Proportional Treaties

March 2023

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01

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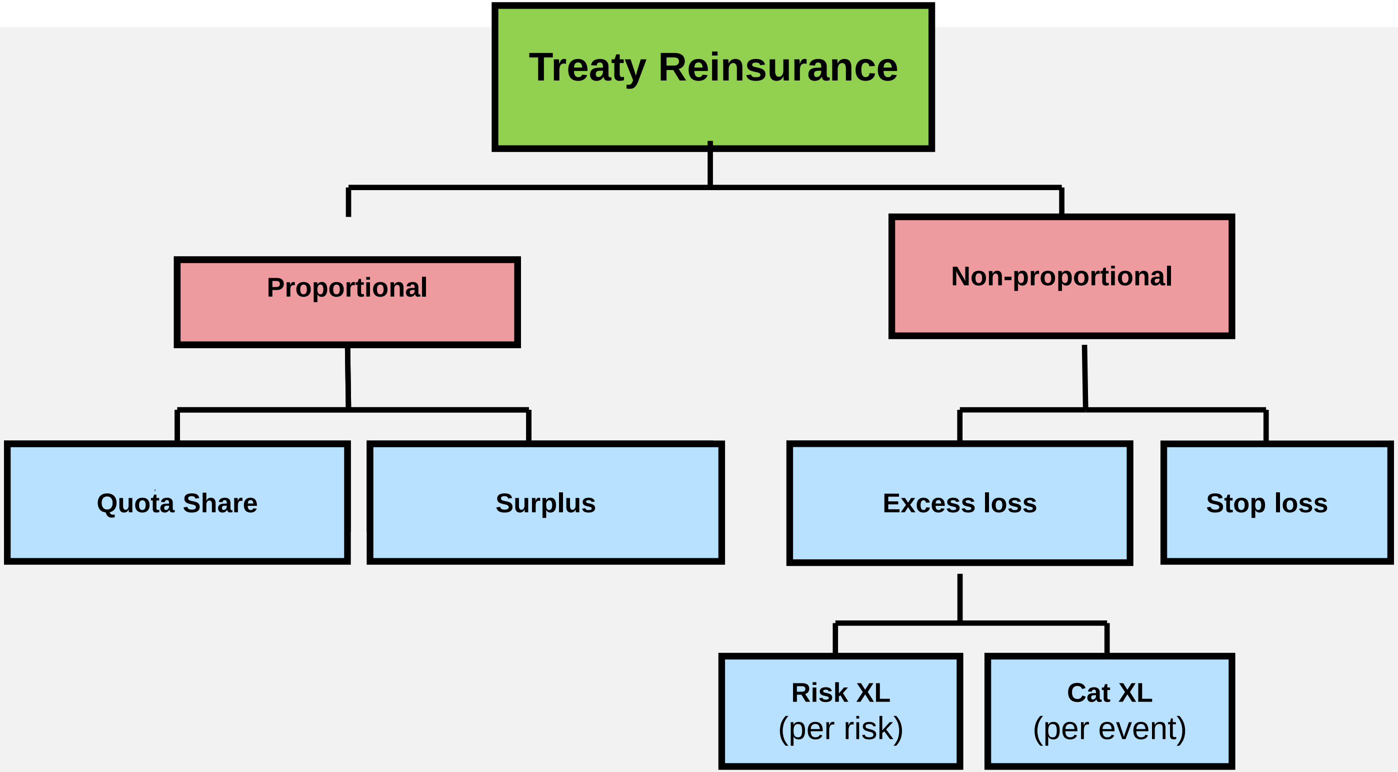
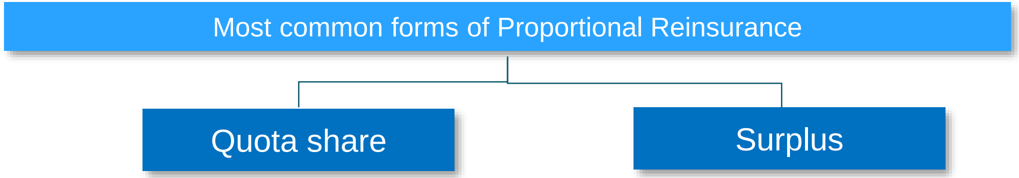
Treaty Reinsurance **Structure**

