

Glossary of reinsurance terms

Eric A. Pearce

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[See table of contents](#)

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Article abstract

We are grateful to the Reinsurance Association of America for permission to reprint the "Glossary of Reinsurance Terms" which the RAA has produced.

In its present form, the Glossary is restricted to a relatively small number of terms, but we are confident that having made this start, the RAA will expand this useful publication until it is truly comprehensive.

Reinsurance is an important international business and one in which the English language is widely used by great numbers of people to whom English is a foreign language.

Many of those who work in the great reinsurance industry must from time to time have felt doubt as to whether a correspondent abroad, or indeed a colleague in the next room, is giving exactly the same weight and meaning to any particular term, as he does himself. Thus it would be of immense benefit to all who are interested in the industry if over the years the expanded Glossary could be accepted internationally and given the force and value usually attributed to a recognized dictionary.

If this ideal is ever to become an accomplished fact it is of paramount importance that the Glossary, published for the express purpose of rendering service and avoiding misunderstanding, should as far as possible state its definitions in terms likely to be acceptable not only in the USA but throughout the world.

This is, perhaps, of particular interest to Canadian readers who operate in many reinsurance markets, but especially in London and the U.S.A. For this reason, we asked our London correspondent to let us have his observations. These are set out below as footnotes.

We should welcome comments from readers, at home and abroad, on the foregoing. Also we should be glad to hear from readers regarding any other reinsurance terms in common use, which it is considered should be included in any future Glossary. These contributions should preferably, but not essentially, give the requisite definition.

Assurances.

Glossary of reinsurance terms *

With comments by
ERIC A. PEARCE

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13

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A S S U R A N C E S

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Assurances.

Acquisition Cost — All expenses incurred by an insurance or reinsurance company which are directly related to putting the business on the books of the company.

14 Aggregate Excess of Loss Reinsurance — A form of excess of loss reinsurance which indemnifies the ceding company against the amount by which the ceding company's losses incurred during a specific period (usually 12 months) exceed either (1) a predetermined dollar amount or (2) a percentage of the company's subject premiums (loss ratio) for the specific period. This is commonly referred to as stop loss reinsurance or excess of loss ratio reinsurance.

Assume — To accept all or part of a ceding company's insurance or reinsurance on a risk or exposure.

Assumption Certificate (Also known as Cut Through Clause) — A statement of coverage by the reinsurer under which payment is guaranteed to a party not in privity with the reinsurance contract.

Automatic Treaty — See Obligatory Treaty.

Base Premium — See Subject Premium.

Binder — A record of reinsurance arrangements pending replacement by a formal reinsurance contract. See Cover Note.¹

Bordereau — A written report of individual cessions usually detailed to show such items as reinsurance premiums or reinsurance losses with respect to specific risks.

Burning Cost — See Pure Loss Cost.

Capacity — The largest amount of insurance or reinsurance available from a company or the market in general.²

¹ Binder.

In the London Market, this is used in common parlance to mean a Binding Authority granted by a reinsurer to an agent, by which the latter can engage the former on a risk or risks.

² Capacity.

It is doubtful whether the word "capacity" alone and unqualified, would have any special meaning in the London Market, other than that given in a standard dictionary.

Carpenter Cover — See Spread Loss Reinsurance.

Catastrophe Reinsurance — A form of excess of loss reinsurance which, subject to a specified limit, indemnifies the ceding company against the amount of loss in excess of a specified retention with respect to an accumulation of losses resulting from a catastrophic event or series of events.

Cede — To transfer to a reinsurer all or part of the insurance or reinsurance written by a ceding company.

Ceding Company (Also Reinsured, Reassured) — The insurer which cedes all or part of the insurance or reinsurance it has written to another insurer.

15

Cession — The unit of insurance transferred to the reinsurer by the ceding company.

Combination Plan Reinsurance — A form of combined reinsurance which provides that in consideration of a premium at a fixed percent of the ceding company's subject premium on the business covered, the reinsurer will indemnify the ceding company against the amount of loss on each risk in excess of a specified retention subject to a specified limit and, after deducting the excess recoveries on each risk the reinsurer will indemnify the ceding company against a fixed quota share percent of all remaining losses.³

"Capacity Risk" means one which is of such a size and/or nature as to require the resources of the whole insurance and reinsurance market to cover it.

"Market Capacity" means the amount of cover available in a particular market, for the protection of a particular risk or class of risks.

³ Combination Plan Reinsurance.

This expression is rarely if ever used in the London Market.

It is difficult to understand from the definition exactly how this form of reinsurance would operate. It appears to be as the name implies, the combination of two reinsurances in one, i.e., an excess of loss and a quota share.

