

# Professional Liability Reinsurance

*August 13, 2024*

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# What is Reinsurance?

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- **Re/Insurance Characteristics**
  - Sharing/Transfer of Risk (Pure vs. Speculative)
  - Indemnification
  - Law of Large Numbers (Pooling Experience)
  - Fortuitous Events
  - Insurable Interest
- **Definition**
  - Insurance for *insurance* companies
- **Retrocession**
  - Insurance for *reinsurance* companies

## **Formally**

*“The transaction whereby the reinsurer, for a consideration [premium], agrees to indemnify the ceding company against all or part of the loss that the latter may sustain under the policy or policies which it has issued.”*

# Historical Context – Basic Concepts

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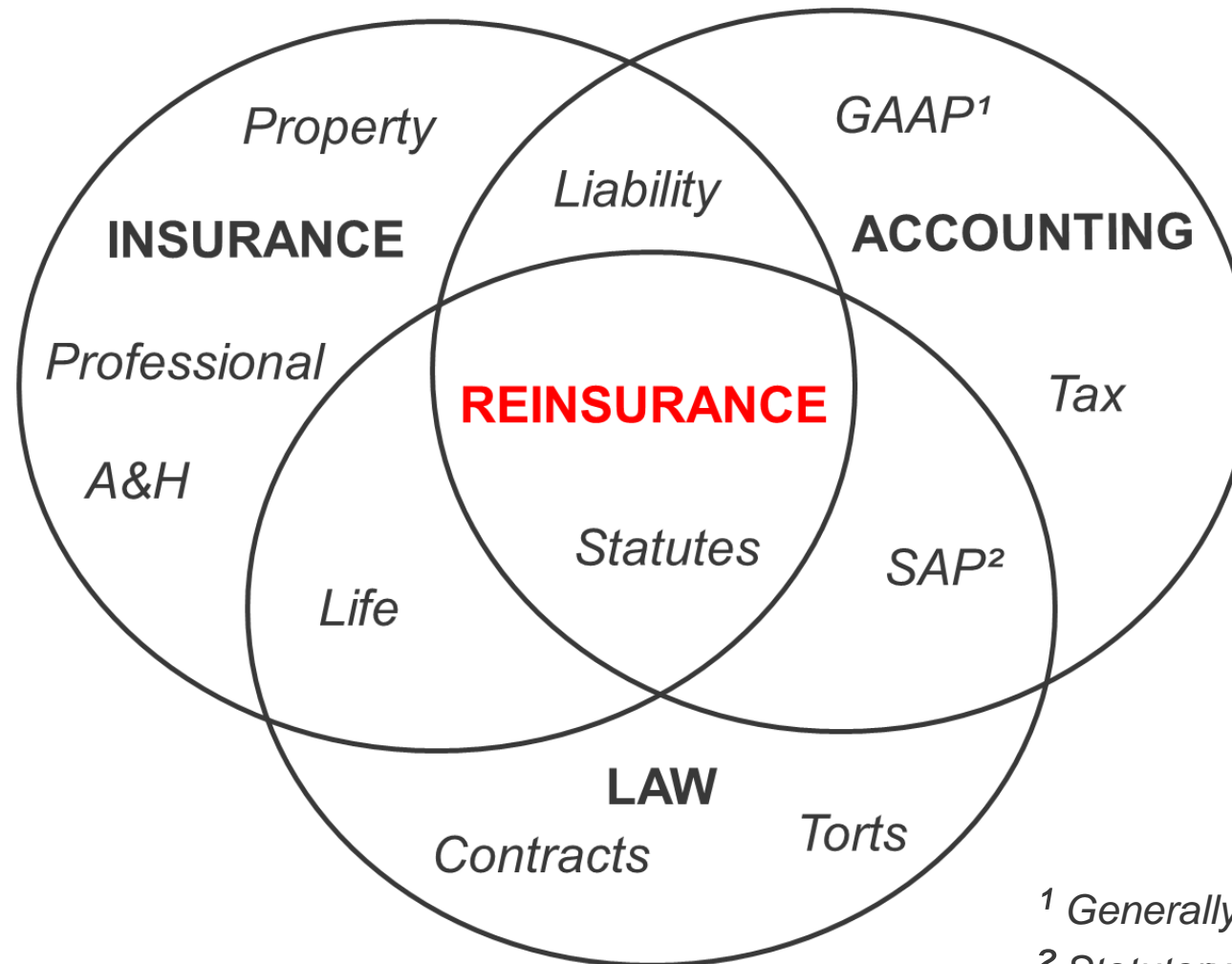
- Utmost Good Faith
- Follow the Fortunes
- Capacity, Reciprocity, and Syndication

# Misconceptions

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- Partnership
- Coinsurance
- Banking/Financing

