Introduction to Reinsurance

Rodolfo Wehrhahn
Rodolfo Weihahn

Reinsurance

Introduction to
Contents

Reinsurance needs

- Surplus relief
- Catastrophic protection
- Expertise transfer
- Financing new business
- Reinsurance needs and a word of warning
- Increasing underwriting capacity
- Risk capital improvement and diversification
- Non-proportional reinsurance

Types of reinsurance agreements

- Treaty reinsurance
- Facultative reinsurance

Forms of reinsurance

- Excess or excess reinsurance
- Proportion or quota share reinsurance
Reinsurance is a financial transaction by which risk is transferred (ceded) from an insurance company (certain) to a reinsurance company (certain). Providers of reinsurance are professional reinsurers which are entities exclusively dedicated to the activity of reinsurance. In most jurisdictions, insurance companies are allowed to participate in reinsurance. The terms of a reinsurance transaction are defined in a reinsurance treaty. Due to the complexity of reinsurance treaties, it is not uncommon that the definitive treaties are only signed months after the risk transfer took place. To document the acceptance of the risk by the reinsurer, a short version of the treaty called a slip is used. Slips are signed before the risk is transferred and accepted by the reinsurer. Some jurisdictions require signed treaties before the risk is transferred.

Reinsurance is to be differentiated from coinsurance, where the risk is shared and not transferred among several insurance companies. Reinsurance always involves legal entities and not individuals. In reinsurance, the contractual relationship is between the cedant and the reinsurer. Only in special situations does the reinsurance treaty have a provision called the "cut through clause" that allows the insured to have a direct legal claim to the reinsurer; for example, in case the insurer becomes insolvent.

Definition

Reinsurance

Introduction to...
Reinsurers can also transfer risks to other entities called retrocessionaires by means of a financial transaction similar to reinsurance called retrocession. Professional retrocessionaires are expected to keep and not to transfer the assumed risk to other entities. In this manner reinsurers and insurers that do accept risks not individually identified can be sure that they will never assume part of the risk they had already transferred. However, there have been situations in the past where retrocessionaires actually transferred the assumed risks resulting in unexpected over retention for the retrocedants. Proper retrocession treaty wording can help here.

Figure 1 illustrates the contractual relationships in typical reinsurance and coinsurance transactions.

The most important reasons for an insurance company to use reinsurance:

- Insurance companies are often offered risks that may surpass their financial strength. Ceding part of the risk may allow them to accept the full risk thus satisfying client’s needs.
- Insurance companies may also use reinsurance. However, in this case the insurer retains the risk of loss above the assumed risks. The reinsurer then bears the full or part of the risk and is paid for it. The reinsurer can also transfer risks to other entities called retrocessionaires.

Figure 1: Difference between reinsurance and coinsurance

Introduction to Reinsurance
Insurance companies having a more diversified portfolio of risks will tend to have more stable financial results. Using reinsurance will allow insurance companies to participate in a diversity of risks using the same committed capital. This diversification effect lowers the total required risk capital.
The use of reinsurance allows insurance companies to partially transfer risks off their balance sheet. While the ultimate responsibility to the policyholders still remains with the insurance company, most jurisdictions recognize reinsurance as a risk management tool that allows a reduction of statutory surplus requirements. The guarantee implicit on a reinsurance contract to pay the reinsured claims is recognized in the capital requirements for the cedant. Hence it is not uncommon to base the prudential requirements on the insured premium net of reinsurance.

Reinsurance thus removes a technical risk but introduces a counterparty risk, since the ultimate responsibility to the policyholders still remains with the insurance company. To offset the counterparty risk, additional surplus is usually required. This additional capital will vary depending on the solvency rating of the reinsurer. Also the amount of surplus relief granted will depend on the rating.

Well-run insurance companies accept risk exposure according to their financial strength. However, the risks may also be exposed to extreme catastrophic events, like earthquakes, floods, plane crashes and other major catastrophic events. Holding enough capital for those extreme events would make the insurance operation economically unviable or at least very expensive. Transferring this exposure to a catastrophic protection is usually achieved through reinsurance. Reinsurers offer catastrophic protection at a more economical price than insurance companies by participating in a more diversified way. Reinsurers are also more capable of dealing with catastrophic events than insurance companies. They also operate in dedicated departments that have gained substantial knowledge of the physical characteristics and history of catastrophic events, thus allowing them to price and underwrite properly the exposure and accept those risks.

Through the reinsurance activity reinsurers acting in several markets with different insurance companies have the ability to acquire significant knowledge of the different products, markets and insurance technical aspects.
niques like underwriting, administration of the policies and claims assessment. This is particularly important when entering a new market, a new line of business or simply launching a new product. Transferring the risk through reinsurance may also include the shift of the underwriting, administration, or other activity related to the risk transferred to the reinsurer. Such a reinsurance agreement allows insurers to focus in their core business outsourcing the non-core activities.

As discussed in Module 1 a rapidly growing insurance activity can require upfront financing. This is particularly true in the case of Life Insurance business. Here the insurance company has to finance the agents or broker's commissions that can be as high as the full first year's premium as well as the underwriting costs that may include medical examinations and financial assessments. Reinsuring part of the business can provide a source of financing especially if the reinsurer agrees to advance the future expected profits of the business in the form of reinsurance commission. This source of financing of insurance business can be attractive compared to other sources such as bank loans or equity. Reinsurers, knowing the business, will have lower risk charges than non-insurance financing sources. Also, in most reinsurance agreements the payback is contingent on the performance of the reinsured business. If the performance of the reinsured business is below expectations the payback needs to appear in the balance sheet of the cedant.

Other reinsurance needs and a word of warning

Insurance companies enter reinsurance agreements for one or more of the above mentioned reasons. There might be other special situations where reinsurance is used as a valid financial and operational tool. However, none of the above mentioned needs is present in the past to individual insurance company's needs has been abused in the past to design tax avoidance, money laundry and other illegal activities. A reinsurance agreement that does not transfer any type of risk is always questionable.
Most reinsurance contracts are either automatic treaty or facultative. Under a treaty reinsurance arrangement, all risks that are defined to be object of the agreement are ceded automatically to the reinsurer, and the reinsurer agrees to accept all those risks. On a facultative treaty, the cedant decides if a risk will be offered to the reinsurer and the reinsurer will decide on an individual basis if it will accept or not the offered risk.

There is a third, less common treaty structure called facultative-obligatory reinsurance. Here, the offering of the risks to the reinsurer is facultative, but the acceptance of the risks is obligatory for the reinsurer.