For example:

- (a) Quota Share.
50% of the first \$500,000.
- (b) Excess of loss.
\$1,000,000 excess of \$500,000 ultimate net loss to the ceding company and the quota share reinsurer.

(There is doubt whether the reinsurance is to apply to "each and every occurrence" or "each and every risk", but the latter seems more likely in view of the reference elsewhere to "loss on each risk" and "excess recoveries on each risk".)

If this example expresses the intention, it would seem that the reinsurer is reinsuring himself in respect of his 50% quota share.

Further, it is stated that "after deducting the excess recoveries on each risk the

Commission — An allowance made by the reinsurer for part or all of a ceding company's acquisition and other costs, including premium taxes. It may also include a profit factor; see **Overriding Commission**.

Commutation Clause — A clause which provides for estimation, payment and complete discharge of all future obligations for reinsurance loss or losses incurred regardless of the continuing nature of certain losses.

16

Contingent Commission (Also Profit Commission) — An allowance made to the ceding company based on a predetermined percentage of reinsurer will indemnify the ceding company against a fixed quota share percent of all remaining losses."

This text leaves some doubt as to what is meant by "excess recoveries on each risk". Does this mean recoveries under (b) in the example above? This is, in fact, defined earlier as "the amount of loss on each risk in excess of a specified retention subject to a specified limit". Possibly "excess recoveries" refers to the amount of loss, if any, on a higher layer of excess of loss reinsurance, that is excess of the "specified limit", being excess of \$1,500,000 in the above example, which is presumably reinsured elsewhere.

If such higher limit is not reinsured, the losses in excess of \$1,500,000 would be payable (at least in the first instance) by the ceding company and it is possible that the intention is to deal with such losses as part of the "fixed quota share percent of all remaining losses".

But the definition seems to imply that under the quota share section the ceding company is indemnified only in respect of losses which are subject to excess recoveries. Thus, in the example above, all losses of \$500,000 or less would be payable in full by the ceding company alone, without any contribution by the reinsurer to such losses.

Although at first sight this seems to be quite unacceptable to the ceding company, the inability to recover any part of losses for \$500,000 or less may be reflected in the premium calculation. This is stated to be "a fixed percentage of the ceding company's subject premium on the business covered". This presumably means that the fixed premium would be in part the consideration for the excess of loss reinsurance and in part a premium relative to the quota share reinsurance.

It would seem likely that the great majority of ceding companies would prefer the more usual forms of reinsurance, namely:

(A) A quota share reinsurance by which the reinsurer would accept and reinsure a fixed percentage (say 50%) of all insurance within a stated category, irrespective of the amount of each individual loss. For this the consideration would be the same percentage (say 50%) of the ceding company's gross premium income, in respect of the said category, less an agreed ceding commission and profit commission.

(B) An excess of loss reinsurance applying only to that percentage (say 50%) of all insurances within the stated category, which is *not* reinsured under (A) above. The relative consideration would be agreed between the parties in the usual manner. For example:

(i) Quota Share: 50% of each and every insurance.

(ii) Excess of loss: \$500,000 excess of \$250,000 each and every occurrence, ultimate net loss to the ceding company.

If required the two reinsurances could be written into one contract, but as there is hardly any point of similarity between the two, it seems preferable to have separate documents.

A S S U R A N C E S

profit realized by the reinsurer under specified reinsurance contract or contracts.⁴

Cover Note — A statement issued by an intermediary or broker indicating that the coverage has been effected. See Binder.

Cut-Off — The termination provision of a reinsurance contract stipulating that the reinsurer shall not be liable for loss as a result of occurrences taking place after the date of termination.

Cut-Through Clause — See Assumption Certificate.

Earned Reinsurance Premium — That part of the reinsurance premium applicable to the expired portion of the policies reinsured.

Excess of Loss Ratio Reinsurance — See Aggregate Excess of Loss Reinsurance.

Excess of Loss Reinsurance — A generic term describing reinsurance which, subject to a specified limit, indemnifies the ceding company against the amount of loss in excess of a specified retention. It includes various types of reinsurance, such as catastrophe reinsurance, per risk reinsurance, per occurrence reinsurance and aggregate excess of loss reinsurance.

Excess per Risk Reinsurance — A form of excess of loss reinsurance which, subject to a specified limit, indemnifies the ceding company against the amount of loss in excess of a specified retention with respect to each risk involved in each occurrence.

Experience Rating — See Prospective Rating and Retrospective Rating.

Facultative Certificate of Reinsurance — A document formalizing a facultative reinsurance cession.⁵

⁴ Contingent Commission.

