R.M.M. Law College, Saharsa

Pt. Lecturer- KESHAV KUMAR SHRIVASTAVA

L.L.B Part- 2nd

Subject- Insurance Act

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Topic- Different methods and advantages of Re-insurance.

Introduction- Reinsurance is insurance that an insurance company purchases from another insurance company to insulate itself (at least in part) from the risk of a major claims event. With reinsurance, the company passes on ("cedes") some part of its own insurance liabilities to the other insurance company. The company that purchases the reinsurance policy is called a "ceding company" or "cedent" or "cedant" under most arrangements. The company issuing the reinsurance policy is referred simply as the "reinsurer". In the classic case, reinsurance allows insurance companies to remain solvent after major claims events, such as major disasters like hurricanes and wildfires. In addition to its basic role in risk management, reinsurance is sometimes used to reduce the ceding company's capital requirements, or for tax mitigation or other purposes.

A company that purchases reinsurance pays a premium to the reinsurance company, who in exchange would pay a share of the claims incurred by the purchasing company. The reinsurer may be either a specialist reinsurance company, which only undertakes reinsurance business, or another insurance company. Insurance companies that accept reinsurance refer to the business as 'assumed reinsurance'.

There are two basic methods of reinsurance:

1. **Facultative Reinsurance**, which is negotiated separately for each insurance policy that is reinsured. Facultative reinsurance is normally purchased by ceding companies for individual risks not covered, or insufficiently covered, by their reinsurance treaties, for amounts in excess of the monetary limits of their reinsurance treaties and for unusual risks. Underwriting expenses, and in particular personnel costs, are higher for such business because each risk is individually underwritten and administered. However, as they can separately evaluate each risk reinsured, the reinsurer's underwriter can price the contract more accurately to reflect the risks involved. Ultimately, a facultative certificate is issued by the reinsurance company to the ceding company reinsuring that one policy.
2. **Treaty Reinsurance** means that the ceding company and the reinsurer negotiate and execute a reinsurance contract under which the reinsurer covers the specified share of all the insurance policies issued by the ceding company which come within the scope of that

contract. The reinsurance contract may obligate the reinsurer to accept reinsurance of all contracts within the scope (known as "obligatory" reinsurance), or it may allow the insurer to choose which risks it wants to cede, with the reinsurer obligated to accept such risks (known as "facultative-obligatory" or "fac oblig" reinsurance).

There are two main types of treaty reinsurance, proportional and non-proportional, which are detailed below. Under proportional reinsurance, the reinsurer's share of the risk is defined for each separate policy, while under non-proportional reinsurance the reinsurer's liability is based on the aggregate claims incurred by the ceding office. In the past 30 years there has been a major shift from proportional to non-proportional reinsurance in the property and casualty fields.

Advantages or Benefits of Reinsurance-

1. Reinsurance boosts Insurance Business

The major advantage of reinsurance is that it assists in the boom of insurance business. It enables every insurer to accept insurance business as the total risk will be distributed among other reinsurers.

If there is no reinsurance, the insurer may not be willing to take up risks, particularly when the risk exceeds beyond his capacity to manage.

2. Reinsurance reduces the risks

The prime principle of insurance is to reduce risk. As the risks are spread across wider area, the loss of the individual is minimized which gives the insurer the secured feel. The revenue of insurance companies are stable due to reinsurance. It also helps the insurance companies to gain knowledge about various types of risks and the basis of rating the risks in the future.

3. Reinsurance Increases Goodwill of Insurer

Reinsurance helps to boost the overall confidence and goodwill of insurer. When the insurer develops confidence, he understands the nature of risks involved beyond his capacity.So reinsurance increases goodwill of an insurer.

4. Reinsurance Limits the Liability

Reinsurance motivates the insurers to undertake and spread the risks. Hence the liability of insurer is limited to the maximum.

5. Reinsurance Stabilizes premium Rates

The premium rates of insurance are stabilized by reinsurance. Generally, the premium rates are calculated on the basis of the loss experienced by the insurer in the past, due to the risk concerned. Reinsurance takes into account of all these data and fixes the premium rate according for various types of risks under mutual agreement.

Thus reinsurance stabilizes the fluctuations in the premium rates of various types of risks.

6. Reinsurance Protects the Insurance Funds

The insurance funds of the insurer is well protected due to reinsurance. Additional security and peace of mind is an added advantage of reinsurance for the insurer and the company that offers the insurance.

7. Reinsurance Reduces Competition

The competitions between inter company is reduced as everyone work in a cooperative manner and with the helping tendency in the insurance business. Thus reinsurance helps to control competition and increase overall morale of the employees in the insurance business.

8. Reinsurance Reduces profit fluctuations

The reinsurance plans reduce, to a considerable extent the violent fluctuations in the profits of the company. If on the other hand, heavy risks are retained by the original insurer, his profits are greatly upset due to a heavy single loss.

9. Reinsurance Encourages new enterprises

It encourages the new underwriters, who in their early period of development, have limited retentive capacity. In the absence of reinsurance facility, the tremendous growth of new enterprises is doubtful.

10. Reinsurance Minimizes dealings

Due to the reinsurance scheme, the insurer is required to indulge in the minimum dealings with only one insurer. In the absence of insurance facility, the insured will have to approach several insurers to enter into various individual insurance agreement on the same property. This involves considerable cost, loss of valuable time and slower down the pace of protection cover.

The End