REINSURANCE AKA INSURANCE FOR THE INSURANCE COMPANY

Reinsurance is a contract between an insurance company, called the ceding company or cedent, and another insurance company, called the reinsurer, that transfers some of the ceding company's financial risks to the reinsurer.

Reinsurance provides the following:

- Capacity -Insurer has an amount of risk that they can cover. This is a “stop loss limit”. The Insurer purchases the excess amount that can be covered through a reinsurer.
- Financial Stability – Insurer receives a ceding commission when writing business. This provides immediate surplus of limits to the insurer.
- Underwriting Flexibility – May be able to insure for more difficult risks if the reinsurer is covering a portion of the exposure.

Reinsurer may reinsure some portion of the risk with other reinsurers known as a retrocession. This can then be done again by the retrocessionaires, and so on.

Reinsurance Treaty:

Ceding insurer agreed to cede and the reinsurer agrees to accept a share of business as specified in the treaty.

- Will exclude classes and/or exposures unacceptable to the reinsurer
- Insurer may go outside of treaty to arrange for separate reinsurance
- Reinsurer required to accept all risks that fall under treaty terms
- Does not incur agent commissions and fees, cost of issuing the policy, cost of inspections, other expenses – so they pay insurer ceding commission

Facultative Reinsurance AKA Facob

Reinsurance is negotiated individually for one specific policy of insurance.

- Facultative underwriter examines the risk and the terms and the conditions of the insurance policy being reinsured. The underwriter determines acceptability, terms and conditions, what portion of the risk they are accepting, and price.
- Unique and larger risks
- More expensive
- Open Cover or Facultative Obligatory – compels the reinsurer to accept the portion of any business of a certain class offered by a ceding insurer or a ceding broker. – Normally exclusive programs.
- Pool Arrangement – number of primary insurers agree to place all business of a certain type into the “pool”. Each member of the pool gets a prearranged percentage of the total premiums and agreed percentage of all losses. IE Terrorism, Marine, Aviation, Pollution, Nuclear, ETC.

Two Structures of Reinsurance

PRO-RATA OR SHARED RISK

Under a proportional or pro-rata, arrangement the reinsurer pays a percentage of each loss covered by the reinsurance policy. In return, it receives the same percentage of the original premium – less a ceding commission.

Two Types of Pro-Rata Reinsurance

Quota Share – Fixed percentage of each risk accepted by the primary insurer and covered by the treaty is ceded to the reinsurer. EX: 80% of the premium and losses for all policies covered by the treaty

- How much loss the ceding insurer retains depends on the size of each policy written and the design of the reinsurance program
- Can be written to provide the insurer with variable retention percentages depending on the category of risk. EX: treaty could provide that the insurer retain 50% and cede 50% to reinsurer for policies with limits under $1 Million.

Surplus Share – Primary insurer establishes its line for each risk. This is spelled out in multiples of the retention. In a three-line surplus share treaty, the treaty capacity would be three times the retention, subject to the treaty limit of liability

- Under most contracts, the ceding insurer is required to maintain a minimum dollar amount
- This amount is turned into a percentage – IE $500K of $1 Million policy would be 50%
- Insurers follow a line guide which specifies how much the insurer will retain on certain types of business

EXCESS OF LOSS CONTRACTS

Reinsurer pays only when losses incurred by the ceding insurer exceed some predetermined limit.

Forms of Excess of Loss Contracts

Per Risk – The reinsurer pays the loss on an individual risk in excess of a predetermined amount up to predetermined limit

Per Occurrence – The reinsurer pays only when the cumulative loss from any one occurrence exceeds the predetermined retention of the reinsured.

- Clash Cover or Contingency Cover – affords catastrophe coverage for losses that involve a combination of multiple coverages - for a single event

Stop Loss or Loss Ratio Aggregate– Reinsurer pays when the reinsurer's aggregate of net losses exceed a predetermined amount or proportion of premium income. EX: Reinsurance covers 90% of its losses in excess of 70% loss ratio up to 92% loss ratio.

Reinsurance can have many variations.

Ceding Commission

Under statutory accounting, an insurer must recognize its acquisition expenses immediately, but receives credit for premium only as it becomes earned during the policy period creating a temporary drain on surplus. To offset this accounting dilemma, the primary insurer can cede a portion of the risk to a reinsurer, receiving a ceding commission and thus enhancing surplus.

The insurer can enter the ceding commission immediately as an assets on its balance sheet. For example assume that an insurer with an initial surplus of $10 million writes $20 million of premium with a 25% acquisition costs of $5 million. Because that premium reserve of $20 million, reducing its surplus to $5 million:

$10 million surplus

+ $20 million written premium

-$ 5 million expenses

-$20 million unearned premium reserve

= $5 million new surplus

REGULATIONS OF REINSURANCE

Insurers receive a credit on their annual statement for the amount of loss ceded to reinsurers.

