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SUGGESTED ANSWERS - MAY 2006

PAPER - 3 - RISK MANAGEMENT AND REINSURANCE

1. (a) Name the category of market failure in an imperfectly competitive market.

Ans:

Purely competitive markets rarely exist. A number of markets including insurance markets are imperfectly competitive. Insurance markets are characterized by market failure.

Neither the insured nor the insurer has all the information they need. Problems of asymmetric information occur when one party to a transaction has relevant information that the other does not have. Such problems of asymmetric information are grouped under four heads.

- a) "Lemons" problems
- b) Principal Agent problems
- c) Problems of adverse selection
- d) Moral hazard problems

(i) **Lemons" problems:** A "lemons" problem occurs when insured knows less than the insurer about the insurer and its products. Insureds purchase insurance policies in good faith. Insurance, especially life and health insurance, is a technical and complicated subject and very few insured have the knowledge to understand the financial strength of the insurer. A bulk of insurance regulation is meant to take care of the "lemons" problem for insurance customers.

(ii) **Principal-Agent Problems:** In economics, a person who represents another is the agent; the person whom the agent represents is referred to as the principal. The agent is interested in maximizing his or her personal gain. This may not be always compatible with the objective of maximizing the gain of the principal. The principal - agent problems relating to insurance business include the method of ensuring that the agent does not misrepresent or withhold information about the insurer and its products from customers or withhold vital information relating to the customer from the insurer.

Likewise, the government has to ensure that the insurance regulator (Insurance Regulatory and Development Authority in India), who is really an agent of the public, safeguards the interests of the public (the principal). The principal-agent problems can be addressed to a large extent, by

providing incentives and disincentives aimed at aligning the interests of the principal with those of the agent.

- (iii) **Problems of Adverse Selection:** This problem arises when the customer's situation is better known to the customer than to the seller of insurance. The problem of adverse selection is common in insurance markets all over the world. To fix a fair premium that reflects the expected value of the losses of the potential insured, the insurer must have full and relevant information about the insured. By withholding some vital information regarding their insurability, some of the insured may be able to obtain favourable prices and terms and conditions. As a consequence, the other insureds in the pool will have to face a distortion in the pricing of insurance policies. In the extreme, adverse selection may lead to the complete breakdown of the mechanism of insurance.
- (iv) **Moral Hazard Problems:** The tendency of individuals to alter their behaviour because of the presence of insurance is referred to as moral hazard problem. Insurers are overly concerned about the possibility that the beneficiary under a life insurance policy might attempt at shortening the life of the insured. Another example of moral hazard: Insurance companies might be concerned about selling a disability income policy under which the insured might obtain payment that is more than he could earn from employment.

Insurers try to minimize such moral hazard problems by inserting suitable provisions in the insurance contract. The claims department of an insurance company is assigned the task of discouraging and identifying cases of moral hazard.

Securing additional information that is required may be a prime method for obviating information asymmetry problems. The adverse effects that a party may suffer in the above-outlined categories of problems can be mitigated by gathering more information. However, it is not as though securing more information is easy and costless – for the consumer, search costs increase while for the insurer it implies additional operational costs. It is, therefore, necessary to consider trade – offs, costs of collecting more information in order to take a more informed decision in the matter and increased claim payments or other costs implied in making decisions with inadequate information.

Of all the types of market failure discussed above, “lemons” problem is considered the most important in insurance. The task of evaluating and monitoring the financial position of an insurer is not easy for individuals and small businesses. The asymmetric information problems for the consumer becomes rather more serious when, because of principal – agent problem, the managers of an insurance company do not divulge the bad financial news about the firm to the sales people and shareholders.

Because of the problem of information asymmetry calling for redressal of this imbalance, and to safeguard public interest in the context of the product involving a financial futures delivery, governments devise stringent regulatory norms governing the functioning of insurance companies.

Market solutions to the problem include evaluation of insurers’ financial strength by intermediaries such as brokers and independent agents and well-functioning rating agencies with continuous and competent monitoring of financial condition of the insurers.

