Sri Lanka Insurance Brokers Association

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Reinsurance Concepts and Practices

06th September 2023

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Topics Covered

- Introduction to Reinsurance
- Coinsurance

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- Reinsurance Arrangements
- Features, advantages and disadvantages of Facultative and Treaty Reinsurance

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- Proportional and Non-Proportional Treaty Arrangements
- Reinsurance Terminology

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Introduction to

Re-Insurance

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The Basics

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- Insurance: Risk transfer mechanism from client to the insurance company
- Reinsurance: Risk transfer mechanism from an insurance company to another insurance or reinsurance company
- Similar to the primary contract; risk transfer. The uncertainty of loss or no loss and the uncertainty of the frequency and severity of the loss.
- Protection of common pool against adverse effects: Larger than expected losses can have adverse effect on the portfolio/balance sheet
- Ensuring reasonable profit to shareholders from carrying the risk
- Spreading of risk among larger community of insurers locally or overseas

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What is Reinsurance?

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- Reinsurance is insuring again by an insurance company with another insurer or reinsurer of the whole or part of a risk that the insurer has already assumed/insured
- “Reinsurance is the insurance of the risk assumed by the insurer”
- It’s a risk transfer mechanism in exchange for a premium
- The company reinsuring is known as the ‘Ceding Company’ or ‘The Reinsured’ and the company accepting the reinsurance is known as ‘The Reinsurer’
- REINSURANCE does not exist without INSURANCE

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Definition of Reinsurance

“A contract
whereby one for a consideration,
agrees to indemnify another wholly or
partially against loss or liability
by a risk the latter has assured
under a separate and
distinct contract as insurer of a third party”

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Reasons for Reinsurance

- Security: Peace of mind from uncertainty loss (frequency and/or severity)
- Stability: Avoid fluctuations in claims costs year to year
- Capacity: Limited liability companies, hence, limited capacity. Enables the insurer to accept business beyond their capacity
- Catastrophe: Effects of large number of claims from a single event
- Macro benefits: Spreading the risk among many players and economies

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Why Reinsure?

- One very large individual loss can wipe out an insurance/ reinsurance company's net assets
- Several single large losses in any one year can destabilize the financial position of the company such as motor, medical, third party liabilities
- Series of losses arising out of one event, such as natural catastrophes, tsunami, could be a drain on reserves
- One event involving accumulation of a very large number of small individual losses (floods, conflagrations)

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Principles for Reinsurance

The FIVE Principles apply to Reinsurance as well

- Insurable Interest – insurer has the legal right to insure again due to the assumed risk/liability under the primary insurance contract
- Utmost Good Faith – Insurer cannot withhold information and must act in good faith with the reinsurer
- Proximate Cause – if it is not excluded, it is reimbursed by the reinsurer
- Indemnity including Subrogation and Contribution – indemnify the loss; no loss no profit; reinsurer too is entitled
- Arbitration – efficient way in settling disputes

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Retrocession

Retrocession is a risk transfer from one reinsurance company to another insurance or reinsurance (usually) company

Retrocession: The transfer of all or part of a reinsurance risk from one reinsurer to another

Retrocessionaire: The reinsurer that contractually assumes all or part of a reinsurance risk from another reinsurer. The transfer is known as retrocession

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Alternatives for Reinsurance

- Limit acceptance to an amount comfortable to the company based on risk appetite
- Increase Share capital
- Be selective in acceptance
- Participate in coinsurance
- Decline risk

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Reinsurance Working

Original Insured → Risk is passed to → Primary Insurer → Part of the risk is passed to → Reinsurer

Original Risk Rs. 10 m → Insurance → Retains Rs. 2 m / Cedes Rs. 8 m → Reinsurance → Accepts Rs. 8 m

Claim

Claim recovery

Source: Reinsurance for Beginners 3rd Edition – R Philippe Bellerose FCII

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Elements of Reinsurance

- ⌘ Distinct and separate contract from the original Insurance
- ⌘ Do not provide wider cover than the originally insured as per the original policy or as per subsequent amendments to the insurance policy through renewal or endorsement
- ⌘ Must cover the same risk as the original insurance
- ⌘ Both Insurance and Reinsurance contract must exist at the same time

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Reinsurance DOES NOT DO

- ✕ Enable the insurer to accept bad/poor risks
- ✕ Protect the insurer against the consequences of inadequate primary rates or conditions
- ✕ Enable the insurer to keep the good risks and divest itself or reinsure of the unacceptable risks
- ✕ Accept a risk it would not otherwise accept
- ✕ Be lethargic in underwriting practices
- ✕ Be ‘Flexible’ in paying claims