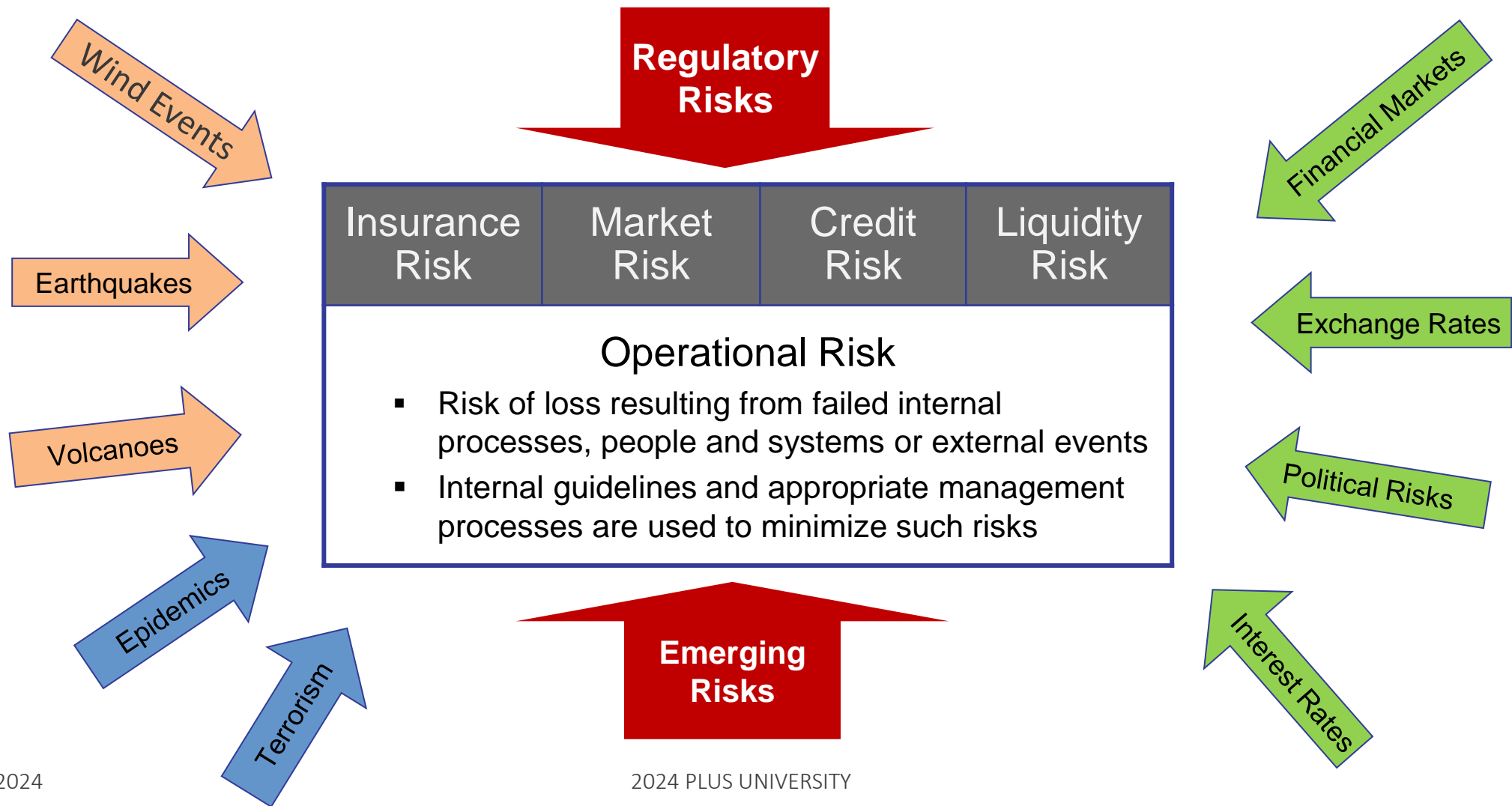
# Modern Foundations



<sup>1</sup> Generally Accepted Accounting Principles

<sup>2</sup> Statutory Accounting Principles

# Global Re/Insurance Risks





# Who, Why and How?

# Who - Classifying (Re)Insurers

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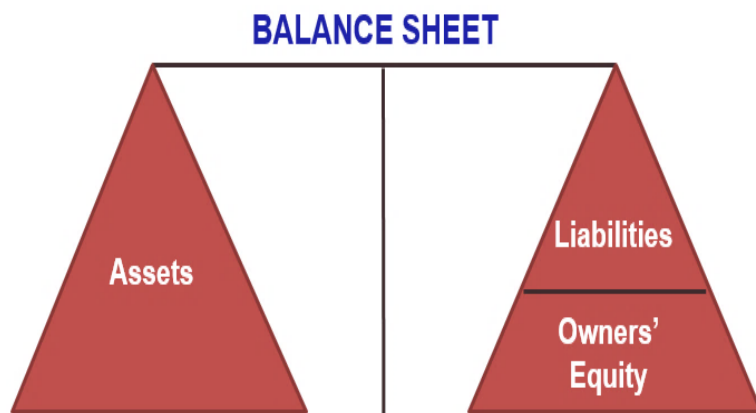
## Ownership

- Proprietary (Including Lloyd's)
- Cooperative(s)
  - Mutual
  - Reciprocal Exchange
  - Captives & Risk Retention Group (RRG)
  - Government, others
- Pools (State/Industry sponsored)

