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- **Glossary of Common Reinsurance Terms**
CNA Re offers a total reinsurance solutions, including treaty, facultative, alternative risk and financial reinsurance.

**Treaty**
Worldwide we offer multi-line treaty capabilities and expertise in writing:
- Working layer property
- Working layer casualty
- Property catastrophe
- Workers’ compensation
- Professional liability
- Specialty, Excess and Surplus lines

**Facultative**
Facultative capabilities include both property and casualty lines globally. Areas of focus include commercial lines, personal lines, inland marine, boiler and machinery, and all package policies. Other classes considered include PML and capacity layers.

Up to $10 million capacity is available for casualty risks. Areas of expertise include automatic and individual risk products such as general liability, automobile liability, umbrella liability, workers’ compensation, liquor liability, wrap ups, railroad protectives, OCPs and specific event covers.

**Alternative risk**
Property and casualty coverage is available for group self-insured associations, captives, risk retention groups, governmental pools and individual risks, using self-insured, single parent captives or large deductive programmes.

**Global financial reinsurance**
Global financial reinsurance writes business around the world. We write individual product line and whole account stop loss contracts, multi-year catastrophe loss spreaders on both an individual loss and aggregate basis and capped loss portfolio transfer.

**OUR UNIQUE APPROACH**

**Understanding your business** – This is a critical first step in building the foundation for our relationship.

**Innovation** – Our philosophy of providing out-of-the box solutions positions CNA Re to offer the types of aggressive reinsurance solutions worldwide that keep our clients competitive.

**Responsiveness** – In today’s world, responsiveness is critical to success. CNA Re strives to provide responsiveness in providing information, answering questions and offering solutions.

Visit our website at http://www.cnare.com
Introduction

What is reinsurance?

Reinsurance is a contract or programme between a primary insurer and one or several reinsurers. Through a reinsurance contract, the company that buys reinsurance spreads its risk by ceding (transferring) a portion of its liability to one or more reinsurers. Reinsurers can also buy reinsurance to spread the risk even further. It has been referred to as insurance of insurance companies.

If that were the end of it, reinsurance would be simple but, of course, it isn’t. A ceding company (the buyer) usually enters into a reinsurance agreement for a very specific reason. That reason, the nature of the risk being insured, the business strategies of all the companies involved, and other factors combine to create a myriad of possible combinations.

Because there are so many different products and so many different ways to combine them into a programme, reinsurance is an art as much as a science. There are formulas and calculations, industry standards, and other guidelines that can be followed, but successful reinsurance planning, placement and management is — like any insurance transaction — also about trust, long term relationships, and creative problem-solving.

The purpose of this guide is to provide a quick reference to the fundamental strategies and concepts that drive this industry.

How Does Reinsurance Work?

When a primary insurer meets its reinsurance needs by entering into multiple contracts with more than one reinsurer, the resulting package of agreements is known as a reinsurance programme.

The advantages of a programme rather than a single reinsurance contract with a single reinsurance company are flexibility and control for the ceding company. The ceding company retains maximum flexibility to adapt the programme as its needs change over time. Naturally, the programme is also designed to be as cost effective as possible for the ceding company.
What Types of Reinsurance Are Available?

What is the difference between treaty and facultative reinsurance?

The two basic categories of reinsurance are treaty and facultative. The difference between them is that a treaty contract covers multiple risks of a certain type while a facultative contract is for a single risk.

A typical treaty contract will cover an entire category of risk or line of business, perhaps up to a certain limit or for a certain period of time. As long as a new risk that is accepted by the ceding company meets all the specifications for its category, as defined by the reinsurance contract, acceptance of that risk by the reinsurer is automatic. Treaty contracts can be written two ways: obligatory and non-obligatory. In a non-obligatory treaty, the client can choose what is ceded based on the prior agreement. For an obligatory treaty, the cedant does not have that option.

By contrast, in a facultative contract relationship between a primary insurer and a reinsurer, the reinsurer retains the faculty (used here as a synonym for "ability") to accept or reject each individual risk offered by the primary insurer.

Primary insurers choose treaty or facultative reinsurance based on their specific needs; and often the two are combined. Facultative reinsurance might be used to provide capacity over the limits of a treaty contract, for example; or when the primary insurer wants to protect their treaty from a potentially adverse risk.

What is the difference between a proportional agreement and a non-proportional agreement?

Regardless of whether the contract form is treaty or facultative, the same loss-sharing methods are available. The contract can be either proportional or non-proportional.

In a proportional agreement for reinsurance, the reinsurer agrees to pay for losses in the same proportion as the share of premium it receives. For example, if the primary insurer cedes 60 percent of its liability to a reinsurer, it pays an amount equal to 60 percent of the original premium for the privilege. Proportional reinsurance is also called pro-rata reinsurance.

