INTRODUCTION TO REINSURANCE

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LONDON SCHOOL OF INSURANCE

The power of knowledge fitting the pieces together

INDEX

1 INTRODUCTION

There can be few religions or societies that do not support the notion that we should help one another, and this fundamental principle has been reflected from the earliest family groups right up to the modern promotion of the welfare state. Without protection from nature's basic risks it is difficult for societies to evolve. Farmers are reluctant to take on heavy debt where they are totally reliant on the weather, and investors are reluctant to send ships around the world, to build large organisations or encourage economic development where too many risks are involved.

The notion of helping one another has ranged from wholly non-profit organisations and charities, to co-operatives, mutual societies, to for-profit insurance companies and more recently takaful.

Whichever form of organisation takes on large and complex risks, it needs to manage those risks responsibly if it is to fulfil its objectives in a business-like manner and properly protect its customers.

There is no substitute for technical appreciation and knowledge when it comes to managing risks, and one of the strategic goals of Africa Re is to promote and support education and training in the insurance and reinsurance space.

This "Introduction to Reinsurance" is the first in a series of courses designed to this end.

This manual has been designed:

- To provide you with an introduction to the world of reinsurance.
- To enable you to feel comfortable with, and understand, the core concepts and the principles.

The main sections of this manual are as follows:

- **The history of insurance and reinsurance**
Learning objective: To understand the origins of insurance and reinsurance to enable you to put these subjects into the context of the general development of commerce and business throughout the world.
As the demands of commerce evolve, so does the need to innovate in insurance and reinsurance.

- **Definition of reinsurance**
Learning objective: To understand the meaning of reinsurance, and the concept of spreading risks starting with the policyholder, the buyer of insurance, and passing through the insurance company, to reinsurers and then on to retrocessionaires.
To know who are the parties to a reinsurance contract.
To understand the legal principles applicable to reinsurance.
To understand the similarities and differences between insurance, reinsurance, and retrocession.

- **The players in the reinsurance market**
Learning objective: To know who are the main buyers and capacity providers in the reinsurance market place and the place of reinsurance intermediaries.

- **Why Insurance Companies Need Reinsurance**
Learning objective: To understand the main drivers behind the need for insurance companies to purchase reinsurance, and similarly for reinsurers to buy retrocession covers.

-**Basic Forms and types of Reinsurance**
Learning objective: To understand the meaning of the words "facultative" and "treaty" which describe the main **forms** of reinsurance.
To understand the meaning of the words "proportional" and "non-proportional" which describe the main **types** of reinsurance.
To understand the meaning of the words "quota share", "surplus" and "facultative obligatory" which are sub-types of proportional treaty reinsurance and how these treaty types spread risk. Also how premiums and losses are distributed working with these treaties.
To understand the meaning of the words "risk excess of loss", "catastrophe excess of loss" and "stop loss" which are sub-types of non-proportional treaty reinsurance and how these treaty types spread risk. Also how premiums and losses are processed working with these treaties.

To understand how some of these forms and types can be used in combination.

-**Documents Related to Reinsurance**
Learning objective: To be aware of the main documents that define the agreements between the market players, the importance of clarity when preparing documents, and the challenge of finding the right mix between detail and too much complexity.

We hope this manual will provide you with the basic knowledge you will need to understand this important and fascinating subject, and will encourage your further research.

Other manuals will soon be available to assist you with your further researches.

2 HISTORY OF INSURANCE AND REINSURANCE

Learning objective: To understand the origins of insurance and reinsurance to enable you to put these subjects into the context of the general development of commerce and business throughout the world.

As the demands of commerce evolve, so does the need to innovate in insurance and reinsurance.

2.1 Origin of Insurance

As noted in the introduction, the idea of mutual aid can be traced back to primitive societies based on simple barter and trade. If a member of the community suffered loss, such as the destruction of the house, or the loss of crops, family and friends would help the individual to rebuild the house, or provide food or seeds to ensure survival – if such resources were available.

As economies evolved, the concept was formalized, as in, for example, the Code of Hammurabi, which dates from circa 1754 BC, and was the Babylonian law code of ancient Mesopotamia. According to this code an investor could agree to forgive a loan in exchange for additional payment if a hazardous voyage was completed successfully.

There is also evidence in the first millennium BC that a concept of “general average” was developed on the island of Rhodes whereby merchants who were transporting their goods on the same ship would create a pool of money to reimburse one or more of them when it was necessary to throw cargo overboard due to a storm or other damage to the ship to prevent sinking.

The concept of guilds, benevolent societies, friendly societies can again be traced back to the Romans in the first millennium BC to give members the benefit of a decent burial and to look after surviving dependents. Examples of guilds exist today in many major cities around the world, and these concepts were further developed to the more efficient distribution of products (for example concept of “villages of co-operation” developed by Robert Owen 1771-1858) and then the co-operative movement which further developed to include areas such as credit unions, established in Germany as from the mid-19th century.

However while the idea of using the payments of the many to reimburse the losses of the few seems to be traceable back to very early times, there is nothing which suggests practices that resemble our modern approach to risk management.

2.2 The first insurance Companies

While the earliest authenticated insurance contract, dated 1347 in Genoa, is a marine insurance contract on a ship called “The Santa Clara”, insurance companies, along the lines we understand then today, really only started to develop during the second half of the seventeenth century.

In the United Kingdom, the Great Fire of London of 1666 highlighted the devastating consequence of loss without any hope of reimbursement, and this, combined with the continual evolution of maritime trade resulted in the establishment of several companies, some of which are still in existence today, such as Lloyds of London (dating from the late 1680s), and the Sun Fire Office dating from 1710. The oldest mutual company in the world was also founded during that period – the Hand in Hand Fire and Life Insurance Society in 1696 – it was acquired by the Commercial Union Group in 1905.

In America, Benjamin Franklin was a prime mover to establish the practice of insurance, especially property insurance and in 1752, he founded the Philadelphia Contributionship for the insurance of houses from loss by fire.

In Germany, for example, the concept of a national insurance program was developed as early as the 1840s in Prussia and Saxony, and Otto von Bismarck introduced old age pensions, accident insurance and medical care that formed the basis for Germany’s welfare state by the 1890s.

Lloyd’s of London in the United Kingdom was historically seen as one of the most entrepreneurial insurance organisations, and as the United Kingdom carried on an active trade with many parts of the world, Lloyd’s could keep itself very well informed as ship’s captains returned from their various travels and met in the Captain’s Room in Lloyd’s to keep underwriters up-to-date. Thus Lloyd’s is a good example to show the evolution of insurance over time.

Lloyd’s began in 1688 essentially covering marine risks, ships and cargo. In the early years it was sometimes difficult to distinguish insurance from pure gambling. In the 1770s Lloyd’s developed more professional underwriting, and the idea of the “lead underwriter”. The “lead underwriter” was a member who had experience of the type of risk being offered, and who would establish a price for that risk. Other underwriters would then be offered a share of that risk based on the price of the lead underwriter. In the 1850s security was taken much more seriously, and underwri-

ters had to resign if they became bankrupt, and to put up money or a guarantee to support their underwriting. In the 1880s a famous Lloyd's underwriter – Cuthbert Heath – wrote the first reinsurance policy and also established the "non-marine" market, writing policies other than marine and fire. By 1905 the idea of gathering proper loss information was established, and this led to risk based pricing. In 1923 the central fund was established as a fund of "last resort" to protect policyholders if an underwriter went bankrupt. By the 1960s Lloyd's of London was well known internationally and helped establish London as the world centre of insurance. Even today, while insurance and reinsurance expertise has spread to many parts of the world, Lloyd's of London remains an icon of the history of insurance.

2.3 The Early Professional Reinsurers

Whether it can be called reinsurance or not, a contract which spread a part of the risk between risk takers took place in the year 1370, when one underwriter, Guilano Grillo, contracted with others, Goffredo Benaira and Martino Sacco to reinsure a cover on a ship on just part of the voyage from Genoa to Bruges. While Grillo covered the ship through the Mediterranean sea, he passed the risk to Benaira and Sacco from Cadiz to Bruges.

The first independent reinsurance company, the Kölnische Rückversicherungs-Gesellschaft (Cologne Reinsurance Company) was founded in Germany in 1843, following a great fire in Hamburg. Several other reinsurers were formed in Germany in the second half of the 1800s, but most failed due to severe competition and bad business practices.

Following the great fire of Glarus, the Schweizerische Rückversicherungsgesellschaft (Swiss Reinsurance Company) was established in 1863. This soon led to an exchange of reinsurance business amongst the insurance and reinsurance companies in Europe.

Much of this business was of a reciprocal nature, where the insurance company in one country would exchange business from the insurance company in another country. While professional reinsurers did not have original insurance business as such, they often created pools of business which could be used for reciprocal purposes.

Another well known reinsurance company the Münchener Rückversicherungs-Gesellschaft (Munich Reinsurance Company) was created in 1880.

In the United States, the Supreme Court of New York upheld the validity of a reinsurance contract already in 1837, but reinsurance companies were slow to develop. It appears that already early on treaties were ceded mainly to foreign unadmitted reinsurers. The first American reinsurance company was the Reinsurance Company of America, but that was liquidated in 1890. Generally the prohibition of reinsurers operating on a "non-admitted" basis, that is to say refusing to allow local insurance companies to take credit of any kind for such reinsurance, made it difficult to operate efficiently there. Protectionist legislation has operated in America with regard to reinsurance since these early days.

The practice of reinsurance on reinsurance, known as retrocession can be dated back to 1854 when the "Globe Compagnie d'Assurance contre l'incendie" in France ceded fire business to "Riunione Adriatica" in Italy.

2.4 The development of Reinsurance in Africa

As noted in the introduction, the notion of self-help has existed everywhere since the beginnings of the human race. Africa has been no exception, and the practice of, for example, working the fields together (kobufedi in Pedi culture), or re-building houses together (dibanisani in Xhosa culture) or the mutual covering of funeral costs (masingcwabane in Zulu culture) are proof of such practices.

Insurance and reinsurance as it evolved in Europe and North America was introduced into Africa as the colonial powers swept through the continent, and local branches were established.

As African countries became independent, many went through different stages of political and economic organization passing from highly centralized state-controlled countries to mixed economies to market driven economies. Many continued to be serviced for their reinsurance needs by their historic partners, mainly in Europe, especially in the early years, or through using one or other of the well-known intermediaries, many operating out of the London market.

But, as the reinsurance industry plays an important role as a vehicle for the mobilisation of funds, a number of African countries turned their attention to the sector after independence, with a view to sourcing funds from it for the development of their economies. They promulgated the necessary regulations to guarantee substantial control of the market and established national reinsurance companies in the hope that such organisations would, among other things, play a role in stemming the outflow of foreign exchange, by way of reinsurance transactions in the international market.

In this connection, the developing world was encouraged by a number of observations made by UNCTAD. For instance, at its first session in 1964 followed by a subsequent session in 1972, UNCTAD noted, "a sound national insurance and reinsurance market is a necessary characteristic of economic development."

Nationalisation was regarded as a necessary tool for economic growth and development in those years and it is not surprising that the urge to set up national insurance and reinsurance companies reached a peak in the 1970`s. Such companies, particularly on the reinsurance side, got the necessary backing from Government and enjoyed legal cessions.

Egypt Re, which has since merged with Misr Insurance company (2008), was the first local reinsurer in Africa (1957), followed by Société Centrale de Réassurance, Morocco (1960).

The second group of national companies were set up mainly between 1972 and 1990: Ghana Re (1972), CCR Algeria (1973). Kenya Re (1973), National Re Sudan (1974), Tunis Re (1981), Sen Re (1988), Namib Re (1998) and Tan Re (2001).

In recent years, some countries have set up or are in the process of setting up their own national carriers such Gabon (SCG Re), Uganda (Uganda Re), Ethiopia (Ethiopia Re), Angola (Ango Re) and Seychelles (Sey Re).

Apart from national reinsurers, regional reinsurers were also set up, starting with Africa Re, a clear market leader in Africa, which was established in 1976 by 36 member states of the Organization of the African Unity (OAU) and the AfDB with the aim of reducing the outflow of foreign exchange from the continent and assisting in fostering the development of insurance and reinsurance activities within the African continent. The other regional reinsurers are Cica Re (1982), Zep Re (1990) and Waica Re (2011).

After the wave of state reinsurance companies from 1957 up to 1984, privately owned local reinsurance companies commenced operations starting with Best Re in 1985 in Tunisia, which moved to Malaysia in 2011. Since then, over a dozen private companies have been set up in the continent, including Continental Re (Nigeria) in 1987, Mainstream Re (Ghana) in 1995, East Africa Re (Kenya) in 1995, FBC Re (Zimbabwe) in 1995, and FM Re (Zimbabwe).

2.5 The Basis of Modern Insurance

The basis of modern insurance has become an interesting subject of debate.

During the twentieth century insurance was based on the "law of large numbers", this is an axiom that states that the larger the number of similar risks exposed to a defined loss, the greater the probability that actual loss experience of those risks will equal the expected loss experience. Put another way, the bigger the portfolio of risks, the lower the volatility.

Based on this axiom, insurers have been able to develop stable consumer based housing, liability and motor portfolios where large numbers make it much easier to price individual policies and produce stable results over a period of years.

Where there is severe competition, many insurers prefer to pursue market share over technical pricing, and this can make results much more volatile again.

However in many evolving economies, consumers do not have the economic power, nor the assets to buy or need insurance other than that which is legally required, so in such circumstances, while insurance companies can build up large motor insurance portfolios, they need to look more to the industrial insurance sector to further develop their portfolios.

Small and medium-sized enterprises (also known as SMEs) can offer opportunities based on the law of large numbers. Based on staff headcount, micro enterprises would be up to 10 employees, small enterprises would be 11 to 50 employees, and medium-sized would be 51 to 250 employees.

The debate starts to become more heated as companies become larger and larger. One of the results of the evolution of capitalism has been the creation of larger and larger entities. For example, 7 major companies hold nearly 35% of the worldwide prescription drug market. Similarly with the advances in technology one can ask who will eventually control vehicle manufacturing, a group of the traditional manufacturers or a group of high-tech entities.

As capitalism has evolved, so have actuarial techniques, and there is thus a move away from the more simplistic law of large numbers approach to a more complex granular and dynamic risk-based approach, which takes much more account of the overall impact of risks composing a particular company's exposures.

Thus the basis of modern insurance is changing today more rapidly than in the past, as the risks in the world themselves are changing and becoming ever more complex and inter-related.

3. DEFINITION OF REINSURANCE

Learning objective: To understand the meaning of reinsurance, and the concept of spreading risks starting with the policyholder, the buyer of insurance, and passing through the insurance company, to reinsurers and then on to retrocessionaires.
To know who are the parties to a reinsurance contract.
To understand the legal principles applicable to reinsurance.
To understand the similarities and differences between insurance, reinsurance, and retrocession.

3.1 Definition

Reinsurance is essentially a specialist form of insurance transacted between professionals; hence many of the principles and practices applying to the conduct of insurance business equally apply to reinsurance. However, some principles have a different application in reinsurance.

A legal definition of reinsurance was given by Lord Mansfield in the case of Delver v. Barnes (1807), that reinsurance

> "consists of a new assurance, effected by a new policy, on the same risk which was before insured in order to indemnify the underwriters from their previous subscription; and both policies are in existence at the same time".

This definition relates to facultative reinsurance, which was the earliest form of reinsurance. It cannot be said that all forms of reinsurance satisfy Lord Mansfield's requirement that 'both policies are in existence at the same time', because with the development of treaty contracts, ceding companies have a blanket authority, within certain agreed criteria, to cede future risks underwritten.

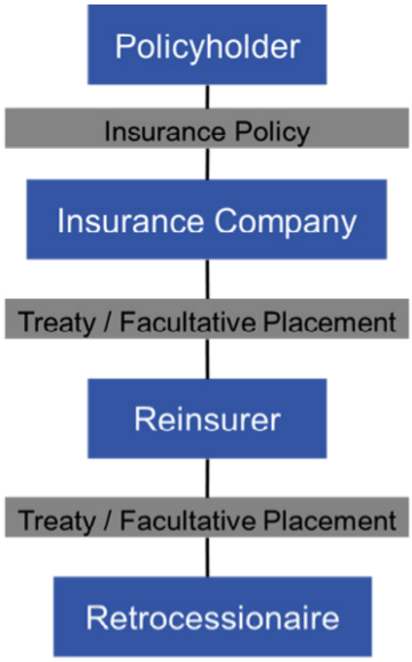
A simple definition of reinsurance therefore is that it is the acceptance by an insurer, known as a reinsurer, of all or part of the risk of loss of another insurer, called the ceding company.

3.2 Spreading Risks: from Policyholders to Reinsurance

No week goes by without a report appearing in newspapers, on radio and television of an event occurring which will cost millions, or even billions, of dollars. We live with and suffer from all kind of natural disasters earthquakes, floods, fire, windstorms, bush fires, drought. All these can cause tremendous suffering in human, material and financial terms.

Since the industrial revolution, man has created many risks which, potentially, carry the same catastrophic consequences. Most risks, either natural or man made, are insured and yet the potential losses are often beyond the capacity of any single insurance company or even insurance market.

The spreading of risks between the various parties can be summarised as follows:



A person or company who buys insurance, the policyholder, pays a premium to its insurance company, the insurance company, and is issued with a policy i.e. the contract between the purchaser (the policyholder) and the insurance company, detailing the risks that are covered, under what conditions they will be covered, and how to claim in the event of a loss.

An insurance company can issue hundreds or even thousands of policies in any given year. These policies generally fall within certain categories of risk – Fire, Liability, Motor – and into certain categories of policyholder – consumer, small and medium sized enterprise, large industrial concern.

The insurance company will thus have a number of categories of risk/policyholder in which its own exposures will equal the sum of all the sums insured of the policies it has sold.

The insurance company then needs to manage the risks/liabilities these groups of policies produce.

One way to spread the risk is by way of co-insurance, finding other insurance companies in the marketplace willing to take a share in these policies. However in a competitive market an insurance company may not wish to share information on its customers with competitors.

Another way to spread the risk is to reinsure with one or more reinsurers.

Reinsurance is therefore the means by which insurance companies can obtain the protection they need.

Similarly reinsurers need to manage the risks/liabilities their reinsurance acceptances produce. When reinsurers reinsure their risks, this is known as a retrocession and the entity selling capacity is known as a retrocessionaire.

3.3 Parties to a Reinsurance Contract

As noted above in 3.2, an insurance company will quickly find itself exposed to large numbers of risks being the total of all the sums insured under the policies it has issued. These policies are legal contracts between the relevant policyholder and the insurance company.

When the insurance company decides to spread its risks by way of reinsurance, it will reinsure a part of these risks with a reinsurer. Thus a reinsurance contract is between an insurance company and a reinsurer.

It is very important to note that the parties to the reinsurance contract do not include the policyholder. The policyholder only has a contract with the insurance company. Thus the policyholder has no rights against the reinsurer, and the reinsurer has no obligations to the policyholder.

Where an important or large policyholder is involved, and they have a concern about the credit rating of the insurance company they are using, or they are using the insurance company merely to front the risk, the policyholder may the able to persuade the parties to the reinsurance contract to agree to a "cut-through clause" which gives the policyholder a contractual right to deal directly with the reinsurer under certain defined circumstances.

Equally if the reinsurer fails to honour the reinsurance contract, for example, by not paying a loss, the insurance company is still liable to the policyholder for the full amount of the loss up to the sum insured in the policy.

Such a situation is clearly of concern to regulators, who's job is to protect policyholders and ensure they receive payment in the event of a valid claim, irrespective of the financial condition of either the insurance company or the reinsurance company. Thus in addition to requiring their local insurance companies to adhere to strict rules with regard to the assets they hold against their liabilities, the regulator may, in addition, require any reinsurers offering capacity to local companies to have a minimum credit rating, or to deposit cash locally to cover their liabilities, or they may limit the credit that any local company can take for the reinsurance cover that it has.

3.4 Legal Principles Applicable to Reinsurance

In many jurisdictions around the world the legal principles applicable to reinsurance are the same as those applicable to insurance. From the point of view of the reinsured, the buyer of reinsurance cover, there is an obligation/duty of utmost good faith, also known as the duty of "uberrimae fidei" and the reinsured must have an "insurable interest" in the risk being reinsured and the reinsured can only make a valid claim if the "principle of indemnity" is also satisfied.

Utmost Good Faith:

Given that the person or company who offers a risk for insurance or reinsurance knows, or should know, much more about that risk than the party willing to consider providing cover, it is natural that a greater degree of transparency should be expected than from a party to a simple commercial contract. Thus there is an obligation on the party seeking the cover to disclose all material facts so that the contract will accurately reflect the actual risk(s) being covered. The principles underlying this rule were stated by Lord Mansfield in the leading case of Carter v Boehm (1766) 97 ER 1162, 1164:

«Insurance is a contract of speculation... the special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only: the underwriter trusts to his representation, and proceeds upon confidence that he does not keep back any circumstances in his knowledge, to mislead the underwriter into a belief that the circumstance does not exist... good faith forbids either party by concealing what he privately knows, to draw the other into a bargain from his ignorance of that fact, and his believing the contrary."

Equally therefore reinsurance contracts demand the same obligation and the principle of utmost good faith is considered the foundation of reinsurance as well. Essentially this means that the buyer of the cover (the insurance company or ceding company as it is known in reinsurance parlance), or its agent/intermediary, must honestly present the risk(s) to the seller (in this case the reinsurer) and can only make a valid claim if it has in fact suffered a loss.

Thus if the ceding company hides material aspects of the risk(s) or falsely declares values, then it will be unable to successfully recover a claim from the reinsurer.

For example, if the ceding company/reinsured informs the reinsurer that it expects to cede a motor liability premium of USD 200,000 when it knows full well that it will likely cede in excess of USD 500,000, then it has misrepresented the facts to the prospective reinsurer, who will have the right to rescind/cancel the contract based on this misrepresentation.

Insurable Interest:

As noted in 2.2 above, there was a period when, during the development of Lloyd's of London, it was not clear whether transactions were based on some sort of professional assessment of the risk, or were a pure gamble. This problem was not particular to Lloyd's at the time, it was prevalent in many institutions offering covers at the time. The principle of insurable interest was thus introduced as a prerequisite for any insurance contract to be effective to distinguish that contract from gambling. The United Kingdom was the first country to pass legislation that prohibited insurance contracts if no insurable interest existed. This requirement is contained in the Life Assurance Act of 1774 which renders life insurance contracts illegal if there is no insurable interest, and the Marine Insurance Act 1906, s.4 which renders such contracts void.

Thus the insured must have an "insurable interest" in the subject matter of the policy, or such policy will be void and unenforceable as it will be considered gambling. An insured has an insurable interest in a policy when they can show some type of financial benefit from the existence of the subject matter to be insured, or that they will suffer a pecuniary loss from the loss of such subject matter should the risk covered by the insurance policy occur.

Equally a reinsured must have an "insurable interest" in the subject matter of the reinsurance. If, for example, the reinsured wishes to obtain reinsurance to cover flooding in the centre of the country's capital city, but it does not have any risks there, then the reinsurance will be considered null and void. Thus, even if there is flooding at that location, as the reinsured had no pecuniary interest in that location and cannot prove it suffered any loss from the occurrence of the event it cannot make a claim under any reinsurance cover.

It should also be noted that although Uzielli v. Boston Marine Insurance Co. (1884), 15 Q.B.D. 16. established that an insurer has a potential liability under every subsisting policy that it has issued, and that it has an insurable interest in each risk, it is important to note in the "reinsurance" context that it's interest is contingent upon the insured under the original policy also having an interest in the subject-matter. Without such an insurable interest of the insured, both the insurance and the reinsurance are void.

Indemnity:

The principle of indemnity dictates that an insured or a reinsured should not profit from the cover it buys, but should only be compensated for its actual loss, thus settlement depends on the terms of the contract and the real amount of loss suffered. With some covers, determining the real amount of the loss is relatively easy. It is impossible to evaluate the worth of a human life and thus in life insurance the real amount of the loss is simply the face value of the policy when the insured person dies. Under liability insurance the liability damages rendered in a judgement by the court and the proven legal costs are generally paid out, subject to the policy limit. Calculating the indemnity under a property loss of profits cover can be very complex as it is often very difficult to prove what profit the insured might, or might not, have made had the loss not occurred. It must always be clear that moral hazard can occur if an insured or a reinsured is allowed to make a profit out of a loss event, not only because such a situation is clearly against public policy but also because it would materially increase the cost of obtaining cover. Equally an insured or reinsured cannot collect the same loss from multiple insurance policies or multiple reinsurance covers, even if they were with different parties.

Thus if the ceding company does not in fact itself have a real loss, then it has no right to make a claim against the reinsurer. For example, there is a large motor loss and the ceding company has to pay USD 250,000 to injured passengers, but it is able to recover that money in full from the insurer of the driver who was responsible for the accident, then it cannot also claim the money from its reinsurer. Although there has been an accident, and there has been a valid claim under the original policy, the ceding company has suffered no loss, so it cannot make a claim against the reinsurer.

Generally apart from these three important aspects that distinguish insurance/reinsurance contracts from normal contracts, the general contract law of the country in question will apply.

3.5 Similarities and Differences between Insurance and Reinsurance

In general there is not a great deal of difference between an insurance contract and a reinsurance contract. There is a need in both cases to thoroughly understand the risks being offered by the buyer, and to ensure that the contract properly describes those risks, the price for the cover, and the conditions under which a claim will be made.

