

## **EXTRACTS of the NEW INSURANCE ACT 2003 for buyers of Insurance Policies**

### GENERAL COMMENT

The Insurance Act 2003 attempts to reinvigorate Nigerian insurance market in two ways by ensuring the adequacy of capital and by creating an expansion in business.

### CAPITAL ADEQUACY OF INSURERS

In order to ensure that only serious players remain in the business of insurance, the new law provides minimum levels of capital for different groups of insurance business<sup>1</sup> and all insurers are expected to meet the new capital requirement by 26<sup>th</sup> February 2004<sup>2</sup>.

These are as follows:

1. Life Insurance only - N150m

2. General Insurance only - N200m
  3. Life & General Insurance - N350m
- ### COMPULSORY INSURANCES

Due to incidences of fire/explosion

all risks insurance for any building construction works compulsory. In addition to previous compulsory insurances, the new list is as follows:

1. Motor Liability Insurance
2. Marine Cargo Insurance
3. Fire Insurance for public buildings<sup>3</sup>
4. Contractors All Risks for building construction<sup>4</sup>

Under Motor liability, a minimum cover of N1m is required for third party property damage.<sup>5</sup>

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and collapsed buildings affecting the populace, the new insurance law

responded by making fire insurance for public buildings and contractors

### COMPULSORY FIRE INSURANCE FOR PUBLIC BUILDINGS

It is important to emphasize the definition given to "public buildings" for purposes of compulsory fire insurance. Public buildings include the following

<sup>1</sup>S.9, Insurance Act 2003

<sup>2</sup>S. 9(2) Insurance Act 2003 provides that the new paid-up capital shall come into force 9 months from the date of commencement. The date of commencement was 27<sup>th</sup> May 2003.

<sup>3</sup>S.65, Insurance Act 2003

<sup>4</sup>S.64, Insurance Act 2003

<sup>5</sup>S.68, Insurance Act 2003

<sup>6</sup>S.65(2), Insurance Act 2003. The section specifically states that "Public Building" includes a tenement house, hostel, a building occupied by a tenant, lodger or licensee and any building to which members of the public have ingress and egress for the

1. Tenement houses
2. Lodgings
3. Place of education
4. Place of medicine
5. Place of business

This means that any building where members of the public are present, either as tenants, lodgers (whether in guest houses, motels, hotels, hostels, clubs etc.), students, patients, clients, customers, etc.<sup>6</sup>, must be insured against the hazard of fire, earthquake, storm and flood (i.e., 'special perils').

## RECLASSIFICATION OF FIRE INSURANCE AS DOMESTIC BUSINESS

Fire Insurance has also been reclassified as "domestic insurance"<sup>7</sup>, meaning that overseas insurance/reinsurance is primarily prohibited, subject to satisfaction of local capacity<sup>8</sup>.

## NO INSURANCE ON CREDIT

The provision that insurance business cannot be transacted on credit basis remains.

## USE OF FOREIGN INSURERS

It would appear that it is no longer possible to maintain non-admitted policies (i.e., foreign policies) for risks of damage to property located in

Nigeria.

Under the new law, "any property located in Nigeria, whether movable or immovable, or any insurable interest or liability in relation thereto" must be insured with an insurer registered in Nigeria and such insurer may "reinsure such property or liability overseas where the Nigerian insurance industry lacks the capacity to retain the risk".<sup>10</sup> Any insurance, which contravenes the above provision, is considered to be an offence, which, upon conviction, attracts a fine equivalent to the amount of the premium paid in respect of the Policy multiplied by ten (10).<sup>11</sup>

## SETTLEMENT OF CLAIMS

The law remains that insurers are duty bound to settle admitted claims within 90 days from the issuance of Discharge Voucher.<sup>12</sup>

## CONSUMER PROTECTION

It remains an offence for an insurer to mislead the public by way of advertisement or in statements made on its product literature.<sup>13</sup>

## DISCOUNTS & REBATES

The prohibition of discounts on and rebates of premium, which is not in accordance with tariff (where

applicable) or the published rates of insurers, remains. It would appear that published rates include rates agreed under a trade association guideline.<sup>14</sup>

## PARASTATALS

The monopoly enjoyed by NICON Insurance Corporation on Government / Public Sector business and the right of first refusal enjoyed by Nigerian Reinsurance Corporation have been removed by the new law.<sup>15</sup>

## INSURING YOUR EXCESS RISK

The whole point of the new law is to guide the development of a more vibrant insurance market in Nigeria. It aims to achieve this by addressing the issue of capacity to retain risks locally, first from the point of capitalization and secondly via business development provisions. Thus, before any risk can be insured abroad, either by way of reinsurance<sup>16</sup> or otherwise by direct insurance,<sup>17</sup> the client / insurer must obtain leave from the National Insurance Commission. Such leave will only be granted where the client/insurer can prove that local capacity has been filled and it is necessary that the excess risk be insured or reinsured abroad in order to ensure adequate security.