This term is sometimes used in the London Market, but the alternative "Profit Commission" is very much more readily understood.

The clause in the definition which reads: "An allowance based on a predetermined percentage of profit" might be misunderstood.

It seems to imply that it is the percentage of profit which is predetermined: as if, for example, the reinsurer were to agree that if the percentage of profit were exactly 5%, a part or the whole of it would be returned to the ceding company. There may be such agreements in existence, but in the overwhelming majority of contracts which are subject to a Profit Commission, it is the percentage of profit commission which is predetermined, not the percentage of profit.

⁵ Facultative Certificate of Reinsurance or « Certificate of Facultative Reinsurance ».

A S S U R A N C E S

Facultative Obligatory Treaty — A reinsurance contract under which the ceding company may cede exposures or risks of a defined class that the reinsurer must accept if ceded.

Facultative Reinsurance — Reinsurance of individual risks by offer and acceptance wherein the reinsurer retains the "faculty" to accept or reject each risk offered by the ceding company.

18 Facultative Treaty — A reinsurance contract under which the ceding company has the option to cede and the reinsurer has the option to accept or decline individual risks. The contract merely reflects how individual facultative reinsurances shall be handled.

Flat Rate — (a) A fixed rate not subject to any subsequent adjustment. (b) A reinsurance premium rate applicable to the entire premium income derived by the ceding company from the business ceded to the reinsurer as distinguished from a rate applicable to excess limits.

Gross Line — The total limit of liability accepted by an insurer on an individual risk (net line plus all reinsurance ceded).

Incurred but not Reported (IBNR) — A phrase referring to losses which have occurred but have not been reported to the insurer or reinsurer.

Line of Business — The general classification of business as utilized in the insurance industry, *i.e.*, fire, allied lines, homeowners, etc.⁶

Line Sheet (Also Line Guide) — A schedule showing the limits of liability to be written by a ceding company for different classes of risk.⁶

Loss Development — The difference between the estimated amount of loss(es) as initially reported to the reinsurer and the amount of an evaluation at a later date or the amount paid in final settlement(s).

⁶ Line of Business and Line Sheet.

In the sense of the definition, the term "Line of Business" is rarely, if ever, used in the London Market. "Line" has a rather narrow meaning in reinsurance usage. It is the amount accepted on a risk, and this is, in fact, the meaning of the word in the term "Line Sheet".

The latter is now well recognised in London, although "Table of Limits" is more usual.

"Line of Business" as defined, would be expressed in London as "Class of Insurance" or "Category of Insurance".

Notwithstanding the foregoing, the expression "Fire and Allied Lines" is sometimes used in London. "Fire and Allied Perils" is more usual.

A S S U R A N C E S

Loss Loading or "Multiplier" — A factor applied to pure loss cost or losses to produce a reinsurance rate or premium.

Net Line (Also Net Retained Line) — Gross line on an individual risk less all reinsurance ceded.

Net Loss — The amount of loss sustained by an insurer after giving effect to all applicable reinsurance, salvage, and subrogation recoveries.

Net Retention (Also Net Retained Liability) — The amount of insurance which a ceding company keeps for its own account and does not reinsure in any way.⁷

19

Non-Admitted Reinsurance — Reinsurance for which no credit is given in the ceding company's Annual Statement because the reinsurer is not licensed or authorized to transact the particular line of business in the jurisdiction in question.

Obligatory Treaty (Also Automatic Treaty) — A reinsurance contract under which the subject matter business must be ceded by the ceding company in accordance with contract terms and must be accepted by the reinsurer.

Over-Line — The amount of insurance or reinsurance exceeding the insurer's or reinsurer's normal capacity inclusive of automatic reinsurance facilities.

Overriding Commission — An allowance paid to the ceding company over and above the acquisition cost to allow for overhead expenses, often including a margin for profit.

Participating Reinsurance — See Pro Rata Reinsurance.

Policy Year Experience — Reinsurance experience calculated with all applicable premiums and losses assigned to the experience year in which each reinsured policy becomes effective.

Pool (Also Associations, Syndicates) — An organization of insurers or reinsurers through which particular types of risks are underwritten with premiums, losses and expenses shared in agreed amounts.

⁷ Net Retention and Retention.

It is noted that by definition in the USA there is a vast difference between these two terms. This is not so in the London Market, where a specified retention is considered to be nett, unless otherwise stated.

Portfolio — The entire liability of an insurer for inforce policies or outstanding losses or both as respects a described segment of the insurer's business.⁸

Portfolio Reinsurance — The transfer of a portfolio via a cession of reinsurance.

