Specimen coursework assignment

M21 – Commercial insurance contract wording

The following is a specimen coursework assignment including questions and indicative answers.

It provides guidance to the style and format of coursework questions that will be asked and indicates the length and breadth of answers sought by markers. The answers given are not intended to be the definitive answers; well-reasoned alternative answers will also gain marks.

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Coursework submission rules and important notes

Before commencing work on, or submitting, your coursework assignment it is essential that you fully familiarise yourself with the content of *Mixed Assessment Candidate Guidelines*. This includes the following information:

- Answers to a coursework assignment should be between 5,000 and 10,000 words in total depending on your writing style.
- Arial font and size 11 to be used in your answers.
- Important rules relating to referencing all sources including the study text, regulations and citing statute and case law.
- Penalties for contravention of the rules relating to plagiarism and collaboration.
- Six month deadline from enrolment date for the submission of coursework answers.
- The total marks available are 200. You need to obtain 120 marks to pass this assignment.
- Do not include your name or CII PIN anywhere in your answers.

Top tips for answering coursework questions

- Read the Learning Outcome(s) and related study text for each question before answering it.
- Ensure your answer reflects the context of the question. Your answer must be based on the figures and/or information used in the question.
- Ensure you answer all questions.
- Address all the issues raised in each question.
- Do not group question parts together in your answer. If there are parts (a) and (b), answer them separately.
- Where a question requires you to address several items, the marks available for each item are equally weighted. For example, if 4 items are required and the question is worth 12 marks, each item is worth 3 marks.
- Ensure that the length and breadth of each answer matches the maximum marks available. For example, a 30 mark question requires more breadth than a 10 or 20 mark question.

M21 Specimen coursework assignment

The coursework questions link to the Learning Outcomes shown on the M21 syllabus as follows:

Question	Learning Outcome(s)	Chapter(s) in the Study Text	Maximum marks per answer
1	Learning Outcome 1	Chapter 1	10 marks
2	Learning Outcome 2	Chapters 2 & 3	20 marks
3	Learning Outcome 2	Chapters 2 & 3	20 marks
4	Learning Outcome 3	Chapter 3	30 marks
5	Learning Outcome 3	Chapter 3	10 marks
6	Learning Outcome 3	Chapter 3	20 marks
7	Learning Outcome 4	Chapters 4, 5 & 6	10 marks
8	Learning Outcome 4	Chapters 4, 5 & 6	20 marks
9	Across more than one Learning Outcome	Across more than one chapter	30 marks
10	Across more than one Learning Outcome	Across more than one chapter	30 marks

M21 Specimen coursework question and answers

Question 1 - Learning Outcome 1 (10 marks)

You are a claims handler for an insurer. You have received an insurance claim notification from one of your commercial clients, who suffered a loss soon after policy inception. On reviewing the risk details section of the market reform contract you note the following survey subjectivity:

“Conditions TBA - Subject to Survey".

You establish that the survey report has been received by the underwriting department of the insurer and has been found to be unsatisfactory; however, no action has yet been taken.

(a) Identify, with justification, **four** significant pieces of additional information that should have been included in the above survey subjectivity that would have met contract certainty principles. (8)

(b) Explain briefly **two** implications for the insurer if they tried to reject this claim on the basis of the above survey subjectivity. (2)

Answer to Question 1 (Learning Outcome 1)

(a) As a general comment the subjectivity does not provide anywhere near enough clarity to be able to reasonably interpret its implications. Subjectivities must state clearly how they can be resolved and the consequences of not meeting them.

Four pieces of additional information:

1. 'TBA': using acronyms allows for ambiguity within a contract and would not meet contract certainty guidelines. Although there may be an understanding of an acronym within insurance market practice, it does not guarantee that the insured will have the same understanding. There may also be more than one interpretation for the same acronym, e.g. in this case does TBA stand for 'to be agreed' or 'to be achieved'? Is the survey subjectivity a condition which is still to be agreed, i.e. is it not certain that this condition exists or is the subjectivity something that must be achieved? The acronym should have been written out in full.

2. Timing of survey: the contract has been agreed with an obligation to carry out a survey but no mention is made of when the survey must be carried out during the policy period. I would expect that the insurer would need to have the survey carried out relatively soon after inception to have any value for risk management or to afford the insurer an opportunity to change terms as appropriate to the survey results. However, timing is not mentioned and the insured can theoretically carry out the survey on the expiry date, or not at all considering that the impact of non-compliance is not mentioned. Timing would increase contract certainty; if the survey was to be carried by a deadline which proceeded the loss then the insurer may have a stronger case to deny the claim.

3. Implications of non-compliance: a subjectivity should state the ramifications for the insured if the survey is not completed. At the moment the contract does not give certainty on how the insurer will respond; will they change the excess/deductibles, will they issue notice of cancellation, charge more premium, introduce a sublimit, apply an exclusion? Any of these examples would be possible if stated clearly as part of the subjectivity but currently it is not clear how the insured would be affected or whether the insurer has the right to change terms at all.

4. Implications of inadequate survey results: even if the above points 1–3 are included, the subjectivity does not state what will happen in the event that the survey results are not satisfactory to the insurer, as in this example. The insurer should have the ability to renegotiate the contract if the survey reveals a poorer risk than imagined by the insurer at inception – a material change in risk. However, by not indicating what will happen in the event of a poor survey, the insurer might unwittingly agree that coverage is fine to continue whatever the survey results demonstrate.

