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# Reinsurance Demystified

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Tim Fletcher is a vice president based in Gen Re's Atlanta office. He oversees the specialty lines of business that consist of professional liability and employment liability claims. In his role at Gen Re, Tim manages a staff of experienced claims executives and provides advice on various claim and legal issues.

Tim earned a bachelor's degree in journalism from the University of Minnesota and a law degree from the William Mitchell College of Law. Tim is admitted to the Georgia bar and also holds a Chartered Property Casualty Underwriter designation. He is a guest lecturer at the Georgia State University J. Mack Robinson College of Business.


*Keith Katsma*
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Keith is a vice president based in Gen Re's Chicago office. His focus is on auto, general liability, and umbrella claims. Keith obtained his undergraduate degree in economics from the University of Illinois at Chicago. His law degree is from the IIT/Chicago-Kent College of Law, and he was admitted to the Illinois bar in 1984.

Session Description:
Join this session to learn – in understandable terms – the different types of reinsurance and the reasons companies purchase it. The presentation will include a real-world case study that illustrates how a reinsurance claims professional can lend expertise to a complex case in a way that helps the reinsurer and the ceding-company client.

Top Three Session Ideas

*Tools or tips you learned from this session and can apply back at the office.*

1. ______________________________

2. ______________________________

3. ______________________________

# Reinsurance Demystified

## Session Outline

Overview

What is Reinsurance?

Why Buy Reinsurance?

What is Reinsurance?
- Insurance vs. Reinsurance

Types of Reinsurance
- Facultative
- Treaty/Program
- Quota Share
- Excess of Loss

What About Expenses?
- Pro Rata
- Added to Loss

Q & A

# Reinsurance Demystified

Keith Katsma
Tim Fletcher

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## What is Reinsurance?

- Agreement between two companies
  - Reinsurer
  - Ceding company ("Cedent")
- Reinsurer agrees to indemnify cedent for all or part of loss sustained by cedent under policy or line of polices
- In essence, reinsurance is "insurance for insurance companies."

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# Why Buy Reinsurance?

- Capacity (Premium and Large Line)
- Spread Risk / Stabilize Loss Experience
- Protect against Excess Verdict and Extra Contractual ("Bad Faith") Exposure
- Gain Underwriting and Claims Assistance
- Obtain Relief for Catastrophic Storm Event

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# What is Reinsurance?

## Insurance

- Contract between company and individual or entity
- Insurer deals with policyholder
- Subject matter: Property, Person, Benefit or Legal Liability
- Highly regulated
- Many small claims constitute bulk of reserves and payments
- Fast loss development

## Reinsurance

- Contract between two companies; sophisticated purchasers
- Reinsurer deals with cedent
- Subject matter: Defined portion of insurer's contractual liability
- Not highly regulated
- Few large claims constitute bulk of reserves and payments
- Slow loss development

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## Types of Reinsurance

- Facultative
  - Per risk / Policy
  - Example: XYZ Construction's umbrella policy
- Treaty / Program
  - Contract encompasses entire class of business with specific terms, conditions and amount of reinsurance provided for each risk
  - Example: All of Ceding Company's umbrella policies

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## Types of Reinsurance

- Quota Share:
  - Reinsurer and Cedent share loss based on state percentage
  - "Ground Up" / "Dollar One"
- Excess of Loss
  - Reinsurer pays percentage of loss over stated amount or retention
  - Retention tailored to cedent's risk appetite and may vary over time

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## Types Of Reinsurance

- "Fac" and "Treaty" can be either Quota Share or Excess of Loss
- "Treaty" can have more than one coverage layer
  - Example: 40% Quota Share for first $1,000,000 and 100% of $9,000,000 xs $1,000,000
- On some occasions "fac" and "treaty" can apply to the same risk

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## What About Expenses?

- Pro Rata
  - Reinsurer's ALAE is proportionate to its share of loss
  - Example: Reinsurer pays 50% of $1,000,000 loss. Expenses reimbursed at 50%
- Added to Loss
  - ALAE added to loss before paying loss
  - Can result in recovery for indemnity payment less than retention
  - Erodes available limits similar to primary policy

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**Facts**

This loss takes place in a state that applies "Pure Comparative" negligence with no joint and several liability.

Jeff Locke is the founder and principal owner of JL Homebuilders ("JL") which constructs high-end homes. Several years ago, Locke and his wife Lynne (now known as Lynne Smith) divorced. Locke and Smith share custody of their 16-year-old son John, with John spending each Wednesday and every other weekend at Locke's house. However, John is at the Locke's much more than what's called for in the custody agreement.

JL owns a 1998 GMC Yukon which John frequently uses. Three days prior to the date of loss, the Yukon went in for a transmission replacement and was to be out of service for several days. Locke called his friend Greg Coleman to seek permission to use Coleman's 2005 Chevy Tahoe that had been parked in the Locke's driveway while Coleman's son Gary attended an out-of-state wedding. Wanting to help his longtime friend, Coleman agreed and knew that John would be using the vehicle.

That night, John took the Tahoe to an underage drinking party held in a field outside of town after sunset. Attending were Rich Karlis and Rick Danmeier, Mitch Berger and multiple other minors. (Likely due to their parents divorcing at roughly the same, Karlis and John Locke had become close friends.) All involved became intoxicated, particularly Danmeier. After several hours, John Locke gave into Karlis's repeated pleas to drive the Tahoe. Berger and Danmeier jumped into the Tahoe. Karlis then circled the party at increasing speed with the headlights off. Concerned about Karlis's erratic driving, several partygoers called his cell phone and urged with him to stop. Karlis finally did so. Just as John Locke told Karlis to park the car, Karlis slammed on the accelerator and struck Danmeier who had just exited the car.