## Licensing Status

- Licensed (Admitted) or Authorized (Accredited)
- Unlicensed/Foreign (Non-Admitted) or Unauthorized (Non-Accredited)
- Off-Shore ("Alien")

# Why – First, Some Accounting Concepts



Understanding financial statements  
is important for grasping insurance  
& reinsurance concepts

| Income Statement<br>For the Year Ended December 31, xxxx |                   |
|--|-------------------|
| <b>Revenues and gains:</b>                               |                   |
| Sales, net   | \$ 785,250        |
| Interest income  | 62,187            |
| Gain on sale of plant assets                             | 24,600            |
| <b>Total revenues and gains</b>                          | <b>872,037</b>    |
| <b>Expenses and losses:</b>                              |                   |
| Cost of goods sold                                       | \$ 351,800        |
| Selling Expenses   | 197,350           |
| General and Admin. Exp.                                  | 78,500            |
| Depreciation   | 17,500            |
| Interest   | 27,000            |
| Income taxes   | 62,500            |
| Loss: sale of investment                                 | 9,000             |
| <b>Total expenses &amp; losses</b>                       | <b>743,650</b>    |
| <b>Net income</b>  | <b>\$ 128,387</b> |

## Generally Accepted Accounting Principles (GAAP)

| Balance Sheet |   |             |   | Income Statement |  |            |                       |
|---------------|---|-------------|---|------------------|--|------------|-----------------------|
| Assets        | = | Liabilities | + | Owners' Equity   |  | Net income | = Revenues – Expenses |

## "Comparable" Statutory Accounting Principles (SAP)

| Assets, Liabilities, Surplus and Other Funds |   |                                   |   | Statement of Income    |  |              |                                |
|--|---|-----------------------------------|---|------------------------|--|--------------|--------------------------------|
| Net Admitted Assets                          | = | Loss Reserves & Other Liabilities | + | Policyholders' Surplus |  | Net income * | = Premiums Earned – "Incurred" |

\* Note: Underwriting perspective, not a portrayal of overall Net Income

# Why is Reinsurance Purchased?

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## Several “Needs” May Exist

- Capacity
- Stability
- Catastrophe Protection
- Premium Growth
- Other

# Capacity

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- Risk or “Large Line”
- Regulations affecting insurers
  - The “10% Rule”
- Risk Appetite / Manage limits / Common Sense

# Stability

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- Limit large fluctuations in results
- Greater predictability in loss ratio
- Need to satisfy shareholders, policyholders, regulators, investors

# Catastrophe Protection

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## Protects insurers against:

- Historically
  - *Property Per Occurrence Catastrophe*
- Defined as
  - *Multiple policies involved in a single catastrophic loss or event*
- Today, broadly available to cover property and casualty involving
  - *Multiple insureds covered by a policy or policies involved in a catastrophic loss or event*

# Premium Growth / Capacity

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- Also referred to as “Surplus Relief”
- Arises from conservative nature of Insurance accounting principles (SAP)
- New/Growing insurers need to “finance” the premiums they write
- One Measure:

$$\text{“Leverage Ratio”} = \frac{\text{Net Premiums Written (NPW)}}{\text{Policyholders' Surplus (PHS)}}$$

