

Glossary of Reinsurance Terms

CITATION

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This glossary is a combination of 357 terms prepared specifically for Reinsurance Contract Wording in 1992 (designated as +) and the terms appearing in the 1980 text, Reinsurance, revised in 1997 (available in Spanish as of 2001). While there are differences of opinion among authorities concerning the nuances and subtleties of many words herein (as will be the case in the formation of any dictionary of technical terms), the Editor of these books believes the definitions are representative of current practices and accordingly he accepts responsibility for any errors created in the compilation and hopes the definitions will nevertheless be helpful. Words set in NONBOLD CAPS are defined elsewhere in the Glossary.

ACCIDENT-YEAR EXPERIENCE - Simplistically, the matching of all losses occurring (regardless of when the losses are reported) during a given twelve-month period of time (usually a calendar year) with all premium earned (regardless of when the premium was written) during the same period of time. More specifically, the total value of all losses occurring (losses paid, plus loss reserves) during the defined twelve-month time period (i.e., the date of loss falls within the time period) is divided by the **EARNED PREMIUM** (see its definition) for this same exposure period. As the experience is developing, loss reserves are used in the calculation, but the ultimate result cannot be finalized until all losses are settled. While any twelve-month period can be used to define the exposure period, the year beginning January 1 is normally used. The most accurate method uses **EXPOSURE EARNED** premium (see its definition under **EARNED PREMIUM**) as the denominator, whereas in practice **ACCOUNTING EARNED** premium (see its definition under **EARNED PREMIUM**) is frequently used as a matter of convenience.

CALENDAR-YEAR EXPERIENCE - Simplistically, the matching of all losses incurred (not necessarily occurring) within a given twelve-month period, usually beginning on January 1, with all premium earned within the same period of time. Incurred losses will include the change in **IBNR**. More specifically, the total value of all losses incurred (not necessarily occurring) during the calendar year is divided by the **ACCOUNTING EARNED** premium for this same exposure period. Losses incurred are equal to the sum of losses paid, plus the outstanding loss reserves at the end of the year, less the outstanding loss reserves at the beginning of the year. Once calculated for a given period, calendar-year experience never changes.

POLICY-YEAR EXPERIENCE - Simplistically, the segregation of all premiums and losses attributable to policies having an inception or renewal date within a given twelve-month period. More specifically, the total value (losses paid plus loss reserves) of all losses arising from (regardless of when reported) policies incepting or renewing during the year is divided by the fully developed earned premium for those same policies. The finally developed earned premium will always equal the written premium for those policies. **POLICY-YEAR EXPERIENCE** resembles **ACCIDENT-YEAR EXPERIENCE** in that, while the experience is developing, loss reserves are used in the calculation, but the ultimate result cannot be finalized until all losses are settled. **POLICY-YEAR EXPERIENCE** is different in that premiums earned from policies incepting during a one-year period of time will earn over the course of both the year of inception and a later year(s). Similarly, losses to be included will be occurring over the same extended time period. Also known as **UNDERWRITING YEAR**.

ACCOUNT EXECUTIVE - The individual, either as employee of a reinsurer or a reinsurance intermediary, who is responsible for all matters pertaining to the reinsurance account of a particular insurer.

ACQUISITION COSTS - All expenses incurred by an insurance or reinsurance company which are directly related to acquiring insurance accounts (insured, or reinsured) for the company.

ADMINISTRATION EXPENSES - Costs incurred in conducting an insurance operation other than loss adjustment expenses, acquisition costs, and investment expenses.

ADMITTED ASSETS - Assets recognized and accepted by state insurance laws in determining the solvency of insurers or reinsurers.

ADMITTED COMPANY -1) An insurer licensed to conduct business in a given state. 2) A reinsurer licensed or approved to conduct business in a given state.

ADVANCE DEPOSIT PREMIUM - An amount paid by a reinsured to a reinsurer which is held for the payment of the reinsured's losses. At some time in the future, any balance in the fund remaining after paying losses and any agreed reinsurance expenses will be returned to the reinsured. Also known as **BANKING PLAN**.

ADVANCE PREMIUM - The amount charged at the start of a treaty, to be adjusted later. Also known as **DEPOSIT PREMIUM** or **PROVISIONAL PREMIUM**.

ADVERSE SELECTION - The conscious and deliberate submission by a reinsured company to a reinsurer of those risks, segments of risks, or coverages that appear less attractive for retention by the reinsured.

AGENCY REINSURANCE - 1) A designation that identifies the reinsurance of one or more of an agent's policies, with the agent acting for the reinsured under its authority. 2) A contract of reinsurance between a policy-issuing insurer and a reinsurer that concerns or

is confined to business produced by a named agent of the insurer, usually generated by that agent and administered directly with the reinsurer with permission of the insurer. While there are other reasons for the practice, the usual intent is to allow an agent to issue larger policies than the insurer would otherwise permit. Usually, agency reinsurance is written as proportional reinsurance on property or other first-party insurances.

AGENT COMMISSION - In insurance, an amount paid an agent for insurance placement services.

+AGGREGATE EXCESS OF LOSS - The reinsurer indemnifies an insurance company (the reinsured) for an aggregate (or cumulative) amount of losses in excess of a specified retained aggregate amount of losses incurred by the company over a specified period of time (e.g., one year), up to a limit of a specified aggregate amount. Can be written excess of a dollar amount (e.g., \$500,000 in the aggregate excess of \$500,000 in the aggregate) or excess of a percentage (loss ratio) amount (e.g., 50 loss ratio points excess of 75 loss ratio points). Can also be written with an interior deductible, i.e., to apply only to losses excess of a stated dollar amount (e.g., \$500,000 in the aggregate excess of \$500,000 in the aggregate applying only to losses greater than \$50,000 per loss).

+AGGREGATE EXTENSION - An extension of coverage permitting the aggregating of what would otherwise be two or more accidents or occurrences so that they are considered as one accident or occurrence for purposes of an excess of loss reinsurance. Thus, only one company retention and one reinsurer's limit of liability apply. Many variations may be used in further defining the term, e.g., the aggregating is usually tied to loss arising out of one policy during one policy period or, if not to one policy, then loss to one insured during a specified period.

+AGGREGATE EXTRACTION - A provision permitting a portion of what would be considered as one loss to be extracted and included as part of a separate loss. Example: an aggregate policy, where the reinsurance contract considers all loss under such a policy to be one occurrence, when one of the losses under that policy is involved in the same loss as another policy(ies) of the reinsured company. The aggregate policy loss may be extracted and combined with the other policy(ies) loss to make a more favorable claim under the reinsurance contract.

AGGREGATE STOP-LOSS REINSURANCE - A form of excess of loss reinsurance which indemnifies the reinsured against the amount by which the reinsured's losses incurred (net after specific reinsurance recoveries) during a specific period (usually twelve months) exceed either an agreed amount or an agreed percentage of some other business measure, such as aggregate net premiums over the same period or average insurance in force for the same period. This form of reinsurance is also known as stop-loss reinsurance, stop-loss-ratio reinsurance, or excess of loss ratio reinsurance.

AGGREGATE WORKING EXCESS - A form of per risk excess reinsurance under which the primary company retains its normal retention on each risk and additionally retains an aggregate amount of the losses which exceed such normal retention.

ALIEN COMPANY - An insurer or reinsurer domiciled outside the U.S. but conducting an insurance or reinsurance business within the U.S.

AMORTIZATION PERIOD - Synonymous with payback period, this term is used in the rating of per occurrence excess covers and represents the number of years at a given premium level necessary to accumulate total premiums equal to the indemnity.

+ANNIVERSARY - The annual renewal date of a contract, whether the contract actually expires or is continuous. The date is usually twelve months after the effective date of the contract, but may be at some other time if the contract were written for other than one year. In provisions dealing with RUN-OFF CANCELLATION, the anniversary referred to is that of the underlying policies, not the reinsurance contract.

ANNUAL STATEMENT - A summary of an insurance company's (or reinsurer's) financial operations for a particular year, including a balance sheet supported by detailed exhibits and schedules, filed as a public document with the state insurance department of each jurisdiction in which the company is licensed to conduct business. Also known as CONVENTION BLANK.

ARBITRATION CLAUSE - A provision sometimes appearing in reinsurance treaties whereby the parties agree to submit any dispute or controversy to an unofficial tribunal of their own choosing in lieu of the tribunals provided by the ordinary process of law. Although the wording of the clause may vary, it normally provides for the appointment of two arbitrators, one selected by each party, who in turn appoint an umpire, and the decision of a majority of the arbitrators is binding on the parties to the reinsurance treaty.

AS IF - A term used to describe the recalculation of prior years of loss experience to demonstrate what the underwriting results of a particular program would have been if the proposed program had been in force during that period.

ASSOCIATION, Underwriting - See POOL.

ASSUME - To accept all or part of a ceding company's insurance or reinsurance on a risk or exposure.

ASSUMED PORTFOLIO - The transfer of in-force insurance liability from an insurer to a reinsurer (or vice versa) by the payment of the unearned premium reserve on those policies alone, or the concurrent transfer of liability for outstanding losses under those policies by the payment of the outstanding loss reserve from the insurer to the reinsurer (or vice versa). The former is a premium portfolio, the latter a loss portfolio.

ASSUMPTION ENDORSEMENT - Another name for CUT- THROUGH ENDORSEMENT.

ASSUMPTION REINSURANCE - See PORTFOLIO REINSURANCE.

+ATTACHMENT POINT - The dollar amount of a reinsured company's retained risk or loss at which point reinsurance begins to apply. See RETENTION.

AUTHORIZED REINSURANCE - Reinsurance placed with a reinsurer which is licensed or otherwise recognized by a particular state insurance department. See CREDIT FOR AUTHORIZED REINSURANCE.

AUTOMATIC TREATY - An agreement between reinsured and reinsurer (usually for pro rata reinsurance, and usually for one year or longer), whereby the ceding company is obligated to cede certain risks as provided in the agreement and the reinsurer is obligated to accept. See OBLIGATORY TREATY.

+BAD FAITH - The failure of an insurer to settle within policy limits when there was an opportunity to do so (and a court award in excess of the policy limits).

BALANCE - A concept in surplus share reinsurance dealing with the relationship between written premium under the treaty and the maximum limit of liability to which the reinsurer is exposed. The precise relationship will vary from treaty to treaty, but if the ratio desired for a specific treaty is achieved, the treaty is referred to as "balanced."

BANKING PLAN - An agreement in which the ceding company pays the reinsurer a premium over a specified number of years which is intended to fully fund a specific limit of liability. If the premium is not fully expended by a payment of losses within the contract period the unused portion is returnable, less a reinsurance expense. Also known as ADVANCE DEPOSIT PREMIUM PLAN.

BASE PREMIUM - The reinsured company's premiums (written or earned) to which the reinsurance premium rate is applied to produce the reinsurance premium. Also known as SUBJECT PREMIUM, PREMIUM BASE, and UNDERLYING PREMIUM.

BASIC LIMITS - The minimum amounts of insurance for which it is the practice to quote premiums in liability insurance. Additional amounts are charged for by the addition of certain percentages of the premium for the minimum (or basic) limits.

BINDER (REINSURANCE) - A record of reinsurance arrangements pending the issuance of a formal reinsurance contract (which then replaces the binder). See COVER NOTE.

+BOILERPLATE (LANGUAGE) - Clauses employing generally accepted wording with little variation, considered to be common among most treaties as so-called standard language.

BORDEREAU(X) - Furnished periodically by the reinsured, a detailed report of insurance premiums or losses affected by reinsurance. A premium bordereau contains a detailed list of policies (or bonds) reinsured under a reinsurance treaty during the reporting period, reflecting such information as the name and address of the primary insured, the amount and location of the risk, the effective and termination dates of the primary insurance, the amount reinsured and the reinsurance premium applicable thereto. A loss bordereau

contains a detailed list of claims and claims expenses outstanding and paid by the reinsured during the reporting period, reflecting the amount of reinsurance indemnity applicable thereto. Bordereau reporting is primarily applicable to pro rata reinsurance arrangements and to a large extent has been supplanted by summary reporting.

