Court ruling creates delayed gender crisis for European markets

The decision by the European Court of Justice to ban the use of gender in the underwriting process while not unexpected will cause a rethink for the direct and reinsurance markets both in non-life and life classes

The court did give the market some valuable breathing space with the new rules not coming into force until December 2012. From that point gender will not be an acceptable underwriting criteria for the market.

As the decision was handed down Michael Mendelowitz, Dispute Resolution Lawyer and Head of the contentious insurance and reinsurance practice at Norton Rose LLP said that the core ingredient for any smooth transition in terms of reinsurance programmes will be a common sense approach by both parties.

"My feeling would be that pricing will not be an immediate issue, loss exposures – whether on an accident/occurrence/event basis or in the aggregate – are unlikely to change significantly if at all," he said. "A more difficult question will be the adequacy of premium rates: the natural tendency of underwriters will be to increase the rates which are currently lower than to decrease the rates which are higher, but the markets which we're talking about - particularly motor - are fiercely competitive, so one should probably expect an evening out of rates in the medium to longer term."

Mr Mendelowitz added: "The market will need, first of all, to consider very carefully the exact terms of the declaration that the court has made: my understanding is that the case has gone forward to date simply on an issue of constitutional law – i.e. is the Belgian legislation which enacts the derogation from the Gender Directive valid or not? A finding that EU member states or insurers in those states have been breaching the EU Treaty or Charter of Fundamental Rights does not necessarily mean that the policies that the insurers have written up to now are void or even voidable. If however the upshot is that certain policies are indeed invalid, then – although a transitional period may be illogical in the circumstances – insurers and reinsurers can be expected to behave sensibly and use the breathing space to renegotiate reinsurances of policies which may be invalid. If such renegotiations fail, the proper legal analysis would seem to be that all affected reinsurance contracts will be automatically terminated by reason of frustration. The parties will have to make restitution of benefits received with a view to putting each other back into the position which they were before the contracts were entered into. That, however, is bound to cause practical difficulties.

"I would expect the market to behave rationally and not to panic. Most reinsurers will probably seek to initiate a dialogue with insurers and vice versa. Some parties may, however, see this as an opportunity to escape from contracts which have turned out to be commercially disadvantageous and will therefore argue that as the original contracts are invalid, the insurer has no risk to reinsure. We can therefore expect disputes to arise."

Katie Tucker, Lawyer in the Insurance group at law firm Pinsent Masons, said the delay in implementation gave the industry a vital buffer to ensure its approach will meet with the new guidelines, but there remained a huge level of uncertainty.

"The inclusion of a transitional period under the judgment will provide a huge relief for insurers," she added. "This is good news for the insurance industry that will have a decent amount of time in which to bring their systems and processes into line. The transitional period reflects the Court's appreciation of the huge change its ruling will mean for the way in which the insurance industry prices and provides benefits under insurance. A real concern is the remaining uncertainty relating to the impact of the judgment on premiums and benefits for policies written prior to 21 December 2012. It will therefore be important for the FSA to be fully engaged with the issues."

INDUSTRY VIEW

US Court amplifies uncertainty while adopting House of Lords' viewpoint

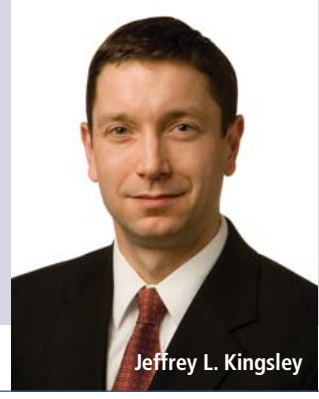
Reinsurance disputes have traditionally been resolved by a panel of arbitrators pursuant to an arbitration clause. The system is tried and tested, but not always seen as the most beneficial to one or more parties once a dispute arises. With increasing frequency, a party will proceed to court in an attempt to secure relief in the judicial system over arbitration. It has thus become ever so important to understand the jurisdictions where a dispute could be venued. Strategic and practical decisions can then be made with respect to seeking or opposing arbitration.

While there is a strong judicial predisposition toward enforcing valid arbitration agreements, a concern among many reinsurance professionals is whether a court in the United States will appreciate the unique nature of the reinsurance industry. This fear of uncertainty in the judicial system is not without merit since in recent years courts in the United States have taken an active role in setting aside arbitration panel decisions for a variety of reasons – few of which take into account the practical realities of the industry.

Further amplifying the concern over whether United States' courts understand the unique relationships surrounding a reinsurance agreement, the United States Court of Appeals for the Second Circuit recently addressed the follow-the-fortunes doctrine. In *Arrowood Surplus v. Westport Insurance Co.*, the Second Circuit found that a reinsurer is not obligated to fund its cedent's settlement because the losses fell outside of the time period outlined in the reinsurance agreement. The case involved a dispute over whether the Arrowood policy provided one or three years of coverage to the policyholder. Arrowood eventually conceded three and then sought reimbursement from Westport. Simply stated, the Second Circuit declared that the follow-the-fortunes provision cannot be viewed so broadly as to negate the express terms of the reinsurance agreement. Furthermore, the court opined that to view the follow-the-fortunes clause so broadly would effectively change the terms and conditions of the agreement.

If the holding in *Arrowood Surplus v. Westport* sounds familiar, it is because this same language and justification was used by the House of Lords in issuing its' 2009 decision in *Wasa v. Lexington*. While some in the reinsurance industry wondered what more the cedent might have done in *Wasa* to protect itself, proponents of the *Wasa* decision nevertheless praised the House of Lords' ability to take into account the commercial practicalities an adverse decision would have on the reinsurance industry. After the decision, however, it was uncertain whether jurisdictions beyond the United Kingdom would appreciate the practical significance of the reinsurance agreement.

The Second Circuit's decision and holding in *Arrowood* illustrates that jurisdictions outside the United Kingdom are looking at the practical long-term significance in rendering a decision. Nonetheless, this begs the question as to whether the true intent of the follow-the-fortunes doctrine is applied, and whether an arbitration panel would view the dispute the same as a court. Both the *Arrowood* and *Wasa* decisions continue to illustrate the need to understand the legal landscape and strategic implications of proceeding to court or arbitration.



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