer via an acceptance letter that requires the reinsurer to review the premium report. Worse yet, sometimes they intend to cede the risk but never do. Does this fall under E&O (errors and omissions)?"
- "What is a reasonable time to provide acceptance or to decline an offer of facultative reinsurance? The reinsurer may or may not hear anything back from the cedant. Maybe those cases show up in the next billing. What is fair notice and what happens if the reinsurer never hears anything back?"
- "The offer would expire normally and the cedant would lose coverage. Sometimes the cedant comes back later, invoking the E&O clause. Sometimes the reinsurer has already given that capacity to somebody else."
- "Language normally states you have to expressly accept the offer in a certain timeframe or it expires. The problem we run into is that three years later, a claim comes through and the cedant says we meant to send it to you—it's E&O. Well, it's not E&O—there's no contract. That's where the disagreement comes."
- "Direct writers say they simply don't have the ability to always accept the cases in writing, they don't have sophisticated enough procedures. The biggest issue is that at claim time if the reinsurer doesn't have money and doesn't have a name, can you come back and claim E&O to force the coverage?"
- "The reinsurer has the stronger case that there is no coverage if they never received any premium or an acceptance letter."
- "If the cedant can show knowledge on the reinsurer's part—10 years of reports were audited and objections were never raised, then yes it is covered."
- "Regarding the E&O question—show prejudice—you gave that capacity to someone else, so even if it falls under E&O, you have the stronger case."
- "Is premium being paid? A name appears on a report but then at claim time, the cedant says we forgot to send you the premium."
- "I have heard regarding prejudice that it doesn't matter how harmed you are. We're told, 'You are our partner.' We get arguments that there are no conditions on E&O."
- "E&O is the last refuge of a desperate cedant."
- "If you didn't like the risk, you wouldn't have made the offer. That plays into the business decisions."
- "The reinsurer should send out the notice [at expiry] that that offer has been withdrawn. …"
- "But that's a lot of work. … "

- “Sometimes it makes it easier on everyone if those notices go out. There isn’t an obligation to do so. This would reinforce the reinsurer’s position.”
- “Is the onus on the reinsurer or cedant that the offer was not accepted?”
- “Due diligence would say either or both.”
- “How does this affect your relationship with your retros [retrocessionaire]?”
- [Retro] “We don’t participate in ex gratia payments. In the first instance [reinsurer covers claim] the reinsurer thinks they are not really on the risk but this is a good client so they want to help out. We need to ask and take a look at the circumstances underneath. ”
- “We would communicate with retros before making a decision on payment of a mishandled death claim.”
- “This will affect reinsurer securitization programs where the retros are sticklers. The reinsurer has a lot less flexibility to take the partnership route if risks are being sent to a secondary market.”
- “This does not happen a lot but it does happen and when it does, it’s for big amounts.”
- “It would help if management saw this report and the need for improved administration in facultative offers and acceptances. Everyone can do better and apply more resources. On the direct side, it should be someone’s job to send out accept/nonacceptance notices on every facultative case. The reinsurer’s side would send out the rescind offer notices.”
- “That would be useful.”

5.1.2 Author Observations

There has been little treaty evolution pertaining to facultative issues. Problems stem not from the treaty language but rather the issuance and post-issue administration of the policy. See Appendix A.2.1 for sample language.

The potential administrative breakdown occurs when the policy is issued without informing the reinsurer that the facultative offer was accepted. The reinsurer may never receive the premium. On an existing but unknown error, the direct writer believes it has ceded the mortality risk when in fact it has not. We suggest preventive and proactive risk management to manage the operational risk exposure by establishing a business practice to track and tag each facultative request through to conclusion by providing notification of acceptance or rejection on every facultative request. Since errors can occur, the direct writer should establish a review policy and/or create diagnostic tools to discover missed cases. A cost-benefit analysis suggests the cost to institute such a practice would outweigh the benefit of avoiding one large death claim.

Likewise, reinsurance companies should establish a practice to track, tag and review their facultative offers to conclusion. On nonconfirmed, nonpremium paying cases, cedants should be sent notice that the offer has been withdrawn a certain time period after the facultative offer’s expiry (e.g., three months). If a reinsurer is likely to allow coverage on an expired offer through E&O or as a business decision, cost analysis suggests an effective diagnostic can be implemented to minimize administration risk.

5.2 Reinsured Risk Amount

Issues stem from billing errors that occur because the administration differs from the treaty language requirements. Many times policies cannot be administered per the treaty language.

5.2.1 Participant Comments

- "Either there is too much detail in the language that then turns out not to be what the company actually does on their billing statements or wrong terminology is used due to the complexity of the type of insurance plan."
- "This section is not always clear, especially with older treaties. I've seen a number of treaties that say something completely different from what is done in practice. However, the reinsurer is usually satisfied as long as the basis for premium payments matches what is requested at claim time."
- "We have a lot of old treaties that we didn't write and often find they are not administrable the way it's written but we don't know which reinsurers will accept what we have been paying for versus what the treaty says."
- "Do you adjust the language?"
- "We have suggested changing the language but many times a reinsurer would rather accept the [current] premium vs. creating an amendment. The problem is when a case comes up with a huge difference between per the treaty and administration."
- "The dollar amount is the driving force. We discover something isn't in line with the treaty and when you realize how big it is, then that provision gets pointed out."
- "When you find errors, how far back do you go? Sometimes you don't have the records to correct it, for example, lapses."
- "Two things happen. We have the records and we conform to the records or we don't have the records and we conform to practice. We don't have a time period."
- "When do you inform your reinsurers upon discovery of systemic error?"
- "We communicate with the reinsurer as soon as we understand the nature and extent of the issue."
- "If it's a systemic problem, what do you do about death claims?"
- "Claims should be netted. If administration is not per the treaty, we prefer to go back as far as records go to correct administration. We correct death claims, in force and lapses. Our position is that you should go back and fix it."
- "A lot of E&O provisions say put the parties back to the position they should be in. Sometimes that's not an easy situation or even possible but ideally that's what should happen."
- "On older treaties, usually there are no records, so you say the words are different than the practice and that we both agree to follow practice and everyone's happy and an amendment occurs later in the year."
  "It doesn't happen often but when it does it can have a meaningful financial impact."

[The ensuing discussion regarding E&O and financial impacts were tabled and then continued during the E&O provision; see 5.10 E&O.]

5.2.2 Author Observations

There has been little treaty evolution pertaining to the reinsured risk amount. As with facultative reinsurance, problems arise due to administrative errors. There are times when the treaty cannot be maintained administratively as worded. The treaty negotiation team should communicate with the reinsurance administration team to ensure administration can be executed per the treaty requirements prior to signing the treaty.

When correcting a systemic error, the ceding company should look at in-force policies, death claims and lapses. Unless stated otherwise in the treaty, errors should be corrected for as many years as documentation permits. The ceding company should communicate with the reinsurer as soon as they understand the nature and extent of the issue.

If a cedant and reinsurer are aware that practice does not follow the treaty language, an amendment to close the operational risk exposure is in the best interest of both parties. In many cases, the ceding company is not aware of the discrepancies between language and administrative practice. A proactive step is to implement the appropriate resources and diagnostic tools to ensure the treaty is correctly administered. Errors and financial impacts become a recurring theme expounded upon in other provisions. The dialogue heats up during the next provision, late reporting.

5.3 Late Reporting

Prior to 2000, treaties did not include time limits for late reporting. Systemic administrative errors have resulted in millions of dollars of premium adjustments. The problem is compounded for the reinsurer because the retrocessionaire treaty may have tighter restrictions on acceptance of late reported policies. Late reporting of issued policies may cause the reinsurer or retro to exceed their risk exposures. Reinsurers are and have been attempting to place time limits or shorten existing time limits on late reporting.

5.3.1 Participant Comments

- "We do not allow exclusions merely for late reporting. Need to show that the delayed reporting materially prejudiced the reinsurer."
- "The errors and omissions provision in past treaties simply stated the intent was to restore parties to the positions they would have held, absence the error … relatively straightforward. Then around the 2005-07 timeframe, the provision received more attention as reinsurers seemed tired of late reporting, particularly terminations, since they had already recognized these premiums. When the direct company finds such terminations, the reinsurers are insisting upon expanding the E&O provision to address late reporting. Discussions then occur as to what would be considered late? How would it be negotiated? How do we resolve? Language suggested by reinsurers is very reinsurer specific and customized."
- "Most issues are around any type of penalty or remedy requested by the reinsurer for late reporting including the reinsurer's request to deny liability, etc."
- "This was a source of extreme contention when we pushed it a few years ago. Resulting treaty language provides limited protection against the effects of poor cedant reporting."
- "Prior language would state: to be in a position if it had been done correctly. Reinsurers want a time limit. Reinsurers want three to five years or less; direct companies want longer. This is purely a recording issue, driven by the reinsurers."
- "Ideally, the position would be to fix the errors to get everyone in the position had everything been done correctly. Reinsurers want to put a time line on that, and I certainly understand that. What happens if the reinsurer loses money because you pass a deadline? "
- "Would someone approach the reinsurer if it is in the reinsurer's favor and many years have passed?"
- "How many times is it in the reinsurer's favor?" [laughter]
- "What if there are systematic and consistent errors?"
- "Prejudice could be an argument but the other side is, the deal is the deal. A day or week isn't going to be a problem. When you start getting to one to two years, then it gets a little tougher. A lot has to do with how often this happens. If it's 20 times a year, then something has to be done. You bend and then it happens some more; there's a point when you have to take a stand."
- "Some have language that delayed reporting is not enough to deny a claim. Examples of prejudice events are it has a dramatic effect on my financial statements or I can't get retro coverage."

- “If you only feed your reinsurance administration system once a year and miss it, it might be the next year, then you don’t have reinsurance?”
- “The financial surprises from one quarter to the next and that kind of a thing is really the harm. No one is holding anyone’s feet to the fire for isolated errors. It is the big block that is missed in the conversion and is reported a year or two later.”
- “We get situations where an entire block isn’t ceded [the marketing name of the product was changed]. The cedant comes to us after five to 10 years and says, we have this block we were supposed to cede, you haven’t seen any of it, you haven’t been paid for it and, by the way, mortality isn’t very good.”
- “In our treaties, we don’t say we will accept all your term business anymore. We need to know what’s coming, not just for legal reasons, but administrative reasons.”
- “If we materially breach our obligation by constantly giving you late reports, we are in material breach of the contract and that is grounds for getting out of the contract.”
- “The new business element isn’t that common; the problem is terminations. Don’t surprise me two years from now that you didn’t inform me on 100,000 terminations. I’ve already recognized the premiums on my books … on two blue books. Most times, single cases won’t alarm anyone—it’s those systemic errors that are surprises that affect your blue book you need to be concerned about.”
- “The worst I’ve seen is when a cedant didn’t properly code the rates and then adjusted everything many years later and that ended up being a huge hit.”
- “It is not the reinsurer’s burden to tell the cedant to administer the business correctly because the cedant is responsible.”
- “Prejudice is more than surprise by the size. It has to be: I am surprised by the size and it is messing up my financial reporting and here is why or I am surprised by the size and now my retro isn’t paying or something else.”
- “Most of what we’ve discussed would constitute traditional E&O. Does E&O last forever—10, 20, 30 years? Can it always be used to correct errors in the treaties?”
- “If the risk is for 40 years, the administration is for 40 years and the passage of time does not eliminate the right to correct errors under the E&O clause. However, the passage of time results in the loss of records. If the error occurred 40 years ago and your documentation goes back 20 years, you can only collect 20 years of past premium.”
- “Can the passage of time ever be prejudice?”
- “Prejudice means explain to your cedant why you are burdened above and beyond where you should be. Tell me a story about why you are harmed.”
- “There is an end date for certain things. You should have done your job.”
- “Life insurance and reinsurance is a long-tail business. We are very averse to having hard-stop limits.”
- “There’s no point at which a ceding company would ever commit to getting things right contractually? This prejudiced thing is fine. This language stinks. It took forever to get it, yet the protections we have are so weak they barely protect us at all. Why would anybody enter into a contract where they can’t know whether it’s right for 10, 20 or 30 years?”
- “It is difficult to have a hard and fast rule.”

- "I don't think it is. There is a point in time, is it 10 years, 20 years? There is a point in time; you just don't want to commit to it."
- "In negotiations there has been an effort by reinsurers to narrow the timeframe to five or three years."
- "And three years is really narrow?"
- "But in my example you might not know for two years that there is a problem."
- "Is that OK? In the SOX [Sarbanes–Oxley Act of 2002] era? Really? That's a way to run a company?"
- "Theoretically, no, but practically you don't want to be limited if an error has occurred. But I do agree with you that there is some point that beyond that is unreasonable. … I'm trying to convey the fact that over the past 10 years, we have seen a change and it is pushing the limits of some of the things we can do."
- "Reinsurer/cedant relationships are fluid and no two are alike. If both parties love each other and they are ready to do a big deal, there is a lot more flexibility in fixing problems. If they hate each other and haven't done anything together for 10 years, then you hold people's feet to the fire. Anytime there is a problem in treaty interpretation, it forces the parties to sit back at the table and pound through this thing. You can't possibly anticipate for the next 40 years what's going to happen. The flexibility is enormous. You could say it gives carte blanche to the ceding company do whatever they want, that is if you want the business."
- "I was stunned by the fact that the ceding companies are unwilling to commit to anything. That's not the way the world works. The evolution of treaty language, it should have evolved more."
- "Should language be standard or should it be customized to the client's situation. If there are certain ceding companies that have a really bad back office administration compared to a company that always reports on time, should reinsurers view this client differently in how they shape the contract? Instead of saying it's one size fits all."
- "It takes a while to determine the strength of a company's back office."
- "You don't know that a good company today won't be bad after a few mergers in 10 years."
- "If you are talking about something from 40 years ago and you are using today's environment to decide, you have to evaluate in the environment of 40 years ago, not with what we know today."
- "All six pages of it versus 200 pages today?" [laughter]
- "It isn't all because of bad systems. There are also bad practices and human errors."
- "There are some things we can't handle."
- "You shouldn't commit to what you can't do."
- "When I acquire a company whose administration has been bad for 12 years and I don't even have records that go back to correct it, my intent is not to pull one over on the reinsurers. But you have to work with me because I don't have the ability to reconstruct what they did 10 years ago. Now you're holding my feet to the fire; that's not a partnership."
- "I cringe at the word partnership." [laughter]

- “You agreed to take that risk when you decided to buy the company. You had to know their reporting was bad.”
- “When you go through your due diligence to buy a company, that stuff does not come to the table … it would take too long to uncover.”
- “Reinsurance reporting has a strong dependence on the quality of direct reporting. I am plagued by the idea that the reinsurance reporting is wrong because the data provided to it is incorrect. The problem is magnified if you acquire a company.”
- “I guarantee that if your agents were getting mispaid for three years, you’d figure out a way to fix it.”
- “We feel differently when a company knows they have problems but refuse to fix them.”
- “It is not usually that we refuse to fix them but rather we have three problems and we have decided to fix one after the other two and not instead. Furthermore, reinsurance was always last on the list for my company.” [concurring responses]
- “If you report late, you are no longer covered. Late reporting is not meant to be a consideration as to whether you have coverage or not.”
- “E&O doesn’t apply forever. Direct companies can’t use E&O to always cover a late reported case such that the reinsurer never has any defense to that situation. I want to understand and limit the real use of the E&O clause to the purpose it was intended for. The question is how long?”
- “Should E&O have a statute of limitations on late reporting? Reporting of a claim, block of business—does E&O apply after one year? Two years?”
- “We should break E&O down by error—the time limit would differ based upon the type of error.”

5.3.2 Author Observations

Prior to 2000, late reporting was not contentious. However, the prevalence of late reporting and consequences has resulted in current difficulties. Language is evolving to address multiple issues. For example, in the early 2000s, retros did not have language to address this risk. A risk exposure problem arises if they accept risks only to be informed years later that their exposure exceeds their tolerance due to late reported policies. Language is now included that “The Retrocessionaire will not automatically accept any Late Reported Policies” and then outlines conditions. See Appendix A.2.3 for sample past and current language.

Errors place undo strain on the relationship between the ceding company and their reinsurers. Contention then arises over the use of E&O due to the impact on financials. Are known problems errors or practices? Are premium billing mistakes covered indefinitely? Some companies have deferred addressing problems. Relying on reinsurer reviews is insufficient. A review requires complete information on a block of policies, information that the reinsurers lack. Reinsurers view administration as the direct writer’s job and responsibility to see the job is done correctly. A suggested solution is to invest in appropriate administrative resources and/or to perform self-audits or to engage third-party audit specialists on a periodic basis.