## 2023 P&C Industry

NPW \$ 857b

PHS \$ 1,043b

NPW : PHS

\$ 0.82 : \$ 1.00

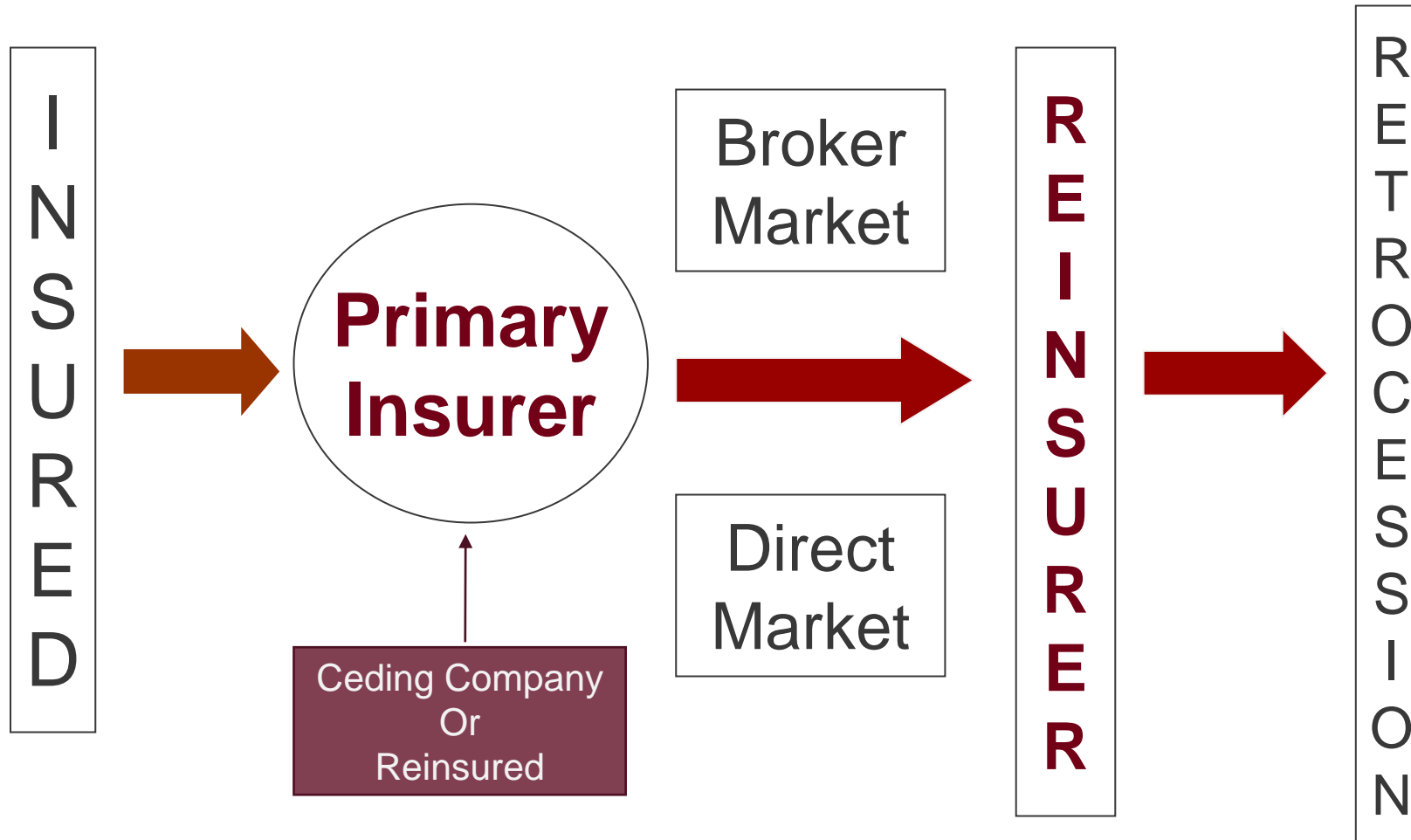


# Other Functions

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- Expertise (Claims, Underwriting, etc.)
- Entry into new classes/territories
- Exit from classes/territories
- Capital preservation
- Rating agency considerations
- Regulatory concerns

# How - Insurance/Reinsurance Distribution



# Types of Reinsurance

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- Facultative
- Treaty
- Other (Hybrid/Financial)

# Facultative Reinsurance - Characteristics

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- *Individual risk* review/underwriting
- Contract / Agreement: “Certificate” issuance
- Treaty protection / Hazardous risks
- Hybrid agreements
- Advantages / Disadvantages
- Professional liability focus

# Treaty Reinsurance - Characteristics

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- ***Portfolio or Group*** of policies (Class/Line(s) Of Business)
- Obligatory reinsurer acceptance
- Pooling effect
- Agreement/Treaty – multiple risks/exposures
- Professional liability focus

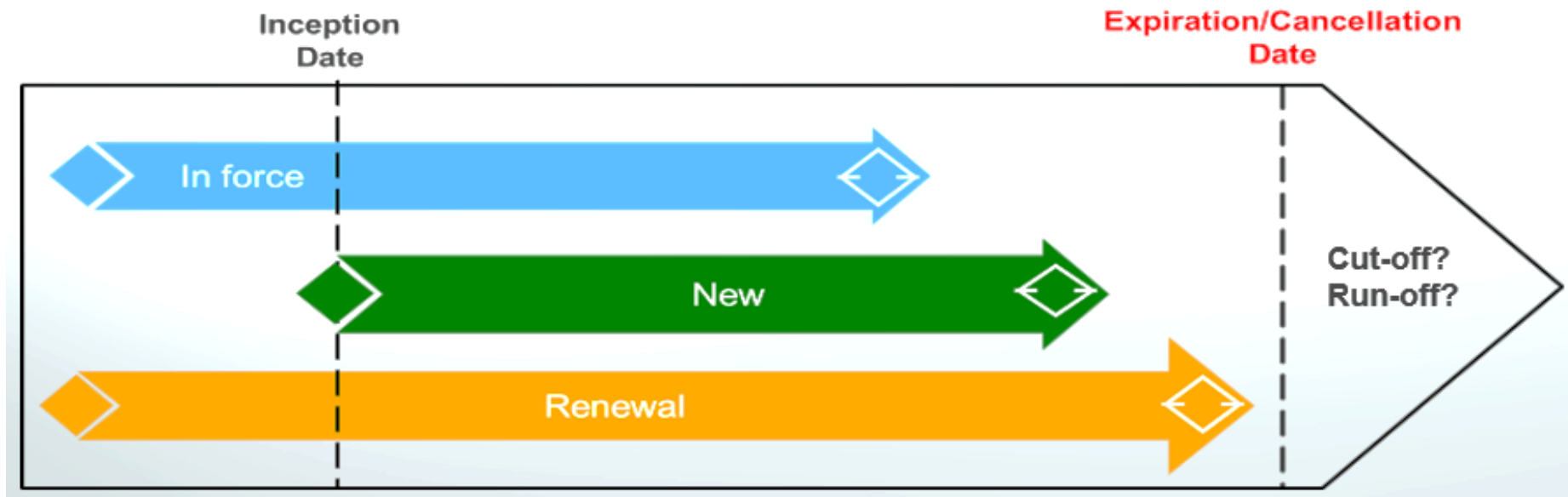
# Forms of Reinsurance Agreements

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- Proportional (Pro Rata)
- Non-Proportional (Excess of Loss)

