9.0 RE-INSURANCE

A reinsurance transaction is an agreement made between two parties, called ceding company and reinsurer, whereby the ceding company agrees to cede, and the reinsurer agrees to accept, a certain share of risk upon terms as set out in the agreement.

Reinsurance is the insurance of insurance. According to German Commercial Law, "Reinsurance is the insurance of the risk assumed by the insurer". Reinsurance is always a contract of indemnity, even in life and personal accident insurance, because it protects the insurer from a diminution of his property, caused by insurance policy obligations. Whereas insurance is a contract between the insurer and the insured, reinsurance is a separate contract between the insurer and the reinsurer. Each of these contracts is independent of the other. Insurance and reinsurance both are separate different contract.

Difference between reinsurance and coinsurance

In co-insurace risk is shared among several insurance companies, each one of themhaving direct contractual relationship with the insured for the portion of the risk accepted by that company. In reinsurance, the contract is between insurance company (called ceding company or cedant or reinsured) and the reinsurer. The insured is not involved in this contract.

9.1 NEED FOR RE-INSURANCE

1. It provides additional underwriting capacity to the insurer thereby helping them to expand the volume of business it writes at a faster rate than otherwise would be possible without a corresponding increase in its capital base.
2. It helps a direct insurance company to spread the risks internationally thereby reducing the exposure to catastrophic perils in the particular location where the insurer is situated.
3. Thus, Important benefits of reinsurance are:

→ Reduced volatility of underwriting results
→ Access to capital (of the reinsurer) which otherwise would not be possible to attain
→ Access to reinsurers' expertise and services especially in the areas of product development, pricing, underwriting and claims management

9.2 MAJOR REINSURERS

Following are the top ten reinsurers by their non-life gross premium undewritten in 2012 :

	(USD Millions)
Munich Reinsurance Co.	22,539
Swiss Reinsurance Co.	19,468
Lloyd's	15,770
Hannover Reinsurance Co.	10,201
Berkshire Hathaway	9,668
SCOR	6,146
Korean Re	5,113
Everest Re	4,311
China Re	4,184
Partner Re	3,910

Did you know....

Cologne Re, the oldest Reinsurer still in existence now known as Gen Re, was established in 1846 following the devastating fire affecting the city of Hamburg. This exposed the inadequacy of reserves of direct Insurers.

Did you know….

GIC Re is ranked among the top 20 global Reinsurers by AM Best.

9.3 RATING AGENCIES

Since Reinsurers provide the second level of financial security, it is essential that their own financial strength is of a very high level. To assess & certify this, there is a need for organizations with unimpeachable credentials & academic rigour. Some of the well known names in the field of financial ratings are listed below.

International rating agencies

Standard & Poor

A M Best

Moody's

Indian rating agencies

CARE (Credit Analysis & Research Ltd.)

Duff & Phelps Credit Rating India Pvt. Ltd. (DCR India)

CRISIL (Credit Rating Information Services of India Ltd.

ICRA (Investment Information & Credit Rating Agency of India)

The IRDA regulation in this regard requires minimum BBB rated Reinsurer (By Standard & Poor or equivalent), with whom an Indian Insurer can place business.

Typically a Rating Agency expresses forward-looking opinions about relative creditworthiness of issuer Company and its obligations. Creditworthiness is a multi-dimensional phenomenon. The likelihood of default is seen as the single most important dimension of creditworthiness. The secondary dimensions of creditworthiness is: payment priority, recovery, and credit stability

Briefly, a credit rating is an indicator of a Company's overall capacity and willingness to meet its financial obligations.

9.4 PRINCIPLES OF REINSURANCE

In reinsurance there are three principles, principle of utmost good faith, principle of indemnity, no reinsurance without retention,

- **Utmost good faith:** the relation between the insurer and the reinsurer is based on the principle of "utmost good faith." In case of facultative reinsurance insurer have to provide details of risk related information. In case of automatic reinsurance principle of utmost good faith is also important.
- **Principle of indemnity:** the principle of indemnity of the insured risk applies automatically on reinsurance. A reinsurer automatically follows the legal and technical future of the reinsured writing and underwriting a risk. Indemnity limit in reinsurance can be more than the sums insured if there are additional legal expenses against the insurer that are incurred while contesting a claim.
- **No reinsurance without retention**: the insurer must retain a part of the risk before reinsuring. Though there cannot be reinsurance of the complete risk, there can be complete retention of a risk. Those risks that are within the retention capacity of an insurer must be retained completely. Reinsurers always try to attach a global spread of risks. When reinsurers are in global market they are not excessively affected by local market bad losses and are capable of meeting liabilities.

