



The Reinsurance Placement Process

Educational Objectives

After learning the content of this assignment, you should be able to:

- ▶ Describe the direct writing and broker reinsurance marketing systems.
- ▶ Describe the major steps in the reinsurance placement process.
- ▶ Explain how facultative reinsurance is placed through the direct writing marketing system.
- ▶ Explain how treaty reinsurance is placed through the broker marketing system.

Outline

Reinsurance
Marketing Systems

Reinsurance
Placement Process

Facultative
Reinsurance Placed
Through the Direct
Writing Marketing
System

Treaty Reinsurance
Placed Through the
Broker Marketing
System

Summary

The Reinsurance Placement Process

3

REINSURANCE MARKETING SYSTEMS

Just as an individual or organization can purchase an insurance policy from an insurer, an insurer can purchase reinsurance from one or more reinsurers. A reinsurer can also reduce its assumed reinsurance risk by purchasing reinsurance coverage from other reinsurers, both domestic and international.

Reinsurance is sold through two primary marketing systems: the direct writing marketing system and the broker marketing system.

Direct Writing Marketing System

In the **direct writing marketing system**, reinsurers sell reinsurance to primary insurers without involving reinsurance intermediaries. Direct writing reinsurers employ their own sales force to solicit and negotiate the reinsurance agreement's terms.

The sales force provides services such as these:

- Reinsurance program design, including an actuarial evaluation of an appropriate retention for the primary insurer
- Advice on underwriting, accounting, and claim handling procedures and controls
- Reinsurance claim processing

Direct writing reinsurers generally have sufficient financial resources to provide sizable reinsurance programs. For example, one reinsurer may provide the entire reinsurance program for a primary insurer.

Broker Marketing Systems

In the **broker marketing system**, a reinsurance intermediary brokers the reinsurance transaction between the primary insurer and reinsurer(s).

Reinsurance intermediaries provide services such as these:

- Examination of the worldwide reinsurance market to optimize the price, coverage, and financial security of the reinsurance
- Reinsurance program design, including an actuarial evaluation of an appropriate retention
- Assistance in negotiation of premiums and terms

Direct writing marketing system

A reinsurance marketing system in which direct writing reinsurers sell reinsurance to primary insurers without involving reinsurance intermediaries.

Broker marketing system

A reinsurance marketing system in which a reinsurance intermediary brokers the reinsurance transaction between the primary insurer and reinsurer(s).

Brokerage

Compensation in the form of a flat fee or a commission that is paid by the reinsurer to the reinsurance intermediary for services provided.

- Advice on underwriting, accounting, and claim handling
- Reinsurance claim handling

Reinsurers pay the reinsurance intermediaries for their services through either a flat fee or a commission, called **brokerage**. The brokerage rates used to calculate the brokerage usually vary by type of reinsurance and premium amount. Reinsurance intermediaries establish an agency relationship with both the primary insurer and the reinsurer. As reinsurance intermediaries do not assume insurance risk, they do not need the same financial resources as direct writing reinsurers.

The number of reinsurers accepting reinsurance through reinsurance intermediaries is greater than the number acting as direct writing reinsurers. Some reinsurers operate in both the direct writing and broker marketing systems. Both systems are common in the United States. Internationally, the broker marketing system is more common.

REINSURANCE PLACEMENT PROCESS

After a reinsurance strategy has been formulated and the portfolio analyzed carefully, the reinsurance placement process can begin. In this process, it is most important that all relevant information is made available to existing and potential reinsurers so they can understand the needs of the primary insurer and assist in putting together a suitable reinsurance program.

The reinsurance placement process involves these three major steps:

- Select a reinsurance marketing system
- Develop a reinsurance agreement proposal
- Complete agreement documentation

Select a Reinsurance Marketing System

The first step in the reinsurance placement process is to select a reinsurance marketing system. Selecting such a system involves weighing several considerations. With both marketing systems—direct writing and broker—emphasis is placed on developing long-term relationships that will prove to be beneficial and profitable to both the primary insurer and reinsurer.

When choosing between a direct writing and a broker marketing system, a primary insurer should answer these questions:

- Which reinsurance marketing system is consistent and compatible with the primary insurer's marketing system? That is, does the primary insurer sell insurance directly or through an intermediary? Does the primary insurer prefer a reinsurer that uses a marketing system similar to its own?
- Are a reinsurance intermediary's services needed? Is the primary insurer able and willing to allocate internal resources to find appropriate reinsurers and place reinsurance, or does it prefer to have a reinsurance intermediary perform those functions?

- Are the loss exposures to be reinsured highly specialized? Are there significant coverage needs that may require the participation of reinsurers that are domiciled outside the United States or that are not licensed to sell insurance in the primary insurer's state?
- Are the knowledge and objectivity expected from a reinsurance intermediary worth the cost, compared with the cost of using a direct writing reinsurer?
- Does the primary insurer already have a good business relationship with a direct writing reinsurer or reinsurance intermediary?

Answering these questions helps determine which marketing system better suits the primary insurer's needs.

Compatible Financial Goals

Employees of direct writing reinsurers contact only those primary insurers viewed as compatible with the reinsurer's financial goals. By evaluating the primary insurer's financial information and discussing financial information and goals with the primary insurer's management, direct writing reinsurers determine whether a mutually beneficial relationship is feasible. Because direct writing reinsurers assume some or all of the primary insurer's insurance risk, they carefully select which primary insurers will be contacted. In contrast, the reinsurance intermediary's role in the reinsurance placement process is to find reinsurers that are compatible with the primary insurer's goals.

Services Provided

Direct writing reinsurers and reinsurance intermediaries emphasize the services they provide to distinguish themselves from competitors. These services may include:

- Reinsurance program design, including actuarial evaluation of an appropriate retention for the primary insurer
- Advice on primary underwriting and claims procedures and controls
- Efficient reinsurance claims processing

Reinsurance intermediaries may provide these additional services:

- Screening the worldwide reinsurance market to optimize the price, coverage, and financial security of the reinsurance
- Placing a treaty with multiple reinsurers
- Maintaining objectivity in discussions with the primary insurers

Direct writing reinsurers emphasize efficiency in their relationship with the primary insurer. They deal directly with primary insurers in negotiating reinsurance agreement terms, handling reinsurance premiums, and processing reinsurance claims. This direct communication may be faster and less prone to misunderstandings than communication through a reinsurance intermediary. However, reinsurance intermediaries may secure better coverage and terms than primary insurers could on their own.



Reinsurance intermediaries also distribute premiums and collect claim payments from the reinsurers involved in the reinsurance program. Primary insurers issue one check for premium payments and send one notice of loss or request for loss payments to the reinsurance intermediary.

Business Relationships

Reinsurance relationships are established over long periods. A direct writing reinsurer or reinsurance intermediary may solicit a primary insurer's business for years before establishing a business relationship. The primary insurer's management must be comfortable with and have confidence in the reinsurer or the reinsurance intermediary before committing to a business relationship.

Develop a Reinsurance Agreement Proposal

The second step in the reinsurance placement process is to develop a reinsurance agreement proposal. This involves assessing the primary insurer's reinsurance needs and the reinsurance market resources that can satisfy them.

Several tasks are necessary to determine the reinsurance agreement's final terms. These tasks differ for direct writing reinsurance agreements, reinsurance intermediary agreements, and agreements using both direct writing reinsurers and reinsurance intermediaries.

Direct Writing Reinsurance Agreements

In the direct writing marketing system, all contact occurs between the primary insurer and the reinsurer. The primary insurer may initiate a reinsurance relationship with the reinsurer. Alternatively, if the primary insurer already has a relationship with a particular reinsurer, it may expand or change reinsurance programs already in place.

The primary insurer discusses its basic requirements and goals with the reinsurer. The reinsurer develops a proposal, usually in the form of a letter or memorandum, and submits it to the primary insurer. The reinsurer makes the proposal subject to acceptance by the primary insurer.

Reinsurance Intermediary Agreements

In the broker marketing system, the primary insurer is considered the reinsurance intermediary's client, so the reinsurance intermediary is expected to act in the primary insurer's interests when placing reinsurance. (The reinsurance intermediary also acts in the reinsurer's **interests** for certain purposes, such as collecting and disbursing reinsurance premiums.)