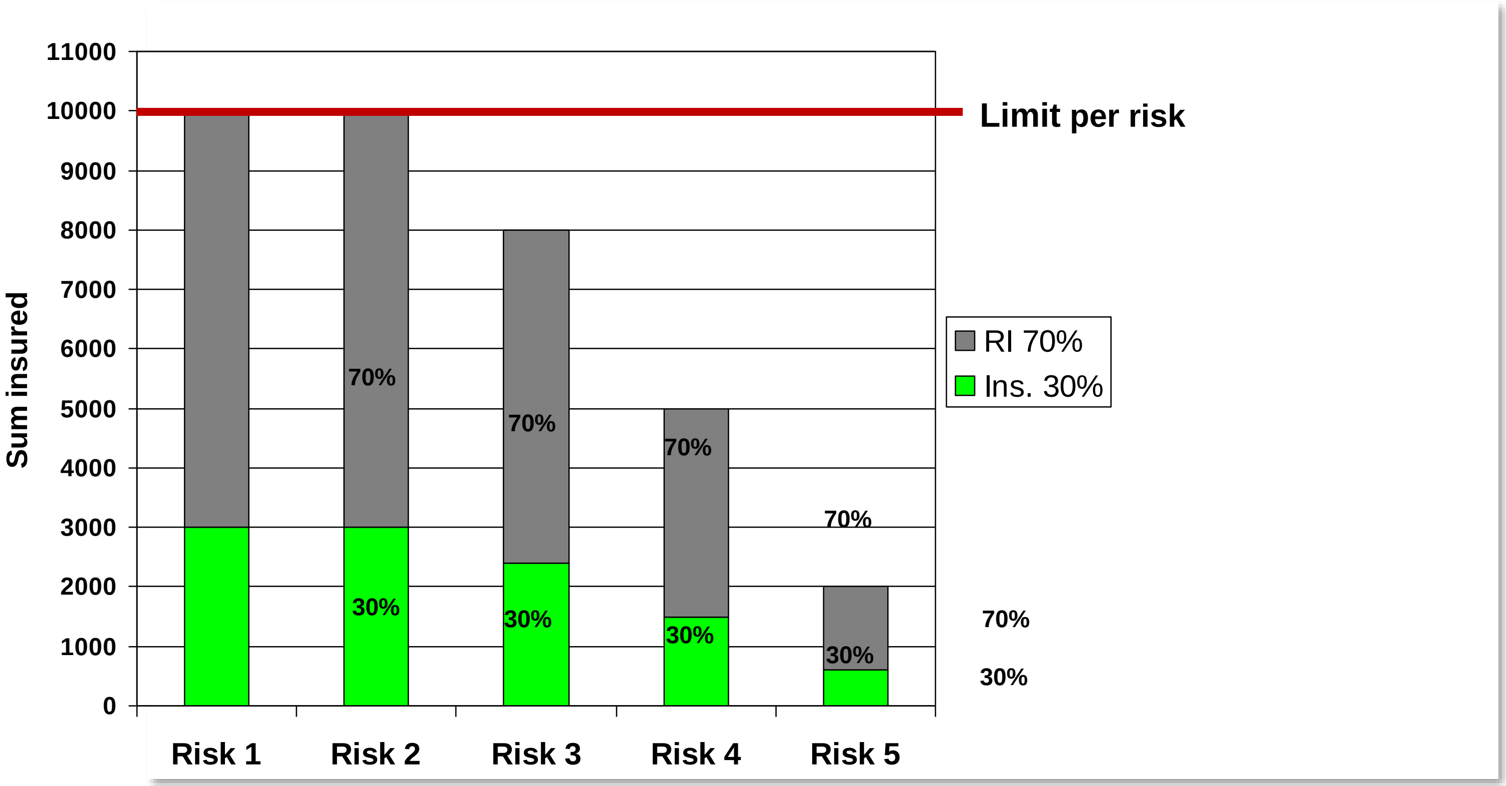


Treaty Proportional

- A proportional treaty is an agreement which binds the ceding company to cede and the reinsurer to accept a share of all risks which are ceded to the treaty.
- Thus, the reinsurer shares proportionally in the premium and claims of risks which are ceded to the treaty.

