Introduction to Reinsurance

Friday May 17

William B. Heberton, Jr., President & CEO, NLC Mutual
Embry Nichols, Vice President, JLT Re
Moderator: Chris McKenna, Vice President & Actuary, NLC Mutual
HOW ARE INSURANCE AND REINSURANCE RISKS TRANSFERRED?
HOW ARE RISKS TRANSFERRED?

**INSURANCE / REINSURANCE BUSINESS FLOW**

**POLICYHOLDER**

The policyholder, or insured, pays a premium to the insurance company in return for the insurance company’s promise to indemnify them in the event of a loss.

**INSURER**

The insurance company elects to transfer, or cede, a portfolio of risks or large individual risks to a reinsurance company.

**REINSURER**

In some instances, a reinsurer may also want to transfer some of its risk through reinsurance. This risk management process is called retrocession.

**RETROCESSIONAIRE**
WHY PURCHASE REINSURANCE?
WHY PURCHASE REINSURANCE?

1. **Capacity** – allows the reinsured to write larger amounts of insurance for a single risk

2. **Stability** – helps smooth the reinsured’s overall operating results from year to year

3. **Financing** – eases the strain on the reinsured’s surplus during rapid premium growth

4. **Catastrophe Protection** – protects the reinsured against a single catastrophic loss or multiple large losses

5. **Expertise & Services** – provides the reinsured with a source of underwriting information when entering a new line of insurance or a new market
HOW IS REINSURANCE PROCURED?
HOW IS REINSURANCE PROCURED?

1. **Intermediary** (Broker)
   - Acts as agent of ceding company
   - Leverages relationships and expertise in marketplace to bring parties together, share information, and negotiate price and terms
   - Brokers serves as conduit for all premium/loss payments but assumes no financial risk

2. **Direct**
   - Reinsurance company works directly with ceding company, no third-party involved

3. **Hybrid**
WHAT ARE DIFFERENT FORMS OF REINSURANCE ARRANGEMENTS?
Facultative and treaty reinsurance can be written on either a pro rata or excess of loss basis.

Pro Rata (Proportional) – reinsurance agreement in which the reinsurer shares the same proportion of the premium and losses of the ceding company. Can either be a Quota Share or Surplus Share.

• Advantages:
  – Good protection against frequency / severity potential
  – Recovery on first-dollar basis
  – Permits recovery on smaller losses

Excess of Loss (Non-Proportional) – reinsurance agreement that, subject to a specified limit, indemnifies a ceding company against the amount of loss in excess of a specified retention.

• Advantages:
  – Good protection against frequency / severity potential, depending upon the retention size
  – Retain more of the ceded premium
  – More economical in terms of cost of administration
FORMS OF REINSURANCE AGREEMENTS

PRO RATA

- **Quota Share – “75% Quota Share”**
  - Shares premiums and losses of every policy the insurer ceded on a fixed percentage basis

- **Surplus Share**
  - The insurer selects the amount of risk at or above a minimum retention level or “line” and may cede multiples of that “line” to a reinsurer up to the contract limit
  - The resulting percentage set is used to apportion all premiums and losses

- **For Quota Share & Surplus Shares**
  - Losses and premiums shared proportionally
  - Usually includes a ceding commission (reimburses ceding company for expenses)

- In this example, the insurance company would share (cede) 75% of all premium and losses.
FORMS OF REINSURANCE AGREEMENTS

EXCESS OF LOSS

- Excess of Loss – “60M xs 40M”

- Excess of Loss (XOL)
  - Requires the insurer to retain a predetermined dollar amount of risk
  - Reinsurer accepts the risk in excess of the ceding company’s retention, up to the maximum treaty limit
  - Premiums and losses are NOT shared proportionally

- Let’s assume a $100M loss occurs. With this structure, the insurer would retain $40M and the reinsurer would pay $60M.
WHAT ARE NUANCES OF REINSURANCE FOR MAJOR LINES OF BUSINESS?
NUANCES OF REINSURANCE BY LINE OF BUSINESS

1. Property
2. Liability
   - General Liability
   - Public Officials
   - Auto Liability
   - Police Professional
3. Workers Compensation
4. Cyber Liability
WHAT IS DIFFERENCE BETWEEN REINSURANCE AND EXCESS INSURANCE?
1. **Reinsurance**
   - Ceding (primary) insurance company writes full limit and then cedes a portion of the limit above attachment point
   - The reinsurance contract "follows the form" of the underlying primary policy
   - Primary carrier assumes credit risk if reinsurer unable to fulfill its contractual obligations

2. **Excess Insurance**
   - The excess carrier writes a separate stand-alone direct contract that covers losses above the primary carrier’s retention
   - Excess carrier could have different coverage terms and conditions than the underlying primary carrier’s policy
   - Primary carrier is not “on the hook” for losses above its retention if reinsurer unable to fulfill obligations