(b) As the subjectivity is not contract certain, the insurer might have difficulty in rejecting the claim on the grounds that the survey is not satisfactory. Firstly, if the insurer drafted the ambiguous condition then the subjectivity will be construed against them, as the drafter. This is the *contra proferentem* rule (CII study text on Commercial insurance contract wording, 2016) of contract construction. Secondly, there is enough uncertainty created by the condition that the insurer could expect a lengthy settlement process, possibly involving costly legal defence fees. It could easily be a good defence for the insured to rely on the survey being completed despite being unsatisfactory, given that the essence of the condition is 'subject to survey'.

Question 2 - Learning Outcome 2 (20 marks)

BDE plc owns a portfolio of properties. BDE plc insures this portfolio with a panel of insurers led by ATE plc in the London subscription market. The slip has been signed on a General Underwriters Agreement part 1 alterations basis which allows ATE plc certain discretion to authorise changes on behalf of all the insurers.

A policy endorsement is drafted by BDE plc's insurance broker to make a number of alterations to the policy. The endorsement includes the following:

- Increasing the sum insured to include an additional small property.
- Adjusting the premium within the terms of the slip.
- Deleting a policy exclusion for the new property.
- A correction of a typographical error.

(a) Explain, with justification, for **each** of the four alterations above whether only ATE plc is justified in signing this endorsement on behalf of the panel of insurers. (16)

(b) Explain briefly whether the panel of insurers is jointly liable for insurance of the additional small property. (4)

Answer to Question 2 (Learning Outcome 2)

(a) The General Underwriting Agreement (GUA) (CII study text on Commercial insurance contract wording, 2016) dictates how amendments to the original slip can be agreed by the slip leader (and other agreement parties) on behalf of all other insurers that participate in a risk. The slip leader's authority is divided into three areas, 'Part 1' amendments to the slip can be agreed by the slip leader only. 'Part 2' amendments can be agreed by the slip leader and other agreement parties only. 'Part 3' amendments should be agreed by all insurers. In abiding by these rules, all underwriters will be bound by the amendments agreed.

- Increasing the sum insured to include an additional small property.

  The GUA generally states that alterations which increase the monetary exposure of an underwriter as a part of the contract or as a whole should be agreed by all underwriters, i.e. a Part 3 agreement. Adding even a small property to the portfolio will increase insurers' exposure, especially when the sum insured is increased as a result as it is here (as opposed to having a sub-limit). In this case BDE plc should have ticked Box 3 on the basis of this change to the coverage. However, if the slip leader (and agreement parties) deem this addition as not a material increase in exposure then it is possible that only slip leaders and agreement parties could agree the change. BDE plc would still have had to sign Box 2 rather than Box 1 and is still not justified in signing Box 1.

- Adjusting the premium within the terms of the slip.

  If the slip allows for adjustment of premium, then BDE plc is allowed to make a change to the premium in accordance with this allowance. For example, if there is an agreed rate for a defined event, e.g. the addition of new property. The terms of the slip should mention whether this is an action that can be taken by the slip leader only. If this is the case, then BDE plc is justified in signing the endorsement in Box 1. However, care should be taken that this is, in fact, the case and that other agreement parties are not mentioned.

- Deleting a policy exclusion for the new property.

  Deleting an exclusion could easily increase the monetary exposure of an insurer – there could be a realistic loss event that is not now excluded by the policy. As described above, this would indicate that BDE plc should have signed either Box 2 or Box 3 depending on whether the change was material in the view of the agreement parties or not. However, an alternative understanding could be achieved if the exclusion was included in the policy wording and the slip leader has been given specific authority in the slip to agree the wording. Removal of the exclusion would therefore be within the slip leader's remit alone and BDE plc would be correct in signing Box 1 for this change.

- Correction of a typographical error.

  If the error is clearly typographical to BDE plc and the insured, then such alteration would be clearly for the slip leader to amend alone under the Part 1 defined alterations of the GUA. The GUA was brought into effect so that more serious issues would be referred to other insurers, without creating unnecessary and burdensome administrative tasks for all insurers. This change does not need the agreement of others and BDE would be correct in signing Box 1 for this change.

(b) The GUA states clearly that insurers' liability is several and not joint. This is represented in the GUA stamp, the GUA agreement referenced in the slip and probably also represented by LMA 3333 being present in the slip. This means that if one insurer fails to pay their share of any loss to the new property, the other insurers will not be liable for that share. All insurers will have to pay their share regardless of whether BDE plc was justified in agreeing the change on behalf of all underwriters. Nevertheless, in acting as the leader, BDE plc is an agent for the following insurers and has a duty of care towards them. BDE plc could end up having to defend their decision to the following insurers and could be liable for their mistakes.

Question 3 - Learning Outcome 2 (20 marks)

You are an insurance broker. You are about to negotiate the renewal of the commercial combined insurance policy for one of your commercial clients, a motorway service station operator. During the discussion with the underwriter you are informed that they are considering including, either implicitly or explicitly, a warranty which terminates or invalidates cover when cash in excess of £5,000 is kept outside a safe.