Besides information asymmetry, non-existent information is another problem that assumes significance for insurance business. Contracts of insurance involve future delivery and determination of price(premium) before the production costs are fully known. Both insured and the insurer face uncertainty as the future is not known.

(b) Explain in detail one of the categories of market failures.

Ans:

It is necessary to explain in detail any of the above 4 heads of market failure providing appropriate examples.

2. Following data gives the monthly premium income in a year of “Evershine Insurance company Ltd.”

Month	1	2	3	4	5	6	7	8	9	10	11	12
Premium Income (Rs. Crore)	10	12	14	8	25	21	28	35	40	45	47	60

- (a) Calculate mean, median and mode for the above data.
 (b) Find variance, standard deviation and coefficient of variation.

Ans:

$$\text{Mean} = \frac{345}{12} = 28.75$$

$$\text{Median} = \frac{25 + 28}{2} = \frac{53}{2} = 26.5$$

Mode = Mode is that observation which occurs more frequently. As no observation on premium income in the given table occurs more than once, mode is not defined in this problem.

Ans: 2(b)

Calculate f , $(f - \bar{x})$, $(f - \bar{x})^2$

$$\Sigma (f - \bar{x})^2 = 3094.7$$

$$\text{Variance} = \frac{3094.7}{12} = \sigma^2 = 257.89$$

$$\text{Standard Deviation} = \sqrt{257.89} = 16.06 \quad \sigma = 16.06$$

$$\text{Coefficient of variation} = \frac{\sigma}{x} \times 100 = \frac{16.06}{28.75} \times 100 = 0.56 \times 100 \quad (1)$$

$$= 56\%$$

CV signals the mathematical risk of premium collection, which is helpful in measuring objective risk.

3. (a) Name the steps of Risk Management Process.

Ans:

IDENTIFY POTENTIAL LOSSES

EVALUATE POTENTIAL LOSSES

SELECT THE APPROPRIATE TECHNIQUE FOR TREATING LOSS EXPOSURES

1. RISK CONTROL
 - RISK AVOIDANCE
 - LOSS CONTROL
2. RISK FINANCING
 - RETENTION
 - NON-INSURANCE TRANSFERS
 - COMMERCIAL

IMPLEMENT AND ADMINISTER THE PROGRAM

A brief explanation of each of the steps involved is necessary.

(b) Explain appropriate techniques in treating Loss Exposure.

Ans:

The techniques available for treating loss exposures are broadly classified as:

1. Risk Avoidance
2. Risk Financing

There are a number of methods to financing risk.

1. Risk retention
2. Insurance
3. Non Insurance transfers
4. Hedging

5. Research to improve information on the basis of which decisions are taken to reduce risk.

Each of these is to be explained briefly, furnishing appropriate examples. (6)

4. Explain the features of the following probability distributions:
 - a. Binomial Distribution
 - b. Poisson Distribution
 - c. Normal Distribution

Ans:

- a. **Binomial Distribution:** This is also known as Bernoulli distribution. It is a discrete probability distribution expressing the probability of one set of dichotomous alternatives, say, success or failure. Suppose the probability that an event will occur at any point in time is p . Then the probability that the event will not occur is given by the equation, $q = 1-p$. Let us label the number of trials as n . The probability of x successes in n trials is given by the formula.

$$\frac{n!}{x!(n-x)!} p^x q^{n-x}$$

Where the expression $n!$ is n factorial and refers to a successive multiplication of the numbers, $n, n-1, n-2, \dots, 2, 1$. Suppose the State Road Transport Corporation (SRTC) desires to estimate the probability of the number of losses. It owns a fleet of 8,000 buses. By using the binomial formula the SRTC authorities can compute the chance of 50 losses, 100 losses, 150 losses or any other number of losses. The losses can be calculated, once p (probability of the loss) and q can be estimated.

In the case of the Binomial Model, the critical assumptions are that the probability of loss is the same, for each exposure and the various exposures to loss are independent of one another. (3)

- b. **Poisson Distribution :** Another discrete theoretical probability distribution that is used in risk management is the Poisson distribution. Strictly speaking, the poisson distribution is the limiting form of the binomial distribution. One can determine the probability of an event, say, car accidents under the Poisson distribution using the following formula.