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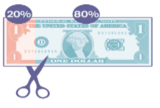

Coinsurance

- Coinsurance is where two or more insurers share the risk in agreed proportions. They are in direct contractual relationship with the Insured as ‘Coinsurers’ of the risk.
- Coinsurance is NOT Reinsurance.
- Coinsurance is done when;
  - Total sum insured is too large to be accepted by one insurer or has no capacity to accept the full risk or has a limitation on the reinsurance arrangements
  - Insured or broker wishes to involve several insurers than placing with one insurer (security or commercial reasons)

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Procedures for Coinsuring risks

- ❖ Usually a broker gets involved
- ❖ Each insurer signs up for a particular share of the risk
- ❖ The Policy will depict the names of the insurers along with their shares and the policy is subject to a ‘Coinsurance Clause’
- ❖ A collective single policy is issued by the Leading Insurer of the panel of insurers
- ❖ Leading insurer means the insurer who usually accepts the largest share of the risk
- ❖ The Leader is responsible for
  - ❖ All negotiations with the Insured or broker
  - ❖ Arranging surveys
  - ❖ Calculating and collecting premium
  - ❖ Issuing policies and endorsements

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Procedures for Coinsuring risks

Contd.

- ❖ Leading insurer handles any changes to the policy, unless there is an unusual request where all coinsurers require sign-off
- ❖ Coinsurers usually pay 5% of their share of the premium to the leader to cover Lead Insurer’s expenses (not in Sri Lanka)
- ❖ Other participating insurers in the panel should check the premiums and policy terms whether they are in line with their acceptance
- ❖ Each insurer is responsible and liable for its own share and not for others, even if one of the insurers in the panels becomes insolvent
- ❖ Each insurer can decide on liability independently.

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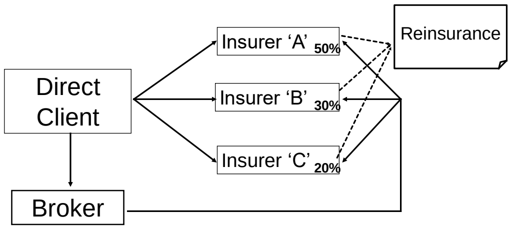
Coinsurance



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2nd Session

- Reinsurance Arrangements
- Features, advantages and disadvantages of Facultative and Treaty Reinsurance

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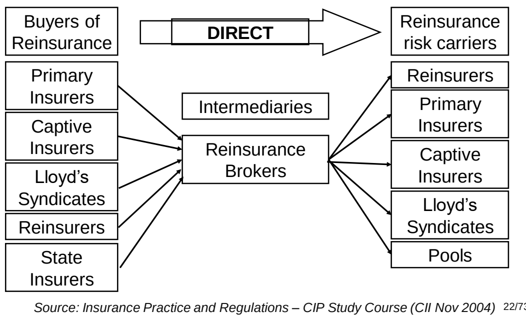
Typical Reinsurance Market



Source: Insurance Practice and Regulations – CIP Study Course (CII Nov 2004) 22/73

Buyers of Reinsurance

- Primary Insurers: the insurer who accepts business from the public
- Captive Insurers Companies: insurance company set-up to cover the risks of the parent company
- Lloyd's Syndicates: similar to a primary insurer seeking to spread the risk
- Reinsurers: Reinsurance companies in turn buying reinsurance
- State Insurance Corporations: State insurance corporations and Government Catastrophe insurance Pools

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Intermediaries: Reinsurance Brokers

- ✓ The party that brings the buyer of reinsurance to enter into a contract with the reinsurance risk carriers
- ✓ They have specialist knowledge of the reinsurance risk carriers and markets (Lead Markets and Follow Markets)
- ✓ To operate, the broker must have two markets; one to acquire the business and the other to place the business

The reinsurance brokers offer following services:

- ✓ Advice the client on their reinsurance needs; more of a consultant and seek to place 100% of the order given
- ✓ Pay premiums to the reinsurers as soon as collected
- ✓ Current accounting position with its reinsurers
- ✓ Inform client's large losses to reinsurers
- ✓ Collect claims from various reinsurers and remit to the client promptly
- ✓ Advise on preparation of wordings for the reinsurance agreement and reinsurance documentation
- ✓ Selection of lead reinsurers and market information
- ✓ Technical advice and training facilities

