CAPTIVE INSURANCE GLOSSARY

Actuary An actuary analyzes, evaluates and manages statistical information to determine rates.

Admitted Insurance Company A company is admitted when it has been licensed and accepted by the appropriate governmental regulator of a state. In determining its financial condition, a ceding insurer is allowed to take credit for the unearned premiums and unpaid claims on the risks reinsured if the reinsurance is placed in an admitted reinsurance company.

Alternative Risk Transfer (ART) is an alternative to traditional insurance. A company's risks are funded by means other than the purchase of insurance through an agent broker from an admitted insurer. ART forms include surplus lines placement, self-insured trusts, risk retention groups and captives. The alternative market seeks to avoid costs associated with insurance brokerage and allow a business to finance its own risk.

Arbitration Clause Language providing a means of resolving differences between the reinsurer and the reinsured without litigation. Usually, each party appoints an arbiter. The two thus appointed select a third arbiter, or umpire, and a majority decision of the three becomes binding on the parties to the arbitration proceedings.

Association Any legal organization of sole proprietorships, corporations, partnerships, limited liability companies or associations that has been in continuous existence for at least one year and has the power to vote all of the outstanding voting securities for its captive.

Attachment Point The dollar amount under an excess of loss reinsurance contract at which a ceding (primary) insurer's retention requirements have been met, and the point at which the reinsurance will respond to a loss.

Bordereau (plural Bordereaux) A form providing premium or loss data with respect to identified specific risks which is furnished the reinsurer by the reinsured.

Burning Cost, A term most frequently used in spread loss property reinsurance to express pure loss cost or more specifically the ratio of incurred losses within a specified amount in excess of the ceding company's retention to its gross premiums over a stipulated number of years.

Cancellation (a) Run-off basis means that the liability of the reinsurer under policies, which became effective under the treaty prior to the cancellation date of such treaty, shall continue until the expiration date of each policy; (b) Cut-off basis means that the liability of the reinsurer under policies, which became effective under the treaty prior to the cancellation date of such treaty, shall cease with respect to losses resulting from accidents taking place on and after said cancellation date. Usually the reinsurer will return to the company the unearned premium portfolio, unless the treaty is written on an earned premium basis.

Capacity is determined by the amount of surplus an insurer is willing to put at risk for the payment of losses experienced by their insureds. An insurer has a fixed amount of premium they are willing to write associated with their capacity.

Catastrophe Reinsurance A form of reinsurance that indemnifies the ceding company for the accumulation of losses in excess of a stipulated sum arising from a catastrophic event such as conflagration, earthquake or windstorm. Catastrophe loss generally refers to the total loss of an insurance company arising out of a single catastrophic event.

Cede to cede is to transfer part or all of a risk to another company (reinsurer). A fee is charged for the service of accepting that risk.

Ceding Commission The cedant's acquisition costs and overhead expenses, taxes, licenses and fees, plus a fee representing a share of expected profits – sometimes expressed as a percentage of the gross reinsurance premium.

Ceding Company The original or primary insurer; the insurance company which purchases reinsurance.

Claims-Made Basis A form of reinsurance under which the date of the claim report is deemed to be the date of the loss event. Claims reported during the term of the reinsurance agreement are therefore covered, regardless of when they occurred. A claims made agreement is said to "cut off the tail" on liability business by not covering claims reported after the term of the reinsurance agreement – unless extended by special agreement. See Occurrence Basis.

Commission In reinsurance, the primary insurance company usually pays the reinsurer its proportion of the gross premium it receives on a risk. The reinsurer then allows the company a ceding or direct commission allowance on such gross premium received, large enough to reimburse the company for the commission paid to its agents, plus taxes and its overhead. The amount of such allowance frequently determines profit or loss to the reinsurer.

Commutation Clause A clause in a reinsurance agreement, which provides for estimation, payment and complete discharge of all future obligations for reinsurance losses incurred regardless of the continuing nature of certain losses such as unlimited medical and lifetime benefits for Workers' Compensation.