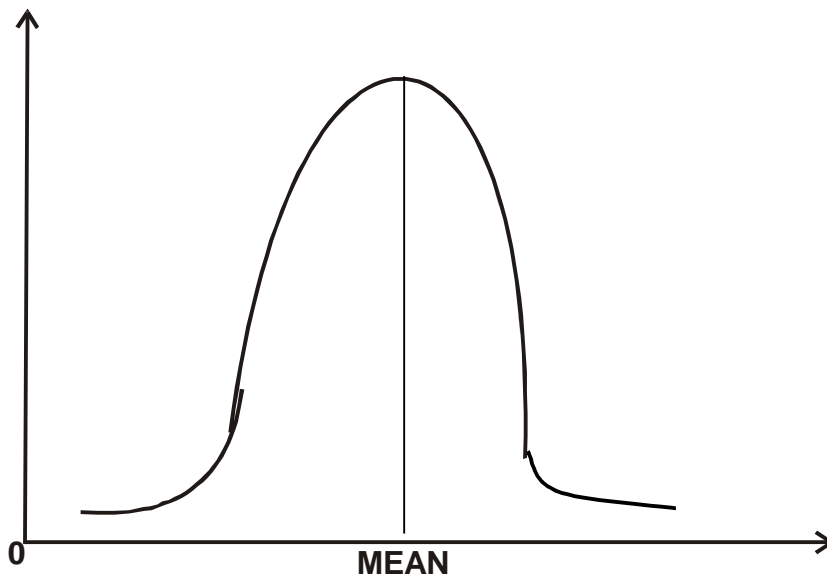
$$p(n) = \frac{e^{-m} m^n}{n!}$$

Where p is the probability that an event n occurs
 n is the number of events for which the probability estimate is required
 m is the mean or expected loss frequency
 e is the base of the natural logarithm, equal to 2.71828

Once the number of losses per year follows a poisson distribution, the time between losses is said to have the “memoryloss” property. That is, the amount of time that will pass before the next loss occurs does not depend on the amount of time that has passed since the last loss that occurred.

As an example, poisson distribution is used in insurance problems to compute the number of casualties.

c) Normal Distribution : A very useful one, a normal distribution is a continuous probability distribution, while the binomial and poisson distributions discussed earlier are discrete distributions. A normal distribution is completely defined by its mean and standard deviation.



The graph of a normal distribution is bell-shaped and symmetric. More values are located near the centre or mean. As we move from the centre, there are fewer and fewer values. The graph of the distribution continues in both directions without ever touching the horizontal axis. Normal distributions are symmetric with respect to the mean. The area underneath the curve above the horizontal axis is equal to 1. This property allows us to represent the area underneath the curve to represent probabilities, the total of all probabilities for a probability distribution is equal to 1. Further more, as a normal distribution is symmetric the

area under the right half of the curve as also the left half of the curve is equal to 0.5.

The mean is the value on the horizontal axis where the graph reaches its peak. The spread of the distribution is given by the spread of the observations. Let us take an example, to illustrate the use of a normal probability distribution. Suppose, a general insurance company has experienced in a year 500 losses with a mean value of Rs.500 and a standard deviation of Rs.150. Then the insurer can assume that about 68 percent of all losses will be within one standard deviation of the mean. Similarly, about 95 percent or 475 of all losses will lie within two standard deviations of the mean. Likewise, about 99 percent of all observations of losses should be within three standard deviations of the mean. For the purpose of risk management if the losses follow a normal distribution, it can be assumed that these relationships hold. This will enable a risk manager to predict the probability of losses being within a certain range of the mean. (4)

5. (a) Explain any three forms of Risk Transfer

Ans:

Risk Transfer: Risk Transfer involves shifting of the financial impact of loss is shifted to another party.

Risk Transfer involves agreement by the transferee to assume the loss or risk that the transferor is desirous of escaping. The process of risk transfer involves a payment by the transferor to the risk bearer or transferee. It is normally done through insurance.

