

REINSURANCE PRACTICE IN ZAMBIA

BY

MWAMBI KASAKWA

(27048705)

A dissertation submitted to the school of Law of the University of Zambia in partial fulfilment of the requirements for the award of the Degree of Bachelor of Laws (LLB).

The University of Zambia

School of Law

P.O. Box 32379

Lusaka.

DECLARATION

I, Mwambi Kasakwa, do solemnly declare that I am the author of this Directed Research paper entitled "Reinsurance Practice in Zambia". I further declare that it is a work of my own ingenuity and that due acknowledgment has been made where other people's work has been used. I truly believe that this research has not been previously presented in the school for academic work. I therefore bear the absolute responsibility for the contents, errors, defects and any omissions therein.

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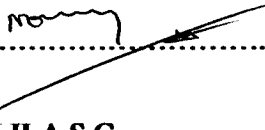
By

**MWAMBI KASAKWA
(27048705)**

Entitled

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DEDICATION

To my parents and my siblings, who have been so supportive and been there for me through it all.

ACKNOWLEDGMENTS

My heartfelt and uttermost gratitude goes to my Lord and Saviour Jesus Christ for carrying me through. I would not have done it without you Lord.

I am deeply grateful to Mr Malila S.C, my supervisor, for an opportunity to learn and tap from his reservoir of academic excellence.

I am also grateful to Mr Mabvuto Sakala and Christina Holder for their valuable input in the creation of this paper.

I am thankful and forever indebted to my family for their unfailing love and unfaltering believing me. Special thanks to Mwango Musongole, Theresa Nambaya, Lois Chisompola, for all the help rendered to me. Thanks also go to Mwamba Mumba, Mukonde, Emmanuel and all my friends for their unending support.

**Mwambi Kasakwa
University of Zambia
April 2011**

ABSTRACT

The world is changing at a fast pace. The way in which reinsurers do business is changing, the products and services they offer is evolving, the range and characteristics of their competitors and their clients is expanding. Reinsurers have been in the forefront in anticipating these changes and in advocating greater regulatory efficiencies to expand their opportunities in a global marketplace. The **Zambian reinsurers** have not been left behind. This paper is a voice for the domestic reinsurance companies that have been crying out for revised laws and policies that will act as a springboard for their emergence and development in the global market. It addresses the weaknesses of the current legal framework in which reinsurance operates. The paper goes on to seek solutions in jurisdictions of other countries that have been known to be trendsetters in this area of law. The solutions uncovered are given as recommendations to the current legal framework.

CHAPTER ONE

1.1 Introduction

The rapid evolution of insurance can only be explained in the context of economic development and the transformation of society in ways of thinking. The increased need for security which this new age has brought is the origin of the reinsurance business. Reinsurance is basically an extension of the concept of insurance that is the sharing of risks. It is simply insurance for insurance companies. It is a transaction in which the reinsurer agrees to indemnify the insurance company on contracts undertaken with the original insured¹. It can also be understood as that practice where an original insurer, for a definite premium, contracts with another insurer (or insurers) to carry a part or the whole of a risk assumed by the original insurer². Insurers include all persons, partnerships, corporations, societies, associations authorized and operating by law to make contracts of insurance. Insurance can be defined as an agreement by which one party, for a consideration, promises to pay money or its equivalent, or to do an act valuable to the insured, upon the happening of a certain event or upon the destruction, loss or injury of something in which the other party has an interest³.

A duty so fundamental to reinsurance is the duty of utmost good faith. It is said that the duty of utmost good faith is important in every reinsurance contract and that it supplements all other express and implied contractual obligations. This means that the duty of utmost good faith goes beyond the traditional duty of good faith and fair dealing implicit in every contract. This duty has to be reciprocal with both the person seeking reinsurance and the reinsurer. This duty is broken when one of the people does not disclose material information concerning the contract. What is material is defined as information that would have prevented the reinsurer from entering into the

¹ Paper by Swiss Reinsurance company, An introduction to Reinsurance Swiss Re language services Switzerland, Zurich 1996 pg 2

² William C Scheide . Reinsurance. In: Dunharn's "Business of Insurance" Vol. II, p. 451. NewYork. RonaldPress. 1950.

³ William C Scheide . Reinsurance. In: Dunharn's "Business of Insurance" Vol. II, p. 452. NewYork. RonaldPress. 1950.

reinsurance contract or would have prompted the reinsurer to change the terms of the contract before execution⁴.

1.2 The origin of Reinsurance

There is nothing in the very early history of insurance which suggests practices that approach in any way our modern reinsurance procedure. The earliest reinsurances first appeared in transport, especially marine insurance, at a comparatively late date (14th or 15th centuries)⁵. Marine insurance in antiquity was conducted chiefly by individuals, more or less in a speculative manner, without a statistical foundation and without retrospective data on loss experience. Single ships and their cargoes in ancient times often had a value disproportionately large to other private holdings, and the whole of the private fortune of an insurer often hung on the outcome of a single voyage or marine adventure. The perils of the sea were greater also, considering the rudimentary state of the shipbuilder's art. It can readily be understood why marine underwriters wanted someone to share their risks.

After having effected insurances, whether on the ship, on the cargo or on both, or on the lives of the captain and crew, an underwriter often would become worried and try to sell parts of his contract to others and necessarily at a higher rate. At first risks on parts of voyages were assigned to others, usually the more dangerous parts.

The first reinsurance contract on record relates to the year 1370, when an underwriter named Guilano Grillo contracted with Goffredo Benaira and Martino Saceo to reinsure a ship on part of the voyage from Genoa to the harbor of Bruges. Grillo offered to retain the risk on the voyage through the Mediterranean and to transfer to Benaira and Sacco the risk from Cadiz through the

⁴ J. Devery Key principles and concepts, Mealey's Fundamentals of Reinsurance Litigation and Arbitration February 2008, Washington D.C

⁵ State University of Iowa. College of Commerce Development and Significance of Mutual Insurance Associations in Iowa. Study III, October, 1950. United States Of America, Iowa Press

Bay of Biscay and along the French coast⁶. Other arrangements of this kind were, no doubt, made in single instances for many years, but these contracts were not in the modern reinsurance sense of the word as we know it now.

The development of reinsurance in the modern sense may be credited chiefly to the fire insurance business. Following the industrial revolution during the last third of the eighteenth century, the growth of the factory system gave rise to the existence of things and interests which rendered insurance necessary in large amounts. Reinsurance developed slowly at first. Insurers of fire risks had, until the amounts of insurance requested became too great, adopted the practice of charging different premiums for different risk classes and by limiting their commitments in certain areas. Furthermore, fire insurance at its outset seems to have been cultivated largely by mutual institutions having assessment arrangements with their members. At the beginning of the nineteenth century, however, stock companies became more numerous in the fire insurance field. These offices soon learned that offering coverage in large amounts, especially in areas of concentrated risk, was an exceedingly hazardous procedure. The stock companies could not appeal to their policyholders for assistance in event of calamitous losses. And so coinsurance practices developed whereby the companies transferred the business which they felt they could not keep to other insurers by means of direct contracts between the other companies and the insured. With this practice modern reinsurance was born.

1.3 The purpose of Reinsurance

The purpose of reinsurance is to spread a risk amongst a number of insurers. Every insurer aims to write a balanced account and if he were to accept for his own account risks which were, in terms of sum insured or limits of indemnity, very much larger than normal, there would be a possibility that one or two losses in respect of such risks in the course of a year could result in financial difficulties of the insurer or even insolvency. In any event, if the account comprised a comparatively small number of large risks, losses would tend to fluctuate within very wide limits from year to year, and much larger reserves would have to be set up than would otherwise be the case.

⁶ G. F. Michelbacher, Workmen's Compensation Insurance. New York. McGraw-Hill Book Company. 1925. p. 336.

There are a number of roles that reinsurance plays. Reinsurance needs to be appreciated because;

Firstly, it protects the insurance accounts against a single large event. This means that when a large calamity occurs, the insurance company will have help from other insurance companies to cover losses of its customers. It would be impossible to tend to losses of all those insured by one company without help from a reinsurance company.

Secondly, reinsurance protects the insurance account from a large claim on a single item. A loss of a smelter in a mining accident would be a large claim to make and as such the common pool from which funds are taken may not suffice to cover losses, as such reinsurance plays a large role in covering such claims.

Thirdly, reinsurance allows for insurance companies to shoulder heavy and hazardous risks with a peace of mind because they know that particular risk has been shared with another insurance company. Thereby allowing insurance companies to enter into new markets that they may be unsure about.

Another aspect to appreciate is that reinsurance minimises loss impact on the insurance companies and thus results in growth of insurance companies because they take on bigger and bigger risks.

Lastly, competition and the desire to provide the best possible service for clients prevents the insurer from setting a limit on the amount for which he is prepared to grant cover. He may then cover amounts contrary to his normal acceptance for a particular class of risk. This is beneficial for clients that need to insure larger items⁷.