BROKER - A reinsurance intermediary who negotiates contracts of reinsurance between a reinsured and reinsurer on behalf of the reinsured, receiving commission for placement and other services rendered from the reinsurer. Under the terms of one widely used intermediary clause, premiums paid a broker by a reinsured are considered paid to the reinsurer, but loss payments and other funds (such as premium adjustments) paid a broker by a reinsurer are not considered paid to the reinsured until actually received by the reinsured.

BROKERAGE COMMISSION - An amount paid a broker for insurance or reinsurance placement and other services.

BROKERAGE MARKET - A collective reference to those reinsurers which accept business mainly through reinsurance intermediaries.

BUFFER LAYER - Used in casualty insurance to describe a stratum of coverage between the maximum policy limit which the primary underwriter will write and the minimum deductible over which the excess or umbrella insurer will cover.

BURNING COST - The ratio of actual past reinsured losses to a ceding company's subject matter premium (written or earned) for the same period. Used to analyze past reinsurance experience or to project the future.

BURNING RATIO - In primary insurance, the ratio of losses suffered to the amount of insurance in effect. Thus, not a "loss ratio," which is the ratio of losses incurred to premiums earned.

BUY-BACK AGREEMENT - A negotiated contractual attempt by an insurer writing primary insurance or excess insurance to curtail further exposure to the insured for defense or indemnity by making a lump sum payment to the insured. Open questions exist as to how these agreements affect third-party beneficiaries of the original insurance policy.

CALENDAR-YEAR EXPERIENCE - See ACCIDENT-YEAR EXPERIENCE.

CAPACITY - The measure of an insurer's financial strength to issue contracts of insurance, usually determined by the largest amount of insurance issuable for a given risk or, in certain other situations, by the maximum volume of insurance (or reinsurance) business it is prepared to accept. See UNDERWRITING CAPACITY.

CAPTIVE INSURANCE COMPANY - An insurer which is wholly-owned by another organization (generally noninsurance), the main purpose of which is to insure the risks of the parent organization.

CARPENTER PLAN - A form of excess of loss reinsurance in which a reinsured company spreads its losses over a three-to-five-year period, first introduced in the U.S. by a broker of that name. See SPREAD LOSS REINSURANCE.

CARRIER, REINSURANCE - An organization assuming insurance liability of another insurer.

+CASH CALL - A reinsurance contract provision, common in proportional contracts, which allows a reinsured company to make claim and receive immediate payment for a large loss without waiting for the usual periodic payment procedures to occur.

CASUALTY CATASTROPHE COVER - Reinsurance which is not exposed on a policy limit basis, i.e., the deductible on the treaty is equal to or exceeds the reinsured's maximum net exposure on any one policy. Therefore, such treaties protect against the infrequent loss involving two or more insureds in the same loss occurrence and are referred to as clash covers. See CLASH COVER and TWO-RISK WARRANTY.

CATASTROPHE NUMBER - Whenever a catastrophe occurs which produces losses within a prescribed period of time in excess of a certain amount (such as \$1 million), the amount of such losses is recorded separately from noncatastrophe losses and is numbered by the American Insurance Association.

CATASTROPHE REINSURANCE - A form of excess of loss reinsurance which, subject to a specified limit, indemnifies the reinsured company for the amount of loss in excess of a specified retention with respect to an accumulation of losses resulting from a catastrophe event or series of events. The actual reinsurance document is referred to as "a catastrophe cover."

+CEDE - In pro rata reinsurance, to pass on to another insurer (the reinsurer) all or part of the financial interests of insurance policies written by an insurer (the ceding insurer) with the object of reducing the cedent's possible liability by sharing with the reinsurer the insurance liability, premiums, and losses from the reinsured business. See CESSION.

+CEDENT - See CEDING COMPANY.

CEDING COMMISSION - Primarily in pro rata reinsurance, an allowance (usually a percentage of the reinsurance premium) made by the reinsurer for part or all of a ceding company's acquisition and other costs. The ceding commission may also include a profit factor for the reinsured. See TURN.

CEDING COMPANY - 1) Correctly used as the reinsured in pro rata reinsurance, where the reinsurer shares in the insurance liability, premium, and losses from the ceded policies of the reinsured. 2) Informally referred to as the reinsured in excess of loss reinsurance, where the reinsurer indemnifies the reinsured for losses in excess of the reinsured's retention. See CEDE.

CERTIFICATE OF REINSURANCE - A short-form documentation of a reinsurance transaction, used especially for facultative reinsurance transactions.

CESSION - 1) The unit of insurance passed (or ceded) to a pro rata reinsurer by a primary company or cedent which issued a policy to the original insured. A cession may accordingly be the whole or a portion of single risks, defined policies, or defined divisions of business, all as agreed in the reinsurance contract. 2) The act of ceding where such act is necessary to invoke the pro rata reinsurance protection.

CLAIM EXPENSES - The costs incurred in processing claims: court costs, interest upon awards and judgment, the company's allocated expense for investigation and adjustments and legal expenses (excluding, however, ordinary overhead expenses of the company such as salaries, monthly or annual retainers, and other fixed expenses which are defined as unallocated loss adjustment expenses). Also known as Loss Expenses or Loss Adjustment Expenses.

CLAIMS MADE BASIS - The provision in a contract of insurance or reinsurance that coverage applies only to losses which occur and claims that are made during the term of the contract. (Losses occurring before the contract term are sometimes covered by the addition of "prior-acts" coverage to the contract, which may be subject to a retroactive date limiting the period in which the covered losses may have occurred. Losses reported after the contract term are sometimes covered by the addition of "tail" coverage, which may be subject to a sunset provision.) Once the policy period is over in claims made covers, the approximate extent of the underwriter's liability is known. On the other hand, the traditional "occurrence" liability insurance method provides coverage for losses from claims which occurred during the policy period, regardless of when the claims are asserted. With the traditional "occurrence" liability coverage method, the underwriter may not discover the extent of liability for years to come from losses asserted to have occurred within the policy period. With claims made covers which are renewed, however, losses which occurred during any period when the policy was in force are again covered if reported during the renewal term. In summary, the traditional method is similar to claims made if the latter has added to it both "prior-acts" and "tail" coverage.

CLASH COVER - A reinsurance casualty excess contract requiring two or more coverages or policies, issued by the reinsured and involved in a loss, for coverage to apply. The attachment point of the reinsurance contract is usually above the limits of any one policy. See **CASUALTY CATASTROPHE COVER** and **TWO-RISK WARRANTY**.

COMBINATION PLAN REINSURANCE - A form of quota share and excess of loss reinsurance combined which provides that, in consideration of a premium at a fixed percent of the ceding company's subject premium on the business covered, a) the reinsurer will indemnify the ceding company for the amount of loss on each risk in excess of a specified retention, subject to a specified limit, and b), after deducting the excess recoveries on each risk, the reinsurer will indemnify the ceding company for a fixed quota share percent of all remaining losses.

COMBINED RATIO - Another name for OPERATING RATIO or TRADE RATIO.

COMMISSION - 1) AGENT COMMISSION - In insurance an amount paid an agent for insurance placement services. 2) BROKERAGE COMMISSION - An amount paid a broker for insurance or reinsurance placement services. 3) CEDING COMMISSION - In reinsurance, an allowance (usually a percentage of the reinsurance premium) made by the reinsurer for part or all of a ceding company's acquisition and other costs. The ceding commission may also include a profit factor for the reinsured. 4) OVERRIDING COMMISSION - a) A fee or percentage of money which is paid to a party responsible for placing a retrocession of reinsurance. b) In insurance, a fee or percentage of money which is paid by the insurer to an agent or general agent for premium volume produced by other agents in a given geographic territory. 5) OVERWRITING COMMISSION - Another name for OVERRIDING COMMISSION. 6) PRODUCER COMMISSION - The same as BROKERAGE COMMISSION. 7) REINSURANCE COMMISSION - The same as CEDING COMMISSION.

COMMON ACCOUNT - See JOINT ACCOUNT EXCESS OF LOSS.

COMMUTATION CLAUSE - A clause in a reinsurance agreement which provides for estimation, payment, and complete discharge of all obligations, including future obligations between the parties for reinsurance losses incurred. The goal is to determine the sum now that is sufficient to cover the loss actually paid over an extended period of time. This clause is often found in contracts reinsuring workers compensation and may be optional (which is usual) or mandatory.

COMPANY - In reinsurance, the reinsured insurance company (although a reinsurer can also be a reinsured in a retrocession agreement).

CONFLAGRATION - A massive fire which destroys many contiguous properties.

CONFLAGRATION AREA - A geographic territory in which many properties are subject to damage by a sweeping fire.

CONFLAGRATION (EXCESS) COVER - See CATASTROPHE REINSURANCE.

CONTINGENCY COVER - Reinsurance protection against the unusual combination of losses. See CLASH COVER.

CONTINGENT COMMISSION - An allowance from the reinsurer to the reinsured based on a predetermined percentage of the profit realized by the reinsurer on the business ceded by the reinsured. Also known as Profit Commission.

+CONTRIBUTING EXCESS - A type of facultative excess of loss reinsurance wherein the reinsured company's policy applies in excess of other valid insurance, reinsurance, or self-insured retention, and the limit(s) of liability of the reinsurer(s) apply(ies) proportionately to

all loss within said excess policy's limit, as in the percentage(s) set forth in the Declarations Page.

+CONVENTION BLANK - Another name for the Annual Statement form prescribed by NAIC (National Association of Insurance Commissioners) of Kansas City, Missouri. See ANNUAL STATEMENT.

+COREINSURANCE - 1) A provision in an excess of loss reinsurance contract requiring the reinsured to retain net and unreinsured otherwise (or to coreinsure) a part of the loss above the contract's retention, the purpose of which is to promote good claims handling by the reinsured. For example, when the reinsurer covers 95% of an excess of loss layer, the reinsured's 5% share of the excess losses is coreinsurance, a proportional sharing of the layer losses. 2) When several reinsurers are independently sharing a reinsurance contract (pro rata or excess, treaty or facultative), each reinsurer is a coreinsurer (as can be illustrated by another term, contributing excess). See CONTRIBUTING EXCESS.

+COUNSEL AND CONCUR - A phrase stating the reinsured company's obligation to obtain the counsel and concurrence of the reinsurer in making claims decisions. Most typically applied to claims decisions made in connection with extra contractual obligations or judgments (loss) in excess of policy limits coverages.

+COUNTERCLAIM (noun) - The assertion of an amount owed by one party to a second party arising out of one agreement or transaction in response to a claim asserted by the second party against the first party arising out of a different agreement or transaction for the purpose of determining the net amount due to the first party. See also SETOFF and RECOUPMENT.

COVER NOTE - A written statement issued by an intermediary, broker, or direct writer, indicating that coverage has been effected. Also known as The Slip. See BINDER.

CREDIBILITY - The measure of credence or belief that is attached to a particular body of statistical experience for ratemaking purposes, frequently defined in terms of specific mathematical formulas. Generally, as the body of experience increases in volume, the corresponding credibility also increases.

+CREDIT FOR AUTHORIZED REINSURANCE, ANNUAL STATEMENT - The legal right of a licensed insurer to increase its Annual Statement policyholder surplus when purchasing pro rata reinsurance from a reinsurer authorized or approved by the domiciliary state insurance department of the insurer. The increase is achieved by the insurer's ceding the unearned premium reserve on the insurance policies affected, and possibly other reserves as well, to the authorized reinsurer, which pays the insurer a ceding commission as an allowance for the insurer's original acquisition costs, thus increasing the policyholder surplus. If excess of loss reinsurance is purchased, where no unearned premium reserve is involved, the credit is achieved by the statutory recognition of loss recoverables from the reinsurer, as is the case for loss recoverables from a pro rata reinsurer. See

POLICYHOLDER SURPLUS, CEDING COMMISSION, and PENALTY FOR UNAUTHORIZED REINSURANCE.

CUMULATIVE LIABILITY - The accumulation of liability of a reinsurer under several policies from several reinsureds covering similar or different lines of insurance, all of which are involved in a common event or disaster.