Contingent Commissions (or Profit Commission) An allowance payable to the ceding company in addition to the normal ceding commission allowance. It is a pre-determined percentage of the reinsurer's net profits after a charge for the reinsurer's overhead, derived from the subject treaty.

Contributing Excess Where there is more than one reinsurer sharing a line of insurance on a risk in excess of a specified retention, each such reinsurer shall contribute towards any excess loss in proportion to his original participation in such risk. Example: Retention $100,000, Reinsurer A accepts one-half contributing share part of $1,000,000 in excess of said $100,000. Reinsurer B accepts remaining one-half contribution share part of $1,000,000.

Domicile means the state or area where the captive resides. So, the captive is domiciled (or governed by the laws and formed) in that state.

Earned Premium (1) That part of the premium applicable to the expired part of the policy period, including the short-rate premium on cancellation, the entire premium on the amount of loss paid under some contracts, and the entire premium on the contract on the expiration of the policy. (2) That portion of the reinsurance premium calculated on a monthly, quarterly or annual basis which is to be retained by the reinsurer should their cession be canceled. (3) When a premium is paid in advance for a certain time, the company is said to "earn" the premium as the time advances. For example, a policy written for three years and paid for in advance would be one-third "earned" at the end of the first year.

Errors and Omissions Clause A provision in reinsurance agreements which is intended to neutralize any change in liability or benefits as a result of an inadvertent error by either party.

Excess of Loss A form of reinsurance under which recoveries are available when a given loss exceeds the cedant's retention defined in the agreement.

Ex Gratia Payment A payment made for which the company is not liable under the terms of its policy. Usually made in lieu of incurring greater legal expenses in defending a claim. Rarely encountered in reinsurance as the reinsurer by custom and for practical reasons follows the fortunes of the ceding company.

Expense Ratio The percentage of premium used to pay all the costs of acquiring, writing and servicing insurance and reinsurance.

Experience (1) The loss record of an insured or of a class of coverage. (2) Classified statistics of events connected with insurance, of outgo, or of income, actual or estimated. (3) What figures show to have happened in the past.Experience may be compiled on different bases to provide various means of appraisal, viz. Accident Year, Calendar Year, or Policy Year, but, for underwriting purposes, should always compare earned premium with incurred losses after the latter have been modified by an allowance for loss development and incurred but not reported losses (I.B.N.R.).

Extra Contractual Obligations (ECO) A generic term that, when used in reinsurance agreements, refers to damages awarded by a court against an insurer which are outside the provisions of the insurance policy, due to the insurer's bad faith, fraud, or gross negligence in the handling of a claim. Examples are punitive damages and losses in excess of policy limits.

Expense Ratio The percentage of premium not directed to the coverage of losses but rather to the payment of expenses associated with writing and servicing the risk.

Facultative coverage is a form of reinsurance where the reinsurer accepts or rejects individual risks. If a member of a group captive has an individual need for additional coverages not shared by the group, these coverages can be placed facultatively with the captive's reinsurance treaty.

Federal Risk Retention Act Revised and enacted in 1981, this law makes allowances for captive and risk retention groups to form and operate. The legislation preempts restrictive and prohibitive state laws that would preclude insurers from giving preferential rates, terms and conditions to groups seeking liability insurance coverage. The act provides definitions to aid in gaining an understanding of RRGs.

Financial Reinsurance A form of reinsurance which considers the time value of money and has loss containment provisions. One of its objectives is the enhancement of the cedant's financial statements or operating ratios, e.g., the combined ratio; loss portfolio transfers; and financial quota shares are examples.

Flat Rate In reinsurance, a percentage rate applied to a ceding company's premium writings for the classes of business reinsured to determine the reinsurance premiums to be paid the reinsurer.

Following the Fortunes, the clause stipulating that once a risk has been ceded by the reinsured, the reinsurer is bound by the same fate thereon as experienced by the ceding company.