(a) Explain the benefit to the insured of not having a warranty, instead relying on an implied term. (15)

(b) Explain the benefit for the insurer of including a warranty in the renewal terms. (5)

Answer to Question 3 (Learning Outcome 2)

(a) A warranty is the most important term to comply with in an insurance policy as it goes to the root of the contract if the terms are not adhered to by the insured. The case given in the question – cash in excess of £5,000 - is an example of a continuing warranty, which means that compliance will need to be maintained throughout the duration of the policy period. If cash above £5,000 is kept outside of the safe then the policy can be voided, by the insurer, from the date of that breach of the warranty and any subsequent loss not recovered by the insured from the insurer.

As an express term in the policy a warranty carries the weight of having been agreed by the parties to the contract in writing, provided that the interpretation is clearly understood. The cash warranty is clearly expressed and means that the insured will have to comply with it in order to have insurance coverage. An expressly stated warranty will have precedence over any contradictory implied condition on the policy.

It will therefore be of benefit to the insured to remove the warranty and have an implied condition. An implied term is not written into the contract but can be implied in fact, custom or law.

If it is implied in fact, then it is presumed to be intended by both parties; one interpretation is that it is required to give the contract business efficacy. This is unlikely to be the case as a similar condition for the case warranty as it does not really relate to efficacy, more controlling the insurer's exposure. Nevertheless, there could be the presumed intention of both parties, where the insured has committed to follow a particular security policy, but where this is not written into the policy.

Implied in custom would be where it is usual practice to include a condition for service station operators – for example where all insurance policies expect that large sums of cash are kept in a safe.

These implied terms would put the insurer in a much weaker position to enforce a condition. Firstly, they would have to rely on an unwritten term and it is unlikely that such implied term would capture the 'cash in excess of £5,000' as the insurer had intended, unless £5,000 is seen as a benchmark for an insured to 'act as if uninsured' or similar. Secondly, the implied term, if not complied with, may not have the same impact as a warranty; it may be interpreted as a condition precedent to liability which would mean that a theft claim could be denied but the contract would continue.

(b) As outlined above, a warranty would put the insurer in a much stronger position. Warranties are strictly enforced and need to be complied with exactly, otherwise a breach will terminate the insurance contract from the date of the breach. Even if a claim occurs which is unrelated to the breach of the warranty, insurers could deny the claim and void the contract if they find out that there was a breach that pre-dates the claim or claims.

Question 4 - Learning Outcome 3 (30 marks)

You are an insurance broker. One of your clients DEF plc renewed its liability insurance through you in January. DEF plc subsequently acquired XYZ plc, which has a renewal date later in the year. DEF plc has instructed you to cancel XYZ plc's current liability insurance mid-term and add XYZ plc to DEF plc's liability insurance.

DEF plc has a losses occurring liability policy and XYZ plc has a claims made liability policy.

(a) Explain, with justification, **two** implications of the current different renewal dates for liability insurance and the liability policy coverage triggers. (14)

(b) Explain **two** actions which could be taken to produce an integrated liability insurance programme. (10)

(c) Explain how the situation would be different if it were XYZ plc that had the loss occurrence policy and DEF plc that had the claims made policy. (6)

Answer to Question 4 (Learning Outcome 3)

(a) DEF plc and XYZ plc both have different policy coverage triggers. DEF plc has a losses occurring policy which means that the policy in force when the claim occurred will deal with the loss. XYZ plc, with a claims made policy, will have the policy in force when the claim is made to deal with the loss.

With the two policies kept separate there is no problem for the coverage, provided that each policy has been renewed on its existing basis. It will likely be part of DEF plc's due diligence, when analysing XYZ plc pre-acquisition, that the liability policies have been consistently renewed and have not changed their basis of coverage trigger.

If DEF plc are seeking to combine the policies (and cancel the XYZ plc policy) then one major implication will be that losses that have occurred for XYZ plc, but not been discovered or reported, will not be indemnified by the loss occurrence policy of DEF plc after cancellation of the XYZ plc policy. Claims reported after the change in trigger, having their origin of liability prior to that change, will not be paid by the claims made policy. As such, there can be a gap in the protection afforded to XYZ plc when changing the coverage trigger.

A second implication could be that DEF plc's insurer would not want to accept XYZ plc on a losses occurring basis, preferring a claims made basis. This could be due to the nature of XYZ plc's business; if for example XYZ plc operates in an industry where incurred but not reported losses are an inherent risk with a long tail, e.g. pharmaceuticals. In order for the insurer to close off their accounts each year without having to make large provision for future claims, they might not allow the incorporation of XYZ plc on the same basis as DEF plc.

(b) In order to provide a seamless policy and prevent loss occurrences that are prior to the integration from being declined by the insurers, one action that can be taken is to add an extended reporting period to the claims made policy (a 'run-off' cover). This has the effect of allowing the insured to claim for losses after expiry of the claims made policy but which arise from occurrences prior to that expiry. Insurers can grant a few extra years of reporting for an additional premium. However, this will never be the same as having a loss occurring policy, so there will always be a risk that some claims will be made after the reporting period that will not be able to be recovered from the claims made policy. Some industrial disease claims take many years after their occurrence to be discovered. Therefore, a second option is to purchase retrospective coverage for the loss occurring policy which allows for occurrences prior to the policy integration to be covered. The losses occurring policy insurers may be more willing to grant this coverage if they 'have the benefit' of the extended reporting period of the claims made policy, i.e. the claims made policy pays first to the extent of its liability, before the losses occurring policy begins indemnity.

(c) This situation would be a lot easier for DEF plc if XYZ plc was the company with the losses occurring policy. A gap in cover would not arise by its incorporation into the claims made policy.