# First - How Policies Are Re/Insured

- **Insurance** companies write new and renewal policies on a “Term” basis with each policy having an inception date and expiration date
- **Reinsurance** contracts may reinsure these policies on either a
  - Term basis – also includes an inception and expiration date, or
  - Continuous basis – includes an effective/inception date and cancellation date
- Reinsurers must further consider “**attachment**” – Losses Occurring During or Risks/Policies Attaching



# Forms of Reinsurance Agreements

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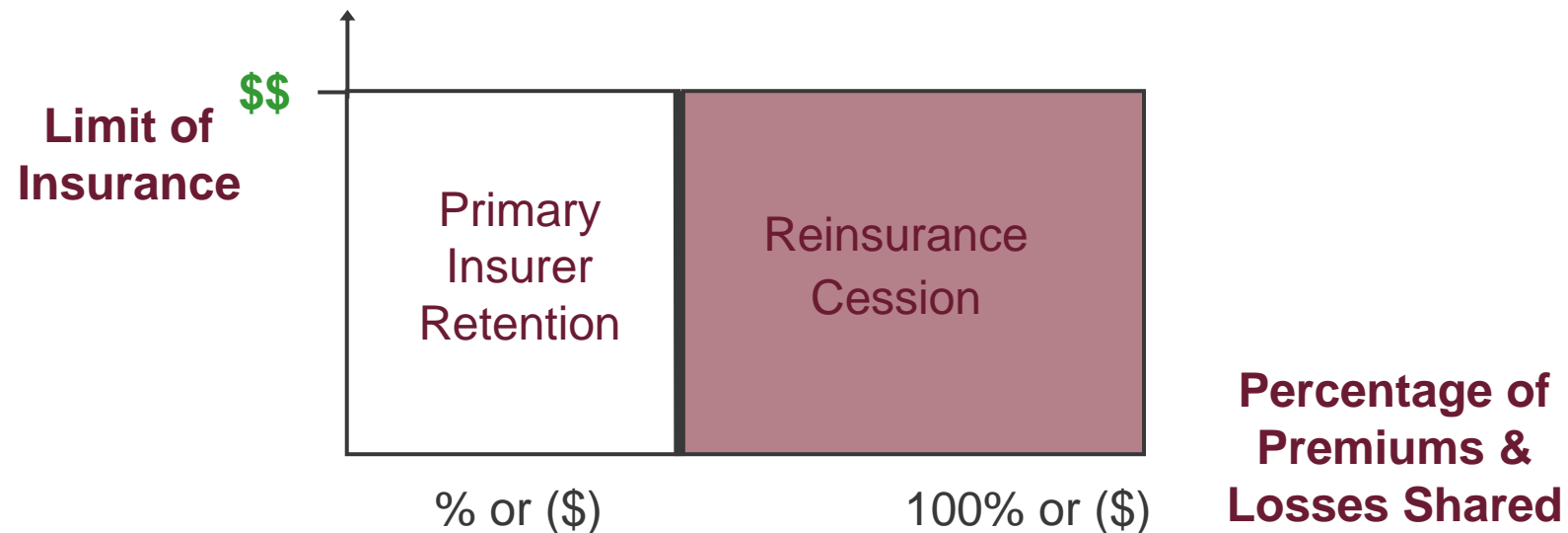
## Proportional (Pro Rata)

- Principal of *sharing* - premium, limits, losses, etc.
- Reinsurance applications:
  - Quota Share – percentage shared is *fixed* based on negotiation
  - Surplus Share – percentage shared *varies* based on dollar amount(s) retained
- Professional liability focus



# Proportional Reinsurance

- Quota Share - Retention expressed as fixed % of policy limit(s)
  - Variable Quota Share – alternative (used less frequently)
- Surplus Share - Retention expressed in \$ resulting in variable % sharing