Fronting/Issuing Company A fronting company is a commercial insurance company licensed and admitted in the state(s) where a risk to be insured is located. The captive contracts with the front to issue its policy to the insured(s). The front then transfers all that risk to the captive and/or reinsurers through a reinsurance agreement known as a fronting agreement. Fronting companies provide various levels of involvement from simply providing the paper for the policies to complete underwriting and issuance. Of course, their fees vary to match the depth of their services. The result is insurance policies issued on admitted paper, but with the risk associated with the coverage retained by the captive.

Incurred Loss Ratio The percentage of losses incurred to premiums earned. (See Experience.)

Indemnify means “to make whole,” or return one to the state that occurred before the loss incident. Insurers generally indemnify two parties: persons damaged by a liability loss, and the insured damaged by a property loss.

Industrial Insured An insured which procures the insurance of any risk or risks by use of the services of a full-time employee acting as an insurance manager or buyer. An industrial insured must have aggregate annual premiums for insurance on all risks totaling at least $25,000 and have at least 25 full-time employees.

Inflation Factor A loading to provide for increased medical costs and loss payments in the future due to inflation.

Intermediary A third party in the design, negotiation, and administration of a reinsurance agreement. Intermediaries recommend to cedants the type and amount of reinsurance to be purchased and negotiate the placement of coverage with reinsurers.

Intermediary Clause A provision in reinsurance agreements which identifies the intermediary negotiating the agreement. Most intermediary clauses shift all credit risk to reinsurers by providing that: 1. the cedant’s payments to the intermediary are deemed payments to the reinsurer; and 2. the reinsurer’s payments to the intermediary are not payments to the cedant until actually received by the cedant. This clause is mandatory in some states.

Layer A horizontal segment of the liability insured, e.g., the second $100,000 of a $500,000 liability is the first layer if the cedant retains $100,000 but a higher layer if it retains a lesser amount.

Lead Reinsurer The reinsurer who negotiates the terms, conditions, and premium rates and first signs on to the slip; reinsurers who subsequently sign on to the slip under those terms and conditions are considered following reinsurers.

Letter of Credit A financial guaranty issued by a bank that permits the party to which it is issued to draw funds from the bank in the event of a valid unpaid claim against the other party; in reinsurance, typically used to permit reserve credit to be taken with respect to non-admitted reinsurance; and alternative to funds withheld and modified coinsurance.

Loss Adjustment Expense LAE means all expenditures of an insurer associated with the adjustment, recording and settlement of claims other than the indemnity itself. There are two types of LAE. Allocated Loss Adjustment Expense (ALAE) is identified by the claim file in the insurers record, such as attorney’s fees. (ULAE) Unallocated Loss Adjustment Expense is the fixed cost an insurer bears to be able to process claims regardless of the individual claims.

Loss Development The difference between the original loss as originally reported to the reinsurer and its subsequent evaluation at a later date or at the time of its final disposal. A serious problem to reinsurers who, being involved in the more serious cases, must frequently wait many years for the final disposition of a loss.

Loss Event The total losses to the ceding company or to the reinsurer resulting from a single cause such as a windstorm.

Loss Ratio The loss ratio is the incurred losses of a captive compared to the earned premiums expressed as a percentage.

Member Organization A member organization is a sole proprietorship, corporation, partnership, or association as a mutual insurer.

Non-Admitted Reinsurance A Company is “non-admitted” when it has not been licensed and thereby recognized by appropriate insurance governmental authority of a state or country. Reinsurance is “non-admitted” when placed in a non-admitted company and therefore may not be treated as an asset against reinsured losses or unearned premium reserves for insurance company accounting and statement purposes.

Occurrence An adverse contingent accident or event neither expected nor intended from the point of view of the insured. With regard to limits on occurrences, property catastrophe reinsurance agreements frequently define adverse events having a common cause and sometimes within a specified time frame, for example 72 hours, as being one occurrence. This definition prevents multiple retentions and reinsurance limits from being exposed in a single catastrophe loss.

Offset Clause A provision in reinsurance agreements which permits each party to net amounts due against those payable before making payment; especially important in the event of insolvency of one party which ceases to remit amounts due to the other.