Portfolio Return — Reassumption by a ceding company of a portfolio.

Portfolio Run-Off — Continuing the reinsurance of a portfolio until all ceded premium is earned or all losses are settled or both.

Premium Base — See Subject Premium.

Primary — This adjective is applied in the reinsurance field to the nouns: insurer, insured, policy and insurance and means respectively: (1) the insurance company which initially originates the business, *i.e.*, the ceding company, (2) the policyholder insured by the primary insurer, (3) the initial policy issued by the primary insurer to the primary insured, (4) the insurance covered under the primary policy issued by the primary insurer to the primary insured (sometimes called "underlying insurance").

Priority — The term used in some foreign reinsurance markets meaning retention.⁹

Profit Commission — See Contingent Commission.

Pro Rata Reinsurance (Also Share and Participating Reinsurance) — A generic term describing all forms of quota share and surplus reinsurance in which the reinsurer shares a pro rata portion of the losses and premiums of the ceding company.

Prospective Rating (Also Self-Rating or Experience Rating) — A method used in arriving at the reinsurance rate and premium for a

⁸ Portfolio.

This word used alone and unqualified would not have any special meaning in the London Market. Where are in current use the following:

Portfolio of unearned premium.

Portfolio of outstanding claims.

Investment portfolio.

⁹ Priority.

It is possible, as stated, that the word "priority" is used to mean "retention" in some markets, but it is much more likely to be used to mean "deductible" in connection with an excess of loss reinsurance.

A S S U R A N C E S

specified period, based in whole or in part, on the loss experience of a prior period.¹⁰

Prospective Rating Plan — The formula in a reinsurance contract for determining reinsurance premium for a specified period on the basis, in whole or in part, of the loss experience of a prior period. See Spread Loss Reinsurance.

Provisional Rate, Premium or Commission — The tentative amounts which are subject to subsequent adjustment.

Pure Loss Cost (Also Burning Cost) — The ratio of the reinsurance losses incurred to the ceding company's subject premium.¹¹

21

Quota Share Reinsurance — A form of pro rata reinsurance indemnifying the ceding company against a fixed percent of loss on each risk covered in the contract.¹²

Rate — The percent or factor applied to the ceding company's subject premium to produce the reinsurance premium or the percent applied to the reinsurer's premium to produce the commission.

Reassured — See Ceding Company.

Reciprocity — The system of placing reinsurance on a reciprocal basis, so that a ceding company will only give a share of its reinsurance to a reinsurer who is able to offer reinsurance in return.

Reinsurance — The transaction whereby the reinsurer, for a consideration, agrees to indemnify the ceding company against all or part

¹⁰ Prospective Rating and Retrospective Rating.

These terms are rarely, if ever, used in the London Market. It is usual to use the generic term "adjustable rate basis" and to define quite precisely the formula to be used in calculating the rate.

If the above terms were used in London it is probable that they would give an entirely wrong impression.

Prospective Rating would imply a rate calculated on some future event (not "experience of a prior period"), whereas Retrospective Rating would imply a rate calculated on past experience (not "experience for the same period").

¹¹ Pure Loss Cost or Burning Cost.

Both terms are in frequent use in London. However, the cost is more usually expressed as a percentage of the subject premium, rather than as a ratio of it.

¹² Quota Share Reinsurance.

It is an essential element of this form of reinsurance that, within an agreed category of insurance, it applies to every risk and that the reinsurer receives a fixed percentage of the subject premium (subject to ceding commission) in consideration of indemnifying the ceding company against (the same) fixed percentage of every loss.

A S S U R A N C E S

of the loss which the latter may sustain under the policy or policies which it has issued.

Reinsurance Premium — The consideration paid by the ceding company to the reinsurer for the reinsurance afforded by the reinsurer.

Reinsured — See Ceding Company.

Reinsurer — The insurer which assumes all or a part of the insurance or reinsurance written by another insurer.

22 Retention — Net retention plus any amounts of other reinsurance permitted under the reinsurance contract.

Retrocession — The transaction whereby a reinsurer cedes all or part of the reinsurance it has assumed to another reinsurer.

Retrospective Rating (Also Self-Rating or Experience Rating) — A method used in arriving at the reinsurance rate and premium for a specified period based on the loss experience for the same period.¹⁰

Retrospective Rating Plan — The formula in a reinsurance contract for determining the reinsurance premium for a specified period on the basis of the loss experience for the same period.

Run-Off — A termination provision of a reinsurance contract stipulating that the reinsurer shall remain liable for loss under reinsured policies in force at the date of termination, as a result of occurrences taking place after the date of termination.