A claim to XYZ plc which occurred prior to the incorporation of XYZ plc's policy into DEF plc's policy would still be covered by XYZ plc's losses occurring policies. A claim which is made after incorporation, with its occurrence also taking place afterwards, would be indemnified by a claims made policy. In fact, it is possible that both policies would respond for claims made on behalf of occurrences before the incorporation. DEF plc's insurer in this instance would likely want to place a retroactive date on the claims made policy to prevent earlier occurrences from affecting their loss record.

Question 5 - Learning Outcome 3 (10 marks)

DNA plc is a property insurer. One of their policyholders, PKS plc, own and operate a factory in a building originally built for a different purpose. PKS plc decides to move to a modern purpose-built factory which is located on a flood plain. PKS plc notifies DNA plc of their move, on the assumption that the insurance will remain in force at a lower premium.

(a) Explain, with justification, the most likely action that DNA plc might take regarding their policy terms and conditions. (5)

(b) Explain the action PKS plc could take, to maintain the insurance with DNA plc, in response to the most likely action that DNA plc might take. (5)

Answer to Question 5 (Learning Outcome 3)

(a) Although PKS plc is moving from a factory which is no longer fit for purpose to a new building, DNA plc will be concerned about the move onto a flood plain. DNA plc will want to understand the exposure of the plain to flood and ask to see a flood risk report for the site, with it stating the likelihood of a flood and the protection measures that would be required to prevent damage to the building. If the report (and subsequent protection measures taken) still indicate that there is elevated flood risk, then DNA plc will likely apply a higher deductible for flood and/or a sub-limit. The deductible could be represented as a fixed monetary amount per occurrence or as a percentage of the loss, subject to a minimum per occurrence. A sub-limit could be written on an aggregate basis, i.e. the maximum exposure the insurer has during the policy period for flood, irrespective of the number of flood claims.

If the flood risk is severe enough, DNA plc may wish to exclude the flood peril outright. This will help reduce DNA plc's overall exposure to a loss, where the previous building may have had a lower probable maximum loss.

DNA plc will also consider the premium that should be charged as a result. This is likely to be a compromise between the perceived benefits of moving to a modern building and the flood risk. If the new building severely reduces the fire risk by having modern fire protection systems in place, then this may offset the flood risk increase in terms of premium. DNA plc would also consider the commercial realities of the market. At the moment the market is soft and PKS plc's broker may be able to pressure DNA plc into accepting the risk without an increase in premium.

(b) As mentioned above, the insured could accept a change to the terms and conditions of the policy, perhaps by pre-empting an increase in deductible and suggesting one. Alternatively, PKS plc could implement flood defences and demonstrate their efficacy to DNA plc. The cost of flood defences may be considerable however they may be justified in terms of the long-term savings in the cost and extent of flood insurance. The decision on the nature and extent of the flood defences will, in order to optimise their effectiveness, need to be taken in conjunction with advice from the insurer and the long-term potential changes in the flood risk. There may be an opportunity, with DNA plc's agreement, to phase in the flood defence works over a period of time, without unduly influencing the premium, excess or any sub-limit, to reach a mutually agreed longer-term satisfactory solution.

PKS plc could try to get a quote from a rival insurer to DNA plc and put pressure on DNA plc to accept terms more acceptable to PKS plc.

Question 6 - Learning Outcome 3 (20 marks)

You are an underwriter for KFG plc, an insurer. KFG plc has recently acquired CMR plc, an insurer. KFG plc specialises in liability insurance, whilst CMR plc specialises in property insurance.

Some of the policyholders of KFG plc are also policyholders of CMR plc. This means that those policyholders who hold policies with both insurers can then be issued with a commercial combined policy.

One of your policyholders, who has recently been issued with a new commercial combined policy, has complained about the inconsistencies in the policy wording. Their complaint is that the definition of terms they had when they insured their property risks with CMR plc is missing from the new commercial combined policy wording. They also complain that there is inconsistency in the terms and language used in the new policy wording.

In the event that this client has a loss resulting in a claim:

(a) Explain, with justification, **three** significant potential implications for the insured arising from the inconsistencies in the policy wording. (12)

(b) Explain, with justification, **two** significant potential implications for KFG plc arising from the inconsistencies in the policy wording. (8)

Answer to Question 6 (Learning Outcome 3)

(a) For the insured there are several potential implications for not having a clear set of definitions or inconsistency in the language and the client has a right to complain as they apparently have not been given any option by KFG plc to contribute to the drafting of the commercial combined policy.

i. The commercial combined policy does not contain the definition of terms that existed in the property wording. We do not know if there are definitions for the liability section but there could be confusion between the understanding of 'damage'. For property this could be defined as the physical loss or physical change in nature of an owned item of property by the insured. For liability this could be defined as similar damage but to third party owned property. If the liability definition prevails in the new wording, then the wording would not be fit for property insurance purposes.

ii. Many policy wordings have a definition of loss occurrence, particularly with regard to natural disasters that occur over a prolonged period of time. If there is no definition of loss occurrence, or more particularly, a 72 hours clause, then the client could be left uncertain as to how an earthquake loss would be adjusted. If an earthquake lasted several days, that is to say, had several individual tremors over three days, the insurer could claim that there were many individual earthquakes, each carrying a deductible. If the earthquake was subject to an aggregate limit then the insurer would have the same limit of liability however with greatly reduced exposure, due to the application of each deductible.

iii. The everyday meaning of a term could be applied instead of the intended defined meaning that would favour the insured. For example, the property wording could insure damage by 'wind' where the intended definition is supposed to be the inclusion of all wind and associated storm and sea damage. However, if the term is undefined in this way in the wording the insurer may be able to successfully decline a loss where a storm causes damage by sea flooding which results in a loss.