Treaty reinsurance allows the cedant to act in an independent and fast-reacting way when accepting risks that fall under the object of the reinsurance agreement. In treaty reinsurance, the acceptance of the risk by the reinsurer together with all financial conditions has already been negotiated and agreed upon. This characteristic of treaty reinsurance to offer "blind acceptance" of the risks to the cedant requires that the reinsurer know and trust the cedant. Treaty reinsurance is therefore only offered after the reinsurer has done proper due diligence on the insurance company to determine the quality of the business that would attract the reinsurer. The important aspects that a reinsurer will pay attention to include:

- The financial strength and stability of the insurance company
- Its historical performance
- The quality and diversity of its business
- The underwriting and claims handling practices

Insurance companies are offered from time to time the opportunity to reinsure very large or unusual risks. In these situations, facultative reinsurance is the best alternative. Here, the reinsurer participates in the underwriting and assessment of the risk. Depending on the risk, the reinsurer will decide whether to accept or decline the risk.

Types of reinsurance agreements

Introduction to reinsurance
terms, like premium, exclusions, and so forth. The already negotiated facultative treaty will govern all other general terms of the agreement.

Basically, there are two forms of reinsurance: proportional and non-proportional reinsurance. The former is generally used for risks that are not highly diversified, while the latter is used for highly diversified risks.

Under a Quota Share reinsurance treaty, the cedant transfers the same proportion or quota of each and every risk that falls under the object of the reinsurance agreement to the reinsurer, and premium, expenses, and claims are also shared in the same proportion. The reinsurer pays the cedant a reinsurance commission to compensate it for the acquisition and administrative expenses of the business. It also allows for sharing profits of the reinsured business.

Non-proportional reinsurance, on the other hand, is characterized by a different sharing formula that allows for sharing profits of the reinsured business. The reinsurer pays the cedant a reinsurance commission on the profit made, whereas the reinsurer pays the cedant a reinsurance premium, expenses, and claims are shared as per the agreement.

The proportion of each risk is transferred to the reinsurer. In the following figure, we can see the distribution of the transferred risks between the cedant and reinsurer.

Figure 3: Quota Share Reinsurance

Introduction to Reinsurance
The reinsurer is responsible for maintaining the appropriate reserves for its share in the business. Some jurisdictions require that certain reserves should be kept with the cedant or in a trust. In these cases, the reinsurer will send the necessary assets to the cedant or the trust to build the reserve corresponding to the reinsured business. The above indicated terms are usually first documented in a reinsurance slip when making a reinsurance offer. The slip will then be used to draft the definitive treaty. A slip containing the most important terms of a Quota Share agreement is attached in Annex 1.

This type of proportional reinsurance is basically a Quota Share agreement that assigns a different proportion to be reinsured to each risk (see figure 4). To determine the proportion of the risk to be reinsured, the insurance company fixes an amount called retention or surplus line as the maximal sum insured that the company will retain on its own account. Any amount above the retention and up to a given amount called capacity will be reinsured. The capacity sometimes is given in number of surplus lines.

Surplus reinsurance allows the cedant to change the level of participation on any type of risk by choosing a given surplus line. As an illustration let us consider a treaty where the retention is US$50 and the capacity US$200 or four surplus lines: Here a particular risk that has a sum insured of US$100 will be shared among the insurer and the reinsurer in a 50% proportion (risk 1 in figure 4). For a risk having a sum insured of US$250, the proportion will be 20% for the insurer and 80% for the reinsurer (risk 2 in figure 4). A risk that has a sum insured lower than the retention will not be reinsured at all (risk 3 in figure 4). The reinsurer will not accept any risks that have a sum insured higher than the capacity (risk 4 in figure 4). Similarly, the reinsurer will not accept risks having a sum insured lower than the capacity (risk 5 in figure 4).
Proportional reinsurance creates a strong alignment of interest between the insurer and the reinsurer since premium, expenses and claims are shared in a proportional manner. The reinsurance premium volume is high as compared to the non-proportional reinsurance because of the sharing of the expenses. A high volume premium may allow the reinsurer to finance substantial upfront costs in exchange of the future profits of the reinsured business.

The pricing or determination of the amount of the reinsurance premium in proportional reinsurance is basically dictated by the underlying insurance premium, as it usually is a percentage of that premium. Also the amount of reinsurance commission should directly reflect the actual costs that the cedant undergoes in acquiring and administering the business. More involved calculations are needed when determining the profit sharing formula. Here sophisticated stochastic models are used. Finally, when the reinsurance agreement includes some sort of financing for insurance in the form of a guaranteed premium by the reinsurer, the actual cost of the actual underwriting premium is adjusted by the amount of this guaranteed premium.

Financial elements

Figure 4. Risk sharing in a surplus treaty
Insurance companies that are looking mainly to protect their portfolio from adverse experience that could result from too many claims or too high claims will usually enter non-proportional reinsurance agreements. In non-proportional reinsurance the protection is provided based on the actual loss the insurer suffers and not the sum insured of the risk.

Surplus proportional reinsurance as described above requires that the sum insured of every individual risk is known to determine the proportionality in sharing the risk. There are however several insurance products where the sum insured is not always known, such as MTPL in the UK or commercial liability in the US, etc. In these cases when individual differentiated risk protection is desired, non-proportional reinsurance can be used.

The basic type of non-proportional reinsurance is the excess of loss reinsurance (XL). In an excess of loss agreement per risk the cedant will pay in case of an event affecting a reinsured risk the claimed amount up to a fixed chosen quantity called the priority of the agreement. The reinsurer will then pay any excess amount claimed above the priority up to the capacity of the contract. As an example, consider in figure 5 an excess of loss agreement where the priority is US$20 and the capacity is US$100 (US$100 XL US$20):

- A claim of US$50 will cost US$20 to the cedant and US$30 to the reinsurer (see figure 5 risk 1).
- A claim of US$15 will be totally paid by the cedant since the total amount is below the priority (see figure 5 risk 2).
- A claim of US$130 will cost US$20 + US$10 = US$30 to the cedant and US$100 to the reinsurer (see figure 5 risk 3).

Note the important difference to the surplus reinsurance that the excess reinsurance only covers actual losses above the priority, so that small claims on the reinsured risk are not protected.
The reinsurance premium for an excess of loss agreement is not proportional to the direct premium collected by the insurer and is determined by the probability of having claims above the priority and attendant cost of capital.