Danmeier is now tetraplegic with limited use of his arms. His parents retain counsel and file suit.

**Damages**

| | |
|---|---|
| • Past Medical Expenses: | $905,225.32 |
| • Future Medical Expenses: | $18,698,734.00 |
| • Lost Earning Capacity: | $9,780,508.00 |
| • Pain And Suffering: | $7,500,000.00 |
| • Increased Risk of Future Complications: | $1,000,000.00 |
| Total: | $37,884,467.32 |

**Coverage**

| Carrier | Insured | Vehicle | Limit |
|---|---|---|---|
| Midwest Insurers Company ("MIC") | JL Homebuilders | 1998 GMC Yukon | $1,000,000 Cmcl Auto<br>$4,000,000 Cmcl Umb |
| Upscale Insurers, Ltd. ("UIL") | Greg Coleman | 2005 Chevy Tahoe | $1,000,000 Pers Auto<br>$5,000,000 Pers Umb |
| Auto Insurers USA ("AIU") | Jeff Locke | | $500,000 Pers Auto<br>$1,000,000 Pers Umb |
| Auto Insurers USA ("AIU") | Lynne Smith | | $500,000 Pers Auto<br>$1,000,000 Pers Auto |
| Patriot Insurance Company ("PIC") | Don Karlis (Rich's Father) | | $100,000 Pers Auto |
| State Farmers Alliance ("SFA") | Stacey Moran (Rich's Mother) | | $100,000 Pers Auto |

**Questions For Discussion**

- Under which of the above policies can John Locke claim coverage?
- Under which of the above policies can Rich Karlis claim coverage?
- How do you assess liability? To what extent does John Locke bear responsibility and under what theory?
- What is the priority of coverage? Which policies should exhaust first? Must one policy and umbrella exhaust first? Or, should all of the primary policies first exhaust before the umbrella policies are reached?

# Key Policy Language

## Auto Insurer's USA ("AIU") Primary Policy, Section IV:

The Liability Coverage provided for **your automobile** also applies to an **automobile** not:
owned by or furnished or available for regular use to you or anyone living with **you.** However, **we** will cover your liability for **your** use of an **automobile** owned by or furnished for the regular use of a **relative.**
b. We extend this coverage only:
(1) to **you;**
(2) to **relatives** who do not own an **automobile**

## AIU Definitions:

"**Relative**": person who resides with you and is related to you by blood, marriage, or adoption.
"**You**" and "**Your**": named insured and his or her spouse

## AIU Umbrella – "Insured" Definition:

(a) A relative, except with respect to aircraft or Watercraft. However, any use of a non-owned auto, other than a temporary substitute auto, by a relative must be with the reasonable belief that such use is with, and within the scope of, the permission of the owner:
(b) Any person using an automobile or watercraft you own, hire or borrow and any person or firm liable for the use of such vehicle or craft. Any person using an aircraft you own. Actual use must be with the reasonable belief that such use is with, and within the scope of, your permission;
(c) Any person using an automobile your relative owns, hires or borrows. Actual use must be with the reasonable belief that such use is with, and within the scope of, your relative's permission.

## AIU Umbrella – "Relative" Definition:

(a) **Your** relative who resides in your household and
(b) Anyone else, under the age of 21, in your care, who resides in your household.

## ISO Personal Auto - "Other Insurance" Clause:

If there is other applicable liability insurance we will pay only our share of the loss. Our share is the proportion that our limit of liability bears to the total of all applicable limits. However, any insurance we provide for a vehicle you do not own, including any vehicle while used as a temporary substitute for "your covered auto," shall be excess over any other collectible insurance.

## ISO Personal Umbrella - "Other Insurance" Clause:

The coverage afforded by this Policy is excess over any other insurance available to an "insured," except insurance written specifically to be excess over this policy.

# Key Policy Language

## ISO Commercial Auto - "Other Insurance" Clause:

a. For any covered "auto" you own, this coverage form provides primary insurance. For any covered "auto" you don't own, the insurance provided by this coverage form is excess over any other collectible insurance. However, while a covered "auto" which is a "trailer" is connected to another vehicle, the Liability Coverage this coverage form provides for the trailer is:
   (1) Excess while it is connected to a motor vehicle you do not own.
   (2) Primary while it is connected to a covered "auto" you own.

b. For Hired Auto Physical Damage Coverage, any covered "auto" you lease, hire, rent or borrow is deemed to be a covered "auto" you own. However, any "auto" that is leased, hired rented or borrowed with a driver is not a covered "auto."

c. Regardless of the provisions of Paragraph a. above, this coverage form's Liability Coverage is primary for any liability assumed under an "insured contract."

## ISO Commercial Umbrella - "Other Insurance" Clause:

a. This insurance is excess over, and shall not contribute with any other insurance, whether primary, excess, contingent or on any other basis. This condition will not apply to insurance specifically written as excess over this Coverage Part.

   When this insurance is excess, we will have no duty under Coverages A or B to defend the insured against any "suit" if any other insurer has a duty to defend the insured against that "suit." If no other insurer defends, we will undertake to do so, but will be entitled to the insured's rights against all those other insurers.

b. When this insurance is excess over other insurance, we will pay only our share of the "ultimate next loss" that exceeds the sum of:
   (1) The total amount that all such other insurance would pay for the loss in the absence of this insurance; and
   (2) The total of all deductible and self-insured amounts under all other insurance.