When purchasing reinsurance, the reinsurance intermediary works with the primary insurer to develop the proposal and performs these tasks:

- Contacts prospective reinsurers
- Presents the proposal to prospective reinsurers
- Obtains quotes and acceptances
- Handles rejections and counteroffers
- Drafts the reinsurance agreement (in most cases)
- Facilitates the reinsurance agreement's documentation

In performing those tasks, the reinsurance intermediary makes the offer, on the primary insurer's behalf, to reinsurers that meet the primary insurer's requirements.

Before accepting the business, reinsurers may audit the primary insurer. The reinsurance intermediary coordinates those audits to minimize disruptions to the primary insurer's operations. Several reinsurance audits may be conducted simultaneously to minimize disruption to the primary insurer.

Co-Agreements With Direct Writing Reinsurers and Reinsurance Intermediaries

In the past, primary insurers worked with either a direct writing reinsurer or a reinsurance intermediary. However, because of the increased complexity of reinsurance, competition, and demands for more reinsurance than one reinsurer is willing to provide, the use of both direct writing reinsurers and reinsurance intermediaries has become more common.

The primary insurer may contact a direct writing reinsurer for a specific portion of its reinsurance program and a reinsurance intermediary for another portion. If the direct writing reinsurer cannot write the entire reinsurance program, it may contact another reinsurer rather than send the primary insurer to a reinsurance intermediary. In another case, the primary insurer may suggest that the direct writing reinsurer and reinsurance intermediary share a single reinsurance agreement.

If a reinsurance intermediary was initially involved in the reinsurance placement, the reinsurance intermediary may approach the direct writing reinsurer about the primary insurer's reinsurance program if additional reinsurance coverage is needed or if the primary insurer has a specialized need and the direct writing reinsurer has the required expertise. The direct writing reinsurer may recognize the reinsurance intermediary relationship, or it may function independently. Many direct writing reinsurers have established internal departments to work with reinsurance intermediaries in an attempt to access additional business opportunities.

The complex relationships between direct writing reinsurers and reinsurance intermediaries can complicate preagreement negotiations. Therefore, primary



insurers, reinsurers, and reinsurance intermediaries must take precautions to prevent misunderstandings by documenting the liabilities assumed by each party to the agreement.

Complete Agreement Documentation

The third step in the reinsurance placement process is to complete agreement documentation. This involves reducing the negotiations into writing. Both preagreement and final agreement documentation are integral parts of any reinsurance placement.

Preagreement documentation helps guide the reinsurance transaction until the final agreement is executed and is used for these purposes:

- Establishing underwriting intent
- Providing necessary information
- Meeting regulatory requirements
- Resolving disputes

Establishing Underwriting Intent

Preagreement negotiations create the spirit of the agreement. A complete and concise record of negotiations ensures that all parties understand the agreement's intent. The preagreement documentation also serves as a record of why and how the underwriting decision was made.

Providing Necessary Information

Reinsurers need certain underwriting information to decide whether to accept or reject a proposal. The documentation prepared during preagreement negotiations contains information that is used in the formal proposal and the final agreement. That information should be as accurate and complete as possible.

Meeting Regulatory Requirements

Two types of preagreement documentation are required by state insurance statutes.

The first type is the broker of record letter. When a reinsurance intermediary places reinsurance on a primary insurer's behalf, the reinsurance intermediary must have written authorization from the primary insurer to negotiate the agreement. A broker of record letter provides that authorization and protects reinsurers from assuming insurance through a reinsurance intermediary who does not have authority from the primary insurer. A broker of record letter also protects primary insurers by clarifying their relationship with the reinsurance intermediary.

The second type of preagreement documentation required by state insurance statutes is the premium and loss account. Reinsurance intermediaries are



required to maintain at least one premium and loss account, which separates their own funds from those of primary insurers and reinsurers. Premiums and claim payments of multiple primary insurers or reinsurers can be in the same account if the records clearly identify for whom the funds are held. This recordkeeping requirement prevents offsetting the funds paid to one insurer with funds paid by another insurer.

Considerable time may elapse between negotiations and the final agreement. Consequently, primary insurers, reinsurance intermediaries, and reinsurers often use the preagreement documentation to guide premium cessions and loss payments before the final agreement is signed. This practice works because reinsurers that agree to the reinsurance agreement's terms are bound by those terms even if the agreement has not been signed.

However, state insurance regulators prefer that primary insurers have final agreements rather than preagreement documentation to guide their actions. One accounting rule developed by the National Association of Insurance Commissioners (NAIC) requires that reinsurance agreements be signed no later than nine months after the effective date for the agreements to receive reinsurance accounting treatment. This accounting rule, often referred to as the nine-month rule, encourages contract delivery.

Regulatory efforts are also focusing on the concept of contract certainty. Contract certainty generally requires the complete and final agreement of all terms between the insured and insurer by the time the contract is entered into, with contract documentation provided promptly thereafter. See the exhibit "Contract Certainty in the U.S. and Abroad."

Resolving Disputes

Preagreement documentation can also help resolve issues even after the final agreement is signed. Disputes in reinsurance agreements generally are resolved through arbitration. Reinsurance arbitrators are not precluded from referring to the preagreement documentation to ascertain the intentions of the parties or from using that information to resolve the dispute. However, preagreement documentation has only limited use in litigated reinsurance issues because, in the U.S., the final agreement is considered to supercede all preagreement negotiation and documentation.



Contract Certainty in the U.S. and Abroad

In the United States, the superintendent of the New York State Insurance Department issued Circular Letter 20 in October 2008 and a supplementary letter in January 2010 establishing the department's contract certainty expectations for insurance and reinsurance contracts. The department defined contract certainty as having documentation of all agreed terms of an insurance policy or reinsurance contract by the date of inception and issuing and delivering such policy or contract within thirty business days of inception of coverage. Proper contract documentation is defined to include a "binder, cover note, or similar documents, provided that it reflects all agreed terms and conditions to which the reinsurers have agreed." The supplement allows insurers and producers the flexibility to determine themselves the allocation of the thirty-business-day time period in order to meet contract certainty. Licensees had twelve months from the date of the Circular Letter to develop and implement practices assuring contract certainty in at least 90 percent of their policies and contracts. The department intends to use formal examinations, inquiries to licensees and information gathered from insureds to monitor.

Reinsurance regulators in other countries also have implemented rules and regulations based on the contract certainty concept. In England and Bermuda, for example, contracts must be final and certain on the contract's effective date. Australia, meanwhile, uses two benchmarks (the Two-Month Rule and Six-Month Rule) to achieve contract certainty.

Michael Moriarty, "Supplement No. 1 to Circular Letter No. 20 (2008)," State of New York Insurance Department, January 2010, www.ins.state.ny.us/circltr/2010/cl2008_20s1.pdf (accessed May 25, 2010). [DA06145]

FACULTATIVE REINSURANCE PLACED THROUGH THE DIRECT WRITING MARKETING SYSTEM

Facultative reinsurance is placed on an individual loss exposure basis, and the reinsurer retains the right to accept or reject each individual loss exposure submitted by the primary insurer. For simplicity, this illustration shows how facultative reinsurance is placed through a direct writing reinsurer; however, both facultative and treaty reinsurance can be placed either through a direct writing or a broker marketing system.

The placement of facultative reinsurance is guided by both regulatory and internal requirements that pertain to the assuming and ceding of reinsurance. In addition, these typical procedures, which include preagreement and final documentation, are an integral part of the facultative reinsurance placement process:

- Proposal
- Clearance and underwriting
- Authorization
- Confirmation



- Reinsurance binder
- Policy documentation
- Facultative reinsurance certificate

Often, the primary insurer's underwriter will not commit to selling an underlying insurance policy until the reinsurance terms are finalized. Consequently, because facultative reinsurance terms often determine the underlying policy's coverage and price, the facultative reinsurance agreement is usually finalized quickly.

Proposal

The primary insurer submits a proposal directly to the reinsurer. The proposal, also called a submission, contains sufficient underwriting information for the reinsurer to make an initial judgment about whether the proposed reinsurance fits the reinsurer's underwriting guidelines. The proposal also outlines the essential terms to be included in the final agreement.