Reinsurers have responded by seeking protection and mitigating risk through treaty language. All companies are collaterally affected. See the E&O Provision (5.10) for additional comments.

5.4 Claims

Claim issues include reinsurer consultation, reinsurer involvement on contestable or litigated claims, and direct company's decisions pertaining to extracontractual obligations (ECOs). Direct companies want certainty of coverage and do not want to lose sleep at night regarding the risk that a claim is not covered.

5.4.1 Participant Comments

- "There has always been plenty of discussion over the reinsurer's expected claims documentation. In other words, what does the reinsurer want to see on contestable vs. noncontestable claims? As a direct writer, we don't want to send papers on every claim; some reinsurers want to see claims papers on every claim. There is discussion about how contestables are handled and the reinsurer's ability to opt out versus participating in the contest."
- "In a number of situations, the reinsurer insisted on a claims provision that we could not administer as written. Sometimes the reinsurer indicates that they understand that we can't administer as written and that we should go ahead and accept the wording anyway. This leads to problems down the road when personnel changes."
- "We have also had problems with litigation cases. Often it is not feasible to include the reinsurers in legal negotiations as they are happening. In the case where the court makes a decision that a claimant should be awarded more than the contractual obligation, but not due to any fault of the ceding company, it's sometimes difficult to get the reinsurer to agree to bear their share of the extra amount."
- "Use of fast-track language and setting 'proof' levels needs to be addressed. Participation in ECOs, opt-out clauses and expense participation by the reinsurer are areas usually requiring discussion and negotiation."
- "Parties generally agree in concept, but the reinsurer's requirement to consult or advise on certain claims (large, contestable, suicide, foreign death, disappearance, etc.) prior to payment can be problematic during negotiation (some direct writers still see the reinsurer's role/payment as follow the fortunes). Nothing in the treaty prevents the direct writer from paying the claim; however, if the direct writer does not act in good faith or comply with the terms of the claims section, the reinsurer may not be liable."
- " 'Extra-contractual obligations'—compensatory or punitive damages due to negligence or bad faith—and 'voluntary' ex gratia payments—those the insurer is not required to make (e.g., a business decision)—are generally not shared by the reinsurers, i.e., the reinsurer is not the direct writer's D&O [directors and officers] liability carrier."
- "The biggest struggle is we pay the premium but we find out at claim time that for some reason this policy isn't covered."
- "Once you are out of the contestable period, things flow pretty smoothly."
- "Some of the bigger disagreements occur on the underwriting side."
- "We include language that states that we obligate our reinsurers to follow our fortunes at settlement. Some reinsurers have an issue with this and argue this makes it more difficult to deny claims, which is the point of this language. We are not buying reinsurance coverage so we can get into a debate later whether or not we interpreted our own policy correctly. We

are buying reinsurance coverage and the only way you get out of following our fortunes at settlement is if you can show ex gratia standard, which is a very hard standard. You have to show us that not only do you disagree that our underwriter issued it incorrectly but there is no way a reasonable person could have issued the policy at all. We want certainty of coverage. Business decisions are not covered."

- "If you are going to put follow the fortunes in the treaty, you need to define it somewhere within the treaty."
- "As an insurer that deals with several reinsurers on thousands of treaties, we generally do not want the time and expense of responding to ad hoc reinsurer questions outside of the regular audit process."
- "Intentional underwriting deviations do not fall into follow the fortunes. If I intentionally issue a policy outside the underwriting guidelines then I cannot reasonably suggest it falls within those guidelines. Therefore, I have no reinsurance."
- "Sometimes underwriting errors are covered by E&O and sometimes they aren't. Premium would have been different but he still dies, so reinsurer follows the fortunes. If it should have been declined, then you shouldn't have issued the policy and therefore no reinsurance."
- "Does follow the fortunes apply to underwriting? It has evolved. If underwriting is reasonable and exercises prudent underwriting judgment, you follow us; outside of that, it must fall under E&O."
- "ECOs: We are flexible except we expect the reinsurers to make a timely decision. Problem is reinsurers keep asking for more information and the case is turning before they decide. If the direct company is winning, then they join in; if losing, they decline. Insist on prompt response from the reinsurers—in or out in a timely manner."
- "Reinsurers sometimes want to be deemed in and sometimes want to be deemed out. The problem is, if we deem out, I don't want to overlook a case and pay millions when it is an easy win. But don't want to pay ECO either."
- "Agent misrepresentation: If it's an employee agent, the direct company lives with his sins, but if it's an independent agent, the reinsurer is brought in."
- "Disability suits have changed the stance of reinsurers and how they now follow the direct company's decision. We don't recommend, consult or give any opinion."
- "Foreign deaths: Reinsurer has expertise and the advantage of seeing more cases. No paper exchanges hands—only a verbal exchange."
- "Older treaties with policies in force contained language that explicitly stated that the direct company was required to obtain the opinion of their reinsurance partner upon the death of a policyholder. Reinsurers no longer follow older treaties that you must get the reinsurer's opinion."
- "STOLI [stranger originated life insurance] are claims we would love to contest—bad agent activity—however, it is beyond the contestable period and it costs more to litigate than to pay claims."
- "Legal fees: How often do you send legal bills assuming they participate? Clients should manage the fees. Reinsurer's don't want overly detailed legal bills. Pay pro rata share on outside legal fees."

- “Pick your poison: Claims personnel doesn’t know if it’s reinsured so they give their best effort and reinsurance doesn’t enter into their judgment. For this reason, it is better for claims and reinsurance not to talk to each other. This method limits information available to reinsurer.”
- “A policy lapses and is outside the one-month grace period but the direct company never sent notice of lapse. The policyholder dies and you pay the claim because you will lose if you take it to court. Is the reinsurer liable because of your administration error?”

5.4.2 Author Observations

The treaty language has evolved in two areas where treaty language has affected the claim process. Direct companies have not resisted these changes; their major concern is certainty of coverage. First, because of several lawsuits in previous years, reinsurers are no longer willing to provide an opinion on a death claim. Reinsurers will not provide a written opinion even on cases where they are considered the expert (e.g., foreign death). Second, reinsurers do not want to be tied to the direct company’s decision pertaining to extracontractual obligations. Reinsurers now want the option to opt out of a claim the direct company is contesting. Direct companies are comfortable with this change provided the decision to partake in the contest or to opt out of the contest is a prompt decision. See Appendix A.2.4 for sample past and current language and a description of the evolution.

The differences between direct companies and reinsurers are not because of the treaty language. The major change in claims is the evolution of “follow the fortunes.” Reinsurers will follow the fortunes as long as all requirements of the follow the fortunes concept have been met. The requirements of follow the fortunes can be found in research and case law applicable to the appropriate jurisdiction and fact pattern. Both sides agreed employee agent misconduct and intentional underwriting deviations do not fall into follow the fortunes. In these cases, reinsurers may deny claims or may seek to refund previously paid premiums instead of paying claims.

5.5 Reductions, Terminations and Changes

There are companies that are not administering reductions, terminations and changes correctly as stated in the contract either due to system limitations or operational deficiencies.

5.5.1 Participant Comments

- "Reductions, terminations and changes is not a contentious issue; however, treaty discussions on the handling of face increases can take time and we sometimes find that in reality, policies are not being administered in accordance with the terms of the treaty."
- "Parties generally agree but the language can be confusing. For example, figuring out how to adjust retention on a by-life basis where there are multiple policies (including individual and joint) when one policy reduces or lapses can get very complicated. A suggestion is to add examples to the treaty templates."
- "Retention claw back or backfill is when a reduction or termination occurs, a direct company reduces reinsurance on remaining policies to maintain their retention. Some companies can't handle it."
- "If a system can't handle it, reinsurers prefer the direct company not recover retention previously ceded."
- "Some companies administer it manually because they want to minimize their reinsurance [to keep the mortality profits]."
- "What do you do on a death claim?"
- "Reinsurers enforce correct retention upon death."
- "You have to be consistent [on your in-force business and on claims]."
- "Administratively, when everybody went to self-administration, we [the industry] should have converted retention to a by-policy basis."
- "If treaty language does not match how you administer changes, then you have a problem."
- "Maybe there should be some treaty language options where these scenarios are described so that treaty language is accurate."

5.5.2 Author Observations

This provision is often not contentious during treaty construction. The issue is not the language but the execution of the requirements. The treaty requirements can prove to be contentious later if not executed properly. Reinsurers feel some companies have made business decisions to accept or ignore known problems rather than address and correct the problems. Contention then arises over the use of E&O. Are known problems errors or practices? Are premium billing mistakes covered indefinitely? The prevalence of administrative problems and the direct writers usage of E&O places strain on the reinsurers. "Bad apples" can affect the whole industry. If a company cannot execute existing requirements, we recommend addressing deficiencies and/or modifying language on new treaties and amending existing treaties to requirements the company can execute correctly.

Reductions in disputed death benefit face amounts should be proportional and language stating this should be included in the contract. If reductions are not proportional, then the direct company expends work resources and spends money reducing the claim but often has no financial benefit for their efforts (excess of retention cases). Proportionality of reductions should be in the treaty. In-force reductions should be as stated in the treaty.

5.6 Changes of Plan (or Conversions, Exchanges and Replacements)

The words "conversion" (contractual policy changes) and "replacement" (noncontractual policy changes) are frequently used interchangeably. Conversions are commonly treated as new issues within a company's reinsurance administration because of administration system limitations.

5.6.1 Participant Comments

- "There seems to be much discussion concerning what/how conversions are handled. Conversion rates are always an issue as well as both parties' understanding of what plans are actually converted from and to."
- "Parties generally agree but the language can be confusing—there is no such thing as a 'noncontractual conversion.' Noncontractual changes (e.g., replacements) handled incorrectly as contractual conversions can lead to situations when discovered after the policy is issued to the insured where it is impossible to restore the direct writer and reinsurer to the position they would have occupied but for the error as per the remedy under the 'Errors and Omissions' article. Noncontractual changes like replacements require (a) new underwriting/agent commission; (b) new reinsurance rates; (c) being reinsured under the correct treaty for that new business based on the effective date and plan; and (d) suicide and contestable provisions based on the effective date of the newly issued policy. If these are incorrectly treated as conversions (where new underwriting/evidence of insurability is not required), incorrect reinsurance rates (point-in-scale rather than new) may be paid; it may not even be with the right reinsurer if the reinsurer of the new plan/effective dates is not the same; and the suicide/contestability period should have started over and not run from the original policy date. So a death within two years will not have the correct suicide and contestability protections as required by the reinsurance agreement."
- "An acquired company's policyholders wished to convert to the current (acquirer) products. The original treaties from the acquired company generally had specific language—policyholders could only convert policies to a current product being offered [by the same company] at that time. However, the acquired company ceased writing new business and these products were replaced by the acquirer's products. This requires negotiations and amendments to address handling and rates. Conversions in general suggest antiselection, thus causing higher reinsurance premium rates for conversions. This creates a problem if treaties do not address converting to products sold by a new legal entity."
- "Reinsurers use direct company acquisitions as an opportunity to exclude conversions by saying the acquirer products are not covered."
- "When an acquired company ceases to write new business, a provision should be included in reinsurance treaties to allow conversions to be issued on products the acquirer is currently selling even if those products are sold under a different legal entity. We decided to create products within each acquired company for the sole purpose of conversions. This is expensive."
- "Conversions and replacements are frequently used interchangeably. Replacements should be treated as a new policy (assuming underwriting)."

- "Conversions turned out to be much more risky than anyone thought. This creates a need to be more specific. Conversion rates need to be specified in the contract. Conversions are an administrative nightmare. Are the correct rates/durations being applied? Is the converted policy pointing to the correct treaty?"
- "[Our] conversions use a separate YRT [yearly renewable term] scale."
- "The YRT premiums for conversions are generally greater than new issues in the same treaty. Conversions should be administered point in scale and not as new issues."
- "Some companies have difficulty tracking conversions, exchanges and replacements. Their systems don't have the data."
- "We generally look to place conversions in new pools because of difficulties in administering them in the original treaty and to simplify administration among multiple direct writers."
- "The reinsurer says the converted policy is not included in treaty. But it's not new business either and administration treats it so at times."
- "There is no good solution."

5.6.2 Author Observations

There are at least three different methods to handle conversions. Most treaties today either state a conversion 1) remains in the same treaty with the same reinsurance premiums as the original policy or 2) remains in the same treaty but with premiums as stated in the treaty. A third method includes conversions in the treaty currently accepting new issues. The converted policy would have premiums unique to conversions. Since these premiums would be much higher than the premiums are in the original treaty (companies have realized the increased mortality risk from conversions) most direct companies prefer conversions remain with the original treaty.

Replacements should be treated as a new policy (assuming underwriting, contestable periods, etc.). Language has evolved to address these issues. The language changes attempted to clarify definitions but the issue remains that both insurers and reinsurers continue to use the words conversion and replacement interchangeably when the distinctions are important. See Appendix A.2.6 for sample past and current language.

The industry does not have a standardized approach to handling plan changes that has demonstrated effectiveness in treaty construction and in operations. Language needs to be *s*pecific regarding which treaty covers the converted policy and conversion reinsurance premium rates need to be included in the treaty. The treaty needs to be flexible enough to support the business needs of both sides. Language needs to reflect system capabilities and company operations. This is doable and will evolve toward a standard.

5.7 Premium Accounting

The language between reinsurers is not consistent. The primary issue with premium accounting surrounds premium rate guarantees and the ability to increase reinsurance premiums. Cedants do not construe the lack of rate guarantees as a re-pricing vehicle. Explicit premium guarantees at current rates would likely result in the reinsurer setting up deficiency reserves.

5.7.1 Participant Comments

- “Reinsurers usually want short guarantee period (e.g., one year) then an unrestricted ability to increase rates. The direct writer can recapture only if it can’t or doesn’t increase rates proportionately. Some direct writers would prefer certain criteria be defined for reinsurers to raise rates.”
- “We insist on meaningful premium guarantees terms in YRT treaties.”
- “Some reinsurers express YRT premiums as rates with allowances and other reinsurers as percentages applied to the rates. This leads to interpretation issues after the fact.”
- “Rate guarantee provisions still seem to vary a lot and often we have to request that this provision be added after receiving a draft without it. We have also seen reinsurers try to increase premiums even though the treaty doesn’t give them the right.”
- “Reinsurers want to use the right to increase premiums as a means to re-price the old business. Should there be criteria to allow that? Pricing has been greatly affected by investment returns; language hasn’t changed but this is now becoming an issue as well as other circumstances.”
- “If a reinsurer increases the rates, you have the right to recapture. But do you want to recapture?”

[The next three comments pertain to language that requires the reinsurer to raise rates on all treaties]

- “They have to increase rates across a large block of business. How does the direct company know the reinsurer actually raises rates on everyone?”
  “A treaty should be self-contained and the language above breaks this rule.”
- “One of the keys to this is that if rates were increased and disputed, then the rates of all other treaties would be included in discovery. Reinsurers do not want this at all.”“Rate guarantees should have some basis on mortality. A reinsurer tries to recover past losses by raising rates. Regulators look and ask if this is now truly a transfer of risk.”
- “Language is as it is so reinsurer’s do not have to hold deficiency reserves. A hypothetical: If you no longer need to hold deficiency reserves [for example, principle-based reserves], what would happen to this clause?
- “There would be a hard guarantee (you cannot increase rates).”
- “It would be tied to the recapture rights in the contract.”
- “Suppose mortality is bad because underwriting was aggressive [e.g., a business decision]. Should a reinsurer raise rates, deny claims, neither or both?”
- “The reinsurer should go to the ceding company and say you are in breach of this contract. We can force a recapture or we can increase rates. We want to get our damages back and be made whole.”

- "Recapture is not an answer to raising rates because I need the coverage."
- "The intent is to not change the rates. No one enters into a deal knowing they underpriced it but intend to jack up prices at a later date."
- "The intent to never increase rates was often expressed verbally, that it was merely included for reserve purposes."
- "Intent means nothing if it is not in the contract. We've gone from gentlemen's agreements to huge legalese treaties."

5.7.2 Author Observations

Treaty language is not standardized across the industry and the many variations increase the interpretation difficulties. Language has evolved (or rather transitioned) along several paths to protect the ceding company and limit the reinsurer's optionality. Some contracts state that premiums are not guaranteed, others add that the reinsurer may change premiums. Other contracts have guarantees equal to the valuation mortality and the reinsurer may change premiums up to guarantees. Some contracts place conditions on the reinsurer's ability to increase rates such as requiring the increase to apply to all the reinsurer's YRT business and some contracts grant the direct company recourse such as recapture. See Appendix A.2.7 for sample language.

