When Reinsurance Programs Fail

A regulatory and arbitral perspective on enforceability, security and insolvency

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Reinsurance is the silent guarantor of solvency

Enforceable

Does the agreement pay what the cedent expects?

Follow-the-fortunes, notice and ambiguous terms

Real

Is the collateral actually there and usable?

Trust assets, letters of credit and funds withheld

Holds under stress

Who controls the remedy when a party fails?

Offshore recourse, jurisdiction, setoff and trust survival

A regulator is concerned about the enforceability of reinsurance because it is essentially an alternative form of capital for a ceding insurer. The NAIC has promulgated, and states have passed model laws designed to maximize the likelihood reinsurance is recoverable

Three lenses for arbitrators

Treaty

What did the parties promise?

Text, incorporated terms and course of dealing

Regulatory status

What credit or reserve treatment applies?

Accounting treatment does not rewrite the contract

Receivership law

Who decides and who gets paid?

Forum, stays, setoff, priority and claim allowance

An answer under one lens may be incomplete under the others

Risk transfer has two related but distinct lives

Statutory accounting

Has significant insurance risk transferred?

Is there a reasonable possibility of significant loss?

Does the cedent retain prohibited control?

Contract enforceability

What risks does the treaty actually cover?

Do side agreements alter economics?

Do exclusions, caps or conditions defeat the claim?

Regulatory credit can disappear without automatically deciding every contract claim

Security must work outside insolvency

Letter of credit

Confirm the bank, amount, evergreen notice, draw window and replacement security.

Trust

Test eligible holdings, current value, substitution rights and the beneficiary's ability to withdraw.

Funds withheld

Identify control, investment risk, valuation rules and what happens on recapture.

Downgrade rights buy reaction time—not cash, assets or execution certainty

Does trust security survive the reinsurer's insolvency?

Trust type	Single-beneficiary security—or multibeneficiary regulatory trust?
Beneficiary	Identify the cedent, successors and competing U.S. claimants
Control	Title, withdrawal terms, trustee directions and asset location
Remedy	Direct draw—or supervisory transfer and claims process?

NAIC Model #786 §7(C) addresses a multibeneficiary trust after grantor insolvency

Is the money backing U.S. policyholders really there?

1 Asset manager

2 U.S. life insurer

3 Offshore affiliate

4 Scale

The “Bermuda Triangle”

An asset manager buys or partners with a U.S. life insurer. The insurer sells annuities, invests in the manager’s higher-yield alternative assets, and cedes downside risk to an affiliated reinsurer in Bermuda or Cayman.

In 2024, U.S. life insurers ceded $2.4 trillion of reserves—up 70% from 2019. More than $1.1 trillion went offshore; nearly 70% of offshore life and annuity reserves went to affiliates.

For arbitrators: offshore collateral now makes asset eligibility, cash-flow testing and cross-border enforcement baseline diligence—not an edge case.

Regulators are testing visibility—and recapture risk

AG 55	Adopted August 13, 2025. For qualifying asset-intensive offshore reinsurance, cedents must test and report whether supporting assets remain adequate under moderately adverse cash flows. First reports: April 1, 2026.
Capital	In August 2026, the NAIC directed development of a recapture RBC factor for reserves ceded outside reciprocal jurisdictions by year-end 2027. Bermuda has reciprocal status; Cayman does not.
Scale	At year-end 2025, Cayman life and annuity assets were about $101B (up from $23B in 2020). Bermuda's long-term sector held more than $1.5T.
Stress tests	Illustrative examples: PHL entered Connecticut rehabilitation in May 2024 amid a reported $2.2B shortfall. Bermuda revoked 777 Partners' reinsurer license in October 2024, citing affiliated assets, governance and capital failures.

The arbitral record may now require testing models, asset eligibility and cross-border enforceability.

Arbitration and liquidation law start in different places

Treaty question

Did the parties agree to arbitrate this dispute?

State question

Does receivership law vest exclusive authority or authorize an injunction?

Federal question

Does the FAA or New York Convention require enforcement?

McCarran-Ferguson

Would federal law invalidate, impair or supersede insurance regulation?

Outcome can turn on domestic versus international arbitration, statutory text and the relief sought

Outcomes turn on statutes and posture

Authority	Jurisdiction / posture	Result
Stephens v. All	Kentucky; liquidator versus cedents	State anti-arbitration law reverse-preempted FAA
Munich American v. Crawford	Oklahoma; reinsurer sought estate funds	Exclusive receivership authority defeated FAA petition
Davister v. United Republic	Utah; dispute affecting insolvent estate	Receivership law protected from FAA interference
Suter v. Munich Re	New Jersey; liquidator sued reinsurer	Convention removal allowed; no statutory impairment shown
Corcoran v. Ardra	New York; alien reinsurer	Liquidator exempt under Convention exceptions

