INSURANCE EXAM · IC-85

IC-85 Reinsurance Management

Revision book

17	2	151
chapters	master tables	numbered sections

FREE SAMPLE: Chapter 1 of 17

CHAPTER 1

Introduction

1.1 Nature
1.2 Factors (five heads)
1.3 Insolvency
1.4 World history
1.5 India
1.6 Functions

MUST KNOW

1. Reinsurance = insurance of the insurer's risk; always a contract of indemnity (even life and PA).
2. **Separate contract:** insurer and reinsurer only; the insured has no link with the reinsurer.
3. **Base principle:** utmost good faith; most vital in automatic (obligatory) treaties.
4. Reinsurer shares insurance fate, not commercial fate; if reinsurer fails, cedant pays insured in full.
5. **Dates:** 1370 Genoa; **1821** first fire contract; **1864** British marine ban ends; **1863** Swiss Re; **1880** Munich Re.
6. **India:** **1956** India Re; **1961** cession **20/10/5%**; **1966** fire and hull pools; **1973** four companies under GIC (Act **1972**).
7. SWIFT = Single Window International Facultative and Treaty; US$ **5 m** (SI) / US$ **2 m** (PML).
8. Excess of loss = biggest development in **100 years**; proportional treaties led by World War I.
9. **Shock absorber:** reinsurance does not cut losses, it makes them easier to carry.

1.1 Nature

- **Law of large numbers:** bigger group, better loss forecast; one insurer's book is never big enough.
- **Scenarios:** catastrophe, accumulation, lack of capacity; insurer cannot ask policyholders for more money; shareholders' working capital is the cushion.
- Dispersion = gap between actual and average losses.
- Indemnity because it protects the insurer's property from his policy duties.

1.2 Factors (five heads)

Head	Items
Original risk	Technical risk; contractual risk (fraud, exaggerated claim); both under Follow the Fortunes
Insurer / reinsurer	Deficient underwriting; generous claims; hasty growth; moral hazard
Beyond control	Exchange rate (reinsurer takes none); inflation; currency limits; reserve deposits; tax
Inherent	Accumulation; indirect shares hard to control; weak organisation
Uberrima fides	Facultative: give all facts; automatic: even more

- **Tax may fall on:** ceded premiums, commissions, profit commissions, interest, loss settlement.

TRAP

- **Examples of breach:** growing motor book on a known weak tariff; understating reserves for profit commission or better XL quote.
- Reinsurer pays full share even if insureds give up part of the claim (insurance fate vs commercial fate).

TODAY'S RULE

Reinsurer may deduct balances due to him in all cases.

1.3 Insolvency

Who fails	Effect
Ceding insurer	Reinsurer pays his full share
Reinsurer	Cedant pays insured in full

1.4 World history

Year	Event
1370	Oldest reinsurance contract, Genoa (marine)
1681	Indirect mention, French royal ordinances
1746	Direct mention; British marine ban
1778	Fire reinsurance reference: royal concession, Copenhagen
1821	First fire reinsurance contract
1864	British ban ends (ban exception: bankruptcy, insolvency, death)

Reinsurer	Note
Cologne Re	Founded 1846, began **1852**; oldest existing; merged with Gen Re
Swiss Re	Started **1863**
Munich Re	**1880**
Mercantile and General	**1917**; first in England

- **Lloyd's:** net account till **1900**; slow because of **1746** law; mid-1880s growth through XL.
- Facultative first; proportional treaties main by World War I; XL filled gap for catastrophe hazards.

Year	Insurers
1850	306 in 14 countries
1900	1,272 in 26 countries
1910	2,540 in 29 countries

- **Why growth:** value at risk up and concentrated; new states (small capital, low retention); links with capital markets.

TRAP

1778 = reference only; **1821** = first contract.

1.5 India

Year	Event
1956	India Reinsurance Corporation formed
1961	Compulsory cession: fire and marine cargo **20%**; marine hull and misc **10%**; credit and solvency **5%**; shared equally by India Re and Indian Guarantee and General
1966	Pools in fire and hull; managed by the two statutory reinsurers
1971	63 domestic + 44 foreign insurers
1973	Four companies: National, New India, Oriental, United India; holding GIC (Act **1972**)

- **After nationalisation:** GIC = Indian reinsurer; aims = more retention, best terms, save foreign exchange.
- **SWIFT:** non-reciprocal inward; about US$ **65 m** premium; US$ **5 m** SI and US$ **2 m** PML; London hard-currency account; S&P 'A' (in its time).
- Four companies matched treaty cessions to reciprocal inward (fire, marine hull).
- **Liberalisation:** four demerged; private insurers; inward reinsurance allowed with approval, life insurers too.

TODAY'S RULE

Regulator IRDAI (not IRDA); insurers are registered; Re-insurance Regs **2018** (amended to **2023**); Master Circular **31 May 2024**.

GIC Re obligatory cession (s.101A, Insurance Act **1938**): set by IRDAI notification yearly; **2026**-27 = **4%** of sum insured per general policy, all to GIC Re; terrorism, nuclear, Bharat Maritime pools nil; minimum ceding commission notified.

One cross-border reinsurer's cap (Re-insurance Regs 2018, amended **2023**), on premium ceded outside India: **20%** if rated above A+; **15%** above BBB+ up to A+; **10%** BBB/BBB+. Not applied if overseas premium is up to **Rs 75 crore** and reinsurers are BBB+ or better.

Foreign reinsurer branch: FRB and Lloyd's India Regulations **2024**; net owned fund **Rs 1,000 crore** from **5 Feb 2026** (was **Rs 5,000 crore**).

- **GIC Re:** composite; global reinsurer; London and Dubai; 2000s: top 20, A- A.M. Best; own cover = risk and cat XL plus ART umbrella.
- **Pools (as of 2010):** Terrorism; Marine Hull. Planned: Natural Catastrophe; Nuclear Risks Liability.
- **Regional (1970s):** Asian Re Corporation (India member), African Re Corporation; FAIR for Asia and Africa.

1.6 Functions

- **Objectives:** capacity; larger lines; stable results; profit chance; new risks.
- **Co-insurance:** each insurer liable only for amount he writes; not enough for complex, high-value risks.

Function	Point
Capacity	Take bigger risks
Financial stability	Accumulation in one event; natural perils
Claims ratio	Swings from poor spread, weather, social change, new technology
Accumulation in classes	XL across lines for one event
Spread of risks	By class and geography
Solvency margins	Limits on retained premium; regulator steps in if ratios worsen
Profitability	Spread overheads; control expense ratio
Other	Unusual proposals; expertise; new risks; catalyst for new forms

- **Advantages:** more capacity within net resources; stable net results; wide spread of loss; accumulation controlled; new untested risks.

TRAP

- **Shock absorber:** no loss cut, only easier to carry; purpose is technical.
- "Insurer cannot accept new risks even with reinsurance" is false.