The premium provision is one that epitomizes the passing of the guard from a gentlemen's agreement to a legal contract. The provision has yet to evolve to an industry standard satisfactory to both sides and remains a source of contention. The treatment of existing treaties that provided limited protection to ceding companies is a source of concern and acerbates contention in current negotiations not only in this provision but collaterally affects other provisions. The mirror image of the premium provision is the recapture provision.

Premium rate guarantees and increases controversy has existed for a number of years yet it persists. In the May 2005 *Reinsurance News* James A. Shanman wrote,

> Despite express contractual language permitting reinsurers to raise rates, however, many in the industry believe, some very strongly, that reinsurers cannot and should not do so under any circumstances. Moreover, as a matter of actual practice, rate increases under YRT reinsurance contracts are extremely rare. A number of reasons are cited for this belief. First, it is argued that once the reinsurer sets its rates initially, in fairness it should be bound to live with the profitability or unprofitability of its decision. A second argument is that if the reinsurer has the right to increase its rates freely, there has been no transfer of risk from the cedant to the reinsurer and, thus, the resulting arrangement is simply not reinsurance as it is commonly understood. A third view draws upon the tradition that reinsurance is really a "gentlemen's" or "handshake" agreement.

In the November 2012 *Reinsurance News* Larry Warren wrote,

> The Premium Guarantee language must be clear, effective and have teeth. …
>
> In order to avoid or mitigate the recurring impact of significant losses, the reinsurers may attempt to raise rates especially when the Premium Guarantee Provision in the treaty is weak, unclear or ambiguous, which has very often been the case in YRT reinsurance.

See Appendix A.2.7 for his suggested language.

Section 3.5 of Actuarial Standards of Practice No. 11, The *Treatment of Reinsurance Transactions Reflecting Life or Health Insurance Risks in Financial Statements*, issued in 2005 states,

> Additional Liabilities—For reinsurance ceded, the actuary should consider whether additional liabilities should be established as a result of the reinsurance agreement. The assumptions used in making this consideration should be consistent with the purpose (such as GAAP or statutory accounting). For example, if the reinsurer has the right to raise reinsurance premiums on in-force business without a corresponding right by the ceding entity to raise policyholder premiums or terminate the reinsurance, an additional liability may be indicated.

5.8 Recapture

One Recapture issue is the mirror image to Premium Accounting with the cedant/reinsurer optionality reversed (see 5.7 Premium Accounting). A second issue is whether or not reinsurers wish to include recapture triggers such as rating downgrades. A third issue arises when a reinsurer includes triggers on business that the reinsurer has retroceded to another company. The retrocessionaire wants to retain the business it is insuring and if the direct company recaptures policies due to the trigger the retro will want to be compensated for releasing this business.

5.8.1 Participant Comments

- "The retrocessionaire's concern can be situations where business terminates off their books because an underlying direct writer has recaptured. For example, if a reinsurer includes a rating trigger in a treaty with a direct company, they are in effect allowing the direct company the option to take back some business they have already given to the retrocessionaire. We have negotiated language that provides some but not perfect protection but this is always an item for discussion."
- "We insist on unilateral recapture rights upon an increase in premium rates."
- "Recapture is tied to material breach of the treaty, change in control, insolvency, ratings agency downgrade, RBC [risk based capital] triggers, failure to pay claims, rate increases—we should discuss terminal accounting and recapture fees."
- "Many treaties require the start of a recapture program within a certain limited period after a retention change. However, I've never seen a reinsurer that would not make an exception and allow recapture to start several years after a retention change. We have a number of old treaties that don't contain any recapture provision, which can lead to problems as business situations change. When we write a treaty where recapture is not anticipated, we always try to include a statement that recapture is only available by mutual agreement."
- "There always seems to be discussion over when recapture is appropriate. I'm not necessarily talking about recapture due to a retention increase but other situations such as ratings downgrades, rate increases, etc. Also, oftentimes there is confusion about how recapture is handled in first dollar quota share arrangements."
- "Companies wish to redeploy capital and hence recapture. Others are grabbing back old business as new business dries up. We need to prevent cherry picking."
- "Old language lacks clarity as to the extent of a recapture."
- "Direct companies want control over their own policies. Reinsurers price for a given duration. Several reinsurers have added a recapture fee for 'early' recapture. The 'fixed' nature of the recapture period should be a point of negotiation. Our thinking revolves around the possibility of having a different set of reinsurance rates/premiums depending on the length of the recapture period. The set of recapture period/reinsurance premiums would be determined before the treaty is finalized."
- "We would like to get multiple quotes for different recapture durations and then negotiate the recapture duration."

5.8.2 Author Observations

Similar to premium accounting, treaty language for the recapture provision is not standard across the industry and many variations exist. This provision is an example of guidelines and flexibility versus rules and precision. Historically, treaty language did not anticipate future conditions and lacked the necessary guidelines or precision, thus leaving gaps allowing broad and divergent interpretations.

The recapture provision is also illustrative of the entropy effect where language is reactively rather than proactively responding to changes. Hank Ramsey wrote in the May 2004 issue of *Reinsurance News*:

> Many of these treaties [first dollar quota share] have similar if not identical recapture provisions as the "excess reinsurance" treaties. While the language in these provisions was clear and appropriate for excess reinsurance, it is unclear and inappropriate for quota share reinsurance and poses a very real risk for disputes between the direct writer and reinsurer. … It is the combination of a strong and even perhaps compelling desire of the direct writer to recapture, coupled with this inappropriate and unclear language, which will spark major disputes leading to arbitration and/or legal challenges. …
>
> Reinsurers are nearly unanimous in their opinion that no business under first dollar quota share arrangements be eligible for recapture.

Recapture language has evolved (or rather transitioned) along several paths; however, these issues remain. Recaptures related to retention changes have evolved to address ambiguity regarding applicability to excess and pro rata reinsurance. The financial crisis and other events have linked the option to recapture to triggers such as ratings or capital ratios. Some changes relaxed the requirement that the direct writer gives simultaneous notice of a retention increase with its intent to recapture or otherwise forever forfeit the right to recapture. In exchange, the reinsurer requires recapture of all similarly underwritten eligible business across all treaties to defend against cherry picking only the profitable business. See Appendix A.2.8 for sample past and current language.

5.9 Change in Legal Control

Issues exist when there is ambiguity on the conditions and rights upon a change in control.

5.9.1 Participant Comments

- “Having a say in choosing our partners is important.”
- “If a buyer ends up with a large percentage of our pool, it creates concentration risk.”
- “We have seen reinsurers try to include change of company ownership in the list of situations constituting a change in control. The clause needs to be clear that the change in control refers to assignments and transfers but not to stock purchase agreements.”
- “The reinsurer wanted off the risk because it was bad business. But the sale of the company was not an issue because it was a stock purchase agreement.”
- “If you sell a block, it is not change of control. If you sell a company, management changes and they want to determine who they do business with.”
- “You potentially have a concentration of risk.”
- “This provision is a poison put—placing this clause in a contract reduces the value to a perceived buyer.”

5.9.2 Author Observations

Past language was either absent or non-comprehensive. New treaties should not be vague or silent but should precisely address the definition of a change in control and whether recapture optionality is allowed under a change in control. If necessary, existing treaties will require negotiation according to current business needs and existing treaty terms. Language is evolving. See Appendix A.2.9 for sample language.

As a two-sided option, the inclusion of a recapture option upon a change in legal control could result in benefitting the reinsurer or the direct company. If the direct company has a change in legal control, the reinsurer is allowed to force a recapture of ceded business. If a block of business proves to be unprofitable, the reinsurer will exercise this option. Likewise, if the reinsurer has a change in control, the direct company may use its option to recapture profitable business.

Companies selling a block or subsidiary should consider the impact of including this provision in their treaties. The inclusion of this clause should weigh into the evaluation when acquiring companies. Reinsurers may use this clause to force recapture if the mortality is not as priced. Likewise, if a reinsurer makes an acquisition, direct companies have the right to recapture profitable business.

5.10 Errors and Omissions (E&O)

Historically, the E&O provision was fairly short and open. Treaty language issues on E&O include defining what an error is and what corrective actions and results are permitted or required. The scope of E&O is contentious. Direct companies have taken a broad and liberal approach and application of the E&O clause as an all-inclusive provision. Reinsurers are and have been attempting to narrow the scope.

Some treaties written since 2000 state the E&O provision is specifically for administration errors and not for underwriting errors. Recent treaties have introduced limits on how many years a company can go back to collect premium overpayments or relinquish the reinsurer from the mortality risk on repetitive errors. Language has been introduced in the late reporting provision to set time limitations on reporting. Policies reported after the deadline will not be reinsured without the consent of the reinsurer. Reinsurers are introducing this language as a means to reduce operational risk. The participant comments resume the debates on errors from provisions discussed earlier (e.g., late reporting).

5.10.1 Participant Comments

- "What kind of errors needs to be defined—it should be limited to administrative errors."
- "We view E&O as applying to administration and underwriting and claims practices. If we make an underwriting error, unless there has been some prejudice to the reinsurer that cannot be corrected, it should be covered. For example, suppose it's issued preferred but should be standard. The reinsurer will say it is not in scope. The remedy is to make whole by remitting additional premium and our view is it still would have been issued and the policyholder still would have died. So, if it is an immaterial underwriting error and still would have been issued, then make whole; otherwise (i.e., it would not have been issued) do not make whole. We look to make our reinsurers a partner that shares in the same exposures as if the reinsurer were the direct writer."
- "If language is detailed and too precise or if it is not included or not addressed, then it's not covered in E&O. If language is vague, you can negotiate. Repetitive errors are not considered E&O."
- "What does repetitive mean?"
- "Parties generally agree—unlike virtually any other kind of legal agreement, and after all the care that has gone into developing and defining the respective rights and obligations of the parties, and where there might otherwise be valid legal arguments and matters that could turn into major disputes in other industries, this provision simply states that a party's mistakes or oversights cannot be held against it. There is no such clause in other legal contracts like mortgages, loan documents, wills, etc. However, reinsurers would generally hold that it applies only as long as it is the result of an unintentional administrative-type error (i.e., not an incorrect judgment, business decision or repetitive error, and does not apply to poor underwriting or claim handling) whereas direct writers prefer as broad a coverage as possible (e.g., including business decisions and judgment errors)."
- "Negotiation is around limiting what can be included such as type of errors and how long ago they occurred."

- “E&O applies to admin errors only—it does not include underwriting or ceding’s failure to comply, autobinding, etc. First, it has to qualify as falling under the treaty before you can discuss admin error. For example, underwriting—the requirement is to follow underwriting guidelines but if the underwriter makes a mistake and it should have declined but is rated standard, then the reinsurer discovers it through audit or claim and clients say E&O—but the policy didn’t qualify in the first place.”
- “Does agent misconduct fall under E&O?”
- “E&O does not include an error of judgment, only administrative errors. How are jumbo limit violations being addressed? Where do these fall? Under what provisions, if any?”
- “E&O was created to handle clerical errors in a paper pre-computer age and never intended to include all mistakes that could occur in the treaty. It has been overused. Reinsurers are pushing to include limits. After this limit has been passed, E&O does not apply. Some companies have system limitations they choose not to fix. Errors that occur because of this are treated differently than isolated administration errors.”
- “Direct writers want make whole language. Reinsurers push to exclude certain types of errors—repetitive, just not doing a good job at admin. …”
- “The E&O clause is often unclear about what constitutes an error, i.e., does it cover errors in policy administration or just errors in the reinsurance administration? We have also run into issues with interpretation of ‘repetitive errors’—the intent seems to be that once an error is detected, it is the responsibility of the parties to prevent it from continuing to happen in the future. Some reinsurers interpret this to let them off the hook for correction of errors that have happened multiple times in the past without detection. We also have old treaties that don’t include any E&O clause—this causes all sorts of trouble when an error is found.”
- “The ceding company is more likely to make errors. The reinsurer should get essentially the same risk as the ceding company. Administration and underwriting errors are covered. Reinsurer is covered to the extent that the error would not have occurred. Business decisions are not an error. E&O doesn’t cover any intentional acts.”
- “Follow the fortunes applies if we agree on what it means:
    - “Follow underwriting guidelines
    - “Follow claims procedure
        - “Not followed: follow the fortunes does not apply
        - “Is it an error? Is the reinsurer prejudiced?
        - “Claim should not have been paid but an information nugget was missed. If the reinsurer can prove that the claim would not have been paid had the reasonable nugget been uncovered, then they do not have to pay claim.”
- “We don’t buy reinsurance to get into a debate with you on how our policy should be interpreted, how our underwriting guidelines should be interpreted or how our claims handling guidelines should be interpreted. We are buying reinsurance so that you are bound unless you can show we have no basis on how we handled the policy.”
- “The reinsurer has to trust the ceding company to say you made a business decision. The cedant will not necessarily dig hard enough to prove the error prejudiced, which would provide the reinsurer grounds not to pay the claim.”

- “Reinsurer relies, trusts, on the direct company—upmost good faith. We trust you to administer, pay claims and disclose. … Therefore the burden should be on the direct company to prove the error was not a mistake.”
- “The reinsurer is within their rights to ask questions on claims.”
- “Prejudice is only if there should have been a decline (underwriting). Reinsurer is on the hook for all other errors. There is incentive to not make errors (a string of bad audits will be reflected in rates, profitability of company).”
- “Because it is a time-consuming process, most cases will not be reviewed. As a result, most errors will not be uncovered and therefore no premium reimbursement is applied on these policies.”
- “Perform an audit if experience differentiates from expectations.”
- “A suggested compromise: Instead of the ceding company always fixing the error by paying/recovering the correct premium, reduce the death benefit to be consistent with what the paid premium would have been able to purchase had the correct underwriting been applied.”
  [Direct writer] “This is not a good partnership.”
- “I don’t want to lose a reinsurer as much as you probably don’t want to lose the business. We will therefore work on these cases to find out if there is a pattern. Suppose there is a less-than-skilled underwriter—it may not be errors, he may just not be good at what he does. If an underwriter makes a mistake, you correct it; if the mistake is made again, you tell me to correct it. Now I make the same mistake 10 times in a row. At a certain point, it is no longer an error.”
- “I have seen reinsurers come in and say you have this systemic error that has been going back for 10 years, therefore, we are not going to cover it.”
- “Reinsurer is only reinsuring mortality risk and not operational risk.”
- “We have found cases that have been flat out wrong and should have been declined. We go back and take these cases from our reinsurers. Reinsurance is a relationship built on trust and you build trust over time. It is not one thing that builds trust but rather many things.”
- “Removing these cases from reinsurance speaks volumes about your integrity. But your view/action is not across the industry.”
- “Treaty language is necessary because things change. These changes affect trust.”
- “Should past treaties be amended to reflect the current point of view?”
  “No.”
- “What happens if language doesn’t reflect original intention?”
- “Amendment.”
- “Underwriting errors were covered under E&O in the past. Reinsurers are trying to walk away from this. The question is should they be allowed to exclude underwriting errors now.”
- “Suggested solution: Reinsurers perform audits and/or ask for evidence of errors rather than making exclusions to E&O clauses that haven’t been historically present.”
- “E&O will evolve into four to six categories: administration, late reporting, claims, underwriting. … Determine how each of these will be handled in different sections of E&O clause. It is easier to exclude rather than include.”

- “Modifications of the E&O clause is a two-way street.”
- “In reinsurance, the arbitrator will say go back to time zero, so you need to keep documentation.”
- “If there are no records, try to come to a reasonable solution.”
- “We have a seven-year time limit because we destroy records after seven years.”

5.10.2 Author Observations

E&O language has myriad variations and varies from company to company and even from treaty to treaty. From a reinsurer’s perspective, an E&O clause introduces operational risk. Over the past 10 to 15 years, direct companies have requested large recoveries from reinsurers under E&O. In response, reinsurers have taken steps to eliminate or lessen the impact of specific errors through the introduction of new treaty language, a trend that is expected to continue. E&O will evolve into several distinct categories each with appropriate treatment. See Appendix A.2.10 for sample language.

At least one reinsurer had a difficult time understanding why with the technology available today direct companies had so much difficulty with reinsurance administration. Companies should be able to diagnose and analyze information to manage and maintain accurate reinsurance administration. Reinsurers feel some direct companies treat E&O as a reason not to address operational risk gaps. Above a threshold, contention arises over nonisolated errors, the use of E&O, if and when known problems become practices not errors and whether mistakes are covered indefinitely. As with late reporting, a suggested solution is for the cedant to invest in appropriate administrative resources and/or to perform more thorough and effective audit reviews on a periodic basis.

After a period of time, known errors are deemed to be a business practice and thus fall outside E&O. The reinsurers are evolving toward a shorter and shorter timeframe and a stricter application of this precept. Direct writers would prefer no time limit. Some direct writers have been slow to accept this evolution and/or institute necessary changes to backfill operational gaps. This is another example where a few companies to some degree collaterally impact the entire industry and treaty construction.