Clearance and Underwriting

After the proposal is received, the reinsurer can use a clearance process to gather information about both the primary insurer and the underlying insured. The clearance process can answer these questions:

- Is the reinsurer already providing reinsurance coverage for the insured represented in the submission?
- Is another underwriter employed by the reinsurer that is evaluating the proposal?
- Has the reinsurer provided reinsurance for the same loss exposure before, and if so, what was the reinsurer's previous underwriting experience?

The clearance process can help to prevent situations in which the reinsurer accepts more than the maximum amount of reinsurance it wants to provide on any one loss exposure. Acceptance of too much reinsurance coverage on a loss exposure is called overlining.

After the clearance process is completed, the reinsurance underwriter determines what additional information is required. Property facultative reinsurance underwriters and primary insurance underwriters require much of the same information, including details about construction, occupancy, protection, and external exposures (COPE).

Additionally, both property and casualty facultative reinsurance underwriters need to know the premium quoted by the primary insurer for the loss exposure, the type of reinsurance sought (pro rata or excess of loss), and the amount of facultative reinsurance coverage requested. The reinsurer may also request that the primary insurer provide additional information on the loss exposure, such as loss control and financial information.



Using that information and a facultative reinsurance worksheet, the facultative reinsurance underwriter analyzes the loss exposure to determine whether it meets the reinsurer's underwriting criteria. See the exhibit "Casualty Facultative Reinsurance Worksheet Sample."

The facultative reinsurance underwriter considers these questions in performing this analysis:

- Is this the type of loss exposure that the reinsurer wants to reinsure, and has it been priced to stand a reasonable chance of earning an underwriting profit?
- If the loss exposure is unacceptable, could a specific change make the loss exposure acceptable?
- Is this type of loss exposure excluded from the reinsurer's retrocession arrangements, if any?
- How much expertise do the primary insurer's underwriters have with this type of loss exposure?
- Is the amount of reinsurance coverage requested for the loss exposure within the reinsurer's capacity?
- Is more information required before an underwriting decision can be made? If so, what is required?

The exhibit shows an underwriting record that a facultative reinsurance underwriter may use. See the exhibit "Underwriting Record Sample."

If the facultative reinsurance underwriter decides that the loss exposure is acceptable, the next step is to price the reinsurance. Underwriters generally make pricing decisions based on their knowledge of the individual loss exposure being submitted and their experience with similar loss exposures. In addition, facultative reinsurers usually have established procedures that their underwriters follow so that the facultative pricing is within a range acceptable to the reinsurer, competitive with other reinsurers, and consistent with other submissions with similar hazard characteristics.

Using their pricing procedures, facultative reinsurers attempt to determine the extent to which their assumed liability will be subject to losses from the underlying policy and what they think is a fair price for that exposure to loss. This is known as exposure rating. Similar approaches to pricing are used for both casualty facultative reinsurance and property facultative reinsurance. However, there are differences in approach for each type.

When pricing casualty facultative reinsurance, underwriters often rely on increased limit factor tables developed by insurance advisory organizations such as Insurance Services Office, Inc. (ISO). Increased limit factor tables are used by primary insurers to price layers of underlying coverage in excess of the primary insurer's base limit.



Casualty Facultative Reinsurance Worksheet Sample

<input type="checkbox"/> UMBRELLA <input type="checkbox"/> X/S UMB <input type="checkbox"/> BUFFER <input type="checkbox"/> EXCESS <input type="checkbox"/> HOME OFFICE REFERRAL										BRANCH	
NAME AND ADDRESS OF RISK										UNDERWRITER	
CEDING CO. POLICY LIMIT										DATE RECEIVED	
PRODUCER #/PRODUCER & ADDRESS/CLIENT CONTACT											
MAX. LIMIT TO BE PURCHASED BY RISK		CEDING CO./CO. #		SUBMISSION:		PHONE		MAIL		OTHER	
DESCRIPTION OF OPERATIONS	PRIMARY OPERATON										
	PAYROLL										
	AREA										
	SALES/RECEIPTS										
U/W'S EVALUATION	HAZARD RATING (LMH)		CATSTROPHE POTENTIAL — PRIMARY/LEAD PROGRAMS — SPECIFIC vs CLASS								
	AL										
	GL Operations ()										
	Premises ()										
	Products ()										
	Comp. Ops. ()										
	EL ()										
	OVERALL										
U/L CONSIDERATIONS	(✓ FOR YES)	EXP	COV	(✓ FOR YES)	EXP	COV	AUTOS	#	\$	= \$	%L = 1 = LH =
	COMPREHENSIVE AL			AIRCRAFT			PPT				
	COMPREHENSIVE GL			LANDING FACILITY			PU/VAN/LT				
	ISO Y/N FORM:			WATERCRAFT			MED TRK				
	PAST AS CLAIMS MADE			MARINE FACILITY							
	GENERAL AGGREGATE			RAILROAD							
	PER:LOC/PROJECT			WC EL			HVY TRK				
	PERSONAL INJURY			OD							
	BLANKET CONTRACTUAL			FELA							
	PRODUCTS/COMP. OPS.			ADMIRALTY			TRACTORS				
	CCC REAL PROPERTY			BROAD AS PRIMARY							
	CCC PERSONAL PROPERTY			NON-CONCURRENT DATES							
	BROAD FORM PD			CLAIMS MADE			TRAILERS				
	XCU/DEZ			RETRO DATE			BUSES				
	LIQUOR LIAB.			DISCOVERY PERIOD							
	INCLD. MEDICAL MALP.			LASER ENDT							
	PROF. LIAB./E&O										
	ADVERTISER'S LIAB.										
	FOREIGN LIAB. (GL/AL)										
	LOSSES	PAST 5 YEARS		VALUATION DATE:		O/S CLM SERVICE Y/N					
1ST \$ BASIS Y/N		AGG X/S \$100,000 Y/N		OCC X/S \$10,000 Y/N		EXPIRING PROGRAM: (LEAD/EXCESS)					
YEAR											

DA051711

Underwriting Record Sample

RISK CLEARANCE		
FRC RECORD ID #		
RISK IS		
<input type="checkbox"/> CLEAR	<input type="checkbox"/> NOT CLEAR	<input type="checkbox"/> DETAILS ATTACHED
OPERATOR'S INITIALS	DATE	TYPE NEW/RENEWAL
COVERAGE		
LIMITS		
REMARKS (U/W, TYPE OF OPERATION, ETC.)		

INTER-BRANCH COMMENTS		
GENERAL PROCESSING INFORMATION		
OWNERSHIP CODE	INDUSTRY CODE	TYPE OF COVERAGE EXCESS/OTHER
LAYER POSITION	QUOTE/BINDER TEXT ID	
COVERAGE FORM	CERT TEXT ID	
DIARY REASON (OPT)	DATE	

<input type="checkbox"/> QUOTE: GOOD FOR _____ DAYS /UNTIL RENEWAL OR _____ (U/W DATE: _____)		
<input type="checkbox"/> BINDER: EFFECTIVE _____ FOR _____ DAYS (U/W DATE: _____)		
<input type="checkbox"/> CERTIFICATE: TERM <input type="checkbox"/> ANNUAL <input type="checkbox"/> OTHER _____ TO _____ DAYS (U/W DATE: _____)		
CEDING COMPANY POLICY LIMIT	<input type="checkbox"/> \$ _____,000,000/\$ _____,000,000	<input type="checkbox"/> \$ _____,000 SIR

CEDING COMPANY RETENTION		<input type="checkbox"/>	%
<input type="checkbox"/>	% OF THE 1ST \$ _____,000/\$ _____,000 PLUS		% OF \$ _____,000/ \$ _____,000 X/\$ _____,000/ \$ _____,000
<input type="checkbox"/>			

LIMITS	<input type="checkbox"/>	%
<input type="checkbox"/> % OF THE 1ST \$ _____,000/\$ _____,000 PLUS		% OF \$ _____,000/ \$ _____,000 X/S \$ _____,000/ \$ _____,000
<input type="checkbox"/>		