Today insurance contracts for multi-national companies can have many of the issues to be considered in international reinsurance contracts – consideration of various legal jurisdictions, choice of law of the contract, currency exposures, political risk, inflation and other economic and legal challenges. Equally these contracts may be on manuscript forms covering a variety of risks. Both contracts involve transfer of risk. In case of insurance, transfer of risk takes place from the insured to the insurer. In the case of reinsurance, the transfer of risk takes place from the insurer to the reinsurer.

Also premium needs to be paid under both the contracts in exchange for the protection offered. In the case of Insurance, the insured pays the premium to the insurer and in the case of Reinsurance, the insurer pays the premium to the reinsurer. Finally both require technical skills to analyse, select and charge an appropriate premium for the risk accepted.

A big challenge for the ceding company is, as already stated, that the insurance contract with the policyholder is a SEPARATE contract to that between the ceding company and the reinsurer. The ceding company needs to be absolutely sure that the conditions of the insurance contract are perfectly reflected in the reinsurance contract, that if the policyholder can make a valid claim under the policy against the ceding company, the ceding company can make a valid claim under the reinsurance. There can be complex issues to resolve where, for example, the ceding company and the reinsurer are subject to different legal jurisdictions, or wordings can have several interpretations.

Equally a reinsurance contract can be in a number of different forms. The ceding company may not be reinsuring each individual risk as such, but only parts of it, or it may only be reinsuring the risk as part of a portfolio of its risks. Here again it is important that the reinsurance contract accurately reflects those parts of the risk that the ceding company wishes to transfer to the reinsurer, and all aspects of the claims process have been fully considered.

Also the services that need to be provided to a ceding company can be quite different from the services expected by a policyholder from an insurance company. Indeed a professional reinsurer may assist an insurance company to enter into a new class of business, including the provision of policy wordings and rating guides.

Under the insurance contract, the buyers are assumed to be less aware about insurance than the seller. Indeed, the seller or the insurance company deals with insurance on a day to day basis and draws up the contract. Understandably, in case of any ambiguity it is always interpreted in favour of the buyer and against the seller. In the case of the reinsurance contract, both the parties deal with insurance on a day to day basis and are supposed to be at similar knowledge levels.

Finally insurance companies generally operate on a local level whereas reinsurance companies operate on an international/inter-continental level

These similarities and differences are summarised below:

SIMILARITIES AND DIFFERENCES BETWEEN INSURANCE AND REINSURANCE

Similarities

Underwriting:	There is a need in both cases to thoroughly understand the risks
Contract:	Need to ensure the contract properly describes the risks
Legal jurisdiction:	There can be complex legal issues in both types of cover

Currency exposures:	These challenges can be in both types of contract
Political risk:	These challenges can be in both types of contract
Inflation:	These challenges can be in both types of contract
Other economic and legal challenges:	These challenges can be in both types of contract
Manuscript form:	Both types of contract can be in manuscript form
Transfer of Risk:	Both contracts involve transfer of risk.
Premium:	Premium needs to be paid under both the contracts in exchange for the protection offered.
Technical Skills:	Both require technical skills to analyse, select and charge an appro priate premium to a risk accepted

Differences

Insurance and reinsurancea re distinct contracts:	Back to back cover is extremely important
Different legal conditions may exist for each party:	Different legal jurisdictions, one party may be subject to sanctions
Does the reinsurance contract cover the same risks:	There can be different interpretations of the different wordings
Different services:	A policyholder's needs are different from the ceding company
Buyer's Knowledge:	Insurance buyers are assumed to be less aware about insurance than the seller. Reinsurance buyers are supposed to be at similar knowledge levels to the reinsurer.
Operations:	Insurance companies generally operate on a local level, reinsurance companies operate on an international/inter-continental level

4. PLAYERS IN THE REINSURANCE MARKET

Learning objective: To know who are the main buyers and capacity providers in the reinsurance marketplace and the place of reinsurance intermediaries.

4.1 Buyers and Providers of Reinsurance

4.1.1 Insurance Companies

Clearly insurance companies are going to be a prime buyer of reinsurance. However as noted in 3.5 above, there are a number of similarities between insurance and reinsurance, especially where individual risks are being reinsured.

Indeed the only essential difference when offering a risk by way of reinsurance is that the risk is being offered by another insurance company as opposed to a potential policyholder, thus it is quite natural that an insurance company would also consider to provide reinsurance capacity to another insurance company under such circumstances.

Thus many insurance companies will offer reinsurance capacity, and may have a department devoted to accepting reinsurance contracts.

However reinsurance, like insurance, is a profession both in terms of underwriting the risks involved and in the provision of services to ceding companies, thus smaller insurance companies are unlikely to provide the range of services and expertise available from professional reinsurers.

4.1.2 Professional Reinsurers

Generally professional reinsurers do not also carry on an insurance activity, they devote their resources to providing reinsurance capacity and services.

For this reason they are not seen by ceding companies as a potential competitor, and equally they will offer capacity to a number of ceding companies in any given market place.

Thus they can have an intimate knowledge of a local marketplace and may be able to provide valuable insights to avoid pitfalls that could easily occur with only the more limited insight that any individual insurance company operating in that marketplace might have.

They may also bring useful knowledge from other marketplaces where similar problems have been resolved in one way or another, or where better pricing models and data may be available.

Just as an insurance company seeks to spread it's risks by way of reinsurance, so a reinsurance company will seek to spread its risks in a similar manner. Thus professional reinsurers also buy reinsurance. A reinsurance of a reinsurance is called a retrocession.

4.1.3 Lloyd's Syndicates

As noted in 2.2 above, Lloyd's of London had its beginnings in a coffee house in London in the late 1680s.

Basically today, Lloyd's of London is an umbrella organisation, a market, providing the infrastructure, control, rules and oversight for syndicates which it allows to operate in its marketplace. Originally syndicates were made up of wealthy individuals, who, as members of a particular syndicate, had unlimited liability to cover any losses the syndicate made. Today a number of syndicates are owned corporately, and while many of these corporations are much wealthier that former individual names, a corporate entity is quite different from an individual name and thus not only the composition but also the character of Lloyd's has changed.

However, as before, syndicates operating in the Lloyd's of London marketplace can only be accessed by admitted "Lloyd's Intermediaries". No insurance company can gain entry to this marketplace and try to place business there. They must use the services of a Lloyd's Intermediary – for more on intermediaries refer to 4.2 – "Reinsurance Intermediaries" below.

Lloyd's syndicates can be authorised to carry on both insurance and reinsurance business. Traditionally Lloyd's syndicates have not carried on life business, and have split their market into marine and non-marine business. Equally some syndicates have specialised in reinsurance, and even particular aspects of reinsurance.

The Lloyd's intermediary understands this special marketplace and knows where best to place the risks it is entrusted with, at the best price, for its client.

4.1.4 Captive Companies

Generally a captive insurance or reinsurance company will concentrate on the risks of its parent, but like all evolving markets some captive companies have considered diversification to be of benefit to them, and they have expanded to write third party risks.

Equally some industries have set up a captive to specialise in risks peculiar to that industry. A good example is Oil Insurance Limited (OIL), a mutual insurance company that insures close to USD 3 Trillion of global assets for its 50+ members.

A captive that concentrates on the risks of its parent is often not authorised to carry on insurance business in all the territories where its parent operates. It thus often seeks a local authorised insurance company to write the risks to its local parent company and then reinsure those risks back to the captive.

In such circumstances the local insurer is said to "front" the risk, ceding it by way of reinsurance to the captive.

Fronting business and insurance/reinsurance business are not the same. A "fronting" ceding company may not be involved in pricing the business, nor in deciding on the terms and conditions. It is thus much more dependent on the ability of the captive to pay losses as they arise (credit risk). Where the ceding company has properly underwritten the business to its usual underwriting standards, and works with reinsurance companies with good ratings the credit risk is usually much lower.

4.1.5 Pools

An insurance pool is often representative of a local marketplace and comprises multiple insurance companies operating in that market. The pool may be used to provide cover for high value complex risks or even for paying losses to policyholders who's local insurance company has gone into liquidation.

A good example of an insurance pool is a pool to cover nuclear liabilities. In many countries the local nuclear power station is covered by the local pool, or the local pool is set up to write such risks from other countries. Where it is writing local risks, any risk held individually by a pool member must be retained net, and only the pool may reinsure itself.

4.2 Reinsurance Brokers

While consumers today may use the internet to obtain the best insurance deal for themselves, large industrial companies who may have a number of different exposures will employ the services of a intermediary who can help them to understand their risks, manage them and find the best markets and wordings to cover them.

An intermediary acts in the interest of its client – in the example above, the industrial policyholder. The intermediary may be paid a percentage of the premium by the insurance company who writes the policyholder's business, or it may be paid by its client on a fee basis. Intermediaries offer advice, and may place business in the world-wide markets.

Where they are not an authorised Lloyd's intermediary and wish to use the capacity of Lloyd's they must work with an authorised Lloyd's intermediary for that part of the risk which is placed in Lloyd's.

Similarly buying the right reinsurance protection for an insurance company's portfolios of risk can be a challenge, and many insurance companies will use the services of an intermediary to help them structure and place their reinsurance needs.

Some ceding companies may work with professional reinsurers directly for parts of their programme and also use a reinsurance intermediary for other parts.

Buying and selling reinsurance is like any marketplace, and it is important to be up-to-date with prices, terms and conditions and to know where the best terms can be obtained with the best security. Responsible and reliable reinsurance intermediaries who have a proven track record in the local market of the client, and also a good knowledge of the world-wide markets, are best placed to provide this information.

THE MARKETPLACE IS SUMMARISED BELOW:

Buyers	Sellers
Insurance company	Insurance company as reinsurer
	Lloyd's Syndicate as reinsurer
	Professional reinsurer
	Captive as reinsurer
	Pool as reinsurer
Lloyd's syndicate	Insurance company as reinsurer
	Lloyd's Syndicate as reinsurer
	Professional reinsurer
	Captive as reinsurer
	Pool as reinsurer
Captive	Insurance company as reinsurer
	Lloyd's Syndicate as reinsurer
	Professional reinsurer
	Captive as reinsurer
	Pool as reinsurer
Pool	Lloyd's Syndicate as reinsurer
	Professional reinsurer
Professional reinsurer	Insurance company as retrocessionaire
	Lloyd's Syndicate as retrocessionaire
	Professional reinsurer as retrocessionaire
	Captive as retrocessionaire

Any of the above parties, as buyers, may use the services of a reinsurance intermediary, but in any dealings with a Lloyd's syndicate, the reinsurance intermediary needs to be a reinsurance intermediary approved by Lloyd's.

5. WHY INSURANCE COMPANIES NEED REINSURANCE

Learning objective: To understand the main drivers behind the need for insurance companies to purchase reinsurance, and similarly for reinsurers to buy retrocession covers.

5.1 Loss Limitation

There are two essential aspects to controlling claims – claims frequency and claims severity.

Claims frequency arises when a ceding company experiences a greater NUMBER of losses than expected. This may occur in a random way – such as experiencing a much larger number of motor losses in a year than expected – simply there have been a lot of losses; or this may occur due to a natural disaster – an area with a number of policyholders being affected by flood, or earthquake or windstorm. Each individual loss in terms of amount may be well within the acceptable size of loss, but experiencing so many more small losses than expected results in a large deficit at the end of the year.

To avoid this situation ceding companies purchase reinsurance.

Claims severity results from losses where the AMOUNT is … or could be, much higher than expected. One way to limit this exposure is by transferring out, by way of reinsurance, a part of the risk at the time of acceptance. Thus if a ceding company writes motor cars with an average value of USD 40,000 and a maximum value of USD 55,000, and an important client wishes to insure a Ferrari worth USD 200,000, the ceding company limits its potential loss by ceding away that part of the risk which exceeds its average value of USD 40,000 and thereby avoids the possibility of having a loss above an acceptable amount.

Severity can also result from an unexpected turn of events. An underwriter estimates a maximum probable loss for a property risk at 10% of the maximum sum insured, and the loss is, in fact, 30% of the maximum sum insured – three times higher than ever expected. Equally a ceding company may estimate, based on its capital free reserves that it cannot afford to pay more than USD 100,000 for any individual claim which could occur, nor USD 250,000 for all claims arising out of one event.

Again to avoid situations which could cause the ceding company to have losses exceeding these amounts, the ceding company will buy reinsurance.

5.2 Provide Capacity to the Insurer

In many countries the premium that an insurer can write is a factor of the capital and free reserves the insurance company has available. Based on the insurance company's capital and free reserves, the company can write a multiple of this amount in premium income. Thus if country A allows insurers to write three times their capital and free reserves in premium, and the capital and free reserves are USD 3,500,000 then the company can write up to USD 10,500,000 of premiums. The "premiums" in such cases are often the premiums "net of reinsurance", thus if the company can find reinsurance capacity, it can write a multiple of the amount based purely on its capital and free reserves. For example, if the company can find reinsurers willing to reinsure 50% of all its risks, then the company can write up to USD 21,000,000 instead of USD 10,500,000. To this extent, reinsurance can be seen as "soft capital" for an insurance company. Rather than raising new capital to write more business, the insurance company can simply try to get more reinsurance capacity.

In addition to its ability to simply write more premium income, an insurer may simply need more capacity on a particular risk. Perhaps the insurer is limited to a sum insured of USD 2,000,000 on office buildings, and an important client requires that the company write USD 4,000,000 if they want to have the business. By seeking reinsurance cover, the insurance company can increase its share in a particular piece of business, by seeking capacity in the reinsurance markets.

5.3 Create Financial Stability

It is a fact of life that investors want stable results. They do not want surprises. When an insurance company makes predictions of its results to its shareholders, it must do all it can to produce results close to, or better than, those predictions. If the insurance company only produces 50% of the predicted profit, or worse, produces a loss, then the shareholders will often require the management to fully explain the situation.

As noted in 5.1 above, the main issues facing insurance companies are to control claims severity and claims frequency. There are reinsurance products for even the most volatile of portfolios, to enable an insurance company to stabilise its results over a period of years.

The issue is one of cost. The more reinsurance a company buys, the more it reduces its risks. There is a true saying that "there is no profit without risk", so it is the challenge of every insurance company management to balance profit and stability, to find the right combination of retention and reinsurance to provide the optimum result.

5.4 Protect Solvency Margins

As noted in 5.2 above many countries require insurance companies to maintain premiums at a certain ratio of their capital and free reserves. This is known as being within the solvency margin. Thus in the example in 5.2 above the insurance company could write USD 10,500,000 of premiums (net of reinsurance) based on its capital and free reserves. If the company wrote instead USD 12,000,000 of net premiums, then it is highly likely the government regulator in the country concerned would take disciplinary action against the insurance company for exceeding its allowed solvency margin.

Motor business is a good example of a class of business where if an insurance company has an attractive product it can produce large amounts of additional premium income very quickly. To avoid problems with the government regulator, the company can monitor its income closely, and as it gets close to its allowed solvency margin it can purchase additional reinsurance to ensure it stays within its permitted ratios.

5.5 Provide Value Added Services

One guaranteed element of our daily lives is that there will be constant change and whether we like it or not there is no escape from the need to innovate and evolve. This may be something the insurance company initiates itself – for example a decision to write engineering business, or it may be the result of extreme pressure from the market, for example to write some type of cyber cover. Where an insurance company has no knowledge of these classes of business it can often turn to a professional reinsurer for help in establishing the necessary know-how to write such classes profitably. Professional reinsurers have a broad experience over a number of markets and can often import good ideas and experience from other markets that have been faced with similar problems. While no market is ever exactly the same as another market, with the skill, capacity and experience of a good reinsurer, it may be possible to adapt wordings and pricing to begin a new class or a new account for a particular insurance company without threatening its stability.

A number of reinsurers can also provide useful market information for existing lines of business and training to an insurance company using their reinsurance capacity. This is a win-win situation for both sides as well trained insurance company employees enhance the profitability of their employer and also contribute to the profitability of the reinsurer.

6. BASIC FORMS AND TYPES OF REINSURANCE

Learning objective: To understand the meaning of the words "facultative" and "treaty" which describe the main forms of reinsurance.

To understand the meaning of the words "proportional" and "non-proportional" which describe the main types of reinsurance.

To understand the meaning of the words "quota share", "surplus" and "facultative obligatory" which are sub-types of proportional treaty reinsurance and how these treaty types spread risk. Also how premiums and losses are distributed working with these treaties.

To understand the meaning of the words "risk excess of loss", "catastrophe excess of loss" and "stop loss" which are sub-types of non-proportional treaty reinsurance and how these treaty types spread risk. Also how premiums and losses are processed working with these treaties.

To understand how some of these forms and types can be used in combination.

Reinsurance can be placed in one of two forms – Facultative or Treaty.

Facultative Reinsurance

- Facultative reinsurance is reinsurance for **INDIVIDUAL RISKS** on a case by case basis
- Practically, the direct insurer is free to choose which individual risks it wants to reinsure, and the reinsurer is free either to accept or refuse any risk offered to it: Hence the term **FACULTATIVE**.

Obligatory Reinsurance

- Obligatory reinsurance is reinsurance for the **ENTIRE PORTOFOLIO** on an automatic basis.
- Practically, the direct insurer is obliged to cede a contractually agreed share of the risks and the reinsurer is obliged to accept that share: Hence the term **OBLIGATORY**

Both the Facultative and Treaty forms can be placed as either Contributory or Proportional Reinsurance, or Non-Contributory or Non Proportional Reinsurance. Facultative reinsurance is dealt with in detail in 6.1 below and Treaty placements are dealt with in detail in 6.2.

There are two main types of reinsurance - Contributory or Proportional Reinsurance, and Non-Contributory or Non Proportional Reinsurance.

Proportional Reinsurance

- This type of reinsurance is based on **RISKS**.
- The reinsurer will receive the premium and will have to pay the losses in proportion to its participation in the sum insured of the original risk: Hence the term **PROPORTIONAL**.

Non-Proportional Reinsurance

- This type of reinsurance is based on **LOSSES**.
- The reinsurer will have to pay only if an actual loss for a risk or number of risks exceeds the deductible, and then only up to the cover limit as contractually agreed. As the price for the cover, the reinsurer gets a negotiated portion of the original premium

Under Contributory or Proportional Reinsurance the insurance company or cedant passes or cedes a proportion of its liability on an individual risk or number of risks to a reinsurer and pays the reinsurer the same proportion of the original premium for the risk or risks. In the event of a claim, the reinsurer in return will reimburse the insurer with the same proportion of the claim or claims.

Thus if you review a reinsurance cover and find that the reinsurance cession is calculated as a function of the sum insured, then you are looking at a contributory or proportional reinsurance. Proportional reinsurance is explained in much more detail in 6.2.2 below.

Non-Contributory or Non Proportional Reinsurances apply not to specific risks but to losses. They limit the amount of loss an insurance company or cedant can suffer under any one claim or event.

Unlike contributory or proportional reinsurance, the cedant does not cede risks to the reinsurer but the reinsurer agrees to pay the amount of a loss over and above, or in excess of, a fixed amount referred to as the cedant's "retention", or "deductible", or "priority". The portion payable by the reinsurer is referred to as the "cover". Thus, the cover relates to losses rather than individual risks forming the ceding company's portfolio. Non-proportional reinsurance is explained in much more detail in 6.2.3 below.

6.1 Facultative Reinsurance

6.1.1. Definition and Key Features

Facultative reinsurance is the oldest form of reinsurance. It can be arranged either on a proportional or non-proportional basis. The word facultative means optional i.e., it gives the reinsurer the right to accept or decline the business being offered to it. Another feature of facultative reinsurance is that it is only used for individual risks.

Generally it is used under the following circumstances:

1. When automatic treaty arrangements - see 6.2 below - have been used up, i.e., a particular risk exceeds the automatic treaty limits.

2. The risk is excluded from the automatic treaty arrangements - see 6.2 below - e.g., it is located outside the geographical limits or it is an excluded class of business.

3. The insurance company does not want to expose its automatic treaty arrangements - see 6.2 below - with particularly heavy and hazardous risks.

4. There is no automatic cover available in a particular class of business e.g. cyber risk where the ceding company rarely issues policies.

5. Where the insurance company wishes to increase its own net account by offering facultative reinsurance in exchange for similar business from other insurance companies (known as "inwards facultative reinsurance").

6.1.2. Advantages and Disadvantages

Advantages:

1. It enables the ceding company to increase its capacity in individual instances where it is commercially necessary or profitable or both to do so.

2. It enables the ceding company to make use of a reinsurer's expertise in a particular class of business where the ceding company may have very little experience itself.

3. It enables the ceding company to offer flexibility to important clients or may enable it to compete for important market accounts where a part of the business is unusual or outside its normal underwriting policy.

4. As noted above, it can enable the ceding company to protect its automatic capacity where it needs or wants to write a particularly hazardous risk which could unbalance its automatic treaties.

5. Offering facultative business can also be a good way for a ceding company to gain knowledge of a new reinsurer with whom it would like to work, to understand better its competitiveness, its ability to reply promptly, and other services it may be able to provide.

Disadvantages

1. The time necessary to offer a risk to the reinsurance markets can delay the issue of a policy which can create problems for intermediaries, agents and clients.

2. Seeking facultative reinsurance increases administrative costs.

3. The ceding company may lose some of its freedom in fixing the price and terms of the insurance and even in certain cases the reinsurer may require the ceding company to refer to the reinsurer when settling losses.

4. It may not be possible to amend the policy unless the reinsurer agrees.

5. If the business is placed facultatively with a competitor, it may provide the competitor with the information it needs to steal the client at the next renewal.

6. Lack of fully "back-to-back" cover or differences in interpretation of the wording of the reinsurance cover may create problems to collect claims.

6.1.3. Proportional Arrangement

For example: The Royal Insurance Company is offered a new risk from one of its most important clients – The International Group. The International Group want to extend their business into furniture manufacturing and intend to buy a factory currently on offer for a good price. Prior to purchase they approach the Royal through their intermediary to obtain cover.

The Royal has a problem as furniture manufacturers, being a hazardous risk, are excluded from their treaties, but they must show flexibility to this important client. So they seek the advice of a reinsurer willing to take 80% of the risk, and together they set terms and produce a policy wording. The proportional reinsurer will then receive 80% of the premium (net of brokerage) and less a reinsurance commission, and pay 80% of the losses.

CASE STUDY

Taking the example above, the Royal agrees terms with the client's intermediary and produces the following proportional "slip" to offer the risk facultatively to reinsurers.

SPECIMEN PROPORTIONAL FIRE FACULTATIVE REINSURANCE SLIP

FIRE AND/OR LIGHTNING AND/OR EXPLOSION

Reinsured:	Royal Insurance Co. Ltd.
Original Insured:	The International Group, 29/31 East Street, Strand.
Cover On:	Buildings/Machinery/Stocks. Furniture manufacturing.
Terms:	At original gross rate less 25% commission and 2.5% brokerage

Period:	12 months at 1st March 2016
Sum Reinsured:	USD 2,000,000 (80%) part of $2,500,000
Retention:	USD 500,000 Sum Insured Basis
Information:	Class 3. Sprinklered,

Original gross rate:	Buildings 0.25%
	Machinery/Stock 0.35%
Sums insured:	Buildings USD 1,400,000
	Machinery USD 700,000
	Stock USD 400,000

The Royal places this facultative reinsurance 100% with The Professional Reinsurance Company.

This is a proportional cover, so as noted under the sum reinsured above, the Professional Reinsurance Company will receive 80% of the premium, and also pay 80% of any losses.

The premium calculation is as follows:

Buildings USD 1,400,000 x 0.25%	= USD 3,500
Machinery USD 700,000 x 0.35%	= USD 2,450
Stock USD 400,000 x 0.35%	= USD 1,400
Total premium	= USD 7,350
Brokerage at 2.5%	= USD – 184
Net premium	= USD 7,166
Retained – 20%	= USD 1,433
Ceded – 80%	= USD 5,733
Less reinsurance commission – 25%	= USD-1,433
Net premium payable to reinsurer	= USD 4,300

If there was a loss to this cover of USD 500,000 then the loss would be apportioned as follows:

Total loss	= USD 500,000
Royal – 20%	= USD 100,000
Reinsurer – 80%	= USD 400,000

6.1.4. Non-Proportional Arrangement

For example: The Royal Insurance Company is offered a new risk from one of its most important clients – The International Group. The International Group want to extend their business into furniture manufacturing and intend to buy a factory currently on offer for a good price. Prior to purchase they approach the Royal through their intermediary to obtain cover.

As this furniture factory is a hazardous risk, the Royal does not want to put the risk into its automatic treaty. At the same time the Royal is able to get a good rate for the risk, and is hopeful of making a good profit if the risk runs well. On the other hand the Royal does not want to have a very large loss which could destroy the result forecast it has given to its shareholders (claim severity), so it decides to limit its potential loss to USD 1,000,000 part of a sum insured of USD 2,500,000. It thus seeks a non-proportional facultative cover for USD 1,500,000 excess of USD 1,000,000.

CASE STUDY

Taking the example above, the Royal agrees terms with the client's intermediary and produces the following non-proportional "slip" to offer the risk facultatively to reinsurers.