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Reinsurance Brokers

The reinsurance broker also provide the following:

- ☺ Security of reinsurers
- ☺ Stability and continuity of reinsurers
- ☺ Selection of leading reinsurers
- ☺ Reinsurance programming
- ☺ Technical advice
- ☺ Arrange reciprocity
- ☺ Reinsurance documentation
- ☺ Market information
- ☺ Training facilities

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Carriers (Sellers) of Reinsurance

- ▲ Reinsurers: Large companies specialised in reinsurance. Do not write any primary insurance. Large international companies such as Munich Re, Swiss Re, GIC Re, Toa Re, SCOR, China Re, Korean Re
- ▲ Primary Insurers: also transact reinsurance
- ▲ Captive Insurance Companies: can accept reinsurance on a small scale. Reinsurance of other captives
- ▲ Pools: Pool are established to write very large risks. Made up of organisations with same risk issues
- ▲ Lloyd's Syndicates: a large portion of the business written are reinsurance

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Retention

- It is the amount of the risk which the insurer is willing "to pay out of its own pocket" in the event of a claim. It is the limit of liability, which the insurer retains for its own net account after reinsurance ceded
- It is the most important factor in planning the development of any underwriting portfolio
- The retention could be either a monetary amount or a percentage share
- The retention may apply to a single risk, or to a series of risks, or to a single loss or a series of losses
- The higher the loss probability, the lower the ceding company's retention
- Retentions are usually fixed for each class of business (Fire, Motor, Marine) with further sub-divisions (marine hull & cargo)
- Following factors influence the retention:
  - Assets, capital and free reserves, solvency
  - Size of the portfolio, premium income & profitability
  - Experience, appetite and loss experience
  - Type and spread of risk
  - Types and forms of reinsurance
  - Management philosophy

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Underwriting limit or Capacity

= Own Retention + Reinsurance capacity

Example:

Rs. 10 m + Rs. 250 m = Rs. 260 m

Total UW Capacity

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Forms and Types of Reinsurance

REINSURANCE								
FACULTATIVE			TREATY					
Proportional	Non-Proportional		Proportional			Non-Proportional		
	Excess of Loss	Stop Loss	Quota Share	Surplus	Facultative Obligatory	Excess of Loss		Stop Loss
						Risk XL	Catastrophe XL	

Source: Reinsurance for Beginners 3rd Edition – R Philippe Bellerose FCII

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Use of Facultative Reinsurance

- ╬ Where the insurer requires cover beyond the automatic capacity
- ╬ Where the risk is excluded under the insurer's treaty
- ╬ Where the insurer does not want to cede to the treaty
- ╬ To reduce the exposure due to accumulation of risks
- ╬ Where the original risk is hazardous
- ╬ To seek expertise and experience of the reinsurer
- ╬ Due to commercial, financial, strategic and reciprocal reasons
- ╬ To obtain capacity when the insurer's volume of business does not justify a treaty

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Features of Facultative Reinsurance

- Facultative reinsurance is the oldest form of reinsurance
- Facultative means ‘optional’; both parties have no obligation to enter into a contract
- Each risk is offered individually and the reinsurer can decide whether to accept or decline.
- Reinsurer could also decide on the terms of cover or offer alternate terms
- Facultative reinsurance or Fac applies to single insurance contract

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Advantages of Facultative Reinsurance

- Reinsurers can negotiate individually the terms of cover
- In terms of capacity, it increases insurer’s competitive edge
- Mainly used to reinsure special risks either which are outside the scope of automatic facilities or for protection of the treaty
- To reinsure amounts in excess of existing treaty facilities
- To reduce the exposure due to accumulation of risks
- Insurer might benefit from the specific knowledge of the reinsurer

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Disadvantages of Facultative Reinsurance

- It Involves great deal of clerical time, effort, costs and other administrative work
- Cannot rely on successful full or part placement
- Requires full disclosure of the information relating to the risk
- Cannot give immediate cover until the full placement is complete
- Commission rates are much lower than on treaty
- Cannot make any changes to the original insurance contract without the sanction of the facultative reinsurer
- May compel the insurer to change the terms of cover and/or premium

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Line Slips/Broker Binders

- More favored in the direct insurance market
- Automatic facility offered by a large direct insurance or reinsurance broker
- Line slip could be provided by 2 - 3 leading reinsurers
- Broker Binders – underwriting authority delegated to the broker

