



from the desk of the Chief Underwriter

This is another in a continuing series of articles concerning underwriting risk selection topics. Zurich Life Underwriting Viewpoint will include both medical and non-medical topics, as well as provide current items and trends of interest to all of our marketing distribution partners.

Reinsurance: It's Function and Importance

One of the fundamental principles of insurance is to spread risk such that no one claim, or group of claims, will impair a company's ability to meet their financial obligations. The life insurance industry uses the same principle of spreading risk with regard to individual lives or blocks of insured lives.

Most direct writing insurers have what are known as "treaties" with reinsurers for the purpose of limiting the amount of risk they accept. Each insurance company also has what is called a "retention limit," which is the maximum amount the company will retain. Reinsurers also have retention limits for the maximum amount of coverage they are willing to retain. Any amounts in excess of those limits are reinsured through their reinsurers who are called "retrocessionnaires."

Ceding companies generally have "automatic" reinsurance limits with their reinsurers for each product. Automatic limits are set at amounts mutually acceptable to the ceding company and reinsurer, and specify the face amount of coverage and age of applicant that the reinsurer is willing to accept "automatically" based solely on the underwriting decision of the ceding company.

Any applications over the automatic limits are underwritten on a "facultative" basis, which means the reinsurer (or retrocessionnaire) would have to see all the application papers and evidence of insurability before accepting their portion of the risk. This transaction is usually invisible to the agent and client.

Reinsurance treaties also contain language that can limit the total amount of insurance to be issued based on the total amount of coverage in force, applied for, or pending with the ceding company as well as other companies. This term used to describe this situation is limit is called a "jumbo limit." For example, if Company A has a jumbo limit of \$10,000,000 and receives an application for \$2,000,000 on an applicant who already has \$10,000,00 in force, then this case must be underwritten on a facultative basis by Company A regardless of their individual retention limit.

Consequently, it is not difficult to "lock up" the reinsurance market on one large case, or multiple large case application submissions to many ceding companies. Reinsurers "reserve facilities" on a first come, first serve basis. Reserving facilities means that the reinsurer will commit their retention limit to the first company that contacts them with an application up to the reinsurers retention limit.

Some carriers also have what are known as "lead" reinsurer agreements. A lead reinsurer is one that has been given approval by one or more other reinsurers to bind them automatically, up to a certain limit, as if each reinsurer had actually underwritten the case. Thus, each reinsurer agrees to be bound by the underwriting decision of the lead reinsurer. The overall result to the client and broker is faster time service and a consistent decision due to only one reinsurer being involved in the direct underwriting process.