

JCC REINSURANCE LTD (LL 01552)

(Formerly Known As CRS Insurance Services (L) Limited)

Brokers • Consultants • Risk Managers

Licensed Offshore Insurance Brokers (BS 970008)

REINSURANCE

Purpose of reinsurance

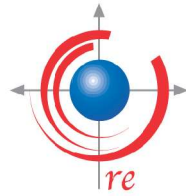
The purpose of reinsurance is to spread a risk amongst a number of insurers. Every insurer aims to write a balanced account and if he were to accept for his own account risks which were, in terms of sum insured or limits of indemnity, very much larger than normal, there would be a possibility that one or two losses in respect of such risks in the course of a year could result in serious losses in the account as a whole. In any event, if the account comprised a comparatively small number of large risks, losses would tend to fluctuate within very wide limits from year to year, and much larger reserves would have to be set up than would otherwise be the case.

On the other hand, competition and the desire to provide the best possible service for clients mean that an insurer cannot limit the amount for which he is prepared to grant cover to the insured to the amount of his own normal acceptance for a particular class of risk, as this would mean that the proposer or his broker might have to approach a number of insurers to obtain the full cover required.

The insurer therefore issues a policy covering the whole of the risk which the insured wishes to have covered and make arrangements with other insurers or reinsurers to reinsure part of the risk. It is important to note that the insured is not a party to the reinsurance contract, and obtain no rights and incurs no obligations under it. In the event of a claim arising, the original insurer must pay to the insured the whole amount of the claim, and then recover appropriate amounts from the reinsurers. If for example, a reinsurer became insolvent and was unable to pay his share of a claim, the resulting loss would have to be borne by the insurer and not by the insured.

1. Definitions of Terms:

Before the various methods of reinsurance are described, it will be useful to note some of the terms which are commonly used in reinsurance.



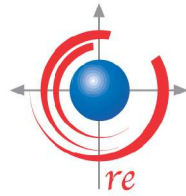
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Ceding Company	This is the term commonly used to describe the original insurer, to whom the business is offered by the proposer or broker.
Reinsurer	This is the company which accepts a share of the business from the ceding company.
Retention	This is the amount of the risk which the ceding company retains for its own account.
Cession	This is the share of the risk which is given to a reinsurer.
Retrocession	It is sometimes necessary for a reinsurer, having accepted a share of a risk from a ceding company, itself to reinsure part of its acceptance. The "reinsurance" of a "reinsurance" is called a retrocession.
Facultative Reinsurance	The oldest type of reinsurance, and one which is still in use to some extent at the present day, is facultative reinsurance. The distinguishing features of this type of reinsurance are that the reinsurers considers each risk offered to him individually, and is free to accept or reject each offer as he considers appropriate. The procedure in connection with facultative reinsurance is in fact very much the same as that which applies to the original acceptance of the business by the direct insurer. The reinsurer is entitled to have before him all the information available to the direct insurer to enable him to decide whether or not to accept the risk. In fire insurance, for example, the reinsurer may wish to consult the plan and report on the insured premises, and to have details of the rates of premium being charged by the direct insurer.



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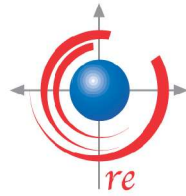
The great disadvantage of facultative reinsurance is that a considerable amount of time and work, with consequent expense, are involved. There is also uncertainty whether sufficient reinsurance can be obtained in any particular case, and this may mean that the direct insurer will have to delay granting cover until the possibility of obtaining reinsurance has been investigated.

Treaties

Because of the disadvantages mentioned above, treaty reinsurance has become very much more popular, and facultative reinsurance is now generally confined to those classes of insurance where reinsurance is comparatively uncommon and to cases where the capacity of treaties is insufficient to provide the whole of the reinsurance required.

A treaty is an agreement between the direct insurer and a group of reinsurers, under which the ceding company undertakes to cede, and the reinsurers undertake to accept, a share of any business which comes within the terms of the treaty. So far as the individual risks ceded under the treaty are concerned, the reinsurers have no option but to accept them. The result of such an arrangement is that the direct insurer is able to grant cover in respect of all business coming within the scope of the treaty, up to a limit of the amount which can be given to the treaty, plus his own retention, in the knowledge that reinsurance facilities are available.

Sometimes details of individual cessions are given to the reinsurers on what are known as bordereaux, but it is more common at the present time to have "blind treaties" under which the reinsurers do not receive details of each individual cession.



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At first sight this might seem to suggest that there are possibilities of abuse by the direct insurers, that they might cede the poorer risks to the reinsurers and retain the good business for themselves. In fact, this does not happen, for two main reasons. First, it is always a condition of a treaty that the ceding company must itself retain a share of the risk, and the maximum amount which the treaty will accept is geared to the amount retained by the ceding company. Secondly, if a company's treaty continually produced poor results, the ceding company would find that it would have great difficulty in obtaining continuance of the treaty when it was due for renewal. Community of interest between the direct office and the treaty is strengthened by the fact that the direct office receives from the treaty a commission depending on the profits of the treaty.

There are various types of treaty, the main types being the following:-

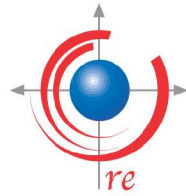
Surplus Treaty

Under this type of treaty, the direct insurer fixes a retention in respect of each individual risk, the retention varying with the merits of each risk, and the reinsurer the surplus with the treaty, subject to its capacity.

