



INTRODUCTION TO REINSURANCE  
WHAT YOUR BOARD NEEDS TO KNOW TODAY

C L E V E L A N D

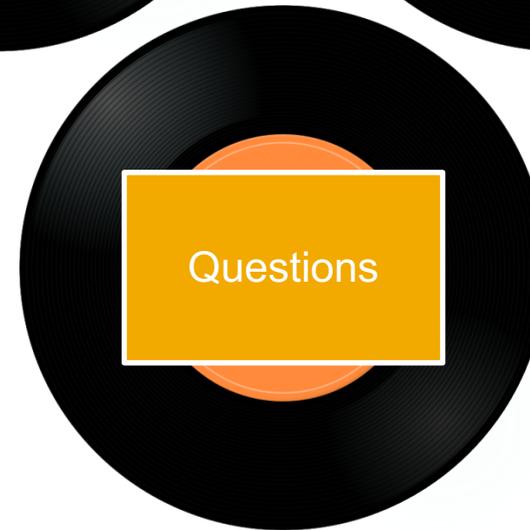
AASCIF 2019

July 21-24, 2019

HILTON CLEVELAND DOWNTOWN  
CLEVELAND, OHIO

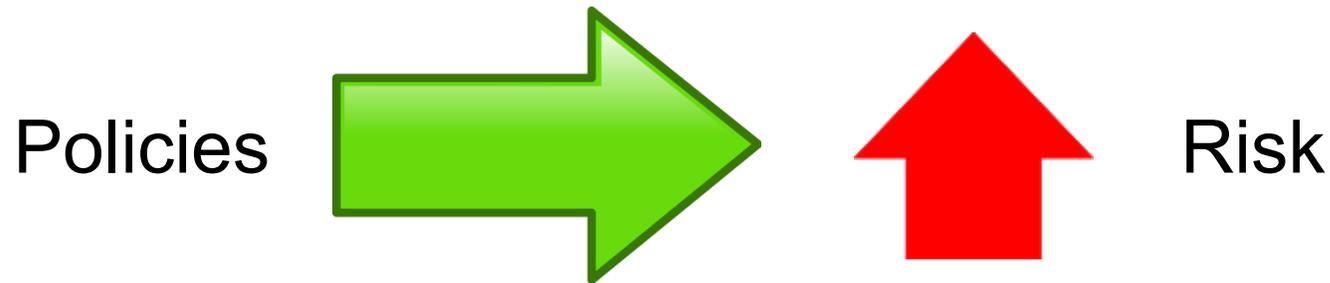
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# Today's Playlist



# Managing Risk

## Every Policy you Write Presents Risk



The rate you charge policyholders may include a Cat load or Terrorism load, but is it sufficient?  
Probably not!

# So What?

## This is Where you all Start to Differ



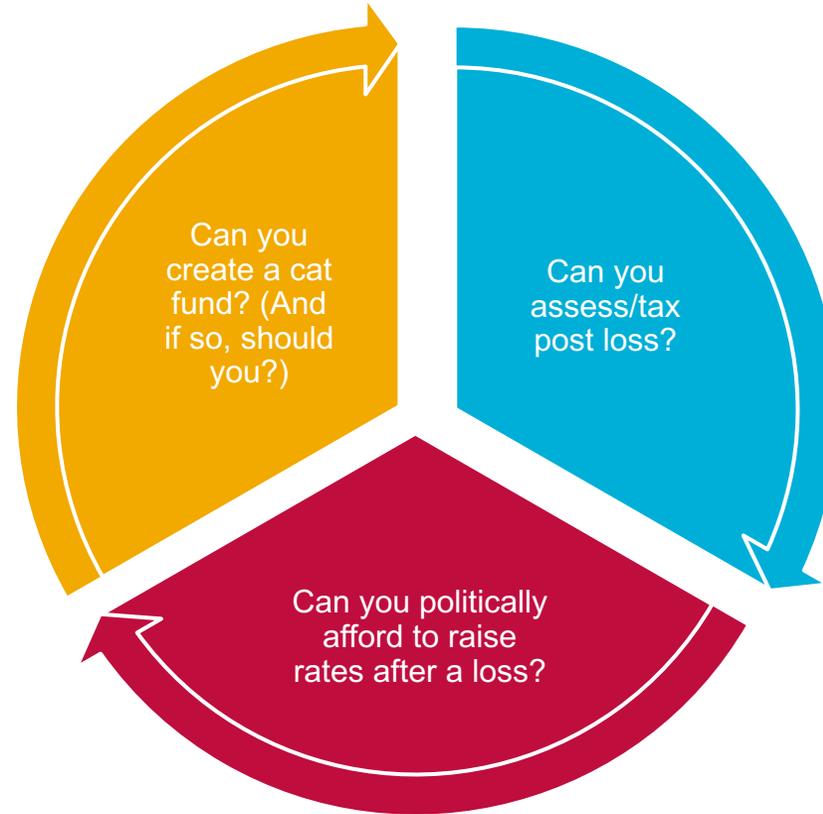
**You don't have to keep the Catastrophe risk. There are options.**