# Forms of Reinsurance Agreements

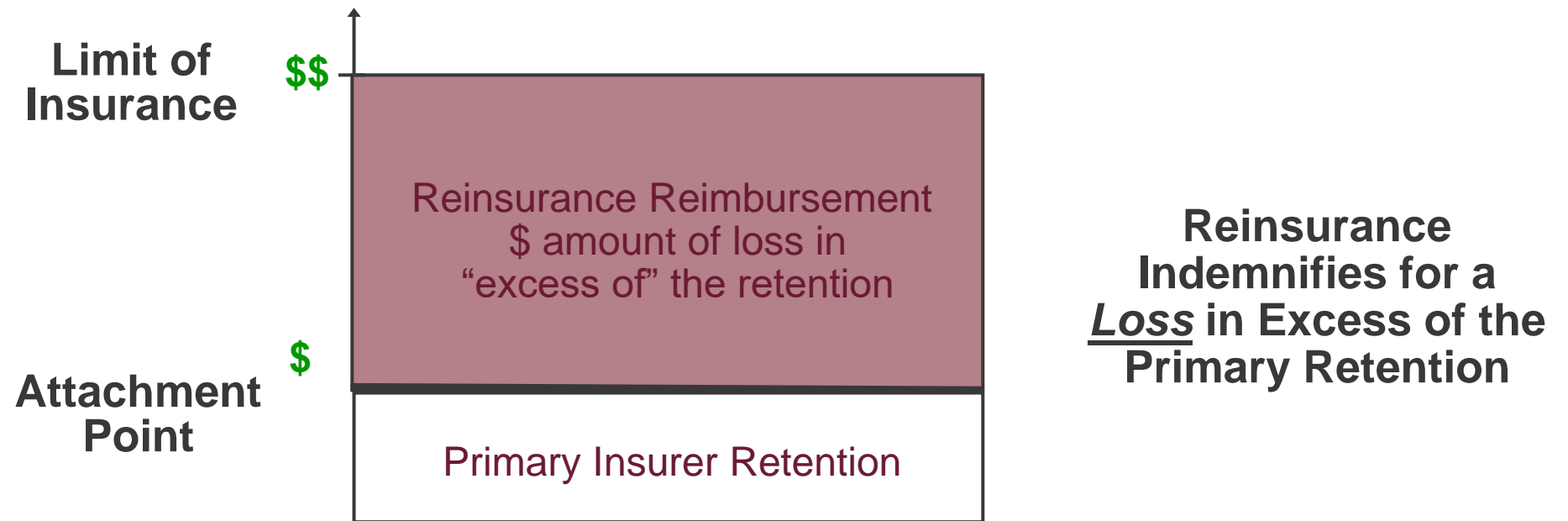
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## Non-Proportional (Excess of loss “XOL”)

- Principal of *indemnification*
- Reinsurance may apply on one or more bases:
  - Per risk / Per occurrence / **Per claim**
  - Per policy
  - Per Occurrence Catastrophe (Property)
  - Per Occurrence / Event Clash (Casualty)
  - In the Aggregate (Loss Ratio or Stop Loss)

# “Excess of Loss” Non-Proportional Reinsurance

## Indemnification Concept

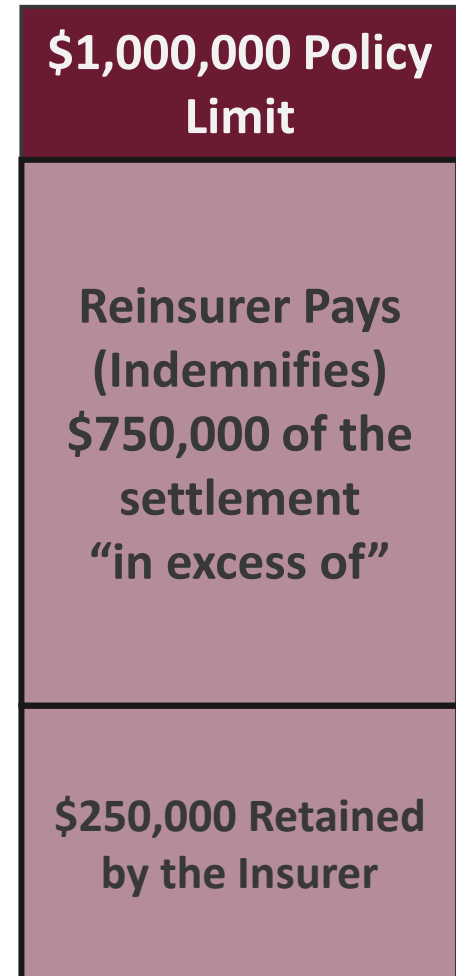


Note:

- “Attachment point” may apply on one of many bases (see prior slide)
- Layering - an important concept, discussed later