SPECIMEN FIRE NON-PROPORTIONAL FACULTATIVE REINSURANCE SLIP

FIRE AND/OR LIGHTNING AND/OR EXPLOSION

Reinsured:	Royal Insurance Co. Ltd.
Original Insured:	The International Group, 29/31 East Street, Strand
Cover On:	Buildings/Machinery/Stocks. Furniture manufacturing
Terms:	10% brokerage
Period:	12 months at 1st March 2016
Sum Reinsured:	USD $1,500,000 any one loss excess of USD 1,000,000 any one loss
Retention:	USD 1,000,000 Sum Insured Basis
Excess of loss	
Premium:	20.5% of original premium
Information:	Class 3. Sprinklered,
Original gross rate:	Buildings 0.25%
	Machinery/Stock 0.35%

Sums insured:	Buildings	USD 1,400,000
	Machinery	USD 700,000
	Stock	USD 400,000

The Royal places this facultative reinsurance 100% with The Professional Reinsurance Company.

This is a non-proportional cover, so the Professional Reinsurance Company will receive the premium it has quoted for the cover = 20.5% of the original premium to pay any losses in excess of USD 1,000,000.

The premium calculation is as follows:

Buildings	USD 1,400,000 x 0.25%	= USD 3,500
Machinery	USD 700,000 x 0.35%	= USD 2,450
Stock	USD 400,000 x 0.35%	= USD 1,400
Total premium		= USD 7,350
Premium due to reinsurer 20.5%		= USD 1,506.75
Brokerage at 10%		= USD – 151
Net premium payable to reinsurer		= USD 1,355.75

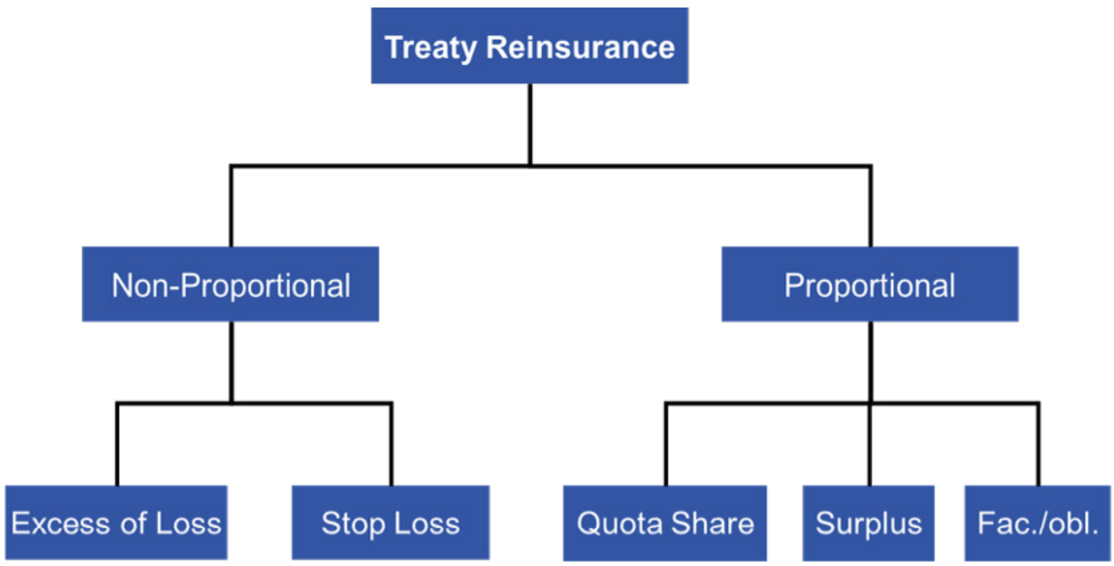
If there was a loss to this cover of USD 500,000 then the loss would be apportioned as follows:

Total loss	= USD 500,000
Royal	= USD 500,000
Reinsurer	= USD 0

If there was a loss to this cover of USD 1,500,000 then the loss would be apportioned as follows:

Total loss	= USD 1,500,000
Royal	= USD 1,000,000
Reinsurer	= USD 500,000

6.2. Treaty Reinsurance



6.2.1. Definition and Key Features

Treaty reinsurance is also known as "Obligatory" reinsurance. That is to say once the terms and conditions of the treaty have been agreed between the ceding company and its reinsurer(s), the ceding company must cede risks falling within the scope of the treaty and the reinsurer(s) must accept those risks. There is no option to do otherwise, except in the instance noted above 6.1.2. Advantages 4 – where the ceding company may – subject to the terms of the reinsurance treaty, and if necessary with the permission of the reinsurer(s) – reinsure facultatively certain hazardous risks which could unbalance the treaty or negatively affect the results.

The key features of treaty reinsurance are:

1. No individual risk scrutiny by the reinsurer.

2. Portfolios of business can be covered as opposed to individual risks.

3. Treaty covers are much cheaper to administrate than facultative business.

4. Risks falling within the portfolio are automatically covered.

5. Properly structured, treaties can provide good protection against both claims frequency and claims severity.

6. A long-term relationship can be established in which the reinsurer's profitability is expected, but measured and adjusted over an extended period of time.

7. One contract encompasses all subject risks.

Reminder: There are two main types of reinsurance - Contributory or Proportional Reinsurance, and Non-Contributory or Non Proportional Reinsurance.

Under Contributory or Proportional Reinsurance the insurance company or cedant passes or cedes a proportion of its liability on an individual risk or number of risks to a reinsurer and pays the reinsurer the same proportion of the original premium for the risk or risks. In the event of a claim, the reinsurer in return will reimburse the insurer with the same proportion of the claim or claims.

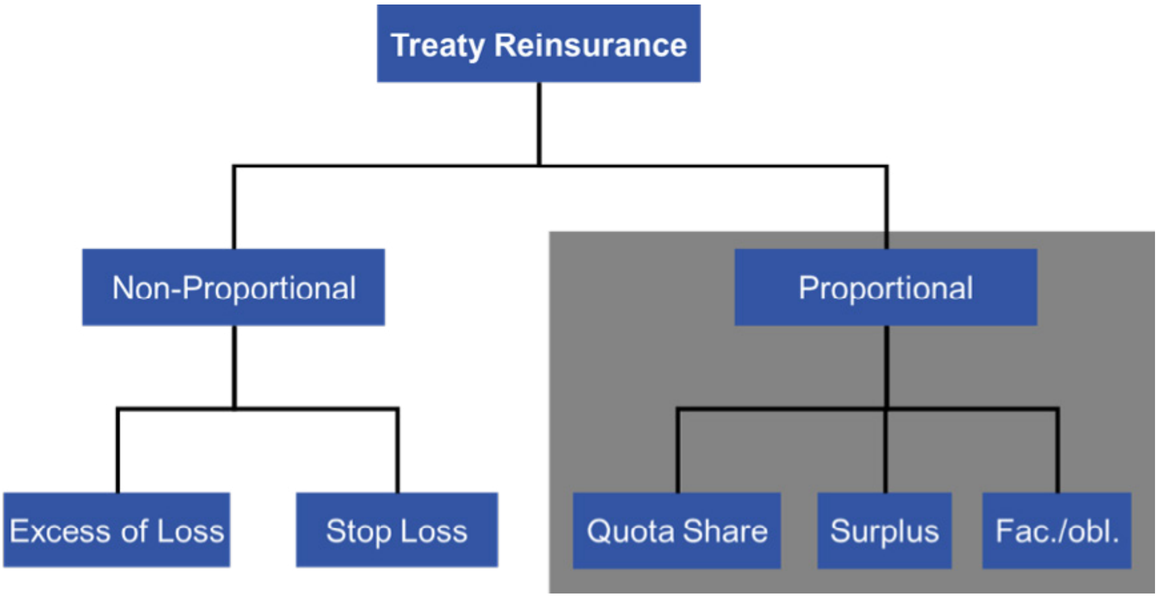
Thus if you review a reinsurance cover and find that the reinsurance is calculated as a function of the sum insured, then you are looking at a contributory or proportional reinsurance.

Non-Contributory or Non Proportional Reinsurances apply not to specific risks but to losses. They limit the amount of loss an insurance company or cedant can suffer under any one claim or event.

Unlike contributory or proportional reinsurance, the cedant does not cede risks to the reinsurer but the reinsurer agrees to pay the amount of a loss over and above, or in excess of, a fixed amount referred to as the cedant's "retention", or "deductible", or "priority". The portion payable by the reinsurer is referred to as the "cover". Thus, the cover relates to losses rather than individual risks forming the ceding company's portfolio.

Contributory or Proportional reinsurance and Non-Contributory or Non Proportional reinsurance can be placed in one of two forms – Facultative and Treaty. In this section we deal with Treaty Reinsurance.

6.2.2 Proportional Treaty Reinsurance



6.2.2.1 Quota Share Treaty

Under a quota share treaty, the ceding company is bound to cede a fixed percentage or proportion of every risk written by it which falls within the scope of the treaty. The same percentage of every risk in a class of business covered is ceded no matter how small or large the sum insured and irrespective of whether the risk is good or bad. This is the main difference between the quota share and the surplus treaty, which we will see later.

The following example illustrates this point. This example is based on a 90% quota share treaty, that is to say the ceding company retains 10% of every risk and cedes 90% of every risk falling within the scope of the treaty. On this basis, the cover would be as follows:

RISK	A	B	C
SUM INSURED	USD 100	USD 10,000	USD 200,000
CEDING COMPANY	USD 10	USD 1,000	USD 20,000
REINSURER	USD 90	USD 9,000	USD 180,000

It is very important to note that both the premiums and the claims are subject to the same percentage distribution. It is usual for the treaty to include a clause which sets out the percentage of each risk to be reinsured and also a monetary or maximum limit for the cover e.g., 90% of every risk to be ceded, subject to a maximum of USD100,000 any one risk. As a further protection for the reinsurer, it is usual for the treaty to state that ceding company would retain a certain percentage for its own account. This would ensure that the ceding company does not write bad business and reinsure everything.

Advantages of the Quota Share:

1. Its operation is simple – there is little administration and accounting is straightforward.
2. A quota share treaty provides capacity for larger risks that would otherwise be very difficult and cumber-

some for the ceding company to underwrite. (It would have to seek facultative reinsurance for each risk individually).

3. There is no "selection against" the reinsurer i.e., the reinsurer gets a proper mix of business as the ceding company is obliged to cede every risk falling within the scope of the treaty, it cannot choose to cede only the poorer quality risks.

4. Generally a quota share treaty benefits from higher commission rates. The quota share, being a selection of every risk written by the ceding company within that class, passes on a larger potential share of the profit than would otherwise be retained by the ceding company, thus it usually pays a higher commission rate.

5. It allows the ceding company to reduce its commitments on each risk to much smaller amounts.

6. By considerably limiting the exposure under each risk, the ceding company requires much less capital to write a large portfolio of business and thus this type of reinsurance arrangement can be used to overcome solvency margin problems.

7. Good protection against claims frequency/severity problems as the retention of the ceding company on every risk is limited.

8. Protection applies from the first dollar, in this example the reinsurer also pays 90% of every loss from the first dollar. Thus the quota share reinsurance treaty permits recovery also on smaller losses.

Disadvantages of the Quota Share:

1. The ceding company cannot select the risks it cedes to the reinsurer and thus must cede also those risks which lie well within its own financial capacity.

2. The relative variability of expected losses on the retained portfolio would be the same as the total portfolio i.e., if the portfolio comprises very dissimilar risks, the proportion retained contains the same lack of homogeneity. The imbalance that results from the number of bigger risks is still evident in the retained portfolio.

When a quota share is often chosen:

1. It is often used by new companies entering the market for the first time.

2. Also when a ceding company is entering into a new class of business or a new area of operation especially where it has little or no experience.

3. Where a ceding company wishes to exchange business rather than just ceding its own business, a quota share treaty is a good vehicle to seek a reciprocal exchange of business.

4. For reducing a ceding company's exposure under policies covering natural perils.

5. For classes of business where although there may be a policy limit, the incidence and size of losses are uncertain e.g., liability business.

6.2.2.2 Surplus Treaty

Under the surplus treaty the ceding company decides the limit of liability which it wishes to retain on any risk or class of risks. This limit, called the ceding company's gross retention, will be the maximum that it will retain. However depending on the treaty terms, it may retain a lower amount if it so wishes.

The surplus over and above this retention level will be allocated to one or more reinsurers on the surplus treaty. (Note: It is also possible for a ceding company to have several surplus treaties i.e. a first surplus, a second surplus, a third surplus, as will be seen later).

EXAMPLE I

The ceding company's maximum gross retention in this surplus treaty is USD 1,000 on fire insurances covering furniture workshops. Then on all such policies with:

SUM INSURED	RETENTION	REINSURANCE
USD 1,000	USD 1,000	NIL
USD 2,000	USD 1,000 (50%)	USD 1,000 (50%)
USD 3,000	USD 1,000 (33%)	USD 2,000 (67%)
USD 5,000	USD 1,000 (20%)	USD 4,000 (80%)

EXAMPLE II

On office blocks, the ceding company's gross retention may be USD10,000 on each risk. Thus on such policies:

SUM INSURED	RETENTION	REINSURANCE
USD 5,000	USD 5,000 (100%)	NIL
USD 10,000	USD 10,000 (100%)	NIL
USD 25,000	USD 10,000 (40%)	USD 15,000 (60%)
USD 100,000	USD 10,000 (10%)	USD 90,000 (90%)

The amount ceded to a surplus treaty is usually expressed by the number of "lines" it contains. Each "line" is equivalent to the ceding company's gross retention. Thus if a ceding company has a maximum gross retention of USD 10,000 and operates a 10 line surplus treaty, the treaty capacity can absorb liabilities over and above the gross retention up to USD 100,000 (i.e., USD 10,000 x 10 lines). If the ceding company's gross retention of $10,000 is added, then the overall underwriting capacity of the ceding company is USD 110,000.

If, for any reason, the ceding company decides to retain only USD 4,000 in a particular risk, then the amount ceded to the treaty for that particular risk may not exceed USD 40,000 (i.e., USD 4,000 x 10 lines).

If the ceding company has risks where the sum insured exceeds the treaty limits, it has two options; (a) to accept the excess amount for its own account (in addition to its existing gross retention) or (b) to seek further reinsurance cover which could be on a facultative basis or by placing a further surplus treaty which would then be termed as the "second" surplus treaty. The first surplus would have priority for any sums insured over and above the ceding company's gross retention, and risks would be allotted to it first.

The second surplus would be involved in a risk where the original sum insured was larger than the amount of the ceding company's gross retention plus the amount allotted to the first surplus treaty for example:

SUM INSURED	RETENTION	1ST SURPLUS	2ND SURPLUS	3RD SURPLUS
USD 10,000	USD 10,000	NIL	NIL	NIL
USD 130,000	USD 10,000	USD 100,000	USD 20,000	NIL
USD 230,000	USD 10,000	USD 100,000	USD 100,000	USD 20,000

A situation may occur where a company decides to spread the risk evenly over its treaties to give reinsurers on the higher layers more business, to achieve this it could decide to reduce its gross retention from USD 10,000 to USD 8,000 – where the treaty terms and conditions permitted this.

There are two ways in which the limits of a surplus treaty may be stated:

1. On a "Sum Insured" limit based on a table of limits.

2. On a "Maximum Probable Loss" limit (MPL).

SUM INSURED LIMIT

This is the actual sum the risk is insured for and is thus also the maximum amount that can be claimed in the event of a loss. Thus, for a 10-line treaty where the ceding company retains USD 10,000 on any one risk, the maximum exposure of the reinsurers on any one risk would be USD 100,000 subject to any scaling down of amount in accordance with the table of limits.

MAXIMUM PROBABLE LOSS LIMIT (MPL)

Unlike the sum-insured limit, the MPL limit is not, as such, restricted (however as we will note later, the reinsurer may insist that the treaty is subject to a minimum MPL of, for example, 50%).

MPLs are commonly used in fire risks, as the property insured may not be totally damaged when a loss occurs. For example, the sum insured may be spread over several buildings, all at a considerable distance from one-another, making the spreading of fire highly unlikely.

Thus, one can estimate that, given the particulars of the risk in question, that an MPL of, for example, 10% can be applied. Taking this example, the MPL for a risk with a sum insured of USD 500,000 is estimated at 10%. Thus the ceding company decides to retain $5,000 on an MPL basis although this still means that the company's liability in the event of a total loss is USD 50,000. 9 lines of the treaty would be used for reinsuring the balance of the sum insured. The reinsurer's liability would be USD 450,000 (Sum Insured) but would not expect to lose more than USD 45,000 (MPL).

While the MPL gives the ceding company the advantage of greater capacity for absorption of risks under the surplus treaty, it has the major disadvantage of making the ceding company and even the reinsurer lose more than they expected in a situation where the MPL is under estimated (in the above example they can lose 10 times more!) For this reason only companies who have considerable expertise in fixing MPL's should use this system. Even where this is the case, cessions to a treaty on an MPL basis may be subject to a provision that the MPL will never be calculated at less than a certain percentage e.g., "the MPL for any cession to the treaty shall not be less than 25%" of the total sum at risk.

Another disadvantage could stem from a situation where the MPL is not properly defined at the inception of the contract so that it would not have the same meaning to both the ceding company and the reinsurer.

MPL can also be interpreted as "Maximum Possible Loss", which is a much more severe calculation than "Maximum Probable Loss". There are also the abbreviations PML – Probable Maximum Loss, and PML – Possible Maximum Loss. It is thus easy for confusion between ceding company and reinsurer to arise, and there is then a need for clarity of meaning.

THE REINSURERS PARTICIPATION

In discussing the treaty, we assumed that the surplus was always ceded to only one reinsurer. However, in practice, this is not usually the case and indeed several reinsurers may participate in each treaty.

The reinsurers' participation may be expressed as follows:

1. 10% but not exceeding 1 line (part of 10 lines)

2. 90% but not exceeding 9 lines (part of 10 lines)

Thus, if two reinsurers participate in a 10-line treaty, based on the above example, the risks would be shared as follows:

	RISK 1	RISK 2	RISK 3
SUM INSURED	USD 10,000	USD 20,000	USD 55,000
CEDING COMPANY'S RETENTION	USD 5,000 (i.e. 1 line)	USD 5,000 (i.e. 1 line)	USD 5,000 (i.e. 1 line)
REINSURER A 10%	USD 5,00 (i.e. 0,1 line)	USD 1,500 (i.e. 0,3 line)	USD 5,000 (i.e. 1 line)
REINSURER B 90%	USD 4,500 (i.e. 0,9 line)	USD 13,500 (i.e. 2,7 line)	USD 45,000 (i.e. 9 line)

From this example it will be seen that even when the total number of lines are not used up, each reinsurer receives their proportion of each and every cession to the treaty. There is always a pro rata share for reinsurers on the same treaty.

PREMIUMS

The reinsurance premium paid by the ceding company to the reinsurer(s) is a percentage of the original premium paid by the insured. The percentage paid to the reinsurer(s) is the same as the percentage of the sum insured ceded by the ceding company. E.g.,

	CEDING COMPANY	REINSURER(S)
SUM INSURED USD 10,000	USD 5,000	USD 5,000
PREMIUM USD 20	USD 10	USD 10
SUM INSURED USD 45,000	USD 5,000	USD 40,000
PREMIUM USD 45	USD 5	USD 40

The premiums for any risks excluded from the treaty and return premiums due under canceled policies are not included in the reinsurance premium. The reinsurer will allow a reinsurance commission to the ceding company to compensate for its original commissions or brokerages, acquisition costs, costs of keeping the business on the books and administration expenses; but commissions paid by the ceding company to agents or intermediaries are not deducted from the reinsurance premium to which the commission is applied.

As the demand for reinsurance increases (because, for example, the business is desirable business for a reinsurer – e.g. well spread household insurance, or because the results of the treaty have been very good), so the level of reinsurance commission can be increased. Thus a reinsurance commission of 35% may be adequate to cover commissions paid to agents/intermediaries, acquisition costs, etc. but the business may be sufficiently desirable for reinsurers to be prepared to pay 40% or more. Another option is that the reinsurer may allow a further commission, usually called a profit commission, if the results under the treaty merit this.

In marine and certain other classes of business, reinsurance premiums are sometimes paid on a "net" basis i.e., less original commission. Here, the reinsurer will only allow a small "over riding commission" to cover the cost of administration of the business and treaty by the ceding company.

CLAIMS

All claims falling within the scope of the treaty will be distributed between the ceding company and reinsurer(s) in the same proportions as the original sum insured was distributed. The ceding company is not allowed to collect the whole loss from only one reinsurer as all reinsurers participating in the business will be expected to bear their share.

An example:

	SUM INSURED	PERCENTAGE	LOSS
	USD 35,000	100%	USD 1,400
CEDING COMPANY RETAINS	USD 5,000	14,29%	USD 200
REINSURER A 10%	USD 3,000	8,6%	USD 120
REINSURER B 90%	USD 27,000	77,11%	USD 1,080

The reinsurer, apart from being liable for its share of the sum insured paid by the ceding company to the claimant is also liable for its share of claims' costs such as legal fees, assessors fees etc., but it is not liable for a share of the office expenses of the ceding company. Recoveries, whether by means of salvage or by the exercise of the rights of contribution and subrogation must be shared in the same proportion as the claim between the ceding company and the reinsurers.

However, reinsurers are often not liable for payments made ex-gratia by the cedant. Ex-gratia payments are payments made by the ceding company which are not legally and contractually necessary, but made by the ceding company for commercial reasons, to keep an important client happy or to secure further business at renewal. Reinsurers will often seek to exclude such payments from the treaty contract, or demand consultation with the reinsurer prior to making any such payment.

Although claims' payments are usually included in the accounts rendered to the reinsurer on a quarterly or half-yearly basis, and deducted from the premiums due to the reinsurer, there must also be a provision in the treaty contract that certain large claims can be paid on demand at the option of the ceding company. The ceding company may simply not have the cash to pay an unexpected large claim, and thus it needs to be able to request immediate payment of such claims from the reinsurer. This provision is known as a "Cash Loss" clause, and it states the minimum amount a claim must have before the clause can be invoked, and the time limit the reinsurer then has to transfer the money.

Disadvantages of the Surplus Treaty for the Ceding Company:

The cost of administration of this type of business is relatively high as the percentage distribution of each risk will be different. At the same time the reinsurance commission is usually lower than that of a quota share treaty.

Disadvantages of the Surplus Treaty for the Reinsurer:

There are inherent characteristics of selection against the reinsurer, which come about when the ceding company decides to keep a higher proportion of the good business and cede a higher proportion of the less desirable risks to the reinsurer. The ceding company by so doing increases its profit through the retention of the good business while the losses are reduced by passing on the less desirable risks to the reinsurer.

Advantages of the Surplus Treaty for the Ceding Company:

One of the main functions, and advantages, of the surplus treaty is to give the ceding company an efficient way to establish "size homogeneity". The surplus treaty gives the ceding company the ability to control the size of its retained liability under each risk in order to allow the law of large numbers to operate with maximum efficiency. The reinsurer absorbs the wide variance of size.

Thus, for example, the ceding company can retain USD 10,000 on an office block, and also USD 10,000 on an oil refinery and USD 10,000 on a large factory, while ceding to the reinsurer USD 50,000 on the office block, USD 150,000 on the oil refinery, and USD 85,000 on the large factory.

At the same time by being able to scale the sum insured according to different types of risk, the ceding company can take lesser amounts on the less desirable risks, thus maintaining the quality of the retained portfolio by being able to take more on the better risks and less on the less desirable risks.

Advantages of the Surplus Treaty for the Reinsurer.

As ceding companies improve their expertise and become more established in a marketplace it is a fact of life that they become more confident in their ability to underwrite risks and manage their portfolio. It is then normal that they want to retain more of the business.

If equally the reinsurer has confidence in the abilities of the ceding company, then generally the reinsurer will be able to retain a certain volume of premium income by entering into surplus arrangements with the ceding company.

Should the ceding company prefer to change its programme from a proportional programme to mainly a non-proportional programme (see below) then the loss of premium for quota share and surplus reinsurers can be significant.

6.2.2.3 Facultative Obligatory Treaty

This is a treaty which combines some of the principles of both the facultative and the treaty method of proportional reinsurance.

It makes it possible for the ceding company, at its discretion, to offer certain selected risks to the reinsurer, which the latter is obliged to accept under the terms and conditions stipulated in the treaty.

Under this arrangement, a high degree of trust must exist between the contracting parties to ensure that the reinsurer receives a reasonable spread of risks as considerable flexibility is provided to the ceding company.

The primary function, when placed in addition to a surplus treaty, is to give the ceding company automatic reinsurance in excess of the capacity of its surplus treaty/treaties.

Thus it may be arranged simply for additional capacity to expand and develop existing accounts. It may also help the ceding company to maintain acceptance shares on large, so called, "target" risks or where accumulation problems may arise. Additionally, in circumstances where the degree of hazard requires the ceding company to limit its own retention, it may be used to cover specific categories of risks which could be of interest to the reinsurer.

The disadvantage of this arrangement is that the risks that may be ceded to this treaty are likely to be fewer and larger than those ceded to surplus treaty, thus producing even less balance for the reinsurer.

("Balance" in a proportional treaty is the amount of loss a treaty can sustain, while still making a profit. If a treaty has a risk limit of USD 250,000 and a net premium to reinsurers of USD 5,000,000 over a number of risks, it can absorb 20 full losses without the treaty going into a loss. Such a treaty, on the face of it, looks to be very well balanced.

If a treaty has a risk limit of USD 250,000 and a net premium to reinsurers of USD 250,000, such a 1:1 balance may suffice depending on the quality of the business and the expected loss frequency.

If a treaty has a risk limit of USD 250,000 and a net premium to reinsurers of USD 50,000, then the balance is 1:5. Five years' worth of premiums will be required to cover one full loss. If such a treaty has even several medium sized losses, it may never recover to a profit even after a number of years. Such a treaty is not well balanced.)

