Wordings Plus Limited , 5th Floor, 120 Fenchurch Street, London EC3M 5BA. 0207 096 6542

WHAT LIES BENEATH

Richard Newman discusses the dangers of reinsurance policies written "as original"

"This Reinsurance is subject to the same terms, provisions, exclusions and conditions (except as regards premium and except as provided herein and subject always to the Limits Reinsured hereon) as are contained within the following Policy ..."
Policy Number : ABCXXXX.
Insurer : ABC Insurance Company."

Whether you place, underwrite or produce facultative reinsurance slips, this clause (or one of its many variants) will be extremely familiar to you. Ideally, a copy of the primary or underlying wording referred to in the reinsuring clause would be provided to the underwriter at the time that the reinsurance slip is underwritten, however this is all too rarely the case. Without sight of the original wording, the underwriter cannot be clear as to the nature of the conditions contained therein and their effect upon the contractual liability that he is being asked to assume. It is therefore essential that he introduces into the reinsurance contract as many elements of certainty as is possible at the time of underwriting. This article identifies a number of ways in which this can be achieved. Treaty insurers have adopted the practice of incorporating standardised clauses and conditions within their issued agreements for many years, and so it is particularly surprising that more measures of this type have not found their way into facultative reinsurance practice.

The first point is that the existence of a unique, original or underlying policy number in no way guarantees the existence of a contract document and does not achieve contract certainty. It merely shows that a document number has been allocated to it and the contract itself may be in one of many stages of drafting or held in abeyance due to the existence of problems or information yet to be identified or ascertained. For this reason, it is quite feasible for the reinsurance to fulfil its contract period without the underlying wording ever being produced.

One solution to achieve certainty as regards reinsurance terms and conditions is that of imposing a standard wording, identified by its name and/or reference, to apply until such time as the original wording is produced and agreed by reinsurers. This can also hasten the issuance of the original

wording by dint of its potentially being more restrictive with a consequential potential impact on reinsurance claims. This measure has been adopted by a number of brokers within the market to achieve Contract Certainty. By imposing such a wording as standard – and termed a “So Deemed” policy wording –the terms and conditions of the reinsurance slip are deemed to be those applicable to the reinsurance, notwithstanding the original terms and conditions. The reinsured party is thus able to assess the impact and acceptability of the proposed “So Deemed” reinsurance wording at the time of negotiation of the reinsurance contract terms and conditions.

Another measure that may be adopted is that of the temporary imposition of the terms and conditions of an original wording negotiated for a prior period of insurance until such time that the wording for the current period is agreed and in place.

In the event that reinsurers are unable to adopt the above measures or agree to wait for the issuance of the original wording (since in some cases, the broker may also be responsible for its issuance, particularly where the reinsured is an overseas insurance company), clarification of certain key terms and conditions applicable to the reinsurance will ensure that certainty is introduced as to their form and their impact upon the contract. A properly drafted reinsurance slip will identify precisely those conditions applicable to the original policy and those applicable to the reinsurance contract.

The common and dangerous practice to be resisted at all costs is the acceptance of key terms and conditions identified as being “as original” (as stated in the original wording). Without a copy of that wording, a reinsurer cannot ascertain (a) the way in which such terms are worded (b) their acceptability within the gamut of the reinsurance contract and (c) whether they appear at all within the original wording. An illustration of this pitfall is that of the war and civil war exclusion. The standard Lloyd’s NMA 464 clause (and its many company equivalents) used on non-marine risks and adopted by the London market additionally excludes acts of foreign enemies, hostilities (whether or not war is declared), rebellion, insurrection, revolution and other allied events. However, many other original overseas wordings exclude only war and civil war without any mention of the other events specified in NMA 464 (or which only partially exclude those events).

Another suggestion is the inclusion of a radioactive contamination exclusion in a known market format (NMA 1622, NMA 1191 or similar) and a fraudulent claims exclusion (LMA 5062 or similar) where such is not prohibited by the legislation of the country of risk. Reinsurers might also consider an insolvency clause to clarify obligations to the various parties in the event of the insolvency (as defined within that clause) of the Reinsured.

Several insurance companies have a set of their own standard reinsurance conditions which are incorporated within the slip in the form of an Agreement between them and the Reinsurer. These will typically include clauses relating to offset of balances of premiums and losses, jurisdiction, Service of Suit and Arbitration, cut-through, simultaneous payment and the like. It should be stressed that these are conditions agreed by the Reinsured and Reinsurers as pertaining to the reinsurance and are in no way a substitute for a copy of the original wording. However, such

Reinsurance Agreements usually stipulate that the Reinsurer has a copy of the original wording in their possession, so that the provision of a copy is mandatory.

Another danger sign for Underwriters are slips which attempt to provide details of the original coverage by merely listing the named clauses within the wording or which state that the original wording includes “inter alia” certain clauses. These can be regarded at best as providing a summary of the original coverage and, for the reasons stated above, are again not a substitute for a copy of the wording. Slip templates are often generic in the way they describe the type of insurance and interest insured. They may also merely describe the perils or interest as being “as original”. A copy of the original wording will often reveal important differences and/or items which have not been noted in the reinsurance slip. The best prepared reinsurance slip, if drafted without a copy of the original wording, will only be as good as the information provided by the producing broker, who in turn may have been restricted by the original document not having been available to them at the point of contact with the reinsuring broker.

Lastly, the retention retained by the Reinsured is a vitally important piece of information which is often omitted from the slip but without which the underwriter cannot fully estimate the extent of insurable interest for both the Reinsured and Reinsurer. The facultative reinsurance slip should always show the retention amount. There is a current additional worrying trend on London market slips for the inclusion of a clause waving notification of the retention amount but underwriters would be well advised to review its inclusion on a case by case basis. Legislation demands that in certain countries, the original insured retains a specified percentage of risk and in such cases, the retention cannot be waived.

Facultative reinsurance may never enjoy the level of contract certainty afforded to direct risks at the time of placement. The pitfalls are all too clear. However, by adopting the common sense measures we have suggested many of the dangers that lie beneath can be eliminated.