2021 Annual Conference
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REINSURANCE 101 FOR CLAIMS HANDLERS – WHAT YOU NEED TO KNOW AND WHY

This course will introduce property and casualty claims adjusters to basic reinsurance concepts, which are an integral part of the risk transfer industry. The speakers will address the importance of the reinsurance to the insurer, and the significant role that insurance and reinsurance claim professionals play in facilitating the reinsurance relationship. The course will cover several core purposes of reinsurance, its basic types, and the claims perspectives of both the reinsured and the reinsurer. The course will also illustrate the role of the reinsurance intermediary, and the unique process of reinsurance dispute resolution.

Reinsurance is a contract of insurance whereby one insurer (called the **reinsurer** or **assuming company**) agrees, for a portion of the premium, to indemnify another insurer (called the **reinsured** or **ceding company**) for losses paid by the reinsured under its insurance policies issued by the reinsured to its policyholders. The progression of risk transfer is from policyholder, to insurance company, to reinsurer and to retrocessionaire. Reinsurance is a contract of **indemnity**, where the subject matter is the ceding company's liability to its policyholders; therefore, there is no direct relationship between the ceding company's policyholder and the reinsurer.

I. TYPES OF REINSURANCE

A. Role of the Reinsurance Intermediary. The reinsurance intermediary is a key player in the reinsurance value chain, who orchestrates placement and renewal, and coordinates ongoing account servicing, including claims. Even though many reinsurance buyers have experienced ceded reinsurance staff, the intermediary as the insurance company's agent is a conduit to suitable markets and in the forefront of negotiating the contract terms and conditions.

B. Treaty Reinsurance. Treaty reinsurance covers an entire portfolio of business written in a specific line or by a specific profit center. In general, the reinsurer does not have the ability to reject a specific risk that is within the portfolio. The reinsurer follows the terms and conditions of the underlying coverage, subject to the treaty's own terms and conditions.

C. Facultative (Per Risk) Reinsurance. Facultative reinsurance covers a specific risk, individually underwritten by the reinsurer, for a specific amount of limit provided and premium charged. Facultative involves a risk by risk selection, and the reinsurer retains the right to accept or reject an individual submission. Facultative reinsurance often "inures" to the benefit of treaty reinsurance, and can offer protection of the reinsured's net retention.

D. Catastrophe Reinsurance. Catastrophe reinsurance covers the aggregation of losses up to a predetermined limit across multiple policies and/or insureds arising from a specified event, such as a hurricane or wildfire. The contract will set forth the parameters of the event in terms of timing and geographic location. Coverage is usually subject to a retention, and there may be additional premium payable to reinstate the limit provided.

E. Quota Share (Proportional) Reinsurance. In quota share reinsurance, which can be written on either a treaty or facultative basis, the parties share premium and losses "dollar for dollar" subject to a specified percentage. Proportional reinsurance usually includes a feature known as "ceding commission", which assists the ceding company in offsetting the expense of generating the business.

F. Excess of Loss Reinsurance. In excess of loss reinsurance, which can be written on either a treaty or facultative basis, loss in excess of a specific deductible or retention is ceded to reinsurers, who then respond pursuant to their specific percentage, which can be up to 100% depending on the line of business. There is no proportional sharing of premium or loss, instead, the coverage is subject to a negotiated premium that can take numerous forms. Excess of loss reinsurance can be on a per risk or an aggregate basis.

II. WHY PURCHASE REINSURANCE?

A. Risk Transfer. Overall goal is to spread the ceding company's risk to serve one or more financial purposes.

B. Surplus Relief – Financing Growth. Insurance company surplus is subject to a variety of pressures, such as unearned premium reserve requirements, adverse underwriting or investment results, and marketing / growth considerations. Reinsurance provides surplus relief on the balance sheet.

C. Stabilize Results – Catastrophe Protection. Reinsurance allows the insurance company to plan long term growth strategy and protection against outsized adverse effects of catastrophe losses.

D. Additional Individual Risk or Aggregate Capacity. Reinsurance allows an insurer the ability to provide increased limits for a single risk or for an entire portfolio at a level to which management is comfortable, to maximize shareholder value and to comply with regulatory (capitalization) requirements.

E. Market Entry or Exit. Reinsurance can facilitate entry into a new market where the insurance company does not have a track record, or facilitate exit from an unprofitable market by transferring the downside risk potential.

F. Access to Reinsurer Expertise. Reinsurers have a market wide perspective on risks, market conditions, trends, etc. This expertise is often shared via underwriting meetings and claims audits, and can take many forms, including actuarial and modelling analysis, advice as to product development and loss prevention techniques as appropriate.

III. REINSURANCE CLAIMS PROCESS

A. Reinsurance Reporting – Individual Loss and Bordereaux. Per the contract terms, loss is reported either individually (usually for excess of loss and sometimes for proportional) or in bulk (usually for proportional). Timely reporting in accordance with the contract terms is crucial for timely reserving and recognition of exposure in the reinsurer's claim system. Notification of loss is usually provided by the ceding company to the intermediary, which in turn transmits notice to the reinsurer. Bulk losses on proportional contracts are sometimes provided in a consolidated format known as a "bordereau".