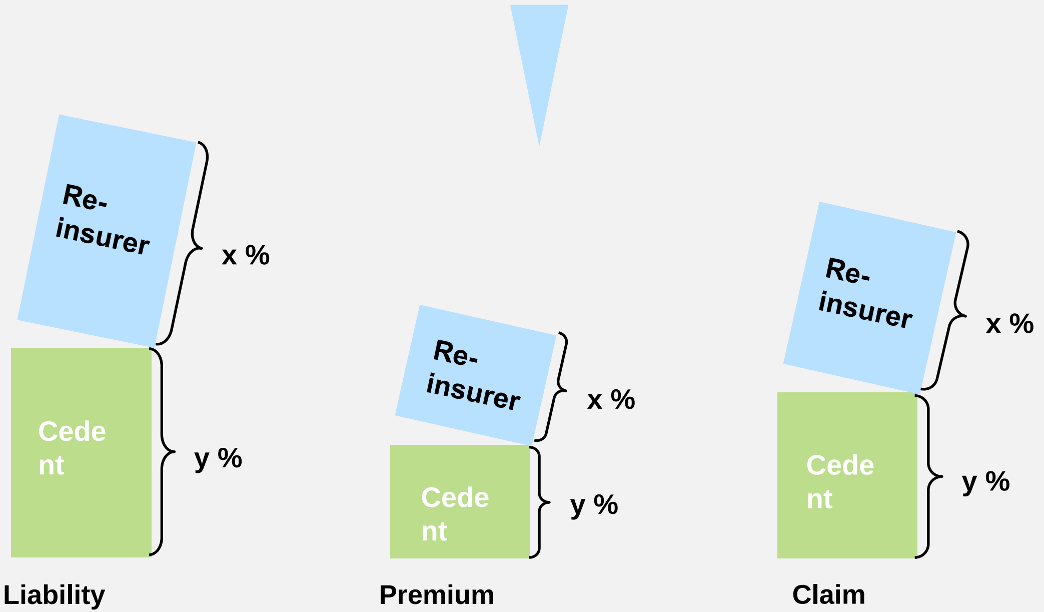


Quota Share Treaty - Example

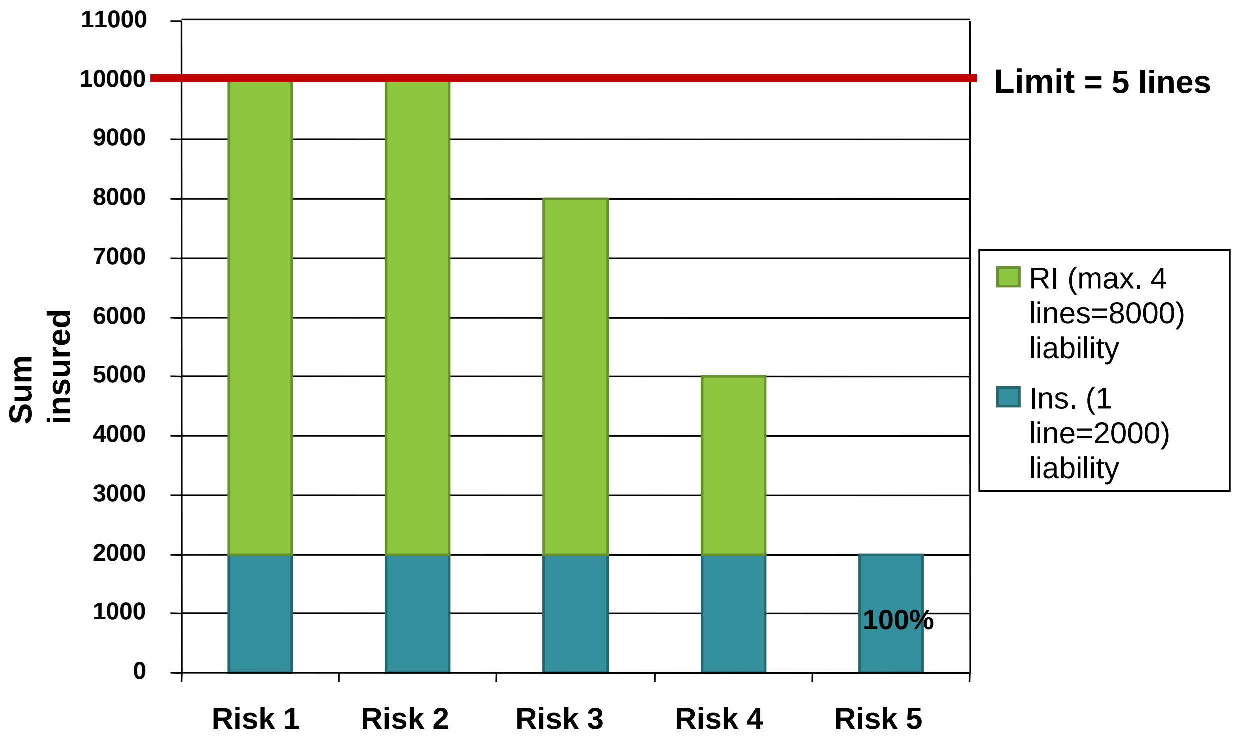


Characteristics of Proportional Treaties

Liability, premium and losses are split proportionally



Surplus Treaty - Example



Structure Continue

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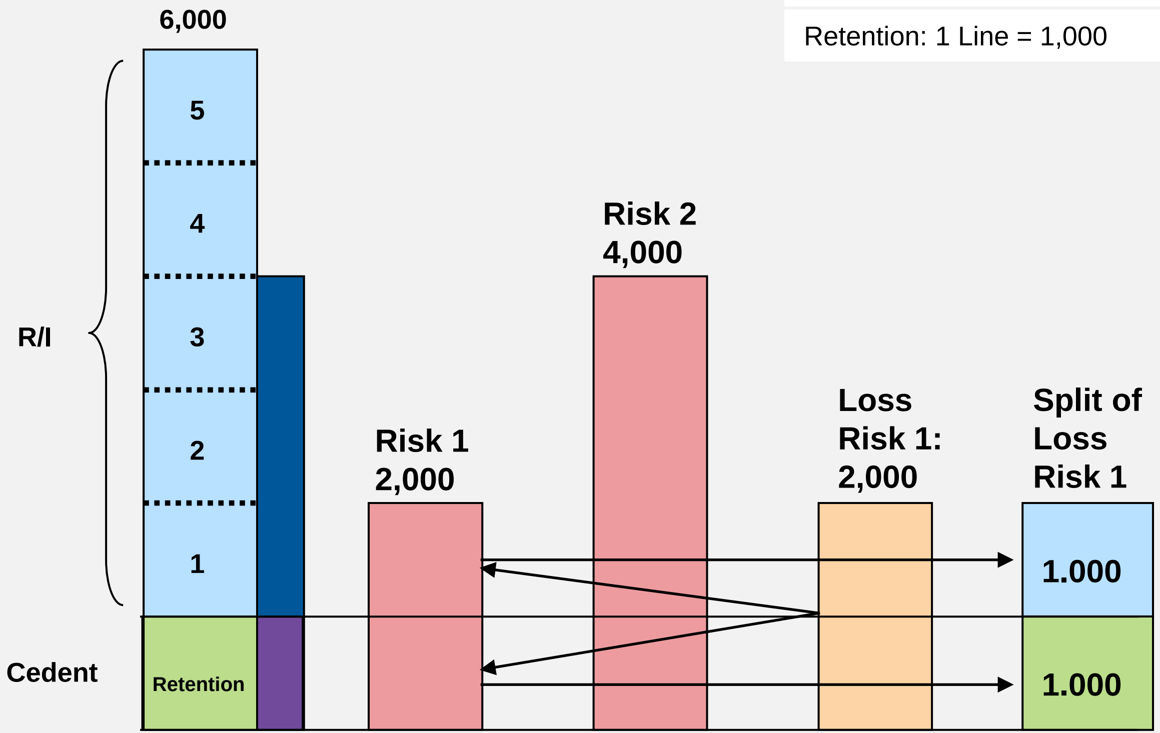
Example: Total Loss (1/2)