Also, as mentioned before, there might be a conflict of interests between the cedant and the reinsurer: the financial incentive of the cedant on settling the claim disappears the moment the claimed amount is higher than the priority since beyond the priority the liability is transferred in full to the reinsurer up to the capacity of the treaty. To avoid these situations, some agreements require either that the reinsurer has to approve payments above the priority or that the cedant retains a copayment of the liability above the priority.

An excess of loss agreement on the whole portfolio is called a stop loss agreement. In a stop loss agreement, the reinsurer will protect the cedant only in case the portfolio coverage is exceeded by adding up all claims paid during the period of coverage. The reinsurer will protect the cedant only in case the portfolio coverage is exceeded by adding up all claims paid during the period of coverage.

A stop loss agreement on the whole portfolio is called a stop loss agreement.

The stop loss agreement is a agreement of the liability above the priority.

In a stop loss agreement, the reinsurer will protect the cedant only in case the priority is exceeded by adding up all claims paid during the period of coverage. The reinsurer will protect the cedant only in case the priority is exceeded by adding up all claims paid during the period of coverage.

The stop loss agreement on the whole portfolio is called a stop loss agreement.

The stop loss agreement on the whole portfolio is called a stop loss agreement.
To better understand figure 6 illustrates the way a stop loss coverage works consider a drop loss event which has an insured loss of $100,000. The stop loss coverage has a deductible of $20,000 and a retention of $80,000. The cedant pays the excess of the insured loss over the deductible. The reinsurer pays the excess of the insured loss over the retention.

In example 1 the total amount paid in claims is $70,000, which is less than the deductible of $20,000. Hence, the cedant pays the full amount of $70,000. In example 2 the total amount paid in claims is $100,000, which is less than the retention of $80,000. Hence, the cedant pays the full amount of $80,000. The reinsurer pays the excess over the retention, which is $20,000. In example 3 the total amount paid in claims is $115,000, which is greater than the retention of $80,000. Hence, the cedant pays the full amount of $80,000, and the reinsurer pays the excess over the retention, which is $35,000.
There is a third class of non proportional reinsurance called "cat-XL". Here, in addition to the necessity to exceed the priority to have reinsurance protection, a catastrophic event has to have taken place. Catastrophic events can be for instance an earthquake, an explosion that has a toll of at least 3 lives, and so forth.

Catastrophic reinsurance does not cover every event. Typical standard exclusions in a Cat-XL agreement are the claims related to nuclear or radioactive incidents. Terrorism is also a common exclusion. For these risks as well as other political risks, government or national industry pools have been established. We discuss pools later in the module.

The pricing of non proportional reinsurance is an involved activity that is done by experienced actuaries. Among the methods used in determining the cost of reinsurance are the burning cost evaluation, scenario modeling and exposure pricing. Burning cost evaluation looks at the past experience of the claims above the priority and below the capacity with adjustments made for inflation, changes in conditions, etc. The resulting cost is the necessary amount to pay expected claims or the so called risk premium. The reinsurance premium is then the risk premium loaded for expenses and profit.

Scenario modeling uses mathematical models that utilize claim distributions to simulate the risk exposure of the reinsured portfolio. Several simulations are run to determine the probable loss above the priority and below the capacity. The resulting modeling of the so called risk premium is then the reinsurance premium.

Exposure pricing looks at the existing reinsured portfolio and assigns empirical probabilities for claims to occur to every risk reinsured that could result in amounts above the priority.

In non-proportional reinsurance the typical duration of an agreement is annual since changes in the market conditions, the economy and the reinsured portfolio affect directly the reinsurance costs. A non proportional agreement does not offer a profit sharing participation that in case of the proportional reinsurance is used to compensate the cedant for good underwritten business because of the different exposure that the cedant and the reinsurer have here.
Reinsurance provides a flexible and effective tool to insurance companies for the management of the risks they are assuming. A combination of several reinsurance agreements is called a reinsurance program. A well-structured reinsurance program will provide important competitive advantages but can be quite complex.

Several reinsurers may participate in a reinsurance program, according to the specific terms of the agreement. This structure is more flexible. The design of a reinsurance program will usually include several features to ensure that the reinsurers are adequately compensated for the risks they are assuming.

Example 1: In this example, the claim is first split 50% between the cedant and the Quota Share reinsurer. Then the XL coverage protects the share in the claim of the cedant of $50, paying $30 in excess of $20.

Example 2: In this example, the XL pays $50 of the claim and the cedant is left with a claim of $70. Then the Quota Share reinsurer assumes half of that payment.

The participation of the cedant, the Quota Share reinsurer and the XL reinsurer is shown in Figure 7. The figure illustrates the effect of a quota share reinsurance and an excess of loss reinsurance in different orders.
Participants of the reinsurance industry

As discussed above the main participants in the reinsurance industry are the professional reinsurers, the retrocessionaires and the insurance companies. Reinsurance brokers also play a fundamental role in the placement of reinsurance programs, in particular when dealing with special programs. Captives, Pools and Offshore Reinsurers complete the reinsurance industry.

Reinsurance brokers

For complex reinsurance programs or when the reinsurance capacity is scarce, insurance companies utilize the services of reinsurance brokers. Reinsurance brokers are companies or professional individuals that are licensed and supervised dedicated to provide professional advice to insurance companies on the placement of their reinsurance programs. Reinsurance brokers are paid through reinsurance commissions that are proportional to the placed reinsurance premium. Reinsurance brokers also offer administrative services and product development. In most jurisdictions reinsurance brokers are required to hold an error and omissions liability policy for the protection of the insurance companies.

In recent years the press has reported on major financial scandals related to the non transparency of the reinsurance commissions. Professional reinsurance brokers have reacted offering detailed disclosure of their commissions. As an example we have attached in Annex 3 a disclosure commitment issued by Guy Carpenter.

Captives

Large industrial conglomerates that are interested in keeping their risks within the group usually operate with a captive. A captive is a legal entity, usually a stock insurance company owned by the group that accepts and retains risks emanating only from the same industrial group.

Pools

Insurance companies may want to insure an unusual or new type of risk but fear they will not have enough business of that type to benefit
risk capital is required when using low-rated reinsurers.

The law of large numbers is used in insurance to provide a large enough sample to give more predictable and consistent results from year to year. Pooling was in fact the way insurance of modern passenger airplanes began. The World Bank has been promoting pools to cover catastrophic risks like the Turkish Catastrophic Insurance Pool (TCIP) and the Caribbean Catastrophic Risk Insurance Facility (CCRIF).