Reinsurers have, in some instances, removed the underwriting error from the E&O clause. In many treaties, an underwriting error still falls within E&O. However, treaties do exist that exclude all underwriting errors by stating that the E&O provision is exclusively for administration errors. At least one direct writer has no intention of revising their stance on the E&O provision, i.e., to weaken it.

Both sides agreed that if prejudice occurs, then the reinsurance company is not obligated to pay the death claim on the policy in which prejudice occurred. Two examples of prejudice are business decisions and policies issued on an uninsurable person. Prejudice is extremely difficult for a reinsurer to prove. The reinsurer has to trust the ceding company to determine they made a business decision. The ceding company may not investigate a case to the fullest extent because, if prejudiced, the reinsurer would not have to pay the ceded death benefit. Reinsurers are within their rights to ask questions on claims and have the right to conduct an audit if they deem the explanation unsatisfactory. Reinsurers may initiate an underwriting audit, an administration audit or both. However, an audit is a time-consuming and demanding process. A partial audit will not review every case and errors will remain unknown. Thus, trust remains a fundamental element regarding errors, practices and business decisions.

5.11 Change in Ratings/Financials

This provision became more prevalent in treaties after the 2008 financial crisis but there is still no standard provision or starting point.

5.11.1 Participant Comments

- "What if the entire industry is downgraded allowing the recapture of profitable business? It can snowball."
- "Financial Impairment of the Reinsurer'—all three (change of control, ratings downgrades, RBC ratios) are desired by direct writers but undesirable for reinsurers. Understandably, direct writers are under pressure from analysts, regulators and their management to reduce credit risk and are looking for ways to protect themselves, whereas reinsurers resist due to the liquidity issues caused by a perceived impairment that could then compound the situation into a 'run on the bank,' as well as concerns that triggers could be antiselective and also that triggers impact securitization programs."
- "Reaching agreement on agency rating levels for triggers for recapture, which rating agencies use, use of RBC and all of the above are significant areas of contention."
- "We almost never uses ratings; RBC is more likely. The former is not in our control; the latter is somewhat under our control. If one is included, it is almost always RBC."
- "Reinsurers are very unlikely to include rating clauses. They use RBC clauses. Ratings are out of their control."
- "Reinsurers have responsibility to maintain a certain RBC."
- "Some companies have a mandate stipulating they can't sign a treaty that doesn't include a downgrade clause. A compromise is saying no single event can instigate the recapture (e.g., two downgrades and a drop in RBC)."
- "We usually don't exercise the right but instead work with the reinsurer (e.g., security, trust, letter of credit) until there is an improvement in their RBC levels."
- "If a reinsurer fails to pay claims, we then recapture."
- "It is more of a shield rather than a sword. It is there to protect but as soon an event occurs where the RBC level drops below where specified in the contract, you don't start swinging the sword and recapturing and ending the relationship but rather it is a cause to come to the table and determine what you should do to fix the situation."
- "Would you be willing to pay a recapture fee?"
  "Yes."
- "Would you cede the block back if ratios increased after you already recaptured?"
  "No, in most cases we would have already ceded the recaptured block to another reinsurer."
- "This clause is not an obligation to recapture; it is just a shield to say, if I fully expect the reinsurer will recover and they can post collateral, I will not recapture."
- "What is the risk on YRT business?"
- "Claims are not paid."
- "Then recapture if claims are not paid. Advantage of recapture option is it is immediate."
- "In reality, it is a one-way option. This clause can be used to recapture profitable business from the reinsurer and with YRT, there is not much risk for the ceding company."

5.11.2 Author Observations

This provision is relatively new. This provision reduces counterparty risk for the cedant but creates additional liquidity risk for the reinsurer. Prior to 2000, there was essentially no standard provision on financial impairment of the reinsurer. In the early 2000's this provision was increasingly being requested by direct writers leading up to the financial crisis in 2008. Since the financial crisis, it has become prevalent but there is still no standard provision or starting point. Requests are typically reviewed on a case-by-case basis. As a recent and emerging provision, there are many variations. See Appendix A.2.11 for sample language.

5.12 Offsets: Netting Provisions

The major offset issue is in that some companies believe disputed claims and premiums should be included in the netting calculation.

5.12.1 Participant Comments

- “Parties generally agree in concept but sometime negotiations occur relative to (1) whether the ‘right’ is relative to all including disputed—or only to undisputed—premiums and claims due, as an insolvency or a ‘pre-insolvency’ remedy for delinquency/nonpayment; (2) whether the ‘right’ applies to just this one treaty, or across all treaties; (3) whether routine ‘netting’ of claims against premiums is/is not a ‘right’ under this provision that can be unilaterally exercised at will.”
- “We insist on express offset rights.”
- “The insolvency statute is why it needs to be in the treaty.”
- “If someone owes you money, why should you pay them anything until they pay you back?”
- “We don’t have the confidence what we owe you is correct.”
- “Netting is done without waiting on claim approval.”
- “Netting is done only after the claim is paid.”
- “What about settlements?”
- “They are eventually netted.”
- “Netting causes claims to be paid that we are not ready to pay.”
- “Netting claims doesn’t change your rights, but now you have my money and it is harder to get it back.”

5.12.2 Author Observations

There has not been much change in this provision over the last decade—the circa 2000 provision is about the same as the current standard provision. Sample 2012 language is: “The direct writer and reinsurer will have the right to offset any undisputed balances, due from one party to the other under this treaty or under any other reinsurance treaty between the direct writer and reinsurer. The right is in addition to any rights of offset that may exist at common law.” For additional language, see Appendix A.2.12.

5.13 Automatic Binding Limits

Because there is no central repository to monitor the insurance available to a prospective policyholder, there are times when the jumbo limit is breached. On these occasions, there is disagreement on how much, if any, reinsurance coverage a cedant has.

5.13.1 Participant Comments

- "There's always been a fair amount of discussion over who is responsible for monitoring the automatic binding and jumbo limits, per insured, under the agreements. It seems the ceding company believes the reinsurer has more information to be able to monitor whether an automatic binding and/or jumbo limit is breached and so should take responsibility for their share in the event of a breach. However, reinsurers believe that since the ceding company underwrites the insured, the direct writer should know how much insurance is in force and applied for and therefore, should be responsible for the risk in the event of a breach. How can we tighten the language on this and come to a mutual understanding?"
- "Binding limits are often inconsistently stated, i.e., do they include the company's retention or not? And are they stated as the individual reinsurer's limit or the limit for the pool of reinsurers? Distinguishing between these when language is not clear is very difficult."
- "The industry needs to get on the same page. Is binding limit for the specific reinsurer or for the total pool? Does the binding limit include or exclude ceding company retention?
- The NAIC [National Association of Insurance Commissioners] has model laws. The Treaty Sourcebook falls short. Can't the SOA [Society of Actuaries] or ACLI [American Council of Life Insurers] have models—not antitrust—just getting everyone on the same page?"
- "Automatic binding and jumbo limits must be based upon information known from initial amounts in application."
- "It is not always clear that there is a meeting of the minds on jumbo limit applications. There is confusion sometimes around the application of increases to both autobind and jumbo limits."
- "Automatic binding limit: Some reinsurers want pool binding limit as well as their individual binding limit, some only want to see their acceptance limit. There are different interpretations in the industry by what is suggested by automatic limits, e.g. acceptance limits versus binding limits."
- "Automatic binding limit language is not consistent:
  - "Some present it as just their share.
  - "Some present it as their share plus our retention.
  - "Some present it as the whole pool and you can't tell if that includes your retention."
- "We need some standardization and, most importantly, clarification."
- "It is very difficult to track jumbo limit and autobind."
- "Jumbo is extremely hard for reinsurers to administer because they don't have all the information."
- "There is potential to exceed your autobind if the reinsurance system does not link all policies purchased by a policyholder [or correctly]."
- "The contract states the jumbo limit and if it is exceeded, then no reinsurance should be attached. In reality, the question that always comes up is what about the innocent breach?"

- “I have never seen an innocent breach but have yet to fight it.”
- “Just because the policyholder doesn’t put insurance on an application doesn’t excuse the underwriter. He has to do his job.”
- “If the agent has knowledge, is it an innocent breach?”
- “Great question but no real answer.”
- “Technology is great for the industry but it is haunting us on the jumbo limit issue.
  - “No facultative application”
  - “Automatic issue process”
  - “Difficult to validate and the ability to comply is diminished”
- “Reinsurers see a lot of false negatives. Policies have lapsed but still being showed in force [due to a lag in lapses].”
- “The only way to solve is to have some company that maintains applied-for and placed amounts. If the [SOA] wants to take away anything from this session, that should be the charge: To get this industry back on its feet where there is a repository that is reporting amounts by carrier that an underwriter can access just like the medical information.”
- “The repository needs to be fed information and paid for by direct writers. The direct writers don’t feel that at the end of the day they are bearing this risk. Therefore, the direct writers aren’t willing to fund it. It won’t work unless everyone participates.”
- “If an agent is involved, do you go after them? Do they take disciplinary action? What is the answer?”
- “We try to.”
- “We exclude liability caused by agent misconduct.”

5.13.2 Author Observations

The automatic binding limit and jumbo limit have evolved in the last 10 years to provide more clarity on the limits. Treaties are now stating both the maximum share a ceding company is allowed to cede to a reinsurer under the treaty and the total death benefit permitted to a policyholder under the treaty. Treaty clarity should help minimize automatic binding limit errors going forward because the ceding company should have knowledge of their own block of business.

Improving treaty clarity helps but there is still the problem of ascertaining the correct amount of insurance in force for the policyholder. If a policyholder omits current insurance on their application then unless the underwriter discovers the additional insurance by other means, the issuance of a policy could result in exceeding the jumbo limit as stated in the reinsurance treaty. Reinstatements can also result in limits being breached. It is also difficult to determine whether or not binding limit errors fall under the errors and omissions clause of the treaty.

In the August 2008 issue of *Reinsurance News* David Atkinson wrote,

> If the jumbo limit is exceeded on a life, there are two choices: retain the risk or submit on a facultative basis.

> The increasing concern comes from this simple question: What happens if a direct writer is *unknowingly* over the jumbo limit when it automatically binds its reinsurers? …
>
> Retrocessionaires have been clear that, whether all in-force and applied for amounts on a life are known or unknown at the time of issue, the jumbo limit will be enforced at claim time. …
>
> The life insurance industry has no central repository for the accumulation and reporting of amounts in-force *or* applied for on a life. As a result, over the jumbo situations are at risk for not being discovered until time of claim.

A central repository was discussed at the roundtable and considered to be highly beneficial. Two challenges of a central repository are that participation is voluntary and participants would fund the costs. Although a repository was deemed to be the appropriate solution to an industry problem, a repository was deemed unlikely to come to fruition.

5.14 Miscellaneous Provisions

The following provisions were less vetted. The below comments reflect participant views, concerns and issues receiving attention during the construction process but not necessarily contentious.

5.14.1 Participant Comments

Retention Limit Changes

- "We have quota share treaties that are not at all clear as to what is meant by retention limit changes. For example, is it the maximum dollar amount retained or the quota share retained? These two concepts need to be clearly separated."
- "We need more consistency in language—how is retention calculated in first dollar quota share arrangements?"

Arbitration

- "It is against the trend and relatively new for us but arbitration is not beneficial and does not save money or time. First, we tried to make modifications to the clause. We can get everything and more in a court setting. Confidentiality typically is not an issue as most disputes with reinsurers are generally the result from demands for payment of reinsurance reimbursement; we do not need to keep the dispute hidden."
- "Arbitration does not reflect when the treaty was put together or how, i.e., gentleman agreement era or current era."

Confidentiality

- "Confidentiality can go both ways—reinsurers provide proprietary/competitive information. Nondisclosure agreements (NDA): Is it mutual or a one-way exchange? Direct writer wants to audit IT (information technology) security. However, you can't let them use 'we don't like your IT' as an excuse to recapture. NDA can be longer than the treaty. Technology—the mobility of data—has created challenges and new issues."
- "There are some terms included in ceding company confidentiality language that can be onerous for the reinsurer (e.g., any third parties or retrocessionaires are to be held to the same standards as the reinsurer and that those third parties have signed the same terms)."

Underwriting Guidelines (or Forms, Manuals and Issue Rules)

- "We do not include underwriting applications or rules in the treaty. We also look to expressly bind reinsurers to coverage issued as a result of reasonable underwriting judgment."
- "In the direct world, there is a barbell: Some underwriters have 20 plus years of experience and there are many with very little experience. Soon, many experienced underwriters will retire. Who will replace these experienced retirees?"
- "Underwriting guidelines—variations: We try to avoid any mention of discretionary guidelines. Reinsurers want more specifics suggesting the guidelines form an exhibit to the reinsurance treaty."

Credit for Reinsurance (or Credit for Reserves)
- "There can be some discussion about what happens if a reinsurer loses license in a state or if there is a change in regulation."

Automatic and Facultative-Obligatory Reinsurance (or Automatic Reinsurance)
- "Treaty discussions involve underwriting language, jumbo language, prudent underwriting judgment, business decisions."
- "Sometimes there is difficulty defining what is in and what is out."

Commencement of Liability
- "Usually the disagreement comes with facultative terms (i.e., prior to issue of the policy, during the lifetime of the insured). Other factors include facultative allocation rules, receipt of confirmation to reinsurer, etc. Allocation rules for placement of facultative cases—a lot of ceding companies don't want to include this information in the treaty."

Covenants and Warranties
- "This is a new area of contention. What is being warranted is getting more attention and insertions."

Effective Date, Duration and Termination of Agreement (or Duration of Agreement)
- " The reinsurer can have an issue with how the termination clause of its outbound retro treaty lines up with the termination clause of its inbound treaties."

Funds Withheld
- "This only comes up during discussion of financial impairment and if the deal needs to be saved. Everyone agrees conceptually but implementation is difficult. How?"

Notice
- "Reinsurer typically wants more notice time with respect to changes such as underwriting guidelines, retention changes etc. We often find that that time from decision to implement in the market doesn't allow for as much time as reinsurer would like."

Placement Rules for Facultative Reinsurance
- "This is rarely mentioned in treaties anymore and particularly with respect to tie-breakers and increase in auto and jumbo limits resulting in less shopping on a [facultative] basis."

Premiums and Allowances (or Reinsurance Premiums)
- "Sometimes rates are not consistently included in the agreement. It could be because tables are so large. What can we do to alleviate this issue?"

Reinsurer Obligation
- "I have seen situations in a pool type arrangement where you couldn't tell what portion of the reinsurance was covered by a particular reinsurer. For example, a given reinsurer might cover 20 percent of the excess of retention but the treaty might simply say it is an excess of retention treaty."

Other

- “We would like a global standard for worldwide reinsurance treaties amongst our companies. We have discussed internally. We don’t have language but are interested in working through the concepts.”
- “What is the reinsurer’s liability for agent fraud, negligence and other misconduct?”

6 Conclusion

A reinsurance treaty's long-term nature challenges both parties during the construction process to negotiate intent and then translate and formulate intent into language that pulls together rules, clarity, guidelines and flexibility to pass the test of time. The business climate and quality of business practices, administration and operations may change favorably or unfavorably.

Reinsurance treaties are more complicated today than they were 20 years ago and will continue to evolve as new problems emerge. Twenty years ago, reinsurers did not necessarily anticipate the operational risk created from business and administrative practices. Such risk has manifested itself in reinsurers paying millions in premium reimbursements or death claim payments on policies they had not received notification. Likewise direct writers have paid millions in denied claims on coverage they thought they had or intended to have.

Rumsfeld said, "There are also unknown unknowns—the ones we don't know we don't know." If intent, language, interpretations, time, practices and known errors cost companies on both sides millions, what about the unknowns? Treaty provisions have evolved as a means to address the known and the unknown.

Each side agreed there was room for improvement regarding operations and business practices as well as meeting/serving industry needs. Suggestions included facultative notification, back office and administrative errors, especially repetitive errors not being addressed, consistency between treaty language and requirements with business practice, a repository to address autobind and jumbo limit compliance, and E&O categories.

The direct company/reinsurer/retro relationship may not be a partnership but there is no denying the three sides have built strong business relationships. The friendships and the respect each side has for the others was evident prior to and during the in-person roundtable discussion. It is because of the respect and friendships the three sides have for each other that we have no doubt reinsurance treaties will evolve to the mutual benefit of the life insurance industry.