Proportional reinsurance can be written on either a quota share or a surplus share basis. In a quota share
arrangement, the reinsurer assumes a fixed percentage of each risk. In a surplus share arrangement, the ceding company sets a retention limit and the reinsurer takes the rest (the surplus). The alternative to proportional reinsurance is excess of loss, which is explained in the next section.

**Characteristics of Pro Rata and Excess of Loss Reinsurance**

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<td>Rate is percent of original premium less ceding commission</td>
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<td>Settlement of premiums and losses by account (Bordereau)</td>
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**Characteristics of Quota Share and Surplus Share**

<table>
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<tr>
<th><strong>Quota Share</strong></th>
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<td>Property or casualty</td>
<td>Often property only</td>
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<td>Fixed percentage sharing</td>
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<td>No individual cessions</td>
<td>Individual cessions</td>
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<td>Reinsurer’s premium is percent of original premium, less a negotiated ceding commission</td>
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<td>Settlement of premiums and losses by account</td>
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How does excess of loss reinsurance work?

In an excess of loss agreement, an attachment point is set. In the event of a claim, the reinsurer pays nothing unless the claim amount exceeds that attachment point.

To illustrate, imagine a primary insurance policy with a coverage limit of $2 million. The primary insurer takes an excess-of-loss reinsurance contract with an attachment point of $750 thousand. Now imagine that a claim of $1.8 million must be paid. The primary insurer is responsible for $750 thousand and the reinsurer is responsible for the rest ($1,050,000).

Now imagine that the claim is for $500 thousand instead. In that case, the primary insurer is responsible for the full $500 thousand and the reinsurer pays nothing.

Excess of loss reinsurance can be written per risk, per occurrence or as an aggregate or stop loss. In per risk excess of loss reinsurance, the reinsurance limit and retention applies "per risk" (building/location) rather than per occurrence, per event, or in the aggregate. Per occurrence is used to reinsurance against catastrophes and is usually written for property exposures. Aggregate excess of loss or stop loss stipulates participation by the reinsurer when the aggregate losses for the primary insurer exceed a certain level, usually stated as a loss ratio. Stop loss can cover the property and casualty books of business or property only.

For all types of excess of loss there is no relationship between premium and loss in a non-proportional agreement. The premium is negotiated separately and based on a variety of factors.

Conceptually, proportional reinsurance focuses on the size and nature of the overall risk, whereas non-proportional reinsurance focuses more narrowly on the size of the potential loss to the reinsurer.
## Characteristics of Non-Proportional (Excess of Loss)

<table>
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<th>Per Risk</th>
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<td>Negotiated rate exposure basis, usually no commission</td>
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<td>Premiums are settled by annual adjustment of deposit premium</td>
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<td>Usually minimum premium</td>
<td>Usually minimum premium</td>
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<td>Losses settled individually</td>
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<td>Retention is for each risk/building/location</td>
<td>Retention is usually above a minimum of two full-risk losses</td>
<td>Retention and limit is stated as a loss ratio</td>
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<td>Usually has a per-occurrence limitation</td>
<td>Often has a co-insurance provision when the reinsured shares in the loss above the retention</td>
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</tbody>
</table>

What are the Benefits of Reinsurance?

Why buy reinsurance?

Primary insurers exist to serve the insurance needs of businesses and individuals. The variety of those needs is reflected in the many different types of primary insurance contracts available. By the same token, the reinsurance market exists to serve the insurance needs of insurers, both primary and reinsurance. Those needs can also vary widely, hence the many types of reinsurance products available.

A company buys reinsurance to satisfy some or all of the following needs:
1. Increase capacity
2. Enhance stability
3. Protect against catastrophes
4. Obtain surplus relief to enable growth
5. Gain access to underwriting expertise
6. Withdraw from territory or line of business

How is reinsurance used to increase capacity?

Regulations typically prohibit a primary insurer from risking more than 10 percent of its surplus on any one risk. With reinsurance, a primary insurer can increase its large line capacity, i.e., its ability to provide coverage for large, individual risks.

Reinsurance also can be used to increase a primary insurer’s premium capacity, which is usually limited by regulations (and by the opinions of rating organisations) to a 3:1 ratio of written premium to surplus.

How is reinsurance used to enhance stability?

Reinsurance is often used to smooth out the peaks and valleys of a primary insurer’s profits and losses. By reinsuring some of its risk, the primary insurer gains a steady flow of profits, which improves its ability to attract and retain capital. In effect, the primary insurer is giving up some of its potential profit in return for a steady revenue flow.
How is reinsurance used to protect against catastrophes?