Without reinsurance, an insurance company will have to shoulder all the risks of loss it has assumed from all of its policyholders. Unlike its policyholders, it will not have the advantage of

⁷ G.S Patrik Reinsurance www.jccre.com

spreading its risk of loss to other companies and policyholders. Should it accumulate too much business in a particular geographic location or in a particular line of insurance, it may find that its capital will be severely strained. By using reinsurance, accumulation risk, catastrophic risk, and overall risk are lessened.

In addition, smaller companies necessarily rely more on reinsurance to spread their risk of loss and to avoid accumulation and catastrophic exposures. These companies also often rely on the underwriting and claims expertise of their reinsurers to improve their products and better serve their insured. Reinsurers supply assistance to insurers in specialized areas where the insurer may have little or no experience. The qualified members of staff of a professional reinsurer will offer services regarding the production process to new insurers in particular or to insurers taking up new business lines or expanding their area of operations to foreign countries. Without strong reinsurance relationships, these smaller and regional insurers are likely not to exist.

Reinsurance, because of its characteristics, is inherently an open market. This implies that foreign companies are allowed to participate in domestic markets worldwide so long as they are licensed to do so. Consequently competition is taut. This is because foreign funded companies are more appealing to customers and thus get customers easily as compared to the indigenous reinsurance companies. This poses a difficulty on domestic companies to gain monopoly even in their own countries. This is even more real for fresh companies that are just starting out. As such domestic reinsurance companies need to make use of the advantages of policy support at an early stage to develop and emerge and be able to compete at an international level.

The peculiar development of the national and international economy of the European countries since the World War has apparently made reinsurance the backbone of insurance, mainly that of private property insurance. Zambia's economy has not been left behind in this area. The Governor of the Bank of Zambia was able to assert that the economy of Zambia has been changing for the better in the following words,⁸

⁸ at a cocktail dinner held by the Zambia State Insurance Corporation Limited the year 2004

“In this regard, allow me to reiterate what I have been saying at other fora; that the insurance industry plays a critical role in the economic growth and development of any country. Here in Zambia, the insurance industry, with gross annual premiums of approximately K273 billion for life and non-life business, and about K550 billion for pensions, controls colossal sums of money which could be used for investment locally. Such growth in the use of insurance in Zambia has given birth to the need for reinsurance for companies with larger quantities of covers to undertake”.

At present in Zambia, there are two registered reinsurance companies in place; Zambia Reinsurance Company Limited and Prima Reinsurance Plc. Zambia Reinsurance company was incorporated in Zambia in 1998 and started trading under the Insurance Act No. 27 of 1997 in 1999. This company was established as the first resident reinsurance company in the Zambian insurance market providing facultative and treaty reinsurance business.

Prima Insurance Plc was incorporated 2006 and started trading in 2007. It is licensed by the Pensions and Insurance Authority. Also located in Lusaka at Plot 13/62 Central Street in Chudleigh. Prima Reinsurance Plc is the more prominent one of the two companies. Prima Re has been rated by Global Credit Rating Company and attained BBB+ (Triple B plus) on a National rating scale on its claims paying ability.⁹

It was set up and was incorporated on 11th August 2006 as a public limited company (Plc). Prima Re is licensed by the Pensions and Insurance Authority to conduct reinsurance business. It started its operations on 1st January 2007. Prima Re accepts treaty and facultative business in the following classes: Fire, Engineering, Marine, Aviation, Motor, Miscellaneous, Accident and Agriculture. Prima Re is the first Zambian owned reinsurance company in the market and was officially launched in May 2007 by the Minister of Finance and National Planning.

However this company has faced much contradictions and difficulties. Some involved legal safeguards put in place to regulate insurance which otherwise absent would allow growth and expansion of the reinsurance business in Zambia. Most of the difficulties stem from the fact that

⁹ This rating is an independent third-party evaluation that subjects all insurers to a rigorous criteria. The rating performs a constructive and objective role in the insurance industry towards the prevention and detection of insurer insolvency.

Zambia treats reinsurance and insurance as the same and therefore does not provide any differences in policy making. This difficulty is exemplified in section 3 (d) (4)¹⁰

“no insurer may transact both general and long term insurance business”.

This implies that a company should treat life insurance and business insurance as two different companies. This is impractical for the reinsurance general because it is unlikely that life reinsurance can flourish at a big scale and setting it up as separate business would result in more losses as compared to profits. Therefore allowing a reinsurance company to treat life and business insurance as one business would bring an additional revenue to the business. At the moment Prima reinsurance does not engage in life business for the aforementioned reason.

This research aims at evaluating the laws and the practices in place as regards insurance *vis-à-vis* reinsurance and to ascertain whether they provide fertile ground for the growth of domestic reinsurance in Zambia.

Research has shown that several legal systems across the globe play an active role in the development of their financial sectors¹¹. Reinsurance has not been an exception. In Kenya, a policy was assented to that sets its national reinsurance company as priority concerning any reinsurance transaction in Kenya. This means whenever the need to cover a big risk arises the national company takes the risk it can shoulder and the rest is then thrown to foreign funded companies. In Mozambique, Mozambican insurance and reinsurance companies and their branches of insurance and reinsurance companies with registered offices abroad are allowed to carry out the insurance and reinsurance business in the country, provided that it has been authorized by the Ministry of Finance for such purpose and is registered with the Insurance General Directorate (Inspeccao Geral de Seguros- IGS)¹²

Zambian law does not recognize the different types of problems that a reinsurance company may face because the nature of the business is an international one. There is an obvious difference

¹⁰ Insurance Act No.26 of 2005

¹¹ Paper by presented Jean-Luc Bernasconi State Secretariat for Economic Affairs (SECO)First Initiative Annual Report 2009 Washington D.C United States

¹² African guide-trinity international 11p 2010

between the competition in reinsurance and direct insurance business. The competition between foreign- funded companies and direct competition is about luring customers. This study aims to bring to light the problems that reinsurers face as a result of legislation that is put in place. The three main players, will be interviewed to unveil a more elaborate picture of the industry. These include the Reinsurers, the insurance companies and the pension insurance authority.

Further, the ultimate objective of the study is to critically analyse all operating legal machinery put in place to regulate insurance in Zambia. In particular, the Insurance Act of 1997 as amended by Act No 26 of 2005 chapter 392 of the laws of Zambia, the insurance regulations, the Pension and Scheme Regulation Act 1996 which establishes the Pensions and Insurance Authority body.

An assessment of this legal machinery will uncover specific objectives which include the analysis of the formal laws, regulations and informal regulation of the reinsurance industry and whether the regulations put in place are conducive to the growth of the domestic reinsurance market. As a means to give recommendations so as to remedy any gaps uncovered, the essay will take into consideration other jurisdictions such as the United States of America and a few other jurisdictions. Review of these jurisdictions will point out elements that may be applied in Zambia to improve the competitiveness of the Zambian domestic reinsurance market.

The prevailing assumption is that the current laws and practice concerning reinsurance in Zambia are satisfactory. The fact that terms of a contract of reinsurance are left to be decided by the two parties contracting leaves a common thought that reinsurance contracts cannot be regulated further. Therefore transactions between local insurers and foreign reinsurers are not looked into by the existing authority in detail. This leaves a situation where the insurer is not protected by any laws in its country of origin. This paper will investigate this notion, within its study scope all reinsurance practices in Zambia. If this investigation uncovers that the law may regulate reinsurance further for the benefit of Zambia then the assumption that reinsurance regulation is satisfactory at present is a misleading notion.

The remainder of the paper is organized as follows. The next chapter will discuss the legal framework in which reinsurance operates. Outlining the laws applicable to registration and operation of reinsurance companies. Chapter three discusses the weaknesses that exist in Zambia's reinsurance industry as seen by the reinsurance companies, insurance companies and finally its regulator the Pensions Insurance Authority.

CHAPTER TWO

2.1 Introduction

Zambia the law concerning insurance is found in the Insurance Act¹³ and the Pensions Scheme Regulation Act.¹⁴ These two Acts harmonise the various pieces of legislation that regulate the insurance industry. This chapter will review the necessary provisions of both these Acts in relation to regulation of reinsurance in modern day Zambia. It will outline the legal framework in which reinsurance operates.

2.2 The Insurance Act

The Insurance Act, number 27 of 1997, which replaces Chapter 705 of 1967, regulates the insurance industry in Zambia. The long awaited legislation finally became effective on the 13 February 1998. The act currently regulates both long and short-term business, but separate licenses are required. This is provided for in subsection 4 of section 3 which reads “Subject to subsection (5), no insurer may transact both general and long term insurance business”. It is important to point out that most provisions in the Insurance Act are not specific to reinsurance and as such most provisions that apply to insurance apply to reinsurance as well.

2.2.1 Company Registration and Operating Requirements

There are no major impediments to the establishment of new insurers. In terms of the insurance act. Applications are submitted to the registrar and need to include: the articles of the company; certificate of incorporation; a statement of assets and liabilities; details of share capital; copies of all documentation to be issued to policyholders including policies and proposal forms and any other information required by the registrar. Subsection 2 of section 10 requires the application to specify the name and address of the company; the class of insurance business for which the applicant seeks authorization; matters relating to assets and liabilities to meet its obligations. The knowledge of the applicant’s assets helps in determining the capabilities of the company.