## Example: Excess of Loss (XOL)

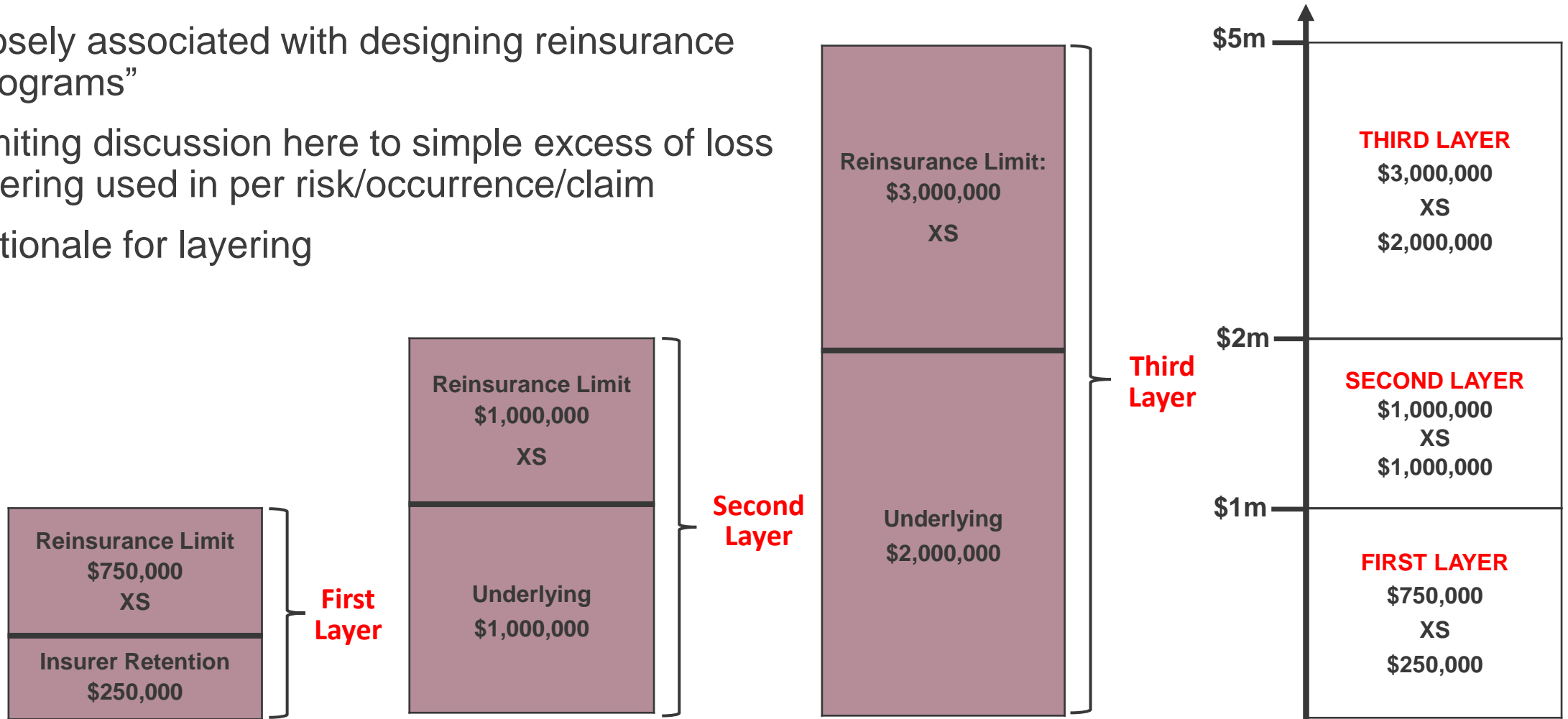
- The Insurer wrote \$1 million “claims-made” policy and purchased:
  - Excess of Loss Reinsurance providing \$750,000 excess of \$250,000 per claim
- Dr. Klutz, an orthopedic surgeon, failed to properly treat a fracture suffered by a high school athlete
- Dr. Klutz and the insurer were able to settle the case for \$1,000,000 (including expenses)



# Reinsurance “Layering”

- Closely associated with designing reinsurance “programs”
- Limiting discussion here to simple excess of loss layering used in per risk/occurrence/claim
- Rationale for layering

Concept of  
“Reinsurance  
Tower”



# Example: Clash Coverage

- Instead of ‘per claim’ coverage an insurer purchases the following
  - Per Event / Clash reinsurance providing the following reinsurance protection:  
\$5,000,000 excess of \$500,000 **per medical incident**
- Dr. Klutz was involved in another case **with two of his associates** that was settled for a total of \$3,000,000, with fault apportioned equally among the three doctors (\$1M each)
- Each doctor was covered under a \$1,000,000 policy

| Limits   | Dr. Klutz                        | Dr. Slow               | Dr. Prone              | Total       |
|--|----------------------------------|------------------------|------------------------|-------------|
| Loss   | \$1,000,000                      | \$1,000,000            | \$1,000,000            | Recovery    |
| Reinsurance Limit<br>\$5,000,000<br>“in excess of” | Paid Loss<br>\$833,333           | Paid Loss<br>\$833,333 | Paid Loss<br>\$833,333 | \$2,500,000 |
| Retention  | \$500,000<br>Retained by Insurer |                        |                        | \$500,000   |

# Additional Reinsurance Issues

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- Attachment Basis / “Insuring Reinsurance”
- Contract Wording / Documentation
- Pricing Issues (Primary & Reinsurance)
- Trends and Emerging Issues
- And much more...