A ceding company may often combine a quota share with a surplus treaty are combined with each other to cover a particular class of business.

Under this circumstance, cessions are first made to the quota share treaty and, once the limit under that treaty is exhausted, further amounts are ceded to the surplus treaty.

Under the quota share treaty, the ceding company reinsures its gross retention. This gross retention is equal to the "line" on which the surplus treaty is based. It is important to stress that it is the "gross" retention i.e. the whole of the underlying quota share, that is considered as the "line" under the surplus treaty, as opposed to the "net" retention of the ceding company, which is limited to the share the ceding company retains under the quota share treaty. The difference between gross and net retentions is shown in the following examples:

QS treaty limit = USD 200,000 any one risk

The ceding company's net retention under the quota share is 20% = USD 40,000 any one risk

The surplus treaty has a limit = 10 lines.

Based on the "gross" retention of the ceding company, the surplus treaty thus has a capacity of USD 2,000,000 any one risk. (If it was based on the "net" retention, the surplus treaty would only have a capacity of USD 400,000 – a big difference).

Under the above example, all risks up to a USD 200,000 sum insured would be ceded to the quota share treaty and the ceding company would retain 20% of the amounts ceded.

Any balance of sum insured over USD 200,000 would be ceded to the surplus treaty, up to a maximum of USD 2,000,000 (if the gross retention of the cedant is applied). On either basis, the ceding company is never exposed for more than USD 40,000 for its own account.

It can be seen that it is extremely important, once again, to have clarity of meanings, in this case to determine whether the surplus treaty, when arranged in conjunction with a quota share, is based on the net or gross retention, as the difference in monetary limits can be considerable.

EXAMPLES

Based on the above figures:

QS treaty limit	= USD 200,000 any one risk
Cedant's 20%	= USD 40,000 any one risk
Surplus capacity	= USD 2,000,000 any one risk based on gross retention

Example 1

Risk sum insured	= USD 100,000
Distribution:	
Cedant's retention	= USD 20,000 (20% part of 100% of the risk which falls 100% within the QS capacity)
QS cession	= USD 80,000
Surplus cession	= USD 0

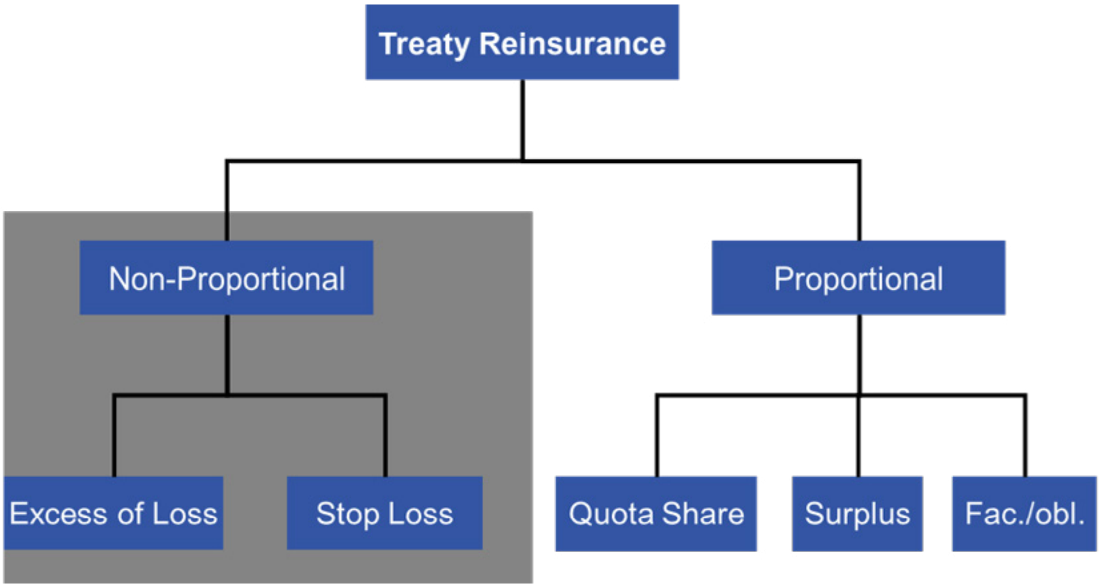
Example 2

Risk sum insured = USD 2,000,000

Distribution:

Cedants retention = USD 40,000 (20% part of QS capacity of USD 200,000)

QS cession = USD 160,000 (80% part of QS capacity of USD 200,000)



Surplus cession = USD 1,800,000 (being the balance which is within the surplus total capacity of USD 2,000,000)

6.2.3 Non-Proportional Treaty

Non-proportional treaties do not apply to specific risks but to losses. Non-Proportional treaties limit the amount of the ceding company's loss for any one claim.

The ceding company does not cede risks; the reinsurer agrees to pay the amount of loss over and above (in excess of) a certain amount (variously referred to as the "retention", the "deductible" or the "priority"). The reinsurer then agrees to pay an amount up to an upper limit, referred to as the "cover" or "limit". Thus a reinsurer might agree to cover the ceding company for USD 50,000 any one risk (cover or limit) excess of USD 10,000 (the retention or deductible or priority).

Non proportional treaties take one of two forms: -

1. The Excess of Loss treaty, which provides cover on a "per risk" basis or on an "event" or "occurrence" basis.
2. The Stop Loss treaty, which covers a whole portfolio of risks, or even the whole account of a ceding company.

Advantages of Excess of Loss treaties for the Ceding Company:

- The ceding company obtains protection only against the large losses that could strain its financial capacity.

It therefore assists the cedant in cutting off its potential liability at a chosen monetary limit.

- This results in an increase in the amount of premium retained for net account because the reinsurer is not involved in the more frequent small losses below the deductible.

- Administration is much simpler than for a proportional treaty and the administrative costs are consequently much lower. The ceding company is not required to maintain a table of retention limits for each risk, nor calculate cessions of risk.

- It provides a better cash flow situation as lower amounts of premium are paid to reinsurers and claims are recoverable immediately a loss is paid.

Disadvantages of Excess of Loss treaties for the Ceding Company:

- If the original insurances are inadequately rated, the excess of loss reinsurer has the freedom to quote rates on the basis of its own experience for such business. The difference in pricing has to be borne by the cedant.

- Normal excess of loss treaties offer protection to the cedant for the losses over its deductible (i.e., the treaty takes care of the loss severity aspect). But if there is an increase in the frequency of losses, especially below the deductible, it may create a great strain on the cedant's financial position as it cannot recover anything from the excess of loss treaty for such losses.

- The arrangement is thus likely to result in a greater volatility of results for the ceding company.

- The future cost of cover is difficult to assess as the reinsurer may take into account the global results of a marketplace, or even its own global results when reacting to a series of large losses.

- The company cannot use non-proportional business for reciprocity.

- There can be challenges to structure the right amounts of cover, especially in the case of natural perils – how many events to cover, and where the cover is on a risk basis – how many individual claims to cover. Generally the amount of reinsurance cover is subject to an event or risk limit, but this amount can be reinstated upon payment of an additional premium. These terms are contained in the treaty in the reinstatement clause.

- Unlike proportional treaties, non-proportional reinsurances provide little or no assistance in financing the expansion of the ceding company's business, for example, the reinsurance premium is payable in advance even before the cedant has received premium from the insured(s). Also, it receives no ceding commission or profit commission.

Advantages of Excess of Loss treaties for the Reinsurer:

- The reinsurer has more control over the terms of the cover.

- Improved cash flow, as premiums are generally payable on 1st January or half yearly, while claims are only payable if, and when, they are paid by the ceding company.

- The reinsurer can adjust pricing annually, and can also reprice if additional reinstatements are necessary during the term of the cover.

Disadvantages of Excess of Loss treaties for the Reinsurer:

- There is less community interest with the ceding company, there is no concept of "follow the fortunes" and therefore potentially much less continuity.

- The volume of premiums is much lower than participating in a ceding company's proportional business, thus the reinsurer has much less turnover.

- Where business is long term – such as motor casualty business, there can be challenges to properly reflect inflation and "incurred but not reported" (I.B.N.R.) claims.

6.2.3.1 Risk Excess of Loss Treaty

Under a "per risk" excess of loss treaty the reinsurer pays any loss on an individual risk in excess of a predetermined amount up to a specified upper limit. This ensures that the exposure of the company (claims severity) is reduced to a fixed sum. However a per risk excess of loss treaty does not offer any protection against any accumulation of losses arising out of one event or an aggregation of losses occurring within a calendar year (claims frequency).

The per risk excess of loss cover is also referred to as a "working" excess of loss reinsurance when claims are likely to occur with a certain frequency. Working excess of loss reinsurance treaties are often used for fire and allied perils as well as for marine cargo accounts.

Example of a per risk excess of loss cover

The ABC Insurance Company has decided to have a net retention of USD 100,000 on all textile risks in its portfolio. It protects its net retention with an excess of loss cover of USD 60,000 in excess of USD 40,000 which means that the reinsurer pays up to USD 60,000 after the cedant has paid at least USD 40,000. For example, if a loss of USD 75,000 occurs in a factory, the ABC Company would pay its share i.e., USD 40,000 and the reinsurer will reimburse the sum of USD 35,000.

6.2.3.2 Catastrophe Excess of Loss Treaty

The term "catastrophe" excess of loss is usually used to describe the "per event" or "per occurrence" cover. Such reinsurances are frequently arranged to protect property insurance accounts covering fire and natural perils, and marine portfolios where a particularly severe incidence of a catastrophic nature may affect a number of policyholders at the same time.

Example of a catastrophe excess of loss

A storm causes 1,000 losses of USD 5,000 each on policies covering private residences that all fall within the ceding company's net retention. If the ceding company has a non-proportional cover of USD 4,000,000 excess of USD 500,000 the above loss will be distributed in the following manner;

Total loss	= USD 5,000,000 (1000 x USD 5,000)
Cedant's retention per event	= USD 500,000
Recovery from reinsurer	= USD 4,000,000
Additional un-reinsured amount payable by the cedant	= USD 500,000

6.2.3.3 Stop Loss Treaty

The role of the Stop Loss treaty is to protect the annual result of the ceding company in one class of business against negative volatility due to a marked increase in the size and number of losses in that class of business.

The reinsurer under the Stop Loss treaty covers losses incurred by the cedant in a particular class of business when the cedant's annual loss ratio exceeds an agreed percentage of the premium income for that class.

All the losses suffered by the cedant for the year are added up and any loss, no matter how small, over and above the agreed loss ratio is covered.

The reinsurer's limit and the ceding company's retention are expressed as percentages, although it is also common for the reinsurer's limit to be expressed in a monetary amount as well. For example, "to cover 30% of all losses in excess of a loss ratio of 90% up to and including a loss ratio of 120% with a maximum loss to the reinsurer of USD 100,000». From the above, there is also the result that losses over the 120% loss ratio revert back to the cedant but it can of course choose to arrange for this to be covered by another reinsurance cover, where pricing permits.

Example of a stop loss cover

Crop business can be a very volatile business, where large profits or large losses usually occur due to the nature of the business. The ceding company thus decides to protect the results of its crop account, by placing a cover of 30% in excess of an annual loss ratio of 90%. At the end of an accounting year it is found that the loss experience is 120%. The reinsurer is thus liable for the 30% that exceeds the 90% retention of the cedant.

These types of cover can expose the reinsurer to potential abuse, especially if the ceding company is trying to guarantee itself a profit.

For example if the ceding company's expense ratio is 30% in a class of business, then if it buys enough stop loss protection excess of only 70% of its retained income, it cannot ever make a loss. It is clearly not the job, nor the intention, of reinsurers to offer a financial guarantee to a cedant, for in allowing this to happen, prudent underwriting is removed.

Therefore, cover is only granted at a level that ensures that a cedant has already suffered a material loss to its retained account.

Furthermore, the reinsurer often requires the cedant to act as co insurer for a part of the cover (for example a co-insurance of 10%) as an additional incentive to maintain a sound underwriting policy.

The reason why the reinsurer will also include a monetary limit in the treaty is in order to know its maximum commitment in advance. The treaty is not intended to give the ceding company a blank cheque which it could be if the cedant could choose to write as little or as much business as it wanted to. Thus the reinsurer not only expresses the cover it provides in percentage terms but also makes it subject to a monetary limit. This also helps the reinsurer to retain some control over the balance of its own account.

Stop loss treaties can be expensive. For this reason they are often unattractive to ceding companies.

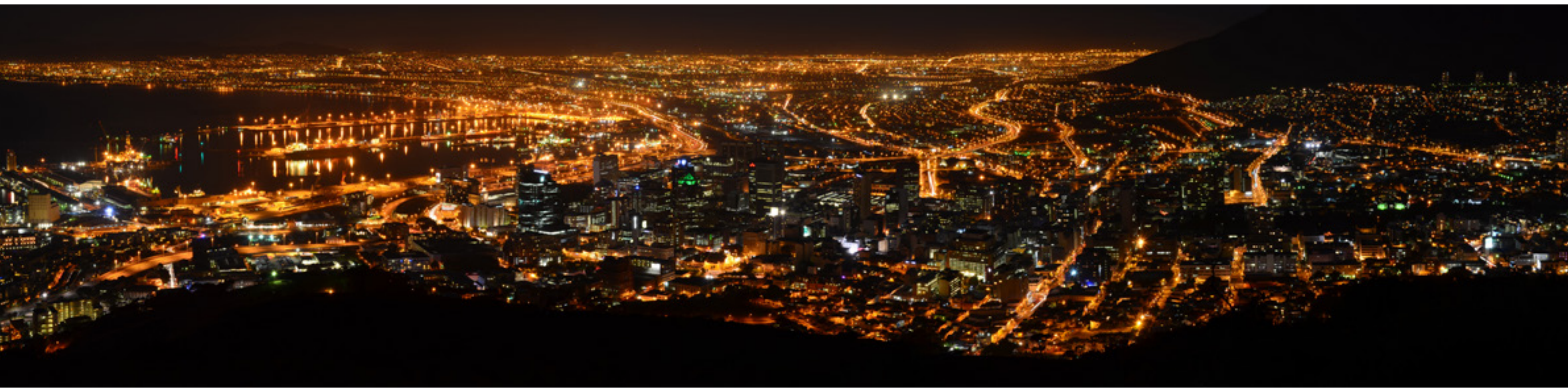
6.2.3.4 Case Study

It is important to be able to clearly distinguish between risk covers (claims severity) and event covers (claims frequency).

Example

The XYZ Insurance company has an excess of loss treaty covering its property business for USD 450,000 in excess of USD 45,000 any one event. A fire occurs damaging three adjacent buildings. The loss for repairs is USD 15,000 for the first building, USD 20,000 for the second, USD 45,000 for the third. The event that caused the damage is the same for the three buildings and the aggregate loss for the event is USD 80,000. The reinsurer therefore pays USD 35,000 (i.e., the amount in excess of USD 45,000), as the cover has been arranged on an "an event" basis.

If however the loss had been covered on a "per risk" basis, then the loss on a "per risk" basis arising out of one event is taken into consideration. In the above example, as none of the individual losses exceed the priority (USD 45,000), the reinsurer has nothing to pay.



7. DOCUMENTS RELATED TO REINSURANCE

Learning objective: To be aware of the main documents that define the agreements between the market players, the importance of clarity when preparing documents, and the challenge of finding the right mix between detail and too much complexity

7.1 Intermediary's / Reinsurer's Cover Note

A intermediary's cover note is a confirmation of cover sent to the ceding company by the intermediary stating the terms and conditions of the placement effected by the intermediary and the percentage placed with each reinsurer.

An example cover note is presented below:

COVER NOTE FOR FIRE PER RISK EXCESS OF LOSS REINSURANCE

Intermediary & Company,

44 High Street,

P.O. Box 192

Londontown, XJY 926

T: 971 7900 Email: info@intermediary&company.com

Effective 1st January 2016

Cover note

COMPANY:	Peoples Insurance Company Ltd, Africatown, Africa
PERIOD:	Losses occurring during the period 12 months commencing 1st January 2016
TYPE:	FIRE "PER RISK" EXCESS OF LOSS REINSURANCE
CLASS:	The Reinsured's net retention of direct writings and facultative Reinsurances written in its Property Department.
LIMIT:	USD 20,000 ultimate net loss each and every loss each and every risk in excess of USD 10,000 ultimate net loss each and every risk
WARRANTED:	All sums insured over USD 30,000 are reinsured proportionately or so deemed
TERRITORIAL SCOPE:	Continent of Africa
REINSTATEMENT:	Three full free reinstatements
PREMIUM:	Rate: 5% of Gross Net Premium Income
	Minimum & Deposit Premium: USD xx payable annually in advance
DEDUCTION:	10% Brokerage

GENERAL CONDITIONS:	Loss Adjustment Expenses to be included with the Ultimate Net Loss.
	Extra Contractual Obligations Clause
	Ultimate Net Loss Clause
	Net Retained Lines Clause
	Notice of Loss Clause
	Confidentiality Clause
	Commutation Clause by Mutual Agreement
	Errors and Omissions Clause
	Insolvency Clause
	Offset Clause
	Arbitration Clause
	Access to Records Clause
	War and Civil War exclusion.
	Nuclear Energy and Atomic Pools exclusion.
	Excess of Loss reinsurance exclusion.
ACCOUNTING:	Premiums - Payments within 30 days of respective due date.
	Losses - Payments within 30 days of receipt of proof of loss.
	Outstanding losses reported individually as they occur.
WORDING:	To be agreed by Leading Underwriter only.
INFORMATION	As per information schedule (not attached)

EFFECTED WITH:

Reinsurer	Share
Africa Reinsurance Company	40%
France Reinsurance Company	35%
UK Reinsurance Company	20%
German Reinsurance Company	5%

This Cover Note confirms the terms and conditions of the reinsurance negotiated with the listed reinsurers on your behalf. In the event that any of these details do not meet with your approval, or the security of the participating reinsurers does not meet with your requirements, please notify this office immediately. If all is in order, please sign and return one copy of this Cover Note to confirm your approval and complete our files.

Reinsurance Intermediary & Company, Limited

SIGNED

Particular note should be taken of the statement:

This Cover Note confirms the terms and conditions of the reinsurance negotiated with the listed reinsurers on your behalf. In the event that any of these details do not meet with your approval, or the security of the participating reinsurers does not meet with your requirements, please notify this office immediately. If all is in order, please sign and return one copy of this Cover Note to confirm your approval and complete our files.

Once the cover note is signed by the Ceding Company, the Ceding Company has confirmed its acceptance of all the terms and conditions.

While intermediary's cover notes are still used, it is becoming more the practice to issue a full wording instead of a cover note.

The problem with a cover note is that it is not a reflection of the complete contract between the reinsurers and the ceding company – not all clauses, nor the wording of the clauses are included, and even the contract itself is conditional – subject to "wording to be agreed by leading underwriter only". What if the leading underwriter does not agree the wording? What if, in the meantime, there has been a devastating loss to the intended reinsurance?

A reinsurer's cover note would be similar to the intermediary's cover note example above except that it would be sent directly from the reinsurer concerned and it would only list that reinsurer.

Such a situation might occur because the reinsurer is writing the layer 100%, or because part of the layer is placed directly and part of the layer is placed via a reinsurance intermediary. If the latter is the case it is especially important that cover notes are carefully checked and compared for any differences. A serious problem could arise if material differences between cover notes are only picked up at the time of a large loss.

7.2 Reinsurance Treaty Agreement

Best practice dictates that whenever possible the full treaty wording has been issued, agreed and signed prior to the date of inception of the cover.

An example of a relatively detailed reinsurance treaty agreement is included herein as Appendix A. It is not the purpose of this course to take a detailed look at reinsurance treaty wordings. The objective here is to give the reader an appreciation of a treaty wording in general, and the importance of going into the detail necessary so that both parties have clarity on what is being reinsured and what is not.

Clarity is a very challenging objective in treaty wordings. The more one goes into detail, the greater the danger of "not seeing the wood for the trees", but if one does not go into detail, then the parties may not have the same understanding of the agreement.

8. CONCLUSION

This course is an introduction to reinsurance, to give the reader a basic understanding of this important subject. The importance of reinsurance should not be underestimated.

When the management and shareholders of an insurance company issue a policy to a client, they make a promise to pay that client should the event insured against occur.

Thus all employees of the company should be working to ensure that that promise is kept. Certainly the regulator, the entity which the Government has put in place to control all the insurance companies in the marketplace is interested that that promise is kept, and if an insurance company fails to keep that promise then apart from dis-satisfied customers and complete loss of reputation, the regulator will intervene and apart from sanctions there is a risk that everyone working for the company is out of a job.

Reinsurance is insurance that insurance companies purchase to protect themselves from large losses (claims frequency and claims severity) due to the considerable liabilities they have accumulated through the issue of a large number of policies (promises to pay).

Reinsurance is thus an essential part of an insurance company's efforts to keep itself solvent, to protect it from the risk of default due to a series of large payouts, and indeed the regulator may require an insurance company to have reinsurance to carry on its business.

To understand how important reinsurance is, one need only consider some "realistic disaster scenarios" – an obligation for insurance companies in many jurisdictions today.

Realistic disaster scenarios could include:

1) A major fire, explosion or natural peril event, such as a flood in the heart of the major city of the country where the insurance company is established. What could be the value impact of such an event affecting say 1 square kilometer in the city centre as regards the policies issued by the insurance company? Some account would also need to be taken not only of property policies, but also motor policies, cargo and liability exposures.

2) Combine such a major event with a stock market collapse, such that the asset side of the insurance company's balance sheet is also hit in the aftermath of such a disaster.

Generally it only takes a small amount of research of such events to understand how important it is for an insurance company to properly understand the risks it writes, to control its accumulations and consequently its claims severity and frequency. The main protection once these elements are understood is reinsurance.

9. TEST

9.1 Multiple Choice Questions

1) Which of the following statements is correct?
   a. Reinsurance is a financial transaction where one party transfers risk and pays a premium
   b. In reinsurance there is no direct contract between the reinsurer and the policyholder
   c. Reinsurance is between companies not individuals
   d. Reinsurance is only available from professional reinsurance companies

2) Which contractual party below is not a party to a reinsurance contract?
   a. Cedant
   b. Retrocessionaire
   c. Co-insurer
   d. Reinsurer

3) Reinsurers can also purchase reinsurance, what is the correct term for this?
   a. Retention
   b. Reinsurance commission
   c. Proportional reinsurance
   d. Retrocession

4) Which of the following statements is correct?
   a. Insurance companies buy reinsurance to reduce retained claims frequency and claims severity
   b. Insurance companies buy reinsurance to cover ex gratia payments
   c. Insurance companies buy reinsurance to reduce the number of claims they have
   d. Insurance companies buy reinsurance to be able to pay claims more quickly

5) Which of the following statements is correct?
   a. Reinsurers are paid a commission to provide reinsurance
   b. When the reinsurer makes a loss, it is compensated by an overriding commission
   c. The reinsurer receives a premium net of cancellations and returns
   d. The reinsurer must pay the ceding company an additional premium when it makes a profit

6) Which of the following statements is correct?
   a. A quota share treaty only covers risks above the ceding company's gross retention
   b. A quota share treaty equals the net retention of the ceding company
   c. A 1st surplus treaty only covers risks above the ceding company's gross retention
   d. A 2nd surplus treaty only covers the ceding company's gross retention

7) Which of the following statements is correct?
   a. A facultative reinsurance covers a portfolio of business of a ceding company
   b. In a facultative reinsurance the reinsurer receives a proportion of the premium plus commission
   c. In a facultative reinsurance the reinsurer receives an agreed proportion of the original premium
   d. A facultative reinsurance enables the ceding company to improve the quality of the risk

8) A ceding company has a per risk excess of loss contract for USD 20,000 excess of USD 10,000. Which of the following statements is correct?

a. The ceding company can recover claims up to USD 30,000
b. The ceding company can recover a loss of USD 10,000
c. The ceding company can recover USD 5,000 if the overall loss is USD 10,000
d. The ceding company can recover USD 7,000 if the overall loss is USD 17,000

9) A ceding company has a 1st surplus treaty of 5 lines and a gross retention of USD 10,000. Which of the following statements is correct?

a. The ceding company can automatically cover a risk up to USD 70,000
b. If the sum insured were USD 100,000, the ceding company could cede USD 50,000 to the surplus treaty
c. If the sum insured were USD 20,000, and there was a loss of USD 8,000, the ceding company could collect USD 4,000 from the 1st surplus reinsurers
d. If the sum insured were USD 100,000, and there was a full loss, the ceding company could collect USD 50,000 from the 1st surplus reinsurers

10) A ceding company has a 50% quota share and a per risk excess of loss treaty on its net retention of USD 30,000 excess of USD 10,000. Which of the following statements is correct?

a. The ceding company wants to write a risk with a sum insured of USD 50,000, so it cedes USD 30,000 to the excess of loss treaty and USD 20,000 to the quota share.
b. The ceding company has a gross retention of USD 50,000, and writes a risk with a sum insured of USD 40,000. There is a full loss. The ceding company recovers USD 20,000 from quota share reinsurers, and USD 10,000 from its per risk excess of loss treaty.
c. The ceding company has a gross retention of USD 100,000 and writes a risk for USD 75,000. There is a partial loss of USD 37,500. The ceding company recovers USD 18,750 from its quota share reinsurers and USD 10,000 from its per risk excess of loss reinsurers.
d. There is an earthquake and the ceding company has four claims from the same event where the amount for its net retention is USD 50,000 being three claims costing USD 10,000 and one claim costing USD 20,000. The ceding company can only claim USD 10,000 from its per risk excess of loss cover

9.2 Case Study

You have written the following risk, and you have a new accountant in the department who asks you to help answer the questions below the slip terms and conditions.