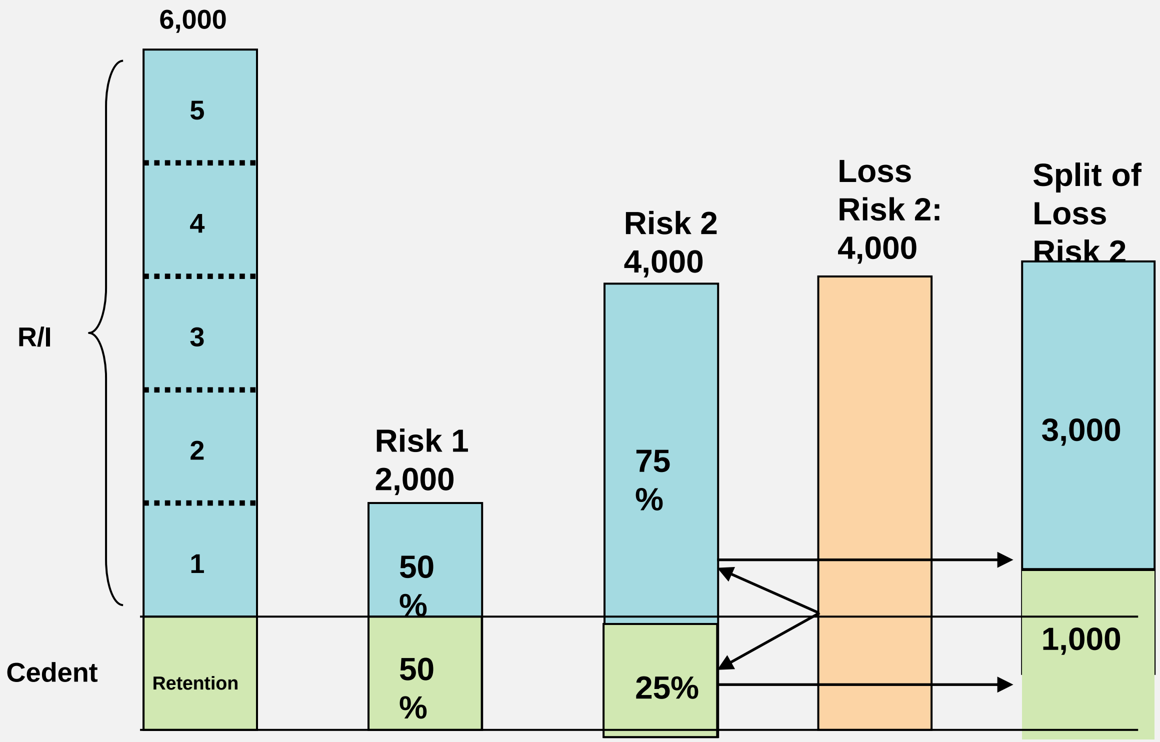
Reinsurance: 5 Lines = 5,000

Retention: 1 Line = 1,000



Proportional Treaty Loss Cession

Example: Total Loss



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RENDERING OF ACCOUNTS

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Reinsurance accounts reflect the financial transactions on the treaty and are prepared by the ceding company or broker & Sent to the reinsurers .

THE ACCOUNTS FULFIL THE FOLLOWING FUNCTIONS

To provide the reinsurer with information on what is happening on the treaty in financial terms.

Summarising the balances due from either party.

To provide the required information for preparing treaty stats and assessment of the treaty portfolio.

Reinsurance Accounts

Requirements

- The contract wording provides precise details of the accounting arrangements between the reinsured and the reinsurer.
- All proportional treaties underwritten during a relevant UY period are reinsured.

Technical	Financial	Settlement
• Premium • Losses • Commissions • Other deductions	• Underwriting Results	• Balances Due • Cash Movement

Rendering of accounts

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Reinsurer's signed line	Periodic reporting (quarterly, Half yearly, Annually)	Accounts due within 45/ 60 days after close each period

As agreed, the cedant has to indicate the COB for each account submitted

The wording contains Payment conditions clause:

- From cedant to reinsurer: Within 15 days after the accounts due date
- From reinsurer to cedant: After confirmation of account – generally within 2 weeks after accounts are reported
- The offset Clause:

  Offsetting: in line with treaty wording but not against non-proportional claim without reinsurer's agreement

Key treaty **terms** relevant for accounting purposes

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RENDERING OF ACCOUNTS			
Premium	Commission & Brokerage	Paid losses	Outstanding Loss reserves

ACCOUNTING METHODS		
Underwriting year basis	Occurrence year basis	Calendar year basis

ANNUAL ACCOUNTS			
Profit commissions	Sliding Scale Commission	Loss participation	Portfolio entry & withdrawal

Premium

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Commission & Brokerage

- Commission : Can be a standard or tentative percentage rate that reinsurer pays to the cedant
- When a reinsurer receives a share of the treaty through a broker, the reinsurer will normally agree to a brokerage
- Not applicable to business ceded directly
- The percentage of brokerage payable is applied to the written premiums

Direct Insurer → **Broking company** ← **Reinsurer**

Losses

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Outstanding Loss Reserves

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1. Reported as losses occurred on policies attached to the treaty which remained unpaid
2. Cedant then estimates the likely cost of the outstanding losses and reports them to the reinsurer at the end of the period. (In the quarterly accounts)
3. Timely reporting of loss reserves assist the reinsurer to:

- Make adequate provision for future losses
- Verify any annual accounts (Portfolio accounts, profit commission and Sliding Scale Adjustments)
- Calculate IBNR accurately

Example : Contract/ Wording

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REINSURANCE COVER NOTE – 2018
FIRE SURPLUS

Reinsured	**XYZ INSURANCE PLC**
Period (Article 1 and 17.1.a.)	Continuous contract subject to 3 months notice of cancellation as per 31st December any year. Hereon effective, 1st January 2018.
Type (Preamble)	**Fire Surplus Treaty**
Portfolio (Article 7)	Incoming: Premium - 40% Losses - 90% Outgoing: Premium - 40% Losses - 90%
Commission (Article 8)	Sliding Scale : As per Appendix 6.1 Provisional Commission 27.5% Terrorism: 25% flat
Profit Commission (Article 8)	Not Applicable
Bordereaux (Article 9.5)	List of outstanding losses in their years of occurrences to be submitted with quarterly accounts separately.
Accounts (Article 10.1 and 10.2)	Quarterly to be submitted within 45 days after close of each quarter
Confirmation/Settlement of Accounts (Article 10.3 and 10.4)	Confirmation within 15 days of receipt of Accounts Settlement to follow within 15 days of confirmation by the debtor party.
Currency (Article 12)	Settlement Currency: **United States Dollar**
Intermediaries	ABC Brokers Limited
Brokerage	2.50%

Example : Reinsurance Treaty statement

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Ceding Company : **Sunshine Insurance PLC**

Treaty : Engineering Surplus

Period : From 01/01/2017 to 31/12/2017

Account : 1^{st} Quarter 2018 UY; 2018

Currency : USD

Munich Re share: 30%

Premium	10,000
Less Commission (25%)	(2,500)
Less Paid Losses/ Claims	(3,500)
Less Brokerage (2.5%)	(250)
Balance due to Reinsurer	**3,750**

Coverage system

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REINSURANCE ACCOUNTING METHODS

Underwriting year method

- Describes the year, in which the policy has been underwritten.
- Signing a policy means here the beginning or renewal of a reinsurance policy duration.

Calendar Year Method

Describes the year for which premiums, provisions & claims have been deducted from the cedent & for which loss reserves have been reported (generally 01.01.-31.12.).

Occurrence year method

Describes the year in which a claim occurred or was caused.

Importance of Coverage Systems

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- When preparing the accounts : “what premiums & losses should go into the accounts, and according to which treaty criteria and how?”.
- When preparing the annual statements such as Sliding Scale Commission, PC’s and Loss Participation: what system of presentation is to be used?
- For preparation of reinsurance statistics.

✓ It is therefore essential to know that coverage systems are used not only to present statistics but also initially to define what should be included in the accounts and how.

Accounting Mode : (UY)

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- Breakdown of all accounting items are as per UY i.e. in the year in which the policy was underwritten by the cedant.
- All premiums and losses occurring under the covered policies are to be allocated to the UY.
- UY basis helps in recovering the losses which occur on a specific policy during the period of treaty where the breakdown of paid and reserved claims are on an UY.
- Accounts for premiums and losses in subsequent years are to be allocated to the original UY.

In Principle:

✓ There is no premium and loss portfolio movements for UPR for UY basis.

✓ Proportional and fixed commission agreements apply per underwriting year.

✓ All result-dependent calculations are to be prepared on an underwriting year basis.

✓ Usually suitable for long tail classes of business

Statement of Account: 2nd Quarter 2019
Cedant : ABC Insurance PLC
Reinsurer : Munich Reinsurance of Africa Ltd

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Marine Hull Quota Share Treaty

Underwriting Year Method

Currency : USD

2nd Quarter 2019 period ending as at 30.06.2019			
Description	**U/Y**	**Debit**	**Credit**
Premium Ceded	2019		5,500.00
	2018		4,200.00
	2017		1,150.00
	2016		750.00
			11,600.00
Commission (15%)	2019	825.00	
	2018	630.00	
	2017	172.50	
	2016	112.50	
		1,740.00	
Paid Losses	2019	680	
	2018	1050	
	2017	460	
	2016	510	
		2,700.00	
NET AMOUNT DUE TO YOU			7,160.00

Accounting Mode : (Occurrence Year)

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- Breakdown of all accounting items by occurrence year.
- Wherever possible, a breakdown of paid and reserved claims by occurrence year.
- All losses paid must be in the years of occurrence means where the claim was caused.

In Principle:

- ✓ There is premium portfolio movements but no loss portfolio movements.
- ✓ Loss reserves as at the end of the reinsurance treaty period go into the Run-off.
- ✓ Proportional and fixed commission agreements apply per occurrence year.
- ✓ All result-dependent calculations are to be prepared on an occurrence year basis.

Statement of Account : 2nd Quarter 2019
Cedant : ABC Insurance Company
Reinsurer : Munich Reinsurance of Africa Ltd

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Personal Accident Quota Share Treaty			
Year of Occurrence Method			
Currency : USD			
2nd Quarter 2019 period ending as at 30.06.2019	O/Y = Year of Occurrence		
Description	O/Y	Debit	Credit
Premium Ceded			6,000.00
Less Commission		1,800.00	
Less Paid Losses	2019	1,250.00	
	2018	960.00	
	2017	120.00	
	2016	370.00	
		2,700.00	
NET AMOUNT DUE TO YOU			1,500.00

Accounting Mode : (Accounting Year)

- All accounting items are allocated to the current accounting year.
- Works on a portfolio transfer basis.
- There is premium and loss portfolio movements
- No rendering of accounts in subsequent years for former reinsurance treaty periods

In Principle:

✓ Proportional and fixed commission agreements apply per accounting year.