<sup>7</sup> S. 72(2)(a) Insurance Act 2003

<sup>8</sup> S. 72(4) Insurance Act 2003

<sup>9</sup> S. 50 Insurance Act 2003

<sup>10</sup> S. 65(7), Insurance Act 2003

<sup>11</sup> S. 65(8), Insurance Act 2003

<sup>12</sup> S. 70, Insurance Act 2003

<sup>13</sup> S. 74, 75, Insurance Act 2003

<sup>14</sup> S.76, Insurance Act 2003

<sup>15</sup> S.99, Insurance Act 2003

<sup>16</sup> S. 65(7) Insurance Act 2003

<sup>17</sup> S. 72(4) Insurance Act 2003

<sup>18</sup> S. 72(2) Insurance Act 2003. Domestic Insurances include Fire Insurance & Reinsurance Business, Motor Insurance & Reinsurance Business, Liability Insurance & Reinsurance, Life Insurance & Reinsurance Business, Accident Insurance and Reinsurance Business and such other insurance/reinsurance business as may be prescribed by the National Insurance Commission.

<sup>19</sup> S. 72(3) Insurance Act 2003

# Machinery breakdown/ consequential loss insurance

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## INTRODUCTION

The business of manufacturing is intricate and at a time when factories are being automated to maximize economies of scale, a lot depends on the production line. Maintaining a good production line requires that factory plant must be in perfect condition, permitting little error. Any error in production, whether caused by damage to a vital aspect of the plant or by human error can result in a great loss of revenue. It can also mean the difference between profitability and bankruptcy.

Equipments involved in a plant can be used to automate processes right from cleaning/sorting, mixing/cutting, refining/forming, packaging/bagging. All these processes determine the merchantable quality of the final product and can affect the pricing on the open market. Therefore, anybody who is running an automated manufacturing concern, whether in whole or in part, must give thought to how any damage to plant

or break in production can affect revenue. In doing this, concerns must be given to how to minimize the incidence of damage or production error. Having done that, it might become apparent that the owners may not be able to bear the loss of revenue in the case of damage to a vital part of the plant or if down time between repairs and running stretches beyond a particular number of days. The owners might then wish to consider how to transfer this risk. Replacement of any damaged plant might have been provided for in the books of account by way of depreciation, in which case the owners should have enough funds set aside for such eventuality. Another way is by transferring that financial risk to a third party, an insurer for example.

## RISK TRANSFER

Insuring the risk of damage to plant/machinery comes under what is referred to as machinery breakdown (MB) insurance. It is one amongst the many other classes of insurance available under

engineering risk. Essentially, this type of insurance covers damage to plants and machinery whether in use or at rest from usage or when being dismantled for the purpose of cleaning or overhauling.

If a plant or machinery runs haywire during process runs, any damage could affect other properties and may result in injury to or death of persons within the vicinity of the plant. Whilst such a policy will not normally cover losses suffered by the employees (because workmen compensation insurance might be available), family members of the owners or employees are usually covered as they can be considered persons lawfully present on the premises at the time of the incidence.

Just as it is prudent for the owners to assess the risks to which they are likely to be exposed, insurers also consider a proper and detailed assessment of the risk important before assuming cover.

## RISK IDENTIFICATION

Examples of items of plants and machinery include boilers, pressure vessels, turbo generators, electrical distribution panels, transformers, cranes, forklifts, bulldozers, pumps / compressors, electric motors and production machines to mention but a few. Each of these items must be properly considered to determine the ones that are best covered under a Fire insurance policy in order to minimize areas of potential conflict. Presumably if damage to a machine is likely to be caused by incendiary properties, it might be better to cover such equipment under a fire policy. However, if the machine can suffer damage due to internal mechanics leading to non-incendiary explosion (whether or not resulting in subsequent fire by external atmospheric conditions) or benign damage to the machine, it might be better to cover the machine under a machinery breakdown policy.

## RISK MANAGEMENT

The risk management begins by identifying the type of plant proposed for insurance. This information can be primarily obtained by providing a list, which will also require full description of the Make, Model, Serial number, the Year of manufacture, Size, Capacity, Country of manufacture and Manufacturers Local representative. This enables the insurer to have primary information on the integrity of the machinery and also as a basis for settlement of claim in the event of loss.