FIRE REINSURANCE SLIP- FIRE AND/OR LIGHTNING AND/OR EXPLOSION

R/1:	Great West Insurance Co. Ltd.
O/I :	East West Manufacturing Co. Ltd 29/31 East Street, Capital City
On:	B/M/Stocks. Light Engineering Works.
Terms:	O.G.R. less 25% Commission and 2.5% BKGE
Period:	12 months at 1st March 2016
Sum Insured:	USD 1,000,000 p/o USD 2,000,000

Retention: USD 50,000 net. MPL basis.

FAC R/1 Placing: USD 150,000 (6 lines surplus treaty, therefore 3 lines facultative required)

Full. R/I clause

Information: Massive Construction Class 1. Sprinklered,

O.G.R. B/- 0.15%. M/S 0.25%

Sums insured: B/- USD 900,000

M/- USD 700,000

S/- USD 400,000

1 Loss 2013 USD 50,736

MPL 50%

Full R/I Clause

Being a Reinsurance of and Warranted same rate terms and conditions as and to follow the settlements of the Reinsured and that the Reinsured retains during the currency of this policy at least, on the identical subject matter and risk and in identically the same proportion on each separate part thereof but in the event of the retained line being less than as above Reinsurers' lines to be proportionately reduced.

Case Study - Questions:

1) What is the premium payable for 100% of the risk?
2) How much premium does Great West Insurance receive?
3) What would be the gross premium that facultative reinsurers receive?
4) What would be the net premium of facultative reinsurers?
5) How much brokerage would be payable?

10. GLOSSARY

Back-to-back cover:

When a reinsurance cover is back-to-back with the underlying policy it means that the underlying policy and the reinsurance cover will operate according to the same terms, and that the reinsurer will follow the settlements of the reinsured. This condition exists when the contract contains a full reinsurance clause.

Captive (re)insurance company:

A captive (re)insurance company is a company which is wholly owned by another usually non-insurance company with the objective to insure the risks of its parent organization. Captive (re)insurance companies may also be created by industry groups e.g. OIL, a captive insurance company that insures close to USD 3 Trillion of global assets for its 50+ members.

Catastrophe Excess of Loss Treaty:

A catastrophe excess of loss treaty is usually used to describe the "per event" or "per occurrence" reinsurance cover. Such treaties are frequently arranged to protect property insurance accounts covering fire and natural perils, and marine portfolios where a particularly severe incidence of a catastrophic nature may affect a number of policy holders at the same time, for example, a flood or earthquake or hurricane which affects a number of policies at the same time (claims frequency).

Ceding company:

The insurance company passing or ceding business to the reinsurer. Also termed "reinsured" or "cedant".

Ceding commission: A deduction allowed by the reinsurer on the premium due on the cession.

Cession:

That part of the original insurance which is reinsured.

Cover:

A term used to denote the contract or agreement of insurance or reinsurance which protects or "covers" the party transferring the risk. In non-proportional treaties the "cover" is the amount the reinsurer is willing to pay exceeding the retention or deductible for which the ceding company and underlying reinsurers if any are liable.

Cut-through clause:

A clause that provides that, in the event of the insurance company's insolvency, any part of a loss which may be covered by a reinsurance contract is paid directly to the insured by the reinsurer. The cut-through clause is so named because it «cuts through» the usual payment process firstly from the reinsurer to the insurance company and then secondly from the insurance company to the insured, substituting that process by omitting the insurance company altogether, and having that part of the claim settled directly from the reinsurer to the insured. This should only change the routing of the payment and should not result in any increased risk for the reinsurer, but complications can arise where the reinsurer has already paid the amount to the insurance company – which is now in liquidation – and is then being asked a second time to pay directly to the insured – which results in the reinsurer having to pay twice and hope it can recover some part of the first payment from the liquidator.

Deductible:

The amount, in non-proportional reinsurance, below which the reinsured will retain losses for its own account. In a stop loss treaty, this amount can be expressed either as an annual monetary amount or as a ratio of claims to premium (Claims Ratio).

Excess of loss:

A non-proportional reinsurance, where the reinsurer's liability only attaches when a loss exceeds a certain amount and then only for the excess of that figure up to an upper limit.

Ex-gratia:

A "claim payment" made by the reinsured "as a favour" without a legal or contractual obligation. If a claim is paid in full or in part by a reinsured without admission of liability and without waiver of right, it is paid ex-gratia.

Facultative reinsurance:

An agreement between the reinsured and the reinsurer relating to one specific risk, which the reinsurer has agreed to reinsure on such terms and conditions as may be prescribed by the reinsurer.

Fronting/fronts:

An arrangement whereby a licensed insurance company agrees to issue a policy on a risk(s) at the request of an entity, often a captive (re)insurance company on behalf of its industrial parent, which is not licensed to write business in the country concerned, with the intention that the risk(s) be ceded 100% to that unlicensed entity/captive (re)insurance company. Today many countries have specific regulatory requirements with regard to fronting.

Gross net retained premium income:

Gross retained premium income less premium returns, cancellations and rebates, plus premiums paid for reinsurance cessions inuring to the benefit of the present cover, if any, and intermediaries'/agents' commissions.

Indemnity:

The principle of indemnity is a defining characteristic of insurance. The purpose of an insurance contract is to make the insured "whole" in the event of a loss – to put the insured back in the position it was before the loss. Thus the insured should make neither a profit nor a loss from the occurrence of the insured event. In a reinsurance contract the reinsurer is only liable to pay a loss after it has been paid by the ceding company, so it is a contract of indemnity.

Insurable interest:

Insurable interest is an essential requirement that an insured must have so that the insurance company is legally able to issue a qualifying insurance policy. If the insured does not have a financial interest in the subject of insurance and suffers no financial loss when the insured event happens then the insured does not have an insurable interest and it is not possible to issue an insurance policy to cover that event.

Layered:

A term used to describe a slice of cover where the risk is placed in blocks (layers). Each layer of the programme operates consecutively and each may be underwritten by a different reinsurer.

Lloyd's syndicate:

A Lloyd's syndicate is an entity made up of one or more underwriters who underwrite risks, possibly on behalf of themselves, and on behalf of their names. A name may be an individual or a corporation who has put up funds as may be prescribed by Lloyd's from time to time, so that the syndicate is permitted to accept business within the Lloyd's market infrastructure.

Loss any one risk:

Each and every loss affecting any one risk is considered as an individual claim under the cover irrespective of the number of risks affected in the same loss occurrence. "Any One Risk" has the equivalent meaning.

Maximum possible loss:

The maximum monetary loss which could be sustained by insurers on a single risk as a result of a single fire or explosion when the most unfavourable circumstances combine and when, as a consequence, the fire is not at all or not satisfactorily fought against and is therefore only stopped by impassable obstacles or a lack of physical property.

Minimum and deposit premium:

A minimum agreed premium paid by the reinsured to the reinsurer at the inception of a reinsurance contract and which is subject to adjustment at a later date when all of the relevant rating facts are known. Adjustments are normally made once the reinsured's premium for the period is known.

Net retained loss:

Such loss or portion of loss in respect of which liability is assumed by the reinsured for its own account and which is excluded from the reinsurance agreement.

Non-proportional:

See under excess of loss.

Obligatory reinsurance:

A reinsurance agreement under which the original reinsured must cede and the reinsurer must accept all risks falling into the class of business covered by the reinsurance agreement.

Pools and pooling arrangements:

Pooling is a risk spreading device where a combination of insurance companies in a specific class of insurance agree to share the premiums and losses in agreed proportions.

Probable maximum loss – PML:

The maximum loss that might be expected at a cautious estimate to occur as a result of a single loss event taking into consideration all the circumstances of the risk.

Property:

All land, buildings, structures, plant, equipment, vehicles, contents and all materials of whatever description whether fixed or not.

Proportional:

A generic term describing quota share, surplus and facultative obligatory reinsurance in which the reinsurer shares a proportional part of the business ceded by the ceding company. Also known as pro rata reinsurance.

Quota share reinsurance:

Quota share reinsurance is a sub-type of proportional reinsurance treaty where the ceding company cedes an agreed-on percentage of every risk it insures that falls within the class or classes of business covered by the reinsurance treaty to the reinsurer or reinsurers. The reinsurer or reinsurers pay the same percentage of any loss.

Reciprocity:

Concept of a two-way transaction between the parties to spread the risks of both parties; generally a transaction which is expected to be profitable for both parties over the long term.

Reinstatement:

The restoration of cover under an excess of loss treaty after its exhaustion, wholly or partially following payment of claims. Where reinstatements are applicable, the number of reinstatements and the method of calculation of the additional or reinstatement premium payable is specified.

Reinsurance:

Reinsurance is a transaction where a reinsurer, in return for receiving premium, agrees to indemnify the ceding company against all or part of a loss that it may suffer under a specific policy or in a defined portfolio of policies that it has issued.

Reinsured:

The party issuing the original policy of insurance and ceding the business to the reinsurer.

Reinsurer:

A reinsurance company or Lloyd's syndicate which accepts the risks which the insurance company insures.

Reinsurance agreement:

An agreement whereby an insurance company i.e. the reinsured transfers part of its risk under insurance policies it writes by means of a separate contract with a reinsurer.

Reinsurance brokerage:

The remuneration paid to a reinsurance intermediary and deducted from the reinsurer's premium.

Retention:

If that part (expressed as an amount or percentage) which is retained by the ceding company, then it is known as a "net" retention OR if that part (expressed as an amount or percentage) which is kept by the ceding company AND its quota share reinsurers, then it is known as a "gross" retention.

Retrocession:

A reinsurance of a reinsurance (the cedant becomes a "retrocedant")

Risk excess of loss treaty:

Under a risk excess of loss treaty, or per risk excess of loss treaty, the reinsurer pays any loss on an individual risk in excess of a predetermined amount up to a specified upper limit. This ensures that the exposure of the company (claims severity) is reduced to a fixed sum. However a per risk excess of loss treaty does not offer any protection against any accumulation of losses arising out of one event or an aggregation of losses occurring within a calendar year (claims frequency).

Set-off:

The merging (wholly or partially) of the credits/debits between the contractual parties under one or more agreements, whereby one party pays the net debit balance due to the other party.

Stop loss:

A specialised form of excess of loss reinsurance, usually applicable to certain lines of insurance showing wide loss variation. The reinsurer is not responsible for the amount by which any individual claim exceeds a fixed sum, but instead indemnifies the reinsured in respect of an annual loss ratio on a particular portfolio in excess of a stipulated level.

Surplus reinsurance:

Surplus reinsurance is a sub-type of proportional reinsurance treaty where the ceding company cedes a proportion only of those risks which exceed its gross retention (that is to say the amount retained by the ceding company and its quota share reinsurers, if any) up to a defined limit where those risks also fall within the class or classes of business covered by the surplus reinsurance treaty. Where a ceding company negotiates more than one surplus treaty, the treaties are known as 1st surplus, 2nd surplus etc. A 2nd surplus treaty would only qualify for a cession once the 1st surplus capacity has been exhausted.

Treaty reinsurance:

A treaty reinsurance is a reinsurance agreement between a ceding company and a reinsurer which covers a portfolio of business. Reinsurance treaties can be divided into two basic forms: a) Proportional in which the ceding company cedes a share of the premium to the reinsurer, who pays an equal share of the loss and b) Non-proportional where the reinsurer only indemnifies the ceding company for losses which exceed a predetermined amount. Sub-forms include on the proportional side - Quota-Share, Surplus and Facultative Obligatory treaties, and on the non-proportional side - Excess of Loss, Catastrophe and Stop-Loss treaties.

Uberrimae fidei or utmost good faith:

A legal Latin term meaning “of the utmost good faith”. A legal requirement in insurance and reinsurance contracts where one party generally has all the knowledge about the risks it wants to place and the other party is reliant on receiving the full information on those risks. A breach of utmost good faith, especially in regard to full and voluntary disclosure of the elements of the risks to be covered, will be grounds for redress and even rescinding the contract.

Ultimate net loss:

Is the gross loss suffered by the ceding company less any recoveries from other reinsurance which reduce the loss to the treaty in question.

It is the amount actually paid or payable for the settlement of a claim for which the ceding company is liable (and it may include or exclude defense costs), after deductions are made for any eligible recoveries.

Utmost good faith:

See under Uberrimae fidei.

EXAMPLE REINSURANCE AGREEMENT

Wording in RED requires amendment depending on specific individual terms agreed

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Proportional Reinsurance Agreement
Fire and Engineering Surplus

CONTRACTUAL DETAILS

SLIP REINSURANCE AGREEMENT NUMBER: ARC/FAPENG/SPLS/..........

made and entered into between

ABC INSURANCE COMPANY LIMITED, LAGOS, NIGERIA,

(hereinafter called the "Reinsured")
of the one part

and

AFRICAN REINSURANCE CORPORATION, LAGOS, NIGERIA,

and/or its Subsidiaries and/or Regional Offices,
(hereinafter called the "Reinsurer")
of the one part

This Slip Reinsurance Agreement consisting of the Contractual Details and Contractual Wording together with all Appendices, Annexes and Addenda pertaining thereto, shall be read together as one Contract and is issued in two originals to be signed by both parties in executing this Agreement.

A new Slip will be issued on each anniversary date in replacement of the Slip of the previous Treaty underwriting year. However, no new Slip will be issued in case of Termination of the Agreement in accordance with Article 19 of the Contractual Wording.

It is understood and agreed by the parties to this Slip Reinsurance Agreement that wherever the word "Nil" appears for any of the serially numbered section of this Slip, it will be construed as being of no effect and/or will not operate for the Agreement.

For the purpose of this Agreement, the words "Agreement", "Contract", Reinsurance" and "Treaty" shall have the same meaning wherever they may appear and may be interchangeable.

1. Reinsured:	ABC Insurance Company Limited, Lagos, Nigeria. 10th Floor 444 Presidential Road Lagos Nigeria E-mail:
2. Period:	Continuous contract commencing on 1st January 20xx subject to three (3) months' notice of cancellation prior to 31st December in any year. However, it is understood that the provisional notice of cancellation is automatically tendered at 30th September of each year by both the Reinsured and the Reinsurer hereon, unless otherwise advised by either party to this Agreement. No formal document will be issued by either party in this connection. Signing hereon is in respect of the period effective from 1st January 20xx to 31st December 20xx, both days inclusive and Local Standard Time at the place of loss.

3. Type: Fire and Engineering Surplus Reinsurance Agreement.

4. Class of Business: All insurances whether direct or by way of coinsurance and facultative reinsurances and/or compulsory legal cessions to the Reinsured, accepted and underwritten and/or renewed by the Reinsured in its Fire and Engineering Department and designated by the Reinsured as Fire and Engineering business covering:

FIRE

a) Material Damage and Business Interruption following the perils of: Fire, Bush Fire, Lightning or Thunderbolt, Explosion, Non-Political Riot, Strike, Civil Commotion, and Malicious Damage, Lock-out Workers, Aircraft and aerial devices or articles dropped therefrom, Burglary and/or theft, Impact by animals trees, aerial, satellite dishes or vehicles, Bursting or Overflowing of Water Tanks or Pipes, Cyclone, Hurricane, Tornado, Typhoon, Earthquake, Volcanic Eruption, Subterranean Fire, Flood, Tidal Wave and Tsunami, Collapse, Subsidence, Ground Heave, and Landslide; and including the following interests:

b) Domestic Package policies excluding motor policies;

c) Industrial All Risks and Assets All Risks policies excluding all Contractors' All Risks, Erection All Risks, Machinery Loss of Profits and Deterioration of Stock exposures but limited to 5% cover for Machinery Breakdown and Electronic Equipment.

ENGINEERING

a) Boiler and Pressure Vessel (BPV);
b) Machinery Breakdown;
c) Contractors' All Risks (CAR);
d) Erections All Risks (EAR);
e) Contractors' Plant, Machinery and Equipment (CPM);
f) Electronic Equipment including associated Increased Cost of Working (ICOW);
g) Deterioration of Stock following Machinery Breakdown (DOS);
h) Consequential Loss (Loss of Profits/Loss of revenue) following Boiler and Pressure Vessel Explosion and Machinery Breakdown;
i) Third Party Liability written in conjunction with Contractors' All Risks and Erection All Risks (TPL).

5. Territorial Scope: Risk situated in Nigeria and Nigerian interest abroad and incidental Worldwide subject to prior referral to the Leading Reinsurer, but excluding risks situated in USA and Canada.

Incidental shall mean anywhere in Africa for 100%, but for the rest of the World not exceeding 20% of the Treaty Maximum Reinsurance Cession defined under section 6. Treaty Detail hereafter.

6. Treaty Detail: FIRE

Reinsured's Retention: One Gross Line maximum of N10,000,000 any one risk Material Damage and Business Interruption combined on sum insured basis or Probable Maximum Loss (PML) for best class risk, scaled down according to the Table of Retentions as per Appendix No. 1 attaching to and forming part of this Agreement.

First Surplus Treaty Cession Limit: Fourteen (14) Gross Lines, subject to a Maximum Cession Limit of N140,000,000 any one risk Material Damage and Business Interruption combined on sum insured basis or Probable Maximum Loss (PML) for best class risk, scaled down according to the Table of Retentions as per Appendix No. 1 attaching to and forming part of this Agreement.

ENGINEERING

Reinsured's Retention: One Gross Line maximum limit of N100,000,000 on sum insured basis or Probable Maximum Loss (PML) for the best risk, scaled down according to the Table of Retentions as per Appendix No.1 attaching to and forming part of this Agreement.

Third Party Liability Section:
Maximum cession of N 10,000,000 any one loss occurrence. To be reinsured in conjunction with and in the same proportion as the Material Damage Section(Contractors' All Risks and Erection All Risks)

The Gross Retention on the Third Party Liability Section of Contractors' All Risks and Erection All Risks insurances shall bear the same proportion to the original Third Party Liability limit as the Gross Retention in the Material Damage section bears to the whole Sum Insured for Material Damage

First Surplus Treaty Cession Limit: Ten (10) Gross Lines, subject to a Maximum Cession Limit of N1,000,000,000 on sum insured basis or Probable Maximum Loss (PML) for the best risk, scaled down according to the Table of Retentions as per Appendix No.1 attaching to and forming part of this Agreement.

Third Party Liability Section:
Maximum cession of N 10,000,000 any one loss occurrence. To be reinsured in conjunction with and in the same proportion as the Material Damage Section(Contractors' All Risks and Erection All Risks)

The Gross Retention on the Third Party Liability Section of Contractors' All Risks and Erection All Risks insurances shall bear the same proportion to the original Third Party Liability limit as the Gross Retention in the Material Damage section bears to the whole Sum Insured for Material Damage

.

In addition the following special terms shall apply to this Agreement:

1. It is understood and agreed that any amount surplus to the combined maximum retention and treaty limits shall be reinsured only on a proportional basis.

2. Event Limit: NGN 500,000,000

any one occurrence and in the annual aggregate for Natural Perils exposure, subject to the terms and conditions of the Event Limit Clause as per Appendix no.3, attaching to and forming part of this Agreement.

3. The Minimum Maximum Probable Loss is 50% unless Leading Reinsurer's agreement is obtained for a lesser factor.
In respect of Material Damage and Business Interruption the Probable Maximum Loss may be expressed separately as a monetary and/or percentage figure, and in this case the combined total any one Risk shall not be less than the above-stated Probable Maximum Loss factor.

4. Coinsurance acceptances by the Reinsured are limited to 50% of one gross line specified herein, always subject to the Table of Retentions.

5. Facultative Reinsurance acceptances by the Reinsured are limited to 50% of one gross line specified herein, always subject to the Table of Retentions.

7. Exclusions:

This Agreement will not cover, among others, certain types of insurances and reinsurances, locations, risks and perils, and properties, in respect of material damage and consequential loss resulting therefrom, specified hereafter

Exclusion as per Appendix no. 5:

1. War, Civil War, Political Risk and Terrorism Exclusion Clause.
2. Nuclear Energy Risks Exclusion Clause (Reinsurance) (1994) (Worldwide excluding U.S.A. and Canada) - NMA 1975A.
3. Nuclear Causes Exclusion Clause.
4.Radioactive Exclusion Cause (Reinsurance).
5. Terrorism Exclusion Clause for Contamination and Explosives.
6. Computer Loss General Exclusion Clause.
7. Electronic Data Recognition Clause EDRC (B).
8. Computer Virus and on-line risks "Clarification Agreement".
9. Institute Chemical, Biological, Bio-Chemical, Electromagnetic Weapons and Cyber Attack Exclusion Clause.
10. Transmission and Distribution Lines Exclusion Clause.
11. Pollution and Contamination Exclusion Clause.
12. Asbestos Exclusion Clause.
13. Supplementary Fire and Engineering Exclusion List as per Appendix no. 6 attached.

Amendments to exclusions shall be advised in writing to and be expressly agreed by the Leading Reinsurer only.

Special Acceptances of risks excluded from the scope of this Agreement shall be agreed by the Leading Reinsurer. Such Special Acceptances will not be documented in this Agreement wording.

However, any previously agreed Special Acceptances will be renegotiated prior to each individual policy renewal date.

8. Rates:

Original Gross Rate (OGR).

9. Commission:

Commissions shall be calculated on the premium ceded to the Agreement net of any taxes whenever applicable.
a) Flat: 30% for fire section.
25% for Engineering section.

b) Sliding Scale Commission: As specified in Appendix No 4.
Separate accounts for Fire and Engineering sections.

10. Over-riding Commission:

Nil

11. Profit Commission:

Separately for Fire and Engineering
Rate:....%
Reinsurer's Management Expenses: .....%
Losses carried forward: ... years
The statement shall be submitted with the fourth quarter account.
Engineering section to be rendered on underwriting year basis.
Full details of Profit Commission calculation: As specified in Article 5 of the Contractual Wording.

12. Loss Participation: Nil

13. Taxes and Deductions from Reinsurance Premium: Nil

14. Reserves Deposits:
(a) Premium Reserve: Nil (or as per legal requirement)
(b) Loss Reserve: Nil (or as per legal requirement)
Interest on reserves: Nil or as agreed

15. Portfolio Assumption and Withdrawal:

FIRE
a) Premium for both assumption and withdrawal: calculated on the basis of "Eights system" on the premium net of actual commission (excluding premiums for monthly business) for the four quarters preceding the date at which this Agreement takes effect (Premium Portfolio Entry) or at which this Agreement terminates (Premium Portfolio Withdrawal).

"Eighths" system calculated as follows for unearned premium:-

12,50% of Written Premium ceded in the First Quarter plus

37,50% of Written Premium ceded in the Second Quarter plus

62,50% of Written Premium ceded in the Third Quarter plus

87,50% of Written Premium ceded in the Fourth Quarter

(b) Loss for both assumption and withdrawal: Calculated at 90% of all losses outstanding at the date of commencement of this Agreement (Loss Portfolio Entry) or at the date of termination of this Agreement (Loss Portfolio Withdrawal) .

Nil portfolio at inception of Agreement but clean-cut every year with incoming and outgoing premium and loss portfolios accounts to be presented simultaneously with the account(s) for the fourth quarter of the preceding year.

ENGINEERING
Nil. Risks ceded to any Underwriting year shall run off to natural expiry.

16. Notification of Claims: All individual claims amounting to NGN 15,000,000 and above for 100% to the Treaty to be advised to the Leading Reinsurer not later than 14 days after a loss occurrence with full copy of the policies in force and all surveyors' and assessors' reports to be provided to the Leading Reinsurer.

17. Cash Loss Limit: NGN 15,000,000 and above for 100% to the Treaty, subject to deduction of balances outstanding as per the Set-off Clause. Full policy copy and all assessors' reports to be provided to the Leading Reinsurer.
Cash loss request to provide start and end date of policies.

18. Accounts rendering:

Quarterly accounts shall be submitted separately per class of business and as soon as possible but not later than 45/60 days (six/eight weeks) after the close of each quarter.

Engineering section to be rendered by underwriting year.
Settlement of any balance by the Reinsured to the Reinsurer shall accompany the quarterly account.
Settlement of any balance to the Reinsured by the Reinsurer shall follow within 14/30 days of the receipt of the quarterly account by the Reinsurer.
Any inadvertent error or omission shall be corrected in the subsequent quarterly account unless such error or omission has a major effect on the balance to be remitted, in which case, correction thereof shall be made immediately by a supplementary account.
Losses paid and outstanding will be advised with the quarterly accounts in their years of occurrence.
Balances to be settled in Nigerian Naira (NGN).

19. Interest on Overdue Balances:

Interest at 110% of market prime lending rate on balances due from the due date to the date of payment.

20. Bordereaux and Reports:

A list of outstanding losses in their years of occurrence shall be submitted with each quarterly account, separately for each class of business.

In addition, the Reinsured shall submit Natural Perils Accumulation reports as per CRESTA form by zones specified or any other agreed form, together with the quarterly accounts.

21. Currency:

Contract currency: Nigerian Naira (NGN).
Settlement currency: US Dollar or any other currency equivalent at the rate of exchange ruling as at the Due Date.