How much risk can you take?

- ERM tolerances – reinsurance has a role in managing enterprise risk
- Whatever you can afford to?
- Rating agency concerns
- If reinsurance is so cheap that it becomes an arbitrage
- When you can responsibly keep risk and still retain ability to keep prices stable after a large loss
- Up to the point where you can predict and budget for losses, and then reinsure everything else

# Reinsurance is an Option

## The Other Options aren't Ideal



Reinsurance is a much more efficient way to gain access to capital

# What is Reinsurance?

## Unique Characteristics of Reinsurance



### Basically, it is insurance for insurance companies

- Or, “it is a mutual agreement in which, for consideration (premium), the ceding company agrees to cede to the reinsurer and the reinsurer agrees to indemnify the ceding company for a portion of the loss or liability on the risk assumed by the ceding company as the insurer”

### Business based on custom and traditions

- “Utmost Good Faith” or Uberrimae Fidei – requires the ceding insurer to disclose to the reinsurer all material facts about the risk being reinsured
- This doctrine is closely aligned with the notion that the reinsurance relationship is a partnership, where each party to the contract shares in the risk underwritten and reinsured
- Regular contact and visits are recommended
- Follow the Fortunes/Settlements – the idea that reinsurers cannot question the decision of the cedent

### There is no regulation of reinsurance rates

# Reinsurance Glossary

## An Attempt to Confuse



- **Excess of Loss reinsurance** – the insurance company is indemnified for losses that exceed a specified dollar amount
- **Retention** – the attachment point where the excess of loss reinsurance begins
- **Limit** – the maximum amount payable under the reinsurance program  
*An example of the above is “\$250M xs \$100M” where the reinsurer indemnifies the insurance company above the \$100M retention for the next \$250M. Or, in the event of a \$350M loss, the insurance company would retain \$100M and collect \$250M from the reinsurer.*
- **Maximum Any One Life (“MAOL”)** – the most that any one claimant / injured worker can contribute to the reinsured loss
- **NBCR** – terrorism emanating from Nuclear, Biological, Chemical, or Radiological sources
- **TRIPRA** – The Terrorism Risk Insurance Program Reauthorization Act. The program was reauthorized in 2015 and provides a backstop by the federal government against insured terrorism losses

# Types of Reinsurance

## Two Basic Types



### Treaty Reinsurance

- Reinsurance covering multiple original policies.
- Reinsurance covering an entire book or portfolio of business. Typically defined in the reinsurance agreement (contract)

### Facultative Reinsurance

- Reinsurance covering a single policy or location
- Typically a very large or “volatile” risk
  - There is some component or characteristic of the policy / risk that that the insurance company would rather not retain.

# Forms of Reinsurance

## Most Common Forms



### Quota Share Reinsurance

- Share the premium and the risk
  - Typically from the ground up to a certain loss level – 25% quota share of the first \$1,000,000 of loss

### Excess of Loss Reinsurance Reinsurance (“XOL”)

- Reinsurance coverage begins after a retention (deductible) and is capped at a limit
  - \$5,000,000 xs \$5,000,000
- There are usually multiple layers of excess of loss reinsurance stacked on top of each other – why?

