

## The Net Retained Lines Clause, is it really necessary?

Eric A. Pearce

Volume 49, Number 4, 1982

URI: <https://id.erudit.org/iderudit/1104158ar>

DOI: <https://doi.org/10.7202/1104158ar>

[See table of contents](#)

Publisher(s)

HEC Montréal

ISSN

0004-6027 (print)

2817-3465 (digital)

[Explore this journal](#)

Cite this document

Pearce, E. (1982). The Net Retained Lines Clause, is it really necessary? *Assurances*, 49(4), 393–397. <https://doi.org/10.7202/1104158ar>

Article abstract

À nouveau, notre collaborateur, M. Eric A. Pearce, nous donne une étude sur la réassurance. Cette fois, il se demande si la clause dite « Net Retained Lines Clause » est vraiment nécessaire. A.

## The Net Retained Lines Clause, is it really necessary?

*A commentary by*

ERIC A. PEARCE, F. C. I. I.

*À nouveau, notre collaborateur, M. Eric A. Pearce, nous donne une étude sur la réassurance. Cette fois, il se demande si la clause dite «Net Retained Lines Clause» est vraiment nécessaire. A.*

393



Recently, whilst I was undertaking an entirely different research, I re-read the standard contract wording for physical damage excess of loss reinsurance as issued by an important group of reinsurers. This aroused afresh my interest in examining side by side the Ultimate Net Loss Clause and the Net Retained Lines Clause, and the relative importance of the latter.

The two clauses as they appear in this standard text, are as follows:

### **Clause No 1.**

Ultimate Net Loss. The term "ultimate net loss" shall mean the sum actually paid by the Company in respect of any loss occurrence including expenses of litigation, if any, and all other loss expenses of the Company (excluding, however, office expenses and salaries of officials of the Company) but salvages and recoveries, including recoveries from all other reinsurances, shall be first deducted from such loss to arrive at the amount of liability, if any, attaching hereunder.

All salvages, recoveries or payments received subsequent to any loss settlement hereunder shall be applied as if recovered or received prior to the aforesaid settlement, and all necessary adjustments shall be made by the parties hereto.

Nothing in this clause shall be construed to mean that a recovery cannot be made hereunder until the Company's net loss has been ascertained.

**Clause No 2.**

Net Retained Lines. This agreement shall only protect that portion of any insurance or reinsurance which the Company acting in accordance with its established practices, retains net for its own account. Reinsurer's liability hereunder shall not be increased due to an error or omission which results in an increase in the Company's normal net retention nor by the Company's failure to reinsure in accordance with its normal practice, nor by the inability of the Company to collect from any other Reinsurer any amounts which may have become due from them whether such inability arises from the insolvency of such other Reinsurer or otherwise.

394

Purists in the drafting of excess of loss contracts have suggested from time to time that if Clause No 1 is accurately written, then Clause No 2 is superfluous. The purpose of these notes is to examine and test the theory.

The intention of Clause No 1 is to determine exactly which items of expenditure may be included and which amounts are to be excluded from the final settlement between the Company and the Reinsurer. Broadly we see that practically every expense is to be included, except office expenses and salaries of officials. It is emphasized however, that salvages, recoveries and recoveries from all other reinsurances are to be applied in reduction of the amount of the loss. The second paragraph has two functions. To remind the Company that all recoveries received subsequent to a loss settlement are to be applied exactly as if they were received prior to such settlement; and to remind the Reinsurer that he can be called upon to make interim payments before the final settlement of the loss.

The purpose of Clause No 2, however, is to determine those sums insured or sums accepted by way of reinsurance which can be included within the scope of the reinsurance contract, irrespec-

tive of whether there is a loss or not. In effect this means amounts retained net by the Company.

I see no inconsistency between the two clauses in intention, although ambiguity might be avoided in Clause No 1, if the phrase "recoveries from all other reinsurances" were replaced by "amounts due under all other reinsurances, whether recovered or not". Also in Clause No 1 it may seem illogical that office expenses and salaries of the Company's own officials are excluded whereas similar expenses payable to independent assessors (if any) can be included.

395

My main reservation as regards Clause No 2 is that it is likely to raise more problems than it solves. I am particularly apprehensive that difficulty and misunderstanding may arise from differing views as to the meaning of some of the phrases.