Offshore reinsurance companies are reinsurers which operate in special geographic zones, often with less demanding regulatory and favorable tax environments. A great deal of reinsurance is conducted through these centers although much of the actual management of these companies is done in the parents' home offices in Europe, London and New York. The purpose of offshore reinsurance has been to optimize the use of capital and thus create competitive advantage. However, special scrutiny is required when offshore reinsurance is involved. The lack of a strict regulation or the low capital requirements in some offshore centers can lead to failing reinsurers with huge liabilities. The risk of capital insolvency and the need for regulatory scrutiny is higher when offshore reinsurers are involved. Exports of offshore reinsurance from Europe have been discouraged because of the risk management losses through these centers. Although the need of reinsurance is considered a real deal, offshore reinsurance is conducted with less demanding regulations and specific reinsurance zones, often with less demanding regulations and fewer restrictions compared to their onshore equivalents.


discussion of the regulatory issues

Risk Insurance Requiring (CRR)

In recent years, insurance companies have used the law of large numbers in insurance pools to cover catastrophic risks. These pools have been used to provide a large enough sample to give more predictable and consistent results from year to year. However, the risk of capital insolvency and the need for regulatory scrutiny is higher when offshore reinsurers are involved. Exports of offshore reinsurance from Europe have been discouraged because of the risk management losses through these centers. Although the need of reinsurance is considered a real deal, offshore reinsurance is conducted with less demanding regulations and specific reinsurance zones, often with less demanding regulations and fewer restrictions compared to their onshore equivalents.
Virtually every insurance supervisor in the world has the right to monitor reinsurance arrangements for domestic insurers and to require that they be strengthened. Regular information on the reinsurers can be obtained from the supervisory authorities at their legal domicile.

Professional reinsurers play an important role somewhat related to supervision. Reinsurers impose discipline on the reinsured companies particularly in emerging markets. It is the reinsurers who tell them what reserves to hold and what premiums to charge. In countries where there is little or no insurance regulation this an extremely important role played by the reinsurer.

Reinsurance accounting is very complex and only partly covered here. A dedicated module on accounting for insurance activities will be published later in this series.

Because of the importance of reinsurance in the impact of the finances of the insurance companies, the governance structure of the insurer should ensure that the boards take particular interest in this topic and that the internal control systems ensure that the appropriate reinsurance program is in place.

### Understanding a Reinsurance Treaty

A reinsurance treaty is very complex and only partly covered here. A reinsurance treaty in very general terms defines payments between insurance companies. In diagram form it looks like this:

<table>
<thead>
<tr>
<th>Company 1</th>
<th>Reinsurer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premiums</td>
<td>Claims</td>
</tr>
<tr>
<td>Annual Premium</td>
<td>Premium</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Reinsurance treaties are agreements between insurance companies and reinsurers to share risks. The terms of the treaty define the conditions under which the insurer agrees to cede risks to the reinsurer and the conditions under which the reinsurer agrees to accept those risks. Reinsurance treaties are typically structured to align the interests of both parties and to provide risk transfer for the insurer.

### Accounting and Control Issues

Reinsurance plays an important role in the insurance industry. It allows insurers to transfer risk to reinsurers, thereby reducing their exposure to losses. However, reinsurance transactions can be complex and challenging to account for. Proper accounting and control practices are essential to ensure that reinsurance transactions are recorded accurately and that the financial statements of the insurer reflect the true financial position and results of operations.

Reinsurance accounting is subject to specific regulations and standards, which vary by jurisdiction. Insurers must ensure that their reinsurance transactions are recorded in accordance with these regulations to avoid penalties and reputational damage.

Professional reinsurers play an important role in the insurance industry. They help insurers manage risk and reduce losses. However, reinsurers can also be strategic partners, providing information and insights that help insurers make better decisions.

Professional reinsurers can also be a source of information and guidance. Regular information exchange and collaboration between insurers and reinsurers can lead to improved risk management and better outcomes for both parties.
In this diagram Company 1 cedes business to the Reinsurer. The treaty calls for Company 1 to make payments to or transfer funds to the reinsurer. These payments are usually called something like (1) deposit premium, (2) annual premiums, (3) investment income, and (4) risk charge. Not all treaties will have all these items and some may have more.

The reinsurer must also make payments or transfer funds to Company 1. These payments will be called something like (1) reinsurance commissions, (2) expense allowance, (3) claims and (4) increase in reserves. Again not all treaties will have all these items and some may have more.

The treaty may also have a provision to share the profit. This can be done through a profit sharing agreement, experience rating refund, or profit charge.

In most cases the payments between the companies are netted so that only one transfer of funds takes place. This is called the right of offset. Each company has the right to offset what it owes and what it is owed.

The flexibility in reinsurance is that each one of these terms can be defined in many ways.

Some points to look for include:

- Who is the reinsurer? Is it a strong reputable company?
- What is the definition of the business reinsured? The block of business should be identified in a clear manner giving the date of issue, the policy form used for the business, the type of business and information needed to identify the premiums, reserves etc.
- What is the risk actually reinsured? Is it all of the risk that Company 1 has assumed? If it is not, are the reserves calculated actuarially or is all of the risk taken by the reinsurer?
- Under what conditions does the reinsurer have to pay? Is there liquidity in the treaty? Will the reinsurer have to pay cash immediately upon a claim or will it be able to delay payment?
- Under what conditions can the reinsurer cancel the contract? On cancellation what are the remaining responsibilities of the reinsurer?
- How long does the treaty run? Is it indefinite or for a fixed time period? Will the reinsurer stop accepting new risks at a certain time or at the end of the treaty period?
Who has responsibility for the claims run off tail on any business that takes a long time to settle such as liability and marine?

Is there an arbitration clause to settle disputes?

Some standard terms of a reinsurance treaty include:

- Parties to the agreement are the ceding company and the reinsurer. The policyholder is not involved and hence normally has no claim on the reinsurer. In most cases the policyholder will not know the policy is reinsured.
- Reinsurance is an indemnity arrangement. The reinsurer indemnifies the ceding company for what it pays in claims.
- Both parties have the right to defend against a claim and if one chooses not to it will pay its share to the other company and leave the other to absorb all legal costs. If the defense is successful the one that did not join the defense does not get a refund.
- The reinsurer has the right to inspect the records of the ceding company at any time.
- A choice of law will be stated. In case of a dispute between the parties there will be no time wasted arguing which law applies.
- An “actuarially equivalent” clause can save pages of formula. An actuary will develop an actuarial table or formula to calculate the amount that will be paid by the reinsurer. The formula is then included in the treaty.
- The treaty may say that some things happen upon termination of the policy. Examples are that the reinsurer will have the right to inspect the files of the ceding company and will have the right to keep the records.
- The errors and omissions clause says that unintentional clerical errors will be set right in the next statement and are not cause to cancel the contract.
- An “actuarially equivalent” clause can save pages of formula for what happens if the treaty is terminated at different times. The treaty may say that something happens if termination is in December 31 and in all other cases the annuity ends.

