

Treaty Tips

Keeping An Eye On “Losses”

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osing sight of fundamental treaty definitions as a reinsurance arrangement changes over time can result in unexpected consequences. For example, in *Employers Reinsurance Corp. v. American Southwest Insurance Managers, Inc.*, the dispute centered on whether a \$1.3 million claims start-up fee paid by Employers Reinsurance Corp. (ERC) pursuant to an administrative services agreement put in place three years into the reinsurance transaction should be included in calculating “losses incurred” by ERC under the treaty between it and American Southwest Insurance Managers (ASI). Greater “losses incurred” by ERC resulted in lower commission rates for its counterparty, ASI, the managing general agent and producer of the reinsured business.

ASI took the position that the fee did not fall under the definition of “losses incurred” because the administrative services agreement characterized the fee as “additional compensation” to the service provider (an affiliate of ASI), not a part of the separately calculated loss adjustment fees. The court rejected ASI’s argument, noting that the treaty’s definition of “losses incurred” – which apparently was not re-visited when the administrative ser-



vices agreement was effected – expressly included “loss adjustment expenses.” The court went on to reason that, however characterized in the services agreement, the \$1.3 million claims start-up fee constituted a part of the expenses incurred by ERC for the loss adjustment services, thereby warranting inclusion in “losses incurred.”