Parent A parent is a corporation, partnership, or individual that directly or indirectly owns, controls or holds with power to vote more than 50% of the outstanding voting securities of a pure captive insurance company.

Participating or Pro Rata Reinsurance Includes Quota Share, First Surplus, Second Surplus, and all other sharing forms of reinsurance where under the reinsurer participates pro rata in all losses and in all premiums.

Peril This term refers to the causes of possible loss in the property field – for instance: Fire, Windstorm, Collision, Hail, etc. In the casualty field the term “Hazard” is more frequently used.

Per Risk Excess Reinsurance Retention and amount of reinsurance apply “per risk” rather than on a per accident or event or aggregate basis.

Policy Year The year commencing with the effective date of the policy or with an anniversary of that date.

Pool An organization of insurers or reinsurers through which particular types of risks are underwritten with premiums, losses, and expenses shared in agreed ratios.

Portfolio Reinsurance In transactions of reinsurance, it refers to all the risks of the reinsurance transaction. For example, if one company reinsures all of another’s outstanding Automobile business, the reinsuring company is said to assume the “portfolio” of Automobile business and it is paid the total of the unearned premium on all the risks so reinsured (less some agreed commission).

Portfolio Run-off The opposite of Return of Portfolio – permitting premiums and losses in respect of in-force business to run to their normal expiration upon termination of a reinsurance treaty.

Premium, Deposit When the terms of a policy provide that the final earned premium be determined at some time after the policy itself has been written, companies may require tentative or “deposit” premiums at the beginning which are readjusted when the actual earned charge has been later determined.

Premium (Written/Unearned/Earned) Written premium is premium registered on the books of an insurer or reinsurer at the time a policy is issued and paid for. Premium for a future exposure period is said to be unearned premium for an individual policy, written premium minus unearned premium equals earned premium. Earned premium is income for the accounting period, while unearned premium will be income in a future accounting period.

Professional Reinsurer A term used to designate a company whose business is confined solely to reinsurance and the peripheral services offered by a reinsurer to its customers as opposed to primary insurers who exchange reinsurance or operate reinsurance departments as adjuncts to their basic business of primary insurance. The majority of professional reinsurers provide complete reinsurance and service at one source directly to the ceding company.

Profit Commission A provision found in some reinsurance agreements which provides for profit sharing. Parties agree to a formula for calculating profit, an allowance for the reinsurer's expenses, and the cedant's share of such profit after expenses.

Pure Premium The portion of the premium that covers losses and related expenses.

Quota Share A form of insurance wherein all insurance parties (primary and reinsurers) share a portion of all losses on an individual basis. Quota share is credited with being the original form of insurance. The story goes that a group of ship owners and financiers were sitting around in a little coffee shop in London called Lloyd's

Reinstatement Clause When the amount of reinsurance coverage provided under a treaty is reduced by the payment of a reinsurance loss as the result of one catastrophe, the reinsurance cover is automatically reinstated usually by the payment of a reinstatement premium.

Reinstatement Premium A pro rata reinsurance premium is charged for the reinstatement of the amount of reinsurance coverage that was reduced as the result of a reinsurance loss payment under a catastrophe cover.

Reinsurance is the concept of one insurance company being insured by another. There exists a primary insurer and then a secondary insurer to guarantee that a business can cover its claims in case of a crisis.

Reinsurance Treaty An agreement between a reinsurer and a ceding insurer setting forth details of the reinsurance agreement.

Reinsurer An insurer or reinsurer assuming the risk of another under contract.

Retention The net amount of risk which the ceding company or the reinsurer keeps for its own account or that of specified others.

Retrocession A reinsurance of reinsurance. Example: Company "B" has accepted reinsurance from Company "A", and then obtains for itself, on such business assumed, reinsurance from Company "C". This secondary reinsurance is called a Retrocession. The transaction whereby a reinsurer cedes to another reinsurer all or part of the reinsurance it has previously assumed.

Retrospective Rating A plan or method which permits adjustment of the final reinsurance ceding commission or premium on the basis of the actual loss experience under the subject reinsurance treaty – subject to minimum and maximum limits.