7 References

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APPENDIX 1: Questionnaire & Results

(return to Section 4.2)

Life Reinsurance Treaty Construction Questionnaire

A) Do you consider your company a:

Large Company Direct Writer	
Mid-Size Company Direct Writer	
Small Company Direct Writer	
Reinsurance Company	

For each part below, please rate each provision/article and exhibit on a scale of 1-5:

Scale 1 = highly satisfied or much agreement
Scale 5 = highly dissatisfied or much disagreement

Column B asks: From your perspective, rate your degree of satisfaction with the outcome.
Column C asks: From your perception of your reinsurance partner, rate their degree of satisfaction with the outcome.
Column D asks: Rate the degree of disagreement at the onset of and during the process.
In Column E (Comment section) on items with 4's and 5's, please provide a brief description of specific examples that formed your opinion.

B) Provisions/Articles	**Satisfactory Results (B)**	**Partner's View of Results (C)**	**Ease in Process (D)**	**Satisfactory Results**	**Partner's View of Results**	**Ease in Process**	
	Average Rating			**Number of 4's or 5's**			**Total 4's or 5's**
1 Preamble	1.2	1.2	1.2	0	0	0	0
2 Definitions	1.3	1.3	1.8	0	0	1	1
3 Automatic and Facultative-Obligatory Reinsurance (or Automatic Reinsurance)	1.5	1.6	1.8	0	0	0	0
4 Facultative Reinsurance	1.4	1.5	1.5	0	1	0	1
5 Commencement of Liability	1.2	1.3	1.5	0	1	1	2
6 Reinsured Risk Amount	1.6	1.6	2.1	0	0	4	2
7 Premium Accounting	1.8	1.9	2.3	2	1	2	5
8 Funds Withheld	1.6	1.3	1.6	1	0	0	1
9 Reporting	1.5	1.6	1.8	0	0	0	0
10 Late Reporting	2.0	2.3	2.4	2	1	4	7
11 Reductions, Terminations and Changes	1.6	1.4	1.8	1	0	1	2

B) Articles	Satisfactory Results (B)	Partner's View of Results (C)	Ease in Process (D)	Satisfactory Results	Partner's View of Results	Ease in Process	
	Average Rating			Number of 4's or 5's			Total 4's or 5's
12 Changes of Plan (or Conversions, Exchanges and Replacements)	2.3	2.1	2.3	2	1	1	4
13 Claims	2.5	2.9	3.2	2	4	5	11
14 Credit for Reinsurance (or Credit for Reserves)	1.6	1.7	1.6	1	2	0	3
15 Retention Limit Changes	1.6	1.6	1.6	0	0	0	0
16 Recapture	2.6	2.8	3.3	2	4	6	12
17 General Provisions	1.3	1.3	1.3	0	0	0	0
18 DAC Tax Election	1.0	1.1	1.0	0	0	0	0
19 Good Faith	1.3	1.3	1.1	0	0	0	0
20 Insolvency	1.6	1.8	1.8	0	0	0	0
21 Change in Legal Control	2.1	2.6	2.8	2	2	4	8
22 Change in Ratings	2.5	2.6	2.8	3	2	4	9
23 Change in Financial/Capital Ratios	2.5	2.7	2.8	3	3	4	10
24 Offsets: Netting Provisions	1.8	2.2	2.1	0	1	0	1
25 Errors and Omissions	2.6	2.6	3.1	3	4	5	12
26 Dispute Resolution	1.4	1.3	1.4	0	0	0	0
27 Arbitration	1.6	1.6	1.6	0	0	0	0
28 Service of Suit and Consent to Jurisdiction	1.7	1.7	1.7	0	0	0	0
29 Confidentiality	1.3	1.6	1.6	1	1	1	3
30 Notice	1.2	1.3	1.3	0	1	1	2
31 Effective Date, Duration and Termination of Agreement (or Duration of Agreement)	1.5	1.7	1.4	0	0	0	0
32 Execution	1.2	1.2	1.2	0	0	0	0
33 Other: *	1.6	1.7	1.8	0	0	1	1

* Other Representations/warranties, agent liability, underwriting errors, negotiation process and redlining, involvement of legal counsel, compliance with law (e.g., Office of Foreign Assets Control) wording, reinsurer obligation, premium rate guarantee

C) Exhibits	Satisfactory Results (B)	Partner's View of Results (C)	Ease in Process (D)	Satisfactory Results	Partner's View of Results	Ease in Process	
	Average Rating			Number of 4's or 5's			Total 4's or 5's
1 Retention Limits of Ceding Company	1.3	1.3	1.4	0	0	0	0
2 Plans Covered and Binding Limits	1.7	1.5	1.7	0	0	0	0
3 Underwriting Guidelines (or Forms, Manuals and Issue Rules)	1.8	1.8	1.8	0	0	0	0
4 Application for Facultative Reinsurance	1.1	1.1	1.1	0	0	0	0
5 Allocation Rules for Placement of Facultative Cases	1.5	1.5	1.5	1	1	1	3
6 Premiums and Allowances (or Reinsurance Premiums)	1.8	1.7	1.8	0	0	1	1
7 DAC Tax Net Consideration Report	1.0	1.0	1.0	0	0	0	0
8 Reporting Requirements (or Self-Administered Reporting)	1.5	1.8	1.8	0	0	0	0
9 Ceding Company Data	1.7	1.8	1.8	0	0	0	0

Appendix 2: Sample Language

Below is sample language for many but not all of the articles in Section 5. Our numbering of the subsections in Appendix 2 corresponds to the subsections in Section 5. For example, Section 5.8 Recapture corresponds to Appendix A.2.8. The sample language examples are modified excerpts taken from actual treaties. Some of the examples have headings, numbering, labeling and references such as Article 6, Section 3.9, Exhibit B or Paragraph 4. The numbering of articles from one example does not bear any relationship to the numbering in another example.

A.2.1 Facultative Reinsurance (return to Section 5.1.2)

Example 1: Current and Past Language

Article X. Facultative Reinsurance

X.1 The Ceding Company may submit any application on a Policy identified in Exhibit B to Reinsurer for its consideration on a facultative basis including, but not limited to, policies with amounts in excess of the Automatic Binding Limits.

The Ceding Company shall apply for reinsurance on a facultative basis by sending to the Reinsurer a mutually acceptable application for facultative reinsurance. In addition to the facultative application, the Ceding Company shall provide all underwriting evidence that is available for risk assessment including, but not limited to, copies of the application for insurance, medical examiners' reports, attending physicians' statements, inspection reports, and any other information bearing on the insurability of the risk. The Ceding Company also shall notify the Reinsurer of any outstanding underwriting requirements at the time of the facultative submission. Any subsequent information received by the Ceding Company that is pertinent to the risk assessment shall be immediately transmitted to the Reinsurer.

After consideration of the facultative application and related information, the Reinsurer shall promptly inform the Ceding Company of its underwriting decision. If the Reinsurer makes an offer, the Ceding Company must accept the Reinsurer's offer during the lifetime of the insured and within the lesser of (i) the time period specified in the Reinsurer's offer or (ii) one hundred and twenty (120) days after the Ceding Company's receipt of such offer. The Ceding Company shall accept the Reinsurer's offer by (i) written notification or (ii) reporting such risk on the periodic reports it provides to the Reinsurer pursuant to Section x.x and Exhibit X.

If the Ceding Company fails to accept the Reinsurer's offer as set forth above, the Reinsurer's offer shall expire and no reinsurance coverage shall exist on the risk. Article X, Errors and Omissions, shall not apply to this Article.

If any risk is to be submitted to more than one reinsurer for consideration, the Allocation Rules for Placement of Facultative Cases as outlined in Exhibit X will apply.

A.2.3 **Late Reporting** (return to Section 5.3.2)

Example 1A: Past Treaty Language

If through unintentional error, oversight, omission, or misunderstanding (collectively referred to as "errors"), the Reinsurer or the Ceding Company fails to comply with the terms of this Agreement and if, upon discovery of the error by either Party, the other is promptly notified, and the error is corrected, each Party will be restored to the position it would have occupied if the error had not occurred. Any errors in the administration of this Agreement shall not invalidate the reinsurance provided hereunder.

If it is not possible to restore each Party to the position it would have occupied but for the error, the Parties will endeavor in good faith to promptly resolve the situation in a manner that is fair and reasonable, and most closely approximates the intent of the Parties as evidenced by this Agreement. Any resolution made to correct such an error will not set a precedent for any similar subsequent error.

Example 1B: Current Treaty Language

Current treaty language may include the above past language but also includes the following:

The following are not considered Errors:

A circumstance that would be an "Error" but it is a "Late Reported Policy" or a "Late Reported Termination" defined and covered as follows.

a. Late Reported Policies will be excluded from coverage. A "Late Reported Policy" will include any single policy reported by the Ceding Company more than (x) years after the policy was effective which has a net amount at risk ceded to the Reinsurer greater than $(x);

b. The Reinsurer will only refund the last (x) years of premium for Late Reported Terminations. A Late Reported Termination is a covered policy terminated in accordance with its terms or by agreement of the parties that is reported by the Ceding Company more than (x) years after the termination was effective.

A.2.4 Claims (return to Section 5.4.2)

Example 1
Certain reinsurance treaty wording regarding claims evolved in the following way between 2000 and 2012.

2000: Only a few brief paragraphs, stating (1) "the direct writer will give prompt notice of claims, and copies of materials relating to the claim shall be furnished upon the reinsurer's request"; (2) the direct writer will "act in accordance with its standard practices and enforce the conditions of the policy"; and (3) "the reinsurer will accept the good faith decision of the direct writer in payment or settlement of the claim, and pay its proportionate share of interest due and exceptional investigation expenses, but not routine investigation or internal administrative (salary) costs, or ex gratia payments or ECOs."

2012: The provision has grown to several pages. While now clarifying that "the direct writer is responsible for the settlement of claims in accordance with applicable law and policy terms, and it is their sole decision to determine whether a claim is payable under the policy," a great deal has been added as follows:

Relative to (1) giving "notice of claim," it now states that "the direct writer must notify the reinsurer in writing as soon as possible, but no later than 12 months after the direct writer receives notice of a claim" (i.e., this "sunset" provision has been added).
Relative to (2) "handling claims in accordance with the direct writer's standard practices," it now states "it is the direct writer's sole decision to determine whether to investigate, contest, compromise, or litigate a claim; the direct writer acknowledges that it obtains certified death certificates and follows industry standard and investigates certain claims" (e.g., those occurring: within the contestable period, where there is a reasonable question regarding the validity of the insured's death or the authenticity of the proofs of death, outside the United States or Canada, where the insured is missing or presumed dead, or where there is a reasonable suspicion of fraud.) Further, the direct writer acknowledges that a claim investigation generally includes confirming proof of death, medical records to validate the insured's medical disclosures, and, if material, financial condition at the time of application. Investigations may also include obtaining police reports, coroner's reports, financial records, or other information that would be appropriate under the circumstances. The direct writer also acknowledges that it does defend against claims where a material misrepresentation is found in the application and the policy is within the contestable period, where fraud is found and there is a legal remedy available, or where there is insufficient proof of death.

Relative to (3) "the reinsurer will accept the good faith decision of the direct writer," it now states "before making a claim decision or settlement offer, the direct writer must seek the reinsurer's recommendation if the death occurs during the contestable period"—and the direct writer must "notify the reinsurer of its intention to investigate, contest, compromise, or litigate, and provide to the reinsurer all relevant information and documents, as such become available, pertaining to contested claims and will promptly report any developments during the reinsurer's review"; "if the reinsurer does not support the contest of the claim, the reinsurer will pay the direct writer its full share of the reinsurance benefit, and will not share in any subsequent reduction or increase in liability or in any subsequent expenses incurred"; and "if the reinsurer supports the direct writer's decision to contest the claim and that contest results in a reduction or increase in liability, the reinsurer will share in any reduction or increase in proportion to its share of the risk"; "if the death occurs during the contestable period where the direct writer is not contesting the claim, or if it occurs outside of the U.S. or Canada, or is one for which there is no body—where the insured is missing and presumed dead." There is language similar to prior standard re: ex gratia and ECOs.

This change moved us away from a "follow the fortunes" approach, as reinsurers took on an increasing proportionate share of the risk as direct writers had less "skin in the game."

Example 2A: Treaty Language
The following is an example of a claim provision that we cannot accommodate because our claims department does not know whether there is reinsurance on a policy or not.

It is agreed, however, that if the amount of reinsurance on the particular life carried by the Reinsurer hereunder is in excess of the amount of insurance on such life retained by the Ceding Company, or if the amount of the disability carried by the Reinsurer in connection with any claim for such benefits under a policy reinsured hereunder is in excess of the amount of such benefits retained by Ceding Company, all papers in connection with such claim shall be submitted to the Reinsurer for its authorization before payment is made.

Example 2B: Treaty Language
The following is an example of better claim language we can comply with because it specifies dollar amount limits rather than percent reinsured.

Before conceding liability or making settlement to the claimant, the Company will seek the Reinsurer's recommendation if:

1. The claim occurs during the contestable period and the Company is contesting the claim, or
2. The claim occurs during the contestable period and the Company kept its retention at the time of issue and it is not contesting the claim, but the face amount per life exceeds $1,000,000 or
3. The claim occurs outside of the contestable period and the Company kept its retention at the time of issue and it is not contesting the claim, but the face amount per life exceeds $1,000,000, or
4. The claim occurs outside of the United States or Canada, and the face amount per life exceeds $0, or
5. The claim is one for which there is no body, i.e. the insured is missing and presumed dead, or
6. The claim is one for which there is reasonable doubt as to the authenticity of the death certificate or the reliability of the medical report concerning such death.

If the Reinsurer discovers that the Company's claims paying practices and procedures differ materially from those performed at the inception of the Agreement or from the Business Guidelines, then, in addition to any other remedies, the Reinsurer may, with 30 days' written notice, adjust the threshold amounts specified above.

Claims: Extracontractual Damages

Example 3A: Current Treaty Language
The Reinsurer assumes no liability under this Agreement or otherwise for any extracontractual damages assessed against Ceding Company, its agents or representative, on account of any policy reinsured hereunder, including, but not limited to, consequential, compensatory, exemplary, or punitive damages.

Example 3B: Current Treaty Language
In no event, however, shall the Reinsurer be liable for any punitive or compensatory damages or statutory penalties which are awarded against the Ceding Company based on any act or omission to act by the Ceding Company in connection with the insurance reinsured under this Agreement.

Example 3C: Current Treaty Language
In no event shall the Reinsurer have any liability for any extracontractual damages which are awarded against the Ceding Company as a result of acts, omissions, or course of conduct committed by the Ceding Company in connection with the insurance reinsured under this agreement.

The Reinsurer does recognize that circumstance may arise under which the Reinsurer, in equity, should share to the extent permitted by law, in paying certain assessed damages. Such circumstances are difficult to define in advance, but involve those situations in which the Reinsurer was an active party in the act, omission, or course of conduct which ultimately results in the assessment of such damages. The extent of such sharing is dependent on good faith assessment of culpability in each case, but all factors being equal, the division of any such assessment would be in the proportion of total risk accepted by each party for the plan of insurance involved.

Claims: Extracontractual Obligations

Example 4A: Past Treaty Language
Mid-1990's:
The Reinsurer will share with the Ceding Company all expenses that are not routine. Expenses that are not routine are those directly incurred in connection with the contest or the possibility of a contest of insurance or the assertion of defenses. These expenses will be shared in proportion to the net amount at risk for the Reinsurerand the Ceding Company. However, if the

Reinsurer has released its liability under Section Y of this Article, the Reinsurer will not share in any expenses incurred after the date of release.

Example 4B: Past Treaty Language
Early 2000's:
Extra-Contractual Damages. The Reinsurer will not participate in extra-contractual damages, other than statutory damages, which are awarded against the Ceding Company as a result of an act, omission or course of conduct committed solely by the Ceding Company in connection with the reinsurance under this Agreement. The Reinsurer shall, however, pay its share of statutory penalties awarded against the Ceding Company in connection with reinsurance under this Agreement if the Reinsurer elected to join in the contest of the coverage in question and the denial of the claim was the sole basis of the award.

Example 4C: Current Treaty Language
2012:
same as early 2000's

Example 5A: Past Treaty Language
Mid-1990's:
In no event shall the Reinsurer have any liability for any Extra-Contractual damages which are assessed against the Ceding Company as a result of acts, omissions or course of conduct committed by the Ceding Company other than a good faith decision to deny claim liability, in connection with insurance reinsured under this Agreement. It is recognized that there may be special circumstances involved which indicate that the Reinsurer should participate in certain assessed damages. These circumstances are not amenable to advance specific definition, but could include those situations in which the Reinsurer was an active party in the act, omission or course of conduct which ultimately results in the assessment of such damages. The extent of such participation will be determined on a good faith assessment of culpability in each case, but all factors being equal, the division of any such assessment will generally be in the proportion of net liability borne by each party.