Setoff protects mutuality but disrupts equal distribution

Commercial logic

Pay only the net balance between the same parties in the same capacity

Receivership concern

A reinsurer with setoff may receive more value than creditors paid through the statutory priority system

Common statutory limits

Mutual debts or credits • Rights fixed at liquidation • No claims acquired to manufacture an offset • Contingent or unmatured obligations may be excluded

Regulators will test every setoff before the arithmetic

1. Same parties—and no affiliate mismatch?
2. Same capacity—and truly mutual obligations?
3. Both obligations fixed at the liquidation cutoff?
4. Any transfer or claim acquired to manufacture the offset?
5. **Does the liquidation court reserve allowance or limit the remedy?**

Commercial logic favors the net; receivership law protects equal distribution

Receivership begins mid-arbitration: the arbitrator's checklist

1 Pause and verify

Obtain the petition, order, stay or injunction; invite focused submissions

2 Test authority

Statute, seat, FAA/Convention, delegation and any leave from the receivership court

3 Confirm the party

Receiver substitution, counsel authority, service and capacity

4 Preserve rights

Collateral status; proof-of-claim and claim-bar deadlines; confidentiality

5 Choose a path

Stay, proceed with leave, bifurcate, or determine gross liability only

6 Shape the award

Separate liability, setoff and distribution; direct enforcement to the proper court

An order may pause or reshape the case; obtain its text before acting

Six propositions to carry into the hearing room

01 **Enforceability: text controls deference, notice and ambiguity**

02 **Ongoing security: test trust and LOC mechanics before distress**

03 **Offshore crisis: verify assets, cash flows and recapture risk**

04 **Jurisdiction: forum turns on statute, posture and relief**

05 **Setoff: expect regulators to test mutuality, timing and priority**

06 **Trust survival: identify the trust, beneficiary and remedy**

Questions and discussion

Exhibit 1 | Letter of credit draw and renewal

NAIC Credit for Reinsurance Model Regulation #786 §13(A), (D)

Model #786 §13 requires a qualifying LOC to be clean, irrevocable and unconditional, payable on sight, with an evergreen mechanism and advance nonrenewal notice.

Proposition 2 — Ongoing security: test trust and LOC mechanics before distress

The NAIC model translates an assurance of "collateral" into specific mechanics: an eligible, clean, irrevocable and unconditional instrument, sight payment, automatic renewal and advance notice of nonrenewal. Those details are critical because a creditworthy-looking LOC may provide little practical protection if its amount, issuing bank, draw documents or timing fail when the cedent needs liquidity. The model is not itself the controlling law unless adopted; the relevant state rule and actual LOC must be compared.

https://content.naic.org/sites/default/files/model-law-786.pdf

Exhibit 2 | Trust withdrawal while solvent

11 N.Y.C.R.R. § 126.3(d)(1)

A qualifying New York trust gives the beneficiary a withdrawal right "at any time, without notice to the grantor," subject to written notice to the trustee.

Proposition 2 — Ongoing security: test trust and LOC mechanics before distress

New York's withdrawal rule highlights a difference between assets being held in trust and assets being accessible to the beneficiary. A qualifying arrangement gives the beneficiary a direct withdrawal mechanism, without prior notice to the grantor, subject to the specified notice to the trustee. Panels must still examine the trust instrument, asset eligibility and the governing regulatory conditions.

https://www.law.cornell.edu/regulations/new-york/11-NYCRR-126.3

Exhibit 3 | Trust after reinsurer insolvency

NAIC Credit for Reinsurance Model Regulation #786 §7(C)(1)–(2)

Model #786 §7(C)(1)–(2) addresses a multibeneficiary trust after grantor insolvency, including regulator- or court-directed transfer and distribution to U.S. beneficiaries.

Proposition 6 —Trust survival: identify the trust, beneficiary and remedy

The model shows that a multibeneficiary trust may move into a supervisory transfer and claims process rather than a cedent's immediate draw. After the grantor's insolvency, a qualifying multibeneficiary regulatory trust may be subject to regulator or court-directed transfer and distribution for U.S. beneficiaries. The relevance is both substantive and procedural: the trust can remain a source of protection while the path to payment shifts away from an immediate individual draw. Trust type, beneficiary status and the governing order therefore shape the remedy. Compare the adopted rule and trust instrument before directing payment.

https://content.naic.org/sites/default/files/model-law-786.pdf

Exhibit 4 | Stephens and reverse preemption

Stephens v. American International Insurance Co., 66 F.3d 41, 45 (2d Cir. 1995)

Kentucky's anti-arbitration insurance rule was preserved from FAA preemption under McCarran-Ferguson, and the liquidator could not be compelled to arbitrate.