(b) An unclear wording can have implications for the insurer as well.

i. There is inconsistency in the terms used in the policy which can lead to an ambiguous interpretation of the contract. Such terms could be interpreted by the *contra proferentum* rule which takes the meaning against the drafter of the policy. In this instance this is the insurer as they have issued the commercial-combined wording. If the inconsistencies are numerous then there could be several places in the wording that would be interpreted against the insurer.

ii. The insurer could be relying on a defined term in order to restrict coverage. For example, if the policy mentions only granting machinery breakdown coverage resulting from 'defined perils', if there is no definition of such perils, then the policy could be interpreted according to a much wider insuring clause, perhaps on an 'all-risks' basis The insurer would be solely relying on an interpretation which gave a well-known technical meaning to the perils, which is far from guaranteed unless such definition relates to industry-standard clauses.

Question 7 - Learning Outcome 4 (10 marks)

You are an underwriter for BCD plc, an insurer, which is considering offering commercial property insurance. You have been asked to investigate the advantages and disadvantages of reinsuring this new line of business on a fixed proportional reinsurance basis to protect its profitability.

Identify, with justification, **three** advantages and **two** disadvantages for BCD plc in reinsuring the new line of business on a fixed proportional basis. (10)

Answer to Question 7 (Learning Outcome 4)

A proportional basis of reinsurance (CII study text on Commercial insurance contract wording, 2016) is where BCD plc reinsures a fixed proportion of each risk to the reinsurance panel, paying the reinsurer the same proportion of the premium and receiving the same proportion back for any claims.

The advantages of such an approach are:

- Reinsurers are obliged to accept all risks that fall into the reinsurance treaty terms and conditions and therefore this allows BCD plc to boost its capacity and participation in individual exposures.
- BCD plc could expect to receive a ceding commission from the reinsurers, i.e. a discount to the proportional premium cost in return for sourcing the business and underwriting the risk. BCD plc is therefore able to receive earnings for business that they would underwrite in any case; treaty commission is usually higher than would be achievable for facultative risks.
- Proportional reinsurance is also relatively simple to administrate for each risk with BCD plc's portfolio being automatically reinsured as long as a relatively short list of criteria is satisfied. BCD plc would not need to agree each individual risk with the reinsurer.

The disadvantages of this approach:

- BCD plc is obliged to cede each risk to the reinsurer and is usually not allowed to select against the reinsurer by retaining the 'good' risks and only ceding the 'bad' risks. Therefore, BCD plc is not in a position to maximise on such opportunities to their benefit as may be the case with a facultative or non-proportional reinsurance.
- With proportional reinsurance, BCD plc is still exposed to large catastrophic losses and is only reducing its 'horizontal' exposure, rather than its vertical exposure. A stop loss policy would be able to contain the loss to a lower level and it would be cheaper to reinsure the excess than to have a proportional reinsurance.

Question 8 – Learning Outcome 4 (20 marks)

You are a claims handler for a liability reinsurer which includes amongst its clients two insurers. Each insurer has reinsurance on an excess of loss treaty basis. Each insurer notifies you of a claim involving industrial disease.

The following table sets out each insurer's industrial disease exposure period and the reinsurance parameters. Each insurer is reinsured subject to the Accident Circle Occupational Disease clause: ACOD/B.

Insurer	**Industrial Disease Exposure Period (years)**	**Reinsurance Period (years)**	**Basis of Reinsurance**	**Claim**
A	10	5	Limit of £250,000 and a retention of £50,000	£200,000
B	12	4	Limit of £300,000 and a retention of £60,000	£150,000

(a) Calculate, **showing all your workings**, the contribution of the reinsurer to **each** claim. (12)

(b) Explain how the reinsurer's contribution to each claim would change if **each** reinsurance had been subject to the clause: ACOD/A. (4)

(c) Explain how the reinsurer's contribution to each claim would change if **each** reinsurance had been subject to an index clause. (4)

Answer to Question 8 (Learning Outcome 4)

(a) The ACOD/B clause (CII study text on Commercial insurance contract wording, 2016) outlines the method of claims adjustment for occupational disease claims relating to employer's liability or workers compensation. It relates the length of the exposure to the period that that exposure is actually reinsured, the period the employee is employed during that exposure period. It spreads out the liability of such exposure to each year that the exposure is reinsured. For the purposes of this question, it will be assumed that these two employees are employed by their employers for the full exposure period and that each employer is insured for the same period by the insurer.

Business A has had an exposure period of ten years which has been reinsured for five years. The claim is £200,000. Accounting for the claim across the exposure period (per ACOD/B), the total liability for any one year of the treaty insurance is £200,000 / ten years = £20,000 per year. The claim to each treaty period is £20,000.

Next, the retention of the reinsured and the liability of the reinsurer is reduced by the proportion that each period of the treaty bears to the total period that the employer was insured by the reinsured. In this case each treaty period is one fifth of the total reinsured period. Therefore, if the retention is £50,000 then each treaty period is £50,000 / 5 years = £10,000. The treaty limit of £250,000 is similarly reduced to £250,000/ 5 years = £50,000 per treaty period.

