

THE POSITION OF THE REINSURANCE COMPANY IN THE CASUALTY BUSINESS

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The rapid growth of the casualty business is a familiar phenomenon. We are informed upon competent authority that from 1890 to 1926, the net premium income of casualty companies in the United States grew from less than \$8,000,000 to more than \$800,000,000.

It may not be so generally known that, in recent years, the volume of reinsurance premiums in the casualty field has increased relatively more rapidly than has the net premium income.

The writer is not aware of any published figures in which reinsurance data are combined for any considerable number of companies.

However, the "New York Insurance Report" shows for each casualty company not only net premiums in force but also gross premiums in force and reinsurance premiums in force, at the end of the calendar year. This enables one to make a comparison as respects the business in force at the end of the year between reinsurance premiums and net premiums.

In order to gauge the growth of casualty reinsurance both absolutely and relatively during recent years, the writer combined the data as to premiums in force for certain companies doing business in the State of New York during the years 1915 and 1925 respectively. The combined figures are shown in Exhibit "A". Certain strictly reinsurance companies were excluded from the comparison, as well as companies having, in either year, a premium volume less than \$1,000,000. Companies doing a "one-line" business, such as strictly accident and health companies, were also excluded. Mutual companies were omitted because their business has thus far been confined to the compensation and liability fields, where the volume of reinsurance is relatively small. Data as to non-cancellable accident and health business were also omitted on the ground that this class of business is properly an adjunct of life insurance rather than of casualty insurance.

The most significant fact revealed by the comparison was the increase in the relative volume of reinsurance. At the end of

1915, for the companies observed, net premiums in force were \$112,000,000, in round figures, and reinsurance premiums in force were approximately \$3,900,000. The reinsurance premiums in force were only $3\frac{1}{2}\%$ of the net premiums in force. At the end of 1926, the corresponding figures were \$438,000,000 and \$36,500,000 respectively. The total volume had increased 290%, whereas the volume of reinsurance had increased more than 800%, the ratio of reinsurance to net premiums having increased from 3.5% to 8.3%.

The entire volume of reinsurance premiums for 1925 was undoubtedly substantially in excess of the reinsurance premiums in force at the end of that year for the observed companies. If we take the ratio of reinsurance to net for 1925 based on premiums in force for the companies observed, *viz.*, 8.3%, and apply it to the total casualty premium volume, we should arrive at the total volume of reinsurance premiums within a reasonable margin of error.¹ This method indicates approximately \$50,000,000 as the volume of reinsurance premiums in 1925 for companies admitted to New York State and not less than \$60,000,000 as the countrywide volume for 1926.

If we look at the figures for the several kinds of insurance as shown in Exhibit "A", it will be noted that for almost all lines the ratio of reinsurance to net premiums increased substantially from 1915 to 1925. The exceptions are compensation and plate glass, where the reinsurance arrangements (at least to the extent revealed in the published figures) must have been confined to the excess type, and miscellaneous property damage (including sprinkler), where the reduction in the ratio of reinsurance to net premiums is very slight.

The figures we have deduced indicate conclusively that in the casualty and surety field reinsurance is becoming a problem of more and more importance. This holds good for the business

¹In the absence of actual figures, it is, of course, open to conjecture whether the ratio of reinsurance premiums to net premiums indicated for the observed companies holds for other companies admitted to New York State and for companies not doing business in that jurisdiction. However, in the data taken off by the writer, no account was taken of the business of an important stock company co-insurance pool, which is essentially a reinsurance arrangement. Furthermore, there is a considerable volume of reinsurance on the "excess" basis where little, if any, "premiums in force" are shown at the end of the year. For these reasons, it is believed that the estimate we have given of total reinsurance premiums is conservative.

as a whole and for the great majority of individual companies even though it may not hold for some few of the largest companies.

The question which next presents itself is: "Has the growth of reinsurance companies kept pace with the growth of reinsurance?"

In 1915, there was one casualty reinsurance company doing business in the State of New York and its premium income was \$954,000. In 1925, there were four such companies with a combined premium income of approximately \$10,790,000. If we take the entire volume of reinsurance business for New York admitted companies as \$5,000,000 in 1915 and \$50,000,000 in 1925, we find that during the ten years, the proportion ceded to strictly reinsurance companies² had increased but very little, *viz.*, from 19.1% to 21.6%.

These figures cannot be said to indicate that casualty reinsurance companies in the United States have fully realized their opportunity, for they undoubtedly still remain, regardless of any change in conditions since 1925, only a minor factor in the reinsurance situation. For this reason, the remarks in this paper will be directed very largely towards the writer's concept of the proper position of the reinsurance company rather than towards present day conditions.

Before presenting any views as to the ultimate functions of the reinsurance company in the American casualty business, it will be necessary to introduce some description of conditions and practices as they now are. The aim will be to make the descriptive matter as brief as possible³ but adequate to an understanding of the current status and of the ideas which later will be set forth in this paper.

EVOLUTION OF THE TREATY

In the unfolding of human society, archaeologists recognize the epochs of stone, of bronze and of iron. In point of time, these epochs are relative rather than absolute. The shores of the

²We have excluded from "strictly reinsurance companies" any companies known to write a substantial volume of direct business. However, we have not excluded any company from the reinsurance category merely because it writes excess cover for self-insurers.