- Insurers still responsible for loss whether reinsurance pays or not
- Must place insurance with licensed and accredited reinsurers in the insurer's state of domicile
- Alien reinsurers must provide acceptable collateral in the form of cash, a letter of credit, or a trust fund.
- Insurers are penalized on their balance sheet for reinsurance recoverables more than 90 days past due

Insurer Insolvent

- Liquidator or Conservator appointed by state to supervise insolvent insurer assets
- Reinsurance contracts generally include insolvency clause. This makes the full reinsurance payable, regardless of the insolvency of the reinsured.

CUT-THROUGH CLAUSE

A form of direct contractual relationship with a policyholder with a cut-through clause in the reinsurance contract. A cut-through clause or assumption certificate is an agreement between the reinsurer and the primary or ceding insurer.

- Spells out circumstances the insurer shall go into the hands of a receiver, assignee, trustee or successor or the purpose of liquidation, or on account of insolvency. This will detail what the reinsurer will pay to a third party, other than the reinsured insurer, any amounts that the reinsurer may become liability to pay under the contract of reinsurance.
- A specific cut-through clause permitting direct recourse by a policyholders is rarely found in reinsurance contractors, unless there is a group under the same controlling ownership.
- Contracts of indemnity not in favor of the Insured
- Not easily obtained- normally needed due to lack of financial stability
- Some courts have invalidated due to they create a privileged class of creditors

Bordereaux: used in surplus line area with MGA' s also; usually monthly reports of what written, certain terms and usually separate claims bordereaux.

Would suggest becoming familiar with some of the basic terms including quota share, excess of loss, treaty, facultative, gross and net lines, retrocession.

A Glossary of Reinsurance Terms

Bordereau (plural Bordereaux): A form providing premium or loss data with respect to identified specific risks which is furnished the reinsurer by the reinsured.

Burning Cost: A term most frequently used in spread loss property reinsurance to express pure loss cost or more specifically the ratio of incurred losses within a specified amount in excess of the ceding company's retention to its gross premiums over a stipulated number of years.

Cede: When a company reinsured its liability with another, it "'cedes" business. Ceding Company: The original or primary insurer; the insurance company which purchases reinsurance.

Cession: The unit of insurance passed to the reinsurer by the ceding company; it corresponds with the policy units of any insurance company. A cession may accordingly be the whole or a portion of (a) single risks or (b) defined policies or (c) defined divisions of a policy as agreed.

Commutation Clause: A clause usually found in Lloyd's treaties, which provides for estimation, payment and complete discharge of all future obligations for reinsurance losses incurred regardless of the continuing nature of certain losses such as unlimited medical and lifetime benefits for Workmen's Compensation.

Contingent Commission (or Profit Commission): An allowance payable to the ceding company in addition to the normal ceding commission allowance. It is a predetermined percentage of the reinsurer's net profits after a charge for the reinsurer's overhead derived from the subject treaty.

Cover Note: A document issued by an agent or a broker which tells the insured that the agent or broker has effected the insurance described therein. Since there are often delays in issuing, a cover note gives the insured a description of what insurance the agent or broker has put in effect. A cover note is similar to a binder although a binder has greater validity, being a document issued by a company or its agent instead of one given by the broker to his customer.

Excess of Loss Reinsurance: A form of reinsurance which indemnifies the ceding company for that portion of the loss (arising out of a loss occurrence) which is in excess of a stipulated sum or primary retention of the ceding company. Excess of Loss is the normal form of reinsurance of liability risks, but it also has special applications in all branches. It should never be confused with Surplus, which in reinsurance always refers to a pro rata distribution of the original coverage when it exceeds specified amounts.

Ex Gratia Payment: A payment made for which the company is not liable under the terms of its policy. Usually made in lieu of incurring greater legal expenses in defending a claim. Rarely encountered in reinsurance as the reinsurer by custom and for practical reasons follows the fortunes of the ceding company.

Facultative: Facultative reinsurance means reinsurance of individual risks by offer and acceptance wherein the reinsurer retains the "faculty" to accept or reject each risk offered.

Following the Fortunes: The clause stipulating that once a risk has been ceded by the reinsured, the reinsurer is bound by the same fate thereon as experienced by the ceding company.

Gross Line: The amount of insurance the company has on a risk including the amount is has reinsured. Net lines plus reinsurance ceded equal gross lines.

Net Line: (1) The amount of insurance the company carries on a risk after deducting reinsurance from its gross line; (2) The maximum amount of loss on a particular risk to which an insurer or reinsurer exposes itself without reinsurance.

Over-Line: A commitment by an insurer or reinsurer above and beyond its normal facilities or capacity.

