

SECTION 12

REINSURANCE

CHAPTER I REINSURANCE

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- Reinsurance is the **transfer** from one insurance company (the ceding company) to a second insurance company (the reinsurer - assuming company) all or part of a **risk** originally accepted by the first company
- As at December 31, 1996, reinsurance of \$122 million was deducted from Export Development Corporation – Canada insurance policies in force leaving a contingent liability on insurance and guarantees of \$7.4 billion
- EDC remains fully liable to policyholders for the insurance obligations with recourse to the reinsurer

Two main types of reinsurance:

- Treaty reinsurance
 - coverage on predetermined book of business
- Facultative reinsurance - EDC's Experience
 - individual risks are reinsured by offer and acceptance

Three Methods of achieving spread of risk:

- Proportional method
- Excess of Loss
- First Loss

Common types of first (and excess of) loss insurance:

- Per risk
- Per event
- Stop Loss
- Spread Loss

Common types of proportional reinsurance:

- Quota Share
- Surplus Share

Example

EDC has provided Foreign Investment Insurance to Oil and Gas Pipelines, a Canadian oil and gas transportation company, to cover the political risks associated with its equity investment in a project in Venezuela. Total insured volume is \$140 million and premium is \$3 million. ABC Reinsurance provided reinsurance of \$40 million in respect of Transfer and Expropriation risk on a first loss basis. The reinsurance premium is \$1 million.

EXAMPLE OF TERMS OF REINSURANCE AGREEMENT

- Liability
 - Reinsurer liable to EDC on a first loss basis up to \$40 million with respect to losses arising as a result of Transfer risk or Expropriation risk.
 - EDC retains for its own account 100% of the excess of Transfer and or Expropriation losses above \$40 million up to \$140 million.
- Premium
 - Full premium for EDC's share and reinsurer's share billed and received by EDC. Reinsurer to receive their share of premium within 45 days of effective date of Agreement.
- Payment of Loss by Reinsurers
 - When reinsurers liable to EDC in respect of payment of loss, EDC will give reinsurers advance notice and request payment from reinsurer of its percentage share of loss be received by EDC on the date payment is to be made to insured.
- Recoveries
 - Recoveries to be retained by EDC and shared between EDC and reinsurer on a proportional basis. Recovery expenses to also be shared on a proportional basis.

Maximum Liability Schedule				
Policy No: FLL-01-0001				Claims
From	To	Maximum Liability		Expiry
Date	Date	Amount	Currency	Date
Feb 1,1997	Jan 31,2002	140 million (GROSS)	Cdn.	Jan 31, 2003
		40 million (CEDED)		
		100 million (NET)		

REINSURANCE ACCOUNTING ENTRIES

1) GL Entries created upon issuance of policy

Premium receivable	2,000,000	
Reinsurance premium receivable	1,000,000	
Deferred premiums		3,000,000
(to record receivables)		
Deferred reinsurance premiums	1,000,000	
Reinsurance premium payable		1,000,000
(to record amount due to reinsurer)		

2) Monthly recognition of premium income and provision

Deferred premiums	50,000	
Reinsurance income ceded	16,667	
Deferred reinsurance premiums	16,667	
Premium income	50,000	
(to record monthly premium income)		
Provision expense	25,000	
Allowance for claims (ceded)	8,333	
Provision expense (ceded)	8,333	
Allowance for claims	25,000	

(to record monthly provision expense at 50%)

1. $\$3,000,000/5 \text{ yrs} = \$600,000/12 = \underline{\$50,000}$

2. $\$1,000,000/5 \text{ yrs} = \$200,000/12 = \underline{\$16,667}$

3) Receipt of premium

Bank	3,000,000	
Medium term bank suspense		3,000,000

4) Allocation of cash receipt

Medium term bank suspense	3,000,000	
Premium receivable		2,000,000
Reinsurance premium receivable		1,000,000

5) Cash Disbursement

Reinsurance premium payable	1,000,000	
Bank		1,000,000

REINSURANCE RECONCILIATION AT END OF POLICY TERM

Deferred Premiums	Premium Receivable	Premium Income			
3,000,000 (2)	3,000,000 (1)	2,000,000 (1)			
		2,000,000 (4)			
		3,000,000 (2)			
<table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="text-align: center; border-bottom: 1px solid black;">Provision Expense</th> <th style="text-align: center; border-bottom: 1px solid black;">Allowance for Claims</th> </tr> </thead> <tbody> <tr> <td style="border-right: 1px solid black; padding: 5px;">1,500,000 (2)</td> <td style="padding: 5px;">1,500,000 (2)</td> </tr> </tbody> </table>		Provision Expense	Allowance for Claims	1,500,000 (2)	1,500,000 (2)
Provision Expense	Allowance for Claims				
1,500,000 (2)	1,500,000 (2)				

Reinsurance Premium Rec	Deferred Reinsurance Premiums	Reinsurance Premium Payable
1,000,000(1)	1,000,000(1)	1,000,000(1)
1,000,000(4)	1,000,000(2)	1,000,000(5)

Reinsurance Income Ceded	Provision Expense (Ceded)	Allowance for Claims (Ceded)
1,000,000(2)	500,000(2)	500,000(2)

REINSURANCE RECONCILIATION

Bank	Medium Term Suspense
3,000,000(3)	3,000,000(4)
1,000,000(5)	3,000,000(3)

FINANCIAL STATEMENT PRESENTATION REINSURANCE

Balance Sheet

Allowance for claims

Gross \$1,500,000

Reinsurance ceded (500,000)

Net allowance for claims \$1,000,000

Note: Disclosure either on Balance Sheet or in Notes to Financial Statements.

INCOME STATEMENT

Revenues

Gross premiums earned	\$3,000,000
Reinsurance premiums ceded	(1,000,000)
Net premiums earned	\$2,000,000