³For a comprehensive description of reinsurance in the compensation and liability lines, see "Distribution of Shock Losses in Workmen's Compensation and Liability Insurance", G. F. Michelbacher, *Proceedings*, Vol. VII, page 235.

Mediterranean sustained a society employing weapons and implements of bronze before Northern Europe had emerged from the stone age; and America remained in the stone age many centuries after the inception of the age of iron in Europe.

Similarly, we may discern an evolutionary tendency in casualty reinsurance; and this tendency holds even though progress along the evolutionary path has not been uniform throughout the business. The principal gradients along this path may be described as follows:

1. *The Facultative Stage.* In this stage, there are no comprehensive reinsurance arrangements (treaties) between companies. The underwriter "places" reinsurance, when and as the spirit moves him, with such companies (usually "direct-writing") as will accept it. This stage, although the lowest in the development of casualty reinsurance, still prevails widely throughout the business, particularly in the fidelity, surety and burglary lines.

2. *The Open Treaty Stage.* This is a status in which the company has comprehensive and permanent reinsurance arrangements (treaties) with one or more other companies (direct carriers and/or reinsurance companies) outlining a definite procedure for "ceding" reinsurance. The cessions made are recorded in a list (bordereau) transmitted to the reinsurer at stated intervals. In treaties of this general type, there is considerable variation as to the freedom accorded the ceding company as to what risks are to be reinsured and to what extent. Almost invariably if a risk is to be reinsured at all, the ceding company must "retain" a portion bearing not less than a stated ratio to the amount of reinsurance ceded. However, the salient characteristic of the open treaty is the discretion allowed to the direct carrier, and this discretion is almost invariably very material. Typically where a risk is regarded as particularly desirable, the ceding company may refrain from placing any reinsurance under the treaty, keeping all of the risk for itself or keeping the major portion and placing the remainder facultatively. On the other hand, where the risk is manifestly undesirable, the ceding company is in a position to retain only its minimum, if it so desires, give the treaty company its maximum proportion and place any remaining "surplus" facultatively. In some cases, the reinsurer under such a treaty has the right to object to or cancel individual risks, but such a provision, where it is included, is of little value because of the

relatively slight information which the reinsurer possesses as to the relative quality of the risks. Under the open treaty, the reinsurer's only protection is a desire on the part of the ceding company to develop a permanent relationship with the reinsurer, and history records that in many cases the "dominant wish" of the ceding company has been an immediate profit at the expense of the reinsurer rather than such a permanent relationship. The open treaty is still the prevailing type in the fire reinsurance business⁴ and the earlier treaties in the casualty business follow this pattern probably because of fire insurance precedent.

3. *The Fixed Treaty Stage.* In this stage, the reinsurer's interest in each risk proceeds automatically from the terms of the treaty. Before he writes a given risk, the underwriter knows the amount of his company's retention and the extent of the reinsurance. The fixed treaty enables the underwriter instead of dissipating his time and energies in a "swapping" contest with his competitors to think of his problems on the wholesale basis. From the administrative standpoint also, the fixed treaty has marked advantages, many of which have not yet been fully developed.

SHARE, EXCESS AND SURPLUS

There are two forms of reinsurance cover, namely, "share" and "excess".

On the share basis, the reinsurer assumes a stated proportion of the entire risk. This proportion applies to the premium and to the loss, if any, as well as to whatever salvage or other recoveries there may be.

On the excess basis, the reinsurer is not involved in any loss except to the extent to which it is in excess of a stated amount. Since, in most forms of insurance, the greater number of losses are small as compared to the total amount of insurance, under the excess plan, the reinsurer's premium is not in direct proportion to its maximum liability. An example will clarify the distinction between the two forms.

Burglary reinsurance is sometimes on the share, sometimes on the excess basis. Let us suppose a policy for \$20,000 in amount

⁴"The System of Treaty Reinsurance in Fire Insurance", H. Ernest Feer, published 1926, by the Insurance Society of New York.

on mercantile open stock, the premium for which is \$340.00. Let us assume that the reinsurance is on the share basis and that the carrier retains \$10,000, ceding the reinsurer an equal amount. In this case, the premium of the reinsurer and that of the ceding company would be the same, *viz.*, \$170.00. Under this policy there occurs a loss amounting to \$15,000, and later part of the goods are recovered, resulting in salvage to the extent of \$3,000. Obviously, the ultimate net loss under the policy is \$12,000, of which the reinsurer bears exactly one-half, or \$6,000.

On the other hand, if this risk had been written on the excess basis, let us say with a retention of \$10,000 on the part of the ceding company with respect to any loss, the reinsurer's premium for this particular policy would have been very much less than half the total premium, say not more than 10%, or \$34.00. Its share in this particular loss would have been \$2,000, *i. e.*, the amount by which the ultimate net loss exceeded the direct-writing company's retention, as under the excess plan all salvage is applied in reduction of a loss before determining the reinsurer's share.