22. General Conditions:

All terms, conditions and clauses applicable to this Agreement, including those listed below, are more fully defined in the Contractual Wording:

1. Share Ceded
2. Period of Application
3. Reinsurer's Liability
4. Follow the Fortunes
5. Class of Business
6. Territorial Scope
7. Retention and Limit
8. One Risk
9. Prior Facultative Reinsurance
10. Protection of Reinsured's Retention
11. Self-insurance
12. Exclusions
13. Records of Cessions and Bordereaux
14. Premium and Commission

15. Profit Commission
16. Loss Participation
17. Taxes and Deductions
18. Premium Reserve Deposit
19. Outstanding Loss Reserve Deposit
20. Portfolio Premium and Loss Portfolio Transfer
21. Claims Reporting and Settlement
22. Accounts
23. Currency Conversion
24. Set-Off
25. Change of Underwriting Practice
26. Incorrect or Incomplete Information
27. Inadvertent Delay, Errors and Omissions
28. Inspection of Records
29. Commencement and Termination
30. Special Cancellation
31. Extended Expiry
32. Alterations
33. Intermediary
34. Change in Law
35. Interpretation
36. Choice of Law and Jurisdiction
37. Arbitration
38. Sanctions Limitation and Exclusion
39. Several Liability Notice – LSW 1001 (Reinsurance)

23. Special Conditions:	None other than may exist in this Agreement.
24. Warranties:	None other than may exist in this Agreement.
25. Intermediary:	The Intermediary for this Agreement is: XYZ Reinsurance Brokers Limited, xxx, xxx, xxx, Nigeria.
26. Brokerage:	2.5%
27. Choice of Law and Jurisdiction:	It is agreed that this Reinsurance Agreement (including arbitration tribunals) shall be governed by the Laws of Nigeria and the Courts of Law in Nigeria will have exclusive jurisdictions in all matters relating to this Agreement. As more fully defined within the Contractual Wording. However no indemnity under this Agreement shall apply to compensation for damages in respect of judgments delivered or obtained by a court of competent jurisdiction within the U.S.A or Canada or any of their territories.

28. Seat of Arbitration:

The Seat of arbitration will be Lagos, Nigeria.

Appointor: The Secretary General for the time being of the Court of Arbitration of the International Chamber of Commerce.

29. Wording:

Full Contractual Wording is incorporated.
This Slip Reinsurance Agreement details the Agreement terms entered into by the Reinsured and the Reinsurer and constitutes the full Reinsurance Agreement.

30. Leading Reinsurer:

African Reinsurance Corporation, the “Reinsurer”.

31. Acceptance:

African Reinsurance Corporation, signing hereon for: xx% of 100%.

Information:

a) Estimated premium income for the Treaty:

	Fire	Engineering
Revised 20xx:	N 500,000,000	N 500,000,000
20xx:	N 750,000,00	N 750,000,000

Treaty premium to be submitted split by Class of business
b) Reinsurance presentation including statistics, profiles (as at 30th September) and underwriting procedures have been seen and noted by the Reinsurer.

CONTRACTUAL WORDING

ATTACHING TO AND FORMING PART OF FIRE AND ENGINEERING QUOTA SHARE AND SURPLUS SLIP REINSURANCE AGREEMENT NUMBER: ARC/FAPENG/SPLS/..........

Made and entered into between

ABC INSURANCE COMPANY LIMITED, Lagos, Nigeria,
(hereinafter called the "Reinsured")
of the one part

and

AFRICAN REINSURANCE CORPORATION, Lagos, Nigeria,
and/or its Subsidiaries and/or Regional Offices,
(hereinafter called the "Reinsurer")
of the other part

WHEREBY IT IS AGREED between the parties as follows:

Article 1: Share Ceded, Territorial Scope and Retention Clauses

1.1 Share Ceded

The Reinsured shall cede and the Reinsurer agrees to accept by way of Quota Share and Surplus reinsurance the proportion stated in the Contractual Details (hereinafter called the "Reinsurer's participation") of the business specified in the Contractual Details but not exceeding the treaty limits stipulated therein.

1.2 Period of Application

This Agreement applies to policies issued or renewed in respect of insurances and reinsurances during the period specified in the Contractual Details.

1.3 Reinsurer's Liability

The liability of the Reinsurer shall commence immediately the retention of the Reinsured has been exceeded and run concurrently and obligatorily with that of the Reinsured.

1.4 Follow the Fortunes

The Reinsurer shall be subject to the same terms and conditions as the original policies and shall follow, subject to the terms of this Agreement, the underwriting fortunes of the Reinsured in respect of all business ceded hereunder.

1.5 Class of Business Covered

The Type and Class of Business are specified in the Contractual Details.

1.6 Territorial Scope

The Reinsurer shall only cover those risks accepted by the Reinsured which are situated within the Territorial Scope as defined in the Contractual Details.

1.7 Retention and Limit

The maximum retention by the Reinsured for its own account and the limit of this Agreement any one risk are specified in the Contractual Details. Notwithstanding the foregoing, the Reinsured may cede any compulsory legal cession, in which event the share hereunder shall be based on the amounts remaining after taking such reinsurance into account.

The amounts of co-insurance and inwards facultative reinsurance ceded to this Agreement are specified in the Contractual Details.

1.8 One Risk

The Reinsured shall be the sole judge as to what constitutes One Risk and/or accumulation of risks.

1.9 Prior Facultative Reinsurance

The Reinsured may reduce the amount to be ceded in respect of any risk by effecting individual proportional facultative reinsurances when in the Reinsured's opinion this is in the interest of both parties, but the reinsured shall not effect facultative reinsurance protection solely for the protection of the business retained for its own account.

1.10 Protection of Reinsured's Retention

The Reinsured reserves the right to effect, at its own discretion, excess of loss protection for its net retention and such excess of loss protection shall not be considered as invalidating any of the provisions of this Agreement.

1.11 Self-insurance

A policy and/or contract granted by the Reinsured in which the Reinsured either solely or jointly with another party or parties is named as the Insured and/or Reinsured, shall be deemed to be a policy and/or contract falling within the scope of this Agreement, notwithstanding that there may be no legal liability under such policy and/or contract by reason of the fact that the Reinsured is named as an Insured and/or Reinsured.

Article 2: Exclusions

The Reinsurer shall not be liable for any losses caused by or arising from the exclusions detailed in section 7 of the Contractual Details.

Special Acceptances of risks excluded from the scope of this Agreement shall be agreed by the Leading Reinsurer. Such Special Acceptances will not be documented in this Agreement wording.

However, any previously agreed Special Acceptances will be renegotiated with the Leading Reinsurer annually.

Article 3: Record of Cessions and Bordereaux Clause

3.1 Record of Cessions

The Reinsured shall maintain a record of all cessions hereunder and of all renewals and alterations thereto and these shall be advised as stated in the Contractual Details to the Reinsurer on a bordereau form.

3.2 Bordereau

Bordereaux shall serve only to provide information to the Reinsurer in respect of risks ceded under this Agreement. Risks outside the scope of this Agreement shall not be covered by this Agreement by virtue of an entry on a bordereau form.

Article 4: Premium and Commission Clauses

4.1 Premium

The Reinsured shall pay to the Reinsurer its proportion of the original premiums (less only returns, cancellations and premiums paid for prior reinsurances which inure to the benefit of this Agreement) which the Reinsured itself receives for the original insurances. The Reinsurer shall be entitled to its share of premium for the liability assumed on insured risks even if the Reinsured has not received the premium owing to it.

4.2 Payment of Premium

The Reinsurer's obligations to pay claims are contingent on and subject to the payment of the due premium by the Reinsured and until such premium is received, the Reinsurer shall have no obligations whatsoever to pay any claims, provided that, any set-off applied in terms of this Agreement shall constitute compliance with this provision.

4.3 Commission

4.3.1 Flat Commission

The Reinsurer shall allow commission on the premiums ceded in the accounts for this Agreement at the rate specified in the Contractual Details but unless otherwise agreed and specified in the Contractual Details no other deduction shall be made.

4.3.2 Sliding Scale Commission

If applicable, the Sliding Scale Commission shall be calculated as specified in the Contractual Details.

4.3.3 Overriding Commission

If applicable, the Reinsurer shall pay to the Reinsured an overriding commission on the premiums ceded under this Agreement at the rate specified in the Contractual Details.

Article 5: Profit Commission Clause (if applicable)

5.1 Profit Commissions Formula

The Reinsurer shall pay to the Reinsured a profit commission as detailed in the Contractual Details calculated on the profit arising from all business ceded under this Agreement and included in the accounts for each annual period of this Agreement in accordance with the following formula: -

Income (Credit):

1. Release of preceding years' Unearned Premium Reserve. On Entry into the Premium Portfolio this item shall be replaced by the corresponding Incoming Premium Portfolio from the previous accounting year.

2. Release of the Outstanding Loss Reserve as at the end of the preceding year. On Entry into the Loss Portfolio this item shall be replaced by the corresponding Incoming Loss Portfolio from the previous accounting year.

3. Premium included in the accounts for the current year.

Items 1 and 2 will not apply to the first Profit Commission Statement

Outgo (Debit):

1. Commission included in the accounts for the current year.

2. Any other agreed deductions as specified in the Contractual Details.

3. Paid Losses and Loss Expenses included in the accounts for the current year including cash losses paid by the Reinsurer during the current year and not brought into account.

4. Unearned Premium Reserve calculated on the Premium Income for the current year at the rate specified in the Contractual Details. On Withdrawal of Premium Portfolio this item shall be replaced by the corresponding Outgoing Premium Portfolio as at the end of the current year.

5. The Outstanding Loss Reserve as at the end of the current year. On Withdrawal of the Loss Portfolio this item shall be replaced by the corresponding Outgoing Loss Portfolio as at the end of the current year.

6. Reinsurer's Management Expenses calculated on the Premium Income for the current year at the rate specified in the Contractual Details.

7. Deficit (if any) brought forward from the previous year's statement.

5.2 Inuring Recoveries

Any Premium and Loss recoveries under reinsurance which inure to the benefit of this Agreement shall be taken into consideration.

5.3 Loss Carried Forward

Any loss resulting from each year's profit commission calculated shall be carried forward for the number of years stated in the Contractual Details. Within this period any loss shall be used to eliminate and/or reduce any subsequent year's profit(s) in the order in which they arise.

5.4 Profit Definition

Any excess of Income over Outgo shall be deemed to be the profit for the annual period.

5.5 Profit Commission Statement

The Reinsured shall render to the Reinsurer a statement for each annual period in accordance with the above formula and any profit commission due shall be included in the account as stated in the Contractual Details.

5.6 Profit Commission on Termination of Agreement

On termination of this Agreement no Profit Commission Statement shall be rendered until all liability of the Reinsurer has ceased. All entries appearing in accounts rendered to the Reinsurer after the date of termination together with the appropriate entries relating to the last period this Agreement was in force shall be included in the final statement.

Either party shall have the right at any time to request the re-calculation of the Profit or Deficit for any year should it be found that by under or over payment for outstanding claims, the Profit Commission paid was inaccurate.

Article 6: Loss Participation

If applicable, the Reinsured's Loss Participation share shall be calculated as specified in the Contractual Details.

Article 7: Taxes and Deduction Clause

7.1 Taxes and Deductions

The financial transactions arising out of this Agreement are subject to tax implications as specified in the Contractual Details.

Article 8: Premium Reserve Deposit Clause

8.1 Premium Reserve Deposit Retained and Released

If applicable, the Reinsured shall retain from the Reinsurer a Premium Reserve Deposit in cash calculated at the percentage stated in the Contractual Details on the premium ceded to the Reinsurer in the accounts rendered hereunder. Such retained Deposit shall be released to the Reinsurer in the corresponding account of the following year.

Notwithstanding the above the Reinsurer shall have the right to set up the deposit in cash with the Reinsurer or in the form of securities.

In the case of a securities deposit, a separate agreement shall be made between the parties.

8.2 Interest on Deposit

The Reinsured shall credit the Reinsurer in the final account for the year with the interest accrued on the cash Deposit retained in each annual period.

8.3 Interest Rate

The annual percentage rate of interest payable is as stated in the Contractual Details.

8.4 Alteration in Interest Rate

Alternations in the rate of interest payable at the renewal of this Agreement shall be applied to all cash Deposits in accounts rendered from the commencement of that year regardless of their underwriting year designation.

8.5 Deposit Held in Trust

Any amounts held by the Reinsured in accordance with the provisions of this clause remain the property of the Reinsurer so far as the applicable Law permits and are held by the Reinsured as trustee for the Reinsurer and may only be utilised by the Reinsured in the event and up to the amount of the Reinsurer's failure to discharge its liability under this Agreement.

8.6 Set-off of Deposit

The Reinsurer may at its discretion direct that any such amounts or any portion thereof which should be released to the Reinsurer in accordance with the provisions of this clause or an amount equivalent to the value thereof shall instead be set-off against any amounts owed by the Reinsurer to the Reinsured under this or any other agreements which have been or may hereafter be entered into between parties, it being understood that the Reinsurer shall relinquish to the Reinsured all its rights in the said amount to the extent of any such set-off.

Article 9: Outstanding Loss Reserve Deposit Clause

9.1 Loss Reserve Deposit Retained

The Reinsured shall retain from the Reinsurer an Outstanding Loss Reserve Deposit in cash equal to the Reinsurer's share of all claims hereunder notified by the Reinsured and agreed by the Reinsurer and not paid as at the end of each annual period of this Agreement. The Deposit retained shall be released and a new deposit set up annually in the final account for each annual period.

Notwithstanding the above the Reinsurer shall have the right to set up the deposit in cash with the Reinsurer or in the form of securities.

In the case of a securities deposit, a separate agreement shall be made between the parties.

9.2 Loss Reserve Deposit Release

If on termination of this Agreement the Reinsurer remains liable for settlement of its share of all outstanding claims then in each account rendered thereafter in accordance with the provisions hereunder the Loss Reserve Deposit held by the Reinsured shall be released and a new deposit set up.

9.3 Interest on Deposit

The Reinsured shall credit the Reinsurer in the accounts rendered hereunder with interest at the annual percentage rate stated in the Contractual Details on the amount of Outstanding Loss Reserve Deposit retained in cash at any time.

9.4 Alteration in Interest Rate

Alternations in the rate of interest payable at the renewal of this Agreement shall be applied to all cash Deposits in accounts rendered from the commencement of that year regardless of their underwriting year designation.

9.5 Deposit Held in Trust

Any amounts held by the Reinsured in accordance with the provisions of this clause remain the property of the Reinsurer so far as the applicable Law permits and are held by the Reinsured as trustee for the Reinsurer and may only be utilised by the Reinsured in the event and up to the amount of the Reinsurer's failure to discharge its liability under this Agreement or as stipulated in paragraph 10.6 hereof.

9.6 Deposit Retained and Cash Loss

In the event of the Reinsurer being requested to pay a cash loss in respect of a claim for which a loss reserve deposit has been retained the Reinsurer has the right to request settlement of the claim from the Outstanding Loss Reserve Deposit.

9.7 Set-off of Deposit

The Reinsurer may at its discretion direct that any such amount or any portion thereof which should be released to the Reinsurer in accordance with the provisions of this clause or an amount equivalent to the value thereof shall instead be set-off against any amounts owed by the Reinsurer to the Reinsured under this or any other agreements which have been or may hereafter be entered into between the parties, it being understood that the Reinsurer shall relinquish to the Reinsured all its rights in the said amount to the extent of any such set-off.

Article 10: Portfolio Premium and Loss Portfolio Transfer Clause

10.1 Reinsurer's Liability of Risks in Force and Losses Outstanding

The Reinsurer shall assume liability for its share of all risks in force and all losses outstanding at the date of commencement of this Agreement and in consideration thereof the Reinsured shall credit the Reinsurer with:

(i) a portfolio premium assumption calculated on the total of the Reinsurer's proportion of the premium included in the accounts for the twelve months prior to the commencement of this Agreement,

and

(ii) a portfolio loss assumption calculated on the Reinsured's estimate of the losses outstanding at the date of commencement of this Agreement.

10.2 Reinsured's Option on Portfolio at Termination

On termination of this Agreement the Reinsured shall have the option to cancel the Reinsurer's liability under this Agreement in respect of its share of unexpired risks and/or losses outstanding at the date of termination by debiting the Reinsurer with: -

(i) a portfolio premium withdrawal calculated on the Reinsurer's proportion of the premiums included in the accounts for the last twelve months (excluding premiums for monthly business),

and

(ii) a portfolio loss withdrawals calculated on the Reinsured's estimate of the losses outstanding at the date of termination.

Cessions hereunder not subject to Portfolio Considerations (if any) will run-off to natural expiry.

10.3 Portfolio Percentage Basis

At the close of each year during which this Agreement remains in force the Reinsured shall have the option to transfer the liability of the Reinsurer in respect of the unexpired risks and/or losses outstanding at that date where the Reinsurer's participation has altered in this Agreement for the following year. Such transfer shall only relate to the change in sum of its decreased proportion. The Reinsured shall also credit the Reinsurer with a portfolio assumption for the sum of its increased proportion. The basis of the calculation of the portfolio transfer is as detailed in 10.1 and 10.2 above applicable to a share increase or decrease respectively.

The percentage or basis for the calculation of portfolios mentioned in 10.1 and 10.2 shall be as stated in the Contractual Details.

10.4 Portfolio and Disputed Losses

The Reinsured shall have the option to exclude from such transfer any loss or losses which are or may be the subject of dispute or for which the Reinsured is unable to make an acceptable estimate of the liability of the Reinsurer. Such loss or losses shall remain the liability of the Reinsurer(s) participating in the cession(s) and the Reinsurer(s) shall be kept fully informed of all developments pertaining thereto.

10.5 Portfolio Notification by Reinsured

Not later than the date of commencement of a new year or prior to the date of termination of this Agreement the Reinsured must advise the Reinsurer of its intention if portfolio premium and/or loss is to be assumed or withdrawn in respect of changes in the Reinsurer's share or on termination. The Reinsured cannot effect portfolio loss withdrawal alone without the express written agreement of the Reinsurer.

10.6 Premium Reserve Deposit Procedure

If this Agreement provides for the retention of Premium Reserve Deposits the following procedure shall apply: -

(i) At commencement of this Agreement the Deposit retained shall be equal to the net portfolio premium assumption which shall be released as provided in the Contractual Details.

(ii) On termination of this Agreement the total Deposit retained shall be released on withdrawal of portfolio premium.

(iii) For a portfolio premium assumption relating to an increase in share the Deposit retained shall be revalued to the new participation and released in the normal manner. Alternatively the net portfolio premium assumption may be retained to be released as provided in the Contractual Details.

(iv) For a portfolio premium withdrawal relating to a decrease in share the Deposit retained shall be revalued to the new participation with the proportionate release of Deposit.

Interest at the agreed rate for Deposits as stated in the Contractual Details shall be payable thereon.

10.7 Portfolio Accounting

All the accounting transactions referred to above shall be effected at the same time with the sums relating to the portfolio withdrawal included in the final account of each year. The sums relating to the portfolio assumption shall be included in a preliminary account for the following year which shall be issued simultaneously with the aforementioned account.

10.8 Portfolio Items and Loss Ratio or Profit Commission

The portfolio items shall be included in any loss ratio or profit commission calculations that may be provided for under this Agreement and reserves for unearned premiums and outstanding losses which form part of these calculations shall be revalued to take account of portfolio withdrawals at the close of the year, portfolio assumptions having been credited in a preliminary account at the close of that year. For the computation of a loss ratio the portfolio premium shall be included in the Earned Premium and the portfolio loss included in the Incurred Loss.

Article 11: Claims Reporting and Settlement Clause

11.1 Notification of Claims

The Reinsured shall without delay, advise the Reinsurer of any circumstances which would result in a claim greater than the amount specified in the Contractual Details and thereafter keep the Reinsurer duly informed of any developments regarding the claim.

11.2 Claims Settlement

All loss payments made by the Reinsured within the conditions of the business covered hereunder and falling within the scope of this Agreement shall be binding on the Reinsurer. The Reinsurer shall be liable for its proportion of such loss payments in respect of any risks ceded hereto less its proportion of any recoveries applicable thereto made by the Reinsured whether as salvage or otherwise. All legal costs and professional fees and expenses (excluding salaries of all employees and office expenses of the Reinsured) which are reasonably incurred in connection therewith shall form part of such loss payments.

11.3 Cash losses

The Reinsured shall have the right to request immediate payment from the Reinsurer, of the Reinsurer's proportion of any loss settlement which equals or exceeds the amount stated in the Contractual Details. Any amount so paid shall be credited to the Reinsurer in the next statements of account. All other claims will be settled in account in accordance with Article 12.

11.4 Claims Co-operation

It is a condition precedent to the Reinsurer's obligation to pay under this Agreement, that the Reinsured immediately reports claims for which notification is stipulated in the Contractual Details. Such reporting shall include all material information on the claim, the estimated cost of the loss and the planned settlement thereof.

A further condition precedent to the Reinsurer's obligation to pay is that the Reinsured shall, upon the Reinsurer's request, co-operate with the Reinsurer or any person(s) designated by the Reinsurer in the adjustment and settlement of claims.

In particular, the Reinsurer may require that the Reinsured, after consultation with the Reinsurer, appoint a recognised firm of independent loss adjusters or independent professionals and that it be kept informed of the progress of the settlement and/or be given an opportunity to take part, at its own expense, in the settlement of the claim by delegating a duly authorised representative.

The Reinsured shall not without consulting the Reinsurer or its designated representatives, litigate any such claim.

11.5 Ex-Gratia Claims Payments

Ex-gratia claims payments are excluded from this Agreement and shall be made solely at the cost and expenses of the Reinsured unless the Reinsurer has given its prior consent to contribute to the claims payments made by the Reinsured voluntarily without obligation.

11.6 Outstanding Claims

The Reinsured shall supply the Reinsurer with a statement of unsettled claims as at the end of each quarter such statement showing an aggregate amount for which the Reinsurer may be liable in their years of occurrence. The statement shall be rendered with the accounts not later than the period stated in the Contractual Details.

In respect of the outstanding claims on the Reinsured which exceed the amount stated in the Contractual Details, the Reinsured shall supply the Reinsurer as at the end of each quarter with the name, date of loss and estimated amount of each outstanding claim given separately per year of occurrence. This information shall be forwarded to the Reinsurer not later than the period specified in the Contractual Details.

Following cancellation in terms of the Special Cancellation Clause of this Agreement the information above shall be so forwarded to the Reinsurer until all liability under this Agreement shall have been discharged.

Article 12: Accounts Clause

12.1 Accounts Rendering

The accounts between the Reinsured and the Reinsurer in respect of the business under this Agreement shall be closed as stated in the Contractual Details and rendered in original currency by the Reinsured as soon as possible thereafter but in any event not later than the period specified in the Contractual Details.

12.2 Accounting Items

The statements of account shall show the following details, broken down according to the different shares and classes of insurance:

1 The written premiums payable to the Reinsurer less returns, cancellations and premiums paid for insurances and reinsurances which inure to the benefit of this Agreement.
2 Commissions and expenses.
3 The claims paid less salvages and recoveries.
4 Outstanding losses broken down into years of occurrence.
5 Cash loss recoveries.

All other items or additional information to be included in the accounts are as specified.

12.3 Accounts Confirmation

Accounts shall be assumed to be confirmed if no confirmation or objection by the Reinsurer are received within the period specified in the Contractual Details but inadvertent errors and/or omissions in the accounts shall not delay the payment of any balance due hereunder unless such errors and/or omissions have a major effect on the remittable balance. Any necessary correction shall be made in the next account rendered hereunder except in those cases where the error and/or omission have a major effect on the remittable balance necessitating an immediate adjustment.

12.4 Accounts Settlement

Balances due to the Reinsurer shall be paid by the Reinsured at the same time as the accounts are rendered and balances due to the Reinsured shall be paid at the time of confirmation but not later than the period stated in the Contractual Details.

12.5 Overdue Balances Clause

Any amounts outstanding after the due date on which settlement is due shall be subject to the payment of interest by the debtor party to the creditor party. Interest shall be calculated at the rate stated in the Contractual Details and remain payable until the date upon which payment is received by the creditor party.
The Debtor party shall bear the Creditor party's loss through currency fluctuation.

Article 13: Currency Conversion Clause

13.1 Currency

The Contract and settlement currencies are specified in the Contractual Details.

13.2 Rates of Exchange

For the purpose of this Agreement currencies other than the currency in which this Agreement is written shall be converted into such currency at the rate of exchange used in the Reinsured's books. Where there is a specific remittance for a loss settlement, the conversion will be at the rate of exchange ruling on the date upon which settlement is effected.

13.3 Additional Charges

All additional charges incurred or to be incurred, including but not limited to bank charges, in respect of any payments made after the due date shall be for the account of the debtor party at the rate prevailing at the due date.

Article 14: Set-Off Clause

Any confirmed balances due by either of the parties to this Agreement, whether they arise out of this Agreement or out of other insurance/reinsurance business relationship between the parties, may be set-off against confirmed balances of the other party. This right shall continue to exist after the termination of this Agreement or of any other insurance/reinsurance business relationship between the parties.

If bankruptcy or liquidation proceedings are initiated in respect of either of the parties to this Agreement, the other party may set off all amounts owing to it, whether they arise out of this Agreement or out of any other insurance/reinsurance business relationship between the parties, against all the amounts due or not yet due for payment by it, whether these arise out of this Agreement or out of any other insurance/reinsurance business relationship between the parties. The same right may be exercised by any party to this Agreement that exercises its right of special termination for any other reason indicated in this Agreement.