+CUT-OFF CANCELLATION or TERMINATION - A provision included in the termination clause (or endorsement) which provides that the reinsurer shall not be liable for losses occurring after the termination date. See also **RUN-OFF CANCELLATION or TERMINATION**. (Editor's Note: Cutoff is one word when used as a noun, two words as a verb transitive, and hyphenated as a compound adjective, e.g., a cutoff cuts off insurance business in force on a cut-off basis.)

CUT-THROUGH ENDORSEMENT - An addition to an insurance policy between an insurance company and a policyholder which requires that, in the event of the company's insolvency, any part of a loss covered by reinsurance be paid directly to the policyholder or mortgagee by the reinsurer. The cut-through endorsement is so named because it provides that the reinsurance claim payment "cuts through" the usual route of payment from reinsured company-to-policyholder, followed by reinsurer-to-reinsured company, substituting instead the payment route of reinsurer-to-policyholder-or-mortgagee. The effect is to revise the route of payment only, and there is no intended increased risk to the reinsurer, although endorsement terms may provide otherwise. Similar to the **GUARANTY ENDORSEMENT**, the cut-through endorsement is also known as an Assumption Endorsement.

+DECLARATORY JUDGMENT - A decision by a court in a proceeding, which can be brought by either the insurer or the insured, to determine the rights of the parties. In insurance, for example, a court decision may be sought to determine whether an insurance company has an obligation to defend, indemnify or pay on behalf of its insured policyholder under a policy with regard to a particular loss or losses.

+DEEMED (OR SO DEEMED) - A condition which is said to exist by agreement between the parties even though it may not exist in fact (e.g., "all policy limits greater than \$1,000,000 are to be reinsured on a pro rata facultative basis, or be so deemed.") To deem means to treat as if.

DEFICIT - As used in reinsurance, any excess of charges over credits at the end of any accounting period (which excess shall be a charge in the computation of the contingent commission for the succeeding period, or in computing various experience-rated reinsurance arrangements).

DEPOSIT PREMIUM - When the terms of a treaty provide that the ultimate premium is to be determined at some time after the treaty has been written, the reinsurer may require a tentative or a deposit premium at the beginning. The tentative premium is readjusted when the actual earned charge has been determined. See **ADVANCE PREMIUM**.

DEVELOPMENT - See LOSS DEVELOPMENT.

+DIRECT ACTION STATUTE - A provision in a state's law allowing a third party to cut through the insured or insurer to the insurer or reinsurer.

DIRECT WRITER - 1) In reinsurance, a reinsurer which negotiates with a ceding company without benefit of an intermediary or broker. 2) In insurance, a primary insurer that sells insurance through licensed agents who produce business essentially for no other organizations.

DIRECT WRITTEN PREMIUM - The gross premium income (written instead of earned) of a primary company, adjusted for additional or return premiums but before deducting any premiums for reinsurance ceded, and not including any premiums for reinsurance assumed.

DOMESTIC COMPANY - An insurer conducting business in its domiciliary state from which it received its charter to write insurance, as opposed to a foreign company (which is an insurer conducting business in a state other than its domiciliary state), or an alien company (which is an insurer domiciled outside the U.S. while conducting business within the U.S.).

+DROP-DOWN COVERAGE - In reinsurance, a method of structuring the retention and limit of a particular layer of a property catastrophe excess reinsurance program so that, in the event that a loss (or losses) exhausts the reinsurance limit in a stated lower layer, the unexhausted limit of the highest upper layer would drop down to respond to subsequent loss(es) during the same contract period as a replacement for the lower layer. Such a method is often referred to as "top-and-drop" coverage. For example, if the first layer of \$10 million xs (excess) \$10 million in a program of \$140 million xs \$10 million were exhausted, the top layer (for this example, \$10 million xs \$140 million) will drop down and provide \$10 million xs \$10 million for a negotiated number of additional occurrences. Another use of drop-down coverage may occur within the first catastrophe layer, wherein the loss retention in a contract drops after the first loss and the layer limit then expands. For a different example, if the first layer coverage were \$1 million xs \$1 million and a loss in excess of \$1 million occurred, provision would be made for the retention to drop to a lesser amount, such as \$750,000, and for the limit to expand to \$1,250,000 for the second and subsequent losses in the same period, but subject to the annual aggregate limit as negotiated.

Each and Every - An expression used in treaties and certificates to mean in the aggregate, without exception.

EARLY WARNING TESTS - Financial ratio and performance criteria designed by the National Association of Insurance Commissioners to identify insurance companies which may need closer surveillance by state insurance departments.

EARNED PREMIUM - That portion of written premium equal to the expired portion of the time for which the insurance or reinsurance was in effect. Technically, the following definitions are appropriate:

ACCOUNTING EARNED - This is the most common and widely understood method. The unearned premium reserve at the beginning of the period is added to the premium written (booked) during the period, and the unearned premium reserve at the end of the period is subtracted. Accounting Earned is the figure used in the Annual Statement.

EXPOSURE EARNED - This method calculates the premiums which were actually exposed to loss (or earned) for the period. The date on which premiums were booked is disregarded. What is significant is the effective date and term to which the premium applies. The portion of the premium written which was exposed to loss (earned) is allocated to the exposure period whether the premiums were booked prior to the period, during the period, or after the period. The exposure earned premium eliminates the deficiency contained in accounting earned premium that results from timing problems in the recording of premiums.

ECO - See EXTRA CONTRACTUAL DAMAGES.

ERRORS AND OMISSIONS CLAUSE - A clause in a reinsurance treaty (requiring some affirmative act by the reinsured to activate the reinsurance protection) which stipulates that, in the event of inadvertent error or omission, the reinsured shall not be prejudiced in the fulfillment of the agreement, provided that such error or omission shall be corrected as soon as it is discovered.

EVENT LOSS TRIGGER - An approach designed to deem that all loss from one occurrence had one date of loss, regardless of the type of coverage (i.e., occurrence or claims made), or the number of dates of loss thereunder, or the reinsurance contracts or periods involved. The opposite of an INTERLOCKING loss trigger.

+EVERGREEN CLAUSE - A provision in a Letter of Credit that calls for the LOC to renew each year for an additional year unless written notice of nonrenewal is sent by the bank within a required period of time prior to the LOC's anniversary date.

EXCESS JUDGMENT LOSS - The amount paid by a liability insurer in excess of applicable policy limits occasioned by the failure, on account of negligence or bad faith, to settle a claim for an amount within such policy limits. See LOSS IN EXCESS POLICY LIMIT.

EXCESS LIMITS PREMIUMS - In casualty insurance, premiums for limits or layers of liability added to basic limits, calculated as multiples of basic limits premium. Excess limits premiums were the original (and remain a popular) basis of premium paid for casualty excess of loss reinsurance.

EXCESS OF LINE REINSURANCE - A form of per risk excess agreement under which the indemnity is not a fixed dollar limit but a multiple of the primary company's net loss retention.

EXCESS OF LOSS RATIO REINSURANCE - See **AGGREGATE EXCESS OF LOSS REINSURANCE**.

+EXCESS OF LOSS REINSURANCE - A generic term describing reinsurance which, subject to a specified limit, indemnifies the reinsured company against all or a portion of the amount of loss in excess of the reinsured's specified loss retention. The term is generic in describing various types of excess of loss reinsurance, such as per risk (or per policy), per occurrence (property catastrophe or casualty clash), and annual aggregate. The loss retention in excess of loss reinsurance should not be confused with the policy retention in surplus share reinsurance, which always refers to a pro rata form of reinsurance in which, once a cession of insurance is made, the reinsured and reinsurer share insurance liability, premium and losses, beginning with the first dollar of loss. Also known as **NONPROPORTIONAL REINSURANCE**.

EXCESS PER RISK REINSURANCE - A form of excess of loss reinsurance which, subject to a specified limit, indemnifies the reinsured company against the amount of loss in excess of a specified retention with respect to each risk involved in each loss.

EXCLUSIONS - Those risks, perils, or classes of insurance with respect to which the reinsurer will not pay loss or provide reinsurance, notwithstanding the other terms and conditions of reinsurance.

+EX GRATIA PAYMENT - A claim payment not necessarily required by an insurance policy but made as a commercial accommodation by the insurer to the policyholder.

EXPENSE RATIO - Expenses (other than loss adjustment expenses) incurred during a specific period of time, divided by premiums written during the same period.

EXPERIENCE RATING - Another name for **PROSPECTIVE RATING** and **RETROSPECTIVE RATING**.

EXPIRATION - The cessation of a reinsurance cover when the time period for which it was written has ended. A treaty written on a "continuous until cancelled" basis does not expire automatically but will contain a provision for termination.

EXPOSURE IN RESIDENCE - Harm from a latent substance within the body, even after active exposure is discontinued. In asbestos or other latent bodily injury context, the period during which the body incurs injury or disease as tissue reacts to the hazardous substance. In *Keene Corporation v. INA* (667 F.2d. 1034, D.C. Cir., 1981), Keene's counsel characterized exposure in residence as the subsequent progress of a disease following exposure.

EXTRA CONTRACTUAL DAMAGES (EXTRA CONTRACTUAL OBLIGATIONS, E.C.O.) - In reinsurance, monetary awards required by a court of law against an insurer for its negligence to its insured. Such payments required of an insurer to its insured are extracontractual in that they are beyond the insurance contract between insurer and insured. A reinsurance treaty may cover these damages and, if so, will specify covered situations, percentages applicable, and required premium charges.

EXTRACTION FACTOR - A fraction or percentage of a reinsured company's subject premium which is deducted from the reinsurance premium to recognize and measure that portion of any policies not covered by reinsurance when the policies are written by the reinsured on an indivisible premium basis. For example, if property excess reinsurance does not cover third-party liability or burglary in a reinsured company's Homeowners Policy, an extraction factor would adjust the reinsurance premium accordingly.

FACULTATIVE CERTIFICATE OF REINSURANCE - A document formalizing a facultative reinsurance placement.

+FACULTATIVE REINSURANCE - In pro rata reinsurance, the reinsurance of part or all of the insurance provided by a single policy, with separate negotiation for each policy cession of insurance C for sharing liability, premium, and loss. In excess of loss reinsurance, the reinsurance of each policy, with separate negotiation for each C for indemnity of loss in excess of the reinsured's loss retention. The word "facultative" connotes that both the primary insurer and the reinsurer usually have the faculty or option of accepting or rejecting the individual submission (as distinguished from the obligation to cede and accept, to which the parties agree in most treaty reinsurance).

FACULTATIVE SEMI-OBLIGATORY TREATY - A reinsurance contract under which the ceding company may or may not cede exposures or risks of a defined class to the reinsurer, which is obligated to accept if ceded.

FACULTATIVE TREATY - A reinsurance contract under which the ceding company has the option to cede and the reinsurer has the option to accept or decline individual risks. The contract describes how individual facultative reinsurances shall be handled.

FINANCIAL REINSURANCE - See FINITE RISK REINSURANCE.

FINANCING FUNCTION - A purpose of reinsurance in some cases, e.g., whenever the reinsurer relieves the primary company of, all or part of the company's responsibility for carrying an unearned premium reserve and the reinsurer allows a ceding commission to the primary company. Because the cash or other statutorially recognized assets being transferred (causing a change in assets) are less than the unearned premium reserve change (causing a change in liabilities), the primary company's policyholder surplus is increased by the amount of the reinsurance commission allowance. See SURPLUS RELIEF.

FINITE RISK REINSURANCE - A contract under which the ultimate liability of the reinsurer is capped (often by a maximum loss ratio) and on which anticipated investment income is expressly acknowledged as an underwriting component. Because this type of reinsurance is often purchased to ameliorate the balance sheet effects of statutory accounting principles, it is also known as Financial Reinsurance.

FIRST LOSS RETENTION - The amount of loss sustained by the reinsured before the liability of the excess of loss reinsurer attaches, often referred to as NET LOSS RETENTION. See ATTACHMENT POINT.