Example 5B: Past Treaty Language
Early 2000's:
Same as mid-1990's

Example 5C: Current Treaty Language
2012:
Extra-Contractual Damages:
In no event shall the Reinsurer participate in or be required to pay any Consequential Damages, Compensatory Damages, Exemplary Damages or Punitive Damages or Statutory Penalties (collectively "Extra-Contractual Damages") which are awarded against the Ceding Company or which the Ceding Company may pay voluntarily as a result of a direct or indirect act, omission or course of conduct committed solely by the Ceding Company, its agents or

Representatives, in connection with any aspect of the underlying insurance for reinsurance retroceded under this Agreement. The Reinsurer shall, however, pay its share of Extra-Contractual Damages assessed against the Ceding Company strictly in connection with the denial of a claim on the underlying insurance for reinsurance retroceded if the Reinsurer elected to join in the contest of such insurance.

For the purpose of this provision the following definitions shall apply:

a) "Consequential Damages" are losses that occur indirectly from the act complained of:
b) "Compensatory Damages" are those amounts awarded to compensate for actual damages sustained, and are not awarded as a penalty, nor fixed in amount by statute:
c) "Exemplary Damages" or "Punitive Damages" are those damages which are awarded as a penalty, the amount of which is not governed, nor fixed, by statute; and
d) "Statutory Penalties" arc amounts awarded as a penalty, but fixed in amount by statute.

Contestable Claims

Example 6A: Past Treaty Language

Mid-1990's:

A. The Ceding Company must promptly notify the Reinsurer of the intent to contest insurance reinsured under this Agreement or to assert defenses to a claim for such insurance. If the contest of such insurance results in the reduction of the Ceding Company's liability, the Reinsurer will share in this reduction. The Reinsurer's percentage of the reduction will be its net amount of risk on the individual life as it relates to the Ceding Company's total net amount at risk on the date of the death of the insured.
B. If the Reinsurer should decline to participate in the contest or assertion of defenses, it will then release all of its liability by paying the Ceding Company the full amount of its share of the reinsurance and will not share in any subsequent reduction in liability.

Example 6B: Past Treaty Language
Early 2000's:
Same as mid-1990's

Example 6C: Current Treaty Language
2012:

a) The Ceding Company must promptly notify the Reinsurer of its intent to contest insurance retroceded under this Agreement or to compromise, litigate or assert defenses to a claim for such insurance. The Ceding Company shall promptly submit copies of the underwriting and issue papers and all investigation reports and other relevant claim documents to the Reinsurer. In the event that the Reinsurer does not concur with the Ceding Company, the Reinsurer shall notify the Ceding Company of such decision within five (5) working days after receipt of all necessary information.

b) If the Reinsurer agrees to join in the contest, compromise, litigation or defense the Ceding Company shall promptly notify the Reinsurer of the initiation of any legal proceeding and provide copies of documents pertaining to a lawsuit or notice of intent to file a lawsuit by any claimant or party to the policy as they are received. If the contest of such insurance results in the reduction of the Ceding Company's liability, the Reinsurer will share in this reduction. The Reinsurer's percentage of the reduction will be its net amount of risk on the individual life as it relates to the Ceding Company's total net amount at risk on the date of the death of the insured.

c) If the Reinsurer should decline to participate in the contest or assertion of defenses, the Reinsurer will then release all of its liability by paying the Ceding Company the full amount of its share of the reinsurance coverage and will not share in any subsequent expenses incurred in the contest of the claims.

Example 7A: Past Treaty Language
Mid-1990's:
The Ceding Company shall notify the Reinsurer of its intention to contest, compromise, or litigate a claim involving reinsurance, and the Reinsurer shall pay its share of the payment and specific claim expenses therein involved, unless it declines to be a party to the contest, compromise, or litigation in which case it shall pay the full amount of the reinsurance to the Ceding Company.

Example 7B: Past Treaty Language
Early 2000's:
Same as mid-1990's

Example 7C: Current Treaty Language
2012:
The Ceding Company shall promptly notify the Reinsurer in writing of its intent to compromise, litigate or assert defenses to a claim for benefits on insurance that is subject to this Agreement. In such an instance the Ceding Company will submit copies of all of the documents obtained in connection with the claim to the Reinsurer for review. If the Retrocessionaire does not wish to participate in the Contest, the Reinsurer shall notify the Ceding Company of such decision within five (5) working days after receipt of all of the necessary information. The Reinsurer shall then, within fifteen (l5) days of receipt, discharge its full liability by paying to the Ceding Company the full current net amount at risk under the retrocession and its proportionate share of the covered expenses to-date. Upon such discharge, the Reinsurer shall not be liable for any portion of any further expenses incurred subsequently in contesting the claim. If the balance is not received by the thirty-first (31) day of receipt, the Ceding Company shall have the right to charge interest starting on that day in accordance with Article xxx on the unpaid balance.

If the Reinsurer agrees to participate in the Contest, the Ceding Company shall promptly notify the Reinsurer of the initiation of any legal proceedings and provide copies of documents pertaining to a lawsuit or notice of intent to file a lawsuit by any claimant or party to the policy as they are received. If the Reinsurer participates in the claim contest, should any claim be settled on a compromise basis or should the Ceding Company recover any monies from any third party, the Reinsurer shall participate in the compromise or recovery in proportion to its respective net liability under the policy or policies reinsured. In determining the participating Reinsurer's proportionate share of the net liability, the amount of any reinsurance indemnification received by the Ceding Company as a full discharge of any reinsurer ' s further liability shall he deducted from the total net liability on the policy as at the incurrence of the claim.

Example 8: Current Treaty Language
Recent/newer language

7.1 Claim Amount
The Reinsurer will be liable to the Ceding Company for the benefits reinsured hereunder to the extent that the Ceding Company is liable to the insured for such benefits, and all reinsurance will be subject to the terms and conditions of the policy under which the Ceding Company is liable. The Reinsurer will also be liable for its proportionate share of interest on payment of the claim at the usual interest rate allowed by the Ceding Company.

7.2 Living Benefit or Terminal Illness Benefit
The Reinsurer will not participate in any Living Benefit or Terminal Illness Benefit provided in a policy.

7.3 Notice and Proofs
The Ceding Company will notify the Reinsurer promptly upon receiving notice of any claim involving reinsurance under this Agreement and will promptly send a copy of the policy application and all claims papers and proofs obtained to the Reinsurer for all claims that exceed the Ceding Company's Authority for Claim Approval as outlined in the following article.

If proof of the first death is received on a joint last-to-die plan, the Ceding Company will submit this promptly to the Reinsurer. Should this death take place within the contestable period, then the Reinsurer and the Ceding Company should consult to determine whether they wish to investigate the deceased, the survivor, or both insureds.

For claims other than death occurring within the contestable period of the policy where the Reinsurer reinsures the death benefit but not the benefit subject to claim, the Ceding Company will notify the Reinsurer of such claim. The intent is to allow the Reinsurer the opportunity to review the life risk to ensure that the contestability feature of the life policy is not jeopardized.

7.4 Authority for Claim Approval

The Reinsurer will accept the Ceding Company's decision to pay the claim for policy amounts up to:

- INSERT DETAILS HERE

For policies reinsured on an automatic basis, the Ceding Company is authorized to deny the claim and rescind the policy without prior approval from the Reinsurer for policy amounts up to $XXXXX.

For all other claims, the Ceding Company must obtain a nonbinding opinion from the Reinsurer prior to admitting any liability or making any settlement.

7.5 Rescission Prior to Claim

For policies reinsured on an automatic basis, the Ceding Company is authorized to rescind a policy without prior notification to the Reinsurer for policy amounts up to $XXXXX.

For all other cases, the Ceding Company will notify the Reinsurer promptly upon receiving new information on a reinsured policy when the Ceding Company believes that such new information may be grounds for rescission. The Ceding Company will provide such information to the Reinsurer for its review and secure the Reinsurer's nonbinding opinion prior to rescinding the policy. The Reinsurer will provide this opinion promptly.

If the Ceding Company returns premiums to the policyholder as a result of a policy rescission within the contestable period or as required by law or court order, the Reinsurer will refund the reinsurance premiums to the Ceding Company and the Ceding Company will refund the reinsurance allowances.

For all other situations where the Ceding Company returns premiums to the policyholder as a result of a policy rescission, the Reinsurer will not refund reinsurance premiums to the Ceding Company unless the Ceding Company has obtained the prior approval from the Reinsurer for such refund.

If the Ceding Company intends to initiate a court action for policy rescission or if the policyholder contests the Ceding Company's decision to rescind the policy, article 7.9 *Contest of Rescission or Claim* will apply to such contest.

7.6 Claim Payment

On death claims, the Reinsurer will pay its share in a lump sum to the Ceding Company without regard to the form of claim settlement.

In case of simultaneous death under joint first-to-die coverage, the Reinsurer will pay the Ceding Company the same multiple of the reinsurance amount payable upon the first death as the multiple paid by the Ceding Company under the policy.

The Reinsurer is not responsible for any part of usual expenses that the Ceding Company incurs in settling claims. Expenses in respect of contested claims are further clarified in the article 7.10 Expenses.

7.7 Misstatement of Age, Sex, or Smoking Status

In the event of an increase or reduction in the policy because of a misstatement of age or sex, being established after the death of the life insured, both parties will share in such increase or reduction, in proportion to their initial liabilities under the policy. The reinsurance cession form will be rewritten from commencement on the basis of the adjusted amounts using the reinsurance schedule and premiums at the correct age or sex, and an adjustment for the difference in reinsurance premiums without interest will be made.

A misstatement of smoking status shall render the reinsurance of the policy void.

7.8 Misrepresentation or Suicide

If the Ceding Company returns premiums to the policyholder or beneficiary as a result of misrepresentation discovered at time of claim for an insured event occurring during the contestable period or as a result of suicide occurring during the suicide exclusion period, the Reinsurer will refund the reinsurance premiums to the Ceding Company and the Ceding Company will refund reinsurance allowances.

7.9 Contest of Rescission or Claim

The Ceding Company will promptly notify the Reinsurer of any statement of claim or proceeding in court relating to any policy reinsured under this Agreement and will furnish details of such contest. The Reinsurer will then advise the Ceding Company in writing as to whether or not it agrees to participate in the contest within a reasonable time.
If the Reinsurer agrees to participate in such contest:

The Reinsurer will:

a) review all documentation provided by the Ceding Company with respect to the progress of the contest and make recommendations promptly and in writing;
b) share in the Ceding Company's liability, including any increase or reduction thereof, in proportion to its respective liability under this Agreement subject to article 2.3 *Extracontractual Payments*; and
c) pay its proportionate share of reasonable expenses directly resulting from such contest as described later in this section.

The Ceding Company will:

a) provide on-going updates to the Reinsurer with respect to the progress of the contest; and

b) will make every reasonable effort to secure the recommendation of the Reinsurer before proceeding to trial, admitting any liability, or making any settlement.

If the Reinsurer declines to participate in a contest of a claim:

The Reinsurer may do so and completely discharge its liability by payment of the Reinsurer's share of the benefit to the Ceding Company. In such case, the Reinsurer will neither share in any expenses thereafter incurred in contesting such a claim nor in any reduction in liability.

If the Reinsurer declines to participate in a contest of a rescission prior to a claim:

The Reinsurer will provide notice in writing to the Ceding Company that it will continue to accept its liability for the policy under this Agreement in the case of reinstatement. The Reinsurer will neither participate in the contest nor share in any expenses incurred in the contest of the rescission.

7.10 Expenses

Expenses directly resulting from the contest of a rescission or a claim reinsured under this Agreement and incurred by the Ceding Company subsequent to the issuance of a statement of claim or proceeding in court will be shared by the Reinsurer in the same proportion as such contested liabilities were shared at the time such expenses were incurred. Generally, shared expenses will include:

- external counsels' fees plus disbursements;
- investigative costs and expert witness' fees incurred with the prior agreement of the Reinsurer; and
- fees and expenses of the Ceding Company's in-house legal counsel so long as external lawyers are not engaged or involved in the contest of a rescission or a claim reinsured under this Agreement. The Ceding Company's in-house legal counsel fees will be determined by mutual agreement of the Reinsurer and the Ceding Company in writing from time to time. The Ceding Company will provide detailed billing statements similar to the billing statements of external legal counsel.

In no event will shared expenses include:

- the salaries or expenses of employees or other administrative costs of the Ceding Company with the exception of the Ceding Company's in-house legal counsel, as stipulated immediately above;
- fees incurred for supervision of in-house counsel by external counsel; or
- any share of any expenses associated with the determination of the entitlement to policy proceeds or benefits between competing claimants.

2.3 <u>Extracontractual Payments</u>

The Reinsurer will not participate in Punitive or Exemplary, Compensatory, or Aggravated Damages or any other type of extracontractual payments that are awarded against the Ceding Company as a result of an act, omission, or course of conduct committed solely by the Ceding Company, its agents, or representatives in connection with policies covered under this Agreement.

However, the parties recognize that in some situations the Reinsurer concurred in advance and in writing with the actions which were the basis for the assessment of the extracontractual payments. In these situations, the Reinsurer and the Ceding Company will share in such damages so assessed, in equitable proportions, but all factors being equal, the Reinsurer's assessments would be in proportion to the risk accepted for the policy involved.

The Reinsurer will not be liable for any extracontractual payments resulting from the Ceding Company's failure to implement agreed-upon actions, such as failure to file timely pleadings or to meet court or statutory deadlines.

If the Ceding Company wishes to pay any amount above and beyond what is contractually obligated, in order to maintain its public image, then the Ceding Company will accept the entire liability for such payment.

For the purpose of this article, the following definitions will apply:

> "Punitive or Exemplary Damages" are those damage amounts awarded by the court as redress for bad faith conduct and are intended to act as retribution, deterrence, or denunciation of this misconduct. The amount is neither governed nor fixed by statute.
>
> "Compensatory Damages" are those amounts awarded to compensate for the actual damages sustained, and are not awarded as a penalty, nor fixed in amount by statute.
>
> "Aggravated Damages" are court-ordered amounts that compensate claimants for intangible injuries such as mental distress, humiliation, or aggravating circumstances. These amounts are awarded even though the defendant has acted in good faith and its actions do not justify an award of exemplary or punitive damages.

It is understood that Punitive or Exemplary, Compensatory or Aggravated Damages may be awarded by a court of competent jurisdiction even though the Ceding Company has acted in good faith and its actions do not justify such an award in fact.

A.2.6 Changes of Plan (Conversions) (return to Section 5.6.2)

In some cases, the reinsurer declined to cover policies following conversion because they were not issued to the same legal entity as the original policy.

Example 1: Older Treaty Language

2. Term Renewals and Conversions.
   The renewal and conversion of term insurance shall be considered as a continuation of the original insurance for the purpose of calculating future reinsurance premiums.

Example 2: 1993 Treaty Language

Article IX Conversions

1. If at any time a policy reinsured under this Agreement is converted to a plan of Life insurance not covered under this Agreement, the Reinsurer shall receive the same amount of reinsurance on this new policy that it had reinsured before conversion, provided that the minimum amount of converted reinsurance to be ceded shall be $2,500.

2. It is agreed that the converted policy shall be subject to all terms and conditions of the Automatic YRT Reinsurance Agreement, if any, in force between the Ceding Company and the Reinsurer at the time of the conversion. If there is no Automatic YRT Reinsurance Agreement in force at the time of the conversion, the new policy shall be subject to the facultative reinsurance rates for YRT reinsurance in effect between the Ceding Company and the Reinsurer. Reinsurance premiums for the new policy shall be at attained age for the duration since the last check of insurability, except that the first premium will be reduced by 50 percent.

Example 3: Current Amendment to an Older Treaty

Special Condition (Amendment to handle Conversions from policies that the current company purchased to the current company's policies).

1. The Company and the Reinsurer have recognized a need to document the administration and treatment of term conversions of the term products originally issued by the former xxx.

2. The Company and the Reinsurer also recognize that the original agreements with the former xxx entities (hereinafter referred to as "the Original Agreements") specified that such Conversions were to be reinsured pursuant to the terms as set forth therein.

3. The Company and the Reinsurer wish to memorialize the treatment and reinsurance administration of the Conversions including, but not limited to, under which agreement

such Conversions shall be reinsured, the amounts to be reinsured and the reinsurance premium rates to be used for such Conversions.

Example 4: Current Treaty Language

NOWTHEREFORE, in consideration of these premises and the mutual covenants contained herein, the Company and the Reinsurer agree to amend the Agreement as of the Effective Date as follows:

1. Notwithstanding anything to the contrary in the Original Agreements, the Company and the Reinsurer agree that Conversions shall be reinsured in accordance with the terms of the Agreement and any amendment attached thereto.