Five forms of risk transfer are normally available:

1. Harmless Agreements
2. Incorporation
3. Diversification
4. Hedging
5. Insurance

Any three forms of the above listed risk transfer have to be discussed, giving a brief explanation of each.

(b) Briefly explain the factors determining Risk Financing decisions

Ans:

Factors Determining Risk Financing Decisions :

A number of factors are taken into account before making risk-financing decisions or choosing the category appropriate to them out of the three available options, risk retention, risk reduction and risk transfer.

The factors include

- a. Expected cost
- b. Financial Position
- c. Degree of Risk Aversion
- d. External Constraints

The expected value and the variability of cost of various risk-financing options are prime considerations in regard to the choice people make. The financial position of the individual making the choice also influences his / her decision. The degree of risk aversion of the individual will also be an influencing factor in the choice of risk-financing decision. Finally, the choice of an individual of the type of risk financing he or she makes may be constrained by external factors. e.g. Motor owners are constrained by legislation in many countries to the purchase of motor vehicle insurance. Another example is the constraint that insurance be purchased for the purpose of protecting the collateral. When financial institutions extend credit or provide loans for home purchase or car purchase, they impose a condition that the debtors purchase property insurance.

6. Ram Lagan has Rs. 50,000 and has the following two options.

Option - A

Put Rs. 10,000 in a bank at 8% interest per annum and put Rs. 20,000 in a mutual fund, which will earn 15% with a probability of 0.6 or 20% per annum with a probability of 0.4 and put the balance Rs. 20,000 in a non-bank financial company, which will fetch him 25% interest per annum with a probability of 0.3 or 16% interest per annum with a probability of 0.7.

Option - B

Buy units of "Infrastructure fund" of a mutual fund for the entire amount and the current NAV is 15.00 for a face value of Rs. 10.0. There is a probability of 0.6 that this NAV will touch 25.00 per unit in one year or a probability of 0.4 that this NAV will touch 22.00

Evaluate the options and recommend which one Ram Lagan may purchase.

Ans: OPTION - A

$$\text{i) Rs.10,000} \times 1.08 = \text{Rs.10800} \quad (\text{a})$$

$$\begin{aligned} \text{ii) Rs.20,000} \times 1.15 \times 0.6 \\ + \\ \text{Rs.20,000} \times 1.2 \times 0.4 = \text{Rs.13800} + \text{Rs.9600} = \text{Rs.23,400} \quad (\text{b}) \end{aligned}$$

$$\begin{aligned} \text{iii) Rs. 20,000} \times 1.25 \times 0.3 \\ + \\ \text{Rs.20,000} \times 1.16 \times 0.7 = \text{Rs.7500} + \text{Rs.16,240} = \text{Rs.23,740} \quad (\text{c}) \end{aligned}$$

$$\begin{aligned} \therefore \text{Total value of option A} &= \text{a} + \text{b} + \text{c} \\ &= \text{Rs. 57,940} \end{aligned}$$

Ans: OPTION - B

$$\begin{aligned} \text{Number of units to be purchased} &= \frac{\text{Rs.50,000}}{15} \\ &= 3333.3 \end{aligned}$$

$$\begin{aligned} 3333.3 \times 0.6 \times 25 &= \text{Rs. 49999.5} \\ + &+ \\ 3333.3 \times 0.4 \times 22 &= \text{Rs.29,333} = \text{Rs.79,332.5} \end{aligned}$$

Clearly Option B is Superior and hence is recommended.

7. (a) Explain the method of rating in excess of loss cover by using Burnign Cost method and Loading factor.

Ans:

RATING FOR EXCESS OF LOSS COVERS

One concept which is frequently used in calculation of rate for excess of loss covers is BURNING COST. The ratio of actual past losses to their corresponding premium (written or earned) for the same period. This ratio is used in assessing a portfolio of business and in determining rate of premium for renewal. This can also be termed as experience rating. The burning cost will give the rate of premium, which is just sufficient to cover the losses suffered by the reinsurers. This is then loaded by the underwriter for a reserve in case of worsening of loss experience, catastrophic element, acquisition costs and profit margin. The

loading factor normally used is 100/70 or 100/80 .An example of burning cost calculation will clarify the concept better.