Self-Rating — See Prospective Rating and Retrospective Rating.

Share Reinsurance — See Pro Rata Reinsurance.

Sliding Scale Commission — A commission adjustment on earned premiums under a formula whereby the actual commission varies inversely with the loss ratio, subject to a maximum and minimum.

Special Acceptance — The specific agreement by the reinsurer to include under a reinsurance contract a risk which is not automatically included within the terms thereof.

Spread Loss Reinsurance — A working cover subject to a prospective rating plan.

Stop Loss Reinsurance — See Aggregate Excess of Loss Reinsurance.

Subject Premium (Also Base Premium, Premium Base, Underlying Premium) — The ceding company's premiums (written or earned) to which the reinsurance premium rate is applied to produce the reinsurance premium.¹³

Surplus — The portion of the ceding company's gross amount of insurance on a risk remaining after deducting the retention established by the ceding company.

Surplus Reinsurance — A form of pro rata reinsurance indemnifying the ceding company against loss to the surplus. First surplus reinsurance is the amount of surplus on each risk that must be allotted to the first surplus contract. Second surplus, third surplus, etc. reinsurance is the remaining portion of the surplus that must be allotted to each such respective contract after deducting the amount(s) ceded to the underlying surplus contract or contracts.¹⁴

Target Risk — (a) Certain high valued bridges, tunnels and fine arts collections which are excluded from reinsurance contracts to permit specific handling of the capacity problem and release the reinsurer of any potential heavy accumulation of liability on any one risk from various sources; (b) a large hazardous risk on which insurance is

¹³ Subject Premium.

This term is rarely, if ever, used in the London Market.

From the definition it seems to express two different forms of premium, namely:

(a) The premium applicable to a single policy (for which a facultative reinsurance is arranged) and on which the relative reinsurance premium is based. This would be known in London as the "original gross premium".

(b) The premium of the ceding company derived from a category or categories of insurance forming the subsequent matter of a reinsurance treaty, and on which the reinsurance premium is calculated. This is usually known in London as the "gross premium income" but naturally "nett premium income" is also used where applicable.

Either of these terms, as the case may require, is defined in the contract in some detail, so as to avoid any misunderstanding as to whether it is to include or exclude such items as taxes, general agents' commission, brokerage, policy costs etc.

Base Premium or Premium Base are terms rarely used in London, whereas Underlying Premium is not synonymous with "original gross premium". "Underlying Premium" is usually applied to the premium on a first loss policy, which is sometimes used as a guide to determine the premium for a second loss (or excess) policy.

¹⁴ Surplus Reinsurance.

It should perhaps, be emphasised that the main difference between Quota Share and Surplus, from the purely technical point of view, is that in the case of the former the percentage of cession and retention is constant irrespective of the class of risk within the category of insurance involved; whereas the latter provides a variable cession and retention according to the class of risk within the category of insurance. The amount of the cession and retention per class is determined in accordance with an agreed Line Sheet or Table of Limits.

A S S U R A N C E S

difficult to place; and (c) a large attractive risk which is considered a target for competing insurance companies and producers.

Treaty — A term historically applied to reinsurance contracts.

Underlying — The amount of insurance or reinsurance on a risk which attaches before the next higher excess layer of insurance or reinsurance attaches.

Underlying Premium — See Subject Premium.

24 **Unearned Reinsurance Premium** — That part of the reinsurance premium applicable to the unexpired portion of the policies reinsured.

Working Cover — A contract covering an area of excess reinsurance in which loss frequency is anticipated.¹⁵

¹⁵Nous avons demandé à la Reinsurance Association of America de nous permettre de reproduire ici son "Glossary of Reinsurance Terms." Comme elle y a consenti, c'est avec plaisir que nous le faisons paraître dans ce numéro, avec en renvois pour certaines expressions, les commentaires de notre correspondant de Londres, Monsieur Eric A. Pearce. Monsieur Pearce est une autorité en matière de réassurance. Nous le remercions d'avoir bien voulu ajouter des précisions à certaines des définitions de la R.A.A. Valable pour le marché américain, celles-ci n'ont pas nécessairement en Europe le sens qu'on leur donne dans le marché américain. Il nous a paru utile de mettre en regard les observations venues d'une autre source. Le lecteur et la R.A.A. voudront bien ne pas interpréter autrement les notes de notre collaborateur. Il y a dans son initiative le seul désir de travailler à une cause commune, tout en reconnaissant la valeur de l'effort fait. C'est avec plaisir que nous accueillerions tout autre commentaire qu'on jugerait à propos de nous communiquer.