PREMIUM OUR SHARE		COMMISSION	RATE OF:	PER:
\$		NET/GROSS @ %	\$	
MINIMUM	DEPOSIT	INSTALLMENTS		
\$	\$			

PROGRESSING NOTES:	<input type="checkbox"/> ORDER REPORT: <input type="checkbox"/> D&B <input type="checkbox"/> OTHER <input type="checkbox"/> RETROCESSIONAL FACILITIES, IF APPLICABLE
--------------------	--

TWO HEADS	CM APPROVAL	HO REFERRAL	HO CONFIRMATION DATE	FCH PAGE #
-----------	-------------	-------------	----------------------	------------

3.16 Reinsurance Principles and Practices

CERTIFICATE CODING – PREMIUM DISTRIBUTION			U/W SIGNOFF			DATE:
LINE OF BUSINESS		BI (07)	PD (46)	CSL (13)		
SUBLINE				1ST LAYER	2ND LAYER	3RD LAYER
	CODE	ATTACHMENT PT ↓ %	ATTACHMENT PT ↓ %	ATTACHMENT PT ↓ %	ATTACHMENT PT ↓ %	ATTACHMENT PT ↓ %
AUTO (COMML)	005					
AUTO – NO FAULT	(40)					
M & C (OPERATIONS)	065					
OL & T (PREMISES)	080					
PRODUCTS/COMP OPS	085					
EMPLOYER'S LIAB.	040					
CONTRACTUAL	025					
LIQUOR LAW	060					
O & CP	075					
RAILROAD PROT	100					
WORK COMP	120					
AUTO (PERSONAL)	010					
COMP PERS LIAB	020					
DIC	030					
D & O	035					
EIL						
E & O	050					
MED MALPR	07035					
PROD INTEG IMP	090					
PRODUCTS RECALL	095					
RETROACTIVE						
REVIEW/REMARKS						

[DA05172]

For example, a primary insurer's base limit for general liability policies may be \$100,000 per occurrence and \$200,000 aggregate (denoted \$100/\$200), but those amounts of insurance can be increased in increments (for example, \$200/\$200, \$100/\$300, \$1,000/\$3,000, and so forth) by application of an increased limit factor to the premium developed for the base limit. Likewise, casualty facultative reinsurance underwriters can use increased limit factor tables as guidance to price the liability they have assumed.

The advantage of using increased limit factor tables is that they are actuarially developed and based on considerable industry-wide or company loss data, thereby making them a sound approach to reinsurance pricing.

In contrast, property facultative reinsurance underwriters rely more extensively on the hazard characteristics of the loss exposure in pricing. They do this because property insurance involves loss exposures with more tangible attributes than casualty insurance.

Property facultative reinsurance underwriters often refer to the Lloyd's of London property first loss scale or to computerized analytical tools in pricing. Lloyd's property first loss scale functions similarly to increased limit factor tables by providing an approach to allocate premium between primary and excess layers. Although not actuarially based, the Lloyd's property first loss scale has been used extensively for many years and has proved to be a reliable pricing tool.

Lloyd's property
first loss scale

A scale used to allocate
premium between a primary
and an excess layer.

ISO has developed PSOLD (Commercial Property Size-of-Loss Database), which is designed to aid reinsurers in pricing excess layers of property coverage. The PSOLD product is backed by an extensive aggregate loss history and provides the reinsurance underwriter with flexibility in choosing which data to consider in pricing.

Exposure rating, using the approaches described, is often the first step in facultative reinsurance pricing. Reinsurance underwriters then usually modify the pricing derived from their pricing procedure to reflect loss adjustment expenses, profits and contingencies, unique characteristics of the loss exposure, the effect of inflation, potential investment income, and the competitiveness of the current facultative reinsurance marketplace.

Authorization

If the loss exposure is acceptable, the facultative reinsurance underwriter communicates the authorization to the primary insurer, quoting the reinsurance premium and reinsurance coverage terms. However, authorization is not a guarantee that a reinsurance certificate will be issued. Additional loss exposure information and the final policy provisions must meet the reinsurer's underwriting criteria.

Authorization

The reinsurer's offer to
reinsure the loss exposure
at a certain premium and
under specific terms and
conditions.

Authorizations are usually valid for a period that may range from one to sixty days, depending on the effective date and nature of the loss exposure. This period allows the primary insurer's underwriter to negotiate with the original insured or to determine whether the reinsurance should be purchased. See the exhibit "Facultative Reinsurance Authorization Sample."

Confirmation

To accept the authorization, the primary insurer typically informs the reinsurer immediately and sends a formal confirmation after the underlying policy is issued. This confirmation serves as notice to the reinsurer that the underlying policy has been accepted or bound by the primary insurer. It outlines the terms, conditions, and premium of the underlying policy. The primary insurer also provides any additional information about the loss exposure that was requested by the reinsurer.

Confirmation

The primary insurer's
acceptance of the facultative
reinsurer's authorization.



Facultative Reinsurance Authorization Sample

Reinsurance Company Casualty Facultative Reinsurance Quotation

JUNE 11, 20X4

JOHN DOE
SISTERDALE INSURANCE COMPANY
123 STREET
SOMECITY, PA 19355

INSURED:	ABC COMPANY	REFERENCE NO:	999998 - 2004
CITY, STATE:	SOMECITY, PA	EFFECTIVE DATE:	05/01/X4 - 05/01/X5

DEAR JOHN:
WE HEREBY OFFER OUR REINSURANCE QUOTATION AS FOLLOWS:

ITEM 1—TYPE OF INSURANCE

BODILY INJURY AND PROPERTY DAMAGE LIABILITY OTHER THAN AUTOMOBILE

ITEM 2—POLICY LIMITS

\$2,000,000 EACH OCCURRENCE / \$2,000,000 GENERAL AGGREGATE / \$2,000,000 PRODUCTS & COMPLETED OPERATIONS AGGREGATE

ITEM 3—COMPANY RETENTION

- A. 100% OF THE FIRST \$1,000,000 CSL EACH OCCURRENCE / \$2,000,000 GENERAL AGGREGATE / \$2,000,000 PRODUCTS & COMPLETED OPERATIONS AGGREGATE
- B. NIL OF THE NEXT \$1,000,000 CSL EACH OCCURRENCE / NIL GENERAL AGGREGATE / NIL PRODUCTS & COMPLETED OPERATIONS AGGREGATE

ITEM 4—REINSURANCE ACCEPTED

- A. NIL OF THE FIRST \$1,000,000 CSL EACH OCCURRENCE / \$2,000,000 GENERAL AGGREGATE / \$2,000,000 PRODUCTS & COMPLETED OPERATIONS AGGREGATE
- B. 100% OF THE NEXT \$1,000,000 CSL EACH OCCURRENCE / NIL GENERAL AGGREGATE / NIL PRODUCTS & COMPLETED OPERATIONS AGGREGATE

ITEM 5—BASIS OF REINSURANCE

EXCESS OF LOSS

PREMIUM

\$60,800,000 GROSS ESTIMATED PREMIUM

CEDING COMMISSION

25.00%

ESTIMATED EXPOSURE AMOUNT

1,000,000

REINSURANCE RATE

\$60.8 PER \$1,000 RECEIPTS

COMMENTS

THE ABOVE REINSURANCE QUOTATION IS VALID FOR ONLY 60 DAYS FROM THE DATE OF THIS LETTER. PLEASE NOTIFY US PRIOR TO THE INCEPTION DATE OF THE POLICY TO BIND COVERAGE. ANNUAL PREMIUM IS SUBJECT TO A MINIMUM OF 100% OF THE DEPOSIT PREMIUM.

ISSUING COMPANY: IIA CASUALTY COMPANY

RESPECTFULLY YOURS,

ISSUING BRANCH

500 STREET
SOMECITY, PA 19355
800-555-1000
FAX 555-555-1111

CORPORATE OFFICE

200 STREET
SOMECITY, PA 19355
800-555-1001
FAX 555-555-1100

JANE SMITH

Reinsurance Binder

Until a facultative reinsurance certificate is issued to officially confirm the reinsurance transaction, a binder is supplied to serve as evidence of facultative reinsurance coverage. The reinsurance binder is the temporary written agreement issued by the facultative reinsurer stating that the reinsurer accepts the loss exposure subject to satisfactory review of the underlying policy. A binder describes the loss exposure and summarizes the facultative agreement. See the exhibit "Facultative Reinsurance Binder Sample."