### Other Forms of Reinsurance

- Aggregate, Loss Ratio Excess, Structured Risk, Adverse Development Covers, Loss Portfolio Transfers

# Functions of Reinsurance

## Different Strokes for Different Folks



	Smooth Results	Catastrophe Protection	Surplus Relief	Underwriting Expertise	Exiting LOB or Territory	Obtain Capacity
Facultative				X		X
Pro Rata			X		X	X
Excess of Loss	X	X				X

# Functions of Reinsurance



**Stability / Smooth Results** – Insurance companies plan for certain range of possible outcomes. However there is always the possibility of missing the market to tail events or unforeseen outcomes.

- Marketing Considerations – Policyholders and stockholders like to be identified with a stable and well-managed company
- Management Considerations – Planning for long term growth requires a more stable environment than an insurance company's book of business is apt to provide



**Catastrophe Protection** – protects the reinsured against a single catastrophic loss or multiple large losses

- Natural disasters such as earthquakes, floods, hurricanes, as well as man-made disasters such as terrorist attacks
- Multiple (two or more) large losses arising from the same event, such as a fire that burns down a luxury apartment complex
- CAT losses could impair an insurer's capital or render it insolvent

# Functions of Reinsurance



**Financing / Surplus Relief** – eases the strain on the reinsured’s surplus during rapid premium growth

- As an insurance company’s premiums written is limited by its balance sheet, it can stop writing new business, increase capital, or buy “surplus relief” reinsurance
- Insurers need to maintain an acceptable premium to surplus ratio
- When insurance companies cede premium to a reinsurer, the liabilities (unearned premium) on its balance sheet are lowered and, all other things equal, their surplus will rise



**Expertise & Services** – provides the reinsured with a source of underwriting information when entering a new line of insurance or a new market

- Helps spread the risk on new lines of business until premium volume reaches a certain point of maturity
- Reinsurers and reinsurance brokers provide a variety of value-added services such as Claims Review, Underwriting Review, Product Development, and Actuarial Review
- Provides a back-stop when in unfamiliar coverage areas

# Functions of Reinsurance



**Capacity** – allows the reinsured to write larger amounts of insurance for a single risk

- Example: ABC Insurance Co. wants to write a workers' compensation policy for a very large employer with 200 employees at one location
- Without reinsurance, a major loss from that location could represent a large pay-out and affect the insurer's current year earnings

# Who and Where are these Reinsurers?

## Don't Turn Around!



- **“Professional” reinsurers** – specialize in reinsurance; derive a significant share of their premium from reinsurance
  - Broker-market reinsurers – assume business through reinsurance brokers who provide the production and/or sales support
  - Direct writers – form reinsurance relationships directly with the ceding company (reinsurers can support both)
- **Reinsurance department of primary company** – an insurance company can set up a department to assume reinsurance business
- **Alternative reinsurance** – hedge funds and other financial institutions seeking diversity and enhanced returns.
- **Varied Jurisdictions** – Domestic (US), UK (Lloyd’s), Bermuda, Europe, Asia – worldwide.

# Workers' Compensation Reinsurance

## Two Types of Coverage Commonly Utilized



### Working Layer / Single Claimant Exposed Coverages

- Per Claimant - Reinsurance that will respond to a single person loss
- Per Occurrence – Reinsurance that will respond to a single person loss or to a multiple person loss from the same event. Could involve multiple policies

### Catastrophe Reinsurance

- Reinsurance that will respond to a multi-claimant, multi- policy event
  - Typically a limitation capping the most any one person can contribute to the loss. Covering a single policy or location

# Workers' Compensation Reinsurance

## Key Features



### What is a loss?

- If a loss is deemed compensable (course and scope) by the client, the reinsurers will respond.
- Slip and fall, traffic accident, workplace violence, industrial accident, earthquake, terrorism
- Occupational Disease is mostly excluded under the reinsurance treaty
- Lines other than WC may have a detailed definition of loss. WC tends to “follow form.”



