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Reinsurance Contracts:

Why Governing Law Matters



Executive summary

In the world of reinsurance, the choice of governing law is often overlooked, yet it plays an important role in giving effect to the parties' expectations. Governing law determines how the terms of a reinsurance contract are interpreted, how disputes are resolved, and ultimately, how certainty and predictability are achieved. Despite its importance, many parties default to familiar or convenient choices, such as the law of their local jurisdiction or the governing law of the underlying insurance policies, without fully understanding the implications.

This paper explores why governing law matters in reinsurance contracts and how it impacts the rights, obligations, and remedies of the parties involved. It highlights the unique nature of reinsurance contracts, which are distinct from the underlying insurance policies they protect, and explains why aligning the governing law of reinsurance with that of the underlying policies is often unnecessary and impractical.

The paper examines the advantages of selecting a strong and reliable governing law, such as English law, which is widely used in international reinsurance markets, and addresses the choice of dispute resolution forum. We hope this paper may help you to make informed decisions about governing law, avoid unintended gaps in coverage, reduce the risk of costly disputes, and ensure your reinsurance contracts are fit for purpose in today's complex, globalised market.

Key definitions

Captive – an insurance company that is owned and controlled by a business or group of businesses. It is set up to provide insurance or reinsurance for the risks of its parent company or group.

Facultative reinsurance – a type of reinsurance where the reinsurer agrees to cover a specific, individual risk or policy. Each risk is negotiated and agreed upon separately.

Treaty reinsurance – a type of reinsurance where the reinsurer agrees to cover a portfolio or group of risks automatically, without needing to negotiate each one individually.

Follow the settlements clause – a provision in a reinsurance contract that requires the reinsurer to accept and pay its share of a claim that the insurer has settled. Typically, this will apply even where the insurer has disputed its liability to the insured, but has agreed to settle to avoid incurring potentially larger losses.

Introduction



When two parties to a contract agree the governing law, they are agreeing a set of principles and the legal system that will determine how their contractual obligations will be understood and how any disputes will be resolved. These concepts are critical, because they define what each party is entitled to do, or receive under the contract, and how they can address breaches or disputes.

When it comes to reinsurance contracts, the parties should carefully consider their choice of governing law. Reinsurance contracts are a specialist type of contract that are often complex, and few jurisdictions across the world have a developed and robust framework for interpreting them.

Common practice



In reinsurance contracts, due consideration for governing law is often an afterthought. Typically, the default position is to base the choice on the geographical location of one or more of the parties to the contract, or choose the governing law of the underlying insurance contracts.

The insurer looking to obtain reinsurance cover (known as the “cedant”) may feel more comfortable using the governing law of its local jurisdiction. Intuitively, it may seem sensible for the law governing the reinsurance to be aligned with the law of the underlying policies, to avoid perceived discrepancies due to diverging legal interpretations on the scope of the insurance cover. For captive reinsurers, there may be a preference to use the law of the jurisdiction of its parent group, because the group’s legal department is more familiar with it.

Whilst these choices are understandable, they can present unintended difficulties in the event of a dispute.

Reinsurance contracts are complex and few jurisdictions have a developed and robust legal framework for interpreting them.

Reinsurance as distinct from insurance

While the underlying insurance policies and the reinsurance contract are inextricably linked (they cover losses arising from the same risks), they represent two separate agreements between different parties, with different terms and different purposes. The purpose of the reinsurance is to provide an indemnity to the cedant in the event of losses covered under the insurance policies.

The governing law of the reinsurance contract doesn't impact how the insurer is responsible to their policyholder. That responsibility is decided based on the governing law of the insurance policy. Instead, the governing law of the reinsurance contract only applies to the relationship between the insurer and the reinsurer, covering their specific rights and responsibilities to each other. These include, for example:

- the rights of the reinsurer to have access to the cedant's underwriting and claims records,
- the consequences if the cedant fails to notify the reinsurer about a claim or potential claim,
- the extent to which a reinsurer can control or cooperate in the handling of an underlying claim,
- the question of whether a reinsurer is bound to follow a cedant's negotiated settlement of an underlying dispute, and
- the interaction between the terms of the underlying policy and the reinsurance contract.

It is not necessary to align the governing law of the reinsurance with the governing law of the insurance policies, because they deal with fundamentally different matters.

The reinsurance contract and the insurance contract are linked, but deal with fundamentally different matters. The governing law needn't always be aligned.

Moreover, the governing law of the reinsurance often cannot align with that of the underlying policies. For example, large multinational programmes often involve policies in multiple jurisdictions, with each policy governed by the law at the domicile of the locally insured or, at the location of the risk. If the lead insurer has reinsurance protecting its exposure to the programme, whether through a panel of co-(re) insurers, through a captive reinsurer, or facultative reinsurance, the lead will usually select one governing law, rather than subjecting the reinsurance to the governing law of each of the underlying policies. The same is true for treaty reinsurance covering a portfolio involving multiple territories.



How should parties choose the governing law?