Having gained primary knowledge of the plant, the insurer will normally decide to employ an engineering surveyor to assess the plants and machinery and the process controls. This will enable the insurer to determine whether the installed machinery fits the description on the list earlier submitted, whether the values for insurance are adequate and comparable with replacement/reinstatement cost in the event of loss, whether the running time conforms with manufacturers recommendation to prevent an overrun (i.e., mechanical pressure) which can easily lead to damage. The surveyor will also be asked to estimate the maximum values at risk in the event of loss (i.e., determine the Estimated Maximum Loss EML). In arriving at this, the lay out of key and sensitive installations will be considered in determining whether there is a high concentration of values which may present a high risk factor. It is also important to identify other physical or moral hazards that could increase or mitigate losses should an insured event occur. In doing this, the surveyor is expected to examine maintenance records and loss prevention standards, which could either be corrective or preventive in nature. This enables the underwriter to determine the level of good housekeeping in considering the appropriate premium.

Other useful consideration might involve checking out the physical condition of the plant, to reduce possible damage that may be due

to wear and tear. This might be difficult to assess at the time of loss, especially in Nigeria where the possibility of forensic examination is remote. It might also be necessary to check out how the plant is configured to run and whether there is easy access to the internal parts of the machine for ease of overhauling or repairs. This might affect replacement value consideration. The ease of movement (lifting, loading and unloading for transportation) is also vital, especially in determining conditions of salvage and abandonment.

## UNDERWRITING CONSIDERATION

Experience in the Nigerian market has shown that MB insurance is characterized by frequent and severe losses. The primary reason for this is the fact that a number of companies find it difficult to replace machineries with new ones and reliance on second hand plants is on the increase. Equally, an unusual pressure is placed on power generators to run processing plants and this usage is daunting because generator losses form the biggest part of claims under machinery breakdown. A large number of losses are also caused by human errors and experience of operators also enables the underwriter in determining terms and loss avoidance conditions to impose. It is therefore important for an underwriter to consider the claims history of any manufacturing concern. An examination of loss

history gives the underwriter an insight into the workings of the organization for purposes of making risk improvement recommendations.

The Underwriter, based on the survey report, might also consider whether the machinery breakdown policy is the appropriate policy for the machinery proposed for insurance. In case of an explosion, for example, if it was of a chemical nature, the fire policy picks up the loss but if of a physical nature, the MB policy will be triggered. Where both fire and explosion are recorded at an incidence, it is important to consider the original cause of the fire or explosion. If the fire was caused as a result of electrical breakdown, subsequently resulting in an open fire, the MB policy picks up the loss. Damage by smoke/soot arising from an open fire caused by a MB will also be treated under the MB policy.

### EXTENSION OF COVER

There are other secondary losses or costs that may arise a result of damage to machines and an

underwriter may be willing to cover this under a standard machinery breakdown policy. Examples are damage to surrounding property of the insured, cost of removing debris, cost of expediting repairs (a sort of express service charge which might have an effect on consequential loss of revenue/profit), air freight charges (if spare parts have to be imported). In determining whether or not to grant these secondary covers, an underwriter will consider the limits to be imposed. Also, in determining whether to cover air freight charges, the distance of the country of manufacture becomes a vital information as it can affect the exposure of the insurer.

### BASIS OF COVER CLAUSES:

The underwriter might wish to consider whether or not cover should be granted on "all risks" basis, in respect of replacement of obsolete plant and machinery and as regards provision of standby machinery to reduce process down time and subsequent consequential losses.

Thus, where a particular machine is obsolete, an underwriter will impose a 'basis of indemnity' clause stating that the cost of replacement or repairs shall be the cost applicable to that of a similar machine. Where an underwriter agrees to grant cover on "all risks" basis, physical loss or damage caused by other perils, except that which has been specifically excluded, will be covered. An example is theft, especially of small and expendable components / replacement parts. Provision of cover for substitute machinery may be at a reduced premium, since this in itself might mitigate the incidence of the primary loss.

### ENGINEERING BUSINESS INTERRUPTION INSURANCE

As indicated earlier, owners of manufacturing concerns cannot afford down time, which might greatly affect their revenue basis. Thus it is prudent to transfer the risk of loss of profit. This consequential loss is what is covered under an engineering business interruption (BI)

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#### NOTICES

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For further information or additional copies please contact the Editor Adetola Adegbayi  
Leadway Assurance Company Ltd. 121/123 Western Avenue Surulere, Lagos Nigeria. E-Mail:Newsletter@Leadway.com

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