9.5 Methods of Reinsurance

Two main methods of reinsurance are (i) Proportional and (ii) Non-Proportional.

Proportional method of reinsurance is a method in which the reinsurer shares a proportional part of the ceded insurance liability, premiums, and losses of the ceding company. Also known as Participating Reinsurance and Pro-rata Reinsurance.

Example :
Sum Insured : Rs. 1,00,00,000
Reinsurance : Net Retention : Rs. 20,00,000 (20%) Reinsurance : Rs. 80,00,000 (80%).

Premium : Rs. 10,000.

Premium Apportionment as per R/I arrangement : Net – Rs. 2,000 (20%)
Reinsurance - Rs. 8,000 (80%)

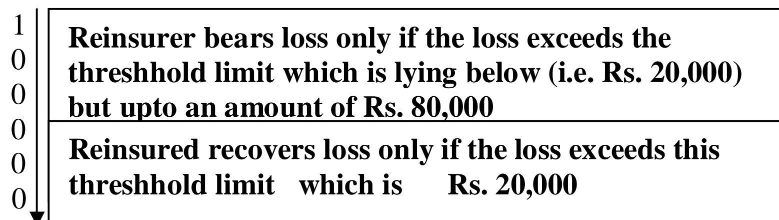
Loss : Rs. 1,00,000.

Loss apportionment as per R/I arrangement : Net : Rs. 20,000 (20%)
Reinsurance : Rs. 80,000 (80%).

Any loss, irrespective of amount, will be recovered to the extent of 80%.

Non Proportional Method of Reinsurance is one in which the reinsurer's response to a loss depends on the size of the loss, so named because the premium in non-proportional reinsurance is not proportional to limits of coverage. The reinsurer agrees to bear the loss only if it exceeds a pre-agreed limit (called the underlying or deductible or excess or priority) and upto a pre-agreed limit (which is called the cover limit). Also known as Excess of Loss Reinsurance.

Example : Same sum insured of Rs. 1,00,000 is reinsured by way of non-proportional method expressed as Rs. 80,000 excess of Rs. 20,000.



Unlike proportional method, here there will be no recovery from reinsurers unless the loss exceeds Rs. 20,000.

Under the above two main methods, there are various sub-types which are as under.

Proportional

Sub-Type A : Facultative

The word "facultative" connotes that both the primary insurer and the reinsurer have the faculty or option of offering, accepting or rejecting the individual risk which is the subject matter of reinsurance. There is no obligation on either side. This is the oldest form of reinsurance.

Sub-type B : Treaties

A treaty is an agreement invariably (though not necessarily) in writing between a ceding company and one or more reinsurers, whereby the ceding company agrees to cede and reinsuer agrees to accept all the risks written by the ceding company which fall within the terms of the treaty, subject to the limits specified therein.

As can be understood from the above, unlike facultative, there is no option for either the reinsured or the reinsurer not to cede or not to accept once the risk falls within the agreed classification.

Treaties also can have their own sub-types as under :

Sub-type B.1 : Quota Share Treaty

A quota share treaty is an agreement by which the ceding company agrees to cede and the reinsurer agrees to accept a fixed percentage of all risks in the particular class or portfolio which is the subject matter of such agreement. For example, an insurance company may decide to arrange a 50% Quota Share Treaty covering its entire Fire business. This means that the insurance company retains 50% and cedes 50% of each and every risk that it writes in that particular class of business or its entire portfolio of Fire risks. There is no scope, during the tenure of the treaty, to vary this percentage or exclude any particular risk from the scope of cession or acceptance.

Premium and losses are shared in the same proportion as the percentage of quota share agreement.

Advantages : 1. Easy to operate 2. Less administrative cost. 3. Beneficial when the insurance company is a new start up and requires assured reinsurance capacity or when an established company enters a new line of business where it does not have adequate experience. In such cases, the ceding company can take advantage of reinsurers' knowledge and technical expertise.

Disadvantages : 1. Ceding company cannot utilise its discretion or underwriting knowledge to keep bigger part of of the good risks leading to more cession of premium. 2. Because of fixed percentage of retention, the ceding company cedes away premium on small risks which otherwise could have been retained.