Policy Documentation

The primary insurer sends a copy of the underlying policy to the reinsurer. If the underlying policy uses a standard coverage form developed by an insurance advisory organization, such as ISO or the American Association of Insurance Services (AAIS), the primary insurer sends only the declarations page and any applicable endorsements to the reinsurer. If the underlying policy uses coverages developed by the primary insurer, or if it contains unusual coverages or provisions, the primary insurer sends a copy of the entire underlying policy to the reinsurer.

Facultative Reinsurance Certificate

After the reinsurer receives the primary insurer's documentation, the reinsurer issues a facultative reinsurance certificate that is attached to the primary insurer's copy of the underlying policy. The certificate is usually a short document (often one page) with the coverage and premium provisions on the front and the operating provisions on the back.

The certificate identifies the underlying insured, the primary insurer, and the underlying insurance policy to which the reinsurance applies. Like the primary insurer's underlying insurance policy, the facultative reinsurance certificate is the final legal contract that specifies all the reinsurance terms, conditions, exclusions, and ceding commission (if applicable).

The exhibits show the declarations and general conditions, respectively, for a sample facultative reinsurance certificate. See the exhibit "Facultative Reinsurance Certificate—Declarations Sample."

The general conditions contain many clauses that are similar to those contained in a reinsurance treaty, such as those concerning retention and limit, definitions, premium taxes, insolvency, and offset. See the exhibit "Facultative Reinsurance Certificate—General Conditions Sample Page."

A facultative reinsurance certificate can be either a pro rata or an excess of loss certificate.



Facultative Reinsurance Binder Sample

Reinsurance Company Casualty Facultative Reinsurance Quotation

AUGUST 11, 20X4

JOHN DOE
SISTERDALE INSURANCE COMPANY
123 STREET
SOMECITY, PA 19355

INSURED:	ABC COMPANY	REFERENCE NO:	999998 - 2004
CITY, STATE:	SOMECITY, PA	EFFECTIVE DATE:	05/01/X4 - 05/01/X5

DEAR JOHN:

WE HEREBY OFFER OUR REINSURANCE QUOTATION AS FOLLOWS:

ITEM 1—TYPE OF INSURANCE

UMBRELLA LIABILITY

ITEM 2—POLICY LIMITS

\$23,000,000 EACH OCCURRENCE / \$23,000,000 AGGREGATE WHERE APPLICABLE, EXCESS \$2,000,000 EACH OCCURRENCE / \$4,000,000 GENERAL AGGREGATE/\$4,000,000 PRODUCTS & COMPLETED OPERATIONS AGGREGATE, EXCESS UNDERLYING

ITEM 3—COMPANY RETENTION

\$18,000,000 PART OF \$23,000,000 CSL

ITEM 4—REINSURANCE ACCEPTED

\$5,000,000 PART OF \$23,000,000 CSL

ITEM 5—BASIS OF REINSURANCE

CONTRIBUTING EXCESS

PREMIUM

\$24,867,000 GROSS ESTIMATED PREMIUM

CEDING COMMISSION

27.50%

ESTIMATED EXPOSURE AMOUNT

\$5,000,000.00

REINSURANCE RATE

\$4.97 PER \$1,000 SALES

COMMENTS

PLEASE EXCLUDE POLLUTION, ASBESTOS, ALL CCC.

PLEASE FORWARD A COPY OF THE COMPANY POLICY WITHIN 90 DAYS OF BINDING. UPON RECEIPT OF YOUR POLICY, A CASUALTY REINSURANCE CERTIFICATE WILL BE ISSUED. ANNUAL PREMIUM IS SUBJECT TO A MINIMUM OF 100% OF THE DEPOSIT PREMIUM.

ISSUING COMPANY: IIA CASUALTY COMPANY

RESPECTFULLY YOURS,

ISSUING BRANCH

500 STREET
SOMECITY, PA 19355
800-555-1000
FAX 555-555-1111

CORPORATE OFFICE

200 STREET
SOMECITY, PA 19355
800-555-1001
FAX 555-555-1100

JANE SMITH



Facultative Reinsurance Certificate—Declarations Sample**Reinsurance Company**
Casualty Facultative Reinsurance Quotation

AUGUST 11, 20X4

JOHN DOE
SISTERDALE INSURANCE COMPANY
123 STREET
SOMECITY, PA 19355ISSUING BRANCH
500 STREET
SOMECITY, PA 19355
800-555-1000
FAX 555-555-1111CORPORATE OFFICE
200 STREET
SOMECITY, PA 19355
800-555-1001
FAX 555-555-1100

INSURED:	ABC COMPANY	REFERENCE NO:	999998 – 2004
CITY, STATE:	SOMECITY, PA	EFFECTIVE DATE:	05/01/X4 – 05/01/X5

CLIENT POLICY NO(S): 9999-9999-TEA

CLIENT POLICY TERM: 01/01/04 – 01/01/05

ITEM 1—TYPE OF INSURANCE

AUTOMOBILE BODILY INJURY AND PROPERTY DAMAGE LIABILITY EXCLUDING NO-FAULT BENEFITS

ITEM 2—POLICY LIMITS

BI & PD \$1,000,000 CSL EACH ACCIDENT

ITEM 3—COMPANY RETENTION

A. 100% OF THE FIRST \$250,000 CSL EACH ACCIDENT

B. NIL OF THE NEXT \$750,000 CSL EACH ACCIDENT

ITEM 4—REINSURANCE ACCEPTED

A. NIL OF THE FIRST \$250,000 CSL EACH ACCIDENT

B. 100% OF THE NEXT \$750,000 CSL EACH ACCIDENT

ITEM 5—BASIS OF REINSURANCE

EXCESS OF LOSS

PREMIUM

\$41,000.00 NET ESTIMATED PREMIUM

CEDING COMMISSION

NIL

ESTIMATED EXPOSURE AMOUNT

\$20,200,000

REINSURANCE RATE

\$202.97 PER UNIT

COMMENTS

ANNUAL PREMIUM IS SUBJECT TO A MINIMUM OF 100% OF THE DEPOSIT PREMIUM.

IIA CASUALTY COMPANY

JANE SMITH

February 11, 20X4

Authorized Signature

Facultative Reinsurance Certificate—General Conditions Sample Page

IIA CASUALTY COMPANY Reinsuring Agreements and Conditions

In consideration of the payment of the premium, and subject to the terms, conditions and limit(s) of liability set forth herein and in the Declarations and any endorsements made a part hereof, IIA Casualty Company (herein called the "Reinsurer") does hereby reinsure the ceding company named in the Declarations (herein called the "Company") in respect of the Company's policy(ies) set forth in the Declarations as follows:

- A. **Retention and Limit.** The Company shall retain for its own account or for that of its treaty reinsurers, if applicable, the liability specified in the Declarations, Item 3. The Reinsurer shall indemnify the Company against losses or damages the Company is legally obligated to pay under the policy or policies reinsured, subject to the limits and coverage set out in Item 4 of the Declarations. The liability of the Reinsurer shall follow that of the Company, subject to all terms, conditions and limits of the Company's policy or policies except where this Certificate specifically provides otherwise, or where the reinsurance is non-concurrent.
- B. **Term.** The certificate period shall be as specified in the Declarations at 12:01 a.m. as to both dates at the place specified in the Company's policy(ies).
- C. **Inspection and Information.** The Company shall make available for inspection, and place at the disposal of the Reinsurer at all reasonable times, all records of the Company relating to this Certificate or claims in connection therewith. The Company shall furnish the Reinsurer with a copy of all policies, all endorsements and material underwriting information and agrees to notify the Reinsurer promptly of all changes that in any manner affect this Certificate.
- D. **Claims and Losses.** The Company shall notify the Reinsurer promptly of any occurrence or claim and any subsequent developments pertaining thereto which in the Company's estimate of the value of injuries or damages sought, without regard to liability, might result in judgment in an amount sufficient to involve this Certificate. The Company shall also notify the Reinsurer promptly of any occurrence or claim in respect of which the Company has created a loss reserve equal to or greater than fifty (50) percent of the Company's retention specified in Item 3 of the Declarations; or, if this reinsurance applies on a contributing excess basis, when notice of claim is received by the Company. While the Reinsurer does not undertake to investigate or defend claims or suits, it shall nevertheless have the right and be given the opportunity, with full cooperation of the Company, to associate counsel at its own expense and to join with the Company and its representatives in the defense and control of any claim, suit or proceeding involving this Certificate.

