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Accident Benefit Carve-out Considerations

The introduction of Statutory Accident Benefit "carve-outs" into Automobile excess reinsurance prompts a number of questions about the interaction of carve-out and residual reinsurance. The need for a clear understanding of this interaction becomes even more imperative when carve-out is described as "inuring to the benefit" of the residual P&C reinsurer.

- Insurers and reinsurers must understand and agree the methods to be used in allocating costs and other expenses between a carve-out and a residual reinsurer or between a carve-out claimant and other claimants involved in the same accident.

- The responsibility for OEF 45 is generally made clear in new proposals. However, there may be other "accident benefits" which, though not strictly Statutory Accident Benefits, are only assumedto be the responsibility of the carve-out market. As an example, a creative claim settlement (eg. buying a business venture in lieu of income replacement) may be rejected by carve-out markets as non-Statutory.

- Commutation by carve-out reinsurers is understood to be full and final, but it should be determined that this applies to all parties. Insurers and residual reinsurers should agree if commutation of a claimant will be conducted simultaneously with carve-out commutation regardless of commutation period of the residual reinsurer. At the very least, the residual reinsurer must establish to whom any subsequent deterioration or improvement in the settlement value of that particular claimant will fall.

- P&C reinsurers are familiar with the concept of one treaty "inuring to the benefit" of another, as in the case of a property risk excess treaty inuring to the benefit of a catastrophe treaty. Unfortunately, this simple comparison is extremely dangerous.

- In the case of Statutory Accident Benefit carve-outs, "inuring" may indicate agreement that any and all AB claims rejected by the carve-out reinsurers due to exclusions, agreement limitations (above and beyond the limited reinstatements normally advised), sunset, refusal or failure to meet obligations for whatever reason, or any other cause not previously contemplated, will fall to the residual reinsurers. The "inuring" clause may well transfer liability to P&C reinsurers for defaulting life reinsurers, certain legal costs associated with the AB claimant, changes in accident benefits, and any number of other exposures which are only assumedto belong to the carve-out market.

- Many, if not all, carve-out commutation wordings apply full and final commutation to the treaty and not simply to individual claims. This constitutes a sunset feature not merely for unreported claims, but also for open claims below the retention at the date of commutation. Insurers and reinsurers must recognise this subtle but extremely important distinction which separates carve-out commutations from the intent of "Sunset Clauses" used by P&C reinsurers in the mid-1980s.. If claims are not reported to the carve-out, or if they are reported, but are reserved below the retention at the date of commutation, residual reinsurers must assume the "sunrise" of both unreported losses and losses which subsequently deteriorate into the layer. For this reason, residual reinsurers must understand how the insurer intends to commute the treaty with the carve-out reinsurer.

- The absence of any agreement or understanding between the insurer and the residual reinsurer can only serve the interests of the carve-out market. The carve-out market will undoubtedly find it much easier to negotiate commutation and coverage disputes when the P&C reinsurer has unwittingly offered a broad safety net for “all remaining loss.”

These, and other possible questions, suggest that insurers and P&C reinsurers must communicate the details of accident benefit carve-outs and establish, through discussion and negotiation, the extent of residual protection, as well as the limitations, both stated and unstated, of carve-out agreements. Only then can the true value of the carve-out protection be assessed.