¹³ No. 27 of 1997 (as amended by Act No. 26 of 2005)

¹⁴ No. 28 of 1996 (as amended by Act No. 28 of 2007)

Thereby protecting policy holders from dealing with companies that will most likely result in liquidation.

According to section 11, the registrar must be satisfied that the applicant has articles consistent with the conduct of insurance, is able to meet its obligations to its policyholders at all times, has sufficient capital to conduct insurance business and is competent to conduct insurance business in the required class. Where the registrar is not satisfied with the above mentioned, he may allow the applicant to amend the application in respect of the licensing sought¹⁵. Once a license is granted, it shall be in force for a year, or for such shorter or longer terms as may be specified in the license. Both Subsection 4 of section 11 provides that it is renewable yearly on application to the registrar. A permanent license would not allow the registrar to check on the conduct of the companies that are set up.

Only companies that have met the minimum share capital requirement may lodge their applications to the registrar as provided for in subsection 1 of section 10 of the Act. The minister on recommendation of the board has the authority to prescribe, by statutory instrument, the minimum paid-up share capital to be maintained by a licensed insurer. This mandate is given to him in section 41 of the Insurance Act. In terms of the act the current minimum is set at ZMK 500mn (USD107, 481), but the registrar is currently requiring ZMK 1bn (USD 214,961) for both life and non-life companies¹⁶.

Details of the reinsurance programme and a statement of investment policy must be submitted to the Registrar as provided for in section 102 of the Act. The Registrar will then examine the reinsurance treaties and other reinsurance contracts entered into by the insurer. This is to make sure the treaties entered into are favourable to the insurer, are in the interest of the insurance industry and the economy at large. If not favourable, the Registrar has the authority to disapprove the reinsurance treaties. This section gives the Registrar powers to alter reinsurance treaties and putting the interest of the economy as priority would require the Registrar to include local reinsurers on these treaties.

¹⁵ Subsection 3 of section 11 of the Insurance Act No. 27 of 1997

¹⁶ Zambia Non Life Insurance Market report (P&C) (c)AXCO 2008 pg 35

A principle office must be maintained in Zambia¹⁷. It is obvious that this section shall not apply to reinsurance because it is a business that allows placement of insurance outside Zambia. Section 120 places a limitation on the buyers to place all assets, liabilities and interests in Zambia. The section provides exemption to reinsurance business. The effect of this provision is that insurance companies are at will to place

Life insurers must appoint an actuary. Section 46 states that before commencing the business of life insurance, a person to be the actuary of an insurer has to be appointed. Subsection 3 of section 43 of the Act states that a life insurer operating for a period of three months without an actuary is guilty of an offence and is liable for every day during which he operates without one.

The chief executive officer (CEO) of an insurance company cannot be appointed prior to the registrar's approval. A full CV must be submitted including academic and professional qualifications. Approval will not be granted unless the CEO is resident in Zambia and has served in the insurance industry for in excess of 10 years¹⁸. The reason for this provision is to ensure that the running of the company is in safe, capable experienced hands. It is important to secure the best management of insurance companies because once clients pay premiums, insurance companies are expected to invest this money. Poor management may result in poor decisions and poor decisions may lead to loss of money.

There are no specific requirements in respect of reinsurance companies and it must therefore be assumed that the requirements are similar to those of insurance companies¹⁹.

2.2.2 Types of licenses

The legislation previously permitted composite insurance companies to operate in Zambia. Separate life and non-life licences were required. However when the Insurance Act was amended in 2005, composite insurers were no longer be permitted. Existing composite companies were

¹⁷ Section 25(1) of Insurance Act No. 27 of 1997 (as amended by Act No. 26 of 2005)

¹⁸ Sub-section 4 (b)(i) of section 26 Of the Insurance Act No. 27 of 1997 (as amended by Act No. 26 of 2005)

¹⁹ Zambia Non Life Insurance Market report (P&C) (c)AXCO 2008 pg 34

given a period of time in which to conform to the requirement.

After the amendment of the Act, it is now a requirement to obtain two separate licences for the conduction of both long term insurance and general insurance business²⁰.

2.2.3 Intermediaries

In terms of Section 5 of the Insurance Act,

“A person shall not engage in insurance brokerage unless the person is a company licensed under this Act.”

Furthermore in terms of Section 13

"A person shall not carry on insurance brokerage in Zambia unless that person is registered as such under this Act".

In addition, in terms of section 24 (1)

“A person who causes another person to enter into, or to make an application to enter into, a contract of insurance with a person who is not a licensed insurer shall be guilty of an offence”.

The Act allows for insurance brokers. These are people who act as go betweens for the insurance and the business. A license may be obtained from the Registrar upon meeting the minimum financial or other criteria as may be prescribed under the Act²¹. Brokers are an important part of the insurance business. This is because there are so many different kinds of policies, each with its own premiums and limitations and it is easy for a lay man to get confused and end up with the wrong coverage. The law allowing for brokers in insurance protects interests of the buyers. The Insurance Act does not specifically cover reinsurance brokers though they are conducting business in Zambia. An example of such a broker is Guardian Reinsurance Brokers (Z) Limited²².

2.2.4 Fines and penalties

Any person or company who carries out business as an insurer or a broker without a licence will be in contravention of section 4 and 5 of the act and may be liable on conviction to a fine or period of imprisonment not exceeding two years, or both.

²⁰ Sub-section 4 of section 3 of the Insurance Act No. 27 of 1997 (amended by Act No. 26 of 2005)

²¹ Sub-section 3 (c) of section 13 Of the Insurance Act No. 27 of 1997 (as amended by Act No. 26 of 2005)

²² www.zsic.co.zm/zsicg/index.php, visited on 22 March 2011

Section 131 poses a general penalty and it reads

“A person who contravenes a provision of this Act or neglects or fails to comply with a direction given by the Registrar under this Act for which no penalty is expressly provided shall be guilty of an offence and shall be liable on conviction to a fine not exceeding twenty thousand penalty units or to imprisonment for a period not exceeding two years, or both.”

2.2.5 Consumer dispute resolution

There is no insurance ombudsman. The PIA has been known in some cases to act as an unofficial arbiter, but in most cases a dispute will go to official arbitration or court if necessary. Arbitration must be held in Zambia in accordance with the Arbitration Act. Wherever possible insurance related cases go to arbitration. The Insurance Act of 1997 contained a provision in part 2 that allowed for appeals to the Registrar against decisions made. It was repealed and replaced with a section addressing submission of a report to the Authority.

2.2.6 Conclusion

The Insurance Act places much emphasis on meeting financial requirements and capability of players in the industry. It focuses on making sure the insurance companies have capabilities to trade with policy holders. The Act seems to protect the general public from insurers. This is exemplified in subsection 2 of section 99 which requires the Registrar at all times to have regard to the need to protect the rights, benefits and other interests of policy holders and any other beneficiaries of policies of insurance. Another example is when the insurance act protects the interests of insured in the event of the insolvency of an insurance company with the establishment of the Policyholders' Protection Board. It is the function of the board to administer the Insurance Fidelity Fund²³. The purpose of this fund is to indemnify policyholders or other persons interested in the policies, in the event that an insurer or broker is unable to meet its liabilities. The fund has the powers to recoup, if possible, any disbursement from the defaulter and is funded by licence fees paid to the registrar for licences granted under the Insurance Act.

²³ Provided for in section 109 Of the Insurance Act No. 27 of 1997 (as amended by Act No. 26 of 2005)

The question that arises is who then protects the companies? With the emergence of reinsurance in Zambia, it is essential that the Act also place protection for local companies that trade with foreign companies. There is need for provisions that protect Insurance companies. For example requiring the foreign reinsurance companies to get permits to trade with local insurance companies from the Registrar. This will enable the Registrar to carry out some form of supervision. The Insurance Act makes little mention of reinsurance. Most provisions that apply to insurance are applicable to reinsurance. Other countries that have appreciated the difference between the two have enacted reinsurance acts to ensure the flourishing of the industry.

2.3 The Pension Scheme Regulation Act

This is an Act that establishes the organization responsible for supervision of the insurance industry in Zambia the Pensions and Insurance Authority. The Act defines its functions and powers to use in order to achieve prudential regulation and supervision of prudential schemes. Section 6 of the Act establishes a board to perform the functions of the Authority. The board is comprised of representatives of the following; Ministry of finance, Ministry responsible for labour and social security, Bank of Zambia, the Attorney General, so on and so forth.

2.3.1 Mandate of the Authority

Functions of the Authority are stipulated in section 5 of the Pension Scheme Regulation Act²⁴. The legislated duties of the Registrar include; to regulate and supervise the establishment and management of insurance businesses; licence re- insurers, insurers, brokers ; formulate and enforce standards in the conduct of business with which a member of the insurance industry must comply ; monitor the solvency of the insurance companies and ensure the observance of sound insurance principles and practices. They may achieve this by putting together articles to advice the insurance companies on the running of their business on their official website²⁵. An example of such is an article put up on the website discussing the importance of efficient internal controls as a way of achieving what is required from them by the board of directors.

