Introduction to Reinsurance

Friday May 17

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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.

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INSURER

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

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REINSURER

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

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RETROCESSIONAIRE

WHY PURCHASE REINSURANCE?

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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?

FORMS OF REINSURANCE AGREEMENTS

PRO RATA VS EXCESS OF LOSS

- 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

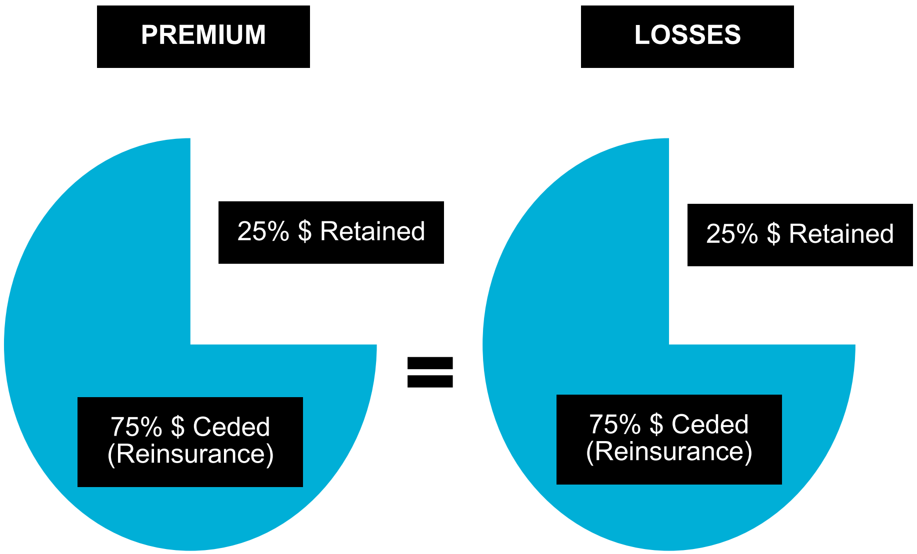
- **Excess of Loss (Non-Proportional)** – reinsurance agreement that, subject to a specified limit, indemnifies a ceding company against the amount of loss in excess of a specified retention

• 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"**



– In this example, the insurance company would share (cede) 75% of all premium and losses.

- **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)

FORMS OF REINSURANCE AGREEMENTS

EXCESS OF LOSS

– **Excess of Loss – "60M xs 40M"**

– Let's assume a $100M loss occurs. With this structure, the insurer would retain $40M and the reinsurer would pay $60M.

- **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

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?

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

GUY CARPENTER

NLC MUTUAL INSURANCE COMPANY