"Surplus" reinsurance is sometimes confused with excess. In fact, in the fire insurance business, the term "excess" is evidently employed when surplus reinsurance (at least from the casualty man's viewpoint) is really meant.⁴ In the proper use of the word in the casualty business, "excess" relates to the amount of the loss, not to the total amount of the policy.

Surplus reinsurance in the casualty business is merely share reinsurance wherein the extent of reinsurance depends on the size of the policy.

Suppose, for example, the direct-writing company decides to retain all of its burglary policies which do not exceed \$10,000 in face amount; that half of any amounts between \$10,000 and \$25,000 shall be reinsured; and that all of any amounts in excess of \$25,000 shall be reinsured. Under this arrangement, the amount by which the face of any policy exceeded \$10,000 would be "first surplus" up to a maximum of \$15,000; and the amount by which the face of any policy exceeded \$25,000 would be "second surplus".

In the case of the risk which we have described, the reinsurer's interest would be represented by half of \$10,000, *i. e.*, \$5,000, as its proportion of the face of the policy. The reinsurance pre-

mium would accordingly be one-fourth of \$340, or \$85, and its share of the ultimate net loss would be one-fourth of \$12,000, or \$3,000.

It is obvious that the excess form of cover is feasible only for those kinds of insurance where losses equalling or approximating the face of the policy are the exception rather than the rule. If we refer again to Exhibit "A", it will be noted that for liability, compensation, plate glass and automobile property damage, the reinsurance premiums are small as compared with the total volume of business. These particularly are the lines where excess reinsurance applies. It applies also to some extent in burglary. The low ratio of reinsurance to total premiums in auto collision may be accounted for by the small amount at risk in the individual case.

DIVERSITY OF REINSURANCE ARRANGEMENTS

It can truly be said that in casualty reinsurance there are at present no generally accepted standards of principle or of practice.

The facultative and the fixed treaty forms, as well as to some extent the open treaty, continue to exist concurrently not only for a given kind of insurance but also in a single direct-writing office.

Aside from this variation in the type of reinsurance arrangement as between companies (or other entities), there is a still further variation in the very structure of the reinsurance relationship.

It is entirely conceivable that all of the following arrangements may be found in a single direct-writing office to-day:

1. Facultative reinsurance with other direct-writing carriers.
2. Co-insurance with a group comprising other direct carriers.
3. Reinsurance with a pool composed of direct carriers.
4. "Reinsurance" with a "company fund".
5. Treaties with other direct carriers.
6. Treaties with reinsurance companies.

A "pool" is an agreement entered into by several companies whereunder each company assumes a stated share, both of premiums and of losses, with respect to a certain "portfolio". The following are examples of such portfolios:

1. The entire amount of compensation or liability risks written by pool members in certain "extrahazardous" classifications. (The best known pool of this type writes "prohibited risks" in liability and compensation insurance and is conducted on the co-insurance principle, *i. e.*, the obligation is "joint and several").

2. Cover on the excess basis for losses exceeding stated limits for certain kinds of insurance written by pool members and/or by other carriers.

3. Coverage on the share basis of surplus lines over and above stated retentions for certain kinds of insurance written by pool members and/or other carriers.

A pool is an association of companies determined by contract and occupying the same relative position as a reinsurance company. It has certain disadvantages which will be touched upon later.

The "company fund" is a device whereby "on paper", at least, a certain amount of "reinsurance" is "ceded" by a given underwriting department to the fund. The fund account is kept as if the fund were a reinsurance company, *i. e.*, the fund is credited with certain premiums and charged with certain losses and the showing of the accident and health, the burglary or the fidelity and surety department of the company is amended accordingly even though in point of fact the insurance corporation itself actually sustains all losses charged to the fund.

THE ACCOUNTING CONTACT BETWEEN THE CEDING COMPANY AND THE REINSURANCE COMPANY

The procedure in reporting premiums and losses to the reinsurance company is, in general terms, defined in the treaty, but in detail it is largely a matter of practice.

Reporting of Premiums. As far as premiums are concerned, the most generally prevailing practice is to report each risk on a "bordereau" (Exhibit B). It is customary for the treaty to provide that bordereaux relating to business written by the ceding company in a given month be filed with the reinsurance company not later than the 20th of the ensuing month. In many cases, however, and particularly where the account is a large one, the bordereaux are transmitted as often as weekly.

It will be noted that the bordereau includes enough data ("Insured or Principal", "Bond or Policy Number", etc.) to

definitely identify each risk. It is possible to glean some idea of the character of the business by inspection of names, geographical locations, classes and amounts of insurance, although such a scrutiny is not at all comprehensive from the underwriting standpoint. Inspection of the bordereaux does reveal, however, whether the company's retentions and the amounts of reinsurance are in accordance with the treaty; whether the reinsurance company's premium is in proper ratio to the total premium; and whether the cessions are being made with promptness.

Exhibit C is the corresponding form for cancellations. In the first column is shown the original cession number to enable the reinsurer to determine the period of the reinsurance and to assure itself that the return premium is in proper proportion to the original premium of the policy. It is also of importance for the reinsurer to verify the fact that cancellations are being reported promptly and that there is not an undue proportion of "flat" cancellations put through late in the policy term. On the cancellation bordereaux it is necessary to show the original premium as well as the return premium in order that a proper deduction may be made from the premiums in force for purposes of the unearned premium reserve.