Some kinds of insurance are more predictable than others and some types of hazards are, by their nature, wildly unpredictable. Natural disasters like earthquakes and storms have the potential to create catastrophic losses, as do events like plane crashes, industrial accidents, and major fires or explosions. Often a reinsurance product is created specifically for catastrophic losses, to limit a primary insurer’s maximum potential loss to some fixed and manageable amount. Such a contract will be written to cover multiple losses under multiple policies that are all caused by a single event.

What is surplus relief and how is it used to finance growth?

Often a primary insurer’s ability to grow is limited by statutory requirements dealing with the accounting of policy acquisition costs and associated premium income. These statutory requirements differ significantly from generally accepted accounting principles and reduce the insurer’s reported surplus significantly. Through a reinsurance agreement, the ceding commission paid by the reinsurer to the primary insurer can be used to offset some percentage of the policy acquisition cost, which increases the company’s reported surplus and permits it to accept more risk. This method of reinsurance is used by insurance companies much like another business would use a bank loan or securities sale to implement a growth strategy. In both cases, the company assumes that incremental profits produced by the growth will more than offset its cost to obtain the needed capital.
**How is reinsurance used to gain access to underwriting expertise?**

A small insurance company that wishes to enter a new and unfamiliar category of business may choose to supplement its own underwriting capabilities with those of a reinsurer who already has experience in that area. Since the reinsurance underwriter has to evaluate the underlying risk anyway, that expertise can be used to underwrite the primary policy. This benefit can be multiplied by choosing multiple reinsurers with expertise in different areas.

**How is reinsurance used to withdraw from a territory or line of business?**

Just as the reinsurer’s underwriting expertise can be used to help a primary insurer enter a new line of business, reinsurance also can be used to extricate a primary insurer from a particular geographical territory or line of business. This way, a company can consummate its business decision with a quick transition for a known cost, without being limited by policy duration, tails and other considerations. This can be accomplished through portfolio transfer, finite or other financial mechanisms.
How Is Reinsurance Underwritten?

What are the factors a reinsurance underwriter must consider?

Typically, a reinsurance underwriter evaluates an entire book of business, as well as the stability, practices and pricing of the primary insurance company. In particular, the reinsurance underwriter must evaluate the loss exposures covered by the primary insurance company and the specific terms of that coverage. In the case of facultative reinsurance, the underwriter is evaluating all of this as well as a specific risk.

Underwriting Factors To Consider:

- Financial status of the primary insurer
- Loss exposure of the primary insurer
- Coverage provided by the primary insurer
- Risk retained by the primary insurer
- Premium pricing of the primary insurer
- The exact wording of the reinsurance contract

In the event of a covered loss, who pays whom?

In the event of a loss covered by a reinsurance contract, the reinsurer pays the amount owed to the entity holding the reinsurance contract, typically a primary insurer or another reinsurer.

Part of the expectation of the ceding company is that this payment will be timely, since in many cases its solvency is at stake. The ceding company is therefore obliged to inform the reinsurer(s) about both actual and potential losses. Normally, the ceding company pays the claimant(s) first and is reimbursed by the reinsurer(s). The lapse of time between payment to the claimants and reimbursement by the reinsurer is usually stipulated in the reinsurance contract.

What kinds of risk can be reinsured?

In this regard, the rules for reinsurance mirror the rules for primary insurance. This is only logical since a risk must be insured before it can be reinsured. The most basic requirement is that there must be an insurable interest and certain jurisdictions may require appropriate transfers of risk. Beyond that, any risk that can legitimately be insured can be reinsured, assuming that the ceding company has done its job correctly. Property, casualty and life insurance can all be an underlying risk in a reinsurance contract. The type of primary insurance and the coverage terms are just some of the factors the reinsurance underwriter must consider.
Glossary of Common Reinsurance Terms

**Admitted reinsurer** – A reinsurer licensed or authorised to conduct business in a given jurisdiction. Also known as authorised reinsurance. The alternative is a non-admitted reinsurer.

**Aggregate excess of loss reinsurance** – A form of reinsurance which stipulates participation by the reinsurer when aggregate losses for the primary insurer exceed a certain level.

**Assuming company** – The company that assumes some part of a primary risk: The reinsurer.

**Bordereau** – (sometimes spelled Bordereaux) A document provided to the reinsurer by the ceding company showing the loss and premium history of specific risks. Usually required in surplus share treaty contracts.

**Catastrophic reinsurance** – An excess of loss reinsurance contract that indemnifies the ceding company for the accumulation of losses in excess of a stipulated sum arising from a single catastrophic event in a series of events.

**Ceding commission** – An amount in excess of the premium, paid by a reinsurer to a primary insurer as part of a reinsurance transaction and meant to offset the primary insurer’s policy acquisition costs.