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Treaty Reinsurance arrangements

Proportional Treaties

- Primary insurer decides the portion to accept and agrees to cede the balance (share of the risk)
- Premiums and losses are shared in the same proportion

Non-proportional Treaties

- Are based on the size of the loss rather than the sums insured
- Reinsurer agrees to pay an amount over and above a certain amount (in excess of) the primary insurer agrees to pay

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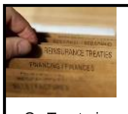

Features of Treaty Reinsurance

- Treaty is an agreement between the primary insurer and reinsurer to accept all risks within certain parameters
- Treaty reinsurance applies to all contracts in a portfolio
- No individual offer and acceptance
- The reinsurer cannot refuse to accept and primary insurer cannot select risks and offer; i.e. obliged to cede and obliged to accept – automatically bound in advance
- The primary insurer has automatic reinsurance facility
- The reinsured receives a ceding commissions on proportional treaties
- Agreement is for a particular period of time (usually for 12 months)
- Treaty as a contract document has terms, conditions and exclusions which the insurer has to comply
- Terms are negotiated at each renewal
- Non-proportional treaties have ‘Reinstatement’ which replenishes the exhausted limits

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Advantages of Treaty Reinsurance

- As there is no individual offer and acceptance, its less administrative procedures
- Treaty commissions to defray business acquisition costs and additional profit commissions if the business is profitable on proportional treaties
- Simplified accounting procedure by way of quarterly accounts (bordereaux)
- As treaties deal with large number of homogeneous risks, computer technology can be easily used

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Disadvantages of Treaty Reinsurance

- Both parties are tied into the contract and cannot be cancelled prior to the expiry of the period (usually one year). Cancellation affects the reputation of the ceding company
- Terms once negotiated cannot be changed during the period; only at renewal
- Too much premium can be lost to the reinsurer on good risks (quota share)
- Blind treaties: unlimited exposure to the Treaty Reinsurers
- The results of the primary insurer and the Treaty Reinsurer could differ

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3rd Session

- ➢ Proportional and Non-Proportional Treaty Arrangements
- ➢ Reinsurance Terminology

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Treaty Reinsurance arrangements

- Proportional Treaties
  - Quota Share treaty
    - Primary insurer defines a fixed portion (%) of every risk and agrees to reinsure the balance portion
    - Premiums and losses are shared in the same percentage
  - Surplus treaty
    - Primary insurer decides how much of each risk it wants to retain (line) for his own account (retention)
    - Premiums and losses are shared in the same proportions (lines)
- Non-proportional Treaties
  - Excess of Loss treaty
    - The ceding insurer pays the first Rs. x of losses arising from an event
    - Reinsurer pays Rs. y in excess of Rs. x
    - Risk Excess of Loss
    - Catastrophe Excess of Loss
  - Stop Loss treaty
    - Protection of the entire portfolio of risks rather than for individual losses
    - When the loss ratio exceeds a particular figure, the reinsurers agree to pay a certain percentage

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Quota Share Treaty Reinsurance arrangement

TSI : Rs. 20 m | Program:25%:75% | Claim : Rs. 1 m

Primary insurer decides to retain 25% of the risk → Primary insurer retains Rs. 5 m of the risk (25%) → Reinsures the balance 75% of the risk (Rs. 15m)

Client receives Rs. 1 m ← Pays 250,000- ← Pays 750,000-

Total Sum Insured	Primary Insurer retains	Reinsurer accepts
1,000	250	750
100,000	25,000	75,000
1,000,000	250,000	750,000
*50,000,000	12,500,000	37,500,000

** There is a maximum acceptance of TSI in the QS treaty agreement* 41/73

Quota Share Treaty

- A Quota Share treaty is an agreement whereby the ceding company is bound to cede and the reinsurer is bound to accept a FIXED PORTION of every risk accepted by the ceding company; usually represented by a % of the TSI
- It is advantageous to the reinsure as they receive a share of each and every risk and obtains a larger share of the profits, if the portfolio is profitable
- Advantages to the INSURER are:
  - Simple to operate
  - Higher commissions and better terms
  - Beneficial for a new company or new class of business because of unknown experience
- Disadvantages to the INSURER are:
  - Large amounts of income are ceded away on a fixed portion
  - The sizes of the risk are not homogeneous

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Surplus Treaty Reinsurance arrangement