Sub-type B.2 : Surplus Treaty

A surplus treaty is a reinsurance agreement where the ceding company is bound to cede and the reinsurer is bound to accept the surplus liability over the ceding company's retention or any other cession that may come before such surplus cession, as per agreement.

Unlike a quota share treaty (where the ceding company is bound to cede a fixed percentage of risk irrespective of whether it has the capacity to retain or not), in a surplus treaty, the cession takes place only when there is a surplus. Example :

Sum Insured Rs. Crores	Statutory Cession 5% Rs. Crores	Net Retention Rs. Crores	First Surplus Treaty (10 lines subject to max Rs. 20 crores) Rs. Crores	Second Surplus Treaty (8 lines subject to max Rs. 16 crores) Rs. Crores	Facultative Rs. Crores
100 cr.	5 cr.	2 cr.	20 cr.	16 cr.	57 cr.
80 cr.	4 cr.	2	20	16	38
60	3	2	20	16	19
40	2	2	20	16	Nil
20	1	2	17	Nil	Nil

Advantages: 1. The ceding company retains a maximum fixed monetary amount and knows what is exactly the maximum liability to its net account whereas in a Quota Share Treaty the monetary amount can vary depending on the sum insured while the percentage remains fixed. 2. The ceding company can retain smaller risks which are within its capacity and need not cede out this premium.

Disadvantages : 1. Regular records of cessions have to be kept thereby increasing administrative work. 2. No. of cessions to the treaty may not be large enough to garner enough premium which will be attractive to reinsurers if number of large risks is not adequate in the cedant's portfolio.

Sub-type B-3 : Facultative Obligatory Treaty

Facultative Obligatory Treaty is an agreement whereby the ceding has the option to cede or not but the reinsurer does not have the option to decline. Once a cession is made by the ceding company, it has to be accepted by the reinsurer. So, it has the characteristic of a facultative reinsurance placement from the point of view of the ceding company but a surplus treaty cession from the point of view of the reinsurer. Usually, this capacity comes after the surplus treaty. However, the nature of the treaty being loaded in favour of the ceding company and biased against the reinsurer, this type of treaty has become quite scarce in the

present day marketplace.

Advantage: Ceding company has absolute discretion whether or not to cede.

Disadvantage: Loaded against the reinsurer who does not have any control over the facility and has to depend on the ceding company for premium.

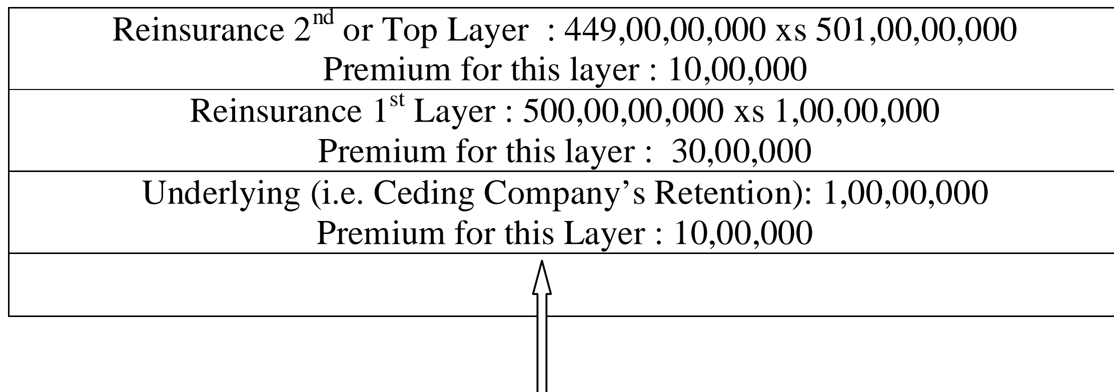
Non-Proportional

Like Proportional method, in Non-Proportional also there are various sub-types.