The extent of detail which should be required in reporting premiums under treaty to a reinsurance company is at this time very much an open question. The bordereau is a legacy from the facultative and open treaty stages of reinsurance. In these earlier stages a bordereau is essential since such a detailed list is the only method of determining the extent of the reinsurer's liability.

The bordereau is still the prevailing procedure in reporting premiums to reinsurance companies, partly because of custom, partly because the treaties for many kinds of insurance are still largely of the "open" type, and partly because in many cases the reinsurance company itself is required by its retrocessionaires⁵ to furnish bordereaux.

The expectation is justified that with the increasing prevalence of the fixed treaty, reinsurance companies will approach a time when it will be possible to do away with bordereaux altogether.

⁵"Retrocession" means "reinsurance of reinsurance". Hence "retrocessionaire" means an entity accepting retrocessions from a reinsurer.

As already indicated bordereaux checking is limited as a means of review of business from the underwriting standpoint and it is also a most inadequate means of determining whether the treaty provisions as regards the ceding of reinsurance have been uniformly carried out by the direct writing company. Practical experience indicates that in the interest of both parties to the treaty, the home office records of the ceding company should be audited from time to time by the reinsurer, since such audits invariably develop facts of material interest to both. The extent of such auditing depends, of course, upon conditions encountered in the individual case.

Since auditing is necessary, the justification for the clerical burden of a detailed bordereau boils down to (a) the determination of the reinsurer's liability and (b) satisfying the requirements of retrocessionaires. Both these reasons for the use of bordereaux can eventually be eliminated by applying the fixed treaty principle to both direct reinsurance and retrocessions.

This condition is already being realized in certain lines. Bordereaux have already been done away with to a certain extent, particularly in the liability business. In this line the reinsurer's obligation is almost invariably definitely fixed by the treaty. Accordingly the reinsurance company in many cases accepts from the ceding company in lieu of a bordereau (which constitutes merely a reiteration for each risk that the ceding company is retaining certain set limits and ceding the excess) a monthly summary of writings (Exhibit D) and of cancellations (Exhibit E).⁶ This summary gives all the data necessary for accounting purposes, including the determination of the unearned premium reserve. The clerical burden of preparing bordereaux is eliminated from the office of the ceding company, and the reinsurer, relieved from the more or less stultifying (because inadequate) process of checking bordereaux, confines its verification of the carrying out of the treaty to an audit of the ceding company's home office records.

Recording of Losses. From every standpoint it is essential

⁶This summary may be merely one copy of a list printed in duplicate on the "printer tabulator", the machine employed in statistical departments for the mechanical tabulation of data. In this case, the clerical labor due to the recording of reinsurance premiums is reduced to "rock bottom".

that the reinsurer be kept informed of all facts bearing upon the extent of its liability in connection with actual claims and potential losses.

As soon as the ceding company has notice of any event which may result in claim liability on the part of the reinsurer, a preliminary loss advice (Exhibit F) is mailed to the reinsuring company. This enables the reinsurer to establish a proper claim reserve. Changes in reserve are reported on special form (Exhibit G) and when the case is finally closed the amount of loss and the reinsurer's share are also reported (Exhibit H).

This procedure puts the reinsurer in touch with the claim situation at its inception and keeps it informed as to developments. It also enables the reinsurer to supplement the information originally furnished by the ceding company through correspondence or otherwise.

In the properly conducted reinsurance office all claims notices are scrutinized not by a clerk, but by an executive, who satisfies himself that his company has all the information it needs, not only in order to establish a proper reserve, but in many cases to assure the fact that the claim, if an important one, is receiving adequate attention in the claims department of the ceding company. Actual experience demonstrates that this is an important service of value to both parties to the contract.

Salvage recoveries are reported on a special form (Exhibit I). The ceding company is obligated to report salvage as soon as recovered. Here again practical experience indicates that the reinsurer should adopt a constructive rather than a passive attitude and that for those kinds of insurance where such recoveries are common, the status as to salvage should be inquired into periodically by the reinsurer and the case not closed until the reinsurer is definitely advised by the ceding company that all prospects of salvage are over. This practice not only protects the reinsurer but incidentally it assures the fact that the ceding company is not overlooking salvage possibilities.

The reinsurer, of course, maintains a file for each individual claim (except in those comparatively few cases where share reinsurance applies uniformly to all the business written by the ceding company for a certain kind of insurance). Correspondingly it maintains a record of claim reserves on all open cases, such reserves being constantly amended in accord with advices

received from the direct writing offices. In the course of months, certain inconsistencies are apt to develop between the records of the ceding company and those of the reinsurer and accordingly it has been found necessary in connection with the semi-annual financial statements (December 31st and June 30th) of the reinsurer to obtain from the ceding company a list of outstanding losses and loss expenses. (Exhibit J). This list is checked against the individual claim records of the reinsurer and any discrepancies are cleared through correspondence. Here again the efforts of the reinsurer are found to be of value not only to itself but to the other party to the contract, for in many cases this procedure has served to bring to the attention of the chief executives of the ceding company certain inadequacies in the procedure followed in their own office in the establishment of claim reserves.

