Reinsurance (PUN005)

Reinsurance, often referred to as insurance for insurance companies, is a contract between a reinsurer and an insurer. In this contract, the insurance company known as the ceding party or cedent transfers some of its insured risk to the reinsurance company. The reinsurance company then assumes all or part of one or more insurance policies issued by the ceding party. Reinsurance is insurance for insurance companies. It's a way of transferring some of the financial risk that insurance companies assume when insuring cars, homes, people, and businesses to another company, the reinsurer. Several common reasons that insurers obtain reinsurance include: expanding an insurance company's capacity, stabilizing its underwriting results, financing, gaining catastrophe protection, spreading an insurer's risk, and acquiring expertise. Reinsurance allows insurers to remain solvent by recovering some or all amounts paid out to claimants. Reinsurance reduces the net liability on individual risks and catastrophe protection from large or multiple losses.

The practice also provides ceding companies, those that seek reinsurance, the chance to increase their underwriting capabilities in number and size of risks. Ceding companies are insurance companies that pass their risk on to another insurer.

Key Takeaways:

- Reinsurance, or insurance for insurers, transfers risk to another company to reduce the likelihood of large pay-outs for a claim.
- Reinsurance allows insurers to remain solvent by recovering all or part of a pay-out.
- Companies that seek reinsurance are called ceding companies.
- Types of reinsurance include facultative, proportional, and non-proportional.

Benefits of Reinsurance: By covering the insurer against accumulated liabilities, reinsurance gives the insurer more security for its equity and solvency by increasing its ability to withstand the financial burden when unusual, major events occur. Insurers are legally required to maintain sufficient reserves to pay all potential claims from issued policies. through reinsurance, insurers may underwrite policies covering a larger quantity or volume of risk without excessively raising administrative costs to cover their solvency margins. In addition, reinsurance makes substantial liquid assets available to insurers in the event of exceptional losses.

Types of Reinsurance: Reinsurance has two basic categories: treaty and facultative. Treaties are agreements that cover broad groups of policies, like all a primary insurer's auto business. Facultative covers specific individual, generally high-value or hazardous risks, such as a hospital, that wouldn't be acceptable under a treaty. Facultative coverage protects an insurer for an individual or a specified risk or contract. If several risks or contracts need reinsurance, they are renegotiated separately. The reinsurer holds all rights for accepting or denying a facultative reinsurance proposal. A reinsurance treaty is for a set period rather than on a per-risk or contract basis. The reinsurer covers all or part of the risks that the insurer may incur.

Reinsurance Deconstructed: Under proportional reinsurance, the reinsurer receives a prorated share of all policy premiums sold by the insurer. For a claim, the reinsurer bears a portion of the losses based on a pre-negotiated percentage. The reinsurer also reimburses the insurer for processing, business acquisition, and writing costs. With non-proportional reinsurance, the reinsurer is liable if the insurer's losses exceed a specified amount, known as the priority or retention limit. In the case of non-proportional reinsurance, the reinsurer doesn't have a proportional share in the insurer's premiums and losses. The priority or retention limit is based either on one type of risk or an entire risk category. Excess-of-loss reinsurance is a type of non-proportional coverage in which the reinsurer covers the losses exceeding the insurer's retained limit. This contract is typically applied to catastrophic events and covers the insurer either on a per-occurrence basis or for the cumulative losses within a set period. Under risk-attaching reinsurance, all claims established during the effective period are covered, regardless of whether the losses occurred outside the coverage period. No coverage is provided for claims originating outside the coverage period, even if the losses occurred while the contract was in effect.

The Bottom Line: Reinsurance, often called "insurance for insurance companies," results from a contract between a reinsurer and an insurer. In it, the insurance company—known as the ceding party or cedent—transfers some of its insured risk to the reinsurance company. As a result, the reinsurance company assumes some or all of the insurance policies issued by the ceding party. Having reinsurance transfers risk to another company to reduce the likelihood of being exposed to large pay-outs for one or more claims

Thank You…