²⁴ No. 28 of 1996 (as amended by Act No. 28 of 2007)

²⁵ www.pia.co.za visited on 22nd November, 2011

The PIA has a legislative power to make regulations so long as they are consistent with the Insurance Act.

In the regulation of the industry the registrar has authority to approve the placement of business outside Zambia. This is provided for in subsection 2 of section 120 of the Insurance Act which states that), where a particular type of insurance is not available locally, the Registrar shall approve the placing of such insurance outside Zambia on such terms and conditions as the Registrar shall think fit.

2.3.2 Legislative process

The insurance industry regulator drafts insurance legislation often in consultation with the pensions and insurance industry. The draft is sent to the supervisory ministry, the Ministry of Finance. On approval the draft is submitted to the Ministry of Justice for parliamentary draftsmen to ensure that the wording is legally adequate. The draft is then submitted by the Ministry of Finance to cabinet. If the draft meets with cabinet approval it is sent to the National Assembly where it must pass through three parliamentary readings.

After the first parliamentary reading the bill is referred to a specialist committee for detailed consideration prior to general debate on the floor of the house. On passing three readings in parliament the bill is submitted to the president. Where a bill has been duly passed and assented to by the president it is published in the gazette as a law. The time taken for legislation to pass through the legislative process varies tremendously. At times urgent legislation may be passed within two months; however, generally the process is considerably lengthy. Once these regulations become law, contravention of the regulations attracts penalties to the offenders. Regulations are seen to be effective way to supervise the insurance industry in Zambia.

2.3.3 Conclusion

Reinsurance in Zambia operates within the confines set out in the Insurance Act. Though most requirements are specifically for insurance companies, the market practice is that the same rules applicable to insurance companies apply to local reinsurance companies. The Pensions and Insurance Authority has adopted the same stance and regulations apply to both types of businesses in the same way. This position attracts a number of grievances from local the reinsurance companies. After laying down the prevailing situation of the law, the next chapter will discuss the problems experienced as a result of the current structure of the law.

CHAPTER THREE

3.1 Introduction

Chapter one lay a brief foundation of the current practice of reinsurance in Zambia. Chapter two wishes to build on this matter further by identifying the pitfalls that exist in the reinsurance field. As this paper wishes to deal with practical problems rather than theoretical ones, one on one interviews were carried out, so as to get the actual problems caused by the laws in place or lack thereof. This part of the essay hence presents the problems as perceived by the three main players in the reinsurance industry. These players include; the reinsurance companies namely Zambian Reinsurance Company and Prima Reinsurance Plc; the Pension Insurance Authority and Madison Insurance Company to represent all other insurance companies.

3.2 Reinsurance companies

The most fundamental problem echoed by both reinsurance companies points to the Insurance Act²⁶. The Insurance Act does not specifically cover the operations of reinsurance companies, it can only be assumed that the provisions for capital, reserving and solvency stated in the Act are applicable to reinsurers.

Section 41 (1) provides that the Minister may, on recommendation of the Board, by statutory instrument, prescribe the minimum paid-up share capital to be maintained by a licensed insurer.

Reinsurance companies perceive this provision to be disadvantageous to them. This is because of a number of reasons. Firstly, the requirement by regulation to produce a share capital²⁷ the same as that of an insurance company is not progressive because of the nature of reinsurance. By nature reinsurance operates at an international level and this inevitably means there is a high level of competition. And as such, having such a low requirement of share capital would not build confidence in international companies looking for reinsurance to engage in business with

²⁶ No. 27 of 1997(as amended by Act No. 26 of 2005)

²⁷ Is defined as the portion of a company's equity that has been obtained by selling of stock to shareholders, it represents the company's ultimate financial base – www.investordictionary.com

Zambian companies²⁸. At present the registrar, requires a minimum of ZMK 1bn () for both life and non-life companies. This 1bn (USD 214,961) is just 0.8 % of income of Kenya Reinsurance Company and 1 % of AFRICA RE's share capital²⁹. Therefore if Namibia was looking to reinsure it would not choose Prima Re over Kenya Reinsurance.

This argument does not stand because these companies struggle to barely rise above the share capital requirement set up by the law. Though it only makes sense that reinsurance companies should have a bigger capital requirement than insurance companies because reinsurers insure insurance companies, if increased the reinsurance companies cannot manage to meet the requirement.

In accordance with the conditions of the Common Market for Eastern and Southern Africa (COMESA) membership, Zambian insurers should reinsure at least 5% of their business with PTA also known as ZEP Re. PTA Re is an institution of COMESA based in Nairobi, Kenya that commenced business in January 1993. It was created by an agreement of Heads of State and governments of the COMESA region in 1990 Mbabane Swaziland. PTA Re transacts treaty and facultative business in the region, administers various reinsurance pools and provides training for insurance industry personnel. Most companies include PTA Re in their treaties for between 5% and 10% depending on the class³⁰. This was presented an issue of concern by the reinsurance companies. The problem is that they do not receive the support demonstrated here from any legislature. They are not compulsory regulations requiring local insurers to reinsure with them.

In view of the issues raised, it can be concluded that PTA re receives policy support and the same treatment should be awarded to Zambian companies. A compulsory percentage to be covered by domestic reinsurers would help increase their revenues. It does not have to be much because it cannot be overlooked that Zambian companies.

²⁸ Exhilda Lumbwe, managing director, Prima Reinsurance Plc 10th December, 2010

²⁹ Excel insurance ltd Market Report (EXICO) 2010, www.exico.com

³⁰ Zambia Non Life Insurance Market report (P&C) (c)AXCO 2008 pg 44

Additionally, it is theoretically mandatory for 5% of local treaty programmes to go to African Re. As there is no legal provision for this in any Zambian legislation, some insurers historically did not make the cession. However, most local companies now make the cession and some cede considerably more than the obligatory 5%. Africa Re is owned by member states of the African Union and the African Development Bank. It was established on 24th February 1976 in Yaoundé, Cameroon following a recommendation by the African Development Bank. It was created with the aim of reducing the outflow of foreign exchange from the continent by retaining a substantial proportion of the reinsurance premiums generated therein³¹.

The agreement known and referred to as the Agreement Establishing the African Reinsurance Corporation confers on African RE its current legal authority to operate. This agreement also empowers any member state to authorize a national institution, either a bank or an insurance company, acting on behalf, to purchase shares reserved for the state. In 2001, it was decided that the Corporation's capital be increased to US\$ 100 million and opened up to non- African investors so as to have a required strategic partners. The strong financial base of this company illustrates how growth occurs when states rise to support companies. In this case States are encouraged to buy shares and because of this, African RE has gone as far as seeking non-African investors³². This support is what the private reinsurers claim to be lacking.

On the other hand, the reinsurance companies complained of the absence of obligatory cessions to local companies³³. This means Insurance companies are not obligated to reinsure with any domestic private companies and are therefore allowed to take their business out of the country as desired. Much of the Zambian treaty business goes to Swiss Re (especially life), Munich Re, PTA Re, CICA Re, East African Re, Continental Re (Nigeria) and Africa Re³⁴.

Absence of such a regulation does not give reinsurance companies the market opportunities they need to grow and expand their capacity. In Mozambique, only Mozambican insurance and reinsurance companies with registered offices abroad are allowed to carry out the insurance and

³¹ Supra note 3

³² Excel insurance ltd Market Report (EXICO) 2010, www.exico.com

³³ Exhilda Lumbwe, managing director, Prima Reinsurance Plc 10th December, 2010

³⁴ Excel insurance ltd Market Report (EXICO) 2010, www.exico.com

reinsurance business in the country. They work to prioritize their domestic markets (Inspeccao Geral de Seguros- IGS)³⁵.

Managing Director of Prima Re³⁶ complained of the non existence of the implementation of special protection of the domestic market which is a common practice around the world especially in developing countries. She gave China as an example of a country whose reform had opened up, promulgation and implementation of a number of important laws, regulations, insurance, reinsurance undertakings that later created extremely favorable conditions. Especially the "Insurance Law" about the legal reinsurance and priority in the domestic reinsurance provision. This is a manifestation of putting national interests first, in order to prevent and resolve insurance, operational risks, to avoid the loss of foreign exchange³⁷.

She went on to say there are instances that they are exempted from pooling arrangements that would award them an opportunity of business which will result in profits and thus growth. They gave an example of the a voluntary pool for fire business, managed by Kenya Re on behalf of the Organization of Eastern and Southern Africa Insurers. This pool is available to assist with capacity building³⁸, especially fire risks. The reality that they are left out on capacity building opportunities will not help them grow.

The reinsurance companies expressed discontentment at section 3 (d) (4)³⁹ which states that no insurer (reinsurer) may transact both general and long term insurance business. They are for the idea that they participate in both types of insurance if they so desire. They feel it is cumbersome to obtain a different license and cede one company into two.