FIRST SURPLUS TREATY - A term exclusive to pro rata reinsurance treaties which defines the amount of each cession as the amount of gross (policy) liability which exceeds, or is "surplus" to, an agreed net liability retention, up to the limit of (reinsurance) liability. Often a maximum net retention is specified in the treaty, with the primary company having the option to choose a lesser retention on individual risks. The amount of first surplus reinsurance provided will be limited to a fixed multiple of the selected retention in each case. Larger policy surpluses are termed "second," "third," and so on, each being the amount of reinsurance afforded once the prior surplus reinsurance capacity plus the true net retention have been exceeded. See SURPLUS SHARE REINSURANCE.

FLAT COMMISSION - A stated commission percentage, payable by the reinsurer to the reinsured, which is not subject to further adjustment under a profit-sharing provision. Common in pro rata facultative reinsurance.

FLAT RATE - 1) A fixed rate not subject to any subsequent adjustment. 2) A reinsurance premium rate applicable to the entire premium income derived by the ceding company from the business ceded to the reinsurer (as distinguished from a rate applicable to excess limits).

FOLLOW THE FORTUNES - A concept inherent in any reinsurance relationship which, when expressed in an agreement, generally runs to a statement that the reinsurer "shall follow the fortunes of the ceding company in all matters falling under this Agreement" or shall do so ". . . in all respects as if being a party to the insurance," or similar language. Expressed or not, the concept speaks to a relationship under which the reinsured's duty to treat reinsured policy rights and obligations as if there were no reinsurance is extended into a right. This right is not open ended: it cannot carry a reinsurer outside its agreement, neither is it fixed. Rather, it rests on mutual trust within the circumstances of each case. Accordingly, some reinsurers avoid "following-the-fortunes" clauses in their agreements, while those in use are normally found in pro rata treaties where the sharing nature of cessions makes proper implementation reasonably evident and self-controlling.

Historically, the "follow-the-fortunes" clause was designed to deal with "errors and omissions," particularly in the case of inadvertent omission by the ceding company of a specific risk on a bordereau, intending to permit the ceding company to include the risk on a bordereau upon discovery of the oversight with retroactive reinsurance. However, the courts have held that under the "follow-the-fortunes" language of a reinsurance treaty, the

reinsurer adopts the language of the primary policy, and thus a third-party creditor of the primary insurer has a right of action against the reinsurer under a reinsurance contract. Such a holding is an exception to the general rule of law applicable to reinsurance agreements that such agreements operate solely between the reinsured and the reinsurer and create no privity between the reinsurer and any third party, and afford no right of action by any third party against the reinsurer on the reinsurance agreement. The historical objective of the clause can be achieved by inserting an "errors and omissions" clause in any reinsurance agreement which is not fully automatic. Neither a "follow-the-fortunes" nor "errors and omissions" clause is necessary in an automatic reinsurance agreement.

FOLLOWING REINSURER - A reinsurer which follows the lead reinsurer on a cover being placed, accepting or rejecting the terms as presented. See **LEAD UNDERWRITER**.

FOREIGN REINSURER - A U.S. reinsurer conducting business in a state other than its domiciliary state, where in the domiciliary state the reinsurer is known as a domestic company (as opposed to an alien reinsurer: one domiciled outside the U.S. but conducting business within the U.S.).

FRANCHISE COVERS - A contractual provision, common in hail insurance but also used elsewhere, stating that no loss is payable until the loss exceeds a certain amount but, when that amount is exceeded, the whole loss is paid.

FRONTING - An arrangement whereby one licensed insurer issues a policy on a risk for and at the request of one or more other unlicensed insurers with the intent of passing the entire risk by way of reinsurance to the other insurer(s). Such an arrangement may be illegal if the purpose is to frustrate regulatory requirements.

+FUNDED COVER - A reinsurance contract under which the reinsured company pays a higher than normal premium intended to build a fund from which to pay expected losses. Because the higher premium reduces the reinsurer's risk (i.e., that losses will exceed the premium), the reinsurer agrees to accept a reduced reinsurance margin. All of the premium less the reinsurance charge will be returned to the ceding company at some time in the future as loss payments, returned premiums, or contingent commissions.

FUNDS HELD ACCOUNT (or FUNDS WITHHELD) - The holding by a ceding company of funds representing the unearned premium reserve or the outstanding loss reserve applied to the insurance business it cedes to a (usually unauthorized) reinsurer.

GAAP (GENERALLY ACCEPTED ACCOUNTING PRINCIPLES) - A method of reporting the financial results of an insurer more in accordance with the going-concern basis used by other businesses. GAAP assigns income and disbursements to their proper period, as distinguished from the more conservative requirements of statutory accounting, by which insurers are regulated.

GLOBAL INSURANCE - Coverage applying to losses arising out of all classes of insurance policies (or almost all classes) and not to a worldwide territory as could be mistakenly interpreted.

G.N.E.P.I.(Gross Net Earned Premium Income) - See SUBJECT PREMIUM.

G.N.W.P.I.(Gross Net Written Premium Income) - SEE SUBJECT PREMIUM.

GRADED SURPLUS TREATY - A surplus share treaty under which the capacity expressed as a number of lines varies according to class or the net retained line of the ceding insurer.

GROSS LINE - The amount of liability an insurer has written on a risk, including the amount it has reinsured. Net line plus reinsurance equals gross line.

+GROSS LOSS - The amount of a ceding company's loss irrespective of any reinsurance recoveries due.

+GROUND-UP LOSS - In insurance, the gross amount of loss occurring to an insured and subject to the insured's insurance policy, beginning with the first dollar of loss and prior to the application of a deductible or deduction, if any, required by the policy. In reinsurance, the term refers to the gross amount of loss occurring to the reinsured, beginning with the first dollar of loss and after the application of deductions required by the reinsurance agreement (that can be several in number): a) the reinsured's retention in excess of loss covers; b) other inuring reinsurances, such as quota share, surplus share, per risk excess, facultative, or common account coverage; or c) the uncollectibility of any reinsurances. For example, ground-up losses subject to a per risk excess treaty protecting the reinsured's net retention would equal the net loss beginning with the first dollar after reduction of the gross loss by recoveries from other treaties, such as surplus covers and facultative placements, but before the application of the deductible in the per risk excess cover itself. See INURE TO THE BENEFIT OF.

GUARANTY ENDORSEMENT - An addition to an insurance policy (between and insurance company and a policyholder covering the policyholder's mortgaged property) which requires that, in the event of the company's insolvency, the mortgagee and/or the policyholder be paid directly by the reinsurer either for any loss covered by reinsurance or (as is often provided) for the full insurance protection afforded by the insurance company. Since the full insurance protection afforded by the insurance company may be above the reinsurance which would be payable to the reinsured company, the reinsurer may be assuming an additional risk in such an endorsement. Similar to the cut-through endorsement, the guaranty endorsement is also known as a Mortgagee Endorsement.

+HARD MARKET - A scarcity of a product or service for purchase, as opposed to a soft market, in which the product or service is available readily and easy to buy. In reinsurance, a hard market is characterized by prudent underwriting and adequate pricing, whereas a soft market reflects sloppy underwriting and deficient pricing.

HONORABLE UNDERTAKING - A clause used in some reinsurance treaties, the purpose of which is that the agreement not be defeated by a strict or narrow interpretation of the language in the treaty.

+HOURS CLAUSE - The colloquial term which limits the time period during which claims resulting from a given occurrence may be included as part of the loss subject to the cover. The time period is usually measured in consecutive hours and most often applies to property reinsurance, e.g., a windstorm, conflagration, or earthquake, and less frequently in occupational disease and other aspects of casualty.

+INCIDENTAL COVERAGE - Coverage for a risk, class or type of insurance that is primarily excluded from a reinsurance contract but is excepted from the exclusion because the risk presents only a minimal exposure to the excluded category. The underwriter judges the extent to which the minor (excluded) aspect of a risk might overbalance the larger exposure of the unexcluded portion of the risk.

INCURRED BUT NOT REPORTED (IBNR) - The liability for future payments on losses which have already occurred but have not yet been reported in the reinsurer's records. This definition may be extended to include expected future development on claims already reported. Thus, technically IBNR covers the field from a) those individual losses that have occurred but have not been reported to the insurer or reinsurer to b) that amount of loss that may arise from a known loss which has been reported as an event but which has not been recorded in full to its ultimate loss value (known as loss development). See **LOSS DEVELOPMENT**.

INCURRED EXPENSE (OTHER THAN LOSS EXPENSE) - An expense which has happened but which may or may not have been paid.

INCURRED LOSS RATIO - The relationship between incurred losses and earned premium, usually expressed as a percentage.

INCURRED LOSSES - 1) In insurance accounting, an amount representing the losses paid plus the change (positive or negative) in outstanding loss reserves within a given period of time. In other words, loss reserves outstanding at the end of the accounting period, plus losses paid during the accounting period, minus loss reserves outstanding at the beginning of the accounting period. For example, a) A loss occurs when specific bodily injury or property damage is legally recognized. b) A loss is incurred when the amount of a loss is booked by the accountants in the financial records of the company. c) A loss occurrence is the accumulation of all loss incurred from the losses that occurred from the same cause. 2) Losses which have happened and which will result in a claim under the terms of an insurance policy or a reinsurance agreement.

+INDEMNITY, CONTRACT OF - In business or insurance, a contract to make a party whole from a loss already, or yet to be, sustained. In reinsurance, however, because a reinsurer is obligated to reimburse (indemnify) the reinsured only after the reinsured's

payment of a loss, a reinsurance contract is a contract of indemnity rather than a contract of insurance.

INDEXING - A procedure which adjusts retention and limit provisions of excess of loss reinsurance agreements in accordance with the fluctuations of a published economic index, such as wage, price, or cost-of-living.

IN-FORCE BUSINESS - Insurance policies in effect (i.e., whose time of coverage is unexpired) as a reinsurance contract period of time begins, with or without reinsurance coverage.

INSOLVENCY CLAUSE - A provision now appearing in most reinsurance contracts (because many states require it) stating that the reinsurance is payable, in the event the reinsured is insolvent, directly to the company or its liquidator without reduction because of its insolvency or because the company or its liquidator has failed to pay all or a portion of any claim.

+INSURANCE - The transfer of risk (chance of loss) from one party (the insured) to another party (the insurer), in which the insurer promises (usually specified in a written contract) to pay the insured (or others on the insured's behalf) an amount of money (or services, or both) for economic losses sustained from an unexpected (accidental) event, during a period of time for which the insured makes a premium payment to the insurer.

+INTERCOMPANY REINSURANCE - Reinsurance entered into among the affiliated members of an insurance group. Often called an intercompany "pool," the practice is common among major insurance groups. The basic purpose is to spread the net (after outside reinsurance) writings and exposures of that group evenly across the group's entire policyholder surplus.

+INTERLOCKING CLAUSE - A clause in a reinsurance treaty designed to mesh and apportion loss from a single occurrence between two or more reinsurance contracts. The exact opposite is the event approach, designed to cause all loss from one occurrence to have one deemed date of loss, regardless of the number of dates of loss or reinsurance contracts involved.

INTERMEDIARY - A reinsurance broker who negotiates contracts of reinsurance on behalf of the reinsured, receiving a commission for placement and other services rendered. Under the terms of one widely used intermediary clause, premiums paid a broker by a reinsured are considered paid to the reinsurer, but loss payments and other funds (such as premium adjustments) paid a broker by a reinsurer are not considered paid to the reinsured until actually received by the reinsured.

INTERMEDIARY CLAUSE - A provision in a reinsurance contract which identifies the specific intermediary or broker involved in negotiating the contract, communicating information, and transmitting funds. The clause should state clearly whether payment to the broker does or does not constitute payment to the other party of the reinsurance

contract. Currently a widely used clause provides that payments by the reinsured company to the intermediary shall be deemed to constitute payment to the reinsurer(s) and that payments by the reinsurer(s) to the intermediary shall be deemed to constitute payment to the reinsured company only to the extent that such payments are actually received by the reinsured company.

INTERMEDIATE EXCESS - Used in property reinsurance to describe a cover exposed to both catastrophe (occurrence) losses and policy limit exposures, excess of the probable maximum loss.