Sub-type A : Facultative : It carries the same characteristics of a proportional facultative reinsurance in that there is option on the part of the ceding company and the reinsurer to accept or decline the risk. Complete risk profiling is to be done by the reinsurer before acceptance and all terms and conditions of coverage are same as original policy. The difference lies in the way the reinsurer responds to a loss. In a proportional reinsurance the reinsurer responds to each and every loss (irrespective of amount of loss) to the extent of his share whereas in non-proportional the reinsurer will respond only when the loss exceeds a threshhold limit (please see description above). Following is an example of non-proportional facultative reinsurance :

Insured : ABC Co. Ltd. Insurer : XYZ Co. Ltd. Share : 100% Sum Insured : Rs. 1000 crores. Policy Deductible : Rs. 50 lakhs Premium : Rs. 50,00,000

Reinsurance Placement :



Policy Deductible : Rs. 50,00,000

Following points can be observed from the above :

i) Only when a loss amount exceeds Rs. 1,00,00,000, it can be recovered from the reinsurers
ii) Loss beyond Rs. 1 crore and upto Rs. 500 crore can be recovered from the 1st layer
iii) Loss beyond Rs. 500 crore and upto the limit of the top layer (Rs. 449 crores) are to be recovered from the top layer.
iv) Premium for the layers are not proportionate to the amount of loss to be borne by that layer

v) Lower layers carry more premium because they are more vulberable to loss

Sub Type B – Treaties

Non-proportional treaties, called Excess of Loss treaties, are usually effected to protect the net retention of an insurer against an exceptionally large loss affecting a single risk (called Risk Excess of Loss covers) or against a catastrophic event (called Catastrophe Excess of Loss covers) which affect a large number of risks which are retained in full or in part to the company's net account. An Excess of Loss treaty can also be arranged to protect an insurance company's gross account or the entire portfolio in which case the company does not have a separate and identifiable net retention for each and every risk.

Example : Risk Excess of Loss

Risk : ABC Petrochemical Co.
Sum Insured: Rs. 1000 crores
Insurer : XYZ Insurance Co. Ltd. Share 100%
Reinsurance Arrangement :
Statutory Cession 5% = Rs. 50 crores (5% of 100%)
Net Retention: Rs.100 crores (10% of 100%)
First Surplus Treaty : Rs. 200 crores (20% of 100%)
Second Surplus Treaty : Rs. 100 crores (10% of 100%)
Facultative : Rs. 550 crores (55% of 100%)

XYZ Insurance Co. Ltd has purchased a Risk Excess of Loss Cover for Rs. 200 crores xs of Rs. 20 crores. If ABC Petrochemicals suffers a total loss, after recovering from all the reinsurance arrangements, XYZ Insurance Co. Ltd will be left with a loss of Rs. 100 crores for its net account which can be recovered from Risk Xs of Loss reinsurers as under :

Gross loss to Net Account : Rs. 100 crores
less Underlying of the Risk XL Cover : Rs. 20 crores = Recovery from reinsurers :
Rs. 80 crores.

It may be noted that after a loss the cover stands reduced by the amount of recovery made but can be reinstated by paying additional premium. This reinstatement provision has to be agreed upon before the inception of the cover.

Catastrophe Excess of Loss Cover
This cover operates on the same lines as the Risk XL Cover but responds only to losses which are of catastrophic nature and usually carries "Two Risk Warranty" which means that at least two risks will have to be affected by the same event if any recovery is sought to be effected from the cover.

Example

Event : Flood
Gross Loss to Company : Rs. 500 crores
No. of Risks Affected : 250
Net Retention on each risk : Rs. 1 crore
Excess of Loss Cover on Net Retained Account : Rs. 300 crores xs of Rs. 30 crores

Expected Recovery from Company's Reinsurance Arrangement

Statutory Cessions @ 5%	=	Rs. 25.00 crores
Net Retention	=	Rs. 250.00 crores
Surplus Treaty 1	=	Rs. 100.00 crores
Surplus Treaty 2	=	Rs. 75.00 crores
Facultative	=	Rs. 50.00 crores
Total	=	Rs. 500.00 crores

While the Co. was prepared to bear Rs. 1 crore loss to its net account on each and every risk, it is saddled with a loss of Rs. 250.00 crores because of number of risks being accumulated due to flood. Because of the Catastrophe XL Cover, it will recover from reinsurers Rs. 250 crores less underlying Rs. 30 crores = Rs. 220 crores.

Stop Loss Covers

Stop Loss Covers operate on the principle that the premium of the protected portfolio is taken as the base and the cover worked out. The cover gets triggered once the agreed percentage of loss is touched and stops when the loss reaches the agreed percentage. Any loss beyond the upper limit (expressed in terms of percentages) falls back to the net account of the ceding company.