✓ All result-dependent calculations are to be prepared on an accounting year basis.

✓ This type of accounting works for property which are annualised policies.

Statement of Account :2nd Quarter 2019
Cedant : ABC Insurance Company
Reinsurer : Munich Reinsurance of Africa Ltd

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Fire Surplus		
Calendar Year Method		
Currency : USD		
2nd Quarter 2019 period ending as at 30.06.2019	Calender Year Method	
Descriptions	Debit	Credit
Premium Ceded		7,500.00
Less Commission (27.50%)	2,062.50	
Less Paid Losses	2,700.00	
NET AMOUNT DUE TO YOU		**2,737.50**

Quiz Test

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1. What are the most common forms of proportional Reinsurance?
2. It is not always important to refer to the treaty wording for verifying conditions & clauses that affect rendering of accounts – *True or false?*
3. Provisional commission is the standard percentage rate that the reinsurer pays to the cedant. *True or False?*
4. Reinsurance accounts convey information to the reinsurer on what is happening on treaty in technical terms, (for example) Choose the incorrect option :

   (A)*Premiums Ceded; (B)Paid losses; (C)Commission; (D)Estimated Premium Income*

Quiz Test

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5. Occurrence year includes premium portfolio movements

   (Yes or No)

6. Occurrence year includes loss portfolio movements

   (Yes or No)

7. Accounting year includes premium portfolio movements

   (Yes or No)

8. Accounting year includes loss portfolio movements

   (Yes or No)

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Portfolio Conditions

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This section specifies the method of handling the portfolio premium and loss portfolio calculation if applicable in the treaty conditions.

Definitions

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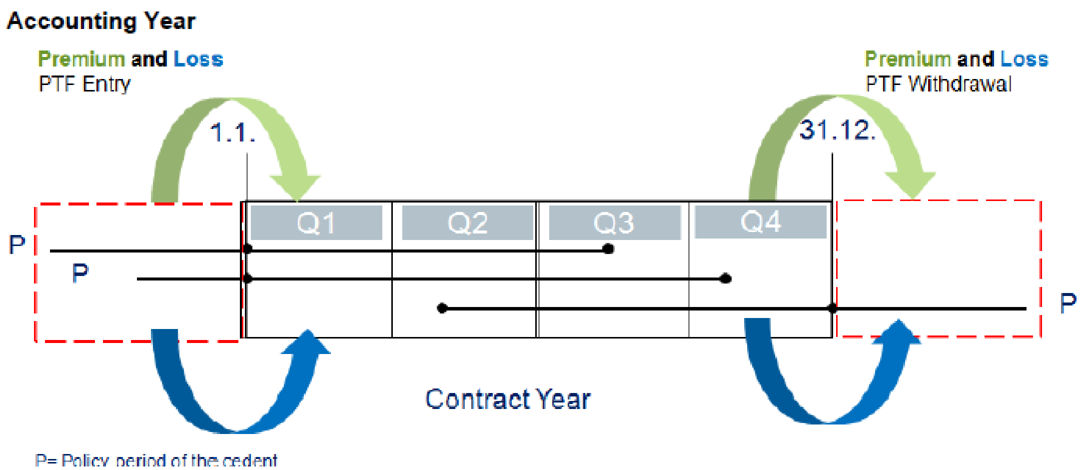
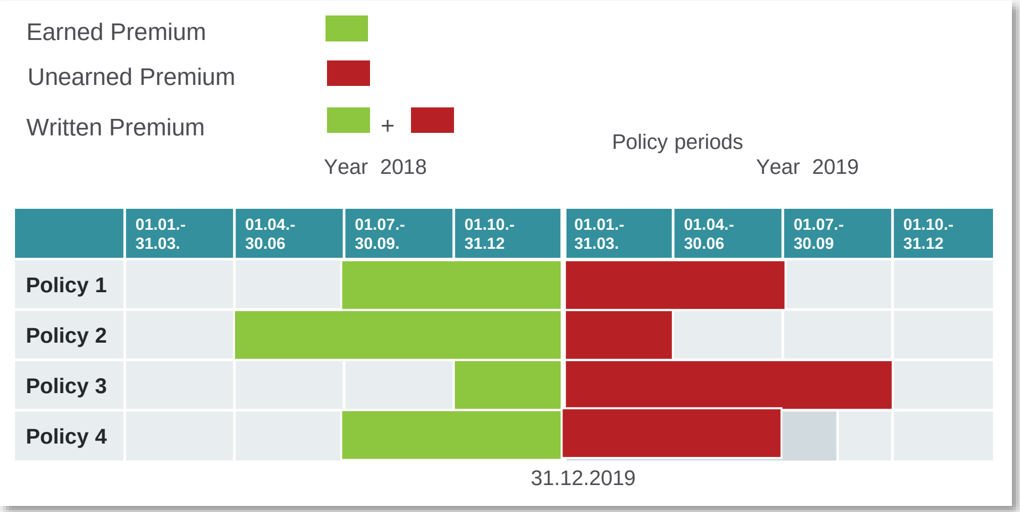
- Premium Portfolio Entry – The reinsurer receives a Portfolio Entry from the Insurer, in return, assumes ***liability*** for the policies underwritten in the previous year.
- Loss Portfolio Entry – The reinsurer assumes the previous years' ***loss reserves*** by receiving a corresponding amount from the cedant for participating in the risk
- Premium Portfolio Withdrawal – At the end of the treaty year, the reinsurer terminates its ***liability*** for policies whose period extend to the next treaty year.
- Loss Portfolio Withdrawal – The reinsurer withdraws from the existing ***loss reserves*** by paying its amount to the cedant, Usually net of a certain discount which is ***usually 90%***

