REINSURANCE

Reinsurance is a practice in which insurers transfer portions of portfolios to other parties (reinsurance) in order to reduce their exposure to claims. Reinsurance can be also be look into as insurance to Insurance Company.

PARTIES TO REINSURANCE CONTRACTS

The contract made between an Insurance Company and a third party to protect the Insurance Company from losses. The contract provides for the third party to pay for the loss sustained by the Insurance Company when the company makes a payment on the original contract.

A reinsurance contract is a contract of indemnity, meaning that it becomes effective only when the Insurance Company has made a payment to the original policy holder. Reinsurance provides a way the Insurance Company to protect itself from financial disaster and ruin by passing on the risk to other companies.

The parties to reinsurance contract are:

i. The reinsurer
ii. The reinsured
iii. The original policy holder or the original insured

1. The reinsurer is the third party or the company issuing reinsurance policies.
2. The reinsured is the Insurance Company that issued the first party and is applying for reinsurance.
3. The original policy holder or original insured is the party who purchased the original policy.

NOTE:

The reinsurance policy is between just the two Insurance Companies (the reinsured and the reinsurer) the original policy holder usually has no right against the reinsurer.

An item may be Insured by many Insurance Company at once.

FORMS OF REINSURANCE

Basically there two types of reinsurance agreement and they are:

i. Facultative reinsurance and
ii. Treaty reinsurance.

1. **Facultative Reinsurance:** It is reinsurance for a single risk or a defined package of risks. The Ceding Company (primary Insurer) is not compelled to submit these risks to the reinsurer, neither is the reinsurer compelled to provide reinsurance protections. Facultative reinsurance allows the reinsurance company to review individual risks and determine whether to accept or

reject the risk. How profitable the reinsurance company is in these types of contract arrangement depending on which of the risks the reinsurer decides to take on.

2. **Treaty:** This is a reinsurance contract in which reinsurance company agrees to accept all of a particular types of risk from the ceding Insurance Company. Reinsurers in a treaty contracts are obliged to accept all risks outlined in the contracts.

FORMS OF TREATY REINSURANCE

Treaty reinsurance could be grouped into two categories namely;

i. Proportional treaty
ii. Non-proportional treaty

1. **PROPORTIONAL TREATY:** This is the form of treaty in which a proportional agreement has been reached to which any risk that falls within the terms and conditions of the treaty will be shared. For example, if a Ceding company cedes 65% of a risk, he will remit 65% of the premium to the reinsurance. The reinsurer also accepts 65% of the risks and will settle claims up to the time at 65%.

   A proportional treaty is further grouped into two namely;

i. Quota share treaty
ii. Surplus treaty

i. **QUOTA TREATY:** Under this treaty, the reinsurance takes a certain percentage of all risks written by insurer. They will receive same percentage of premium and same percentage of all claims that arise. For example, if the agreement between the Ceding Company and the reinsurer is 75% to the reinsurer and 25% to the Ceding Company, the reinsurer will accept 75% of each risk, 75% of premium and 75% of all claims that might arise. The Ceding Company will accept 25% of risk, 25% of premium and 25% of each claim that might arise.

Advantages of Quota Share Treaty

a. It is simple and easy to handle.
b. It serves as a means of saving cost (Administrative cost)
c. It is suitable for a young company that needs fully reinsurance protection.

Disadvantages of Quota Share Treaty

a. Premium is paid away on small risk instead of retaining the whole for insurer's own account.
b. There is no risk of selection against the insurer as they set an equitable share of good and bad risks.

ii. **SURPLUS TREATY:** This is the most common form of proportional treaty. Under this only the surplus above the Ceding Company's retention of each risk is passed to treaty insurer. The capacity of the treaty is defined in line and the line is equal to the retention limit of the Ceding Company. For example, if there are 10 lines treaties, and the retention limit of the Ceding Company is ₦2m, the Ceding Company has the capacity of accepting risk up to ₦2m. this implies that any case above ₦2m will cover other additional surplus treaty which could

be 2nd, 3rd or 4th surplus treaty contract. The insurer can Cede only when the risk is above the retention limit.

2. **NON-PROPOTIONAL TREATY:** This is the form of reinsurance where there is no correlation between the premium received by the insurer and the claim payable by him. If at all premium received and claim payable are the same, it is just coincidence. Under the term of reinsurance, the reinsurer is required to pay the balance of the claims only if the claim exceeds a specific amount as agreed. There are two categories of non-proportional treaty namely;

i. Excess of loss
ii. Stop loss

a. **Excess of loss:** Under excess of loss, the Ceding Company and the reinsurer do not share loss in a fixed percentage. The Ceding Company is allowed to select the maximum amount it can conveniently bear in case of loss and the reinsurer undertakes to pay all losses above this amount. Retention under excess loss is usually high and any excess above the retention is recoverable from the reinsurer. Some reinsurers arrange up to three or four excess of loss cover and the cover are express in layers. The layers can be;

1. Catastrophe layer or
2. Working layer

i. **Catastrophe excess:** This protects the Ceding Company's net account against the risk of accumulation. In the event of one catastrophe or disaster which could result in series of losses. This is principally against disaster arising out of flood, earthquake, windstorm, explosion, etc.
ii. **Working excess:** This cover is arranged against losses on per risk basis, not like the catastrophe that is on per event basis. The excess point is fixed at a very much lower level.

b. **Stop loss:** This form of non-proportional reinsurance is similar to excess of loss as it does not concern itself within individual claim but with total loss cost, if it does not exceed a percentage of the annual premium in a particular class of business. This insurer is not liable for any loss until the loss ration exceed the agreed percentage of the premium for the year.

Functions of reinsurance

1. **Spread of risk:** The incident of risk is spread over a wide area in the contract of reinsurance.
2. Reinsurance makes it possible for direct insurer to handle larger risks than he would have accepted.
3. Reinsurance also helps the direct insurer to stabilize his loss level by removing some of the uncertainties.
4. Reinsurance helps in catastrophe situations by reducing the net cost of acceptable level, as some reinsurance pays claims in excess of a stated figure as agreed.
5. An insurer gains and enjoys confidence in the existence of reinsurance as a result of availability of reinsurance cover.
6. It also helps the insurer to grow in size.

It is important to note that reinsurance is applicable in a situation whereby an insurer accepted risk beyond his financial capacity. It then cedes or transfer part of the risk to another insurer.