³⁵ African guide-trinity international report 11p 2010

³⁶ Exhilda Lumbwe, managing director, Prima Reinsurance, 10th December 2010

³⁷ www.wto.org "A case of China benefits of WTO trading system"

³⁸ The percentage of *surplus* or the dollar amount of *exposure* that an insurer or *reinsurer* is willing to place at risk.

Capacity may apply to a single risk, a program, a line of business, or an entire book of business -

www.investordictionary.com

³⁹ Insurance Act No. 27 of 1997 (as amended by Act No. 26 of 2005)

Further, African Re and PTA Re do not pay levy to the regulatory body and are not under regulation by any Zambian institution. They are under the protection of the Government. This poses a difficulty in monitoring these institutions. The reinsurance companies alleged that Pensions and Insurance body was failing in its duty to regulate reinsurance if certain companies were out of its jurisdiction. This statement has truth in it and in this case the independence of the Pensions and Insurance body has been compromised, because regulation is only effective if jurisdiction is allowed.

3.3 Pensions and Insurance Authority

The Pensions and Insurance Authority is the regulatory and supervisory authority for the pensions and insurance industry in Zambia. The Authority is created by the Pension Scheme Regulation⁴⁰ and the Insurance Act⁴¹ No. 27 of 1997. Prior to the enactment of the Act No. 27 of 2005, PIA existed as Office of the Registrar of Pensions and Insurance under the Ministry of Finance and Planning. Following the enactment of Act No. 27 of 2005 the Authority became a body corporate.

The Pensions Insurance Authority was created with mandate to do the following; Licensing and registration; Prudential regulation and supervision; Formulation and enforcement of standards of conduct for the industry; Protection of pension members and policyholders; Advising Government on insurance national assets and properties⁴².

The author had an opportunity to meet Mr N. Ntimi⁴³ and posed some of the concerns raised by the reinsurance companies to him and he managed to comment on some of them. They too are aggrieved by the reality that some foreign owned reinsurance companies are able to operate by virtue of international treaties between Heads of State. Examples such as PTA re have been given above. He later added that these companies are not even licensed under the Pensions

⁴⁰ Act no. 28 of 1996 (as amended by the Act no.27 of 2005)

⁴¹ Act no. 27 of 1997 (as amended by Act no. 26 of 2007)

⁴² www.pensioninsuranceauthority.com

⁴³ Insurance analyst, Pensions and Insurance body, 28th January, 2011

Insurance Body. They have no active rules regulating them but instead are expected to abide by business conduct and principles of good faith as they transact. This is not satisfactory regulation as expressed by the Pensions Insurance Authority.

With regards to the freedom of local insurance companies to take business out of the country as they please, Mr Ntimi stated that as much as they would like business to stay within the confines of Zambia, Zambian companies do not have the capacity. The share capital that they have is too minimal to cover some of the risks that are exposed in Zambia.

Mr Ntimi explained this point further by giving nature of most of the risks in Zambia. Zambia's economy continues to remain very heavily dependent on mining. Copper is the most important mineral by a substantial margin, followed by cobalt and zinc. Therefore to reinsure a mining company as Lumwana mining company would require a large sum of capital. For example, in 2007 the mining risks came up to a total of K62.8 billion. How would Prima Reinsurance Company manage to shoulder such a risk when its capital base is only K5bn? Consequently K60.7 billion was reinsured almost wholly outside Zambia and this represents a low local retention of only K2.1 billion (3.5%). Mr Ntimi added that reinsurance companies should be realistic enough to view the low share capital requirement as an advantage to them. Restructuring of that requirement would pose a burden on the reinsurance companies to raise the new amount of capital set by the regulator.

For the grievances raised on the issue of the reinsurance companies being expected to take out two separate licenses, Mr Ntimi said that it was actually meant to work in favour of reinsurance companies. This is because general reinsurance also known as non life is basically easier to deal with and is more convenient to write out. They referred to long term insurance as being more complicated and technical, and the companies may not have the expertise needed to write out prudent policies for this kind of reinsurance.

By complicated they had in mind the formalities needed to take out the policies. The reinsurance company will have to design the policy and present it before the Authority and has to prove that it has the capacity to pull off such policies. They also ruled long term insurance to be too

technical because it cannot do without the professional skills of an actuary⁴⁴. For example, in a policy for life assurance, an actuary is there to calculate the mortality rate, assess the standard of living, conditions of health and life style of an individual in order to come up with the premium. PIA concluded that the reinsurance companies lack the expertise needed to conduct such reinsurance and them concentrating on general reinsurance would provide a better platform for their growth and expansion.

On behalf of PIA, Mr Ntimi appreciated the close link between insurance and reinsurance and added that reinsurance growth cannot occur without the growth of insurance taking place. From this angle they identified a number of struggles they are facing as a regulatory body. They began by saying that there was still such a low level of insurance awareness and knowledge in the country, only a small portion of the Zambian population appreciates the pivotal role insurance plays in the economy⁴⁵. The need for more awareness among potential and existing consumers of insurance products is required for the expansion and growth of the insurance industry to take place. In addition, it is a well-known fact that insurers do not educate their clients even concerning the policies the clients are signing themselves up for and as such problems arise only when it is time to make a claim.

Mr Ntimi admitted that there was a need for updated regulations and guidelines measuring up to international standards set up by bodies such as the International Association of Insurance Supervisors (IAIS)⁴⁶.

Mr Ntimi explained that PIA was aware of the excessive reinsurance placements as one of the greatest challenges in the reinsurance industry. From the combined gross premiums business of K626 billion in 2007 was ceded to reinsurers. Out of this amount was K16.8 billion was retained

⁴⁴ Professionals known for their fluent mathematical dexterity, their skills include predicting financial expectations by using stastical models – PIA newsletter issue 1/2010

⁴⁵ Pensions and insurance authority report to the minister of finance and national planning,2008 pg 9

⁴⁶ An organization, whose membership includes reinsurance regulators and supervisors from more than 190 jurisdictions. It aims to contribute to improved supervision of insurance on a domestic as well as international platform. It provides a forum for regulatory bodies to share experiences and understanding. 2009 – 2010 International Association of Insurance Supervisors Annual Report

within Zambia by locally based re-insurer. This translates to over 90% that is K152.9 billion of the re- insured business funds been remitted abroad. The national reinsurance turnover was K169.8 billion of which K16.8 billion (9.9 %) was ceded to the locally licensed insurers, Prima Re and Zed Re, and the rest to the regional and international reinsurers. Analysis of reinsurance cession to the reinsurer's reveals that only 26.2% of this business relates to reinsurance treaties while K12.4 billion was in respect of facultative reinsurance arrangements⁴⁷.

This low retention of risks leads to a very high externalization of funds through reinsurance with foreign based reinsurer. Mr Ntimi pointed this problem to the low capitalization of the Zambian insurance industry as a whole⁴⁸.

The Pensions and Insurance body stated that there was a need for updated regulations and guidelines measuring up to international standards set up by bodies such as the International Association of Insurance Supervisors (IAIS)⁴⁹.

Lastly the PIA concluded that local insurance companies do not express faith in the domestic reinsurance programmes.

3.3.1 Conclusion

After the interview with Mr Ntimi, it was clear that the Pensions and Insurance Body was aware of the problems that are in existence because of lack of regulations addressing them. They further admitted that there was need to update regulations as regards reinsurance. An interview with Managing Director of Prima Re revealed that a board had been selected from amongst experienced insurers to sit and recommend regulations to the Pensions and Insurance Regulation

⁴⁷ Pensions and Insurance Authority report 2007

⁴⁸ Pensions and Insurance Authority report 2007

⁴⁹ An organization, whose membership includes reinsurance regulators and supervisors from more than 190 jurisdictions. It aims to contribute to improved supervision of insurance on a domestic as well as international platform. It provides a forum for regulatory bodies to share experiences and understanding. 2009 – 2010 International Association of Insurance Supervisors Annual Report

board. Until then, the legislation reflects various gaps that are detrimental to the insurance industry as a whole.

3.4 Insurance companies

Madison Insurance Zambia Limited was the first private insurance company to commence operations in the re-liberalised insurance market, on April 1, 1992. The company started as a subsidiary of Meridian International Bank based in Nassau, Bahamas. The collapse of the Meridian Group in 1995 adversely affected the company. At the time, Madison had three years of very good performance with a consistent profit achieved in both non-life and life divisions.

One of the measures taken to save Madison Insurance was an offer by management to sell out the major shareholders. Management recruited strategic equity partners and the new shareholding structure included Hannover Reinsurance Group Africa Limited, which is wholly owned by Hannover Reinsurance Mauritius Limited, and Trans Zambezi International Limited, which was based in Harare, Zimbabwe with offices in the Virgin Islands. Representing management, Lawrence Sikutwa and Associates acquired a 10 percent share⁵⁰.

The collapse of the Zimbabwean Dollar against major currencies led Trans Zambezi to restructure its investment. It disposed of its interests in Madison to Zambia Venture Capital Fund (ZVCF) and Lawrence Sikutwa and Associates effective 1st January 2001. Two years later, Hannover Re divested as well, leaving two shareholders: ZVCF and management under Lawrence Sikutwa and Associates.