Risks A term used to denote the physical units of property at risk or the object of insurance protection and not Perils or Hazard. Reinsurance by tradition permits each insurance company to frame its own rules for defining units of Risks. The word is also defined as chance of loss or uncertainty of loss.

Risk Retention Group A form of captive insurance specifically designed for those insureds who share the same risks. An example of those forming RRGs would be doctors.

Salvage and Subrogation Those rights of the insured which, under the terms of the policy, automatically transfer to the insurer upon settlement of a loss. Salvage applies to any proceeds from the repaired, recovered, or scrapped property.

Subrogation refers to the proceeds of negotiations or legal actions against negligent third parties and may apply to either property or casualty coverages.

Self-Insurance The amassing of funds by an individual or organization to meet his or its insurance needs and to absorb fluctuations in the amount of loss, the losses being charged against the funds accumulated.

Sliding Scale Commission, A ceding commission which varies inversely with the loss ratio under the reinsurance agreement. the scales are not always one to one: for example, as the loss ratio decreases by 1%, the ceding commission might increase only 5%.

Slip A binder often including more than one reinsurer. At Lloyd's of London, the slip is carried from underwriter to underwriter for initialing and subscribing to a specific share of the risk.

Special Acceptance The facultative extension of a reinsurance treaty to embrace a risk not automatically included within its terms.

Spread Loss A form of reinsurance under which premiums are paid during good years to build up a fund from which losses are recovered in bad years. This reinsurance has the effect of stabilizing a cedant's loss ratio over an extended period of time.

Stop Loss A form of reinsurance under which the reinsurer pays some or all of a cedant's aggregate retained losses in excess of a predetermined dollar amount or in excess of a percentage of premium.

Subject Premium A cedant's premiums (written or earned) to which the reinsurance premium rate is applied to calculate the reinsurance premium. Often, subject premium is gross/net written premium income (GNWPI) or gross/net earned premium income (GNEPI), where the term "gross/net" means gross before deducting reinsurance premiums for the reinsurance agreement under consideration, but net after all other adjustments, e.g., cancellations, refunds, or other reinsurance. Normally, subject premium refers to premium on subject business. Also known as base premium.

Surplus is an insurance company's assets in excess of its liabilities. Captives are subject to statutorily required minimum surplus levels as well as practical requirements for premium to surplus ratios.

Surplus Share A form of proportional reinsurance where the reinsurer assumes pro rata responsibility for only that portion of any risk which exceeds the company's established retentions.

Third Party Administrator (TPA) A TPA is an independent company which provides services to the insurance company (captive) for a fee. Typical services provided include claims reporting, administration, and management; and/or underwriting and policy issuance. Typical TPA firms include claims adjusting firms and managing general underwriters (MGU) and managing general agents (MGA).

Treaty A general reinsurance agreement which is obligatory between the ceding company and the reinsurer containing the contractual terms applying to the reinsurance of some class or classes of business, in contrast to a reinsurance agreement covering an individual risk.

Ultimate Net Loss This term usually means the total sum which the assured, or any company as his insurer, or both, become obligated to pay either through adjudication or compromise, and usually includes hospital, medical and funeral charges and all sums paid as salaries, wages, compensation, fees, charges and law costs, premiums on attachment or appeal bonds, interest, expenses for doctors, lawyers, nurses, and investigators and other persons, and for litigation, settlement, adjustment and investigation of claims and suits which are paid as a consequence of the insured loss, excluding only the salaries of the assured's or of any underlying insurer's permanent employees.

Underwriting refers to the issuing and signing of an insurance policy by a party to assume liability in case of specified losses.

Unearned Premium That portion of the original premium that applies to the unexpired portion of risk. A fire or casualty insurer or reinsurer must carry a reserve against all unearned premiums as a liability in its financial statement, for if the policy should be canceled, the company would have to pay back the unearned part of the original premium.

Working Layer, the first layer above the cedant's retention wherein moderate to heavy loss activity is expected by the cedant and reinsurer. Working layer reinsurance agreements often include adjustable features to reflect actual underwriting results.