Portfolio Entry & Withdrawal



Earned Premium and Unearned Premium

Portfolio of an Insurance Company

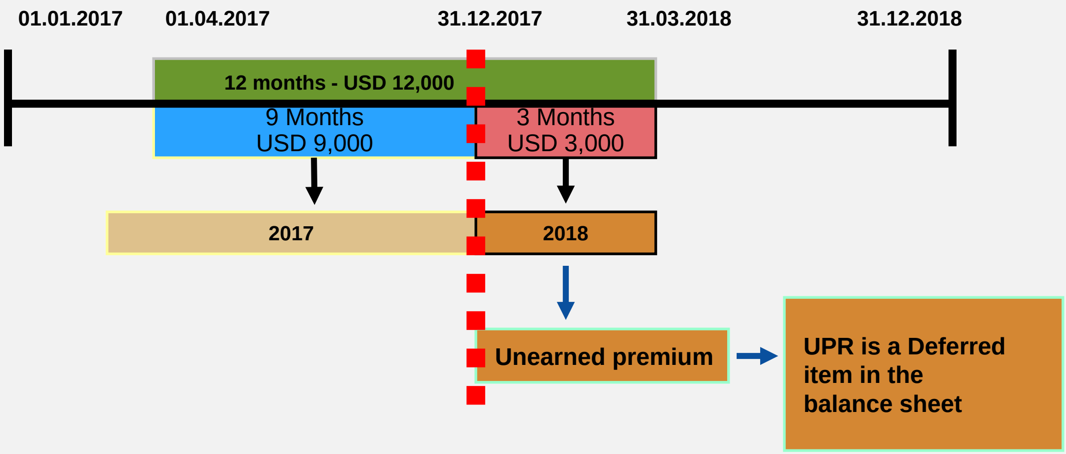


Understand the terms “Earned” and “Unearned”

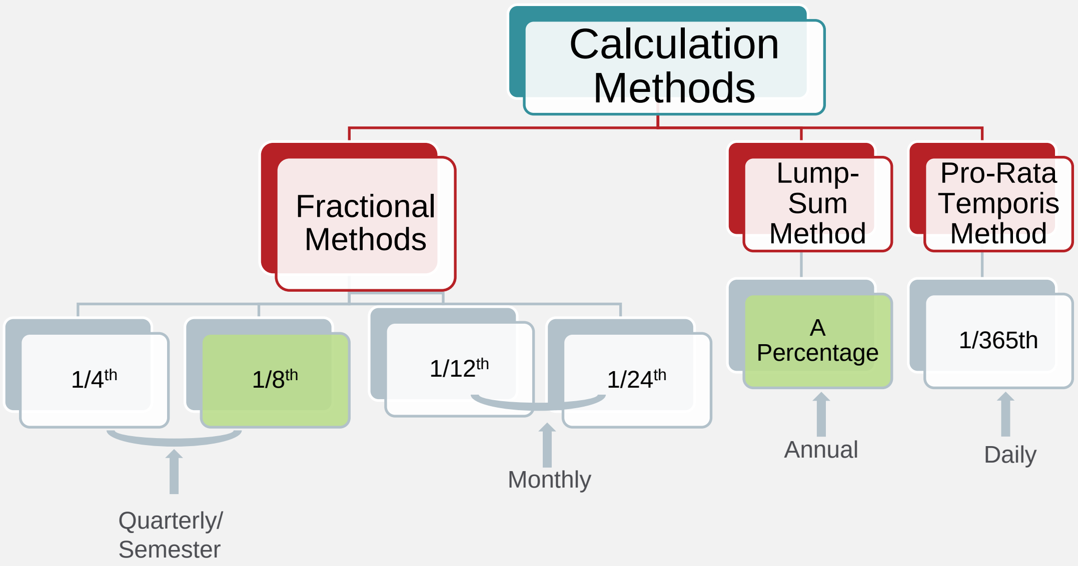
Earned/Unearned Premiums

Term of Policy: 01.04.2017 – 31.03.2018

Premium for 1 year: USD 12,000



METHODS OF CALCULATION



Portfolio Lump Sum Method

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Treaty Condition

PORTFOLIO WITHDRAWAL & ENTRY

Premium Portfolio : 40% Net of Commission

Commission ; 20%

Loss Portfolio: 100% of Outstanding Lösses

Accounting Items	Dollar
Premium	100,000
Commission	20,000
Outstanding loss reserves at 31.12.2017	50,000
Portfolio Withdrawal	
Premium portfolio Entry (100 000 – 20%)* 40%	32,000
Loss portfolio Entry (50 000* 100%)	50,000

Portfolio Calculation under 1/8th method

- For the 8ths system, it is assumed that the majority of each quarter's premiums will expire in the middle of the corresponding quarter in the next year.