Where the Reinsurer has set up a deposit, it may, in the event of bankruptcy or liquidation proceedings being initiated against the Reinsured or in the event of special termination, exercise its rights in respect of the deposit or arising out of the deposit agreement wholly or in part as if they were immediately due debts of the Reinsured, and may set off such debts against any amounts payable to the Reinsured. To the extent that the Reinsurer exercises its right of set-off, it shall waive any rights accorded to it by the deposit agreement.

Article 15: Change of Underwriting Practice Clause

It is a condition precedent to the Reinsurer's liability hereunder that the Reinsured shall not introduce at any time after the Reinsured enters into this Agreement any change in its established acceptance or underwriting policy which may increase or extend the liability or exposure of the Reinsurer hereunder in respect of the classes of business to which this Agreement applies without the prior written approval of the Reinsurer.

Article 16: Incorrect or Incomplete Information Clause

The terms of this Agreement are based on the information supplied by the Reinsured to the Reinsurer prior to the conclusion of this Agreement.

Should the Reinsured have supplied the Reinsurer with information which it knew or should have known to be incorrect or incomplete, this Agreement shall be affected as follows:

(a) If the Reinsurer, in possession of the true facts, would have declined to provide Reinsurance, this Agreement shall be void.

(b) If the Reinsurer, in possession of the true facts, would have provided Reinsurance but under less advantageous terms, this Agreement shall be modified accordingly with effect from the commencement of this Agreement.

The Reinsurer, if in possession of the true facts, will be deemed to have acted as a reasonable Reinsurer would have acted under the same circumstances, unless the Reinsured is able to show otherwise.

Article 17: Inadvertent Delay, Errors and Omissions

Any inadvertent delay, error or omission on the part of either the Reinsured or the Reinsurer shall not relieve either party from any liability which would have attached to this Agreement, provided that such inadvertent delay, error or omission is rectified immediately upon discovery and shall not impose any greater liability on the Reinsured or the Reinsurer than would have attached had the inadvertent delay, error or omission not occurred.

Article 18: Inspection of Records Clause

For as long as either party remains under any liability hereunder the Reinsured shall, upon request by the Reinsurer, make available at the Reinsured's Head Office or wherever the same may be located, for inspection at any reasonable time by such representatives as may be authorised by the Reinsurer for that purpose, all information relating to business reinsured hereunder in the Reinsured's possession or under its control and the said representatives may arrange for copies to be made at the Reinsurer's expense of any of the records containing such information as they may require.

The Reinsurer shall have this right to information as long as either party has a claim against the other arising out of this Agreement.

Article 19: Commencement and Termination

19.1 Commencement

This Agreement shall take effect on the date stated in the Contractual Details and continue in force until terminated and shall be in respect of policies issued or renewed during the period of this Agreement and for policies with periods not to exceed 12 months plus odd time, not exceeding 18 months in all.

This Agreement will follow local standard time.

19.2 Termination

This Agreement may be terminated by either party giving notice of termination on the basis set out in the Contractual Details, such notice to expire on the date stated in the Contractual Details.

During the period of notice the Reinsurer shall continue to participate in all new cessions and renew existing cessions in the same manner as covered by the terms of this Agreement and in all respect as if no notice had been given.

19.3 Service of Notice of Termination

Notice of termination shall be given in writing which shall be deemed to include Registered Letter, Telex, Telegram, Facsimile, or any other permanent means of instantaneous communication. In the event of either party giving notice of termination in accordance with the provisions set out in the Contractual Details then such notice shall be automatically deemed to have been given by both parties.

Article 20. Special Cancellation

1. Either party shall have the right to cancel this Agreement immediately by giving the other party notice in any of the following events:

   (a) If the performance of the whole or any part of this Agreement be prohibited or rendered impossible de jure or de facto in particular and without prejudice to the generality of the preceding words in consequence of any law or regulation which is or shall be in force in any country or territory or if any law or regulation shall prevent directly or indirectly the remittance of any or all or any part of the balance of payments due to or from either party.

   (b) If the other party has become insolvent or unable to pay its debts or has lost the whole or any part of its paid up capital or has any authority to transact any class of business withdrawn, suspended or made conditional.

   (c) If there is any material change in the ownership, management or control of the other party.

   (d) If the country or territory in which the other party resides or has its head office or is incorporated shall be involved in armed hostilities with any other country whether war be declared or not or is partly or wholly occupied by another power.

   (e) If the other party shall have failed to comply with any of the terms and conditions of this Agreement.

2. All notices of termination in accordance with any of the provisions of this Clause shall be given in writing by Registered Letter, Telex, Telegram, Facsimile or any other permanent means of instantaneous communication and shall be deemed to be served upon despatch or, where communications between the parties are interrupted, upon attempted despatch.

3. All notices of termination served in accordance with any of the provisions of this Article shall be addressed to the party concerned at its head office or at any other address previously designated by that party.

4. In the event of this Agreement being terminated at any date other than the expiry date specified herein the then existing premium and loss portfolios shall be withdrawn, net of any retained reserve deposits, either on the basis as specified herein or at alternative terms to be mutually agreed and all liability shall thereby be extinguished or, in respect of those cessions not subject to Portfolio Consideration, run-off to natural expiry.

5. In respect of all cessions allowed to run-off to natural expiry, in the event of this Agreement being terminated at any date other than the expiry date specified herein:

(a) the premium due to the Reinsurer shall be limited to premiums (net of commission) earned by the Reinsured in respect of those policies in force at the date of such termination and calculated in accordance with the Reinsured's normal accounting procedures or at alternative terms to be mutually agreed.

(b) the liability of the Reinsurer shall cease absolutely as at the date of such termination except in respect of losses occurring (or claims made as original) during the currency of this Agreement but which are not settled at the date of termination. In respect of such losses, the liability of the Reinsurer shall continue until its liability is discharged.

6. Termination Amendment

Notwithstanding the provisions above, the right of either party to invoke the termination of this Agreement shall not arise solely due to either party being unable to fulfil their obligations of the whole or any part of this Agreement, due to any sanctions law or regulation applicable to either party which is in force and prohibits such action.

Article 21: Extended Expiry

If this Agreement should expire or terminate whilst a loss occurrence covered hereunder is in progress the Reinsurer will indemnify the Reinsured in terms of this Agreement on any claim resulting from that loss occurrence notwithstanding that part of the loss may have arisen after the time of termination. No part of such loss occurrence shall be claimed against any renewal of this Agreement.

Article 22: Alterations Clause

No variation in the Agreement shall be effective unless evidenced in writing and duly signed on behalf of both parties. Variations sent by instantaneous means of communication are also effective provided they are capable of being shown by means of permanent or retrievable record to have been agreed by both parties.

Article 23: Intermediary Clause

23.1 Intermediary

The intermediary named in the Contractual Details is hereby recognised as the intermediary negotiating this Agreement for all business hereunder.

23.2 Communications

All communications (including but not limited to notices, statements, premiums, return premiums, commissions, taxes, losses, loss adjustments, expenses, salvages and loss settlements) relating thereto shall be transmitted to the Reinsured or the Reinsurer through the named intermediary, subject to the provision of Article 20 (Special Cancellation Clause) herein.

23.3 Payments

(a) Payments by the Reinsurer to the Intermediary for the account of the Reinsured shall be deemed to constitute payment to the Reinsured for the purpose of discharging the Reinsurer's liability hereunder.

(b) Payments by the Reinsured through the Intermediary shall only constitute payment to the Reinsurer when and to the extent that such payments are actually received by the Reinsurer.

Article 24: Change in Law Clause

In the event of any change in the law, whether arising from legislation, decisions of the courts or otherwise, at any time after the Reinsurer entered into this Agreement by which the Reinsurer's liability hereunder is materially increased or extended, the parties hereto agree to take up for immediate discussion at the request of either party a suitable revision in the terms of this Agreement. Failing agreement on such revision within thirty days after such request, it is agreed that the Reinsurer's liability hereunder, whensoever arising, shall be determined as if the said change in law had not taken place.

Article 25: Interpretation Clause

The terms of this Agreement shall be construed in accordance with recognised reinsurance practice rather than being given a strictly literal or legal interpretation.

Article 26: Choice of Law and Jurisdiction Clause

This Agreement (including Arbitration Tribunals) shall be governed by the Law of the Country specified in the Contractual Details whose Courts shall have exclusive or final jurisdiction in any dispute, doubt or question arising hereunder and in the event of any action, claim or demand by any claimant under or by virtue of the original insurance, the liability of the Reinsurer to indemnify the Reinsured in such event shall be limited to judgements delivered or obtained by a Court of competent jurisdiction within the Country specified in the Contractual Details.

Article 27: Arbitration Clause

All matters in difference between the Reinsured and the Reinsurer (hereinafter referred to as "the parties") in connection with this Agreement including its formation and validity and whether arising during or after the period of this Agreement shall be referred to an arbitration tribunal in the manner hereinafter set out.

Unless the parties agree upon a single arbitrator within thirty days of one receiving a written request from the other for arbitration, the claimant (the party, requesting arbitration) shall appoint one arbitrator and give written notice thereof to the respondent.

Within thirty days of receiving such notice, the respondent shall appoint a second arbitrator and give written notice thereof to the claimant, failing which the claimant may apply to the appointor hereinafter named to appoint the second arbitrator.

Before they enter upon a reference the two arbitrators shall appoint a third arbitrator. Should they fail to appoint such a third arbitrator within thirty days of the appointment of the second arbitrator then either of them or either of the parties may apply to the appointor for the appointment of the third arbitrator. The three arbitrators shall decide by majority. If no majority can be reached, the verdict of the third arbitrator shall prevail. He shall also act as Chairman of the Arbitration Tribunal.

Unless the parties otherwise agree, the arbitration tribunal shall consist of persons (including those who have retired) with not less than ten years' experience of insurance or reinsurance as persons engaged in the business itself or advising such business in a professional capacity.

The arbitration tribunal shall, so far as it is permissible under the law and practice of the seat of arbitration, have power to fix all procedural rules for the holding of the arbitration, including discretionary power to make orders as to any matters which it may consider proper in the circumstances of the case with regard to pleadings, discovery, inspection of the documents, examination of witnesses and any other matter whatsoever relating to the conduct of the arbitration, and may receive and act upon such evidence, whether oral or written, strictly admissible or not, as it shall at its discretion think fit.

The appointor shall be as specified in the Contractual Details or if he is unavailable or it is inappropriate for him to act for any reason, such person as may be nominated by the Committee of that body. If for any reason such persons decline or are unable to act then the appointor shall be the judge of the appropriate Courts having jurisdiction at the seat of Arbitration.

All costs of the arbitration shall be at the discretion of the arbitration tribunal who may direct to and by whom and in what manner they shall be paid.

The seat of the arbitration shall be in the place specified in the Contractual Details and the law applicable to both the aforesaid Agreement and this arbitration Agreement shall be the law of that country.

A reasoned award of the arbitration tribunal shall be issued to the parties in writing and shall be final and binding upon the parties who covenant to carry out the same. If either of the parties should fail to carry out the award, the other may apply for its enforcement to a court of competent jurisdiction in any territory in which the party in default is domiciled or has assets or carries on business.

It is understood and agreed that this arbitration agreement shall be construed as a separate and independent contract between the parties hereto and arbitration hereunder shall be a condition precedent to the commencement of any action at law.

Article 28: Sanctions Limitation and Exclusion Clause

No (re)insurer shall be deemed to provide cover and no (re)insurer shall be liable to pay any claim or provide any benefit hereunder to the extent that the provision of such cover, payment of such claim or provision of such benefit would expose that (re)insurer to any sanction, prohibition or restriction under United Nations resolutions or the trade or economic sanctions, laws or regulations of the European Union, United Kingdom, United States of America or African Union.

Article 29: Several Liability Notice LSW 1001 (Reinsurance)

In case there are other subscribing Reinsurers to this Agreement, the subscribing Reinsurers' obligations under this Agreement and/or any other contracts of reinsurance to which they subscribe are several and not joint and are limited solely to their individual subscriptions.

The subscribing Reinsurers are not responsible for the subscription of any co-subscribing reinsurer who for any reason does not satisfy all or part of its obligations.

IN WITNESS WHEREOF, this Slip has been signed in two originals for and on behalf of and by the authority of both the contracting parties to this Agreement, as hereafter:

In this day of 20..
For and on behalf of the Reinsurer

In this day of 20..
For and on behalf of the Reinsurer

TABLE OF COMBINED RETENTIONS FOR FIRE MATERIAL DAMAGE AND LOSS OF PROFITS ATTACHING TO AND FORMING PART OF FIRE AND ENGINEERING SURPLUS SLIP REINSURANCE AGREEMENT NUMBER: ARC/FAPENG/SPLS/..........

The Reinsured shall set its gross retention per risk on the basis of the following table of (maximum and minimum) retentions, which forms an integral part of this Agreement.

When fixing the individual gross retention for each risk, its own merits have to be taken into consideration (e.g. public fire brigade, automatic fire extinguishing facilities, type of construction, nature of contents, exposure to storm, flood, earthquake, loss record, etc.). The gross retention, however, must be kept within the stated maximum and minimum limits. The limits are in terms of sum insured.

Risks which are, under normal circumstances, not prone to major losses such as risks constructed of burnt bricks, stones and/or concrete but roofed with corrugated iron sheets or slates, e.g.:

- Services, such as schools, hospitals, etc.
- Residential and office buildings
- Cement plants and stone crushing activities
- Salt works and refineries
- Desalination plants
- Beverage manufacturing and bottling

Maximum Gross Retention: 100% of gross line

Risks possibly prone to major losses such as:

- Hotels
- Sale of goods (including showrooms and department stores)
- Rolling mills, metallurgical plants
- Electrical Industry
- Chemical plants (except petrochemical industry)
- Food
- Power plants
- Rubber
- Oil mills for cotton seeds

Maximum Gross Retention: 75% of gross line

Risks very prone to major losses such as:

- Foam, plastics
- Explosives, matches
- Paper, leather
- Wood processing, chipboard manufacturing
- Grain silos, mills, fodder factories
- Warehouses, open air storage
- Cold stores
- Textiles
- Cotton risks i.e., producing and processing of raw cotton, semi-finished and finished products of cotton
- Manufacturing textile companies, which include manufacturing of leather garments.
- Animal Feed

Maximum Gross Retention: 60% of gross line

The list of different risks cannot be exhaustive; it should, however, serve as a guideline for the setting of retentions.

APPENDIX NO. 2

ATTACHING TO AND FORMING PART OF FIRE AND ENGINEERING SURPLUS SLIP REINSURANCE AGREEMENT NUMBER: ARC/FAPENG/SPLS

TABLE OF COMBINED RETENTIONS FOR ENGINEERING, CONTRACTOR ALL RISKS AND CONTRACTOS ERECTION ALL RISKS

The Reinsured shall set its gross retention per risk on the basis of the following Table of Retentions:

Class of business	*100% maximum limit One Gross Line any one risk on sum insured basis or Probable Maximum Loss (PML) (Naira)*	*No of lines*	*Reinsurer's Surplus Maximum Cession Limit (Naira)*
Boiler and Pressure Vessel and Consequential Loss combined All insured items shall be ceded in the same proportion.	50,000,000 per premises	10	500,000,000
Machinery Breakdown and Consequential Loss combined All insured items shall be ceded in the same proportion. It is warranted that Consequential Loss insurance will be written in Conjunction with a relevant Machinery Breakdown policy.	50,000,000 per premises	10	500,000,000
Deterioration of Stock following Machinery Breakdown It is warranted that Deterioration of Stock insurance will be written in conjunction with a relevant Machinery Breakdown policy.	50,000,000 per policy	10	500,000,000
Erections All Risks and Construction Machinery combined **Third Party Liability** Cessions shall be on the Basis of the Material Damage section of the Insurance policy. Third party Liability Section and Plant, machinery written in conjunction with Erections All Risks Policy shall be in the same proportion as the material damage section.	100,000,000 per policy 30,000,000 any one loss or occurrence	10	1,000,000,000 Same proportion

Class of business	*100% maximum limit One Gross Line any one risk on sum insured basis or Probable Maximum Loss (PML) (Naira)*	*No of lines*	*Reinsurer's Surplus Maximum Cession Limit (Naira)*
Contractors' All Risks and Contractors' Plant, Machinery and Equipment combined **Third Party Liability** Cessions shall be on the Basis of the Material Damage section of the Insurance policy. Third party Liability Section and Plant, machinery written in Conjunction with Contractors' All Risks Policy shall be in the same proportion as the material damage section.	100,000,000 per policy 30,000,000 any one loss or occurrence	10	1,000,000,000 Same proportion
Contractors' Plant, Machinery and Equipment Retention or Gross Retention and Cession to Treaty shall be on the basis of separate contractors' plant, machine and equipment insurance policies underwritten on an annual insurance period, excluding absolutely third party liability cover and which will not be underwritten in conjunction with Contractors' All Risks policy. All insured items shall be ceded in the same proportion.	30,000,000 per policy	10	300,000,000
Electronic Equipment and Increased Cost of Working combined.	50,000,000 per fire area or per installation or per policy.	10	500,000,000

However, the aggregated Retention or Gross Retention and Cession to Treaty for Electronic Equipment shall not exceed the 100% maximum retention and treaty limits and all covers must be reinsured in the same proportion, depending primarily on the cession on the material damage section.

A "fire area" will represent a complex or insured premises where fire, lightning, explosion or any other insured peril can cause a FATAL loss. In this connection a complex will be interpreted as consisting of one or several buildings or premises which are separated physically and absolutely or structurally by fire walls or other means from the neighbouring buildings or premises.

In the case of pronounced exposure to natural hazards like earthquake or flood and inundation, the retention or gross retention and cession to treaty shall be deemed to apply per location.

NATURAL PERILS EVENT LIMIT CLAUSE ATTACHING TO AND FORMING PART OF FIRE AND ENGINEERING SURPLUS SLIP REINSURANCE AGREEMENT NUMBER: ARC/FAPENG/SPLS/..........

1. For each and every loss occurrence in respect of Natural Perils, the liability of the Reinsurer under this Agreement covering material damage and/or business interruption policies shall be limited to the Reinsurer's proportion of a limit of:

NGN 2,000,000,000 / 10% of the aggregate exposure ceded to the Treaty.

This limitation shall be valid for loss occurrences commencing during the period of this Agreement and involving risks which have been ceded on an underwriting year basis in accordance with the conditions of this Agreement.

If an event involves two or more underwriting years, the above limitation in respect of the Reinsurer's liability under this Agreement shall be reduced in the same proportion as the losses (paid and outstanding) of that event involving this Agreement contribute to the sum of all losses of that event in respect of all underwriting years together.

2. A loss occurrence which is covered according to the conditions of this clause and is in progress when this Agreement should expire or be terminated, shall, irrespective of any other condition(s), be treated as if the entire loss had occurred prior to the expiration of the said Agreements. In this case no part of such a loss occurrence can however be claimed against any Agreement(s) issued in renewal or substitution of this Agreement.

3. The total liability of the Reinsurer during the period of this Agreement in respect of loss occurrences covered according to the conditions of this clause shall be limited to the Reinsurer's proportion of a limit of:

NGN 2,000,000,000 / 10% of the aggregate exposure ceded to the Treaty.

4. A "loss occurrence" in respect of perils to which this clause refers shall be understood to mean all individual losses arising out of and directly occasioned by one and the same event. However, the duration and extent of any "loss occurrence" so defined shall be limited to:

a) 72 (Seventy Two) consecutive hours as regards a hurricane, typhoon, windstorm, rainstorm, hailstorm, tornado, typhoon and/or cyclone;
b) 72 (Seventy Two) consecutive hours as regards an earthquake, seaquake, volcanic eruption and/or tidal wave;
c) 72 (Seventy Two) consecutive hours as regards any claim to which two or more of the abovementioned perils contribute;
d) 168 (One Hundred and Sixty Eight) consecutive hours as regards any claim resulting from a peril mentioned above and not indicated under a) and b).

If any event is of greater duration than the above periods, the Reinsured has to divide that event into two or more loss occurrences whereby:

a) the periods for the first loss occurrence has to commence at the date and time of the first individual loss that is indemnifiable by the Reinsurer;
b) two periods cannot overlap and no gap can be between the two periods.

SLIDING SCALE COMMISSION ATTACHING TO AND FORMING PART OF FIRE AND ENGINEERING SURPLUS SLIP REINSURANCE AGREEMENT NUMBER: ARC/FAPENG/SPLS/..........

The Reinsured shall at the end of each treaty year calculate an adjusted commission on the following "sliding scale" basis:-

If Loss Ratio % is:	Commission % is:
63.00% or more	27.00%
62.00% and more but less than 63.00%	27.50%
61.00% and more but less than 62.00%	28.00%
60.00% and more but less than 61.00%	28.50%
59.00% and more but less than 60.00%	29.00%
58.00% and more but less than 59.00%	29.50%
Equal to or less than 57.00%	30.00%

Provisional Commission: 20%

The commission calculation shall be submitted to the Reinsurer at the same time as the fourth quarter account and the difference between the provisional commission and the adjusted commission shall thereupon become payable by the debtor party.

In the event of cancellation of this Agreement on a run-off basis, then a further calculation shall be done at the end of the second year and a further adjustment of the commission for the year shall then be made, and a similar calculation and adjustment shall be made at the end of each year thereafter, until such time as any outstanding claims brought into such calculation shall be extinguished in which event the calculation and adjustment at the end of that year shall be final.

For the purpose of applying the sliding scale:
"Loss ratio" shall mean the percentage of "Incurred Losses" to "Earned Premiums"

"Incurred Losses" shall mean losses and loss expenses paid during the treaty year plus outstanding loss reserve at the end of the treaty year (calculated on the same basis as the loss portfolio withdrawal, if applicable) less the Reinsurer's reserve for outstanding losses at the end of the previous treaty year (calculated on the same basis as the incoming loss portfolio, if applicable).

"Earned Premiums" shall mean premiums (net of taxes if applicable) paid by the Reinsured under this Agreement for the treaty year less the premium reserve for the treaty year (calculated on the same basis as the premium portfolio withdrawal, if applicable) plus the premium reserve from the previous treaty year ((calculated on the same basis as the premium portfolio credited at the commencement of the treaty year, if applicable)

EXCLUSIONS ATTACHING TO AND FORMING PART OF FIRE AND ENGINEERING SURPLUS SLIP REINSURANCE AGREEMENT NUMBER: ARC/FAPENG/SPLS/..........

APPENDIX NO. 5.1

War and Civil War, Political Risk and Terrorism

The following shall be excluded from this Agreement:

Any loss or damage occasioned by or through or in consequence, directly or indirectly, of any of the following occurrences, namely:

1. War, invasion, act of foreign enemy, hostilities or warlike operations (whether war be declared or not), civil war.

2. Abandonment and/or permanent or temporary dispossession resulting from detention, confiscation, seizure, restraint, commandeering, nationalisation, appropriation, destruction or requisition by order of any government de jure or de facto or by any public authority.

3. Mutiny, civil commotion, military rising, insurrection, rebellion, revolution, military or usurped power, martial law or state of siege or any of the events or causes which determine the proclamation or maintenance of martial law or state of siege.

4. Any act, including but not limited to labour disturbance, lock-out, riot or strike, which is calculated or directed to bring about loss or damage in order to further any political aim, objective or cause, or to bring about any social or economic change, or in protest against any State or Government, or any political or local authority, or for the purpose of imposing fear in the public or any section thereof.

5. The act of any lawfully established authority in controlling, preventing, suppressing or in any other way dealing with any occurrence referred to in clauses 1 to 4 above.

6. Plundering, looting, war pillage

For the purposes of clauses 4, 5 and 6, any loss or damage occasioned directly by a labour disturbance, lock-out, riot or strike or in order to bring about any social or economic change which is not politically motivated as envisaged in clause 4 shall not be excluded.

In any action, suit or other proceeding where the Reinsurer alleges that by reason of these provisions any loss, damage, cost or expense is not covered by this Reinsurance Agreement, the burden of proving that such loss, damage, cost or expense is covered shall be upon the Reinsured.

Terrorism Exclusion Clause

Notwithstanding any provision to the contrary within this agreement or any endorsement thereto, this reinsurance agreement does not cover any liability, loss, damage, cost or expense of whatsoever nature directly or indirectly caused by, resulting from, happening through or in connection with any act of terrorism, regardless of any other cause contributing concurrently or in any other sequence to the loss, damage, cost or expense.

For the purpose of this exclusion, terrorism means an act, including but not limited to the use of violence or force and/or the threat thereof, whether as an act harmful to human life or not, by any person or group(s) of person(s), whether acting alone or on behalf of, or in connection with any organisation(s) or government(s) or any person or body of persons, committed for political, religious, personal, ethnic or ideological reasons or purposes including any act committed with the intention to influence any government and/or for the purpose of inspiring fear in the public or any section thereof.

In any action, suit or other proceeding in which the Reinsurer alleges that by reason of this definition any loss, damage, cost or expense is not covered by this Reinsurance Agreement, the burden of proving that such loss, damage, cost, or expense is covered shall be upon the Reinsured.

APPENDIX NO. 5.2

Nuclear Energy Risks Exclusion Clause (Reinsurance) (1994) (Worldwide excluding U.S.A. and Canada) - NMA 1975A.

This Agreement shall exclude Nuclear Energy Risks whether such risks are written directly and/or by way of reinsurance and/or Pools and/or Associations.

For all purposes of this Agreement Nuclear Energy Risks shall mean all first and/or third party insurances or reinsurances (other than Workers' Compensation and Employers' Liability) in respect of:

(I) All **Property** on the site of a nuclear power station.

Nuclear Reactors, reactor buildings and plant and equipment therein on any site other than a nuclear power station.