2. Notwithstanding anything to the contrary in the Original Agreements, the Company agrees to cede and the Reinsurer agrees to accept ninety percent (90 percent) of each Conversion, but in no event shall the amount be greater than the original amount of term coverage reinsured at the time of the term conversion to a permanent product then offered by the Company.

3. The Company and the Reinsurer agree that those Conversions that convert to a permanent product offered by the Company shall be reinsured with the Reinsurer using the reinsurance premium rates as set forth in Schedule A attached hereto. Reinsurance premiums will be based on policy duration, attained age and classification as though the conversion was issued on the same date and at the same issue age as the original policy. Annual reinsurance premiums charged will be based on per thousand of the net amount at risk.

4. The provisions of this Amendment shall be subject to all terms and conditions of the Agreements which do not conflict with the terms hereof.

Example 5: Current Treaty Language

SCHEDULE A

Conversions to Single Life Plans.

1. Coverage will be maintained with the Reinsurer.

2. Conversions to Single Life Plans will use XXX percent of the percentages below of the 2008 VBT, Male/Female, Nonsmoker/Smoker, Select and Ultimate ANB Table on a point-in-scale basis.

Year	Gender	Iss Ages	Preferred Plus	Preferred NTU	Standard NTU	Preferred TU	Standard TU
1	Both	All	%	%	%	%	%
2-30	Male	0-59	%	%	%	%	%
2-20	Male	60+	%	%	%	%	%
31+	Male	0-59	%	%	%	%	%
21+	Male	60+	%	%	%	%	%
2-30	Female	0-59	%	%	%	%	%
2-20	Female	60+	%	%	%	%	%
31+	Female	0-59	%	%	%	%	%
21+	Female	60+	%	%	%	%	%

A.2.7 Premium Accounting (Rate Guarantee Language)

(return to Section 5.7.2)

In no event shall the Reinsurer increase the reinsurance rates on in-force YRT business ceded under this Agreement unless the Reinsurer also concurrently increases the reinsurance rates for all of its YRT reinsurance assumed individual life insurance business.

Example 1: Current Treaty Language

6.4 Premium Rate Guarantee

The Reinsurer intends to charge the same reinsurance premium rates that are in effect at inception throughout the duration of this Agreement. However, for technical reasons related to deficiency reserve requirements under statutory financial accounting rules, reinsurance premium rates are not guaranteed for longer than one year. Notwithstanding the one-year rate guarantee limitation, the Parties intend to clarify the terms and conditions upon which any future rate increase may be given effect for business covered under this Agreement as follows.

a. New Business. For rate increases to be effective and applicable to new business, the Reinsurer must provide the Ceding Company a minimum of ninety (90) days advance written notice prior to the Reinsurer's proposed rate increase effective date. If the Reinsurer provides notification of a rate increase on new business, the Ceding Company shall have the option to terminate this Agreement with respect to the reinsurance of new policies issued on or after the noticed rate increase effective date. To exercise such termination option, the Ceding Company shall provide written notice to the Reinsurer prior to the proposed rate increase effective date. If the Ceding Company exercises the termination option, the termination shall be effective as of 11:59 p.m. on the day prior to the date the rate increase is to be effective, or another day mutually agreed to by the Parties.

b. In-force Business. With respect to the in-force block of reinsured policies, any prospective rate increase under this Agreement shall be subject to the condition that the Reinsurer is simultaneously seeking to increase rates on its entire book of yearly renewable term ("YRT," including monthly renewable term) business where reinsurance rates are less than the mortality rates in the 2001 CSO table. To be effective, the Reinsurer must provide a minimum of ninety (90) days prior written notice of its intention to increase reinsurance premium rates applicable to in-force reinsured policies. Any increase in reinsurance premium rate must be commensurate with the actual experience and reasonably expected future performance on the Reinsurer's entire book of YRT business. Such increase shall be limited to a maximum rate that cannot be higher than the valuation net premiums for monthly renewable term insurance calculated using the applicable minimum statutory mortality rates and maximum statutory interest rate for each issue year.

If the Reinsurer provides notification of a rate increase on in-force business, the Ceding Company shall have the option to terminate this Agreement and recapture on the next policy anniversary of each policy. To exercise this termination option, the Ceding Company shall provide written notice to the Reinsurer prior to the proposed rate increase effective date. Any increase in rates applies only to reinsurance premiums due for policy anniversaries beginning after the expiration of the notice period. If the Ceding Company provides notice of intent to terminate, the termination and recapture will become effective on individual policy anniversary dates beginning no sooner than ninety (90) days after the Ceding Company has provided notice of its intent to terminate and will not be subject to the requirements specified under the Article 12, Recapture.

Example 2: Current Treaty Language

6.4 Premium Rate Guarantee

The Reinsurer intends to charge the same reinsurance premium rates that are in effect at inception throughout the duration of this Agreement. However, reinsurance premium rates are not guaranteed for longer than one year. Notwithstanding the one-year rate guarantee limitation, the Parties intend to clarify the terms and conditions upon which any future rate increase may be given effect for business covered under this Agreement as follows:

a. New Business. For rate increases to be effective and applicable to new business, the Reinsurer must provide the Ceding Company a minimum of ninety (90) days advance written notice prior to the Reinsurer's proposed rate increase effective date. If the Reinsurer provides notification of a rate increase on new business, the Ceding Company shall have the option to terminate this Agreement with respect to the reinsurance of new policies issued on or after the noticed rate increase effective date. To exercise such termination option, the Ceding Company shall provide written notice to the Reinsurer prior to the proposed rate increase effective date. If the Ceding Company exercises the termination option, the termination shall be effective as of 11:59 p.m. on the day prior to the date the rate increase is to be effective, or another day mutually agreed to by the Parties.

b. In-force Business. With respect to the in-force block of reinsured policies, any prospective rate increase under this Agreement shall be subject to the condition that the Reinsurer is simultaneously seeking to increase rates on Similar Business. For the purposes of this Article 6.4(b), Similar Business is defined as in-force reinsured policies with the following characteristics: a) level term business issued by any insurer, b) issued between 2010 and the date of termination of this Agreement for new business, c) reinsured by the Reinsurer on a YRT basis, and d) the reinsurance treaty has reinsurance rates that are not guaranteed. To be effective, the Reinsurer must provide a minimum of ninety (90) days prior written notice of its intention to increase reinsurance premium rates applicable to in-force reinsured policies. Any increase in reinsurance premium rate must be commensurate with the actual experience and reasonably expected future performance on the Reinsurer's entire book of YRT business. Such increase shall be limited to a maximum rate that cannot be higher than the valuation net premiums for monthly renewable term insurance calculated using the applicable minimum statutory mortality rates and maximum statutory interest rate for each issue year.

If the Reinsurer provides notification of a rate increase on in-force business, the Ceding Company shall have the option to terminate this Agreement and recapture such business on the next policy anniversary of each policy. To exercise this termination option, the Ceding Company shall provide written notice to the Reinsurer prior to the proposed rate increase effective date. Any increase in rates applies only to reinsurance premiums due for policy anniversaries beginning after the expiration of the notice period. If the Ceding Company provides notice of intent to terminate, the termination and recapture will become effective on individual policy anniversary dates beginning no sooner than ninety (90) days after the Ceding Company has provided notice of its intent to terminate and will not be subject to the requirements specified under the Article 12, Recapture.

Example 3A: Larry Warren's suggested language in the November 2012 *Reinsurance News*

We anticipate that the YRT rates shown in this agreement will be continued indefinitely for all business ceded under this agreement. However, because of statutory deficiency reserve requirements, the only guaranteed premiums are premiums equal to the 2001 CSO Mortality Table discounted with the maximum prevailing statutory interest rate according to the issue year.

Example 3B: Warren's suggested language in the November 2012 *Reinsurance News*

We may only increase YRT rates if we increase rates for our entire class of YRT business with **each** of our clients. If we increase YRT rates, then you have the right to immediately recapture without penalty or recapture fee, any business affected by such increase.

A.2.8 **Recapture** (return to Section 5.8.2)

Example 1: Current Treaty Language

a. If there is a “Change of Control” in the Ceding Company, as defined below, the Ceding Company may recapture all of the Policies reinsured hereunder and will be required to pay the Reinsurer a Recapture Fee, due at the end of the Accounting Period during which recapture occurs, which will equal the [product of a formula].

“Change in Control” means the Ceding Company ceasing to be an Affiliate of xx.

An “Affiliate” means Person that directly or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, a specified Person.

“Control” means the possession, directly or indirectly, of the power to direct, or cause the direction of, the management and policies of a Person, whether through the ownership of voting securities, by contract or otherwise.

“Person” includes an association, a corporation, a body corporate, a firm, a joint venture, an unincorporated body, an individual, a partnership, a trust, or any other entity or organization.

b. The Ceding Company may recapture the Policies reinsured hereunder effective after X Date without the payment of the Recapture Fee.

c. The Ceding Company may recapture the Policies reinsured hereunder, based on the conditions as set forth in Article x, Paragraph x (relating to obtaining reserve credit) without the payment of the Recapture Fee.

d. The Ceding Company may recapture the Policies reinsured hereunder in the event of the Reinsurer’s insolvency, as set forth in Article xx, Paragraph x.

e. On or after X date, the Ceding Company may recapture all or an equal the proportionate percentage of all the Policies subject to
   - (i) a Tax Event;
   - (ii) a Rating Agency Event; and/or
   - (iii) a Regulatory Event, subject to payment to the Reinsurer of a Recapture Fee for all or an equal percentage of all the Policies to be recaptured due at the end of the Accounting Period during which recapture occurs.

A.2.9 Change In Legal Control (return to Section 5.9.2)

Example 1A: Past Treaty Language
N/A

Example 1B: Current Treaty Language
Change in Control

A. The Parties agree that the prior written consent of a Party to continue this Agreement will be required with respect to any Change in Control. Any such consent required by a Party will not be unreasonably conditioned, withheld or delayed. For purposes of the foregoing, a "Change in Control" will occur with respect to a Party upon the:
   (i) Consummation of any merger, consolidation, liquidation, dissolution, reorganization or share exchange after which: (1) the Party is not the surviving entity; or (2) the Party's majority shareholder would not, directly or indirectly, beneficially own in excess of fifty percent (50 percent) of the capital stock of that Party; or
   (ii) Sale, transfer or other disposition of all or substantially all of the assets of the Party other than with or to an Affiliate of the Party; or
   (iii) Sale, transfer or other disposition or other change of ownership, directly or indirectly, of more than fifty percent (50 percent) of the capital stock of the Party other than with or to an Affiliate of the Party or other than as part of a transaction following which the Party's majority shareholder would, directly or indirectly, beneficially own in excess of fifty percent (50 percent) of the capital stock of the Party.

B. Failure to obtain the prior written consent of the Party not subject to the Change in Control will constitute a breach of this Agreement and will, at that Party's option: (i) terminate this Agreement with regard to new reinsurance; or (ii) allow the recapture of [all][any portion of the] Original Policies ceded under this Agreement; or (iii) have no effect on the continuation of this Agreement. Selection of any such option shall be provided by written notice to the Party subject to the Change in Control ninety (90) days prior to the effective date of any such option.

C. The Ceding Company reserves the right to recapture all Original Policies ceded under this Agreement in the event the Reinsurer is acquired by another entity if the Ceding Company determines, in its sole opinion, that the resulting entity's participation in any reinsurance risk pool exceeds the Ceding Company's internal pool limits.

Example 2: Proposed Standard Wording (treaties dated 2010 and later)
Reinsurer Change in Control
The Reinsurer shall provide written notice to Ceding Company at least ninety (90) days prior to a "Change in Control" involving the Reinsurer. A "Change of Control" will be deemed if the Reinsurer merges with or becomes acquired by or controlled by, either directly or indirectly, any company, corporation, entity or individual(s) not controlling the Reinsurer at the inception of this Agreement.

If the noticed Change in Control would cause the Ceding Company to violate its internal risk concentration or credit risk guidelines, the Ceding Company shall have the option to terminate the Agreement and recapture all ceded policies under the Agreement, which shall be effective upon the effective date of the Change in Control or such later date as determined by the Ceding Company in its sole discretion. To exercise the termination and recapture option, the Ceding Company shall provide the Reinsurer written notice of its intent to exercise the termination and recapture right no later than sixty (60) days following receipt of the Reinsurer's written notice advising of the impending Change of Control.

Example 3: Proposed Standard Wording (treaties dated 2010 and later)
Reinsurer Change in Control
The Reinsurer shall provide written notice to Ceding Company upon public notice of a "Change in Control" involving the Reinsurer. A "Change of Control" will be deemed if as any event in which [Parent Company] no longer has a controlling interest in the Reinsurer.

If a noticed Change in Control occurs, the Ceding Company shall have the option to terminate the Agreement and recapture all ceded policies under the Agreement at mutually agreed-upon terms. The recapture shall be effective upon the effective date of the Change in Control or such later date as determined by the Parties. To exercise the termination and recapture option, the Ceding Company shall provide the Reinsurer written notice of its intent to exercise the termination and recapture right no later than sixty (60) days following receipt of the Reinsurer's written notice advising of the Change of Control.

A.2.10 Errors and Omissions (return to Section 5.10.2)

Example 1: Older Treaty Language

Errors and Dispute Resolution

10.1 Errors and Omissions

Any unintentional or accidental failure to comply with the terms of this Agreement which can be shown to be the result of an oversight or clerical error relating to the administration of reinsurance by either party ("Error") will not constitute a breach of this Agreement. Upon discovery, the Error will be promptly corrected so that both parties are restored to the position they would have occupied had the Error not occurred. Should it not be possible to restore both parties to this position, the party responsible for the Error will be responsible for any resulting liabilities and expenses. The Reinsurer will not be responsible for negligent or deliberate acts of the Company.

However, nothing in this section shall be used or be construed:

10.1.1 To extend the liability of the Reinsurer beyond any of the limits specified in this Agreement or to extend the liability of the Reinsurer to cover any risk or class of insurance generally or specifically excluded from this Agreement;

10.1.2 To allow the Company to alter its retention on any Policy reinsured hereunder after the occurrence of a loss on such Policy; or

10.1.3 To impose any greater liability on the non-erring party than would have attached if the Error had not occurred.

For greater certainty, the following, while not an exclusive or exhaustive list, shall not be considered Errors:

10.1.4 Any failure by the Company or its agents or representatives to comply with the conditions precedent to automatic reinsurance coverage, the use of prudent underwriting judgment or the rules relating to Business Decisions as set forth in Article 2 of this Agreement;

10.1.5 Any material failure by the Company to comply with Policy terms or its Standard Claims Guidelines and Practices in conjunction with the adjudication of claims;

10.1.6 Any failure to provide the Reinsurer with notice of material changes to (i) the Company's Underwriting Guidelines, (ii) the Company's Standard Claims Guidelines and Practices, or (iii) any Policy form or product specification;

10.1.7 Facultatively submitted business for which the Company failed to notify the Reinsurer of the Company's acceptance of the Reinsurer's facultative offer pursuant to Article 3 of this Agreement; or

10.1.8 Repetitive and systemic Errors in administration or reporting by the Company, for which the Company is on notice, that are not rectified within a reasonable period of time.

Example 2: Current Treaty Language

I. Errors and Omissions: If either the Ceding Company or the Reinsurer commits an unintentional error, oversight or misunderstanding (collectively referred to as "errors") in administering this Agreement, and upon the discovery of the error by either party the other party is promptly notified, the error shall be corrected by restoring both parties to the positions they would have occupied had the error not occurred, however, nothing in this section shall operate or be construed:

1. to extend the liability of the Reinsurer beyond any of the limits specified in this Agreement or to extend the liability of the Reinsurer to cover any risk or class of insurance excluded from this Agreement;

2. to impose any greater liability on the Reinsurer than would have attached if the error had not occurred; or

3. to excuse Material Underwriting Errors. A "Material Underwriting Error" as used in this Agreement shall mean an underwriting error where a policy that did not meet the requirements for issuance under the underwriting rules or sound underwriting judgment as set forth in accordance with Article II of this Agreement was inadvertently issued (i.e., a policy was issued in response to an application that should have been declined). Any other underwriting errors that occur in connection with the underwriting of the Policies reinsured under this Agreement are considered "Immaterial Underwriting Errors."

   The Reinsurer's liability for any policy reinsured on an automatic basis where a Material Underwriting Error has occurred shall be limited to a refund of any reinsurance premium it received for the policy. Such refund shall be made without interest.

   In the event of an Immaterial Underwriting Error, such restoration shall be governed by the terms of this Agreement and shall include, but not be limited to, the Ceding Company's payment to the Reinsurer of the appropriate premium for the risk, effective back to the date of policy inception, in accordance with the underwriting rules.