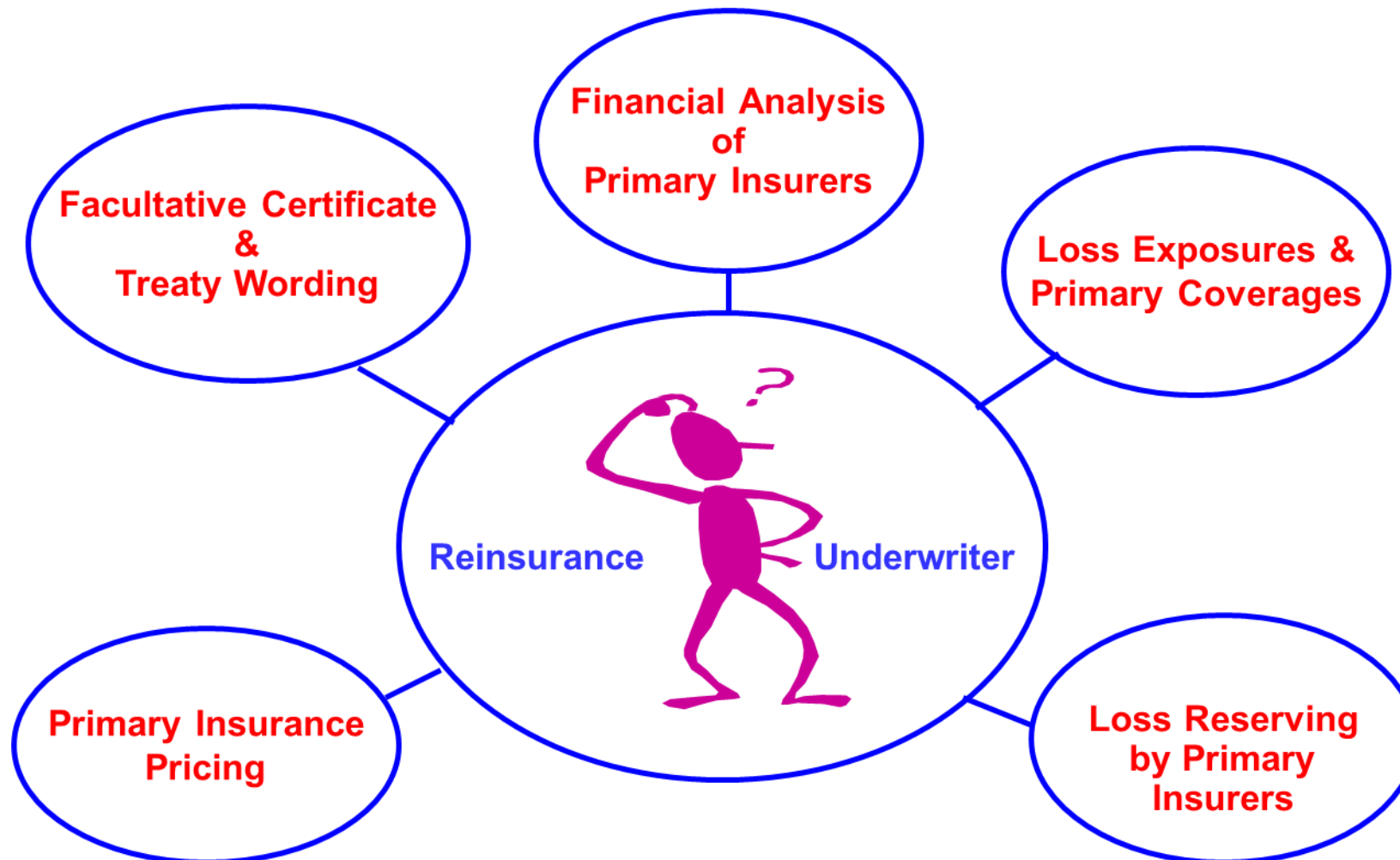
# Reinsurers - Global and U.S. Competition

- S&P identifies 152 reinsurance organizations in 32 countries
- Difficult to distinguish between **primary insurance and reinsurance** premiums
- Note: Not all on Calendar Year basis; foreign exchange rates add volatility

| Worldwide Reinsurance Market, NPW Est. \$260.6B<br>World's Largest Reinsurers (Life & Non-Life) |                                    |          | North America/Western Europe, Est. \$ 227.0B<br>U.S. Largest (Non-Life) Reinsurers (\$80.1B NPW) |   |          |
|---|------------------------------------|----------|--|---|----------|
| Rank  | Company                            | 2022 NPW | Rank   | Company                                 | 2022 NPW |
| 1   | Munich Reinsurance Company         | 48.748   | 1  | National Indemnity Co.                  | 33.089   |
| 2   | Swiss Reinsurance Company          | 43.917   | 2  | Everest Reinsurance Company             | 8.056    |
| 3   | Hannover Rueckversicherung AG      | 31.970   | 3  | Endurance Assurance Company             | 6.817    |
| 4   | Berkshire Hathaway Re              | 22.147   | 4  | Munich Re America, Corp.                | 6.673    |
| 5   | SCOR S.E.                          | 17.047   | 5  | Transatlantic Reinsurance Company       | 4.751    |
| 6   | China Reinsurance (Group) Corp.    | 15.453   | 6  | Odyssey Group                           | 4.433    |
| 7   | Lloyd's (Re only)                  | 14.303   | 7  | General Re Group                        | 4.263    |
| 8   | Reinsurance Group of America, Inc. | 13.078   | 8  | Swiss Reinsurance America Corporation   | 3.611    |
| 9   | Everest Re Group Ltd.              | 12.344   | 9  | Partner Reinsurance Company of the U.S. | 2.562    |
| 10  | PartnerRe Ltd.                     | 7.544    | 10   | SCOR U.S. Corporation                   | 1.606    |
| Source: S&P (TransRe #13 Globally)  |                                    |          | Source: Reinsurance Association of America (RAA)   |   |          |



# Finally: What Do Reinsurance Underwriters Really Do?



# Questions?

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# Thank you!