Tax issues

Reinsurance sent outside the country is often subject to excise tax, usually from 1% to 3% of reinsurance premiums. Tax treaties between countries sometimes address the issue of excise tax and in some cases exempt reinsurance sent outside the country from 1% to 3% of reinsurance premiums. The treaties between countries will say which law of Country X applies. The choice will likely be the law of the jurisdiction of the defendant. The clause will say that the law of Country X applies. The cause of action will be stated in case of a dispute between the companies at any time.

The ceding company is the one that issued the policy that provided coverage. It is the one that made the payments for the claims. It is the one that has the right to the defense of a claim and the right to inspect the files of the reinsurer. It is the one that will pay its share to the reinsurer if it chooses not to defend a claim.

Some standard terms of reinsurance treaties include:

- Is there an arbitration clause to settle disputes?
- Who has responsibility for the claims run off tail on any business?
The complexity of the reinsurance business has been treated in numerous publications. Basically every professional reinsurer offers excellent learning material that goes from basics into complex topics. Here we have aimed to pass enough information to the reader to make her/him familiar with the basic concepts of reinsurance in a compressed manner. At the same time we hope that the course will allow and encourage the reader to reach out for further literature to satisfy the individual needs of knowledge in the matter.

For the convenience of the reader we have added a glossary of the most important reinsurance terms in annex 4 (adapted from http://www.captive.com).

Further suggested reading


Insurer A

Quota Share

Group of Workers

Term 5 year

Death from any cause and accidental death

US$1,000,000 per person and for benefit

US$20,000

January 1, 2002

December 31, 2002

US$1,750,000 (10% of US$1,000,000)

1.75% O

1.216% O

10%

12.16%

20%

20% with a maximum of US$200,000

Payment Frequency

Monthly

Commission

10%

Retro

Life Coverages

Annual premium basis

Reinsurer’s Share

20% Retention

Limit per Person

Currency

Expiration Date

Inception Date

Type of Insurance

Business

 Treaty Class

CEO

Annex I: 

Quota Share slip
Insurer A  
NAEJOQN=J?AIAPDK@  
Stop Loss  
NEOGO?KRANA@  
Group policies issued  
NEOGOAHA?PEKJ  
According to the documentation presented  
PANNEPKNU  
Worldwide of the policies underwritten in the  
domicile of the ceding company  
LNEKNEPU  
The priority limit for this cover will be 95% of  
the original premium net of taxes.  
"KRAN=CA  
Capacity of the contract 30% of the original  
premium net of taxes corresponding to the  
P=HA  
The reinsurer will pay 90% of all claims corre-  
sponding to the risks covered in excess of the  
priority limit for this cover.  
?EJ?ALPEKJ  
The Ceding Company will run for  
own account the resulting co-payment of the  
10% loss.  
EJ?ALPEKJ  
December 31, 2005  
ATLEN=PEKJ  
January 1, 2005  
6% of the original premium net of taxes corre-  
sponding to the risks covered  
IEJEIQILNAIEQI  
US$3 million  
minimum premium
The standard clauses of the reinsurer apply.

There is no profit sharing.

All losses on a quarter's basis will be the premium plus losses on the exchange rate at the end of the local currency, settlement will be in USD dollars. Premiums and losses will be calculated in USD.

Settlements will be made on a quarterly basis at the beginning of each quarter on the exchange rate at the end of the local currency.

Premiums payable at the beginning of each quarter, first quarter as of February 1, 2005. USD2 million.
In a letter to clients dated December 1, 2004 announcing the new policy, Guy Carpenter’s Chairman & CEO, Salvatore D. Zaffino, noted there is a “need within the industry to address issues of full disclosure to clients within the reinsurance marketplace.”

“Guy Carpenter’s relationship with its clients is built on longstanding trust and our ability to help our clients make important decisions in a difficult environment. Transparency and full disclosure should strengthen the trust among all parties to the reinsurance contract and foster better decision-making.”

Since we announced our commitment to transparency, the feedback from clients and reinsurance markets worldwide has been overwhelmingly positive, Zaffino said.

The industry faces many challenges at the moment, from rating downgrades and financial security to claims payment performance and standards of practice around the world. Guy Carpenter intends to be a positive force in addressing these and other issues, Zaffino said.

Guy Carpenter’s “Disclosure Doctrine” addresses the firm’s varied forms of compensation, including standard rates of brokerage for treaty placements, fee for services and the firm’s history with market agreements, all of which have expired or have been terminated.

December 16, 2004

Guy Carpenter Announces Commitment to Full Disclosures (New York)
As part of its "Disclosure Doctrine," Guy Carpenter has committed to making the following disclosures on an ongoing basis:

broker commissions (progressive)

1. When a client appoints Guy Carpenter broker of record, we will disclose to our client the compensation that we anticipate receiving for the services to be provided on the client's behalf.

2. Prior to subsequent renewals of reinsurance contracts, we will review with our client Guy Carpenter's expected compensation based on standard commission rates.

3. Guy Carpenter will continue to strive for consistency in rates of brokerage to be earned by Guy Carpenter within a layer and will disclose any variation in rates to all parties within that layer.

4. Brokerage for each reinsurance transaction will be listed on the Cover Note for all treaty business.

The above policy covers treaty placements globally, which represent in excess of 90 percent of Guy Carpenter's revenues, and will be extended to include facultative placements once a worldwide review of current practices is completed.

In light of recent developments affecting the industry, Guy Carpenter believes it is important to address the issue of compensation in the reinsurance broker marketplace and take this opportunity to reaffirm our commitment to our clients in this regard. Therefore, Guy Carpenter developed this Disclosure Doctrine, which identifies our procedures with regard to the services we provide, the ethics we espouse, and the manner in which Guy Carpenter is compensated.