All loss settlements made by the Company, provided they are within the terms, conditions and limit(s) of this Certificate, shall be binding on the Reinsurer. Upon receipt of an acceptable proof of loss, the Reinsurer shall promptly pay its proportion of such loss as set forth in the Declarations.
- E. **Adjustment Expense.** The Reinsurer shall pay its proportion of expenses which are within the terms of the Company's policy(ies) (other than office expenses and/or payment to any salaried employee) incurred by the Company in the investigation and settlement of claims or suits and its proportion of court costs and interest on any judgment or award, in the ratio that the Reinsurer's loss payment bears to the Company's gross loss payment. If there is no loss payment, the Reinsurer shall pay a proportion of such expenses only in respect of business accepted on a Contributing Excess basis and then only in the percentage stated in Item 4 of the Declarations in the first layer of participation.
- F. **Definitions.** As used in this Certificate, the terms below shall have the following meaning:
 1. **Excess of Loss** – The limit of liability of the Reinsurer, as stated in Item 4 of the Declarations, applies only to that portion of loss settlement within the policy limits in excess of the applicable retention of the Company, as stated in Item 3 of the Declarations.
 2. **Contributing Excess** – The Company's policy applies in excess of other valid insurance, reinsurance or a self-insured retention and the limit of liability of the Reinsurer applies proportionally to all loss settlements within the policy limits in the percentage set forth in Item 4 of the Declarations.
 3. **Non-concurrent** – The reinsurance provided does not apply to any hazards or risks of loss or damage covered under the Company's policy other than those specifically set forth in the Declarations. The retention of the Company and liability of the Reinsurer shall be determined as though the Company's policy applied only to the hazards or risks of loss or damage specifically described in the Declarations.
- G. **Rights.** This Agreement is solely between the Company and the Reinsurer and performance of the obligations of each party under this Agreement shall be rendered solely to the other party. In no event shall anyone other than the Company or, in the event of the Company's insolvency, its liquidator, have any rights under this Certificate.
- H. **Salvage and Subrogation.** The Company shall pay or credit the Reinsurer with the Reinsurer's portion of any recovery obtained from the salvage or subrogation. Adjustment expense for recoveries shall be deducted from the amount recovered. If the reinsurance is on an Excess basis, recoveries shall be distributed to the parties in an order inverse to that in which their liabilities accrued.
- I. **Premium Taxes.** The Company will be liable for all taxes on premiums ceded to the Reinsurer under this Certificate.
- J. **Insolvency.** In the event of the insolvency of the Company, the reinsurance provided by this Certificate shall be payable by the Reinsurer on the basis of the liability of the Company under the policy or policies reinsured without diminution because of such insolvency directly to the Company or its receiver, liquidator or statutory successor.

The Reinsurer shall be given written notice of the pendency of each claim against the company on any policy reinsured hereunder within a reasonable time after such claim is filed in the insolvency proceedings. The Reinsurer shall have the right to investigate each such claim and interpose at its own expense in the proceeding where such claim is to be adjudicated any defenses which it may deem available to the Company or its receiver, liquidator or statutory successor. The expense thus incurred by the Reinsurer shall be chargeable, subject to court approval, against the Insolvent Company as part of the expense of liquidation to the extent of a proportionate share of the benefit, which may accrue to the Company solely as the result of the defense undertaken by the Reinsurer.

K. **Offset.** The Reinsurer may offset any balance, whether on account of premiums, commissions, claims, losses, adjustment expense, salvage or any other amount due from one party to the other under this Certificate or under any other agreement entered into between the Company and the Reinsurer, whether acting as assuming reinsurer or as a ceding company.

L. **Exclusions.** Regardless of the terms and conditions of the Company's policy(ies), this Certificate shall not apply to:

1. Nuclear incident as provided in the Standard Nuclear Incident Exclusion clause Liability Reinsurance; or,
2. War as provided in the standard War Exclusion clauses; or
3. Fiduciary liability in connection with the Employee Retirement Income Security Act of 1974 and as it may be amended.

M. **Arbitration.** As a condition precedent to any right of action hereunder, any dispute arising out of the interpretation, performance or breach of this Certificate, including the formation or validity thereof, shall be submitted for decision to a panel of three arbitrators. Notice requesting arbitration will be in writing and sent certified or registered mail, return receipt requested.

One arbitrator shall be chosen by each party and the two arbitrators shall, before instituting the hearing, choose an impartial third arbitrator who shall preside at the hearing. If either party fails to appoint its arbitrator within 30 days after being requested to do so by the other party, the later, after 10 days notice by certified or registered mail of its intention to do so, may appoint the second arbitrator.

If the two arbitrators are unable to agree upon the third arbitrator within 30 days of their appointment, the third arbitrator shall be selected from a list of six individuals (three named by each arbitrator) by a judge of the federal district court having jurisdiction

over the geographical area in which the arbitration is to take place, or if the federal court declines to act, the state court having general jurisdiction in such area.

All arbitrators shall be disinterested active or former executive officers of insurance or reinsurance companies or Underwriters at Lloyd's London.

Within 30 days after notice of appointment of all arbitrators, the panel shall meet and determine timely periods for briefs, discovery procedures and schedules for hearings.

The panel shall be relieved of all judicial formality and shall not be bound by the strict rules of procedure and evidence. The decision of any two arbitrators when rendered in writing shall be final and binding.

The panel shall make its decision considering the custom and practice of the applicable insurance and reinsurance business as promptly as possible following the termination of the hearings. Judgment upon the award may be entered in any court having jurisdiction thereof. Each party shall bear the expense of its own arbitrator and shall jointly and equally bear with the other party the cost of the third arbitrator. The remaining costs of the arbitration shall be allocated by the panel. The panel may, at its discretion, award such further costs and expenses as it considers appropriate, including attorney fees, to the extent permitted by law.

N. **Cancellation.** Should the Company's policy(ies) be canceled, this Certificate shall terminate automatically at the same time and date. This Certificate may also be canceled by the Company upon not less than 30 days prior written notice, stating when this reinsurance shall terminate. This Certificate may also be canceled by the Reinsurer upon prior written notice to the Company, stating when this reinsurance shall terminate. The date of such termination shall be either:

1. The date written notice is mailed plus the number of days required to cancel the Company's policy(ies) plus 15 days, but in no event exceeding 75 days in all; or,
2. In the event of cancellation for non-payment of premium, the date written notice is mailed plus 15 days.

Proof of mailing shall be deemed proof of notice, and calculation of the earned premium shall follow the Company's calculation in the use of short rate or pro rata tables.

O. **Changes.** The terms of this Certificate shall not be waived or changed except by endorsement executed by a duly authorized representative of the Reinsurer.

IN WITNESS THEREOF, IIA Casualty Company has caused this Certificate of Reinsurance to be signed by its duly authorized officers at Somecity, Pennsylvania. The same shall not be binding upon the Reinsurer unless countersigned by an authorized representative of the Reinsurer.

Corporate Secretary

Chief Executive Officer

IIA Reinsurance



Pro Rata Certificate

A pro rata facultative reinsurance certificate states the facultative limit as either a percentage or a dollar amount. For example, a quota share facultative reinsurance certificate could state the limit as 20 percent of \$1,000,000 or \$200,000 part of \$1,000,000. Both statements indicate that the reinsurer has accepted 20 percent of the \$1 million original coverage limit.

The pro rata facultative reinsurance certificate also shows the primary insurer's retention because the primary insurer can have more than one pro rata certificate on the same loss exposure. For example, the primary insurer may retain 50 percent of \$1 million and purchase two separate facultative quota share reinsurance certificates, one for 20 percent and one for 30 percent. Both reinsurers would want to know how much of the original loss exposure the primary insurer is retaining net.

Excess of Loss Certificate

An excess of loss facultative reinsurance certificate states the certificate limit as a dollar amount in excess of the primary insurer's retention, such as \$250,000 xs \$750,000. This means that the reinsurer has accepted \$250,000 of a \$1 million loss exposure and that the primary insurer has retained \$750,000. If the reinsurance is in excess of other reinsurance, the additional reinsurers are identified in the certificate.