+INURE TO THE BENEFIT OF - To take effect for the benefit of either the reinsurer or the reinsured. With respect to a given reinsurance contract (usually treaty), other reinsurances which are first applied to reduce the loss subject to the given contract are said to inure to the benefit of the reinsurer of that given contract. If the other reinsurances are to be disregarded as respects loss to the given contract, they are said to inure to the benefit of the reinsured. For example, a reinsured has a 50% quota share contract and a per occurrence excess of loss contract (e.g., catastrophe reinsurance) for \$80 million excess of \$20 million. A catastrophe loss of \$100 million occurs. If the quota share contract inures to the benefit of the catastrophe reinsurer, the loss would be divided in this way. Of the gross loss of \$100 million, the quota share reinsurer pays \$50 million. Of the remaining \$50 million, the reinsured bears \$20 million (the catastrophe retention) and the catastrophe reinsurer indemnifies the reinsured to the extent of \$30 million.

On the other hand, if the quota share contract is to inure to the benefit of the reinsured (i.e., disregarded as respects the catastrophe reinsurance contracts), the catastrophe reinsurer pays \$80 million and the remaining \$20 million is divided equally between the reinsured and the quota share reinsurer. The reader should note that the inuring reinsurances affect the amount of risks being transferred by the reinsured and which contract is affected. In the first example, the bulk of the risks went to the quota share reinsurer; in the second, to the catastrophe reinsurer.

+INURING - See **INURE TO THE BENEFIT OF**.

INVESTMENT INCOME - Money earned from invested assets. May also include realized capital gains, or be reduced by capital losses, over the same period.

+JOINT ACCOUNT EXCESS OF LOSS - Reinsurance which is purchased by a reinsured to protect both the reinsured and its reinsurer (usually in quota share) and which applies to net and treaty losses combined.

KENNEY RULE - The ratio of an insurer's net premium writings to its policyholder surplus which is considered safe by the author, Roger Kenney, a recognized authority on insurance company finances and author of the book, *Fundamentals of Fire and Casualty Insurance Strength*. For strictly fire insurance companies, the recommended ratio is 2 to 1: \$2 of net premium writings for each \$1 of policyholder surplus. For multiple line companies, the ratio is 3 to 1.

LAW OF LARGE NUMBERS - A mathematical concept which postulates that the more times an event is repeated (in insurance, the larger the number of homogeneous exposure units), the more predictable the outcome becomes. In a classic example, the more times one flips a coin, the more likely that the results will be 50% heads, 50% tails.

+LAYER - The total amount of excess of loss reinsurance protection which a company needs to protect a given set of exposures is usually not written in one contract. Instead, the total amount is split into pieces or layers and separate contracts are written which fit on top of each other and have similar or identical terms but separate limits which sum to the total amount required. Each of the separate contracts in the series is called a layer or level in the total program.

LAYER RATNG - The prediction of loss frequency within a given layer (or band) of insurance.

+LEAD (OR LEADING) UNDERWRITER - The individual (or organization) with a major role in negotiating the terms and conditions of a reinsurance cover and whose reputation and standing are such that other underwriters respect his or her ability, skills, and judgment and will often follow the terms and conditions set by the lead without further negotiation.

LEVERAGED EFFECT - The disproportionate result produced by inflation on a reinsurer's liability in excess of loss reinsurance compared with the reinsured's liability. In other words, inflationary increases in average claim costs of a reinsured usually produce greater increases for the excess of loss reinsurer, since an increase affecting all losses (those within the retention limit and those above it) multiplies itself when affecting the excess of loss portion above that retention limit. The effect is leveraged in that such increases fall more on the reinsurer, proportionately at least, than the reinsured.

+LINE - 1) Either the limit of insurance to be written which a company has set for itself on a class of risk (line limit), or the actual amount which it has accepted on a single risk or other unit. 2) A class or type of insurance (fire, marine, or casualty, among others), also known as **LINE OF BUSINESS**. 3) In surplus share reinsurance, line is used to describe the amount of the reinsured's retained insurance liability in a reinsured policy before loss, in comparison with the reinsurer's share of that policy's liability (which is surplus to the reinsured's liability) and which is usually expressed as a multiple of the reinsured's retained line. Thus, a "two-line" surplus share treaty affords reinsurance for twice the reinsured's retained liability, enabling the reinsured to write three times as much insurance as was possible before reinsurance. For example, if the reinsured retained a maximum of \$100,000 liability per policy in a given class of insurance, but wished to write policies for a maximum of \$500,000 per policy, a 4-line surplus share treaty would accomplish the objective: provide \$400,000 share reinsurance, with losses shared 1/5 by the reinsured and 4/5 by the reinsurer, beginning with the first dollar of loss.

LINE GUIDE - A list of the maximum amounts of insurance which a company is prepared to write on various classes of risks. Within the primary company, a line guide will usually

include a suggested net retention of liability for each class of risk and is used to instruct its agents and underwriters. Also known as Line Sheet.

LINE OF BUSINESS - The general classification of insurance written by insurers, i.e., fire, allied lines, and Homeowners, among others.

LINE SHEET - Another name for LINE GUIDE.

LLOYD'S (OR LLOYDS) - A kind of organization for underwriting insurance or reinsurance in which a collection of individuals assume policy liabilities as the individual obligations of each. When spelled with an apostrophe, the term refers to Lloyd's of London, the formal name of which is Underwriters at Lloyd's, London.

LONG-TAIL LIABILITY - A term used to describe certain types of third-party liability exposures (e.g., malpractice, products, errors and omissions) where the incidence of loss and the determination of damages are frequently subject to delays which extend beyond the term the insurance or reinsurance was in force. An example would be contamination of a food product which occurs when the material is packed but which is not discovered until the product is consumed months or years later.

LOSS COST - In crop-hail insurance, the ratio of incurred loss to liability, or the dollars of loss per \$100 of insurance in force. In reinsurance, the total value of all losses divided by an exposure base. Also referred to as PURE PREMIUM. See also BURNING COST.

LOSS DEVELOPMENT - The process of changing the amount of estimated loss reserves as a policy or accident year matures, as measured by the difference between the paid losses and estimated outstanding losses at one point in time and the paid losses and estimated outstanding losses at some previous point in time. In common usage the term might refer to development on reported cases only, whereas a broader definition would also take into account the IBNR claims.

+LOSS IN EXCESS OF POLICY LIMIT (XPL) - A loss sustained by a reinsured company when required by a court to pay an amount of loss in excess of the policy's limit (which loss would have been included in the policy's coverage if the policy limit were higher) and resulting from an error or omission by the reinsured company in defending its policyholder, thereby exposing the policyholder to a loss in excess of the policy limit.

LOSS INCURRED - See INCURRED LOSSES.

LOSS LOADING "MULTIPLIER" - A factor used to convert losses to premium and provide for the reinsurer's loss adjustment expense, overhead risk, and profit margin. Also known as Loss Conversion Factor.

LOSSES OUTSTANDING - Losses (reported or not reported) which have occurred but have not been paid.

LOSSES PAID - The amounts paid to claimants as insurance claim settlement.

LOSS RATIO - Losses incurred expressed as a percentage of earned premiums.

LOSS RESERVE - For an individual loss, an estimate of the amount the insurer expects to pay for the reported claim. For total losses, estimates of expected payments for reported and unreported claims. May include amounts for loss adjustment expenses. See INCURRED BUT NOT REPORTED (IBNR), INCURRED LOSSES, and LOSS DEVELOPMENT.

MANAGER - In reinsurance, any person, partnership or corporation representing an insurer or reinsurer and underwriting for the insurer's or reinsurer's account.

MARGIN - See PROFIT MARGIN.

MFL (MAXIMUM FORESEEABLE LOSS) - The anticipated maximum property fire loss that could result, given unusual or the worst circumstances with respect to the nonfunctioning of protective features (firewalls, sprinklers, a responsive fire department, etc.), as opposed to PML (Probable Maximum Loss), which would be a similar valuation but under the assumption that such protective features function normally.

MINIMUM PREMIUM - The least premium charge applicable, frequently used in excess of loss reinsurance contracts (per risk or catastrophe covers) which contain a provision that the final adjusted premium may not be less than a stated amount.

+MORTGAGE INSURANCE - A specialty line among financial guarantees which indemnifies a mortgage lender for loss on real estate loans resulting from default by a borrower if liquidation of the property proves insufficient to cover the outstanding principal.

MORTGAGEE ENDORSEMENT - Another name for GUARANTY ENDORSEMENT.

+NATURAL EXPIRY - Termination of reinsurance on a run-off basis, i.e., reinsurance continues until the expiration of policies reinsured according to their original expiration dates.

NET AND TREATY - The amount of the reinsured's loss retention for its own account (without reinsurance), plus its reinsurance for a given risk or a book of business.

NET LINE - The amount of insurance the primary company carries on a risk after deducting reinsurance from its "gross" line.

NET LOSS - The amount of loss sustained by an insurer after making deductions for all recoveries, salvage, and all claims upon reinsurers-with specifics of the definition derived from the reinsurance agreement. Such net loss may or may not include claim expenses. As provided in the reinsurance agreement, net loss can be confined to the amount paid by the reinsured within applicable policy limits, or it can also include amounts paid by the

reinsured for compensatory damages in excess of applicable policy limits because of failure of the reinsured to settle within applicable policy limits.

+NET RETAINED LIABILITY - The amount insured which the reinsured retains net for its own account and unreinsured in any way, usually a defined term, qualified as required by the reinsurance contract in which it appears. See SURPLUS LIABILITY.

NET RETAINED LINES CLAUSE - Explains that the loss subject to the reinsurance agreement is net of all other reinsurances, whether collectible or not, as well as net of salvages and all other reinsurance recoveries due the reinsured.

NET LOSS RETENTION - The amount of loss which an insurer keeps for its own account and does not pass on to another insurer(or reinsurer). In excess of loss reinsurance, the term "first loss retention" may be preferred.

NEW AND RENEWAL BUSINESS - Insurance policies (exposures or risks) whose terms of insurance begin or continue during a reinsurance contract period of time, with or without reinsurance coverage.

NONADMITTED ASSETS - Assets owned by an insurance company which are not recognized for solvency purposes by state insurance laws or insurance department regulations, e.g., premiums due and uncollected past ninety days, and furniture and fixtures, among others.

NONADMITTED COMPANY - 1) An insurer not licensed in a given state. 2) A reinsurer not licensed or approved in a given state.

NONADMITTED INSURANCE - Insurance protection placed in a nonadmitted insurer.

NONADMITTED REINSURANCE - Reinsurance protection bought by a reinsured company from a reinsurer not licensed or otherwise authorized to transact the particular line of business in the jurisdiction in question. No credit is given the company for such nonadmitted reinsurance in its Annual Statement unless it withholds funds or holds a letter of credit on behalf of such unauthorized reinsurer, as shown in Part 2 of Schedule F of the Annual Statement. See PENALTY FOR UNAUTHORIZED REINSURANCE.

+NONPROPORTIONAL REINSURANCE - Reinsurance in which the reinsurer's response to a loss depends on the size of the loss, so named because the premium in nonproportional reinsurance is not proportional to limits of coverage. Also known as EXCESS OF LOSS REINSURANCE.

OBLIGATORY TREATY - A reinsurance contract (usually pro rata) under which the subject matter business must be ceded by the ceding company in accordance with contract terms and must be accepted by the reinsurer. Also known as AUTOMATIC TREATY.

OCCURRENCE - 1) In a noninsurance sense, an incident, event or happening. In insurance, the term may be defined as continual, gradual, or repeated exposure to an adverse condition which is neither intended nor expected to result in injury or damage, as contrasted with an accident which is a sudden happening. In reinsurance, per occurrence coverage permits all losses arising out of one event to be aggregated instead of being handled on a risk-by-risk basis. 2) One basis or determinant for calculating the amount of loss or liability in insurance or reinsurance when an aggregation of related losses is to constitute a single subject of recovery. For example, in property catastrophe reinsurance treaties, occurrence is usually defined so that all losses within a specified period of time involving a particular peril are deemed to be an occurrence.