The following outlines the manner in which Guy Carpenter receives payment for treaty placement services rendered as a reinsurance intermediary:

Guy Carpenter's longstanding practice is to conform to rates of brokerage in accordance with industry custom and usage. We also
continue to support consistency of rates within a placement and disclosure of brokerage rates. To that end, Guy Carpenter sets forth below the rates of brokerage that would apply to the majority of business we place. These rates are guidelines and are generally standard in the marketplace, but can vary depending on the specifics of a particular placement:

- In some placements, Guy Carpenter receives a brokerage of up to 5% on reinstatement premiums.
- For a small number of placements, Guy Carpenter receives a brokerage of up to 10% of contract premium.
- In a few cases, Guy Carpenter receives a brokerage of up to 20% of the margin.
- In some placements, Guy Carpenter receives a brokerage of up to 5% on non-reinsurance premiums.
- In some placements, Guy Carpenter receives a brokerage of up to 10% on non-reinsurance premiums.
- Where excess of loss reinsurance is triggered, Guy Carpenter generally receives additional brokerage.
- Guy Carpenter generally receives additional brokerage on a piece-by-piece basis.

In addition to our traditional reinsurance intermediary role, Guy Carpenter also provides other services for which we receive fees. Revenue from these activities represents a small portion of Guy Carpenter's annual revenue. Currently, the two primary examples of these services are:

- Reinsurance Solutions International, LLC is a Guy Carpenter subsidiary that receives fees for providing unbundled services such as policy administration, claims administration, premium/reinsurance collections, statutory/GAAP accounting, regulatory compliance and auditing. In addition, RSI provides specialized consulting services focusing on process reengineering, and performance metrics.
- Guy Carpenter & Company, Inc., of Pennsylvania is a subsidiary of Guy Carpenter and is a licensed reinsurance manager overseeing a reinsurance underwriting facility for certain reinsurers. This underwriting facility assumes business from smaller regional and mutual companies.
In the past, Guy Carpenter entered into a limited number of agreements with certain reinsurers that provided payments to Guy Carpenter. These agreements, in the aggregate and in any one year, represented a very small percentage of Guy Carpenter’s total revenue. All of such agreements have either expired or have been terminated.

Guy Carpenter believes that the reinsurance marketplace would benefit from more transparency with the clients with regard to broker compensation. In order to promote this objective, Guy Carpenter will implement the following steps effective on January 1, 2005:

- When a client appoints Guy Carpenter broker of record, we will disclose to our client the compensation that we anticipate receiving for the services to be provided on the client’s behalf.
- Prior to subsequent renewals of reinsurance contracts, we will review with our client Guy Carpenter’s expected compensation.
- Guy Carpenter will continue to strive for consistency in rates of brokerage to be earned by Guy Carpenter within a layer and will disclose to our client Guy Carpenter’s expected compensation.
- Brokerage for each reinsurance transaction will be listed on the Cover Note for all treaty business.

In the past, Guy Carpenter entered into a limited number of agreements with certain reinsurers that provided payments to Guy Carpenter. These agreements, in the aggregate and in any one year, represented a very small percentage of Guy Carpenter’s total revenue. All of such agreements have either expired or have been terminated.

Guy Carpenter believes that the reinsurance marketplace would benefit from more transparency with the clients with regard to broker compensation. In order to promote this objective, Guy Carpenter will implement the following steps effective on January 1, 2005:

- When a client appoints Guy Carpenter broker of record, we will disclose to our client the compensation that we anticipate receiving for the services to be provided on the client’s behalf.
- Prior to subsequent renewals of reinsurance contracts, we will review with our client Guy Carpenter’s expected compensation.
- Guy Carpenter will continue to strive for consistency in rates of brokerage to be earned by Guy Carpenter within a layer and will disclose to our client Guy Carpenter’s expected compensation.
- Brokerage for each reinsurance transaction will be listed on the Cover Note for all treaty business.

In the past, Guy Carpenter entered into a limited number of agreements with certain reinsurers that provided payments to Guy Carpenter. These agreements, in the aggregate and in any one year, represented a very small percentage of Guy Carpenter’s total revenue. All of such agreements have either expired or have been terminated.
A company is "admitted" when it has been licensed and accepted by appropriate insurance governmental authorities of a state or country. In determining its financial condition a ceding insurer is allowed to take credit for the unearned premiums and unpaid claims on the risks reinsured if the reinsurance is placed in an admitted reinsurance company.

Burning Cost—A term most frequently used in spread loss property.

Broker (plural brokers) — A form providing premium or loss data with respect to identified specific risks which is furnished the reinsurer.

Claim—An application for the reimbursement of loss, expense, or damage sustained as a result of a covered event.

Claimant—A person or entity making a claim against another

Compulsory Reinsurance—A company is "admitted" when it has been

Convention

Dispute—A difference or disagreement between two or more parties.

Excess of Loss—A means of financing the excess of loss.

First Party—Primary party who sustains an insured loss.

Fleet Protection—A form of multiple cargo protection.

Governmental—A term which means a governmental authority.

Insured—A person who is covered by an insurance policy.

Insurer—A company that issues insurance policies.

Language providing a means of resolving differences between the reinsurer and the reinsured without litigation. Usually, each party appoints an arbiter. The two thus appointed select a third arbiter, or umpire, and a majority decision of the three becomes binding on the parties to the arbitration proceedings.

Language providing a means of resolving differences between the insurer and the reinsured without litigation.

Reinsurance Company—A company that issues insurance policies.

Retained Loss—The portion of a loss that is retained or borne by the policyholder or by the ceding company.
(a) Run-off basis means that the liability of the reinsurer under policies, which became effective under the treaty prior to the cancellation date of such treaty, shall continue until the expiration date of each policy; (b) Cut-off basis means that the liability of the reinsurer under policies, which became effective under the treaty prior to the cancellation date of such treaty, shall cease with respect to losses resulting from accidents taking place on and after said cancellation date. Usually the reinsurer will return to the company the unearned premium portfolio, unless the treaty is written on an earned premium basis.

Claims-Made Basis—A form of reinsurance under which the date of occurrence of the loss is the date of the claim report.

Ceding Company—The original or primary insurer; the insurance company which purchases reinsurance.

Ceding Premium—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.

Catastrophe Reinsurance—A form of reinsurance that indemnifies the ceding company for the accumulation of losses in excess of a stipulated sum arising from a catastrophic event such as conflagration, earthquake or windstorm. Catastrophe loss generally refers to the total loss of an insurance company arising out of a single catastrophic event.

Cede—When a company cedes a line of business with another it is referred to as a "cede" contract.

Reinsurance Premium—The ceding company's acquisition costs and overhead expenses, licenses and fees plus a profit representing a share of expected profits—sometimes expressed as a percentage of the gross premium.

Claims—The occurrence of a loss event that underlies the policy.

Claims Made Reinsurance—A form of reinsurance under which the date of the claim report is deemed to be the date of the loss event. Claims reported during the term of the reinsurance agreement are therefore covered, regardless of when they occurred. A claims made agreement is said to "cut off the tail" on liability business by not covering claims reported after the term of the reinsurance agreement—unless extended by special agreement. See omnibus reinsurance.