### What is excluded?

- Some programs will have dozens of exclusions in their reinsurance programs (de facto underwriting guidelines)
- Guaranteed markets like AASCIF companies typically have far fewer exclusions, and not related to classes of business, such as:
  - Occupational Disease and Cumulative Trauma
  - Jones Act
  - Participation or membership in any Insolvency Fund
  - Assumed Reinsurance
  - War

# Workers' Compensation Reinsurance

## So What's it Going to Cost Me?



**Reinsurance pricing** is based on a number of factors:

- Company's own experience (particularly on working layers)
- Exposure, measured by:
  - Payroll / Employee counts
  - Composition of the book (Hazard Group Distribution)
  - Proximity to terrorism targets or earthquake faults
  - Expected loss ratios (working layers)
- Market conditions (much of which have nothing to do with Workers Compensation or the jurisdictions where you write business!)
- AASCIF members present a unique diversification for Cat reinsurers

# Workers' Compensation Reinsurance

## Current Trends in the Market



### Market Trends

- Key developments facing reinsurers:
  - Recent hurricane, earthquake, and wildfire activity
  - Reinsurer margins considered very thin
  - A moderation of reserve redundancies and increasing instances of deficiencies
  - Inflation and low investment income
- Even though losses have been dominated by large property events, they affect the overall reinsurance market
- Nearly all reinsurers / capital support both casualty and property programs

### Overall Workers Compensation Reinsurance Capacity

- Per Person coverage / Working layers (up to \$20M): **Adequate**
- Multi-Claimant Catastrophe coverage / CAT layers: **Abundant**
- First dollar Quota Share: **Adequate**
- Good diversity options between U.S., Bermuda, Lloyds, International markets
  - New markets looking to expand capacity
- Facultative market to assume aggregation spikes or carve out certain volatilities

# Now What?

## What Should I Focus on this Year and Next?



Besides the basics of making sure my reinsurance program is responsive to my risk management strategy:

- Rating Agency concerns
- TRIPRA expiration on the horizon
- Something in your state that could affect loss trends? Or ownership of policyholders' surplus? Or anything else that can go bump in the night?
- Has pricing dropped too much – WC is the only commercial insurance line not experiencing rate increases
- How many years can the calendar year combined ratio drop.....2018 is 5<sup>th</sup> straight year below 100%

# Terrorism Risk Insurance Program

## Overview of Federal Terrorism Insurance Backstop Legislation



The Terrorism Risk Insurance Program Reauthorization Act of 2015, **terminating December 31, 2020**, is intended to make coverage available for certified acts of terrorism on the same terms as for other covered risk.

### Program Trigger

Phased-in increase starting on January 1, 2016:



**Insurer deductible:**  
Percent of Direct Earned Premium: **20%**

**Recoupment amount:**  
**140%**

**Cap on liability:** **\$10B**

### Covered Acts

Foreign and domestic terrorism in the U.S. and on U.S. interests abroad, with no separate treatment of Nuclear, Biological, Chemical, and Radiological (NBCR) terrorism. Includes an act of war for workers compensation policies only

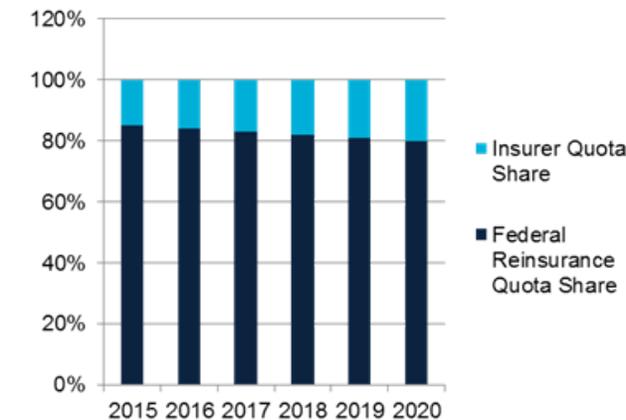
### Certification

Act of terrorism must be certified by the Secretary of Treasury with consultation from the Secretary of Homeland Security and Attorney General

**Certification Level:** \$5M

### Federal Reinsurance Quota Share

Phased-in decrease starting on January 1, 2016:



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QUESTIONS?

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# APPENDIX