TSI : Rs. 50 m | Program:25 lines treaty | Claim : Rs. 1 m

Primary insurer decides to retain Rs. 5 m of the risk → Primary insurer retains 5/50th of the risk → Reinsures the balance 45/50th of the risk (Rs.45 m)

Client receives Rs. 1 m ← Pays 100,000- ← Pays 900,000-

T S I	Primary Insurer retains	Reinsurer accepts
1,000,000	1,000,000	-
5,000,000	*max.* 5,000,000	-
100,000,000	*max.* 5,000,000	95,000,000
*200,000,000	*max.* 5,000,000	*max.* 125,000,000

Balance Rs. 70 m → Facultative, coinsure or limit acceptance

** There is a maximum acceptance of TSI in the QS treaty agreement*

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Surplus Treaty

- A Surplus treaty is an agreement whereby the ceding company is bound to cede and the reinsurer is bound to accept the surplus liability over the ceding company's retention
- The capacity of a Surplus treaty is always a multiple of the ceding company's retention and referred to as "LINES" (e.g. 20 lines treaty or 50 lines treaty)
- Advantages to the INSURER are:
  - Allows the ceding company to retain greater portion of the income
  - Better control over the maximum liability payable
  - Portfolio becomes homogeneous
- Disadvantages to the INSURER are:
  - More administration
  - The 2nd or 3rd Surplus treaties will receive lower commissions

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Facultative Obligatory Treaty

- It has both the characteristics of Facultative and of obligatory treaties
- It is an agreement where the ceding company has the option to cede (not bound as for treaty risks) and the reinsurer is bound to accept (no option to decline as for facultative arrangement)
- It normally comes after a surplus treaty and gives automatic reinsurance facilities to the ceding company when the capacity under the treaty has been exhausted
- It acts as a further surplus treaty except that there is no compulsion to cede
- Usually ceded when other more beneficial arrangements cannot be found

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Facultative Obligatory Treaty *Cont…..*

- Advantages to the INSURER:
  - Immediate reinsurance after treaty facilities
  - Automatic facility for risks of specific nature or irregular patterns
- Disadvantages to the REINSURER:
  - No control can be exercised over the business ceded
  - No flow of business can be guaranteed as under a quota share or surplus
  - There is a danger of anti-selection by the ceding company
- The only advantage to the REINSURER is that the method allows to have a slightly better spread of risks than the facultative method

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Pools

- A POOL is a creation of a common fund by its members for a particular category of business, specially for catastrophes
- Pools are established to cover risks where the local market is not receptive to provide insurance protection
- The members contribute all or part of the premiums
- Examples of Pooling arrangements: Government Riot & Strike and Terrorism Fund, Earthquake Pool, War Pool, Nat Cat Pool
- The members share the claims in the same proportion as premiums or on an agreed basis

- Profit, losses and expenses are shared among members
- Advantages are:
  - Allows the members to transfer risks which otherwise were not insurable
  - Reduce reinsurance premium outgo from the country
- Disadvantages are:
  - Accumulation of risks of a similar nature (XOL protection)
  - Inadequate resources to handle a single event

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Introduction to Non-Proportional Reinsurance

- Do not share the premium in the same proportion
- Do not share the losses in the same proportion
- Accepts liability for losses in excess of an agreed amount
- Agreed amount is known as the 'Deductible', 'Priority' or 'Retention'
- Priority is single risk (Risk XL) or accumulation of losses per event (CAT XL)
- Predetermined number of total losses
- When the loss cover is exhausted, need for reinstatement and reinstatement could be free or at an additional premium

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Non-Proportional Treaty Reinsurance arrangements

Excess of Loss treaty

- The ceding insurer pays the <u>first Rs. x m</u> of losses arising from an event
- Reinsurer pays Rs. y m in excess of Rs. x m

- Risk Excess of Loss
- Catastrophe Excess of Loss

Stop Loss* treaty

- Protection of the <u>entire portfolio</u> of risks rather than for individual losses
- When the loss ratio or amount exceeds a particular figure, the reinsurers agree to pay a certain percentage over the predetermined amount

** Also known as Excess of Loss Ratio*

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Non-proportional Treaty Reinsurance arrangements *Contd…..*

Primary insurer decides to pay any claim up to Rs. 1.5 m

Any claim up to Rs. 1.5 m will be borne by the insurer

Reinsurer pays the excess over Rs. 1.5 m

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Treaty Excess of Loss

- A predetermined sharing of losses for a given period of time
- Fixed monetary amount to retain
- Fixed monetary amount to reinsurer
- There could be several "Layers" of XOL's as below

