

ARBITRATION 101: WHAT EVERY ACTUARY SHOULD KNOW ABOUT ARBITRATION

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WHAT IS ARBITRATION?

- A private system of dispute resolution.
- Available only if the parties agree to arbitrate.
- Defined by the parties' agreement.

WHY AGREE TO ARBITRATION?

- Faster than litigation?
- Cheaper than litigation?
- Confidential?
- Expert arbitrators?

WHAT ARE THE RULES?

- Federal Arbitration Act
- State Arbitration Statutes
- Forum Rules (e.g., AAA)
- Ad Hoc Arbitration

THE FEDERAL ARBITRATION ACT

- Enacted in 1925
- Responded to judicial hostility to arbitration
- Provides for the enforcement of arbitration agreements (9 U.S.C. §2)
- Applies to interstate and international commerce

THE FEDERAL ARBITRATION ACT

- Authorizes courts to enforce arbitration agreements
 - Stay litigation: 9 U.S.C. §3
 - Compel arbitration: 9 U.S.C. §4
 - Appoint arbitrator: 9 U.S.C. §5

THE FEDERAL ARBITRATION ACT

- Authorizes courts to confirm, vacate or modify arbitration awards
 - Confirmation: 9 U.S.C. §9
 - Vacatur: 9 U.S.C. §10
 - Modification: 9 U.S.C. §11

STATE ARBITRATION STATUTES

- Generally similar to FAA
- Limited application to insurance/reinsurance disputes
- But can apply if parties agree

REINSURANCE ARBITRATION

- Arbitration clauses more prevalent in treaties than in facultative certificates
- Reinsurance arbitration clauses typically do not specify rules – i.e., ad hoc

THE ARBITRATION CLAUSE

Any dispute or claim arising out of or relating to this Agreement, including its formation or validity, shall be referred to arbitration. . . .

Arbitration shall be conducted before a three-person Arbitration Panel appointed as follows. Each party shall appoint one arbitrator, and the two arbitrators so appointed shall then appoint a neutral arbitrator before proceeding. . . . The arbitrators and Umpire shall be either present or former executive officers of insurance or reinsurance companies, or arbitrators certified by ARIAS●US. . . .

The Honorable Engagement Clause

The arbitrators and Umpire shall interpret this Agreement as an honorable engagement, and shall not be obligated to follow the strict rules of law or evidence. In making their award, they shall apply the custom and practice of the insurance and reinsurance industry, with a view to effecting the general purpose of the Agreement.

THE ROLE OF ARIAS

- AIDA Reinsurance and Insurance Arbitration Society
 - Certifies arbitrators
 - Develops rules and guidelines for arbitrations
 - Promulgates ethical standards (Code of Conduct)
 - Provides education
 - But not an arbitral forum like the AAA

ANATOMY OF AN ARBITRATION

- Step 1: the demand for arbitration
 - Generally minimal

ANATOMY OF AN ARBITRATION

- Step 2: appointment of an arbitration panel
 - The tripartite panel
 - Party appointed arbitrators
 - Partisan or neutral?
 - ARIAS neutral panel rules.
 - The umpire.
 - The real decision-maker?
 - The potential for gamesmanship.

ANATOMY OF AN ARBITRATION

- Step 3: Organizational meeting
 - Position statements
 - Setting the ground rules
 - The schedule.
 - Confidentiality?
 - Ex parte communications?

ANATOMY OF AN ARBITRATION

- Step 4: Discovery
 - Document discovery
 - Pitfalls for actuaries
 - *How well documented are your analysis*
 - *Are you following the ASOP's ?*
 - Depositions
 - Pitfalls for actuaries
 - *Answer the question being asked*

ANATOMY OF AN ARBITRATION

- Step 5: The hearing
 - Pre-hearing briefs
 - Fact witnesses
 - The role of actuaries
 - Expert witnesses
 - The role of actuaries

ANATOMY OF AN ARBITRATION

- Step 6: The award
 - Reasoned or not?

POST-ARBITRATION PROCEEDINGS

- Confirmation
- Vacatur
 - Limited grounds for vacating an award:
 - Corruption, fraud, undue means
 - Evident partiality
 - Misconduct
 - Arbitrators exceeded powers
 - Manifest disregard?

ROLES OF ACTUARIES

- Do actuaries make good arbitrators?
- When are actuaries required?
 - WC sunset & commutation clauses
- When are actuaries advisable?
 - loss reserve issues
 - interpreting pricing files and calculations
 - profitability analyses
- Are multi-disciplinary perspectives helpful?

Sample Roles of Actuarial Experts in Reinsurance Disputes

- Evaluate actuarial pricing/loss reserve reports
- Reinsurance contract interpretations
- Probabilities of adverse outcomes
- Commutations and profit-share provisions
- Underwriting custom and practice
- Damages
- Appropriate reinsurance brokerage
- Risk transfer and other accounting issues
- Statistical sampling

Actuaries as Fact Witnesses

- Intentional – calculations done specifically in support of an ongoing arbitration
 - Extrapolation of impact on losses of claims handling practices in dispute
 - Impact of loss allocation methods
 - Impact of interest rate assumptions on funded covers
- Non-intentional – when a prior work product is discovered or becomes relevant to a current arbitration
 - Prejudice in late reported claim disputes. (You commuted a ceded cover prior to receipt of claims)
 - Pricing Analysis

Professional Standards and Arbitration

- Code of Professional Conduct
 - <http://www.actuarialstandardsboard.org/code.asp>
- Actuarial Standards of Practice (ASOPs)
 - Updated on a regular basis
 - <http://www.actuarialstandardsboard.org/asops.asp>

ASOP Examples

- 1. Introductory Actuarial Standard of Practice
- 17. Expert Testimony by Actuaries
- 23. Data Quality
- 41. Actuarial Communications

Code of Professional Conduct

- The cornerstone.
- Sets a high bar.
- “An Actuary shall act honestly, with integrity and competence, and in a manner to fulfill the profession’s responsibility to the public and to uphold the reputation of the actuarial profession.”
- “An Actuary with knowledge of an apparent, unresolved, material violation of the Code by another Actuary should consider discussing the situation with the other Actuary and attempt to resolve the apparent violation. If such discussion is not attempted or is not successful, the Actuary shall disclose such violation to the appropriate counseling and discipline body of the profession, except where the disclosure would be contrary to Law or would divulge Confidential Information.”
Actuarial Board for Counseling and Discipline (ABCD).