Proposition 4 —Jurisdiction: forum turns on statute, posture and relief

Stephens makes the forum conflict concrete and shows that an arbitration clause does not end the forum inquiry when state insurance-liquidation law conflicts with the FAA. Even a negotiated arbitration clause can encounter state insurance-liquidation law, and McCarran-Ferguson may protect that law from displacement by the domestic FAA. The important point is not that receivership always cancels arbitration; it is that the governing state rule, the liquidator's statutory position and the relief sought can change the result. Panels should obtain the governing liquidation law and injunction before assuming jurisdiction.

https://law.justia.com/cases/federal/appellate-courts/F3/66/41/487272/

Exhibit 5 | Suter distinguishes a collection action

Suter v. Munich Reinsurance Co., 223 F.3d 150, 161–62 (3d Cir. 2000)

The court characterized the liquidator's case as a collection action—not a delinquency proceeding or an attempt by another party to reach estate assets.

Proposition 4 —Jurisdiction: forum turns on statute, posture and relief

Suter illustrates why posture and requested relief matter. The court distinguished an action brought by a liquidator to collect reinsurance recoverables for the estate from proceedings in which a claimant seeks to reach estate assets. Suter reinforces why emphasis should be on who brought the claim, who would receive the money and what remedy is requested. The international-arbitration setting also calls for an analysis of the Convention rather than mechanically applying domestic FAA outcomes. Panels should build a record that separates the merits of the reinsurance claim from receivership control of distributions.

https://law.justia.com/cases/federal/appellate-courts/F3/223/150/577747/

Exhibit 6 | Corcoran and Convention exceptions

Corcoran v. Ardra Insurance Co., 77 N.Y.2d 225, 232 (1990)

New York's highest court concluded that the Superintendent, acting as statutory liquidator, was exempt from arbitration under exceptions in the Convention.

Proposition 4 —Jurisdiction: forum turns on statute, posture and relief

Corcoran places the liquidator's statutory role and the Convention's exceptions at the center of the analysis, and cautions against treating international arbitration as automatically controlling. In Corcoran, a New York statutory liquidator resisted arbitration of a dispute with an alien reinsurer, and the court applied Convention exceptions. The liquidator's legal capacity, the applicable state receivership rules, the precise treaty obligation and the requested remedy all require attention.

https://www.law.cornell.edu/nyctap/I90_0229.htm

Exhibit 7 | New York setoff statute

N.Y. Insurance Law § 7427(a)

"In all cases of mutual debts or mutual credits between the insurer and another person ... such credits and debts shall be set off and the balance only shall be allowed or paid."

Proposition 5 —Setoff: expect regulators to test mutuality, timing and priority

Under the New York statute, netting starts with mutual debts or credits between the insurer and the other party, rather than commercial convenience. The provision gives arbitrators a checklist for party identity and capacity, while leaving receivership questions about allowance and priority to the statutory process. The panel should separate the amount of a net obligation from the right to receive estate assets.

https://www.nysenate.gov/legislation/laws/ISC/7427

Exhibit 8 | Delaware mutuality rule

18 Del. C. § 5927(a)

"In all cases of mutual debts or mutual credits between the insurer and another person ... such credits and debts shall be set off and the balance only shall be allowed or paid."

Proposition 5 —Setoff: expect regulators to test mutuality, timing and priority

Delaware law likewise makes mutual debts or credits the starting point for setoff. The distinction matters in modern reinsurance programs with affiliates, claims administrators, trusts, funds-withheld accounts or assignments that can obscure which entity is debtor and which is creditor.

The panel should map each claimed amount to its legal parties and capacities and to distinguish factual findings about gross debts from any later ruling on statutory setoff or payment priority.

https://delcode.delaware.gov/title18/c059/index.html

Exhibit 9 | Florida reinsurance setoff cutoff

Fla. Stat. § 631.281(2)(a)

"In the case of a reinsurance agreement, the insurer's obligation must be incurred as of the date of the order of liquidation to allow an offset."

Proposition 5 —Setoff: expect regulators to test mutuality, timing and priority

The Florida statute creates a liquidation-date cutoff specific to reinsurance obligations. The insurer's obligation must have been incurred by the liquidation order. As a result, timing and contingency become central before the panel reaches the arithmetic. Regulators may invoke the cutoff to prevent a later-developed obligation from changing estate distribution.

The panel should build a chronology of when each obligation arose, what remained contingent, and what documents establish that date. Further, this demonstrates how receivership rules can defeat an offset that appears economically straightforward.

http://www.leg.state.fl.us/statutes/index.cfm?App_mode=Display_Statute&URL=0600-0699/0631/Sections/0631.281.html

Exhibit 10 | Florida denies secured status

Fla. Stat. § 631.281(4)

"No claim of offset shall operate to create a secured claim."

Proposition 5 —Setoff: expect regulators to test mutuality, timing and priority

Florida expressly separates an offset from secured-claim status. A valid netting argument therefore does not automatically elevate the creditor in the distribution hierarchy. Arbitrators should avoid drafting an award that inadvertently decides estate priority beyond their authority.

http://www.leg.state.fl.us/statutes/index.cfm?App_mode=Display_Statute&URL=0600-0699/0631/Sections/0631.281.html