One Eighths basis to be calculated as follows:

- 12.5% of Written Premium Ceded in the 1st Quarter

  Plus

- 37.5% of Written Premium Ceded in the 2nd Quarter

  Plus

- 62.5% of Written Premium Ceded in the 3rd Quarter

  Plus

- 87.5% of Written Premium Ceded in the 4th Quarter

- Loss Portfolio calculation 90% or 100% of Outstanding Loss Reserves

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Treaty conditions: **Our share o 70%**	Premium Portfolio is net of 35% commission using the 1/8th Method	Loss Portfolio is 90% of Outstanding Losses

Calculation of Premium portfolio

Gross Premium (our share)	Premium Net Of Comm.	1/8th method
1st Quarter 2018 $ 20,000	13,000	1,625
2nd Quarter 2018 $ 16,000	10,400	3,900
3rd Quarter 2018 $ 24,000	15,600	9,750
4th Quarter 2018 $ 30,000	19,500	17,062.50
Total	**$58,500**	**$ 32,337.50**

Calculation of Loss portfolio

O/S losses as 31.12	$ 20 000	
Loss portfolio	20 000* 90%	**$ 18 000**

Causes and Consequences of Portfolios

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- Change of reinsurer
- Change of the reinsurance shares
- Change of insured self-retention (Change in cession)
- Treaty operating in a clean cut / revenue year basis
- Cancellation of a treaty
- Premium and portfolio movements have a direct influence on the cash flow
- They replace the unearned premiums and/or loss reserves in profit and sliding- scale commission calculations

Portfolios – Advantages and Disadvantages

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Advantages of premium portfolios:

- The direct insurer does not have to render accounts for the previous years's

  reinsurers in respect of :

  - Premium due
  - Claims occurred

Portfolios – Advantages and Disadvantages

Advantages of Loss portfolios:

- The cedant does not have to render run-off accounts for terminated treaties
- Losses concerning previous years are settled with the reinsurer’s share for the current year
- Profit commission / Sliding- Scale commissions for a certain treaty year must not be amended n subsequent year

Portfolios – Advantages and Disadvantages

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Disadvantages of Loss portfolios:

- Limited Practicability –

➢ For the former reinsurer : Profits on loss reserves are realised by the subsequent reinsurer.

➢ For the subsequent reinsurer: Losses on loss reserves are realised by himself.

Dates for Rendering the accounts

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- Portfolio withdrawals and entries must take place simultaneously *either*

  In the last account of the current year (Q4) *or*

  In the first account of the following year (Q1)

- The Portfolio account can have the following design:

  Within the quarterly account *or*

  In a separate portfolio account at the same time as the regular account

Cash Loss

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- The cash payment (Cash Call) is an advance to the cedant.
- The total claim must exceed a certain limit to qualify for cash settlement and this limit is called the Cash Loss limit and immediate ash settlement can be requested.

Cash Call under Proportional Treaty

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- Cash Call/loss arises mostly in **proportional contract.**
- It allows a reinsured to request immediate payment for a large loss without waiting for the quarterly accounts to be due.
- A Cash Call is intended to cushion exceptional burdens on the cedant's liability arising from major losses
- Cash Call conditions are usually included in Proportional Reinsurance arrangements

Procedures to accept the Cash Call

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- The amount of the loss must exceed a certain limit as specified in the wording
- All the qualified claims documentation must be provided following the request so as not to delay the cash call payment
- The claims department will check all the relevant facts, legal assessment and adjusting reports pertaining to the loss
- ***Accounting doesn’t have the authority to accept a cash call prior to claims confirmation***

Time limit for the Cash Call

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- Cash call request is a special recall of funds from the reinsured
- The reinsurer will have to make payment as soon as possible. Usually within 10 days after receipt of such request.
- Once payment is made, the reinsurer then awaits the cash call recovery.

- **Cash CALL Refund**

- Cash Calls are requested before the end of the current quarter. We usually therefore expect the funds to be recovered in that particular current quarter or in the next quarter.
- It is important to control this, otherwise duplicates may occur

Cash Loss Example

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❖**Fire Quota Share**

➢**Treaty Information**

Cash Loss Limit: ZAR 8,000,000 (100%)

Quarterly Accounts, submitted within 45 days

➢**Cash Loss Information**

Cash loss request dated 12.02.2019 in the amount of ZAR 9,000,000

Insured Name : Coco Island

Settlement by Reinsurer on 16.02.2019

➢**Account Information**

Paid Losses in 1st Quarter 2019 : 10,500,000

Current underwriting year 2019 1st Qtr. 2019

Cash Loss Example

COB : Fire QS UY : 2019	Debit	Credit
	ZAR (‘000)	ZAR (‘000)
Premium		50,000
Commission	15,000	
Losses Paid	1,500	
Cash Loss Sett for Durban Warehouse Fire	9,000	
cash loss Refund paid for Coco Island		9,000

Quiz Test

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1. Name 4 calculation methods for portfolios.
2. Run-off accounts are applicable to an accounting year treaty. ***(True or False)***
3. For an occurrence year treaty the cedant must render a loss portfolio withdrawal to the reinsurer. ***(True or False)***
4. Name the 3 different coverage systems that can be used for rendering quarterly accounts.
5. It is up to the cedant to decide whether to submit Run-off / Run-off accounts on clean cut treaty. ***(True or false)***

Quiz Test

6. Name any advantage of having portfolio conditions.
7. Name any disadvantage of having portfolio conditions.
8. Cash Call payment is applicable to the cedant based on its profitability?
9. A cash call can be requested quarterly by the cedant? ***(True or False)***

Thank you for your attention!

March 2023

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