TREATY REINSURANCE PLACED THROUGH THE BROKER MARKETING SYSTEM

Treaty reinsurance is usually written to cover an entire line, or book, of business; in most cases, the reinsurer does not have the right to reject a loss exposure that falls within the class (or classes) of business covered by the treaty. For simplicity, this illustration shows how treaty reinsurance is placed through the broker marketing system. However, both facultative and treaty reinsurance can be placed through a broker market.

The procedures for purchasing treaty reinsurance through a reinsurance intermediary in a broker marketing system are similar to those for facultative reinsurance.

In addition to the broker of record letter and the premium and loss account required by state insurance statutes, these typical procedures, which include preagreement and final documentation, are an integral part of the treaty reinsurance placement process:

- Proposal
- Underwriting
- Authorization
- Treaty documentation



Treaty documentation differs from facultative documentation because treaties cover many loss exposures rather than only one.

Proposal

Reinsurance proposals contain a significant amount of underwriting information about the primary insurer and the loss exposures insured. Because the reinsurance intermediary's proposal specifies the proposed treaty terms applicable until the treaty is finalized, the proposal must provide enough information for the parties to proceed with the reinsurance transaction.

At a minimum, the proposal's underwriting section should contain these categories of information:

- Types and number of underlying policies issued, including limits profiles and geographic distribution of loss exposures
- Past and projected premium base of loss exposures that will be covered by the reinsurance agreement, as well as historical rate change information for the underlying loss exposures
- Loss history of the policies subject to the treaty
- Primary insurer's management philosophy
- Primary insurer's financial information, such as audited financial statements and financial rating service information
- Primary insurer's operating systems and procedures
- Results of on-site reviews of the primary insurer's operations

Underlying Policies Issued

The first type of information that the underwriting section of a proposal should contain is a description of the types and number of underlying policies issued and the percentage of premiums for each type of policy. See the exhibit "Homeowners Policies Issued by Kalmia Insurance Company."

Homeowners Policies Issued by Kalmia Insurance Company

Policy Type	Percentage of HO Premiums	Number of Policies
HO-2	1%	100
HO-3	75%	5,357
HO-4	14%	2,800
HO-5	7%	700
HO-6	3%	500

[DA05178]



Limits profiles summarize coverage limits and corresponding premiums for the loss exposures subject to the treaty. A typical limits profile categorizes the primary insurer's policies into ranges to help the reinsurer understand the loss exposures subject to the treaty. See the exhibit "Limits Profile—Kalmia Insurance Company Homeowners Business."

Limits Profile—Kalmia Insurance Company Homeowners Business

Property Limits*	Average Limits (\$)	Number of Policies	Average Premiums (\$)	Total Estimated Premiums (\$)
\$0–\$25,000	17,350	1,102	289	318,478
\$25,001–\$50,000	45,750	1,496	317	474,232
\$50,001–\$100,000	77,400	809	356	288,004
\$100,001–\$150,000	133,900	803	423	339,669
\$150,001–\$200,000	184,225	1,691	489	826,899
\$200,001–\$250,000	231,025	1,708	514	877,912
\$250,001–\$300,000	267,845	1,044	556	580,464
\$300,001 and over	348,000	804	617	496,068
Total		9,457		\$4,201,726

*Coverage A—Dwelling Limit

[DA05179]

This description of the types of loss exposures should also indicate where the loss exposures are located and how much insurance coverage is being provided in each geographic area. Although this geographic distribution information is crucial for property catastrophe coverages, it can also be useful in evaluating casualty treaties. Some jurisdictions are known for awarding consistently high jury awards in liability cases, so the casualty treaty underwriter should recognize how much insurance is issued in those jurisdictions. The exhibit illustrates a geographic distribution of in-force property insurance policies. Based on this information, the property treaty underwriter could evaluate coastal wind or hail loss exposures. See the exhibit "Geographic Distribution of In-Force Property Insurance Policies Issued by Kalmia Insurance Company."

Premium Base

The second type of information that the underwriting section of a proposal should contain is the past and projected premium base of the loss exposures that will be covered by the treaty and the rate changes associated with the underlying exposures. The premiums shown should be annotated to explain



Geographic Distribution of In-Force Property Insurance Policies Issued by Kalmia Insurance Company

Geographic Area	Number of Policies	Percentage of Premiums
Alabama	1,322	13.9%
Georgia	2,272	24.0%
Florida		
Dade County	3,222	34.2%
Broward County	2,641	27.9%
Total	5,863	62.1%
Geographic Total	9,457	100.0%

[DA05180]

whether they are written or earned, whether they are past, projected, or both; and the extent to which the proposal's premium base is representative of the treaty's loss exposures.

Some insurance policies, such as homeowners and businessowners policies, provide both property and liability coverage under one premium. When the reinsurance agreement covers only the property or liability insurance element, the appropriate premium must be extracted to create a rating base for the treaty. For example, 85 percent of the total homeowners premiums may be included as the subject premium for a property treaty.

Loss History

The third type of information that the underwriting section of a proposal should contain is the loss history of the policies subject to the treaty. A comprehensive loss history is fundamental for estimating future experience. The number of years of loss history that should be provided depends on the type of insurance policies being reinsured and the stability of the loss ratio these policies produce.

Property insurance claims are usually reported soon after the loss occurrence. Property claims are usually settled quickly, although issues about the damaged property's value might delay settlement. Business income losses are categorized as property losses but take longer to settle than most other types of property claims because the policyholders' losses occur over time. Reinsurers usually request three to five years of loss history for property insurance.

Liability insurance claims typically take longer to settle than property claims. Unlike property claims, liability claims are not necessarily reported immediately because injuries and damages often take time to manifest, and it may be months or years before the injured party seeks a remedy. Reinsurers may



require ten or more years of loss history for liability insurance. Because a liability claim's ultimate value may not be known for many years after the occurrence of the event causing the loss, insurers and reinsurers use loss-reserve analysis techniques to evaluate the adequacy of loss reserves.

The loss history should list all claims for the policies subject to the treaty even if a claim does not affect the treaty under consideration. Complete past loss data are important because the reinsurer will want to consider the effect of inflation on the amount of future claims of a similar nature. The loss history also indicates whether the loss amounts shown are net of reinsurance or whether they are gross amounts of loss with no reduction for reinsurance recoveries (called ground-up losses). The loss information should include these details:

- Date of loss
- Date loss notice was received
- Amounts paid and amounts outstanding as loss reserves, along with the amount of insurance for the policy affected by the claim
- Significant loss reserve changes
- Date(s) of loss payments
- Current status of each claim: whether open (claims with future payments expected) or closed (settled claims)
- Any multiple claims against the same policy limit

Management Philosophy

The fourth type of information that the underwriting section of the proposal should contain is the primary insurer's management philosophy. This section allows the primary insurer to explain various facets of its operations to potential reinsurers, including its management's risk tolerance, the insurance markets in which it competes, and its pricing policies and philosophies. It also often includes management's future plans, the background of key members of the primary insurer's management team, and a summary of the primary insurer's support staff.

Reinsurance underwriters look for stable and consistent management practices that lead to predictable results. If the primary insurer is inclined to change reinsurers, production sources, or types of insurance sold, such changes may reduce the stability necessary to build a long-term reinsurance relationship.

Financial Information

The fifth type of information that the underwriting section of the proposal should contain is the primary insurer's financial information. Reinsurers usually expect to see the last several years of the primary insurer's financial statements developed for shareholders and regulators. Treaty underwriters may also require the primary insurer to submit the quarterly versions of these statements since the last year-end report was filed. Finally, reinsurers consult



financial rating services, such as A.M. Best and Standard and Poor's, for a third-party analysis of the primary insurer's financial condition and future prospects.

Operating Systems and Procedures

The sixth type of information that the underwriting section of the proposal should contain is the primary insurer's operating systems and procedures. Primary insurers' systems and procedures are usually described in their operating manuals. Underwriting guides, line guides, and claim department manuals are typically the most useful. Underwriting guides indicate the types of insurance sold by the primary insurer and its underwriting and rating procedures. Line guides indicate the primary insurer's retention on each class of loss exposure ceded under the treaty. Claim department manuals indicate procedures for handling claims and setting reserves.