**Ceding company** – The company that buys reinsurance cedes (transfers) a percentage of its risk to a reinsurer. The ceding company can be a primary insurer or another reinsurer. Also referred to as a cedant.

**Clash cover** – Also known as a contingency cover, it is an excess of loss reinsurance contract. It comes into play when two or more policies of the primary insurer are involved in the same occurrence, workers’ compensation involving accidents affecting two or more people, or expenses (ECO XPL).

**Commutation** - Provision for estimation payment and discharge for future obligations for reinsurance loss or losses regardless of the continuing nature of certain losses.

**Contingent Commission (profit commission)** - An allowance payable to the ceding company in addition to the normal ceding commission allowance. It is a predetermined percentage of the reinsurer’s net profits after a charge for the reinsurer’s overhead, derived from the subject treaty.

**Direct written premium** - Aggregate amount of recorded originated premiums, other than reinsurance, written (but not necessarily collected) during the year, including retrospective audit premium collections but excluding return premiums.

**Excess** – The liability not retained by the primary insurer. Therefore, excess is the total liability less the retained liability. Used in non-proportional or excess-of-loss reinsurance agreements.

**Excess per risk reinsurance** – The percentage of risk retained by the ceding company may be different for each risk transferred.

**Excess of loss reinsurance** – also known as non-proportional reinsurance. The contract specifies an amount (the attachment point) and the reinsurer pays only after the ceding
company’s losses on the contract exceed that amount. It is the opposite of proportional or pro rata reinsurance.

**Extra-contractual obligations (ECO)** – Applies to liabilities of the reinsured that arise as a direct result of its claims handling and not covered under other provisions of the reinsurance contract.

**Facultative reinsurance** – A type of reinsurance, distinguished from treaty reinsurance because the reinsurer retains the faculty (ability) to accept or reject each individual loss presented to it by the primary insurer.

**Finite risk reinsurance** – Form of reinsurance in which the time value of money is considered in developing the premium and which has loss containment provisions. One of the primary objectives of this type of reinsurance is to enhance the cedant’s financial statements or operating results.

**Funds withheld** – In order to comply with government regulations, the ceding company retains unearned premium reserves or outstanding loss reserves, or both, on risks it cedes to a reinsurer.

**Letter of credit** – A banking instrument used by the ceding company to secure amounts recoverable from non-admitted reinsurers in order to comply with statutory requirements. (Frequently abbreviated as ”LOC.”)

**Loss adjustment expense** – As specified in the reinsurance contract, expenses directly allocated to the claim as opposed to overhead.

**Net written premium** – Gross written premium after reinsurance costs but before deduction of commission and brokerage costs.

**Non-admitted reinsurer** – A reinsurance company that is not licensed or authorised to conduct business in a given jurisdiction. Absent certain security considerations, credit for reinsurance is generally denied by the ceding company’s governing regulatory authorities. The alternative is an admitted reinsurer.

**Per occurrence** – An excess of loss agreement covering loss occurrence from an event, disaster or catastrophe which gives rise to many individual losses.

**Policyholder’s surplus** – The amount by which assets exceed liabilities. It is comprised of special surplus funds, common and preferred capital stock, gross paid in and contributed surplus, assigned funds, and excludes common and preferred treasury stocks.

**Portfolio reinsurance** – The ceding company transfers an entire portfolio of business to a reinsurer. The block of business transferred may be a group of policies in force or a group of outstanding losses.

**Primary insurer** – A company that sells insurance to businesses and individuals, and buys reinsurance to cede (transfer) a percentage of its risk to a reinsurer.
**Pro rata reinsurance** – The primary insurer and reinsurer share the risk and revenue according to an agreed percentage. This is a proportional agreement, the alternative to an excess-of-loss agreement.

**Quote share reinsurance** – A proportional reinsurance contract in which the reinsurer assumes a fixed percentage of each risk.

**Reinsurer** – The company that accepts a percentage of a primary insurer’s risk through a reinsurance agreement.

**Retention** – In a reinsurance contract, the amount of the risk being considered that is not ceded to the reinsurer.

**Retrocession** – The reinsurance of reinsurance. The ceding reinsurer is called the retrocedant and the assuming reinsurer is called the retrocessionaire.

**Sliding scale commission** – A predetermined formula under which the commission that is payable by the reinsurer to the ceding company varies inversely with the actual loss experience.

**Stop loss reinsurance** – A form of reinsurance that stipulates participation by the reinsurer when aggregate losses for the primary insurer exceed a certain level.

**Surplus share reinsurance** – A proportional reinsurance contract in which the ceding company sets a retention limit and the reinsurer takes all the risk above that limit (the surplus).

**Treaty** – A type of reinsurance whereby the assuming company agrees to accept all risks of a certain type. The alternative is facultative reinsurance.