+ODD TIME - A term used in run-off language for the part of a policy period greater than the twelve months of coverage usually provided in order to accommodate a special policy term need of an insured, such as bringing the policy anniversary date into conformity with other policies issued to the same insured.

+OFFSET (verb) - To reduce the amount owed by one party to a second party under one agreement or transaction by crediting the first party with amounts the second party owes the first party under other agreements or transactions for the purpose of determining the amount, if any, the first party owes to the second. The use of "offset" as a verb and "setoff" as a noun has been consistently used in federal bankruptcy statutes since the first bankruptcy act was enacted in 1800. See also COUNTERCLAIM, RECOURNMENT, and SETOFF.

OPERATING INCOME or PROFIT - The sum of the net investment income and net underwriting income in any reporting period.

OPERATING RATIO - The arithmetic sum of two ratios: incurred loss to earned premium, and incurred expense to written premium. Considered the best simple index to current underwriting performance of an insurer.

+ORIGINAL CONDITIONS - A term used in both treaty and facultative reinsurance which incorporates by reference all of the terms (as well as amendments, modifications, alteration, and waivers) of the original policy written by the insurer that are not modified in the reinsurance contract, i.e., the location of the property and the rate, among others. See FOLLOW THE FORTUNES, which is totally different in concept and is applicable only to treaty reinsurance, but which is often used in tandem with ORIGINAL CONDITIONS.

+ORIGINAL INSURER - The insurer which writes a policy for a policyholder (which may or may not create the need for reinsurance).

+ORIGINAL POLICY - The policy written by the original insurer.

OVERLINE - The amount of insurance or reinsurance written which exceeds the insurer's or reinsurer's normal underwriting capacity, inclusive of automatic reinsurance facilities. See UNDERWRITING CAPACITY.

OVERRIDING COMMISSION - 1) A fee or percentage of money which is paid to a party responsible for placing a retrocession of reinsurance. 2) In insurance, a fee or percentage of money which is paid by the insurer to an agent or general agent for premium volume produced by other agents in a given geographic territory.

PARTICIPATE - To share in the writing of a risk.

PARTICIPATING INSURANCE - A designated class of insurance that shares in the dividends declared by the primary insurer to policyholders. While mutual insurers issue participating policies mostly, and stock insurers usually issue nonparticipating policies, either type of insurer may seek authorization from its domiciliary state insurance department to issue the other type of policy.

PARTICIPATING REINSURANCE - The sharing of risks, as in quota share and surplus share reinsurance, in which the reinsured and the reinsurer participate pro rata in all losses beginning with the first dollar. See **PRO RATA REINSURANCE**.

PAYBACK PERIOD - A term used in rating per occurrence excess covers showing the number of years at a given premium level required to accumulate total premiums equal to the indemnity. Synonymous with **AMORTIZATION PERIOD**.

+PENALTY FOR UNAUTHORIZED REINSURANCE, ANNUAL STATEMENT - The inability of a licensed insurer to increase its Annual Statement policyholder surplus when purchasing pro rata reinsurance, which is a major reason for purchasing it, if the purchase is made from a reinsurer not licensed or approved by the domiciliary state insurance department of the insurer. Where Annual Statement credit is not allowed in the purchase of pro rata reinsurance, the licensed insurer must establish an unearned premium reserve liability on its Statement for such reinsurance, and possibly other reserves as well, which decreases the insurer's Statement policyholder surplus, hence the penalty. If excess of loss reinsurance is purchased, the penalty is the requirement that the insurer establish a reserve liability for the amount of loss recoverables, as is the case for loss recoverables from an unauthorized pro rata reinsurer. Any penalty can be reduced by the insurer's withholding funds due the reinsurer (shown in the insurer's Annual Statement as a liability, "funds held") or by the reinsurer's providing a Letter of Credit or acceptable security to the insurer. See **POLICYHOLDER SURPLUS**, **CREDIT FOR AUTHORIZED REINSURANCE**, and **FUNDS HELD**.

+PER OCCURRENCE EXCESS - An excess of loss reinsurance where the reinsured company's loss retention and the reinsurer's limit of liability apply to the loss arising from a single occurrence, regardless of the number of risks or policies involved. May be casualty or property: if property insurance, the reinsurance would be called catastrophe excess; if casualty, which would require two or more coverages or policies to be involved in a given loss, the contract is called a clash cover.

PER RISK REINSURANCE - Reinsurance in which the reinsurance limit and the reinsured's loss retention apply "per risk," rather than per accident, per event, or in the aggregate.

PML (PROBABLE MAXIMUM LOSS) - The anticipated maximum property fire loss that could result, given the normal functioning of protective features (firewalls, sprinklers, a responsive fire department, etc.), as opposed to MFL (Maximum Foreseeable Loss), which would be a similar valuation, but on a worst case basis with respect to the functioning of the protective features. Underwriting decisions would typically be influenced by PML evaluations, and the amount of reinsurance ceded on a risk would normally be predicated on the PML valuation.

+POLICIES - Any of the ceding company's (or reinsured's, in excess of loss) policies, binders, contracts of insurance, or reinsurance covered by the reinsurer.

POLICY PROFILE - A study which segregates an insurer's policies into various groupings (for example, by policy limit or policy premium).

POLICY-YEAR EXPERIENCE - See ACCIDENT-YEAR EXPERIENCE.

POLICYHOLDER - The party in whose name an insurance policy is issued.

POLICYHOLDER SURPLUS - 1) The net worth of an insurer as reported in its Annual Statement. For a stock insurer, the sum of its surplus and capital. For a mutual insurer, its surplus. 2) The amount by which the assets of an insurer exceed the liabilities. Another name for surplus to policyholders.

POOL - Any joint underwriting operation of insurance or reinsurance in which the participants assume a predetermined and fixed interest in all business written. Pools are often independently managed by professionals with expertise in the classes of business undertaken, and the members share in the premiums, losses, expenses, and profits. An "association" and a "syndicate" (excluding that of Lloyd's of London) are both synonymous with a pool, and the basic principles of operation are much the same.

PORTFOLIO - A defined body of a) insurance (policies) in force (known as a premium portfolio), b) outstanding losses (known as a loss portfolio), or c) company investments (known as an investment portfolio). (The reinsurance of all existing insurance as well as new and renewal business is therefore described as a running account reinsurance with portfolio transfer or assumption.)

PORTFOLIO REINSURANCE - The transfer of a portfolio of premiums or outstanding loss reserves to a reinsurer; the reinsurance of a runoff. Only policies in force (or losses outstanding) are reinsured, and no new or renewal business is included. Commonly used by an insurer when retiring from an agency, a territory, or from the insurance business entirely. Known also as assumption reinsurance.

PORTFOLIO RETURN - If the reinsurer is relieved of liability (under a pro rata reinsurance) for losses happening after termination of the treaty or at a later date, the total unearned premium reserve on business left unreinsured (less ceding commissions thereon) is normally returned to the cedent. Also known as a RETURN PORTFOLIO or Return of Unearned Premium.

PORTFOLIO RUNOFF - Continuing to reinsure a portfolio until all ceded premium is earned, or all losses are settled, or both. While a loss runoff is usually unlimited as to time, a premium runoff can be for a specified duration.

POSTJUDGMENT INTEREST - Interest which accumulates after entry of the court judgment before it is paid.

+PREJUDGMENT INTEREST - Interest assessed against the defendant in a lawsuit from the time of the injury (or in some instances from the time of filing suit) until the rendering of the court judgment. Commonly considered as part of the loss for insurance purposes rather than an expense, if the interest becomes part of the judgment. Prejudgment interest, allowed in many states, is designed to encourage defendants to settle quickly by allowing interest to accrue (in the event of a verdict for the plaintiff) from a point in time in advance of the verdict.

+PREJUDICE - Injury, damage or loss, especially to one's legal rights or claims.

PREMIUM - The monetary consideration in contracts of insurance and reinsurance.

PREMIUM BASE - The reinsured company's premiums (written or earned) to which the reinsurance premium rate is applied to produce the reinsurance premium. Also known as BASE PREMIUM, SUBJECT PREMIUM, and UNDERLYING PREMIUM.

PREMIUMS EARNED - When used as an accounting term, premiums earned describe the premiums written during a period, plus the unearned premiums at the beginning of the period, less the unearned premiums at the end of the period.

+PRIMARY - An adjective applied in reinsurance to these nouns: insurer, insured, policy, and insurance - meaning respectively: 1) the primary insurer is the insurance company which initially originates the business, i.e., the ceding company in pro rata reinsurance, or the reinsured in excess of loss reinsurance (the first insurer in the insurance-reinsurance relationship, hence primary); 2) the primary insured is the policyholder of the primary insurer; 3) the primary policy is the initial policy issued by the primary insurer to the primary insured; 4) the primary insurance is the insurance covered under the primary policy issued by the primary insurer to the primary insured (sometimes called "underlying insurance").

PRIORITY - The term used in some reinsurance markets outside the U.S. to mean the retention of the primary company in a reinsurance agreement.

+PRIORITY OF REIMBURSEMENT - See REIMBURSEMENT PRIORITY.

PRODUCER COMMISSION - The same as BROKERAGE COMMISSION.

PROFESSIONAL REINSURER - A term used to designate an organization whose business is mainly reinsurance and related services, as contrasted with other insurance organizations which may operate reinsurance assuming departments in addition to their basic primary insurance business.

PROFIT COMMISSION - See CONTINGENT COMMISSION.

PROFIT MARGIN - As a pricing factor (along with expenses and losses), the return the reinsurer expects from the degree of net risk taken. As with any investment, the reinsurer expects a larger return from risky than safe investments.

PROPORTIONAL REINSURANCE - Another name for PRO RATA REINSURANCE.

PRO RATA REINSURANCE - A generic term describing quota share and surplus share reinsurance in which the reinsurer shares a proportional part of the ceded insurance liability, premiums, and losses of the ceding company. Also known as PARTICIPATING REINSURANCE and Proportional Reinsurance. See QUOTA SHARE and SURPLUS SHARE.

PROSPECTIVE RATING PLAN - The formula in a reinsurance contract for determining the reinsurance premium for a specified period on the basis, in whole or in part, of the loss experience of a prior period (as opposed to retrospective rating, which is based on loss experience for the same period). Also known as Experience Rating. See SPREAD LOSS REINSURANCE.

"PROTECTING THE TREATY" - Used to describe any action taken by an insurer to prevent heavy losses to its treaty reinsurer, which can lead to increased reinsurance rates or decreased participation in any profit-sharing arrangements with the reinsurer. An example is the ceding of any individual risk, which is expected to produce a loss large enough to endanger the cedent's favorable treaty experience to a facultative reinsurer.

PROVISIONAL PREMIUM, RATE, OR COMMISSION - The tentative amount which is subject to subsequent adjustment.

PUNITIVE DAMAGES - Damages awarded separately and in addition to compensatory damages, usually on account of malicious or wanton misconduct, to serve as a punishment for the wrongdoer and possibly as a deterrent to others. Sometimes referred to as exemplary damages when intended to make an example of the wrongdoer.

PURE LOSS COST - The ratio of reinsured losses incurred under a reinsurance agreement to the ceding company's subject earned premium for that agreement, before loading. Also known as BURNING COST.

PURE PREMIUM - 1) That part of the premium which is sufficient to pay losses and loss adjustment expenses but not other expenses. 2) Also the premium developed by dividing losses by units of exposure, disregarding any loading for commission, taxes, and expenses. 3) In crop-hail insurance, the ratio of incurred loss to liability, or the dollars of loss per \$100 of insurance in force.

PYRAMIDING SURPLUS - The consolidating of two or more insurer policyholder surpluses (net worths) by the consolidating parent insurer, as required by proper accounting, which can distort the parent's ability to write a larger premium volume than NAIC IRIS test ratios consider acceptable. The distortion is revealed by applying the IRIS test ratio to each insurer's policyholder surplus, independent of the consolidated total. (The term can also be adapted to the pyramiding of reinsurers' liability. See Page 93 of the Property Per Risk chapter).