THIRD LAYER	Rs. 75 m
SECOND LAYER	Rs. 23.5 m
FIRST LAYER	Rs. 10 m
RETENTION	Rs. 1.5 m

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Excess of Loss Treaty Reinsurance arrangements

1st Layer : Rs. 10 million in excess of Rs. 1.5 million
2nd Layer : Rs. 23.5 million in excess of Rs. 11.5 million
3rd Layer : Rs. 75 million in excess of Rs. 35 million

Claim Rs.	Own	1st Layer	2nd Layer	3rd Layer	Total
1.2 m	1.2 m	-	-	-	1.2 m
7.5 m	1.5 m	6.0 m	-	-	7.5 m
30.0 m	1.5 m	10.0 m	18.5 m	-	30.0 m
50.0 m	1.5 m	10.0 m	23.5 m	15.0 m	50.0 m
120.0 m	1.5 m	10.0 m	23.5 m	75.0 m	*110.0 m

** Insurer will bear additional Rs. 10 m unprotected*

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Treaty Excess of Loss Reinstatement Premium Calculations

Treaty Structure	Minimum & Deposit (M&D) Premium	No. of Reinstatements
1st Layer: 40 m xs 10 m	500,000-	2
2nd Layer: 60 m xs 50 m	400,000-	1

Adjusted Loss: Rs. 25 million

Insurer bears : Rs. 10 million
1st Layer pays : <u>Rs. 15 million</u>
Rs. 25 million

Reinstatement Premium (1st Layer):
$\frac{\text{Rs. 500,000-}}{\text{Rs. 40,000,000-}}$ X 15 million = Rs. 187,500-

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Types of Excess of Loss Treaties

1. RISK OR WORKING EXCESS OF LOSS

- Its an arrangement for the protection for the Reinsured should a loss occur on an individual policy which is greater than the predetermined monetary amount the Reinsured is prepared to pay
- Each and every loss which is less than the amount (retention/ deductible/priority/first loss) is borne by the Reinsured
- Reinsurer will respond only if the loss exceeds this predetermined amount up to the contractual limit
- Level of deductible; balance should be maintained
  - Too low; higher reinsurance cost.
  - Too high; paying both the claims and reinsurance premium

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Types of Excess of Loss Treaties

2. CATASTROPHE EXCESS OF LOSS

- Loss event : series of losses arising out of one event
- Accumulation of many single claims arising out of one peril; accumulation of each & every own retention claims under a proportional treaties or Risk XL treaties
- Losses are usually associated with natural perils or conflagrations; occasional and infrequent but major losses
- Two or more risks : "Two Risks Warranty"
- Retention should be greater than any Risk Excess of Loss treaties
- Event hour (usually 72 hours) clause
- It could be all types of losses or restricted perils

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Types of Excess of Loss Treaties

3. STOP LOSS OR EXCESS OF LOSS RATIO

- To cover aggregate losses for a particular class or classes of business for a particular period, usually for a calendar year
- It is used to protect the reinsured's net absolute retained account against attritional losses; relatively small but potentially substantial (medical, motor)
- Stop Loss contracts are expressed in percentage amounts. For example, the (re)insurer can recover 75% of the GNPI if the claims ratio exceeds of 105% of GNPI
- Could also be in monetary amounts. For example, Rs. 25 million in excess of Rs. 5 million

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Facultative Excess of Loss

- Special placement of risks on a case by case basis on XOL
- The direct insurer selects a fixed monetary amount to retain
- The Reinsurer covers the excess amounts up to a defined monetary amount
- In the event of a claim, the insurance company retains all losses up to the retention selected
- The Reinsurer offers full reimbursement above retention
- Will need to pay 'Reinstatement Premium' if the facility is to be reinstated and/or such is given in the contract

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Facultative Excess of Loss

Advantages

- Has a greater control over the amount to be paid to the reinsurer
- Common to place on Estimated Maximum Loss (EML) basis
- Risks are considered individually
- Offer high capacity
- Insurer retains greater share of the premium

Disadvantages

- Successful placement is doubtful
- Full risk details and loss information
- Insurer to bear losses below the excess
- EML might be wrong
- Administration

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Distinctions between Proportional and Non-Proportional Reinsurance