Losses and loss expenses actually paid by the ceding company and properly chargeable to the reinsurer are reported monthly on a "loss bordereau" (Exhibit K), which contains the information necessary for accounting purposes, and enables the claim department of the reinsurer, upon reference to the treaty and the premium bordereaux, to verify the fact that the amounts charged have been properly determined.

The Account Current. (Exhibit L). This account is generally rendered, as in the case of bordereaux, within 20 days after the close of the month in which the business reported was placed on the books of the ceding company. In case of small accounts, quarterly or even yearly reportings are sometimes provided for.

Normally the account comprises a recapitulation of the reinsurer's share of the premiums written and the losses paid by the ceding company in the previous month with due allowance for commissions granted by the reinsurer to the ceding company. The treaty stipulates a date on or before which the account is to be paid. This provision varies, but in no case is the ceding company permitted to take more than 75 or 80 days in which to pay the account, as otherwise the reinsurer might be obliged to charge off a portion of these outstanding premiums as a non admitted asset (in accordance with the insurance department ruling making premiums over 90 days due a non admitted asset).

It is of course essential that in all cases the reinsurer verify the fact that the monthly account is absolutely consistent with

the supporting advices, namely the premium bordereaux (or "statement of reinsurance" where bordereaux are not required) and loss bordereaux.

THE REINSURANCE COMPANY'S STUDY OF EXPERIENCE

No reinsurance company can dispense with a frequent compilation of its own experience, by kind of insurance, and separately for share and excess.

A review of this experience at least quarterly, and preferably each month, will serve to locate "sore spots" in a general way.

However, what is even more important and of more general interest is the compilation of the experience for each treaty company, also by line, and separately between share and excess (Exhibit "M"). Such an exhibit should be prepared quarterly for all ceding companies, and in cases where there is any question as to the tendency of the account, as often as monthly. Ordinarily this exhibit will be prepared gross as to retrocessions, but where the outcome of the account is at all doubtful, it is desirable to show the experience net as to the effect of retrocessions; for on certain forms of insurance the reinsurer's direct profit may be divided with its retrocessionaires, whereas on other lines the loss is sustained either wholly or in greater part by the reinsurer alone.

The object of this review is, of course, to establish the account on a basis where the reinsurer has reason to believe that the tendency will be towards a profit. To this end, unfavorable experience on certain lines will be brought to the attention of the ceding company and negotiations undertaken either for a readjustment of the treaty or for a modification of the underwriting policy of the ceding company.

This procedure brings directly to the attention of the management of the ceding company not only how its reinsurance account is running but also to a very great extent just how successful its underwriting has proved to be. Such an exchange of views between the parties to the reinsurance contract is of value to the ceding company particularly because there can be no question of bias on the part of the reinsurer, who, on the one hand, wants to keep the account, but, on the other, is insistent that it shall be made to pay. In this respect, the interests of the ceding company and the reinsurer are to all intents and purposes identical.

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We have seen how during the past decade in the casualty field reinsurance has grown tremendously, both absolutely and relatively, until now it constitutes one of the outstanding conditions and one of the most important problems of the casualty business. During this decade reinsurance companies have barely held their ground, transacting perhaps one-fifth of the total volume of casualty reinsurance.

The primitive facultative method and the old open treaty still hold sway in spite of the absolute increase in the volume of fixed treaty reinsurance. The casualty reinsurance situation remains a most heterogeneous one, facultative, inter-company, pool, company fund and reinsurance company arrangements existing concurrently and frequently in the same direct writing office.

Reinsurance is the occasion for a vast amount of effort on the part of executives, department heads, underwriters, claims men and accountants. It is also the occasion for a vast amount of clerical detail. This situation has been mitigated to some extent by the development of the fixed treaty, but neither in the matter of relieving the direct writing office of the burden of clerical and supervisory detail nor in that of constructive cooperation on the part of the reinsurer in handling both detail and general problems has the surface been more than scratched.

THE PROPER POSITION OF THE REINSURANCE COMPANY

In the opinion of the writer, no satisfactory solution of the reinsurance problem can be had without a more general adoption of the principle of the fixed treaty and a much wider extension of the activities of reinsurance companies. This means, more concretely, that with but few exceptions a given direct writing company should place *all* of its reinsurance with a single reinsurance company in accord with a comprehensive fixed treaty or group of fixed treaties. For the more important kinds of insurance, coverage extended by the reinsurer would be along the following lines.

1. For *automobile liability, public liability, employers' liability* and *automobile property damage* the coverage would be on the excess basis, the ceding company retaining primary limits commensurate with its financial capacity and underwriting policy. The reinsurer's premium would be the manual excess premium

subject to a commission allowed the ceding company as a contribution toward acquisition and home office expenses (it is customary for the reinsuring company to pay the taxes on premiums ceded to it). It would also be logical for the reinsurer to allow the ceding company a contingent commission in the form of a percentage of the underwriting profit realized by the reinsurer. Excess cover provided by the reinsurer would be limited only by the terms of the original policies of the ceding company.