If the claim to each treaty period is £20,000 and the retention for each treaty period is £10,000 then there is a recovery from the reinsurer of £10,000 in each of the five reinsured periods.

Business B has had an exposure period of 12 years and has been reinsured for four years. The claim is £150,000. In the same way as for A, the claim for each exposure period is £150,000 / 12 years = £12,500 per year.

Next, the retention and the limit of liability is reduced by the period of reinsurance, i.e. one quarter of the total reinsured period. The retention becomes £60,000 / 4 = £15,000 and the limit becomes £300,000 / 4 = £75,000 for each treaty period.

If the claim to each treaty period is £12,500 and the retention is £15,000 then there is no recovery for the insurer of business B.

(b) The effect of ACOD/A is that each any one claim by any one employee is considered as one event without the advantage, to the reinsurer, of any reduction in proportion to the total length of exposure taken into account when calculating the contribution of the reinsurer to the claim. Therefore, for the two claims shown in the above table, the reinsurer's contribution to each would be to:

Insurer A: £200,000 claim less £50,000 retention = £150,000.

Insurer B: £150,000 less £60,000 = £90,000.

(c) An index clause adjusts the reinsurance limit and retention by an 'index' which adjusts for inflation over time. As liability exposures can take time to manifest, a reinsurer does not want to be caught by a heavily inflated claim when the retention was set at a comparatively low level many years ago. The index clause will peg the limit and retention to a well-monitored index, such as the Retail Price Index, beginning at a defined point in time, such as the date of attachment to the insurance policy.

Occasionally there is a margin before adjustment takes place such as in the 'severe inflation clause' (CII study text on Commercial insurance contract wording, 2016), i.e. the policy will only be adjusted if inflation is over 10% for the period of exposure in question. The reinsurer is therefore protected better by increasing the retention as the inflated amount will be applied to each policy year in the manner described in (a).

Question 9 - Across more than one Learning Outcome (30 marks)

You are a property underwriter for KKT plc, a UK-based insurer. One of your insurance brokers presents you with a new business proposition for a hotel group which has hotels in many countries across the Caribbean. The insurance broker is seeking to arrange wide cover at a competitive premium. Your concern is that hurricanes present a major influence on the potential risk exposures for this hotel group and may affect your wider reinsurance programme.

(a) Explain, with justification, **four** significant policy clauses and indemnity limits that would protect the interests of KKT plc in relation to hurricanes. (8)

(b) Explain **one** reinsurance arrangement that would protect the interests of KKT plc in relation to hurricanes. (4)

(c) Explain, with justification, **four** significant policy clauses and indemnity limits that would protect the interests of the hotel group in relation to hurricanes. (12)

(d) Explain **two** significant benefits for the broker in achieving an insurance policy that balances the interests of the hotel group with the policy requirements of KKT plc. (6)

Answer to Question 9 (Across more than one Learning Outcome)

(a)

i. The insurer could apply an outright exclusion for hurricane losses. For a total exclusion they could apply: 'the policy shall not cover losses directly or indirectly caused by, arising out of or in connection with hurricanes'.
ii. They could apply a sub-limit per occurrence for hurricanes which limits the exposure to a much lower level than the total sum insured and a level at which KKT can manage.
iii. Similarly, an aggregate limit could be applied for the period of the policy. Rather than apply a sub-limit per occurrence, all claims that arise from hurricanes throughout the policy period could be capped to one financial limit.

iv. A higher deductible could be applied which is more in line with the catastrophic exposure a hurricane represents. Many hurricane deductibles apply the retention as a percentage of the loss (so that it scales with the size of the loss), subject to a minimum amount. The insurer is therefore less exposed to smaller losses that might arise from less severe categories of hurricane.

(b) A catastrophe excess of loss reinsurance would be the applicable reinsurance arrangement for a hurricane. This is specifically designed for catastrophe events where a loss exceeds the amount the reinsured is willing to retain on an each and every catastrophe or event basis.

(c)

i. The 72 hours clause (CII study text on Commercial insurance contract wording, 2016) will protect the insured against multiple uses of a deductible across a time period where a hurricane or series of hurricanes are active. This is because it defines the loss occurrence specifically so that a time period of 72 hours can encompass a hurricane and the high winds, that form part of the hurricane, that precede and follow it.

ii. An advantage for the insured would be to have an annual aggregate deductible rather than an each and every occurrence deductible. An annual aggregate deductible is a fixed amount which is eroded by claims. It might be initially high but, once eroded, will allow indemnification to be quickly in place for future losses. There can be several hurricanes in a windstorm season so this method of deductible might be advantageous compared to the application of a deductible for each hurricane.

iii. The insured would be significantly better off with a limit of liability set as the full property value of the hotel chain, each and every occurrence. This would mean that for each occurrence of a hurricane, the insured is entitled to the full limit of liability, as opposed to a lower limit that might be granted by a sub-limit or a policy aggregate limit.

iv. An automatic reinstatement clause would make the insurer restore any aggregated limits on the policy after a loss automatically, potentially for no additional premium or at least an agreed mechanism for calculating any additional premium. This gives the insured comfort that if they are hit by a second hurricane in the same policy period, the insurance is in place without having to renegotiate terms after a loss.