(II) All **Property** on any site (including but not limited to the sites referred to in (I) above) used or having been used for:

(a) The generation of nuclear energy; or
(b) The **Production, Use or Storage of Nuclear Material**.

(III) Any other **Property** eligible for insurance by the relevant local Nuclear Insurance Pool and/or Association but only to the extent of the requirements of that local Pool and/or Association.

(IV) The supply of goods and services to any of the sites, described in (I) to (III) above, unless such insurances or reinsurances shall exclude the perils of irradiation and contamination by **Nuclear Material**.

Except as undernoted, Nuclear Energy Risks shall not include:

(i) Any insurance or reinsurance in respect of the construction or erection or installation or replacement or repair or maintenance or decommissioning of **Property** as described in (I) to (III) above (including contractors' plant and equipment), and/or
(ii) Any Machinery Breakdown or other Engineering insurance or reinsurance not coming within the scope of (i) above;
Provided always that such insurance or reinsurance shall exclude the perils of irradiation and contamination by **Nuclear Material.**

However, the above exemption shall not extend to:

(1) The provision of any insurance or reinsurance whatsoever in respect of:

(a) **Nuclear Material**;
(b) Any **Property** in the **High Radioactivity Zone** or Area of any **Nuclear Installation** as from the introduction of **Nuclear Material** or - for reactor installations - as from fuel loading or first criticality where so agreed with the relevant local Nuclear Insurance Pool and/or Association.

(2) The provision of any insurance or reinsurance for the undernoted perils:

- Fire, lightning, explosion;
- Earthquake;
- Aircraft and other aerial devices or articles dropped therefrom;
- Irradiation and radioactive contamination;
- Any other peril insured by the relevant local Nuclear Insurance Pool and/or Association;

in respect of any other Property not specified in (1) above which directly involves the Production, Use or Storage of Nuclear Material as from the introduction of Nuclear Material into such Property.

Definitions

"Nuclear Material" means:-

(i) Nuclear fuel, other than uranium and depleted uranium, capable of producing energy by self-sustaining chain process of nuclear fission outside a Nuclear Reactor, either alone or in combination with some other materials;

and
(ii) **Radioactive Products or Waste.**

"**Radioactive Products or Waste**" means any radioactive material produced in, or any material made radioactive by exposure to the radiation incidental to the production or utilisation of nuclear fuel, but does not include radioisotopes which have reached the final stage of fabrication so as to be usable for any scientific, medical, agricultural, commercial or industrial purpose.

"**Nuclear Installation**" means:
(i) Any **Nuclear Reactor**;
(ii) Any factory using nuclear fuel for the production of **Nuclear Material**, or any factory using nuclear fuel for the processing of **Nuclear Material**, including any factory using fuel for the reprocessing of irradiated nuclear fuel; and
(iii) Any facility where **Nuclear Material** is stored, other than storage incidental to the carriage of such material.

"**Nuclear Reactor**" means any structure containing nuclear fuel in such an arrangement that a self-sustaining chain process of nuclear fission can occur therein without any additional source of neutrons.

"**Production, Use or Storage of Nuclear Material**" means the production, manufacture, enrichment, conditioning, processing, reprocessing, use, storage, handling and disposal of **Nuclear Material**.

"**Property**" shall mean all land, building, structures, plant, equipment, vehicles, contents (including but not limited to liquids and gases) and all materials of whatever description whether fixed or not.

"**High Radioactivity Zone or Area**" means:
(i) For nuclear power stations and Nuclear Reactors, the vessel or structure which immediately contains the core (including its support and shrouding) and all the contents thereof, the fuel elements, the control rods and the irradiated fuel store; and
(ii) For non-reactor Nuclear Installations, any area where the level of radioactivity requires the provision of a biological shield.

APPENDIX NO. 5.3

Nuclear Causes Exclusion Clause

Unless specifically agreed in respect of an insured loss involving Nuclear Material under determined circumstances, this Agreement does not cover legal liability, loss (including consequential loss) or damage, cost or expense caused directly or indirectly by any of the following, regardless of any other cause or event contributing concurrently or in any other sequence to the loss:

Nuclear material, Nuclear Fission or Fusion, Nuclear Radiation, Nuclear Waste from the use of Nuclear Fuels, Nuclear Explosives or any Nuclear Weapon.

For the sake of clarity, the above exclusion does not cover legal liability, loss (including consequential loss) or damage, cost or expense caused directly or indirectly by or contributed to by or arising from ionising radiation or contamination by radioactivity from any nuclear fuel or from any nuclear waste from the combustion of nuclear fuel.

Definitions:

"Nuclear material" as defined in NMA 1975 (A).

"Nuclear fission" means a nuclear reaction in which a heavy nucleus splits spontaneously or on impact with other particle with the release of energy.

"Nuclear fusion" means a nuclear reaction in which atomic nuclei of low atomic number fuse to form a heavier nucleus with the release of energy.

"Nuclear radiation" means the absorption of electro-magnetic radiation by a nucleus having a magnetic moment when in an external magnetic field.

"Nuclear waste" as defined in NMA 1975 (A).

"Nuclear fuels" means a substance that will sustain a fission chain reaction so that it can be used as a source of nuclear energy.

"Nuclear explosives" means an explosive involving the release of energy by nuclear fission or fusion or both.

"Nuclear weapon" means a nuclear device designed, used or capable of being used for the inflicting of bodily harm or property damage.

APPENDIX NO. 5.4

Radioactive Exclusion Cause (Reinsurance)

Unless specifically agreed for an insured loss involving nuclear material under determined circumstances, this Agreement does not cover loss, damage, cost or expense of whatsoever nature directly or indirectly caused by, resulting from or in connection with nuclear energy or radioactivity of any kind including but not limited to any of the following regardless or any other cause or event contributing concurrently or in any other sequence to the loss:

1. ionising radiations from or contamination by radioactivity from any nuclear fuel or from any nuclear waste or from the combustion of nuclear fuel;

2. the radioactive, toxic, explosive or other hazardous or contamination properties of any nuclear installation, reactor or other nuclear assembly or nuclear component thereof;

3. any weapon of war employing atomic or nuclear fission and/or fusion or other like reaction or radioactive force or matter.

APPENDIX NO. 5.5

Terrorism Exclusion Clause for Contamination and Explosives

It is agreed that, regardless of any contributory causes, this reinsurance does not cover any loss, damage, cost or expense directly or indirectly arising out of

a) biological or chemical contamination
b) Missiles, bombs, grenades, explosives

due to any act of terrorism.

For the purpose of this endorsement an act of terrorism means an act, including but not limited to the use of force or violence and/or the threat thereof, of any person or group(s) of persons, whether acting alone or on behalf of or in connection with any organisation(s) or government(s), committed for political, religious, ideological, or ethnic purposes or reasons including the intention to influence any government and/or to put the public, or any section of the public, in fear.

For the purpose of a) «contamination» means the contamination, poisoning, or prevention and/or limitation of the use of objects due to the effects of chemical and/or biological substances.

If the Reinsurer alleges that by reason of this exclusion, any loss, damage, cost or expense is not covered by this Agreement the burden of proving the contrary shall be upon the Reinsured.

APPENDIX NO. 5.6

Computer Loss General Exclusion
General Exclusion applicable to all sections of this Agreement insuring damage to property or the consequences of damage to property or any liability

Notwithstanding any provision of this Agreement including any special exclusion, exception or extension or other provision not included herein which would otherwise override a general exclusion, this Agreement does not cover:

a) loss or destruction of or damage to any property whatsoever (including a computer) or any loss or expense whatsoever resulting or arising therefrom;

b) any legal liability of whatsoever nature;

c) any consequential loss;

directly or indirectly caused by or contributed to by or consisting of or arising from the incapacity or failure of any computer, correctly or at all,

i) to treat any date as the correct date or true calendar date, or correctly or appropriately to recognise, manipulate, interpret, process, store, receive or to respond to any data or information, or to carry out any command or instruction, in regard to or in connection with any such date or

ii) to capture, save, or to process any information or code as a result of the operation of any command which has been programmed into any computer, being a command which causes the loss of data or the inability to capture, save, retain or correctly to process such data in regard to or in connection with any such date or

iii) to capture, save, retain or to process any information or code due to programme errors, incorrect entry or the inadvertent cancellation or corruption of data and/or programmes or

iv) to capture, save, retain or to process any data as a result of the action of any computer virus, or other corrupting, harmful or otherwise unauthorised code or instruction including any Trojan horse, time or logic bomb or worm or any other destructive or disruptive code, media or programme or interference.

A computer includes any computer, data processing equipment, microchip, integrated circuit or similar device in computer or non-computer equipment or any computer software, tools, operating system or any computer hardware or peripherals and the information or data electronically or otherwise stored in or on any of the above, whether the property of the insured or not.

Special Extension to the above General Exclusion

A. Loss or destruction of or damage to the insured property by fire, explosion, lightning, earthquake or by the special perils referred to in B below or indemnified by the Glass, Employer's Liability, Stated Benefits, Group Personal Accident or Motor section shall not excluded by this General Exclusion.

B. The special perils that are not excluded for the purpose of this special extension are damage caused by:

1. storm, wind, water, hail or snow excluding damage to property

    a) arising from its undergoing any process necessarily involving the use or application of water;

    b) caused by tidal wave originating from earthquake or volcanic eruption;

    c)* in the underground workings of any mine;

    d)* in the open (other than buildings structures and plant designed to exist or operate in the open);

    e)* in any structure not completely roofed;

    f)* being retaining walls;

    *for c), d), e) and f) unless so described and specifically insured as a separated Item.

2. aircraft and other aerial devices or articles dropped therefrom;

3. impact by animals, trees, aerials, satellite dishes or vehicles excluding damage to such animals, trees, aerials, satellite dishes or vehicles or property in or on such vehicles.

These special perils do not cover wear and tear or gradual deterioration.

C. The above General Exclusion also does not apply to consequential loss as insured by any Business Interruption indemnity provided by this Treaty to the extent that such consequential loss results from damage to insured property by the perils referred to A above.

D. This Special Extension will not insure any loss destruction, damage or consequential loss if it would not have been insured in the absence of this Computer Losses General Exclusion and this Special Extension.

E. This Special Extension shall not apply to any Public Liability indemnity.

APPENDIX NO. 5.7

Electronic Date Recognition Clause EDRC (B)

Section 1

This Agreement does not cover any loss, damage, cost, claim or expense, whether preventative, remedial or otherwise, directly or indirectly arising out of or relating to:

a) the calculation, comparison, differentiation, sequencing or processing of data involving the date change to the year 2000, or any other date change, including leap year calculations by any computer system, hardware, programme or software and/or any microchip, integrated circuit or similar device in computer equipment or non-computer equipment, whether the property of the insured or not; or

b) any change, alteration or modification involving the date change to the year 2000 or any other date change, including leap year calculations, to any such computer system, hardware, programme or software or any microchip, integrated circuit or similar device in computer equipment or non-computer equipment, whether the property of the insured or not.

This clause applies regardless of any other cause or event that contributes concurrently or in any sequence to the loss, damage, cost, claim or expense.

However, this section shall not apply in respect of physical damage occurring at the insured's premises arising out of the perils of fire, lightning, explosion, aircraft or vehicle impact, falling objects, windstorm, hail, tornado, hurricane, cyclone, riot, strike, civil commotion, vandalism, malicious mischief, earthquake, volcano, tsunami, freeze or weight of snow.

Section 2

Notwithstanding Section 1 above, this Agreement does not cover any costs and expenses, whether preventative, remedial or otherwise, arising out of or relating to change, alteration or modification of any computer system, hardware, programme or software or any microchip, integrated circuit or similar device in computer or non-computer equipment, whether the property of the insured or not.

Section 3

The date change to the year 2000, or any other date change, including leap year calculations, shall not in and of itself be regarded as an event for the purposes of this reinsurance.

APPENDIX NO. 5.8

Computer Virus and on-line risks "Clarification Agreement"

Property damage covered under this Agreement shall mean physical damage to the substance of property.

Physical damage to the substance of property shall not include damage to data or software, in particular any detrimental change in data, software or computer programmes that is caused by a deletion, a corruption or a deformation of the original structure.

Consequently the following are excluded from this Agreement:

A. Loss or damage to data or software, in particular any detrimental change in data, software or computer programmes that is caused by a deletion, a corruption or a deformation of the original structure, and any business interruption losses resulting from such loss or damage. Notwithstanding this exclusion, loss of or damage to data or software which is the direct consequence of insured physical damage to the substance of property, shall be covered.

B. Loss or damage resulting from an impairment in the function, availability, range of use or accessibility of data, software or computer programmes, and any business interruption losses resulting from such loss or damage.

APPENDIX NO. 5.9

Institute Chemical, Biological, Bio-Chemical, Electromagnetic Weapons and Cyber Attack Exclusion Clause.

This clause shall be paramount and shall override anything contained in this Agreement inconsistent therewith.

In no case shall this Agreement cover loss, damage, liability or expense directly or indirectly caused by or contributed to by or arising from:

1. any chemical, biological, biochemical or electromagnetic weapon;

2. the use or operation, as a means for inflicting harm, of any computer, computer system, computer software programme, computer virus or process or any other electronic system.

APPENDIX NO. 5.10

Transmission and Distribution Lines Exclusion

All above ground transmission and distribution lines, including wires, cables, poles, pylons, standards, towers, other support structures and any equipment of any type which may be attendant to such installations of any description for the purpose of transmission and distribution of electric power, telephone or telegraph signals, and all communication signals whether audio or visual.

This exclusion applies to both above and below ground equipment which are more than150 meters (or 500 feet) from the insured structure.

This exclusion applies both to physical loss or damage to the equipment and all business interruption, consequential loss, and/ or other contingent losses related to transmission and distribution lines.

It is understood and agreed that public utilities extension and/or suppliers extension and/or contingent business interruption coverages are not subject to this exclusion, provided that these are not part of a transmitters' or distributors' policy.

APPENDIX NO. 5.11

Pollution/Contamination Exclusion Clause

This Agreement excludes any loss arising from Pollution or Contamination except (unless otherwise excluded) destruction of or damage to the property insured caused by:

pollution or contamination which itself results from a peril reinsured against

any peril reinsured against which itself results from a pollution or contamination

This Agreement also excludes any liability in connection with disposed or dumped waste materials or substances.

APPENDIX NO. 5.12

Asbestos Exclusion Clause

It is hereby understood and agreed that this Agreement shall not apply to, and does not cover, any actual or alleged liability whatsoever for any claim or claims in respect of loss or losses directly or indirectly caused by, arising out of, resulting from, in consequence of, in any way involving, or to the extent contributed to by, the hazardous nature of asbestos in whatever form or quantity.

APPENDIX NO. 5.13

Sanctions Limitation and Exclusion Clause

The Reinsurer shall be deemed to provide no cover and shall not be liable to pay any claim or provide any benefit hereunder to the extent that the provision of such cover, payment of such claim or provision of such benefit would expose the Reinsurer to any sanction, prohibition or restriction under United Nations resolutions or the trade or economic sanctions, laws or regulations of the European Union, United Kingdom, United States of America or African Union.

ATTACHING TO AND FORMING PART OF FIRE AND ENGINEERING SURPLUSSLIP REINSURANCE AGREEMENT NUMBER: ARC/FAPENG/SPLS/..........

6.1 Supplementary Fire and Allied Perils Exclusions List

1. Obligatory Insurances and Reinsurances of any sort.
2. Excess of Loss Insurances and Reinsurances/Layered policies, Stop Loss or First Loss basis (First Loss exclusion is not applicable for Natural Perils and/or Burglary).
3. Liability arising from Insurance Loss Portfolio Transfers of any kind.
4. Pools and Pooling Arrangements.
5. Line Slips, Binding Authorities, Broker Covers and Captive Pools.
6. Advance Loss of profits.
7. All legal liabilities other than Owners/Occupiers Liability insured under Houseowners and/or Householders Combined and Office Comprehensive policies.
8. Policies issued or renewed for a period exceeding 12 months plus odd time provided that each insurance period does not exceed a maximum of 18 months.
9. Marine Hull and Cargo and all Consequential Loss resulting therefrom.
10. Inland Transit (other than for Fire and Allied Perils) and all Consequential Loss resulting therefrom.
11. Aviation Hull and Liabilities including Air Cargo, and all Consequential Loss resulting therefrom.
12. On and Offshore Oil and/or Gas Drilling and Production Rigs, including any Consequential Loss resulting therefrom.
13. Property insured under Motor Vehicle policies of any type.
14. Credit insurance of any kind; guarantees and bonds of any kind, including Financial Guarantees, Fidelity and Surety Bonds.
15. Hail on Growing Crops of all kinds including but not limited to agricultural and horticultural or when written as a peril separately and all business interruption resulting therefrom.
16. Comprehensive Crop Insurance (on crops of all kinds including but not limited to agricultural and horticultural), and all business interruption resulting therefrom.
17. On trees, shrubs and bushes of all types and consequential loss resulting therefrom
18. Money and all Consequential Loss resulting therefrom (other than money covered on a Fire and Allied Perils policy to be declared to Leading Underwriter (African Reinsurance Corporation) and approval obtained.
19. Accidental Damage and Business Interruption resulting therefrom other than under an Industrial/Assets All Risks cover or Accidental Damage extension to the Fire policy, however, limited to 5% or US$100,000 equivalent in local currency maximum whichever is lower, of total sum insured per location, per policy unless declared and agreed by the Lead Underwriter (African Reinsurance Corporation).
20. Livestock and all Consequential Loss resulting therefrom (other than Livestock covered on a Fire and Allied Perils policy).
21. Business written with an aggregate excess which applies to Motor, Liability, Personal Accident, Marine and Aviation business unless agreed by the Leading Reinsurer.
22. Any form of mining risks.
23. Burglary (other than under Domestic combined policies).
24. Theft (other than under Office Comprehensive and Domestic policies)
25. Any exposures out of the USA and Canada
26. Difference in Conditions policies or Difference in Limits policies
27. Engineering, Contractors All Risks, Erection All Risks and Motor
28. Customers and Suppliers extension of a Business Interruption section (or otherwise referred to as Contingent Business Interruption cover) which is:
    - a) not on a named perils basis;
    - b) named direct suppliers where the limit exceeds 20% of the Business Interruption Sum Insured or policy limit whichever is the lesser as stated in the underlying policy schedule, unless agreed by the Reinsurer;
    - c) un-named direct suppliers where the limit exceeds 5% of the Business Interruption Sum Insured or policy limit whichever is the lesser as stated in the underlying policy schedule, unless agreed by the Reinsurer;
    - d)not triggered by damage from named perils occurring at the Customer and/or Suppliers' premises;
    - e)not separately evaluated in terms of accumulation exposure;
    - f) not individually rated, assessed and priced.
29. Stock Floater policies other than in respect of Fire and Allied Perils as defined under this Agreement and restricted to the insured premises as stated in the underlying policy schedule.
30. Ex gratia payments otherwise than with the prior consent of the Reinsurer only.
31. Business Interruption with an indemnity period exceeding 18 months.

Referrals

6.2 Supplementary Engineering Exclusions List

1. Business written on an excess of loss (excepting policies with normal underwriting excesses or deductibles), layered, stop loss or first loss basis (except for First Loss Indemnity policies).
2. Business accepted by the Reinsured under any reinsurance arrangement.
3. All Risks policies covering other classes or perils than falling within the scope of this treaty.
4. Penalty insurance, guarantees or other insurance for performance, products, delay, availability and efficiency.
5. Run-off covers.
6. Insurance covering currency risks, transfer risks, del credere risk and the like.
7. Project works where the cover incepts after commencement of the actual works unless the risk premium is based on the contract in its entirety on an as if basis from the date of commencement of the project works and any loss or damage due to inherent defects existing at the time of the cover incepting being excluded, whether known to the insured or not.
8. Defects Contingency not written in conjunction with a Contractors or Engineering All Risk policy.
9. Marine risks, but not excluding inland transit when written contingent to an Erection All Risks or Contractors' All Risks policies.
10. Contractor's Plant and/or Third Party Liability cover unless written in conjunction with and in the same proportion of an Erection All Risks or Contractors All Risks share.
11. Decennial Liability covers.
12. All offshore risks.
13. Full design cover.
14. Policies naming the Engineer and/or Architect as an insured part, unless the policy excludes Professional Indemnity covers for such parties.
15. Policies covering experimental or prototype machinery and equipment.
16. Machinery Breakdown and Machinery Breakdown Consequential Loss of Profits covers for aircraft engines.
17. Machinery Breakdown and Machinery Breakdown Consequential Loss of Profits for mobile agricultural implements and machines and for irrigation piping and ancillary equipment or household appliances.
18. Profit Sharing or Long Term Agreements.
19. Accidental damage beyond the scope of a standard market Erection All Risks or Contractors' All Risks or Machinery Breakdown or Plant All Risks or Electronic Equipment policy.
20. Third Party Liability on Erection All Risks and Contractors' All Risks policies not limited to the contract site as defined in the contract.
21. Design of temporary works.
22. Erection All Risks or Contractors' All Risk policies where the Defects Maintenance period is in excess of 12 months (unless agree by the Leading Reinsurer) or where the maintenance cover is not limited to defects with origin on site.
23. Debris Removal cover with no damage to the works unless limited in amount and to the site.
24. Confiscation, nationalisation and abandonment.
25. Contingency policies, Difference in Conditions policies or policies covering the deductible under another policy.
26. Insurances which are or should be written in the Motor Department.
27. Aviation Insurances which are or should be written in the Motor Department.
28. Professional indemnity cover.
29. Claims arising from any costs which would be deemed to be excluded under the terms of the Prolongation Clause and any costs beyond those specifically identified and underwritten accordingly.
30. Policies issued on a short period basis, i.e. not the full contract period.
31. "Hours" clause on Contractors' All Risks policies.
32. Conventional annual policies issued on a short period basis.
33. Plant All Risks policies on the basis of reinstatement conditions.
34. Any direct or indirect loss by infectious disease, outbreak (infectious epidemics).
35. Ex gratia payments otherwise than with the prior consent of the Reinsurer only.
36. Space Risks and Space-Related Risks such as satellites, spacecraft, launch vehicles and major components thereof from the beginning of transit to launch site; launch sites.

Referrals

List of referral risks which may be covered subject to the Leading Reinsurer's approval.

1. Advance Loss of Profits or Delay in Start-up covers.
2. Nuclear power plants.
3. Annual blanket covers exceeding 12 months non-cancellable clauses or involving erection or construction periods exceeding 24 months.
4. Projects with a value in excess of Nigerian Naira 300,000,000 Sum Insured for 100%.
5. Lateral Support covers on Contract works policies in excess of a limit of Nigerian Naira 30,000,000.

6. Inclusion of Suppliers and Customers extensions, other than public services, under Consequential Loss of Profits covers.
7. Consequential Loss of Profits covers with Indemnity Periods in excess of 24 months.
8. Petrochemical plants.
9. Waste incineration plants and Black Liquor Recovery boilers.
10. Draglines and underground mining projects.
11. Power stations.
12. Major irrigation systems.
13. Wet risks.
14. Consequences of faulty design cover on civil engineering risks

APPENDIX NO. 7

LOSS PARTICIPATION

ATTACHING TO AND FORMING PART OF FIRE AND ENGINEERING SURPLUS SLIP REINSURANCE AGREEMENT NUMBER: ARC/FAPENG/SPLS/..........

From Loss Ratio of 70% to 200%: Reinsured to pay 100%

In the event that the overall losses for the accounting year exceed 70% of the earned premium, the Reinsured shall take 100% of the losses exceeding the earned premium income from 70% up to 200%.

The loss participation shall be calculated on the basis of a loss participation statement to be drawn up by the Reinsured at the end of each Reinsurance Period. Such loss participation statement shall be sent to the Reinsurer together with the last account for the Reinsurance Period and any amounts due shall be settled at the same time. The loss participation statement shall be adapted at the end of every following Reinsurance Period until the Reinsurance Period under consideration is completely wound up or transferred.

For the purpose of applying the loss participation clause:
“Loss ratio” shall mean the percentage of “Overall Losses” to “Earned Premiums”

It is understood that “overall losses” shall mean losses paid plus reserves for outstanding losses, allocated to the relevant Reinsurance Period. “Earned premium income” shall mean the gross reinsurance premiums ceded, allocated to the relevant Reinsurance Period.

SECTION 9 - TEST ANSWERS

9.1 MULTIPLE CHOICE ANSWERS

1. a, b and c are all correct
2. c
3. d
4. a
5. c
6. c
7. c
8. d
9. b, c and d are all correct
10. b and d are correct

9.2 CASE STUDY ANSWERS

Sum insured		**Rate**	**Premium**	
Buildings	900,000	0.15%	1,350	
Machinery	700,000	0.25%	1,750	
Stocks	400,000	0.25%	1,000	
Total premium			4,100	Answer 1
Great West write 50% of risk =			2,050	Answer 2
Distribution of risk and premium				
Risk		**Premium**		
		% shares	Amount	
Sum insured written by Great West	1,000,000			
MPL at 50%	500,000	100%	2,050.00	
Retention	- 50,000	10%	205.00	
6 lines to Surplus Treaty	- 300,000	60%	1,230.00	
Balance to Fac Placement	150,000	30%	615.00	
Thus				
100% premium is			4,100.00	
Gross premium to Great West		50%	2,050.00	
Facultative reinsurers receive:				
Gross premium		25%	615.00	Answer 3
less reinsurers commission		2.50%	153.75	
less brokerage			15.38	Answer 5
Net premium			445.88	Answer 4