Example

Portfolio Protected : Crop
Total Portfolio premium : Rs. 100
Cover : Reinsurers to pay 120% xs of 90%

Loss scenario 1 : Gross loss to the portfolio : Rs. 70
Recovery : Nil
Net loss to Company : Rs. 70

Loss scenario 2 : Gross loss to the portfolio : Rs. 100
Recovery : (Rs. 100 – Rs. 90 =) Rs. 10
Net Loss to Company : Rs. 90

Loss scenario 3 : Gross loss to the portfolio : Rs. 130
Recovery : (Rs. 120 – Rs. 90 =) Rs. 30
Actual loss to Company : Rs. 90 + (Rs. 130 – Rs. 120 which is the cover limit +) Rs. 10 = Rs. 100. The amount of Rs. 10 which is beyond the cover limit of Rs. 120 has fallen back to the Company's net account.

9.6 COMMISSION

Unlike in direct insurance, commission under a reinsurance contract is not a remuneration but a way to cover the costs incurred by the ceding company to acquire the business . Commission is expressed in terms of percentage of the premium and is entirely a matter of negotiation between the ceding company and reinsurer. However, there are several factors

which influence commission terms, foremost among them being the result of the contract i.e., whether it is resulting in a profit for the reinsurer. Following are the types of commission.

Flat Rate of Commission : Here, an agreed percentage rate is applied on the premium accruing to the contract to arrive at the commission available. If a treaty has a premium income of Rs. 1000 and agreed rate of commission is 20% then the reinsurer will get (Rs. 1000 x 20% = 200) Rs. 800. There is no linkage to loss ratio of the contract.

Sliding Scale Commission : Here, the commission is linked to the loss ratio of the contract and is inversely proportional to the loss subject to a lower and upper limit. If a sliding scale is described as 25% to 35% on loss ratio of 65% to 55%, provisional commission being 30%, it means that if loss ratio is 55% and below, the ceding company will get a commission of 35% and if the loss ratio is 65% and above, the ceding company will get a commission of 25%. One percent rise in loss ratio is linked to one percent fall in commission and vice versa.

Profit Commission (PC) : As the name indicates, it is a commission which is linked to the profit achieved in a reinsurance transaction. This needs to be stipulated in the reinsurance contract at inception and the method of calculation is also mentioned. It may be described as under :

PC : 75% on first 10% and 90% on balance.

Example :

Total premium :	Rs. 1000	
Less commission @ 25% :	Rs. 250	= Rs.750
Less claims	Rs. 500	= Profit Rs. 250

i.e. percentage of profit is 25%

Calculation of Profit Commission :

75% on Rs. 25 = Rs. 18,75 and
90% on Rs. 225 = Rs. 202.50
So, total PC is Rs. 221,25

Overriding Commission

Usually found in retrocession contracts where a retrocedant is paid a commission which is in addition to the commission charged in the basic reinsurance contract. Also used to denote any additional commission charged by the ceding company in a reinsurance contract over and above the usual commission terms. In an Insurance contract, this term is sometimes used to identify the commission paid to the procurer of the business which is in addition to the usual commission agreed but is linked to the volume produced.

Profit Commission on Renewal (PCOR)
Usually found in facultative contracts where the reinsurer agrees to share a percentage of the

profit with the ceding company if the business is renewed with the same reinsurer.

9.7 DESIGNING REINSURANCE PROGRAM

Reinsurance- Its requirement and timeliness

Most insurance companies will need reinsurance in some form or other during their operation. For a company with limited capital, reinsurance could make the difference between survival and failure. For a company with reasonable capital will need reinsurance for stabilizing the operational result. No company will have unlimited capital from its shareholders. Hence it is essential to analyse the reinsurance requirements as soon as possible. For a start-up company it should be at the planning stages and for other well before commencement of underwriting year.

In India, reinsurance programme for all Insurance Companies will commence from 1st April and for General Insurance Corporation it is from 1st May or as decided. For timeliness of the programme the Indian regulator directed that all Insurers have to finalise their treaty reinsurance programme well in advance, so that their reinsurance programme can be received by Regulator at least 45 days before the commencement of the financial year i.e. by 15th February for insurer and 15th March for GIC or as applicable. The final reinsurance document i.e. placement slip other details need to submitted to Regulator within 30th April / 31st May or as applicable for Insurers/GIC respectively.

Objectives of a reinsurance program

The intention of all insurance companies should be to create the most effective reinsurance program according to the prevailing circumstances and regulation of the market. However, in order to achieve this objective, the company must first establish a reinsurance strategy generally based on company's risk management philosophy.