Overriding Commission: An agent or a general agent may have the sole privilege to represent a company in a certain territory and have a contract whereby he is entitled to a commission on any business which a company may write in his territory or through one of his sub-agents. That portion of the commission which the general agent or supervising agent keeps is termed the "overriding commission." The terms Overriding Commission and Overwriting Commission are interchangeable. In reinsurance, the broker who receives a commission for placing a retrocession of a reinsurer through yet another broker receives an overriding commission.

Per Risk Excess Reinsurance: Retention and amount of reinsurance apply "per risk" rather than on a per accident or event or aggregate basis.

Pool: An organization of insurers or reinsurers through which particular types of risks are underwritten with premiums, losses, and expenses shared in agreed ratios.

Portfolio Reinsurance: In transactions of reinsurance, it refers to all the risks of the reinsurance transaction. For example, if one company reinsures all of another's outstanding Automobile business, the reinsuring company is said to assume the "portfolio" of Automobile business and it is paid the total of the unearned premium on all risks so reinsured (less some agreed commission).

Quota Share: The basic form of participating treaty whereby the reinsurer accepts a stated percentage of each and every risk within a defined category of business on a pro rata basis. Participation in each risk is fixed and certain.

Reinstatement Clause: When the amount of reinsurance coverage provided under a treaty is reduced by the payment of a reinsurance loss as the result of one catastrophe, the reinsurance cover is automatically reinstated usually by the payment of a reinstatement premium.

Reinstatement Premium: A pro rata reinsurance premium is charged for the reinstatement of the amount of reinsurance coverage that was reduced as the result of a reinsurance loss payment under a catastrophe cover.

Reinsurance: The practice whereby one party called the Reinsurer in consideration of a premium paid to him agrees to indemnify another party, called the Reinsured, for part of all of the liability assumed by the latter party under a policy or policies of insurance which it has issued. The reinsured may be referred to as the Original or Primary Insurer, or Direct Writing Company, or the Ceding Company.

Retention: The net amount of risk which the ceding company or the reinsurer keeps for its own account or that of specified others.

Retrocession: A reinsurance of reinsurance. Example: Company "B" has accepted reinsurance from Company "A", and then obtains for itself, on such business assumed, reinsurance from Company "C". This secondary reinsurance is called Retrocession.

Self-Insurance: Setting aside of funds by an individual or organization to meet his or its losses, and to absorb fluctuations in the amount of loss, the losses being charged against the funds so set aside or accumulated.

Slip: The piece of paper submitted by the broker to the underwriters at the "boxes" in the "room" at Lloyd's of London on which the Syndicates accepting the risk are identified and the extent of their participation is noted.

Stop Loss Reinsurance: A form of reinsurance whereunder the reinsurer reimburses the ceding company for the amount, if any. by which the latter's incurred losses during any calendar year for a specified class of business exceeded a specific loss ratio. Used particularly in classes of insurance with wide fluctuations in losses from year to year, such as hail insurance.

Surplus Line: A term originating in property insurance, commonly used to describe any risk or part thereof for which there was no available market to the original broker or agent. Now generally translated to mean business, which would otherwise be subject to regulation as to rate or coverage, placed in non-admitted markets on an unregulated basis in accordance with the Surplus or Excess Line provisions of state insurance laws.

Surplus Relief: The use of admitted reinsurance on a portfolio basis to offset unusual drains against policyholders' surplus. The ceding company recaptures equity in unearned premium reserves on the business ceded through the ceding commission allowed by the reinsurer against the gross premiums ceded.

Surplus Share: A form of proportional reinsurance where the reinsurer assumes pro rata responsibility for only that portion of any risk which exceeds the company's established retentions.

Treaty: A general reinsurance agreement which is obligatory between the ceding company and the reinsurer containing the contractual terms applying to the reinsurance of some class or classes of business, in contrast to a reinsurance agreement covering an individual risk. For different forms see Quota Share, Excess of Loss, First Surplus, Second Surplus, Spread Loss, Stop Loss, and Catastrophe.

Ultimate Net Loss: This term usually means the total sum which the assured, or any company as his insurer, or both, become obligated to pay either through adjudication or compromise, and usually includes hospital, medical and funeral charges and all sums paid as salaries, wages, compensation, fees, charges and low costs, premiums on attachment or appeal bonds, interest, expenses for doctors, lawyers, nurses, and investigators and other persons, and for litigation, settlement, adjustment and investigation of claims and suits which are paid as a consequence of the insure loss, excluding only the salaries of the assured's or of any underlying insurer's permanent employees.

Underlying: In respect to Excess of Loss coverages, refers to that amount of risk which attaches before the next higher layer of insurance or reinsurance.

Working Layer: An area of excess reinsurance in which loss frequency is anticipated. The rating approach to such a layer is usually on a retrospective basis.