2. *Miscellaneous property damage.* This is a relatively new form of insurance in which the rates are still a matter of conjecture and in which the indiscriminate writing of high limit policies is apt to prove disastrous. The excess plan just outlined would properly apply here except that the ceding company's minimum retention should be comparatively substantial and the reinsurer should be further protected either by a definite limitation as to its maximum liability or by a provision that the ceding company is to retain part of the entire excess over its minimum retention.

3. *Workmen's Compensation.* The reinsurance for this line would be on the excess plan, the ceding company retaining an amount per accident commensurate with its resources and underwriting policy. The rate for the reinsurance would be a flat percentage of the net premiums written by the ceding company and not subject to commission. Since this form of reinsurance is strictly a calamity cover, it is not properly subject to a contingent commission.

4. The plan just described for workmen's compensation may be applied to *burglary* and to *plate glass* insurance except that in these latter forms the reinsurance contract should specify the limit of the reinsurer's liability. This limit can be fixed at a point which will allow ample writing power to the direct carrier for its ordinary needs.

5. *Fidelity and surety* and *accident and health* would be written on the share basis. *Burglary* might also be written on this basis. The treaty would provide for a table of minimum retentions, according to the kind of insurance and the classification. As respects the surplus over its minimum retention the ceding company would retain a stated portion (not necessarily the same for all kinds of insurance or classes) and cede the remainder to the reinsurer. For certain kinds of insurance or

classes, provision might be made for "first surplus" and "second surplus", the ceding company retaining a substantial proportion of the first surplus and a lesser proportion (or none at all) of the second surplus. The reinsurer's premium would be that proportion of the total premium for a given policy which the reinsurance ceded bears to the face of the policy. This premium would be subject to a commission by way of contribution to the acquisition and general expenses of the ceding company, and for these forms a contingent commission based on the reinsurer's underwriting profits might properly be introduced.

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The above outline is presented not as the only arrangement that might be made but merely to illustrate the lines which a comprehensive reinsurance plan might follow.

Obviously, the entire plan contemplates that the reinsurance company would have retrocessional facilities of a very broad scope, probably broader than any as yet developed by a casualty reinsurance company, particularly for accident and health, fidelity and surety, and burglary lines.

Besides being comprehensive, these retrocessional arrangements should be of a character which would not require the reinsurance company to maintain loss and premium reserves greatly in excess of its actual reserve liabilities; that is to say, they should be such as to permit the reinsurance company to take credit in its official financial statements for at least the major part of its retrocessionaires' share of the loss and unearned premium reserves. This implies that to the greatest extent practicable, the retrocessions should be placed with companies admitted to do business in this country. Obviously such a retrocessional market would be made up mostly of direct writing companies.

Such a plan can be worked out, the writer is sure, without involving any direct writing carrier in "doubling up" of its liability as respects coverage under its own policies.

Where the reinsurance is on the excess basis, the reinsurer would retain a substantial amount over and above the original retention of the ceding company. Where an individual loss in any line subject to excess reinsurance exceeds the combined retentions of the ceding company and the reinsurer, this second

excess would presumably be apportioned among certain insurance corporations, including direct writing companies, in accord with the retrocessional treaties severally contracted with the reinsurance company. Under this plan a given direct writing company might share in the second excess with respect to an accident where it sustained the primary liability. It is not likely that such cases would be frequent enough to constitute a serious objection to the plan.

For those lines where reinsurance is on the share basis, doubling up can be avoided by excluding from the retrocessions made to any direct carrier any portion of risks originating with such carrier. This is merely a matter of accounting procedure for the reinsurance company. The same procedure can be applied in the case of excess reinsurance if such a course is found necessary or desirable.

In certain forms of insurance, the "risk" and the policy are not identical in scope. This situation holds in the case of bank depositary business, where the real risk is the bank, not the individual depositary account; and in the case of accident and health insurance where the total amount of insurance carried by the assured, not any one policy carried by him, measures the risk. In such forms of insurance there is danger of directly overloading the reinsurer and of indirectly overloading direct carriers participating in retrocessional arrangements. The remedy for this is for the reinsurer to maintain a record of individual risks for these kinds of insurance, thereby detecting any such cases of overloading, and then adjusting them through facultative arrangements or otherwise.

BENEFITS OF THE PLAN

Under the plan we have outlined, reinsurance companies would become in American casualty insurance a much more stable and important factor than they are today.

The justification of the plan lies in the benefit which it holds for the casualty business as a whole.

1. *Simplicity.* It cannot be contended seriously that the present lack of standardization in reinsurance is conducive to the best interests of the business. A comprehensive and simple plan would release time, energy and money for constructive

effort in the development of the direct writing company's business. There would be more power available for propelling the ship. The chart would be more intelligible. Instead of several pilots to consult as to the supposed intricacies of the channel of reinsurance, there would be only one, viz., the reinsurance company.