(d) The broker will want to ensure that they are, first and foremost, meeting their client's needs as it is to them that the broker owes a duty. However, many times the interests of both the client and the insurer will be aligned and it will be up to the broker to ensure that these mutual interests are met.

The broker will seek to prevent errors and omissions which could introduce a financial exposure to the broker. If the broker has successfully and accurately presented the risk to the insurer and represents accurately the agreed insurance terms to the client, then it diminishes the chance that the broker has arranged a policy which is not to the client' wishes or breaches an obligation to disclose material facts.

Question 10 - Across more than one Learning Outcome (30 marks)

You are a claims handler for GNG plc, a UK-based reinsurer. GNG plc is the lead reinsurer for ARA plc, an insurer. You have been notified by ARA plc of a reinsurance claim following a significant fire at a petro-chemical plant.

Your initial check of the treaty reinsurance policy wording and investigation of the claim establishes the following facts:

- ARA plc reinsures most of the petro-chemical plant risk, retaining a small percentage for its own account.
- The treaty reinsurance policy contains a claims co-operation and reporting clause.
- ARA plc's policy is written in the currency of US dollars, whilst the reinsurance policy is in UK pounds sterling.
- The fire was not reported to you by ARA plc until four weeks after the event.
- ARA plc has already appointed a loss adjuster.

(a) Explain **three** potential implications for GNG plc arising from the late notification of the claim. (12)

(b) Explain how the reinsurance policy wording and clauses may influence the negotiation and settlement of the loss. (10)

(c) Explain, with justification, whether GNG plc would prefer a currency conversion clause or a currency fluctuation clause in the treaty reinsurance policy. (8)

Answer to Question 10 (Across more than one Learning Outcome)

(a) As a result of the late claim notification GNG plc is not as able to influence the claim mitigation process such as appointing a loss adjuster, using resources to mitigate the size of the claim or length of delay, or approve a course of action for reinstatement. For example, ARA plc could have already approved orders for replacement parts that GNG plc could source much more cheaply. A major problem here is that ARA plc has relatively little exposure to the loss as they are, effectively, just a fronting company for GNG plc. They are therefore committing GNG plc to decisions that have a much greater effect for the reinsurer than for themselves.

GNG plc may also need to manage their capacity requirements and their annual accounts as a fire at a petro-chemical plant is probably a very large loss and will impact the reserves that GNG plc must have in place to provide for the loss. By being able to reserve the loss as soon as possible, ARA plc may have already made decisions that would mean that GNG plc is now over-committed to risks.

If there are circumstances in the claim which would allow ARA plc to subrogate to another party, then these may have already been waived explicitly or through actions taken. For example, the fire may have been caused by a contractor's negligence but ARA plc may have already agreed liability instead of maintaining rights against that contractor. This would cause GNG plc to have a greater loss than necessary.

(b) The claims co-operation clause makes it a condition precedent to liability that:

i. The reinsured (ARA plc) should give reinsurers (GNG plc) written notice as soon as reasonably practicable of any claim made against the reinsured.
ii. ARA plc should give GNG plc all information on the claim at this time and as soon as reasonably practicable for developments.
iii. ARA plc should co-operate with GNG plc and designated persons by GNG plc in the investigation and settlement of the loss.

There may be several areas that ARA plc has breached this clause and therefore GNG plc could be in a strong position to deny it. At the least, ARA plc is in a weaker position to make a full recovery, depending on the extent that the size of the reinsurance claim has been affected by the delay in notification and the strength of the relationship between ARA plc and GNG plc.

Firstly, there will be much discussion around whether ARA plc gave notice as 'soon as reasonably practicable'. Four weeks seems longer than reasonably practicable for an insurer to notify, given that there should be greater awareness of the need and an embedded process for doing so, compared to a delay from the insured themselves. If GNG plc can show this to be the case, this would breach a condition precedent to liability. However, if GNG plc could reasonably have been expected to find out on their own means (a petrochemical fire is likely to be high profile and well-publicised) it might be a reasonable defence for ARA plc to expect GNG plc to already know. One would certainly expect a reinsurer, with a major exposure, to be aware of a high-profile loss.

ARA plc has also clearly not co-operated with GNG plc in the claim investigation either, by appointing a loss adjuster without GNG plc's approval. GNG plc therefore does not have as much influence on the claim and instead of an internationally experienced loss adjuster who has the same understanding as GNG plc in the adjustment of claims, there may be a local adjuster who may have their own bias, not necessarily aligned with the best interests of GNG plc.

(c) Both clauses address a situation where the insurance policy is in a different currency to the reinsurance policy. However, where the currency conversion clause concentrates on the method of converting one currency to another, at an agreed exchange rate, the currency fluctuation clause is used to share the fluctuation in the value of a currency of the original loss between inception and the date of settlement. As a reinsurer, GNG plc would be keen on having a currency conversion clause rather than currency fluctuation. The conversion clause addresses the practicalities of reinsuring a policy with a different basis of premium to the direct insurance policy. By agreeing the date as the date of settlement, there are no obvious winners or losers from the exchange rate as it can increase or decrease (an exception may be in a place where there is consistent inflation or hyper-inflation in a currency but this would be addressed by the reinsurer). The fluctuation clause on the other hand can adjust the reinsurance deductible and limit to the settlement currency at the date of the reinsurance agreement but then convert the resulting settlement into the reinsurance currency at the time of that settlement. If the settlement currency strengthens before the loss is settled, then the insurer has to pay an inflated claim using an uninflated deductible.