As Zambia Venture Capital Fund was wound up in 2005, Lawrence Sikutwa and Associates exercised their pre-emptive rights over ZVCF's shareholding to make Madison a wholly-owned Zambian company⁵¹.

⁵⁰ Good and bad practices in microinsurance report, Madison Zambia, ILO social finance working programme 2005 pg 14

⁵¹ Good and bad practices in microinsurance report, Madison Zambia, ILO social finance working programme 2005 pg 16

Madison and all other insurance companies are aware of the major problem of externalization of funds at a very large scale as above statistics have shown. However as much as this is a major issue, they insist that they are not running charitable organizations and cannot just give away business to local reinsurers for the sake of their growth. They denied the statement that it is because of their lack of faith in local services that they do not mostly reinsure within. Mr Kasase⁵² added that the major reason they do not carry out most reinsurance within the country is the lack of capacity shown by the local reinsurance companies⁵³.

There are two types of reinsurance, treaty reinsurance and facultative reinsurance. The distinguishing feature of facultative reinsurance is that the reinsurers consider each risk offered to him individually and is free to accept or reject each offer as he considers appropriate. The reinsurer is entitled to have before him all the information available to the direct insurer to enable him to decide whether or not to accept the risk⁵⁴. In fire insurance, for example, the reinsurer may wish to consult the plan and report on the insured premises, and to have details of the rates of premium being charged by the direct insurer.

The great disadvantage of facultative reinsurance is that a considerable amount of time and work, with consequent expense, are involved. There is also uncertainty whether sufficient reinsurance can be obtained in any particular case, and this may mean that the direct insurer will have to delay granting cover until the possibility of obtaining reinsurance has been investigated.

In light of the disadvantages mentioned above, treaty reinsurance has become very much more popular. A treaty is an agreement between the direct insurer and a group of reinsurers, under which the ceding company undertakes to cede, and the reinsurers undertake to accept, a share of any business which comes within the terms of the treaty. So far as the individual risks ceded under the treaty are concerned, the reinsurers have no option but to accept them. The result of such an arrangement is that the direct insurer is able to grant cover in respect of all business

⁵² Nkole Kasase Assisant Manager Reinusrance Department, Madision Insurance Company 10th February 2011

⁵³ Nkole Kasase Assisant Manager Reinusrance Department, Madision Insurance Company 10th February 2011

⁵⁴ Paper by JCC reinsurance company ltd on Principles of re insurance www.jccre.com

coming within the scope of the treaty, up to a limit of the amount which can be given to the treaty⁵⁵.

After explanation of the two types of reinsurance, Mr Kasase made it clear that Madison cannot involve the local reinsurance fully in treaty reinsurance because of the nature of treaty reinsurance. Treaty reinsurance is termed as 'blind arrangements' because once the agreement is entered all types of risks included in the agreement must be covered. The insurance will not consult the reinsurance on its capacity per policy. It is for this reason that insurance companies prefer to reinsure outside when using treaty reinsurance because of the security that the companies they are transacting with the capacity to shoulder the risks. Local reinsurers have no large capacity, they cannot be a part of blind arrangements of this nature and it is therefore more convenient for both the insurers and the reinsurers if there was consultation on each policy as regards to capacity. This is the reason local reinsurers are engaged mostly in facultative reinsurance. In spite of treaty reinsurance granting them such an advantage, it poses a low retention rate for the insurance company.

Insurance companies raised the argument that if the insurance industry faces certain challenges that hinder its growth, it is then impossible for the reinsurance industry to grow. They went further to say, problems in insurance must be addressed for reinsurance to grow.

The first problem brought was that majority of Zambians are still not aware of the use of insurance and therefore do not appreciate it. They claim if an average Zambian insured his property against any possible calamity, monies will come from every sector of Zambia and not just the main the ones. Furthermore, they stated that the only obligatory class of insurance is motor third party liability for bodily injury. If there were more compulsory classes of insurance, people would become more aware of insurance and insurance companies would obtain more profits and in turn reinsurance would grow.

The insurance companies raised a concern towards the market practice of 'fronting'. It is a practice where the direct insurer's interest in the insurance program may be nonexistent because

⁵⁵ Paper by JCC reinsurance company ltd on Principles of reinsurance www.jccre.com visited on 10th October ,2010

the direct insurer is merely acting as a front for the reinsurance program. Many commercial risk programs are fronted because the risk bearers with the expertise and interest in insuring the risk are not licensed to do business in the insured's state or are not licensed to write direct insurance. Generally, a fronted program is well-known to the insured and arranged in advance. Where the direct insurer transfers all of its risk to others, the likelihood that the direct insurer will provide the insured with any risk management services and stand by the insured when claims arise is diminished⁵⁶.

In Zambia fronting arrangements are legal. Where a particular type of insurance is not available locally the registrar has the authority to approve the placement of business outside of Zambia. If approval is granted then the business can be fronted by a local company and then reinsured with a foreign carrier, or may in certain instances be placed directly overseas⁵⁷. However, there continue to be certain cases where the above legislation is not taken literally and the local market has not been given the opportunity to fully utilize its capacity prior to the risk being placed largely with foreign markets. This situation is particularly prevalent where overseas investors have global policies and it is to their advantage to minimize the amount of cover insured in the local market. This is detrimental to the local market because it supports externalizations of funds even when local companies are able to cover such risks.

Also, there is no minimum local retention required stated in the law, consequently situations arise where all monies is seen to be externalized and there is no provision of the law that would sanction such a deed.

The insurance companies also complained about a new regulation relating to tax. The law now requires them to pay tariff rates to the governments. They said this will reflect badly on this industry because as they are trying to market insurance to the lay man and make a customer out of him, premiums will be more expensive so as to cater for the profits they wish to make out of the policy as well as raise the money to pay tariffs.

⁵⁶ Larry P. Schiffer Reinsurance Matter, march 2000 www.irmi.com visited on 10th October, 2010

⁵⁷ Zambia Non Life Insurance Market report (P&C) (c)AXCO 2008 pg 30

3.5 Conclusion

Having outlined the problems perceived by the industry in a holistic sense, and having already dealt with the substantive analysis of the law, it would be safe to conclude that the law does not rectify the problems outlined by the reinsurance companies. The law provides for operation of insurance companies in an elaborate manner but leaves questions to be asked regarding the operation reinsurance in Zambia. The Pensions Insurance Authority has chosen to interpret sections of the Insurance Act pertaining to operation of insurance companies to be applicable to Reinsurance withstanding the difference of in the nature of the two businesses. In theory such a decision may be looked at to be arbitrary because there is no law, provision or statute that provides for this. It was common sense on the part of officers of PIA once reinsurance companies emerged to interpret the provisions applicable to insurance companies to apply to reinsurance as well. Regulation cannot function in this way, there is need for proper written down laws concerning operation and conduct of reinsurance companies that can be depended on in times of litigation.

CHAPTER FOUR

4.1 Introduction

It has long been recognized that the level of reinsurance regulation varies substantially in countries throughout the world. This chapter is a review of reinsurance regulations in selected jurisdictions. These selected countries have proved to be standard setters in the area of reinsurance. A study of reinsurance regulation frameworks of these countries that have sustained a growth in their insurance industries is essential to draw out sound regulation that can be used to expand regulation of reinsurance in Zambia in a timely manner. The United States, which imposes a very highly structured level of regulation upon licensed reinsurers stands in stark contrast to countries like Belgium and Ireland where reinsurers are subject to no direct reinsurance supervision and Greece where reinsurers are subject to no supervision whatsoever⁵⁸. However this highly structured level of regulation has been the key to the success of the reinsurance industry in the U.S.

4.2 Reinsurance regulation in the U.S

Insurance and reinsurance regulation in the United States is carried out on a state-by-state basis, not on a federal level. The National Association of Insurance Commissioners (NAIC), attempts to provide some coordination and consistency among the states. It achieves this through model laws and regulations, uniform statutory accounting principles and coordinated company examinations and databases. The NAIC is an organization consisting of the insurance regulators of all US states, territories and the District of Columbia.

4.2.1 Historical perspective

While reinsurance regulation varies substantially throughout the world, reinsurance regulation also varied to a large extent among the individual states in the US as recently as the 1950s. Minutes of NAIC meetings dating back to 1949 and 1950 reflect regulators' concern about abuses relating to reinsurance and the annual statement reductions that states permitted.

⁵⁸ Gesamtverband der deutschen versicherungs wirtscafr haitish insurers' international committee, draft framework for a European regime for the supervision of cross-border reinsurance , at enclose A (1999) [hereinafter DRAFT FRAMWORK FOR A EUROPEAN REGIME].