2. *Actual Protection.* Centralizing reinsurance in one company having adequate retrocessional facilities would do away with the necessity of the company fund, which, after all, is self-insurance, not reinsurance. Furthermore, it would largely eliminate the facultative form of reinsurance, which, in many cases, cannot be said to constitute a satisfactory form of protection since it obligates the ceding company to accept in return other facultative reinsurance which may or may not be desirable. Similarly by eliminating pool arrangements, the able underwriter would be protected from his less capable competitor.

3. *Economic Soundness.* Any reinsurance arrangement which is not profitable to the reinsurer or reinsurers cannot be permanent, and impermanent reinsurance arrangements are always unsatisfactory. A reinsurance company has a substantial and permanent interest in making its own business pay, and a reinsurance company cannot make money unless direct insurance makes money. A reinsurance company, therefore, will not hesitate to point out to a direct-writing company anything which it believes interferes with their joint efforts toward developing a profitable business and under the suggested plan, the reinsurer would be in a position to know "what's what". In at least one well known pool arrangement, the absence of that direct economic incentive which is the very breath of life of the American casualty business has lately writ its unhappy history in characters of great size and sufficiently crimson hue.

The direct writing company's hope of a wholly satisfactory reinsurance arrangement lies in treaties with a strong, well managed reinsurance company, not in membership in a decentralized instrumentality for participation in the underwriting results of its competitors.

4. *Conservation of Premium Income and Insurance Capital.* The plan contemplates a more effective use of existing casualty insurance capital. Furthermore, it implies that the financial

resources of admitted casualty companies shall be fully availed of. When these resources have been used to the full in the problem of furnishing adequate covers to the American insurance public, it will then be logical and proper to employ the facilities afforded by "non-admitted" institutions.

The implication of the plan is not less business for direct-writing companies and more for reinsurance companies except perhaps relatively during a temporary period of readjustment. Ultimately, it implies that through a more effective use of the reinsurance company as an instrument in the service of the business, direct-writing companies will be able to carry the greatest volume commensurate with their resources both in the form of direct business and in the form of retrocessions.

EXHIBIT A.

Kind of Insurance	Premiums in Force					
	December 31st 1915			December 31st 1925		
	Reinsurance (1)	Net (2)	Ratio (1) + (2) %	Reinsurance (3)	Net (4)	Ratio (3) + (4) %
Accident.....	\$655,900.00	\$16,428,200.00	4.0	\$2,477,900.00	\$27,387,600.00	9.0
Health.....	376,500.00	6,935,800.00	5.4	895,100.00	11,138,900.00	8.0
Liability.....	162,800.00	28,969,500.00	.6	2,188,800.00	129,800,800.00	1.7
Compensation.....	101,900.00	19,210,200.00	.5	75,500.00	55,626,300.00	.1
Fidelity.....	423,500.00	5,598,800.00	7.6	7,828,000.00	32,844,800.00	23.8
Surety.....	1,372,300.00	13,219,000.00	10.4	14,278,300.00	57,521,000.00	24.8
Plate Glass.....	3,400.00	2,573,700.00	.1	3,800.00	12,941,200.00	.0
Burglary.....	682,500.00	5,423,300.00	12.5	5,598,000.00	34,287,700.00	16.3
Engine & Steam Boiler.....	77,900.00	8,500,500.00	.9	2,084,600.00	25,330,100.00	8.2
Auto P. D.....	100.00	5,121,200.00	.0	78,800.00	35,486,800.00	.2
Auto Coll.....	..	..	..	72,600.00	9,856,200.00	.7
Other P. D. & Sprinkler....	53,100.00	431,700.00	12.3	447,900.00	4,127,400.00	10.9
Credit.....	..	..	..	484,000.00	2,129,600.00	22.7
TOTAL.....	3,909,900.00	112,411,900.00	3.5	36,513,300.00	438,478,400.00	8.3

The companies included in the above table are as follows:

1915. Amer. Surety. Casualty Co. of Amer. Fidelity & Cas. Globe Indemn. London & Lancashire. Nat'l. Surety. New Amsterdam Cas. Preferred Accid. Royal Indemnity. U. S. Casualty. Aetna Acc. Aetna Life. Commercial Cas. Continental Cas. Fid. & Dep. Hartford Acc. Hartford St. B. Maryland Cas. Mass. Bonding. N. E. Equit. So. Surety. Standard Acc. Travelers Ind. Travelers Ins. U. S. F. & G. Empl. Liab. Gen'l. Accid. London Guar. Ocean Acc. Zurich Gen'l. Acc.

1925. Amer. Surety. Columbia Cas. Eagle Indemn. Fidelity & Cas. Globe Indemn. London & Lancashire. Metro. Cas. Nat'l. Surety. New Amsterdam Cas. N. Y. Indemn. Norwich Union. Phoenix Ind. Preferred Acc. Royal Indemn. Sun Indemn. U. S. Cas. Aetna Cas. & Sur. Aetna Life. Commercial Cas. Continental Cas. Fidelity & Dep. Hartford Acc. & Indemn. Hartford St. B. Indemn. of N. A. Indep. Indemn. Maryland Cas. Mass. Bonding. N. J. Fid. & P. G. Standard Acc. Travelers Indemn. Travelers Ins. Union Indemn. U. S. F. & G. Employers Liab. Gen'l. Accid. London Guar. & Accid. Ocean Acc. & Guar. Zurich Gen. Acc.