On-Site Reviews

The seventh type of information that the underwriting section of the proposal should contain is the results of on-site reviews of the primary insurer's operations. Reinsurance underwriters can develop a more comprehensive understanding of the primary insurer's management, staff, and operations by reviewing operating manuals in conjunction with on-site visits to the primary insurer. Visits may occur at any time before or after the reinsurer offers an authorization on the treaty.

On-site reviews may reveal that the underwriting staff is too small or inexperienced to manage the type of insurance considered, or they may reveal the use of aggressive underwriting techniques that emphasize production over control and quality. Claim reviews may expose consistent underreserving that creates inaccuracies in long-term operating results. A claim review may also expose stairstepping of reserves, meaning that individual reserves are increased incrementally rather than being adequately reserved at the outset, a sign that the claim department may generally be failing to accurately estimate claims' ultimate value.

Underwriting

Reinsurance underwriters must fully understand the treaty's proposed terms and suggest alternative terms, if necessary, to make the treaty acceptable. These are key terms of a reinsurance treaty that underwriters should evaluate:

- Pricing
- Treaty commencement and termination
- Cancellation
- Exclusions



The most frequently negotiated treaty term is its price. Pro rata treaty pricing is a function of the reinsurance commission paid by the reinsurer to the primary insurer. A primary insurer receiving a commission that is greater than its original acquisition expenses may consider pro rata less expensive, because the difference (often called override) may reduce overall expenses or losses under the agreement. Therefore, the profitability of the reinsurance treaty depends on the profitability of both the underlying policies and the reinsurance commission.

Excess of loss treaty pricing is based on reinsurance rates that are applied to the subject premium. The treaty proposal often contains suggested commission levels (pro rata treaties) or reinsurance rates (excess of loss treaties).

Another important treaty term is commencement and termination. The treaty proposal typically indicates the beginning and ending date of the reinsurance coverage. Some treaties provide coverage on a continuous basis, which means that they will continue until they are canceled. Other treaties provide coverage on a term basis, which means that they will expire on a particular date. The commencement and termination provision of a treaty usually indicates whether it is written on a losses-occurring basis (includes losses on underlying policies that are in effect as of the treaty's inception date, as well as newly issued or renewed underlying policies) or on a policies-attaching basis (includes only those losses for underlying policies sold or renewed after the treaty's inception date).

In continuous treaties, cancellation terms should indicate when a cancellation takes effect and what advance notice is required. The cancellation terms should also indicate whether cancellation will occur on a cut-off basis (terminates the reinsurer's responsibility for losses with the treaty's expiration date) or a run-off basis (continues the reinsurer's responsibility for losses until the expiration of the underlying policy), or whether the selection of cut-off or run-off is the primary insurer's option.

Finally, treaties contain exclusions, as do the underlying policies that they reinsure. Treaties usually exclude high hazard loss exposures and causes of loss typically not covered by reinsurance. By excluding specific loss exposures, treaty exclusion provisions establish the parameters for the types of loss exposures the primary insurer can reinsure. As with other treaty terms, treaty exclusions can be negotiated, and they should be negotiated if they appear to overly restrict the primary insurer's marketing strategy.

Lead reinsurer

The reinsurer that negotiates the treaty terms and that generally assumes a significant share of the treaty's liability.

Following reinsurers

Reinsurers that take a percentage of the treaty's liability on the same terms and conditions as the lead reinsurer.

Authorization

Often, the reinsurance intermediary first offers the reinsurance proposal to a **lead reinsurer**. Upon accepting the proposal, the lead reinsurer quotes the rates and other reinsurance terms. After the primary insurer agrees to the lead reinsurer's terms, the proposal is presented to additional reinsurers. Additional reinsurers that accept the proposal are known as **following reinsurers**.



The treaty underwriter's authorization indicates the amount of reinsurance (usually expressed as a percentage of the underlying amount of insurance) that the reinsurer is willing to reinsure. A reinsurer's participation percentage may be the same in the final treaty as in the authorization, but not always. If a treaty is undersubscribed (has an insufficient number of participating reinsurers to provide the necessary reinsurance) or oversubscribed (has more participating reinsurers than needed to provide the necessary reinsurance), reinsurers usually adjust their participation percentages.

The reinsurer can initially communicate the authorization by telephone, followed by a written confirmation. The confirmation letter is not usually executed until the final percentage participation has been determined. This eliminates the need to reissue the confirmation letter if the participation changes. Most treaty authorizations do not contain the time limitations typical of facultative reinsurance because often many reinsurers are involved and the underlying policies to be reinsured are not awaiting reinsurance in order for the underlying policy to be issued. See the exhibit "Sample Treaty Confirmation Letter and Confirmation Signing Page."

Treaty Documentation

Formal treaty documentation includes the confirmation letter, interests and liabilities agreement, and treaty clauses. The reinsurance intermediary and reinsurers should have an originally signed confirmation letter in their treaty files. The primary insurer receives a copy of the signed confirmation letter from the reinsurance intermediary to complete the placement process.



Sample Treaty Confirmation Letter and Confirmation Signing Page

Reinsurance Company

111 Any Street, Any Town, Any State 11111
Phone 800-555-1212 Facsimile 800-555-1213

January __, 20XX

Ms. Susan P. Jones, CPCU
Vice President—Underwriting
XYZ Reinsurance Company
Anywhere, USA

ABC Insurance Company
Excess Catastrophe Reinsurance Contract
Effective: January 1, 20XX
Reinsurance Confirmation

As previously communicated via our January ____, ____ facsimile, we are pleased to formally confirm your participation on the captioned Contract. Your final line(s) are detailed in the attached Reinsurance Confirmation Signing Page.

The final terms and conditions are summarized in the enclosed Reinsurance Confirmation slip that follows our earlier correspondence. Please review the attached material at your earliest opportunity and advise if you have any questions or comments.

Subject to your approval, and in accordance with New York Regulation 98, please sign and return a copy of the Reinsurance Confirmation Signing Page as evidence of your agreement to accept this reinsurance.

Formal documentation will be drafted and forwarded to reinsurers following ABC's review and approval. In the interim, please let us know if we can be of any assistance. We appreciate your continued support of this reinsurance program.

Sincerely,

Dean Haddy, ARe
Senior Reinsurance Analyst

Confirmation Signing Page

Reinsurance Services
111 Any Street
Any Town, Any State 11111

Phone 800-555-1212
Facsimile 800-555-1213

Company: ABC Insurance Company
Contract: Excess Catastrophe Reinsurance Contract
Reinsurer: XYZ Reinsurance Company

On the basis of the terms outlined in Reinsurance Confirmation dated January _____, _____, the undersigned reinsurer confirms its agreement to accept a share(s) in the Contract(s) listed below, effective January 1, _____:

	Coverage Percent	Limit	Retention	Your Participation Percent	Your Dollar Line	Your Reference No.
1st XS Cat	100.0%	\$4,000,000	\$1,000,000	3.0%	\$120,000	
2nd XS Cat	100.0%	\$5,000,000	\$5,000,000	2.0%	\$100,000	

Revisions/Remarks: _____

Signed: _____
XYZ Reinsurance Company

Date: _____

Please sign and return one copy.

[DA05181]

SUMMARY

Reinsurance is sold through two primary marketing systems: the direct writing marketing system and the broker marketing system. In the direct writing marketing system, a reinsurer deals directly with the primary insurer. In the broker marketing system, a reinsurance intermediary deals directly with the reinsurer on the primary insurer's behalf.

The reinsurance placement process involves three major steps: (1) select a reinsurance marketing system, (2) develop a reinsurance agreement proposal, and (3) complete agreement documentation.

The facultative reinsurance placement process through a direct writing reinsurer involves a proposal; clearance and underwriting; authorization; confirmation; a reinsurance binder; policy documentation; and a facultative reinsurance certificate, which can be either a pro rata or an excess of loss certificate.



The treaty reinsurance placement process through a broker market is similar to that for facultative reinsurance. It includes a proposal, underwriting, authorization, and treaty documentation.