Hence, some companies may wish to retain as much as possible of the original premium income while others would be prepared to pay more in reinsurance premiums in order to secure as stable a result as possible and minimize the exposure to risk. The quantum of retention is likely to be influenced by several factors.

At the initial stages a company might put the emphasis on having an administratively simple form of reinsurance while others may be prepared to accept the heavier administrative burden of a more sophisticated reinsurance structure that, in return, offers other advantages.
It is said that for a reinsurance program to be effective, the programme should achieve the following objectives:

- The primary objective of arranging reinsurance is to reduce the company's probability of ruin ("ruin" is the word actuaries use for bankruptcy) at a price acceptable to the company. In this sense, the basic role of reinsurance is to safeguard the solvency of an insurer against random fluctuations in the overall claims experience and an accumulation of losses arising out of one event.

- It should stabilize any fluctuation in the company's annual aggregate claims experience so

that wide fluctuations in results from one year to the next are avoided;
- Reinsurance can be used to allow a company to accept risks beyond its normal retention capacity and to ensure that it is not placed at a serious disadvantage compared to its competitors;
- Reinsurance can be used to finance growth. Generally solvency margins are based on net premiums, hence through reinsurance net premiums for the company can be optimized, so that a company can accept an increasing volume of business without requiring a corresponding increase in capital.

9.8 STEPS IN REINSURANCE PROGRAMMING

i) Reinsurance Programme is to be done every year so that Insurance Company gets per class capacity to write direct Insurance Business.
ii) Fixing of Net Retentions.
   - Designing Proportional Treaties for various classes.
   - Negotiating Commission and Profit Commission terms of Treaties.
   - Arranging Excess of Loss Treaty Programme to protect Net Account of the Ceding
   - Company.
   - Bringing Quotations from Leading Reinsurers for Treaties.
   - Placement of all treaties with good rated securities of reinsurers.

Expectation of Indian Regulator from a reinsurance programme

The Indian Regulator has instructed all insurance companies to draw their reinsurance programme with the following uniform objectives:-

a) maximize retention within country;
b) develop adequate capacity;
c) secure best possible protection for the reinsurance costs incurred;
d) simplify the administration of business

It is generally not possible to obtained reinsurance support for a portfolio making continuous underwriting losses, which might have resulted from inadequate rating or ineffective claim management systems. Under such situation, where unprofitable results arise from extraordinary events and not from the ordinary course of business, the solution is to maintain a technically correct premium level/ introducing proper claim control mechanism.

Many professional reinsurers have compared the reinsurance arrangements to the shock absorbers on a car. The shock absorbers do not make the road smoother but passengers feel the bumps less because these are absorbed by the device fitted to the car. Similarly, reinsurance does not reduce losses but merely smoothes out the effect on the insurer. Continuing the analogy with the car, to ensure that the shock absorbers do not become worn out and the car cease to function, the road must be repaired. So if the underlying problem is inadequate rates or other technical or administrative issues, the insurer must address these issues in order to ensure continued successful operation of the insurance.

9.9 GLOSSARY OF REINSURANCE TERMS

Bordereau:

There are two kinds of bordereaux. The ***premium bordereau*** contains information concerning each individual risk reinsured, such as name of insured, location of risk, insurance amount,

premium, period of insurance, reinsurance amount and reinsurance premium. The ***loss bordereau*** contains details of each loss affecting risks reinsured such as name of insured, date of loss, nature of loss, total loss amount, loss amount reinsured.

Cash Loss

It is a provision in proportional treaty contract which facilitate reinsured to get immediate claim settlement for a large loss as defined in the treaty, outside the usual periodic accounting and settlement procedure

Cedant/reinsured

Cedant is the insurer who places the reinsurance business to a reinsurer. He can also be called as the reinsured.

Cede

Transferring to reinsurers all or part of the financial interests by reinsured with agreed consideration.

Cession:

The amount of risk transferred to the reinsurer by the ceding Company with proportionate premium of the whole risk.

Ceding Commission:

A return of part of gross premium to ceding company by the reinsurer to cover acquisition costs, expenses, taxes etc. Commission is generally fixed as a percentage of the gross reinsurance premiums. Sometimes a sliding scale applies where the commission is related to the loss ratio. This is also known as reinsurance commission.