EXHIBIT D.

Statement of Reinsurance

_____ COMPANY

to

ALPHA REINSURANCE CORPORATION

Writings Sheet No. _____

Kind of Insurance _____

Share or Excess _____

Month of Entry _____ 192_

(Ceding Company's)

NEW BUSINESS AND RENEWALS						PREMIUMS ADJUSTMENTS				
STATE	Term (Months)	Expiration		Policy Year (See note)	Premiums Written		STATE	Policy Year (See note)	Additional Premiums (All Earned)	
		Month	Year		Company	Alpha			Company	Alpha

Note: Policy year separations required on Liability and Compensation only.

EXHIBIT E.

Statement of Reinsurance

_____ COMPANY

to

ALPHA REINSURANCE CORPORATION

Cancellations and Return Premiums Sheet No. _____

Kind of Insurance _____

Share or Excess _____

Month of Entry _____ 192_

(Ceding Company's)

CANCELLATIONS						PREMIUM ADJUSTMENTS						
STATE	Term (Months)	Expiration		Policy Year (See note)	Return Premiums		Original Premiums Cancelled		STATE	Policy Year (See note)	Refund Premiums	
		Month	Year		Company	Alpha	Company	Alpha			Company	Alpha

Note: Policy year separations required on Liability and Compensation only.

EXHIBIT F.

PRELIMINARY LOSS ADVICE
FORM

Alpha Reinsurance Corp.
Claim No.....
Company's
Claim No.....

to

ALPHA REINSURANCE CORPORATION

Mailed192.... Class of Business.....
Name of Principal on Bond or Assured on Policy.....
City..... State.....
Date of Loss.....192....

INSURANCE

Reinsured Policy No.
" " " "
Amount of Policy \$.....
" " " " \$.....
Amount of Retention \$.....
" " " " \$.....
Total Estimated Reserve \$.....

REINSURANCE

Bordereau No.
Cession "
Amount Reinsured with
Alpha Reinsurance \$.....
\$.....
Amount Alpha Reinsurance
Estimated Reserve \$.....

Brief Description of Nature of Claim

SIGNATURE OF REINSURED COMPANY

EXHIBIT G.

Notice
of
Change in Claim Reserve

.....Company

to

ALPHA REINSURANCE CORPORATION

.....Class of Business.....

Gentlemen:

Please be advised we have this day reduced } claim reserve to \$
increased }
withdrawn }

in connection with the following Policy Bond in which your Company is interested as Reinsurer
to the extent of.....(proportion).

Principal }
or }
Assured }
Our Policy }
or Bond No. }
Our Claim No.

Your Cession No.
Your Claim No.

Yours truly,

EXHIBIT H.

FINAL LOSS ADVICE
FROM

Alpha Reinsurance Corp.
Claim No.
Company's
Claim No.

Record of Reinsurance Loss and Loss Expenses
Claimed from

ALPHA REINSURANCE CORPORATION

Mailed 192... Class of business Code.....
Name of Principal on Bond or Assured on Policy.....
City..... State.....
Date of Loss..... 192...
Period.....

INSURANCE

Reinsured Policy No.
Amount of Policy \$.....
Amount of Retention \$.....
Total Loss \$.....
Amount of Loss Expense \$.....

REINSURANCE

Bordereau No.
Cession
Amount Reinsured with Alpha Reinsurance \$.....
Amount Alpha Reinsurance Loss \$.....
Loss Expense \$.....
Does above payment close case?
Yes or No

Brief Description of Nature of Settlement

Prospects of Salvage

SIGNATURE OF REINSURED COMPANY

EXHIBIT I.

SALVAGE ADVICE
FROM

Alpha Reinsurance Corp.
Claim No.
Company's
Claim No.

to

ALPHA REINSURANCE CORPORATION

Mailed 192... Class of Business Code.....
Name of Assured.....
City..... State.....
Date of Loss..... 192...

INSURANCE

Reinsured Policy No.
Amount of Policy \$.....
Amount of Retention \$.....
Total Salvage \$.....

REINSURANCE

Cession No.
Amount Reinsured with Alpha Reinsurance Corp. \$.....
Amount Alpha Reinsurance Corp. Salvage \$.....

Prospects of Further Salvage

SIGNATURE OF REINSURED COMPANY

EXHIBIT M.

LPHA REINSURANCE CORPORATION

EXHIBIT OF EXPERIENCE

From _____ to _____ Compiled _____
 * _____ as to Retrocessions

		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
	Kind of Insurance	Premiums Written	Premiums Earned	Losses Incurred			Total Incurred (3)+(4)+(5)	Loss Ratio (6) / (2)	Commission Ratio	Commissions Earned (2)×(8)	General Expense (2)×-	Total Charges (6)+(9)+(10)	Underwriting Profit (2) - (11)	Profit Ratio (12)-(13)
				Payments		Outstanding								
				Loss	Expense									
ess	Auto Liability Other Liability Compensation Auto P. D.													
	Total Excess													
e	Accident Health Fidelity Surety Burglary, etc.													
	Total Share													
	Grand Total													

*Gross or Net, state which.