ASOP 1 – Introductory Standard

Scope – framework, important definitions, but also guidance.

“ASOP’s are not narrowly prescriptive and neither dictate a single approach nor mandate a particular outcome...The ASOP’s allow for the actuary to use professional judgment when selecting methods and assumptions, conducting an analysis, and reaching a conclusion and recognize that actuaries can reasonably reach different conclusions when faced with the same facts.”

ASOP 23 – Data Quality

- Scope – Since good data are frequently not available, what's an actuary to do?
- Select the best available, relevant data
- Review the data for obvious problems and discard or adjust/modify as necessary
- Disclose, disclose (source, limitations, et.al)

ASOP 17 – Expert Testimony

- Scope – applies to all expert testimony.
- Hypothetical questions, disclosure of conflicts, discovery of errors, etc.
- “take reasonable steps to ensure that the expert testimony is not used to mislead other parties”.
- In cross-examination “the actuary need not volunteer information that may be adverse to the interest of the principal.
- “Nothing in this standard is intended to discourage reasonable differences of actuarial opinion, or to inhibit responsible creativity in advancing the practice of actuarial science.”

ASOP 41 - Communications

- Scope – Includes any written, electronic, or oral communication that offers an actuarial opinion or finding.
- Clarity – Must use appropriate language, taking into account intended users.
- Communications and Disclosures
 - Assumptions
 - Reliance
 - Deviation from ASOPs

The Codes in Practice – Tales from a trial

- “Are you familiar with the Code of Professional Conduct?”
- “Do you regularly review the Code of Conduct”
- “The purpose of this Code is to require actuaries to adhere to high standards of conduct....An Actuary who commits a material violation shall be subject to discipline procedures” ...
 - *“Have you , in performing all your responsibilities, always abided by the Code of Conduct”*
- “If you read further it says “An Actuary shall not provided actuarial services if such services may be used to evade the law“
 - *You complied with that annotation as well?*

The Codes in Practice – Tales from a trial

- “An actuary who issues an actuarial communication should indicate the extent to which the actuary or other sources are available ...
 - *“Did you comply with that while at your previous employers company? And throughout your career”*
- “Conflict of interest – An actuary shall not knowingly perform actuarial services involving an actual or potential conflict of interest”
 - “You are in conflict right now aren’t you?”
 - *Was I performing an actuarial service?*
 - *Was I in conflict?*

The Codes in Practice – Tales from a trial

- “Confidentiality – An actuary shall not disclose to another party any confidential information unless authorized to do so by the principal or required to do so by law”
 - Do you understand this precept? And you adhered to this precept throughout your career?
 - *Have you ever discussed your former company with your current?*
 - *Have you ever used any knowledge you gained at your previous employer and shared with your current?*
 - *Have you ever shared confidential information from your previous employer?*
- ***“The panel wants to make sure you understand that at least an allegation has been raised that there are some potential violations by you of the ethical guidelines governing actuaries”***

Case Study 1:

Company v. Excess Insurers

- Company (a U.S. industry leader) self-insured the first \$3m/\$25m of E&O exposure with BC, an off-shore captive, and purchased a \$197m/275m tower of excess insurance. — When a large claim pierced the excess layers, many of the Excess Insurers refused to pay leading to a series of lawsuits and counter-suits.
- Excess Insurers alleged the reports by the Consulting Actuaries (“CA”) for BC were flawed and misleading. CA conducted year-end reviews to evaluate reserve adequacy and a range for next year’s funding.
- Issues evaluated by actuarial experts included which standards apply and an alleged violation of ASOP 41.

Case Study 2: Reinsurers v. Asbestos Co.

- Manufacturer of asbestos products purchased reserve protection before bankruptcy.
- The ensuing asbestos trust claimed the layer of coverage was exhausted and reinsurers should pay their limits.
- Issues evaluated by experts included claims handling issues, asbestos liability estimation and the projected timing of payments.

Case Study 3: Receiver vs. Actuarial Firm

- Company entered receivership in 2011
- Filed Arbitration against appointed actuary (among others)
- Damages theory assumes that “had AA estimated the Company’s reserves without the material deficiencies identified...above, the Company would have ceased writing business approximately one month after AA’s statements of actuarial opinion were filed.”
- All ASOPs related to reserve analysis were evaluated, as well as an analysis of causation and damages from an actuarial perspective.

BECOMING AN ARBITRATOR

- Qualifications under arbitration clause
 - Officer or director?
 - Active or retired?
 - ARIAS certified?
- ARIAS certification requirements
 - 10 years industry experience
 - Arbitration experience or knowledge
 - Education (ARIAS conferences/ethics programs)
 - Recommendations
 - ARIAS membership

RESOURCES FOR ARBITRATORS

- ARIAS Programs and Certification
- ARIAS Code of Conduct
- ARIAS Practical Guide
- ARIAS Rules
- All available at www.arias-us.org

QUESTIONS?

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