A surplus treaty is spoken of in terms of lines, a line being equivalent to the ceding company's retention. There may, for example, be a 10-line treaty and, if so, the maximum amount which could be ceded would be 10 times the ceding company's retention. If further reinsurance was required, it would have to be obtained facultatively.

Facultative Obligatory

This type of cover is a form of surplus which provides that the company may, if it so wishes (ie it is not obliged as with a quota share and surplus), cede share of risks to its reinsurers. The Reinsurers, on the other hand, are obliged to accept the business ceded.



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Quota Share Treaty

Under this arrangement, a fixed proportion of the whole of a given class of insurance is reinsured. For example, the ceding company may agree to reinsure 75 per cent of the class of business concerned, so that the treaty will receive three-quarters of the premiums and will be responsible for the same proportion of all of the losses. This type of treaty is suitable where an office has only a small portfolio of a particular class of business, but it has the disadvantage that premiums are paid away in respect of small risks which individually do not justify reinsurance.

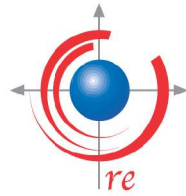
Excess of Loss Treaty

This is an arrangement whereby an insurer decides the maximum amount which he is prepared to bear in respect of any loss, and the reinsurers agree to pay a proportion or the whole of the excess of any loss which exceeds that amount. There is usually an upper limit to such a treaty. As soon as the amount retained is exceeded, the reinsurers are interested and are responsible for the proportion of claims and expenses (plus additional amounts for companies expenses) in proportion which their interest bears to that of the ceding company. Thus the ceding company only gives shares of larger risks to itself reinsurers, thereby retaining more of its own premium and potential profit.

For example, the insurer may agree to bear the first £5,000,000 of any loss, and the treaty may pay, say 90 per cent of the excess of any loss up to £100,000,000. another treaty may be arranged to pay the excess beyond £100,000,000.

Stop Loss/Aggregate Excess of Loss

This is a form of contract on a non-proportional basis which provides that as opposed to the reinsurers paying when a single loss or series of losses arising from a single event exceed a certain figure, if all the claims which occur during a given year exceed a certain percentage of the ceding company's premium the reinsurer will pay all amounts exceeding this figure.



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TERMS:

Original Gross Premium:

The premium actually received from the Insured.

Original Net Premium:

The premium actually received from the insured, less any commission payable to the broker or agent.

Reinsurance Commission:

The amount allowed by the reinsurers to the ceding company to pay the ceding company's office expenses, including salaries of claims officials etc. If it is calculated on original gross premium the commission also includes any amounts payable to brokers or agents.

Profit commission:

The amount paid to the ceding company out of the profits which it makes for reinsurers ie after paying reinsurance commission and expenses expressed as a percentage of the profit.

Management Expenses (Profit Commission):

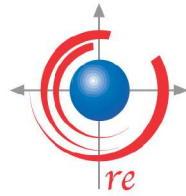
A percentage of the premium is usually deducted before the actual profit for reinsurers is calculated to allow for the reinsurers own expenses, as well as any reinsurance brokerage which may be payable. Without this reinsurers could be making a loss and still pay profit commission.

Deficits carried forward to extinction (Profit Commission):

Any deficit in the profit commission is carried forward into the next year until reinsurers are once again showing an overall profit.

Premium Reserve:

The amount or percentage of the premium retained by the ceding company as a guarantee for the fulfilment of the obligations of the reinsurer. It is actually in respect of so-called unearned premiums ie to allow for the fact that not all policies underwritten by the ceding company commence on the commencement date of the treaty, thus at the end of any underwriting year there is still liability outstanding.



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Loss Reserve:

This is an amount equivalent to the actual known outstanding (ie unpaid but incurred) claims of the company. As with the premium reserve it is effectively a guarantee of the payments of the reinsurers.

Cash losses:

Treaty accounts are normally prepared quarterly and thus if a large claim occurs in the ordinary course the ceding company would be unable to claim from its reinsurers the amount due until the next account. Therefore, a provision is included in reinsurance treaties that, in the event of a single claim exceeding a certain amount, this is to be paid on demand by the reinsurers.

Reinstatement:

On excess of loss contracts the reinsurer who only receives a percentage of the premium does not wish to be committed for an unlimited amount in the event of a series of losses and therefore includes a restriction which states that the cover will only be full reinstated for a given number of times. This amount reinstated is in respect of a full loss of the cover and partial losses are covered up to a total of the treaty cover, multiplied by the number of reinstatements.

Run off:

In the event of cancellation of the treaty as mentioned under "premium reserve" not all policies have expired, some having been commenced in mid year. If the treaty provides for run off protection this means that reinsurers are liable in respect of any policies which have been issued or renewed before the cancellation until the next renewal date of such a policy.

Portfolios:

On the cancellation of a treaty if it is the wish of the ceding company and/or the reinsurer liability should be terminated immediately, this may be done by the reinsurer paying an amount to the ceding company. The premium portfolio is normally the amount unearned at the cancellation date ie where policy liability is still outstanding and this may in effect be the same as the figure as the amount retained as a premium reserve. The loss portfolio is normally the amount of the known outstanding losses, ie incurred but not paid.