PROPORTIONAL REINSURANCE	NON-PROPORTIONAL REINSURANCE
The original risk, premium, claims and acquisition costs are shared between the insurer and the reinsurer	The retention of the reinsured is a monetary barrier before the reinsurer gets involved
The treaty "follows the fortunes" of the original policy	The premium is calculated for the treaty as a whole not in proportion of each policy
It is a partnership between the parties	Easier to administer
Each policy has to be treated separately based on its size and extent of cover when reinsuring	Incomes may be small but profit margins could be high for the reinsurer
Large incomes for the reinsurer but small profit margins to the reinsurer	Reinsurer could limit its exposure on the treaty
The exposure is technically unlimited for the reinsurer	Reinsurer is guaranteed of a minimum premium
Reinsurer is not guaranteed of a minimum premium	

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Reinsurance in Practice

Assumptions: The insurance company has the following treaty arrangements

- ✓ A 25 line Surplus treaty with Rs. 50 m own retention (Treaty Capacity Rs. 1,250 m)
- ✓ Own retention is protected by a 90% Quota Share treaty
- ✓ A Risk XL treaty as follows;
  - ✓ 1st Layer: Rs. 10 m xs. Rs. 1.5 m
  - ✓ 2nd Layer: Rs. 23.5 m xs. Rs. 11.5 m
  - ✓ 3rd Layer: Rs. 65 m xs. Rs. 35 m
- ✓ The total sum insured on a risk: Rs. 200 million
- ✓ Adjusted loss: Rs. 150 million

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Reinsurance in Practice
Proportional Treaty Claim Recovery

Proportional Treaty Arrangement	Own Retention (Line)		Surplus Treaty (25 lines)	Total
Total Automatic Capacity (Rs. 1.3 bn)	50,000,000		1,250,000,000	1,300,000,000
Own Retention covered by Quota Share Treaty	Quota Share (90%)			
	Net Retained	QS Treaty		
Quota Share	**5,000,000**	**45,000,000**		50,000,000
Surplus Treaty Cessions (TSI Rs. 200 m)	50,000,000		150,000,000	200,000,000
Adjusted Claim	150,000,000			
From Treaty arrangement	3,750,000	33,750,000	112,500,000.000	150,000,000

10% of 150 m x 50 m / 200 m

90% of 150 m x 50 m / 200 m

150 m x 150 m / 200 m

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Reinsurance in Practice
Non-proportional Treaty Claim Recovery

Adjusted Claim	150,000,000			
From Treaty arrangement	Own 3,750,000	QS 33,750,000	Surplus Treaty 112,500,000	Total 150,000,000
	Recovery from XL Treaty			
Deductible	1,500,000		1,500,000	
1st Layer	10 m xs. 1.5 m		2,250,000	
2nd Layer	23.5 m xs. 11.5 m		Nil	
3rd Layer	65 m xs. 35 m		Nil	
Insurer's Ultimate Net Loss	Rs. 1,500,000 out of Rs. 150 million claim			

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Reinsurance in Practice
Distribution of the Claim Recovery

Insurer (Reinsured)	1,500,000
Quota Share Treaty Reinsurer(s)	33,750,000
Surplus Treaty Reinsurer(s)	112,500,000
Risk Excess of Loss Treaty Reinsurer(s)	2,250,000
Total	150,000,000

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Insurance and Reinsurance Terminology

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Insurance and Reinsurance Terminology

- Gross Written Premium (GWP): Total premiums on insurance underwritten during a period before deducting any outward reinsurance premium
- Gross Net Written Premium Income (GNWPI): Written premium net of outward reinsurance premium deductions but includes commissions and expenses
- Earned Premium: Actual gross premium earned for the period
- Gross Net Earned Premium: Gross earned premium less outward reinsurance premium deductions but includes commissions and expenses
- Unearned Premium Reserve: The portion of the premium representing unexpired portion of the policies
- Minimum Premium: The least premium charged by the reinsurer, usually in Excess of Loss reinsurance contracts

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Insurance and Reinsurance Terminology

- Deposit Premium: The amount of premium demanded by the reinsurer as an 'instalment' which will be adjusted at later date (Minimum & Deposit Premium – M&D)
- Flat Premium: An amount charged by the reinsurer based on claims experience, expenses and profit
- Pure Premium: That part of the premium sufficient to pay losses and loss adjustment expenses but not other expenses
- 'The Burning Cost': The rate at which the original insurer's premiums are consumed by the claims which is loaded by a factor to allow for expenses and an element of profit
- Adjustable Rate: A percentage rate applied to a cedant's sums insured or premium income which is used to determine the final premium payable.
- Aggregate Deductible: A loss limit which is retained by the cedant.