(GNPI - Gross Net Premium Income; the usual rating base for excess of loss reinsurance. It represents the earned premium of the primary company for the lines of business covered net, meaning after cancellation, refunds, and premiums paid for any reinsurance protecting the cover being rated and gross meaning before deducting the premium for the cover being rated)

In an excess of loss cover the rate of premium is 100/70th of the average burning cost of incurred claims for the current and previous years. Rate to be applied to GNPI.

(b) Tela Insurance Company wants the renewal of excess loss cover for Rs. 20,00,000 excess of Rs. 20,00,000 from Munich Reinsurance Company for the year 2006. GNPI and incurred losses to reinsuror for the last four years is as under:

1980	1,00,00,000	80,000
1981	1,20,00,000	2,00,000
1982	1,50,00,000	4,00,000
1983	1,80,00,000	5,00,000

Calculate the premium to be charged for excess of loss cover. Munich RE usually charges minimum premium at 3% on GNPI of Reinsurance.

Ans:
Solution

Year	GNPI	Incurred losses to XL	Loaded BC with 100/70
(1)	(2)	(3)	(4)
		cover +o/s losses	
		(2)/(3)*100	
1980	1,00,00,000	80,000	1.1143
1981	1,20,00,000	2,00,000	2.381
1982	1,50,00,000	4,00,000	3.810
1983	1,80,00,000	5,00,000	3.969
TOTAL	5,50,00,000	11,80,000	3.064

Hence the rate of premium is 3.064

8. (a) Explain the term “Captives”.

Ans:

CAPTIVES

CAPTIVE INSURANCE COMPANIES

Captive insurers operate from such tax havens as Bermuda, catering to the reinsurance requirements of parent companies situated in Europe, America and elsewhere.

The insurance companies formed by large commercial or industrial establishments, *essentially to take care of their own insurance needs*, are called captives. These captives play a major role in fulfilling the insurance needs of the parent companies *and help the money flow inside the periphery of the business group*. The captives form their bases in places where the investors are given tax concessions by the local governments. There are over 4000 captive insurers operating world wide with nearly 35% of them located in tax havens like Bermuda, Luxembourg, Guernsey, Cayman Islands, Bahamas, Hawaii, Isle of Man, Barbados, Luxembourg, Dublin, Vermont, Singapore and other locations.

The captives were established since 1960's but there was development only a decade ago.

A captive insurance company normally provides coverage at a lower cost when compared to the companies in insurance industry generally. The stocks controlled by the company depend on either one interest or a group of interests covered relating to the business operations. The captive insurance company can be a non-resident, non-admitted or a foreign insurer.

(b) Briefly explain various kinds of Captives.

Ans:

Types of captives:

The various kinds of captives can be branched out as follows:

- ♦ **Single Parent Captives:**
Single parent captives are also called 'pure' captives. These captives provide coverage to single owners who own the company. A risk manager or financial officer at the parent company monitors them.

- ◆ **Association captives:**
An established association generally forms this type of captive. The coverage is provided to its members. In this the ownership vests with the association or individual members. The financial expert at the association level looks after the operation or this responsibility is outsourced to a management company, consultant or a broker.
- ◆ **Industry captives:**
An industry captive is owned by industries with similar specific insurance problem. The shareholders to whom the company is required to report appoint a board of directors.
- ◆ **Agency captives:**
An agent or group of agents owns this particular company. These are formed such that their clients can participate in the programs.
- ◆ **Rent-A-Captives:**
The risks of the members are insured. The investment income and underwriting profits are returned to the insureds. Under this, surplus of certain companies are given on rent in order to establish a self-insurance program and not their own captive.
- ◆ **Protected cell companies:**
These are special category of rent-a-captives since they shield their capital and surplus from other renters in the captive so long as the rent-a-captive 's owner remains solvent.

(c) Mention atleast 4 benefits of Captives.