Ceded Premium Basis—The insurer's premium portfolio under the treaty is written on a basis whereby the reinsurer calculates the net premium to be charged to the insurer based on losses resulting from accidents occurring prior to the expiration of the policy. The ceding company then remits the premium in excess of the premium paid to the reinsurer, which becomes part of the insurer's book of business. (a) Run-off basis means that the liability of the reinsurer is determined as of the date of the claim report and adjusted for any changes in the value of the liability.
the reinsurer, the ceding company allows a ceding or direct commis-
sion allowance on such gross premium received, large enough to reim-
burse the company for the commission paid to its agents, plus taxes
and its overhead. The amount of such allowance frequently determines
profit or loss to the reinsurer.

A clause in a reinsurance agreement, 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 Workers’ Compensation.

An allowance
payable to the ceding company in addition to the normal ceding
commission allowance. It is a pre-determined percentage of the rein-
surer’s net profits after a charge for the reinsurer’s overhead, derived
from the subject treaty.

Where there is more than one reinsurer sharing
a line of insurance on a risk in excess of a specified retention, each such
reinsurer shall contribute towards any excess loss in proportion to his
original participation in such risk. Example: Retention US$100,000,
Reinsurer A accepts one-half contributing share part of US$1,000,000
in excess of said US$100,000. Reinsurer B accepts one-half contri-
bution share part of US$1,000,000 in excess of said US$100,000.

A provision in reinsurance agreements
which is intended to neutralize any change in liability or benefits due
to an inadvertent error by either party.

Commission allowance—A clause in a reinsurance agreement which
provides for estimation, payment and complete discharge of all future
obligations for reinsurance losses incurred regardless of the continu-
ing nature of certain losses such as unlimited medical and lifetime bene-
fits for Workers’ Compensation. The amount of such allowance is
derived from the subject treaty.
A form of reinsurance under which recoveries are available when a given loss exceeds the cedant’s retention defined in the agreement.

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.

The percentage of premium used to pay all the costs of acquiring, writing and servicing insurance and reinsurance.

(1) The loss record of an insured or of a class of coverage. (2) Classified statistics of events connected with insurance, of outgo, or of income, actual or estimated. (3) What figures show to have happened in the past. Experience may be compiled on different bases to provide various means of appraisal, namely Accident Year, Calendar Year, or Policy Year, but, for underwriting purposes, should always compare earned premium with incurred losses after the latter have been modified by an allowance for loss development and incurred but not reported losses (I.B.N.R).

A generic term that, when used in reinsurance agreements, refers to damages awarded by a court against an insurer which are outside the provisions of the insurance policy. Examples are punitive damages and losses in excess of policy limits.

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

A form of reinsurance which considers the time value of money and has loss containment provisions. One of its objectives is the enhancement of the cedant’s financial statements or operating ratios, for example, the combined ratio; loss portfolio transfers; and financial quota shares are examples.

Part of the net reinsurance premium ceded which becomes an addition to the cedant’s statutory surplus.

Excess of Loss—A form of reinsurance under which recoveries are made only when a given loss exceeds the cedant’s retention defined in the agreement.
In reinsurance, a percentage rate applied to a ceding company’s premium writings for the classes of business reinsured to determine the reinsurance premiums to be paid the reinsurer.

Reinsured—The reinsurer who renews the terms and conditions of one or more specific policies or contracts of insurance.

Load Reinsurance—The reinsurance which the reinsurer undertakes to cede.

Once the cedant has agreed to cede a risk, the reinsurer is bound to the same extent as the cedant.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserves—The reserves which the reinsurer has against each reinsured.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a specific loss.

Loss Reserve—The sum which the reinsurer has estimated the loss to be, or which such reinsurer has ceded to the reinsurer to cover a
used to permit reserve credits to be taken with respect to non-admitted reinsurance and alternative to prior-year funds withheld and modified coinsurance.

- **Case—** A provision in reinsurance agreements which permits each party to not annul the assigned loss payable before making a payment for claims.

- **Wrongful Loss**—An adverse contingency accident or event neither expected nor intended from the point of view of the insured.

- **Loss Ratio**—Propor tionate relationship of incurred losses to earned premiums.

- **Loss Event**—The total losses to the ceding company or to the reinsurer.

- **Loss Development**—The difference between the estimated loss as of a stated period beyond the period of the initial report and the cumulative development in the following periods.

- **Loss Adjusting Expenses**—All expenditures of an insurer associated with the adjustment, recording, and settlement of claims, other than the claim payment itself. The term encompasses both allocated loss adjustment expenses (ALAE) which are loss adjustment expenses identified by a claim file in the insurer’s records, such as attorney’s fees; and unallocated loss adjustment expenses (ULAE), which are operating expenses not identified by claim file, but functionally associated with settling losses, such as salaries of claims department.

- **Loss Reserve**—Proportion of the amount of claims and claims incurred but not reported as of a stated date, which is the best estimate of the ultimate cost of all claims incurred and not reported as of that date, adjusted for anticipated costs of investigation, payments, and recoveries, and stated as a percentage of incurred losses.

- **Loss Reserve—Future Events**—The best estimate of the ultimate cost of all claims incurred but not reported as of a stated date, adjusted for anticipated costs of investigation, payments, and recoveries.

- **Non-Admitted Reinsurance**—A company is non-admitted when it has not been licensed and thereby recognized by appropriate insurance governmental authority of a state or country. Reinsurance is non-admitted when placed in a non-admitted company and therefore may not be treated as an asset against ceded losses or as a liability by the ceding company in its financial statements.

- **Premiums**—Amounts paid in advance for insurance, calculated in a different manner depending on the type of insurance.

- **Reinsurance**—Insurance purchased by an insurer to provide additional protection against risks that have been assumed by the insurer. Reinsurance can be either primary or excess.

- **Retentions**—The portion of the risk retained by the insurer or ceding company after reinsurance has been purchased.

- **Total Loss**—The total losses to the ceding company or to the reinsurer resulting from a single cause such as a windstorm.
Introduction to Reinsurance

Premium—The portion of the premium calculated to enable the insurer to pay losses and in some cases expenses. A portion of the premium paid by the insured to the insurer as compensation for the insurer's undertaking to indemnify the insured against loss or damage arising out of the risk involved. The premium is based on rates or charges established by the insurer and is determined by the insurer based on the risk involved.