In a limited number of jurisdictions, such as Australia, regulators require cedants to apply the local governing law to their reinsurance arrangements, but in most jurisdictions, parties are free to choose. Typically the cedant will wish to determine the governing law because the cedant usually has the greater exposure to the risk of dispute and should feel comfortable that the reinsurance cover is sufficiently “back-to-back”.

English law is often favoured by the international reinsurance market. The English insurance market has its origins in the 17th century and English law on reinsurance has been developing for more than 150 years. This being the case, many of the issues that commonly arise under reinsurance contracts have already been determined by the courts, with binding effect. This reduces uncertainty about how a reinsurance contract will respond, and in turn reduces the likelihood that a dispute at the reinsurance level will need to be litigated or arbitrated to be resolved.

Some examples where English law is settled on potentially complex reinsurance issues include:

- Follow the settlements: where a reinsurer has the benefit of a typical “*follow the settlements*” clause, the reinsurer is liable for its share of a loss settlement made by the cedant, provided the cedant acted honestly and took “all proper and businesslike steps” in making the settlement, and provided that the loss falls within the risks covered by the reinsurance. The reinsurer is not allowed to re-open the settlement, avoiding the need to re-litigate the underlying coverage issues.
- The order in which losses attach to a reinsurance contract: a cedant may not manipulate the order in which losses attach to different layers in order to increase its recovery. Each loss has to be met in the order in which it occurs (subject to any agreement to the contrary).
- The reinsurer’s ability to participate in claims: a reinsurer can rely on a condition permitting it to control or cooperate in underlying claims.
- How losses under a reinsurance agreement may be grouped together (or “aggregated”): there are numerous cases on the meaning of common words of aggregation such as “event”, “occurrence”, “cause” or “catastrophe”.
- How the terms of an underlying insurance policy are incorporated into the reinsurance contract: where the reinsurance contract contains a term that is also contained in the underlying policy, English courts will generally give the clauses the same meaning. This reduces the chance of unintended gaps in cover.

Whilst this doesn’t guarantee that no disputes will arise, England has a specialist commercial judiciary, which is very familiar with complex reinsurance concepts, meaning parties can be assured of a reasoned outcome.



By contrast, many other legal systems have rarely had to consider reinsurance matters and therefore many contain no reinsurance law at all. Where their courts have dealt with reinsurance disputes, the decisions tend not to be binding, particularly in civil law jurisdictions, and the issues can be re-litigated, leading to conflicting decisions and further uncertainty. In some jurisdictions the courts may take into account foreign law (and will often refer to English court decisions in particular) but are not obliged to follow them.



Does the jurisdiction for disputes need to match the governing law?

In our view, the most important consideration in choosing the dispute resolution forum should be whether the judges or tribunal have sufficient experience to determine the dispute fairly. As noted above, this cannot be guaranteed in the courts of many jurisdictions, given the rarity and specialised nature of reinsurance disputes.

Reinsurance contracts often now include arbitration clauses as standard, because they allow parties to mandate that the arbitrators have adequate industry experience, while also providing flexibility as to the substantive and procedural governing laws and practical considerations regarding where a dispute would be held.

Where the parties have chosen to arbitrate, it is generally preferable for the arbitration to be situated in a jurisdiction that is aligned with their choice of law. This makes it easier to select a panel and advocates that are familiar with the procedural requirements of the arbitration forum (“seat”), as well as the substantive law of the contract. However, it is also possible for parties to choose a seat of arbitration which is different to the governing law for reasons of geographical convenience or because of perceived advantages under the procedural law of a different seat. A good example of this is Bermuda Form policies, which are generally subject to New York law with the arbitration governed by English procedural rules. This is because English procedural rules are seen as more appropriate to commercial insurance disputes.

Conclusion

Reinsurance contracts are complex, specialised agreements that require careful consideration of their governing law. While it may be tempting to default to familiar or convenient choices, such as the law of a local jurisdiction or the governing law of the underlying insurance policies, these decisions can lead to unintended consequences. The governing law of a reinsurance contract is not a mere formality, it is the foundation upon which the rights, obligations, and remedies of the parties are built.

The governing law of a reinsurance contract plays a critical role in ensuring clarity, predictability, and fairness in the relationship between the cedant and the reinsurer. It determines how disputes are resolved, how key clauses like “follow the settlements” are interpreted, and how losses are aggregated or attached. A strong and reliable governing law, such as English law, provides a well-developed legal framework that reduces uncertainty, minimises the risk of disputes, and ensures that parties can rely on consistent and reasoned outcomes.

Parties entering into reinsurance contracts should approach the choice of governing law with the same level of care and diligence as they do other key terms of the agreement. This decision should be informed by the specific needs of the reinsurance relationship, the complexity of the risks involved, and the reliability of the governing law with regard to reinsurance-specific issues.

By making an informed and deliberate choice, parties can ensure their contracts are fit for purpose, reduce the likelihood of disputes, and foster stronger, more effective partnerships.



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