A questionnaire issued by the NAIC during this time period resulted in responses from 46 states and territories and revealed a number of differences in regulatory approach to reinsurance such as at least one state prohibited cessions to non-admitted reinsurers; at least one state prohibited cessions to non-admitted reinsurers.⁵⁹

Despite the discovery of these differences, the states continued to implement an inconsistent approach to reinsurance regulation until years later. In 1982, the Illinois Department of Insurance submitted a report to the NAIC that suggested the development of a model law on reinsurance which would create financial standards for assuming reinsurers, accounting for reinsurance transactions and reserve credits, circumstances for prior approval of reinsurance arrangements, required provisions for reinsurance contracts and financial reporting and disclosure of certain reinsurance transactions. As a result of this work, the first model law addressing credit for reinsurance was adopted in June 1984.

4.2.2 Status of Direct Regulation of US Licensed Reinsurers

Reinsurers licensed in at least one US jurisdiction are subject to the full spectrum of laws and regulations to which a primary insurer is subject. These regulations concern ; minimum capital and surplus requirements ; risk-based capital requirements ;investment restriction disclosure of material transactions; licensing (fit and proper) requirements, so on and so forth.

The exceptions to this general rule are rates and forms⁶⁰. Because reinsurance is conducted between sophisticated parties of essentially equal bargaining power (insurers and local reinsurers), regulators do not impose regulatory requirements relating to the rates of reinsurance. They practice this to give an upper hand to domestic licensed reinsurers over foreign reinsurers. Local reinsurance companies will be free to conduct business on rates that are convenient for them while imposing rates on foreign jurisdictions.

⁵⁹ IAIS working group in reinsurance ,reinsurers and reinsurance: Relevant issues of Establishing general supervision standards, standards and practices14, 15 (2000).

⁶⁰ IAIS working group in reinsurance ,reinsurers and reinsurance: Relevant issues of Establishing general supervision standards, standards and practices14, 15 (2000).

4.2.3 Status of Indirect Regulation

The US Recognizes the fact that an insurance marketplace as large as theirs is in need of a substantial amount of reinsurance capacity. US regulators do not prohibit non-US reinsurers from assuming reinsurance business in the US, nor do they pretend that they have the regulatory capability or resources to assess the financial strength or claims paying ability of non-US reinsurers.

The US has developed a system whereby the reinsurance transaction is regulated through the credit for reinsurance mechanism⁶¹. The fundamental concept underlying the US regulatory view is that a reinsurer must either be licensed and subject to the full spectrum of reinsurance regulation or provide collateral to ensure the payment of the reinsurer's obligations to US ceding insurers. This approach has created a very open but secure marketplace.

US regulators have the confidence that the non-US reinsurer is able and willing to pay its obligations to US ceding insurers as they become due. This is accomplished through the collateralization of the reinsurer's obligations. Collateralization eliminates the regulator's need to assess the level of regulation in the non-US reinsurer's domiciliary jurisdiction or the financial strength of the particular reinsurer. Collateralization ensures that funds are available to satisfy the non-US reinsurer's obligations and also to make sure funds are available for primary insurers in the case solvency.

This is done to protect the primary insurers in the US. This was a lesson learned by regulators as a result of the large number of US insurer insolvencies that occurred in the 1980s⁶². This was because an open reinsurance market can translate into substantial cost and difficulties in obtaining reinsurance recoveries in the event of a receivership.

⁶¹ Credit for reinsurance is the financial statement accounting effect given to a ceding insurer if cessions are ceded in accordance with prescribed criteria. If the criteria are met, the ceding insurer may record a reduction in insurance liabilities for the effect of the reinsurance transactions.

⁶² A.M. Best company , bests's insolvency study – property/casualty insurer 1969- sure 1991

4.2.4 Options for Non-US Reinsurers

US reinsurance laws provide a number of options for non-US reinsurers that seek to assume reinsurance risk from US ceding insurers.

A non-US reinsurer may obtain a license to conduct insurance/reinsurance in the US by establishing a separate affiliate entity or by directly “entering” the US through a particular state and establishing a branch in the US.⁶³

He may also establish a multiple beneficiary trust which secures its obligations to all US cedents plus a surplus amount which is, for an individual assuming insurer or provide individual collateral (through a trust, letter of credit or other acceptable security) to each of its ceding insurers without the necessity of a surplus amount in addition to its obligations.

4.2.5 Conclusion

US reinsurers are vigilant about maintaining a level playing field among all competitors and striking the proper balance between a global, efficient marketplace and one that is financially secure for ceding local insurers and consumers. The United States has a very open reinsurance marketplace, as illustrated in the high participation of non-US reinsurers. At the same time it is a highly regulated environment that places solvency first and foremost to secure local insurers.

A reinsurer that is not licensed in the US must provide collateral to the extent of its liabilities plus a solvency margin or provide collateral in the amount of the credit that the cedent takes on its statutory financial statements. Therefore, in the US, the purpose of direct and indirect regulation is to ensure the solvency of the reinsurer and to ensure that funds are available to the US ceding insurer in the event of the reinsurer’s insolvency. They achieve this by obtaining regulatory jurisdiction over the licensed reinsurer or through access to funds of the unlicensed reinsurer that are located and secured in the US.

⁶³ Reinsurance Association of America , Alien Reinsurance in the US Market 2000 data (2000).

According to Strain⁶⁴, if the purpose of regulation is to further the national interest by fostering the domestic industry through prohibition of foreign participation, it is misplaced for a number of reasons. First, most countries have a total insurance industry capacity grossly inadequate to cover large exposures such as natural catastrophes. Secondly, the capacity, risk management and other expertise that is available in the global marketplace can result in strengthening and growing the domestic market, providing jobs and the influx of needed capital.

4.3 Reinsurance regulation in non-US jurisdictions

A study was commissioned by the European Commission on the 21 January 2009 with the purpose of reviewing “the methodologies for prudential supervision of reinsurance with a view to the possible establishment of an EU framework”.

The EU Study recognizes that the major common objective for supervision of reinsurance, in those jurisdictions where it is supervised, is the need for protection of the interests of the policyholders. The intent is to reduce the chances of reinsurer insolvency⁶⁵.

In describing the difference between direct and indirect supervision, the study states that direct supervision means that any reinsurer conducting business within the jurisdiction of an EU member state is required to be authorized in some way by the supervisor. Direct supervision includes other requirements, for example, managers must be fit and proper, adequacy of technical provision, minimum solvency margins, and submission of financial statements.

Indirect supervision is conducted via the full supervision of direct insurers. A reinsurer is examined as a result of the supervisor’s scrutiny of the primary insurer’s outward reinsurance program. In conclusion the EU study showed that almost all Member States of the EU supervise reinsurers either directly or indirectly and at other times use a mixture of both direct and indirect supervision.

⁶⁴ R.strain,w Reinsurance contract wording, sweet and Maxwell at 615 (1992)

⁶⁵ http://europa.eu.int/comm/internal_market/en/finances/insur/stud12-02-02.pdf. visited on 14th march 2010

For example, Belgium, Ireland and Greece domestic professional reinsurers are not subject to any reinsurance supervision. Germany, France and the Netherlands apply elements of their direct insurance supervisory regime to reinsurers while a reduced licensing regime exists in Austria, Italy, Spain and Sweden where only the latter two impose solvency margin requirements.

4.3.1 Canada

Canadian regulators operate a licensing system and supervise the reinsurance business essentially the same way as they do direct insurance except that reinsurers are not subject to market conduct regulation. Like the US, minimum initial capital requirements for licensing in Canada are high.

4.3.2 Argentina

The insurance market in Argentina is regulated by the Superintendant of Insurance of the nation, which is a branch of the Ministry of Economy. The Superintendency (SSN) mandated that after September 1, 2011 reinsurance in Argentina must be purchased through national or registered reinsurers⁶⁶.

Currently, there are only six national reinsurance companies authorized to operate in the local reinsurance market. In order to continue underwriting Argentine risks, the foreign reinsurers must comply with all the requirements of the new resolution by September 1, 2011. Reinsurers must obtain a specific waiver from the SSN to write a contract from the reinsurer's home jurisdiction, when such a contract cannot be obtained in the local market. Even under such exceptional circumstances, foreign reinsurers must still register with the SSN after obtaining approval to write any specific risk. After September 1, 2011, reinsurers that are not registered are prohibited from accepting reinsurance operations in the territory of Argentina.

4.3.3 Switzerland

According to the EU Study, while reinsurance is covered in insurance regulation, most requirements for direct insurance companies do not apply to reinsurance companies. Thus, foreign reinsurers, who assume business in Switzerland, require no authorization to do so and are

⁶⁶ www.marval.com.ar/Default.aspx visited on 25th March, 2011

exempted from federal supervision. However, authorization and supervision are required for Swiss reinsurers. Further, there is no requirement in Switzerland that companies provide the regulator with details of collateral or deposits. There are reportedly no current plans in Switzerland to review the treatment of ceded reinsurance.

4.4 Conclusion

The US regulation system appreciates the difference between insurance and reinsurance. Consequently, as elaborated by the study taken by the EU, the US practices a mixture of both direct regulation and indirect regulation. US regulation may subject both the insurers and reinsurers the same spectrum laws but it gives exceptions when it comes to rates and forms. In comparison, Zambian law subjects reinsurers and insurers to the same spectrum of laws. Additionally, no rates are imposed on foreign companies hence putting them on equal footing but to the detriment of local companies because they are not as developed as foreign companies.