QUOTA SHARE REINSURANCE - A form of pro rata reinsurance (proportional) in which the reinsurer assumes an agreed percentage of each insurance being reinsured and shares all premiums and losses accordingly with the reinsured. Quota share reinsurance is usually arranged to apply to the insurer's net retained account (i.e., after deducting all other reinsurance except perhaps excess of loss catastrophe reinsurance), but practice varies. A quota share reinsurer may be asked to assume a quota share of a gross account, paying its share of premium for other reinsurance protecting that gross account.

RATE - The percent or factor applied to the ceding company's subject premium to produce the reinsurance premium, or the percent applied to the reinsurer's premium to produce the commission payable to the primary company (or, if applicable, the reinsurance intermediary).

RATE ON LINE - Premium divided by indemnity. A British term for the rate which, when multiplied by the indemnity, would produce the premium. This term is used extensively in judging the adequacy of rates for per occurrence excess covers, and is the inverse of the American terms, **AMORTIZATION PERIOD** and **PAYBACK PERIOD**.

RECAPTURE - Used often in life reinsurance as the action of a ceding company to take back reinsured risks previously ceded to a reinsurer.

RECIPROCITY - The mutual exchanging of reinsurance, often in equal amounts, from one party to another, the object of which is to stabilize overall results.

+RECOUPMENT (noun) - The application of debits and credits arising out of an agreement or transaction for the purpose of determining the amount due to or from a party under the agreement or transaction. Under recoupment, the debits and credits are applied without regard to whether they represent mutual debts since the debits and credits are limited to those arising under the same transaction or contract and the purpose of recoupment is to determine the amount which the party owes or is owed under that contract or transaction. The term is to be contrasted with setoff, which is the reduction of

the amount owed by one party to a second party under one agreement or transaction by the amount which the second party owes to the first party under a different contract or transaction for the purpose of determining the amount due, if any, to or from the first party. See also COUNTERCLAIM and SETOFF.

+RECOVERIES, REIMBURSEMENT BY - See REIMBURSEMENT PRIORITY.

+RECOVERY - In reinsurance, an amount received by the reinsured company from reinsurance, salvage of damaged property, or subrogation against third parties. If the amount is receivable (due but not yet paid the company), the term used is recoverable, which is comparable to an account receivable.

+REIMBURSEMENT PRIORITY - In a reinsured company's excess of loss reinsurance, from which loss payments have been made to the company, the distribution of salvage and subrogation recoveries received subsequently by the company to reinsurers, beginning with the reinsurer of the highest layer and progressing to the lowest, before benefiting the company. Each reinsurer thereby pays only that portion of the post-recovery, reduced loss it would have paid if the recovery had been received prior to any reinsurance payment.

REINSTATEMENT - The restoration of the reinsurance limit of an excess property treaty to its full amount after payment by the reinsurer of loss as a result of an occurrence.

REINSURANCE - 1) The transaction whereby the reinsurer, for a consideration, agrees to indemnify the reinsured company against all or part of the loss that the company may sustain under the policy or policies that it has issued. 2) When referred to as "a reinsurance," the term means the reinsurance relationship between reinsured(s) and reinsurer(s).

REINSURANCE ASSUMED - That portion of one or more risks the reinsurer accepts from the original insurer or ceding company.

REINSURANCE CEDED - That portion of one or more risks that the ceding company transfers to the pro rata reinsurer.

REINSURANCE COMMISSION - Another name for CEDING COMMISSION.

+REINSURANCE PREMIUM - 1) An amount paid by the ceding company to the pro rata reinsurer in consideration for sharing insurance policy liability, premium, and losses, beginning with the first dollar. 2) An amount paid by the reinsured company to the excess of loss reinsurer for indemnity of the reinsured's losses above the agreed loss retention.

+REINSURED - 1) In pro rata reinsurance, an insurer which has ceded parts of or all of one or more policies to a reinsurer in the process of sharing insurance liability, premiums, and losses. Also known as CEDING COMPANY. 2) In excess of loss reinsurance, an

insurer which is to be indemnified by a reinsurer for losses from one or more policies in excess of the insurer's (reinsured's) loss retention.

+REINSURER - An insurer which assumes the insurance liability of another by way of reinsurance, either pro rata sharing or indemnifying the reinsured for losses in excess of the reinsured's loss retention.

+REINSURING CLAUSE - Language that describes the coverage agreed upon by the parties, i.e., what is covered and when. The key components are three: the indemnity aspect of the agreement, the type of business covered, and the method of determining whether a loss falls within the scope of the agreement. Also known as Cover Clause, Business Reinsured Clause, and Application of Agreement Clause.

RESERVE STRENGTHENING - Increasing estimated loss reserve liabilities, which requires either the reduction of policyholder surplus as more assets are earmarked to offset increasing liabilities or the inflow of assets from outside the corporation.

RETAINAGE - Contract balances held in suretyship by an obligee for payment to a contractor upon completion of the contract.

+RETENTION - The amount of insurance liability (in pro rata, for participation with the reinsurer) or loss (in excess of loss, for indemnity of excess loss by the reinsurer) which an insurer assumes (or retains) for its own account. In pro rata contracts, the retention of liability will be a percentage of the policy limit. In excess of loss contracts, the retention of loss is 1) a dollar amount of loss (comparable to a deductible used in primary insurance), 2) a percentage amount of each layer of insurance liability, 3) an amount of loss which exceeds the reinsurance in place, or 4) all three. See ATTACHMENT POINT and PRIORITY.

RETROCEDENT - The ceding reinsurer in a retrocession, where the assuming reinsurer is known as the retrocessionnaire.

RETROCESSION - The reinsuring of reinsurance. Retrocession is a separate contract and document from the original reinsurance agreement between a primary insurance company (as the reinsured) and the original reinsurer. A retrocession is placed to afford additional capacity to the original reinsurer or to contain or reduce the original reinsurer's risk of loss, and is either specific or blanket. A specific retrocession may be a single risk only or a carefully defined group of risks, structured as pro rata or excess of loss reinsurance. A blanket retrocession covers the original reinsurer's entire net portfolio of reinsured business (i.e., net in being less any specific retrocession protection) and is normally structured as excess of loss reinsurance, arranged separately by major line of reinsured business (i.e., property, casualty, ocean marine, aviation, accident and health, among others).

RETROCESSIONNAIRE - The assuming reinsurer in a retrocession, where the ceding reinsurer is known as the retrocedent.

RETROSPECTIVE RATING PLAN - The formula in a reinsurance contract for determining the reinsurance premium for a specified period on the basis of the loss experience for the same period (as opposed to prospective rating, which is based on loss experience for a prior period). Also known as Experience Rating.

RETURN PORTFOLIO - The reassumption by a ceding company of a portfolio of risks previously assumed by a reinsurer. See **ASSUMED PORTFOLIO**.

REVERSAL EXPENSES - Expenses incurred in the appellate process in an effort to reverse a trial court decision or to obtain a reduction of the damages award. Because appellate expense often inures largely to the benefit of the excess of loss reinsurer, it is customary for the reinsurer to share the corresponding burden of that expense in proportion to the benefit received from the appeal through a reduction in the amount of the court verdict.

+RISK - Defined variously as uncertainty of loss, chance of loss, or the variance of actual from expected results. Also, the word is used to identify the object of insurance protection, e.g., a building, an automobile, a human life, or exposure to liability. In reinsurance, each reinsured company customarily makes its own rules for defining a risk.

RISK-BASED CAPITAL - The amount of capital needed to absorb the various risks of operating an insurance business. For example, a higher risk business requires more capital than one with lower risks. The calculation is intended to be unique to each company.

+ RUN-OFF CANCELLATION or TERMINATION - A provision in the termination clause (or endorsement) of a reinsurance contract stipulating that the reinsurer shall remain liable for loss under reinsured policies in force at the date of termination, as a result of occurrences taking place after the date of termination, until their natural expiry (and often that the run-off period may not exceed twelve months from the date of termination). See **CUT-OFF CANCELLATION or TERMINATION**. (Editor's Note: Runoff is one word when used as a noun, two words as a verb transitive, and hyphenated as a compound adjective e.g., a runoff runs off insurance business in force on a run-off basis.)

SECOND SURPLUS - A supplementary treaty to a **FIRST SURPLUS TREATY**.

+SELF-INSURED OBLIGATION - An exposure of an insurance company within the classes of its reinsured business for which the company has issued its policy (or certificate) to itself, has made a premium declaration on its books, or has prepared an internal memorandum with details of the exposure, the purpose being to cover such self-insured obligation under its reinsurance contracts. Contrast with an uninsured obligation, for which there would be no coverage. Some question the validity of this type of transaction because it violates the contract law principle that an entity cannot contract with itself.

SEMI-AUTOMATIC TREATY - See FACULTATIVE SEMI-OBLIGATORY TREATY.

+SETOFF (noun) - The reduction of the amount owed by one party to a second party under one agreement or transaction by crediting the first party with amounts the second party owes the first party under other agreements or transactions for the purpose of determining the amount, if any, the first party owes to the second. A person asserting a setoff does not seek to recover amounts owed to the person in excess of the amount offset. Under bankruptcy and insolvency statutes, the amounts which may be offset must be mutual debts. This requires that the debts must be owed to and from the same parties in the same capacity. A bankruptcy trustee or a liquidator of an insurer is a different party from the debtor or insolvent insurer. If the liquidator has a claim against a person under special statutory rights granted to the liquidator (such as the right to void preferential transfers or fraudulent conveyances), the claim by the liquidator is owed as a different party than a claim which the liquidator owes as a successor-in-interest to the insolvent insurer. If a party owes the liquidator a debt where the party was acting as a trustee or an equity owner of the insurer, the debt is not owed by the party in the same capacity as the debt the party owes the liquidator as the successor-in-interest to the insurer as a creditor. Some courts have held that salvage and subrogation proceeds held by a reinsured in a trustee capacity are not mutual debts with reinsurance proceeds owed by the reinsurer and therefore cannot be offset. In addition to the mutuality requirement, the insolvency statutes usually have other restrictions on setoffs. The restrictions may vary from state to state. See also OFFSET, RECOUPMENT, and COUNTERCLAIM.

SINGLE RISK REINSURANCE - See FACULTATIVE REINSURANCE.

+SLIDING SCALE COMMISSION - A contractual formula used in pro rata treaty reinsurance under which the ultimate ceding commission payable varies inversely to the loss ratio, within stated parameters. In effect, a retroactive pricing mechanism for pro rata reinsurance.

+SLIP - See BINDER and COVER NOTE.

SOCIAL INFLATION - The increasing of insurance losses caused by higher jury awards, increase in liberal treatment of claims by workers compensation boards, legislated rises in compensation benefit levels (in some cases retroactively), and new concepts of tort and negligence, among others.

SOFT MARKET - See HARD MARKET.

+SPECIAL ACCEPTANCE - The extension of a reinsurance treaty to embrace a specific risk not automatically included within its terms (e.g., a different class of business, an inordinate size of obligation, or an excluded risk). Once accepted, all other treaty terms apply. However, at least one arbitration has declared that a special acceptance required a termination notice separate from the notice canceling the treaty, otherwise the acceptance would lose its "special" nature.

SPECIAL COVERS - A general term used to describe reinsurance agreements written to protect the primary company against certain unusual situations, usually contingent in nature, rather than for the repayment of normal losses suffered under the primary company's policies.

SPECIAL EXCEPTION - See **SPECIAL ACCEPTANCE**.

+SPECIAL TERMINATION - A clause in a reinsurance treaty providing that, if one or more conditions arise, the treaty or agreement can be cancelled immediately. Some conditions could be: the acquisition, control, or merger by or with another company; the loss of a significant part of the company's policyholder surplus; a sudden and substantial change in the company's management; the failure to remit premiums; and insolvency or liquidation. The clause should state which party may initiate the termination, the conditions necessary, the notice requirements, and the method of terminating existing business (i.e., whether to cut off or to run off). Also known as Sudden Death Clause.