There are four important points dealt with in this clause, namely:

- (a) "acting in accordance with its (the Company's) established practices..."
- (b) "due to an error or omission..."
- (c) "failure to reinsure in accordance with its (the Company's) normal practice..."
- (d) "inability of the Company to collect from any other Reinsurer..."

Let us consider the last first. It is essential that the Reinsurer should have the protection which (d) above seeks to provide. Excess of loss reinsurance is not intended to act as an insurance against the insolvency of reinsurers. The Reinsurer cannot in my belief, operate without such protection, which is my reason for wishing to avoid ambiguity by making the change in Clause No 1 which I suggest above. This would serve as a reminder and make the position absolutely clear when a claim against the Reinsurer is being formulated.

The remaining phrases, (a) (b) and (c), reflect a legitimate and understandable preoccupation on the part of the Reinsurer. They emphasize that the reinsurance is not an instrument to recti-

fy the Company's administrative blunders. My criticism is that these phrases are too vague, when dealing with matters which could be vitally important, should a claim occur, particularly so, bearing in mind that the text applies to physical damage.

396

Let us consider some possibilities. What, for example, is an established practice? Suppose that at the inception of the reinsurance the Company retains up to \$10,000 on a particular type of risk. The experience is satisfactory so the retention is increased to \$15,000 and later to \$20,000. Is the established practice that which applied at inception, the alteration which was made some time later, or that which was in operation when the loss occurred? The Company might, I think, assume that the retention of \$20,000 is "established" as soon as the decision has been taken to implement the increase. It is doubtful whether that would be the view of the Reinsurer.

"Error or omission" has a nice familiar ring about it. Everyone in the business knows exactly what it means. As soon as it is discovered the mistake can be rectified and all is well. But is it really like that? Recently one of our contemporaries made a short analysis of some of the many "errors and omissions" clauses in use and found that in a number of cases it was emphasized that the Company should not be prejudiced by any error or omission. Why, one may ask, should this particular contract be different?

When we come to "failure to reinsure in accordance with its normal practice", I assume that the reference is to facultative reinsurance. If it were obligatory reinsurance, there could hardly be a failure to follow normal practice. If the treaty arrangements are altered, presumably the new basis becomes "normal". How normal can facultative placements be? In some markets it is found quite frequently that insurers have arrangements between themselves to offer facultative shares to friends, as a very loose form of reciprocity. This I suppose in time becomes normal practice. If in some instances friends do not accept the shares offered, does this constitute a failure of normal practice and so prejudice the Company's right of recovery under the excess of loss reinsurance? Then again, in some companies the underwriting staff are likely to effect facultative placements on lesser quality risks within a cate-

gory or categories. What percentage of such risks must be reinsured for such placements to become "normal practice"?

A great multitude of doubtful or controversial retentions could be found, any one of which could lead to serious disagreement between the parties. All such disagreement could be avoided by the simple expedient of including in the contract a table of maximum net retentions. If in the event of claim the actual retention were less than the permitted amount, well and good; if it were more, then the maximum would apply.

So, in conclusion I offer the suggestion that the Net Retained Lines clause should be abandoned. The phrases (a) (b) and (c) above would be avoided and replaced by the inclusion of an agreed table of maximum net retentions, and the stipulation appearing as (d) above would be dealt with by a simple alteration to the Ultimate Net Loss clause.

397

---

**Conseil économique du Canada: l'énigme de l'inflation. Treizième exposé annuel et exposé sommaire et indicateurs économiques. Ottawa. Approvisionnements et services du Canada.**

Ces deux brochures, qui proviennent du Conseil économique du Canada, ne sont pas récentes. Elles datent de 1976, en effet. D'un autre côté, le titre est précis et les collaborateurs nombreux et étroitement mêlés à la vie économique de notre pays.

*Inflation*, mot mystérieux, difficile à définir exactement, mais encore plus difficile à cerner. Peut-être le lecteur y trouvera-t-il les éléments qu'il cherche, sans pouvoir toujours les trouver.

Comme le titre le dit, le second opuscule est un exposé sommaire abondamment illustré et fort bien présenté, comme le sont aussi bien les publications fédérales que provinciales.