A number of countries including Zambia and Canada have not found it necessary to tighten regulation of foreign companies that conduct business in their countries giving the reason that the foreign company is not governed by their laws. They view reinsurance as an area of law that cannot be regulated further than setting requirements of set up of business as illustrated in the Zambian Insurance Act. This approach has been costly to most because in an event of insolvency of the foreign companies reinsured with, plenty of policy holders have been seen to lose out. The US regulatory framework has in place methods that monitor foreign companies. The regulations provide that no non-US reinsurer that may transact in the US without obtaining a licence. A licence may be obtained once the reinsurer establishes a separate affiliate entity or by establishing a branch in the US. With this regulation, the regulatory body (NAIC) is able to monitor the foreign company with as much ease as an indigenous one. Hence, policy holders shall be protected from trading with companies that may not be able to cover their costs when claims arise.

Argentina seems to have taken the US view of having a mechanism in place to monitor reinsurance with foreign companies. This is reflected in the requirement of a specific waiver from SSN to write a contract from the reinsurer's home jurisdiction. This permit is given only

when that contract cannot be obtained from the local market. This approach can be distinguished from the *Zambian* one, which allows for reinsurance with foreign companies at will. No special waiver is required and as a result the local market is never a priority.

CHAPTER 5

5.1 Conclusions

In a nutshell, this essay set out to review regulation of reinsurance in Zambia in comparison to other jurisdictions such as the US. In the course of the study, it was the author's intention to ascertain whether laws put in place act as a solution to problems experienced by the reinsurance industry. Further, to evaluate whether the laws in Zambia protect local insurers as they transact with foreign companies and finally to determine if the regulations forwarded by the law propel growth in domestic reinsurance. This was discussed in chapter one.

Chapter two discussed the legal framework in which Reinsurance operates in Zambia. It was revealed that *Zambian law does not contain specific provisions as regards to reinsurance*. Further the Act protects policy holders from abuse resulting from transactions with insurance companies but no provisions are available to protect insurance companies when bargaining with foreign reinsurance companies. This chapter fundamentally showed that the law is not comprehensive as regards to reinsurance. A lot of gaps are left as was tackled in the next chapter.

Chapter three was more or less a continuation of chapter two. It focused on the problems that are experienced by the reinsurance industry and all the players involved. Chapter three looked at whether the law addresses these problems adequately. This chapter concluded that there were gaps present in the regulation system in Zambia.

Chapter four was a review of regulations in the US, Canada and Argentina. It also looked at the study on regulation of reinsurance undertaken by the EU. This chapter basically, discussed reinsurance as practiced by the jurisdictions made above. The findings were briefly compared to what Zambia has to offer.

This research has shown that insurance supervision tends to be aligned on the basis of nation states. The globalized nature of a reinsurer's business may make supervision on a local basis inherently difficult. In designing a system of reinsurance regulation, it is essential that regulatory authorities consider the rationale upon which their system should be based. Obtaining knowledge

about how reinsurance regulation is implemented in other jurisdictions is instructive but confusing when there exists the significant variation of rationales of regulatory systems as shown in this study.

The fundamental question is whether one believes that reinsurance should be regulated. Assuming that one believes that it should, the next question is whether there should be established a system of direct regulation, indirect regulation, or both. Of course, the detail of the components of direct and indirect regulation is the most complex part of the equation.

The answer to the above question is yes. Reinsurance in Zambia should be regulated further. It is believed that further regulation of reinsurance will remedy the problems experienced. The present law as regards reinsurance is not adequate to prevent problems as capital flight, monopoly of industry by foreign companies and it does not protect local insurers from foreign companies.

However, it is important to appreciate the assurance of Zambian insurer's risks by foreign companies because they render services that the Zambian reinsurance industry cannot manage to give. Despite this, the paper does not wish to discuss whether foreign reinsurance companies should not operate in Zambia but rather advocates for emerging reinsurance companies in Zambia. It does so by saying, as much as foreign companies are allowed to function in the domestic industry, favourable policies should be adopted to stimulate growth of emerging companies. Therefore, in effect reinsurance laws do not provide fertile ground for the blooming of domestic reinsurance companies.

This paper as a whole adds to existing literature in the area of reinsurance by bringing out the elements of Zambian legislature concerning reinsurance in a comprehensive manner. It has shown that no particular policies are applicable to domestic reinsurers to enhance growth and improvement of the domestic industry. In addition, the paper shows the importance of an effective and efficient regulatory system for controlling the industry. Finally, it offers some

initial insight into other regulatory systems that have been known to be successful at improving their domestic markets.

5.2 Recommendations

In light of the issues discussed in this paper, the rationale upon which new laws could be made to regulate reinsurance would be to build a comprehensive set of laws regarding reinsurance. Regulation that is comprehensive and particular as opposed to the existing laws that take insurance and reinsurance as the same operation. Standard setters as the US have made specific laws applicable to reinsurance and as such have been able to cater for the difficulties that may be experienced by the reinsurance and not the insurer. For example, the US regulations reflected sound regulations when they put in place a mechanism to prevent loss for their local insurers in the event that companies they reinsure with become insolvent. The US achieved this by expecting the foreign company to obtain a licence before operating in the US in addition, the company is required to set up a branch or place collateral in the country. This is a clear instance of the law being used to protect a domestic market. Further, US also put a regulation requiring a foreign reinsurer to provide collateral and invest it in the US. The intention was to secure funds in case of insolvency but also ended up as a source of investment for the country. Such brilliant initiative is needed to build the *Zambian economy*.

The pensions and Insurance body is empowered to make secondary legislation issued pursuant to acts, principles and policy directives to fulfil its function of influencing the conditions of market access to the market. The PIA is able to decide how the *Zambian market* may be accessed and a recommendation is made to put local reinsurers as priority as shown in *Argentina*. When a risk is brought forward, it would be for the growth of the industry to allow the local companies to cover what they may and then pass the remainder on. It would be irrational to prohibit reinsurance with other countries because it is clear that the *Zambian industry* cannot cover certain risks, such as those in mines. Therefore local reinsurers should be given priority to help them increase capital base. The regulatory body should lay down rules for how those operating in the reinsurance industry must conduct their business. Thereafter the body should supervise compliance through on site supervision. This means physical inspection of local insurers to determine whether they

are complying with regulations. Equal treatment should be awarded by the supervisory body to local reinsurers and reinsurers born out of treaties. Equal treatment means equal opportunities and competition is fair this way.

It should be a requirement that foreign companies that wish to trade in Zambia should obtain a licence from PIA. This will make supervision of foreign companies easier. The industry does require fundamental changes to build skills and information infrastructure. More information should be available about insurance for an ordinary citizen. There is lack of sensitization as regards to insurance and as such many people do not purchase insurance. This is important to attain because the growth of insurance is in effect growth of the reinsurance industry. Additionally, officers of PIA should liaise and co-operate with other international organisations, particularly those involved in issues of financial markets supervision and promotion of financial growth, stability and integrity.

To some extent, Zambia has direct supervision for its local reinsurance companies. However, there is need to adopt indirect supervision of foreign companies that wish to cover risks in Zambia. An implementation of the above recommendations is a start to the enforcement of an indirect alley of supervision.

Further, the need for affordable health care for the ailing is a problem especially for developing countries such as Zambia. Clearly, most people with high medical costs cannot pay those costs themselves that is why they purchase insurance. However insurers are permitted to charge somewhat higher premiums for individuals with these higher health risks or for businesses that have more workers with high medical needs. Consequently, consumers who need care the most are the very ones who cannot obtain or afford coverage.

Many policymakers are exploring ways to expand health coverage. Lawmakers have put forth numerous proposals, including reinsurance, to make health care easier to obtain and more affordable. With this in mind, they ventured into the notion of public reinsurance. This is simply

a state government organizing and sponsoring a reinsurance program. A government-sponsored reinsurance program can equitably spread the highest-cost claims among insurers in a market. This is done when the government contributes additional revenue to the risks shouldered by insurance companies and in turn the insurance companies will reduce premiums paid to them by the consumer. This is an idea worth considering and adopting for a country like Zambia. More than three quarters of the population is living below the poverty line and to have government subsidize health care for an ordinary Zambian through reinsurance would make healthcare much more affordable.

There is need for a national reinsurance company to combat capital flight. The insurance companies reinsure large risks with foreign companies on the basis that domestic reinsurance cannot manage to cover the risks. Consequently the most profitable transactions are given to foreign companies thereby encouraging capital flight. However if a national reinsurance company were to be created, because of the kind of funding that the government can undertake, it may have to capital base to cover even the largest of risks. Coverage of these risks by a national reinsurance company would lessen capital flight. This company may also enter agreements of the nature that, when insurers purchase reinsurance, the national reinsurance may shoulder these risks hand in hand with domestic companies thereby handing them business opportunities.

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