SPREAD LOSS REINSURANCE - A type of excess of loss property reinsurance which provides for a periodic adjustment of the reinsurance premium rate based on the reinsured's experience for preceding years (usually five), plus a loading for the purpose of compensating the reinsurer for a) its expenses, b) the possibility of unusual losses, c) those losses occurring at the end of the period of the treaty which the reinsurer might not have a chance to recoup if the treaty is not renewed, d) a catastrophe possibility, and e) the reinsurer's profit. In casualty reinsurance, adjustments to the above may be required for such other factors as economic and social inflation. Also known as **CARPENTER PLAN**.

STATUTORY ACCOUNTING PRINCIPLES (SAP) - Those accounting procedures required by state law which must be followed by insurance companies in submitting their financial statements to state insurance departments. Such principles differ from generally accepted accounting principles (GAAP) in important respects, e.g., SAP requires that expenses must be recorded immediately and cannot be deferred to track with premiums as they are earned and taken into revenue. See GAAP.

STATUTORY POLICYHOLDER SURPLUS - See **POLICYHOLDER SURPLUS**.

+STATUTORY SUCCESSOR - The party designated by law (e.g., a liquidator, conservator, or receiver appointed by a court) to receive reinsurance proceeds due an insolvent insurer's estate (instead of other claimants, such as guaranty funds or individual policyholders).

STOP-LOSS REINSURANCE - See **AGGREGATE STOP-LOSS REINSURANCE**.

STRENGTHENING RESERVES - See **RESERVE STRENGTHENING**.

+STRUCTURED SETTLEMENT - The loss payment by the insurer in the form of a lump sum to the claimant (or its attorney), plus a discounted dollar amount (the premium) to an

annuity company (affiliated or not with the insurer), which annuity company agrees to pay the claimant (the annuitant) an amount per year for either a period of years or for the lifetime of the annuitant.

STUB POLICY - An insurance policy written for less than one year.

SUBJECT PREMIUM - The reinsured company's premiums (written or earned) to which the reinsurance premium rate is applied to produce the reinsurance premium. Also known as BASE PREMIUM, PREMIUM BASE, UNDERLYING PREMIUM, and Subject Matter Premium Income.

G.N.E.P.I. (Gross Net Earned Premium Income) - The usual rating base for excess of loss reinsurance. It represents the earned premiums of the primary company for the lines of business covered net, meaning after cancellation, refunds, and premiums paid for any reinsurance protecting the cover being rated, but gross, meaning before deducting the premium for the cover being rated.

G.N.W.P.I. (Gross Net Written premium Income) - Gross written premium less returned premiums and premiums paid for reinsurance which inures to the benefit of the cover in question. Its purpose is to create a base to which the reinsurance rate is applied. Same as G.N.E.P.I., except premiums are written instead of earned.

+SUDDEN DEATH CLAUSE - See SPECIAL TERMINATION.

+SUNSET - A provision in a contract limiting coverage to losses reported to the reinsurer within a certain number of years from a given point in time, such as the end of the contract year in which the loss occurs.

SURPLUS CREDIT - See CREDIT FOR AUTHORIZED REINSURANCE, ANNUAL STATEMENT

SURPLUS LIABILITY - That portion of a reinsured company's gross liability on any one risk which exceeds the amount the company is willing to retain net for its own account. See NET RETAINED LIABILITY.

SURPLUS RELIEF - 1) The result of reinsurance ceded on a portfolio basis to offset extraordinary drains on the reinsured's policyholder surplus. The need for policyholder surplus relief is created when an insurance company wishes to write more policies, or larger policies, or both, than its policyholder surplus (assets minus liabilities) can finance. Put another way, the initial costs of writing primary insurance policies (which must be expended immediately) exceed the initial premium income (which is not available to offset costs until it is earned over the policy period, usually twelve months as required by law), and the company is therefore limited in its policy writings by the amount of its net worth, or policyholder surplus. 2) A designation of a reinsurance the main purpose of which is to finance new or in-force business, or both. See FINANCING FUNCTION, PORTFOLIO, PORTFOLIO REINSURANCE, CEDING COMMISSION, and TURN.

+SURPLUS SHARE REINSURANCE - A form of pro rata reinsurance indemnifying the ceding company against loss to the extent of the surplus insurance liability ceded, on a share basis similar to quota share. Essentially, this can be viewed as a variable quota share contract wherein the reinsurer's pro rata share of insurance on individual risks will increase as the amount of insurance increases, given the same reinsurer's retained line, in order that the primary company can limit its net exposure to one line, regardless of the amount of insurance written. First surplus is the amount of surplus on each risk (one or more multiples of the reinsured's line) that must apply first to the first surplus contract. Second surplus, third surplus, etc., reinsurances are the remaining portions of the surplus liability that must apply to each such respective contract after deducting the amount(s) ceded to the underlying surplus contract or contracts.

SURPLUS TO POLICYHOLDERS - See POLICYHOLDER SURPLUS.

SYNDICATE - An association of individuals or organizations to pursue certain insurance objectives. For example, individual underwriters in Lloyd's of London associate in separate syndicates to write marine insurance, reinsurance, life insurance, etc., entrusting the administrative details of each syndicate to a syndicate manager. See POOL.

TARGET RISKS - Risks designated in reinsurance treaties or contracts by the reinsurer that are specifically excluded (e.g., high valued bridges, tunnels, fine arts collections), because they normally are of such size and capacity demand as to require individual acceptance, lest "blind" cessions under automatic reinsurance overline the reinsurer.

+TERM - The time period during which a reinsurance contract remains in effect.

+TERMINATION CLAUSE - Continuous contracts remain in force until affirmative notice is given by one of the parties to terminate. This clause details the requirements of the notice. See SPECIAL TERMINATION CLAUSE.

TRADE RATIO - The combination of loss incurred to earned premiums ratio and incurred expense to written premiums ratio. Also known as Combined Ratio and OPERATING RATIO.

+TRADING DOLLARS - In reinsurance, when the premium payments approximately equal the benefits.

+TREATY - A reinsurance agreement between the reinsured company and the reinsurer, usually for one year or longer, which stipulates the technical particulars applicable to the reinsurance of some class or classes of business. Reinsurance treaties may be divided into two broad classifications: a) the participating type, which provides for sharing by reinsured and reinsurer of insurance policy liability, premiums, and losses; and b) the excess type, which provides for indemnity by the reinsurer only for loss which exceeds some specified predetermined amount. For different forms, see QUOTA SHARE,

SURPLUS SHARE, EXCESS OF LOSS, FIRST SURPLUS, SECOND SURPLUS, SPREAD LOSS, STOP LOSS, and CATASTROPHE.

TREATY BALANCE - See BALANCE.

+TREATY REINSURANCE - A standing agreement between reinsured and reinsurer 1) for the cession and assumption of certain risks as defined in the pro rata treaty, or 2) for indemnity by the reinsurer only for the reinsured's losses above the reinsured's loss retention. While most pro rata treaty reinsurance provides for automatic cession and assumption, it may be optional or semi-obligatory and is not necessarily obligatory.

TRENDING - The necessary adjustment of historical statistics (both premium and losses) to present levels or expected future levels in order to reflect measurable changes in insurance experience over time which are caused by dynamic economic and demographic forces and to make the data useful for determining current and future expected cost levels.

TURN - Referred to as "the turn," this word describes the excess of reinsurance commission received by a ceding company over its actual costs incurred in producing the business ceded. The excess is considered a profit to the ceding company. See CEDING COMMISSION.

TURNKEY PRODUCT - One built, supplied, and installed in a complete condition, ready to be operated.

+TWO-RISK WARRANTY - A provision in a property catastrophe excess treaty (as distinguished from a casualty catastrophe treaty) to exclude one-risk exposures by requiring that there be at least two risks involved in an occurrence to recover from the property catastrophe excess treaty. See CASUALTY CATASTROPHE COVER and CLASH COVER.

UBERRIMAE FIDEI - Literally, of the utmost good faith. A defining characterization or quality of some (contractual) relationships, of which reinsurance is universally recognized to be. Among other differences from ordinary relationships, the nature of reinsurance transactions is dependent upon a mutual trust and a lively regard for the interests of the other party, even if inimical to one's own. A breach of utmost good faith, especially in regard to full and voluntary disclosure of the elements of risk of loss, is accepted as grounds for any necessary reformation or redress, including rescission. See UTMOST GOOD FAITH.

ULTIMATE NET LOSS - 1) In reinsurance, the unit of loss to which the reinsurance applies, as determined by the reinsurance agreement. In other words, the gross loss less any recoveries from other reinsurance which reduce the loss to the treaty in question. 2) In liability insurance, the amount actually paid or payable for the settlement of a claim for which the reinsured is liable (including or excluding defense costs), after deductions are made for recoveries and certain specified reinsurance.

UNAUTHORIZED INSURER, REINSURER - An insurer not licensed, or a reinsurer neither licensed nor approved, in a designated legal jurisdiction.

UNAUTHORIZED REINSURANCE - Reinsurance placed with a nonadmitted reinsurer which is not licensed or approved in the jurisdiction in question. See CREDIT FOR AUTHORIZED REINSURANCE and NONADMITTED REINSURANCE.

+UNBUNDLED - The separation of coverages previously combined into a reinsurance contract.

UNDERLYING - The amount of loss which attaches before the next higher excess layer of insurance or reinsurance attaches.

+UNDERLYING POLICY - See ORIGINAL POLICY.

UNDERLYING PREMIUM - The ceding company's premiums (written or earned) to which the reinsurance premium rate is applied to produce the reinsurance premium. Also known as PREMIUM BASE, BASE PREMIUM, and SUBJECT PREMIUM.

UNDERWRITING ASSOCIATION - See POOL.

UNDERWRITING CAPACITY - The maximum amount of money an insurer or reinsurer is willing to risk in a single loss event on a single risk or in a given period. The limit of capacity for an insurer or reinsurer may also be imposed by law or regulatory authority.

UNDERWRITING INCOME - The excess of premiums earned by a reinsurer during any reporting period over the combined total of expenses and losses incurred by the reinsurer during the same period.

UNDERWRITING LEVERAGE - The ratio of premium writings to surplus.

+UNDERWRITING YEAR - Also known as policy year, see the definition of POLICY-YEAR EXPERIENCE under ACCIDENT-YEAR EXPERIENCE.

+UNDERWRITING-YEAR BASIS - In rating, the use of all premiums written as arising from all policies written or renewed during the year and all losses relating to those same policies, whenever they may occur. See POLICY-YEAR EXPERIENCE under ACCIDENT-YEAR EXPERIENCE.

UNEARNED PREMIUM RESERVE - The sum of all the premiums representing the unexpired portions of the policies or contracts which the insurer or reinsurer has on its books as of a certain date. It is usually based on a formula of averages of issue dates and the length of term.

UTMOST GOOD FAITH - Firm adherence to promises made to another, including disclosure of all relevant facts, and complete trust in the fidelity of the other; the absence of any concealment or deception, however slight.

+VICARIOUS LIABILITY - The liability of one party which by law becomes the liability of another, such as the liability of an employer for the acts of an employee.

+VOIDABLE PREFERENCE - A payment made by an insolvent debtor which, by statute, is recoverable by the debtor's estate because it was either made within a particular fixed period of time prior to commencement of insolvency proceedings or it was in payment of a noncontemporaneous debt, and had the effect of giving the particular creditor who received it more than that creditor's pro rata share of the debtor's assets.

WARRANTED NO KNOWN OR REPORTED LOSSES - In ocean marine insurance, a statement made on application for excess or catastrophe reinsurance, which is being backdated, to protect the reinsurer from placement of reinsurance after a loss has occurred.

WELLINGTON AGREEMENT - An agreement between insurers and asbestos producers that established a claims handling center to agree on and coordinate payments to claimants and arbitration procedures between producers and insurers.

WORKING EXCESS - A contract covering a type of excess reinsurance (per risk) in which loss frequency is anticipated, as opposed to loss severity. Thus, a working cover would usually have a low indemnity and would attach above a relatively low retention. See PER RISK REINSURANCE.

+WRITTEN AS SUCH - Insurance written to cover a specific peril and specifically referred to as such, as opposed to insurance which may incidentally cover the peril, e.g., flood insurance written under a flood insurance policy versus a personal property floater, which would cover flood among a myriad of other perils.

XPL - See LOSS IN EXCESS OF POLICY LIMIT.