Risk—The chance of loss or damage arising out of the risk involved. The risk is determined by the insurer based on the risk involved.

Portfolio Run-off—The process of balancing the portfolio of reinsurance with premiums, losses, and expenses.

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 reinsurer is said to underwrite the Automobile business of the ceding company.

Risk Excess Reinsurance—Reinsurance written with an understanding of the insurer's risk.

Excess—The amount of risk in excess of a specified amount.

Pass—To transfer the risk from one party to another.

Policy Year—The year commencing with the effective date of the policy.

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 Run-off—The process of balancing the portfolio of reinsurance with premiums, losses, and expenses.

Premiums—The portion of the premium paid by the insured to the insurer as compensation for the insurer's undertaking to indemnify the insured against loss or damage arising out of the risk involved. The premium is based on rates or charges established by the insurer and is determined by the insurer based on the risk involved.

Risk—The chance of loss or damage arising out of the risk involved. The risk is determined by the insurer based on the risk involved.
the premium arrived at by dividing losses by exposure and in which no
loading has been added for commission, taxes, and expenses.

Written premium is premium registered on the books of an insurer or reinsurer at the time a policy is issued and paid for. Premium for a future exposure period is said to be unearned premium for an individual policy, written premium minus unearned premium equals earned premium. Earned premium is income for the accounting period, while unearned premium will be income for a future accounting period.

A term used to designate a company whose business is confined solely to reinsurance and the peripheral services offered by a reinsurer to its customers as opposed to primary insurers who exchange reinsurance or operate reinsurance departments as adjuncts to their basic business of primary insurance. The majority of professional reinsurers provide complete reinsurance and service at one source directly to the ceding company.

A provision found in some reinsurance agreements which provides for profit sharing. Parties agree to a formula for calculating profit, an allowance for the reinsurer's expenses, and the cedant's share of such profit after expenses.

The basic form of a 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.

When the amount of reinsurance coverage provided under a treaty is reduced by the payment of a reinsurance loss as the result of a catastrophe, the reinsurer's reinsurance coverage is automatically reinstated at the premium paid by the cedant on a pro rata basis.

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.
The reinsured may be referred to as the Original or Primary Insurer, or Direct Writing Company, or the Ceding Company.

3FJOTVSFS
— An insurer or reinsurer assuming the risk of another under contract.

3FUFOUJPO
— The net amount of risk which the ceding company or the reinsurer keeps for its own account or that of specified others.

3FUSPDFTTJPO
— 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 a Retrocession. The transaction whereby a reinsurer cedes to another reinsurer all or part of the reinsurance it has previously assumed.

3FUSPTQFDUJWF3BUJOH
— A plan or method which permits adjustment of the final reinsurance ceding commission or premium on the basis of the actual loss experience under the subject reinsurance treaty—subject to minimum and maximum limits.

3JTLT
— A term used to denote the physical units of property at risk or the object of insurance protection and not Perils or Hazard. Reinsurance by tradition permits each insurance company to frame its own rules for defining units of Risks. The word is also defined as chance of loss or uncertainty of loss.

4BMWBHFBOE4VCSPHBUJPO
— Those rights of the insured which, under the terms of the policy, automatically transfer to the insurer upon settlement of a loss. Salvage applies to any proceeds from the repaired, recovered, or scrapped property. Subrogation refers to the proceeds of any legal actions against negligent third parties and may apply to either property or casualty coverage.

4FMG
— Setting aside of funds by an individual or organization to meet his or its losses, and to absorb fluctuations in the amount of loss.

Settlement
— Setting aside of funds by an individual or organization.

Settlement 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.

settlement
— Setting aside of funds by an individual or organization.

Settlement 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.

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

Risk
— An insurer or reinsurer assuming the risk of another under contract.

Direct Writing Company
— An insurer or reinsurer assuming the risk of another under contract.
A binder often including more than one reinsurer. At Lloyd's of London, the slip is carried from underwriter to underwriter for initialing and subscribing to a specific share of the risk.

The facultative extension of a reinsurance treaty to embrace a risk not automatically included within its terms.

A form of reinsurance under which premiums are paid during good years to build up a fund from which losses are recovered in bad years. This reinsurance has the effect of stabilizing a cedant's loss ratio over an extended period of time.

A form of reinsurance under which the reinsurer pays some or all of a cedant's aggregate retained losses in excess of a pre-determined dollar amount or in excess of a percentage of premium.

A cedant's premiums (written or earned) to which the reinsurance premium rate is applied to calculate the reinsurance premium. Often, subject premium is gross/net written premium income (GNWPI) or gross/net earned premium income (GNEPI), where the term "gross/net" means gross before deducting reinsurance premium for the reinsurance agreement under consideration, but net after all other adjustments, for example, cancellations, refunds, or other reinsurance.

Also known as base premium. It is determined under statutory accounting rules. Surplus determines an insurer's or reinsurer's capacity to write business.

The excess of assets over liabilities. Statutory surplus is an insurer's or reinsurer's capital as determined under statutory accounting rules. Surplus determines an insurer's or reinsurer's capacity to write business.

The excess of a cedant's premiums (written or earned) to which the reinsurance premium rate is applied to calculate the reinsurance premium. Often, subject premium is gross/net written premium income (GNWPI) or gross/net earned premium income (GNEPI), where the term "gross/net" means gross before deducting reinsurance premium for the reinsurance agreement under consideration, but net after all other adjustments, for example, cancellations, refunds, or other reinsurance.

Some or all of a cedant's aggregate retained losses in excess of a pre-determined dollar amount or in excess of a percentage of premium.

A special loss—A form of reinsurance under which the reinsurer pays in whole or in part an incurred and estimated incurred loss.

The applied extension of a reinsurance treaty involving and subrogating to a specified share of the risk of London. The slip is carried from underwriter to underwriter for inclusion more than one reinsurer. At Lloyd's
includes hospital, medical and funeral charges and all sums paid as salaries, wages, compensation, fees, charges and law 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 insured loss, excluding any sums paid in respect of the defense and investigation of claims and suits which are paid in respect of claims against the assured or any underlying insurer.

Working Layer — The first layer above the cedant's retention premium.

The company would have to pay back the unearned part of the original premium if the policy should be canceled, and insurers must carry a reserve against unearned premiums as a liability in their financial statement.

Working Layer — The first layer above the cedant's retention premium where moderate to heavy loss activity is expected by the cedant and reinsurer.

Working Layer reinsurance agreements often include adjustable features to reflect actual underwriting results.

Unearned Premium — That portion of the original premium that applies to the unexpired portion of risk, if the policy is not canceled.