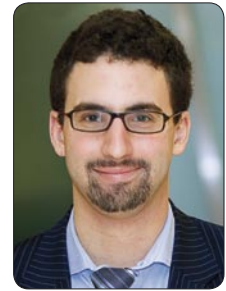


Legal issues for the global reinsurance markets in 2009?

It could be said that 2008 saw the "perfect storm". The sub-prime debacle transformed into a financial crisis of mammoth proportions. Hurricanes Ike and Gustav created high, if not record-breaking, losses. The repercussions of these events will be felt into 2009. Terrorism still looms large. Emerging exposures, such as climate change and nano-technology add to this. The regulators' response will also impact upon the insurance industry. While hardening rates give some cause for optimism, there are many pressures upon the industry. **Mr David Abbott**, Partner, and **Mr Daniel Futter**, Associate, in the Commercial Risk and Reinsurance team at Barlow Lyde & Gilbert LLP, survey some of the legal issues which are likely to arise in 2009.



Mr David Abbott



Mr Daniel Futter

Faced with losses to their assets, insurers are more likely to subject all claims to a higher level of scrutiny. Claims managers will also feel the impact of the credit crunch as policyholders seek to make up for their lost profits with claims that cannot be reconciled with their policies. Furthermore, as individuals seek culprits for their credit crunch losses, they will apply litigation pressures to their advisers who will turn to insurers for assistance.

Claims figures revised upwards

The impact on insurers of the sub-prime and wider financial crisis will play out in 2009. The likely claims figures are being revised upwards. The number of suits filed in the US relating to the financial crisis had risen dramatically in 2008 and will continue into 2009. It remains to be seen what scale litigation will reach in the UK, and other jurisdictions. Financial Insurance's and Directors' & Officers' insurers face increased claims; and issues relating in particular to notification, aggregation and follow settlements will undoubtedly arise.

More particularly, the collapse of Madoff's hedge fund seems certain to lead to increased litigation and subsequent claims against insurers. The Fairfield Greenwich Group, for example, has lost US\$7 billion of their investors' money in Madoff's fund and their investors have already brought proceedings against their fund managers. Others investors will follow suit and claims may be made against professional advisers who will hold Professional Indemnity policies.

Bogus household and vehicle claims

Comparisons can be made with the collapse of Enron, however the resulting litigation (and its outcome) is likely to be different, as the economic climate may lead to much harder fought litigation. The Enron claims were settled during a time when defendants had reserves and access to cash. For many, the credit crunch has created a very different situation.

As individuals and businesses suffer, insurance policies may be used as a last ditch attempt to obtain monies. The effects of the credit crunch have already had a marked impact on detected frauds in the UK markets, with 160,000 frauds occurring in 2008, in contrast to the 91,000 in 2007. Much of this fraud consists of bogus household and vehicle claims.

What constitutes substantial exaggeration?

However, there will also be an increase in business interruption claims where the sums claimed are wildly inflated. In *Orakpo v Barclays Ins Services Limited (1995)*, it was stated that the courts will accept some exaggeration in claims, but should the exaggeration become substantial then it is likely that the claim will be fraudulent.

The question that insurers will need to be clear about is exactly what constitutes a substantial exaggeration as the English Courts have not yet defined just what this means.

Adequate fraud detection measures

Reinsurers may want to consider whether their cedants have sufficient measures in place to detect fraud. Should it prove that their internal fraud detection measures are inadequate, then reinsurers may have a range of remedies that they can bring against insurers, depending on the nature of the reinsurance and the depth of any failings.



Heavier regulatory approach

Following the convulsions that shook the UK banking sector, the previous 'light touch approach' of the Financial Services Authority (FSA) is likely to become much heavier.

Until now, the approach of the FSA was not enforcement-led and its regulation was said to be based on principles rather than on an elaborate and detailed code. As governments evaluate the role of their regulators in the credit crunch, they may decide that the existing regulation of banks and financial service providers is insufficient.

A new approach may lead to a much greater scrutiny of the insurance market. In 2009, enforcement, still principle-based, could come to the forefront of the FSA's regulatory policies. The FSA has stated that it intends to increase the use of criminal sanctions as a deterrent. The approach to regulation is expected to face close scrutiny in the US, once President-elect Obama comes into office.

Solvency II

Another area where regulation may depart from what was long expected is Solvency II. In early 2008, there were those who argued that the modelling of insurance solvency requirements on the banks was an excellent idea. It is hard to say that now. Solvency II will also increase the burden on an industry in which there are few spare funds. We shall see whether the resolve is there to push on with Solvency II.

Asbestos worries not over

Asbestos will remain a significant concern for reinsurers.

Britain's use of asbestos ended on 24 August 1999 with the Asbestos (Prohibitions) (Amendment) Regulations 1999. However, the waves of asbestos litigation have not ended and show no sign of abating. In 2008, the High Court ruled in the 'Trigger Litigation', a decision of substantial importance. In 2009, this decision will be appealed and further arguments will be heard before the English Court of Appeal.

Pleural plaques consultation paper

Early 2009 will also result in the publication of the pleural plaques consultation paper by the Ministry of Justice. Although the British Government has denied plans to follow the Scottish example of legislating against *Johnson v NEI International Combustion Ltd (2007)* pressure following from the consultation may lead to unexpected developments.

Ongoing concerns in 2009

The issues we have highlighted mostly arose out of the events of 2008. A number of ongoing concerns will also affect insurers in 2009. Climate change, though not currently headline material is still perceived as a major long-term threat to the industry. It remains to be seen whether we shall see increased natural disasters in 2009 as a result.

Terrorism is still a very present factor and any terrorist action in 2009 would test the national pools put in place in many countries and how they interact, via the wordings, with private covers. Let us hope at least that any significant losses in 2009 are limited to natural and financial causes. 