Cover note:

A preliminary but binding document issued by a broker stating the main terms and conditions for the reinsurance agreed upon, pending the finalization of the contract wording.

Cut Through Clause:

This clause is more common in Aviation facultative placement. The clause provides that in the event of loss the original insured have right to recover the claim from participating reinsurers although they are not party to the contract of reinsurance.

Earned premium:

That part of premium that relates to the expired part of the policies.

Endorsement:

A document setting out modification of terms / risk after a contract is in place.

Follow the fortunes:

Follow the fortunes has the same meaning as "pay as may be paid". However follow the fortunes will not extend the reinsurer's liability to include a liability for loss falling outside the terms of the reinsurance. The concept inherent in any reinsurance relationship which, when expressed in agreement that the reinsurer and the ceding company are bound by the same fate on all risks ceded to a treaty.

Fronting

An arrangement by which the insurer (who is the reinsured) transfers the entire risk to the

reinsurer without retaining anything to its own account. Usually, in a fronting arrangement the ceding company charges a fee which is called the fronting fee. This type of transaction is not permitted as per Reinsurance Regulations currently in force in India.

From the Ground Up (or FGU):
Total claims payable by insurer from one occurrence with deductible of reinsurance being applied.

Hours Clause:
It limits the time period during which claims resulting from one occurrence may be included as part of the loss subject to the cover. The time period is usually measured in consecutive hours and most for property reinsurance

I.B.N.R.:
Incurred But Not Reported. At the end of any reinsurance contract when losses are being accounted for, it is assumed that there are some losses which have occurred but are yet to be reported to the reinsured. This is accounted for in addition to the outstanding losses that are known and is usually arrived at by an actuarial method of calculation. Calculation of IBNR is not only a requirement in reinsurance but in direct insurance as well.

Incurred losses:
Total of all losses occurred during a period, whether paid or not.

Layer:
This is peculiar to excess of loss contract and refers to a stratum of cover, i.e., above a pre-agreed level up to a pre-agreed level.

Line:
The amount fixed by the ceding company as the maximum retention capacity on any one risk. One line forms the unit of surplus reinsurance. The liability (capacity) of a surplus treaty is usually expressed in number of such lines.

Losses Occurring:
All losses that occur within the period of the treaty are covered, no matter when the original policy was issued.

Loss ratio:
The ratio of claims incurred (i.e., both paid and outstanding) to premiums earned.

Loss outstanding:
The sum of claims which have occurred but not been settled.

Non-proportional reinsurance:
This is reinsurance agreements for loss transfer where reinsures are not liable for all losses suffered by insurer. The liability of reinsurer starts only when the loss exceeds the underlying. The transfer of liability to reinsurer does not form a pro rata part of the underlying direct insurance.

PML:
It is an estimate by insurers of the maximum loss which could affect a risk within the realms of probability, disregarding unlikely coincidences and catastrophes. PML of risk is calculated mainly for material damage. For other than Act of God perils and for business interruption PML is generally at 100% subject to time excess.

Reinstatement:
When the reinsurance cover has been exhausted or reduced, the reinstatement provision re-establishes it to its original figure. It normally requires payment of an additional premium. As a rule the number of reinstatements is limited as stipulated in the contract.

Reserve (Premium or Loss):
As a security for the reinsurer's share of the unearned premiums and / or the outstanding losses, the ceding company may withhold an amount equal to such premium and loss reserves. The ceding company usually pays interest on such deposits.

Retention:
There are two types of retention. First type is called Risk retention (called Net capacity) and second type is called Loss retention (Underlying of excess of loss cover). The part of a risk (sum **insured**) that is kept for own account by the cedant is known as risk retention. The amount of loss retained in the ceding company's account for arranging excess of loss protection is known as loss retention.

Underwriting Year
The specific 12 month period during which policies are issued and become subject of the relevant reinsurance contract. In a reinsurance contract, the underwriting year may be closed after a certain (agreed) time period or may be kept open till development of all premium and losses. If an underwriting year is closed say, after 12 months or 24 months, and premium and losses are yet to fully develop, it is a practice to debit the existing reinsurers with an agreed percentage of premium and losses and credit the reinsurers of the next open underwriting year.

Unearned premium:
That portion of the premium of a policy that applies to the unexpired portion of the risk. A reinsurer must always set up a reserve for unearned premiums in the balance sheet and sometimes the reinsurer has to deposit his share of such unearned premium reserve with the ceding company.

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