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Insurance and Reinsurance Terminology

- Aggregate Limit: The maximum sum of recoveries payable under a reinsurance agreement.
- Attachment Basis: A provision that determines whether, and in what manner, a reinsurance agreement covers a specific loss.
- Broker of Record: The appointed broker for a contractual reinsurance agreement.
- Broker Market: When business is written through reinsurance brokers.
- Capacity: The maximum Rs. amount of exposure that an insurer or reinsurer can underwrite. Capacity may be used when referring to a single risk, a program, a line of business or an entire book of business.
- Catastrophe: High severity events such as hurricanes, earthquakes and other disasters, involving multiple insureds and/or locations.

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Insurance and Reinsurance Terminology

- Cedant: An insurance company which contractually transfers (cedes) a portion of risk to a reinsurer. The term can also refer to a reinsurer which transfers (cedes) a portion of its portfolio to a Retrocessionnaire.
- Ceding Commission: The costs incurred by the cedant in negotiating an insurance contract including overhead expenses and a share of expected profits. Expressed as a percentage of the gross reinsurance premium.
- Combined Ratio: The sum of the loss ratio and the expense ratio. A combined ratio below 100% is representative of a profitable underwriting portfolio.
- Commutation: The conclusion of all obligations between the parties to a reinsurance agreement, often completed with a lump sum cash settlement.

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Insurance and Reinsurance Terminology

- Cover Note: The document or receipt issued by the intermediary to the cedant confirming terms and conditions and the percentage share placed with each reinsurer.
- Direct Market: When reinsurance business is written directly by a reinsurer, rather than through a third party or broker.
- Estimated Maximum Loss (EML): An insurer's assessment of the worst possible loss scenario.
- Event / Occurrence: A natural or man-made disaster which gives rise to a large loss.
- Follow the Fortunes: A condition in a reinsurance contract where it is agreed that the reinsurer is bound to the same experience as the cedant in terms of the risks covered.
- First Loss: The first part of a loss retained by the reinsured.
- Franchise: A term used to describe the amount that triggers a policy.

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Insurance and Reinsurance Terminology

- Gross Line: The maximum limit an insurer or reinsurer is willing to accept before ceding portions of their exposures to a reinsurer or Retrocessionnaire.
- Ground Up Loss: The total measure of an insurance loss, including deductibles and before any retention or reinsurance is applied
- Hard Market: A fluctuation in the insurance/ reinsurance market characterized by an increase in the pricing level.
- IBNR (Incurred But Not Reported): Insured losses that have occurred but have not been reported. and that are accounted for by an estimated reserve
- Layer: A term refers to a segment of a reinsurance cover.
- Lead Reinsurer: The reinsurer who first signs the slip after negotiating the terms, conditions and premium; reinsurers who subsequently sign on to the slip under those terms are considered "following reinsurers".

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Insurance and Reinsurance Terminology

- Program: A series of, usually consecutive, reinsurance layers.
- Profit Commission: A profit allowance payable to a reinsured from the reinsurer. This is a pre-determined percentage agreed by both parties and payable when the contract period is closed and the results are finalized
- Rate on Line: Reinsurance premium divided by indemnity.
- Reinstatement Premium: An additional reinsurance premium paid to restore (reinstate) the portion of limit used after a loss.
- Reserves: An estimated amount put aside in the insurer's or reinsurer's accounts for claims that have not been paid
- Retrocession: The transfer of all or part of a reinsurance risk from one reinsurer to another (retrocessionnaire).
- Retrocessionnaire: A reinsurer that contractually assumes all or part of a reinsurance risk from another reinsurer. The transfer is known as retrocession.

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Insurance and Reinsurance Terminology

- Soft Market: A fluctuation in the insurance/reinsurance market, characterized by increased competition in which prices are depressed, and is usually attributed to excess capacity.
- Slip: A binding contract authorizing the acceptance of risk, often including more than one reinsurer.
- Special Acceptance: A risk which, due to underwriting class or limit, would not otherwise be covered but is attached to the reinsurance agreement by specific written agreement between the cedant and the reinsurer
- Ultimate Net Loss (UNL): The total payments resulting from a claim, including loss adjustment expenses to which the retention and the reinsurance limits apply.

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