B. Loss / Exposure Assessment. Upon receipt of an individual loss notice from the ceding company, the reinsurance claims staff will undertake an assessment of the facts, coverage and exposure potential reported. The claim staff will assess both the exposure to the underlying contract and the potential impact to the reinsurance contract.

C. Primary and Reinsurance Contract Review. Key aspects of the primary contract to be reviewed include the basic insuring agreement, policy term, limits and exclusions. Key aspects of the reinsurance contracts include the subject business clause, treaty term, exclusions, the definition of Ultimate Net Loss, treatment of expenses, treaty limits and retention. It is a core responsibility of reinsurance claim staff to ascertain that a particular cession is covered by the reinsurance contract, that the calculation of the exposure is correct, and to raise questions via the intermediary on these issues as appropriate.

D. Reserving and Payments. The reinsurance claims department usually has service level standards for timing of individual case reserves and payment of undisputed claims. Reserves are based on the reinsurer's assessment of the exposure. The reinsurer's share of reported reserves is known as "RCR" or "reported case reserve." If the reinsurance claim staff judges that the reported reserve is insufficient for the projected exposure, "additional case reserve" or "ACR" may be posted. Covered losses are paid to the reinsurance intermediary, either by the claims department directly for excess of loss business, or via the technical accounting department for proportional business.

E. Claim Audits. Key aspect of the underwriting process for renewal, and to support the reserving process whether accounts are in force or in runoff. Claim audits are usually coordinated through the reinsurance intermediary and take place at the office of the ceding company, although remote audits directly into the ceding company's claim system are becoming more common. The audit presents an opportunity for direct contact with the ceding company's claims management and staff. The audit includes an evaluation of the overall claim operation, including management controls, authority levels, litigation guidelines, third-party administrator oversight, caseloads and reinsurance reporting protocols. Most importantly, the claim audit is an assessment of the ceding company's reserving practice and philosophy, and whether ACRs need to be booked. The audit process should be a collaborative effort between the ceding company and reinsurance claim staffs, each side contributing information and knowledge regarding the subject business so that exposures are appropriately identified, and concerns discussed.

F. Trends and Analytics – The reinsurance claim staff is charged with understanding the subject business, the market where policies are sold, the venues where losses arise and other conditions that will impact claim values. The claim staff's role is twofold: running an efficient operation for the timely setting of reserves and issuance of payments arising from covered losses, and providing internal stakeholders (underwriting, actuarial and senior management) with information that affects the loss results.

IV. REINSURANCE CLAIMS DISPUTES

A. Commercial Relationship. Unlike an insurance policy, where one party has all the bargaining power (known as a "contract of adhesion"), reinsurance is a contract where both parties are sophisticated market participants. Reinsurance contract wordings are manuscript, and for the most part, all terms and conditions are subject to negotiation.
B. Utmost Good Faith. Like all insurance contracts, the commercial foundation of the reinsurance relationship is one of "utmost good faith", whereby the parties are expected to disclose all information that materially affects the risk.
C. Arbitration. In practice, disputes as to coverage provided by the reinsurance contract are often resolved on a commercial basis in the interest of preserving the business relationship. If, however, disputes cannot be resolved commercially, reinsurance contracts almost universally compel the parties to arbitration and not litigation. The intention is to reach a resolution of the dispute in a cost-efficient manner that ensures finality to the extent possible. Arbitration is highly favored in the US and courts generally will enforce arbitration clauses mutually agreed by the parties.
D. Common Issues. Reinsurance disputes can arise from any term or condition in the contract, but many relate to whether a single loss or group of losses are eligible for recovery. The allocation of loss across multiple policy periods and/or multiple reinsurance periods is often cause for differing positions as to the operation of core reinsurance clauses. The number of occurrences, as respects both the primary insurance and the reinsurance contract, is another example. Whether an aggregation of losses can be grouped together as "event" for reinsurance purposes is also a common reinsurance dispute.
E. Mechanics. Arbitration clauses often dictate that the dispute will be heard by a panel of three people, one arbitrator chosen by each party and an umpire selected by the arbitrators or by an agreed random selection. Most arbitration clauses are written on the basis of an "honorable engagement." This allows the arbitration panel to view the reinsurance relationship and its contractual terms in accordance with the agreement's general purposes, rather than according to the "strict rules of law". The rules of evidence are somewhat relaxed, although the arbitration panel can authorize common discovery elements, such as document production and depositions. The parties will generally submit

written briefs / position statements; evidence and arguments are often presented live to the panel hearings.

F. Decision and confirmation. By agreement of the parties, the arbitration panel may issue a reasoned opinion, or it may simply advise the outcome of the dispute without a detailed opinion. The grounds to challenge the decision of an agreed arbitration panel are extremely narrow, as a result, most arbitration decisions are not publicly available, and they generally do not have precedential value.