Reference List

Phillipson, P & Penaluna, S. (2016) M21 Commercial insurance contract wording, Chartered Insurance Institute.

Question deconstruction and answer planning

The following three plans are based on 10, 20 and 30 mark questions respectively.

Question 5 - Learning Outcome 3 (10 marks)

DNA plc is a property insurer. One of their policyholders, PKS plc, own and operate a factory in a building originally built for a different purpose. PKS plc decides to move to a modern purpose-built factory which is located on a flood plain. PKS plc notifies DNA plc of their move, on the assumption that the insurance will remain in force at a lower premium.

(a) Explain, with justification, the most likely action that DNA plc might take regarding their policy terms and conditions. (5)

(b) Explain the action PKS plc could take, to maintain the insurance with DNA plc, in response to the most likely action that DNA plc might take. (5)

Question deconstruction

- Review learning outcome 3 in the course material and the relevant information in the study text.
- Highlight the instructions within the question (which are circled in red above).
- Consider the context. DNA plc, an insurer, have a client which is considering changing the way they operate. You have been asked to explain how the changes in the risk may affect the policy.
- There are two parts to the question. Part (a) focuses on the action DNA plc might take, whilst part (b) focuses the reactive action that PKS plc could take.

Answer plan

Part (a): You need to **explain** and **justify** the most likely action within this context (5 marks).

Part (b): You need to **explain** the action within this context (5 marks).

This is a 10 mark question, your answer should be shorter than the answers to either a 20 or 30 mark question.

Question 2 - Learning Outcome 2 (20 marks)

BDE plc owns a portfolio of properties. BDE plc insures this portfolio with a panel of insurers led by ATE plc in the London subscription market. The slip has been signed on a General Underwriters Agreement part 1 alterations basis which allows ATE plc certain discretion to authorise changes on behalf of all the insurers.

A policy endorsement is drafted by BDE plc's insurance broker to make a number of alterations to the policy. The endorsement includes the following:

- Increasing the sum insured to include an additional small property.
- Adjusting the premium within the terms of the slip.
- Deleting a policy exclusion for the new property.
- A correction of a typographical error.

(a) Explain, with justification, for each of the **four** alternations above whether only ATE plc is justified in signing this endorsement on behalf of the panel of insurers. (16)

(b) Explain briefly whether the panel of insurers is jointly liable for insurance of the additional small property. (4)

Question deconstruction

- Review learning outcome 2 in the course material and the relevant information in the study text.
- Highlight the instructions within the question (which are circled in red above).
- Consider the context which how is of a subscription policy for a property owner and an endorsement has been produced by a broker which alters the terms of the policy. You have been asked to explain the impact of the alterations.
- The marks in part (a) are greater than for part (b).
- The 4 marks available in part (b) are for a brief explanation.

Answer plan

Part (a): You need to **explain** and **justify** if the insurance broker is justified in signing the endorsement on behalf of the insurers in each of the four alterations (4 marks for each).

Part (b): You need to explain the liability of the insurer in relation to the addition of the small property (4 marks in total).

As this is a 20 mark question, your answer should be longer than the answer to a 10 mark question but shorter than the answer to a 30 mark question.

Question 4 - Learning Outcome 3 (30 marks)

You are an insurance broker. One of your clients DEF plc renewed its liability insurance with you in January. DEF plc subsequently acquired XYZ plc, which has a renewal date later in the year. DEF plc has instructed you to cancel XYZ plc's current liability insurance mid-term and add XYZ plc to DEF plc's liability insurance.

DEF plc has a losses occurring liability policy and XYZ plc has a claims made liability policy.

(a) Explain, with justification, **two** implications of the current different renewal dates for liability insurance and the liability policy coverage triggers. (14)

(b) Explain **two** actions which could be taken to produce an integrated liability insurance programme. (10)

(c) Explain how the situation would be different if it were company XYZ plc that had the loss occurrence policy and DEF plc that had the claims made policy. (6)

Question Deconstruction

- Review learning outcome 3 relating to the content in the course material and the relevant information in the study text.
- Highlight the instructions within the question (which are circled in red above).
- Consideration of the context which includes your role as an insurance broker for a client who has just purchased another company and the liability programme for each will be affected as a result.

Answer plan

Part (a) is worth 14 marks, (b) is worth 10 and (c) 6 marks, so each needs to be answered accordingly in terms of length and depth. Look at the mark allocation in conjunction with the instruction verbs (which are further defined in the glossary at the end of this document.

In part (a) you need to explain two implications (5 or 6 marks each) in relation to the renewal dates and also to justify your choice (1 or 2 marks for each).

In part (b) you need to explain two actions you could take to integrate the liability programme.

In part (c) you are asked to explain a 'what if' scenario for 6 marks.

As this is a 30 mark question, your answer should be longer than the answers to 10 and 20 mark questions.

Glossary of key words

Analyse

Find the relevant facts and examine these in depth. Examine the relationship between various facts and make conclusions or recommendations.

Describe

Give an account in words of (someone or something) including all relevant, characteristics, qualities or events.

Discuss

To consider something in detail; examining the different ideas and opinions about something, for example to weigh up alternative views.

Explain

To make something clear and easy to understand with reasoning and/or justification.

Identify

Recognise and name.

Justify

Support an argument or conclusion. Prove or show grounds for a decision.

Recommend with reasons

Provide reasons in favour.

State

Express main points in brief, clear form.