Moreover, where such an error occurs, the Ceding Company shall audit its records for similar errors and take the reasonable actions necessary to correct errors discovered in such audit.

If it is not possible to restore each party to the position it would have occupied had the error not occurred, the parties shall endeavor in good faith to fashion a resolution to the situation created by the error that is fair and reasonable and most closely approximates the intent of the parties as evidenced by this Agreement. Any grossly negligent or deliberate acts or omissions by the Ceding Company or its agents regarding the insurance provided are the responsibility of the Ceding Company and its liability insurer, if any, but not that of the Reinsurer.

Example 3: Current Treaty Language

In the event that either the Ceding Company or the Reinsurer fails to comply with any terms of this Agreement, and if such failure is shown to be unintentional and the result of an error, oversight or omission in the administration of this Agreement (collectively referred to as "Error(s)"), then this Agreement will not be deemed abrogated thereby. Both the Ceding Company and the Reinsurer will be restored, to the extent possible, to the respective positions that they would have occupied had no such failure occurred.

This article shall not be construed to initiate the Reinsurer's liability if the conditions of article 1.1 *Automatic Reinsurance* or article 1.2 *Facultative Reinsurance* are not met.

If it is impossible or inequitable in the circumstances for both parties to be restored to the position they would have occupied had the Error not occurred, then the parties will agree to an equitable result having regard to the nature of the relationship and all of the circumstances, including any financial harm caused by such error to the non-defaulting party.

This clause will not serve to relieve either party from making every reasonable effort to perform its obligations within the time standards either recommended herein or otherwise mutually agreed upon. Unless an agreement has been reached with the Reinsurer beforehand, the Ceding Company will be liable for the entire risk when the required reinsurance has not been reported to the Reinsurer in a timely manner due to continuous back-log in the Ceding Company's administration.

There is a mutual obligation on both the Ceding Company and the Reinsurer to ensure that all Errors (both favorable and unfavorable) are identified and corrected in an equitable manner at the earliest possible date. The party first discovering the Error will notify the other party in writing promptly upon discovery thereof, and the parties shall act to correct such failure promptly. Any monetary adjustments made between the Ceding Company and the Reinsurer to correct an Error will be made with interest as long as it does not benefit the party that made such Error.

This article shall apply only to Errors relating to the administration of reinsurance covered under this Agreement and not to the administration of the insurance provided by the Ceding Company to its insured. Any negligent or deliberate acts or omissions by the Ceding Company regarding the insurance provided are the responsibility of the Ceding Company and its liability insurer, if any, and not that of the Reinsurer.

If either party discovers that the Ceding Company has failed to cede the reinsurance as provided in this Agreement, or failed to comply with its reporting requirements, the Reinsurer may require the Ceding Company to audit its records for similar Errors and to take the actions necessary to avoid similar Errors in the future.

This article shall not be construed as a waiver by either party of its right to enforce strictly the terms of this Agreement nor shall any resolution of an Error adopted by the parties set a precedent for the handling of any other Error.

If seven (7) years have elapsed since the Error occurred, there will not be rectification as above, unless both the Ceding Company and the Reinsurer agree to such rectification.

The following situations are not considered Errors, for the purposes of this article:

a) Grossly negligent or deliberate acts;
b) Business decisions to materially vary from agreed to underwriting, administration or claims practices without the agreement of the Reinsurer (e.g., waiving a normal underwriting rule or requirement or accepting a risk with a rating lower than the rating required by the underwriting manual without sound justification);
c) Repetitive errors, meaning any error made after the Ceding Company has been requested, after the occurrence of one or more similar errors, to audit its records and/or take other reasonable remedial actions to avoid such similar errors and has failed to do so within a reasonable time, unless the Ceding Company can show that the error would likely have occurred even if the remedial measures had been undertaken in good faith and on a timely basis;
d) Any failure to arrange for the required reinsurance under this Agreement due to the Ceding Company's practice of conducting a limited search of its records for other prior in-force insurance on the same individual insured;
e) Facultatively submitted business where the Ceding Company has either not notified the Reinsurer of its acceptance of the Reinsurer's unconditional offer within the period specified in the offer or incorrectly advised the Reinsurer to close its file.

In any of the above circumstances, the Reinsurer has the right to deny liability on the cession; however, in certain circumstances, the Reinsurer may consider such case on a facultative-obligatory basis.

A.2.11 Change in Rating/Financial Control (return to Section 5.11.2)

Change in Ratings
Example 1A: Past Treaty Language
N/A

Example 1B: Current Treaty Language
During the term of this Agreement, the Parties will endeavor to maintain ratings with A.M. Best of at least X and with Standard and Poor's of at least X. If a Party's ratings are downgraded by both A.M. Best and Standard and Poor's and both rating organizations consider the downgrade to be effective long-term (rather than temporary), the other Party will have the right, at its option, to: (i) terminate this Agreement for new business; (ii) recapture [all][any portion of the] Original Policies ceded under this Agreement; or (iii) consider the downgrade to have no effect on the continuation of this Agreement. Selection of any such option shall be provided by written notice to the Party subject to the change in ratings ninety (90) days prior to the effective date of any such option.

Change in Financial/Capital Ratios
Example 2A: Past Treaty Language
N/A

Example 2B: Current Treaty Language
During the term of this Agreement, the Reinsurer shall notify the Ceding Company within X business days of the occurrence of one or more of the following:

(i) Failure to maintain risk based capital (RBC), as measured by the formula prescribed by the insurance department of the Ceding Company's state of domicile, of no less than X percent of the authorized control level RBC;

(ii) A Change in Control of the Reinsurer, where "Change in Control" is signaled by the requirement that the Reinsurer file such change with any insurance department or with the Securities Exchange Commission;

(iii) A material change in the overall credit quality of the Reinsurer's investment portfolio from the Effective Date; where "material change" means the quality rating pursuant to the NAIC designation for more than 20 percent of all securities in the Reinsurer's investment portfolio is of a lower quality than an NAIC 2 rating;

(iv) A change in the Reinsurer's insurance financial strength rating as assigned by A.M. Best company to less than X; and

(v) A financial leverage ratio of the Reinsurer of greater than X percent; where "financial leverage ratio" means the principal amount of senior and subordinated indebtedness outstanding, excluding any advances from the Federal Home Loan Bank, at the Reinsurer divided by the sum of: (a) total capital and surplus, plus (b) the asset valuation reserve, plus (c) the interest maintenance reserve, where (a), (b), and (c) are the respective amounts as reported on the Reinsurer's most recent statutory financial statements as filed with the state of domicile of the Ceding Company.

Example 3: Current Treaty Language

Insolvency and Financial Impairment

1. Insolvency of a Party to this Agreement

   A party to this Agreement will be deemed insolvent when it:

   a. applies for or consents to the appointment of a receiver, rehabilitator, conservator, liquidator, or statutory successor of its properties or assets; or
   b. is adjudicated as bankrupt or insolvent; or
   c. files or consents to the filing of a petition in bankruptcy, seeks reorganization to avoid insolvency, or makes formal application for any bankruptcy, dissolution, liquidation, or similar law or statute; or
   d. becomes the subject of an order to rehabilitate or an order to liquidate as defined by the insurance code (or other applicable law) of the jurisdiction of the party's domicile.

2. Insolvency of the Ceding Company

In the event of the insolvency of the Ceding Company, all reinsurance payments due under this Agreement will be payable directly to the liquidator, rehabilitator, receiver, or statutory successor of the Ceding Company, without diminution because of the insolvency, for those claims allowed against the Ceding Company by any court of competent jurisdiction or by the liquidator, rehabilitator, receiver, or statutory successor having authority to allow such claims.

In the event of insolvency of the Ceding Company, the liquidator, rehabilitator, receiver, or statutory successor will give written notice to the Reinsurer of all pending claims against the Ceding Company on any policies reinsured within a reasonable time after such claim is filed in the insolvency proceeding. While a claim is pending, the Reinsurer may investigate and interpose, at its own expense, in the proceeding where the claim is adjudicated, any defense or defenses that it may deem available to the Ceding Company or its liquidator, rehabilitator, receiver, or statutory successor.

The expense incurred by the Reinsurer will be chargeable, subject to court approval, against the Ceding Company as part of the expense of liquidation to the extent of a proportionate share of the benefit that may accrue to the Ceding Company solely as a result of the defense undertaken by the Reinsurer. Where two or more Reinsurers are participating in the same claim and a majority in interest elects to interpose a defense or defenses to any such claim, the expense will be apportioned in accordance with the terms of this Agreement as though such expense had been incurred by the Ceding Company.

The Reinsurer will be liable only for the amounts reinsured and will not be or become liable for any amounts or reserves to be held by the Ceding Company on policies reinsured under this Agreement.

3. Insolvency of the Reinsurer

In the event of the Reinsurer's insolvency, the Ceding Company may immediately cancel the Agreement for future new business and will notify the Reinsurer in writing of its intent. The parties agree to waive the notification period (as provided in Article X, Duration of Agreement) for this cancellation. The effective date will be no earlier than the effective date of the Reinsurer's insolvency.

Upon giving written notice to the Reinsurer, in accordance with this Section 3, the Ceding Company may also recapture, without penalty, all of the in-force business reinsured by the Reinsurer under this Agreement.

4. Financial Impairment of the Reinsurer

In the event that the Reinsurer becomes financially impaired (as defined in this Section), the Reinsurer will have one hundred eighty (180) days to cure such impairment (the recovery period). Curing the impairment means restoring the triggered item to above the trigger point. During the recovery period, the Ceding Company agrees to defer any decision regarding Recapture to allow the Reinsurer the opportunity to restore the triggered item to above the trigger point. If at the end of the recovery period, the impairment is not cured, the Ceding Company shall have the right in its sole and absolute discretion, but not the obligation, to recapture from the Reinsurer all reinsurance in force under this Agreement by providing written notice of its intent to recapture. Such notice must be provided to the Reinsurer within eighteen (18) months of the Reinsurer's financial impairment. The date of the Reinsurer's financial impairment is deemed (as the case may be) to be the date of the rating agency action(s) or the date the Ceding Company receives notice of the triggering Risk-Based Capital (RBC) level, as these are set forth below.

The Reinsurer will be considered financially impaired if:

(1) The ratio of Total Adjusted Capital to Company Action Level Risk-Based Capital falls below 150 percent; or

(2) Any one of following rating downgrades occurs:
   (a) Its Standard & Poor's Financial Strength rating falls below BBB+ at any time; or,
   (b) Its Moody's rating for Insurance Financial Strength falls below A3 at any time; or,
   (c) Its A.M. Best rating falls below A- at any time; or,
   (d) Its Fitch Claims Paying rating falls below A- at any time.

Discontinuance of an agency's rating at the Reinsurer's request will be considered a downgrade by that agency and may trigger Recapture in accordance with the above, unless a nationally recognized rating agency is substituted for the discontinued rating agency, with a rating assigned which is at an equivalent rating level to that discontinued.

If a rating or RBC Ratio falls to or below a triggering level but is subsequently improved above such triggering level, the original trigger level for ratings or the RBC Ratio will again be effective.

If the improved rating was used to determine the Reinsurer's financial impairment, the eighteen (18) months Recapture notice period is terminated as of the date the Ceding Company receives written notice of the improved rating.

Once the Reinsurer is considered financially impaired based on the rating trigger, any further drop in its rating(s) by the rating agency(ies) used to determine its impairment will be considered a subsequent financial impairment which will start a new eighteen (18) months Recapture notice period, measured from the date of the most recent ratings action.

The effective date will be no earlier than the date the Ceding Company notifies the Reinsurer in writing of its intent to recapture.

In the event of the Reinsurer's financial impairment, the Ceding Company may immediately cancel the Agreement for future new business and shall notify the Reinsurer in writing of its intent. The parties agree to waive the notification period for this cancellation (as provided in Article X, Duration of Agreement). The effective date will be no earlier than the effective date of the Reinsurer's financial impairment.

5. Transfer of Funds upon Recapture

If the Ceding Company exercises its right to Recapture any reinsurance in force under this Agreement, as provided herein, the following payments will be made between the two parties:

1. Recapture Settlement

   The Reinsurer will pay the Ceding Company any Unearned Premium as of the effective date of recapture and all claims incurred prior to the effective date of recapture.

   Such claims include:

   a. all settled claims as of the effective date of Recapture,
   b. all pending claims as of the effective date of Recapture as these claims become settled, and
   c. all incurred but not reported claims with a date of death prior to the effective date of Recapture that are reported to the Ceding Company within a period of one (1) year following the effective date of Recapture. These claims will become due and payable by the Reinsurer as they are settled by the Ceding Company.

2. Recapture Fee

   If the Ceding Company recaptures any reinsurance in force under this Agreement as a result of the Reinsurer's financial impairment as defined in Section 4, the Ceding Company will pay the Reinsurer a recapture fee

Special Recapture

In the event that any two of the Reinsurer's financial strength ratings (or, if such rating agency modifies its rating system, the equivalent rating under the modified system) fall below the following levels:

Agency	Minimum Acceptable
S & P	A-
A.M. Best	B++
Fitch	BBB+
Moody's	Baa1

for ninety (90) consecutive business days, and Reinsurer neither provides security or transfers the business as provided in sub-paragraphs a. through d. below, then the Ceding Company may immediately recapture reinsurance ceded under this Agreement. In the event business reinsured under this Agreement becomes eligible for special recapture hereunder, the Ceding Company shall provide prompt written notification to the Reinsurer of its intent to recapture.

a. If the Reinsurer provides security, the security shall be equivalent to the Reinsurer's share of Statutory Reserves for the insurance risks ceded under this Agreement.

b. Such security will be provided within sixty (60) days after the date the Ceding Company provides notice that such additional security is required. Such security will be maintained during the entire period that the Reinsurer's ratings with any two agencies are below the levels stated above.

c. The amount of such security shall be equivalent to that required to enable the Ceding Company to take statutory reserve credit for the reinsurance ceded under this Agreement in all United States jurisdictions in which the Ceding Company is required to file statutory financial statements. The form of security may be (i) assets in trust (in the manner specified in Article 30 of this Agreement) or (ii) other security that is acceptable to the Ceding Company.

d. Reinsurer may transfer the reinsurance effected under this Agreement to another reinsurer by assignment of this Agreement or otherwise, provided that such other reinsurer at the time of said transfer, has an A.M. Best rating of (A) or better and accepts a transfer by assignment of this Agreement (inclusive of all amendments) without materially modifying the substantive terms thereof and pays compensation for the value of the business.

2. In the event the Reinsurer unilaterally decreases the reinsurance allowances as set forth in Exhibit C or increases the annual premium rates to which such allowances apply to a level unacceptable to the Ceding Company, then the Ceding Company at its option may recapture all of the business reinsured in accordance with paragraph 4 below by first providing prompt written notification to the Reinsurer.

3. Beginning Date of Recapture and Effect on the Reinsurer's Liability and Reinsurance Premiums. A mutually agreed upon beginning date of recapture will be established. The beginning date of recapture may be any date on or following the date of notice by the

Ceding Company of its intention to initiate a recapture program. If the parties cannot agree on a beginning date, such date will be the date of notice of recapture given by the Ceding Company pursuant to paragraph 1 or 2 above. Recapture shall not release the Reinsurer or the Ceding Company from liability for any outstanding amounts due to the other party prior to the recapture. If premiums have been paid on the reinsurance for a period beyond the date of recapture of any policy, the Reinsurer will refund any unearned reinsurance premiums. However, policy fees, if any, will be deemed earned for a policy if the policy is reinsured during any portion of that policy year.

4. This Special Recapture provision shall survive the termination of this Agreement.

A.2.12 **Offsetting/Netting Provisions** (return to Section 5.12.2)

Example 1: Current Treaty Language

Article N. OFFSET
Any undisputed debts or credits with respect to this Agreement, whether in favor of or against either the Reinsurer or the Ceding Company, are subject to recoupment and only the balance will be allowed or paid. In addition, any undisputed mutual debts or credits with respect to this Agreement or any other agreement between the parties may be offset and only the balance will be allowed or paid.

The rights of offset and recoupment shall not be affected or diminished because of the insolvency of either party. The intent of the parties is that recoupment and offset shall be permitted to the maximum extent allowed by law.

To the extent the Ceding Company subtracts the amount of claim payments due from the amount of premium it owes the Reinsurer prior to the Reinsurer's review and approval of any such claim amounts, such netting will be allowed only under the Reinsurer's reservation of rights. For the avoidance of doubt, the right of offset set forth above only applies to amounts that are undisputed by both parties. As such, in the event that a disputed claim is netted from the premium due to the Reinsurer, the Reinsurer will be entitled to reimbursement of any such amount either by repayment of the amount or by subtracting the amount from other claim amounts owed to the Ceding Company.