Ans:

Benefits of captives:

The corporations and groups who want to take financial control and manage risks by underwriting their own insurance than paying premiums to the third-party insurers can opt for captives. A Captive is nothing but a tool to such organizations.

The benefits of a captive are as follows:

- ◆ Provides insurance for certain exposures, which other insurance companies might not provide.
- ◆ Helps to retain the premiums within the group by the parent company.
- ◆ Operating costs are reduced.
- ◆ There is an improved cash flow.
- ◆ There is an increase in coverage and capacity.
- ◆ Better investment as well as investment income.
- ◆ There is a direct reach to wholesale reinsurance markets.
- ◆ There is flexibility in underwriting and funding.
- ◆ Provides greater control over claims.
- ◆ Availability of smaller deductibles for operating units.
- ◆ Proves an additional negotiating leverage with underwriters.
- ◆ Availability of incentives for loss control.

The captives adopt their own methods in order to protect their business exposures.

- ◆ they generally retain the smaller losses in their own account and they reach out for excess of loss exposure in cases of larger loss exposure.
- ◆ In order to spread their portfolio in a better way they write inward reinsurance business.
- ◆ There is a reinsurance pool organized for their clients.
- ◆ There is also a reciprocal and non-reciprocal reinsurance arrangement.

9. (a) What is inward Reinsurance?

Ans:

INWARD REINSURANCE

The trend of direct insurers undertaking inward business is on the rise in recent times as it results in increase of gross premium and net retained premiums. Inward Reinsurance business is defined as the insurance business taken up by a direct insurer or reinsurer from the cedent in turn for share in the premium volume generated by the cedent or on a fee basis. The growing reinsurance market kindled new hopes for many insurance companies, which traditionally carry insurance business to undertake inward reinsurance business along with their main line of business. In a retrocession arrangement, a reinsurer (the retrocedent) cedes all or part of the reinsurance risk it has assumed to another reinsurer (the retrocessionaire).

As the market for inward reinsurance is throwing attractive returns, many kinds of companies all over the globe are jumping in to the fray of inward reinsurance.

However, the company taking up inward reinsurance should look at its competence in terms of market knowledge, research facilities, sound actuarial practices and knowledge of changing risk profiles in the market.

(b) Why do Insurance companies go for inward Reinsurance?

Ans:

A reinsurance company would, in addition to ceding its business, also accept some reinsurance business. Some of the reasons why companies go for inward reinsurance are as follows:

- ◆ To increase the gross premium and net retained premium
- ◆ To achieve a lower expense ratio by maintaining the volume of premium income as ceding reduces the premium income
- ◆ To obtain a better and wider spread of business
- ◆ To counteract the drain of foreign exchange caused by ceding of premium
- ◆ To earn an investment income which may be derived from the cash flow.

After examining all the pros and cons a company has to design its corporate strategy for its underwriting policy. It can write lines for its net account or it can write larger shares and create a retrocession treaty to take care of the surplus over its net retention.

(c) Before finalizing inward Reinsurance programmes what are the considerations made by Insurance companies?

Ans:

Some considerations an insurance company should keep in mind while finalizing its inward reinsurance programme for the year are given below:

- ◆ Treaty or facultative –facultative involves more administrative work as each offer will have to be scrutinized. Treaty is less expensive but it requires a thorough knowledge of the market and treaty clauses.
- ◆ Territorial scope-if the company wants a greater geographical spread then it should underwrite foreign business keeping in view the political and economic conditions of the country.
- ◆ Direct or brokers:- if the company has experienced staff, direct business can be solicited. However, this will involve travel expenses to procure business. So, initially it is better to place business through a broker.

- ◆ Class of business- the company should decide whether it wants to underwrite property business, which is an annual basis or casualty business.
- ◆ Acceptance limits-keeping in view the financial standing and premium income of the company, the acceptance limit should be large enough to make it attractive for the brokers and ceding companies to offer business.
- ◆ Finally, IRDA has brought in certain norms for acceptance of inward business, which have to be adhered to while designing the inward programme.

10. Amphi Insurance Company has signed a first surplus and 2nd surplus reinsurance treaty of 10 lines and 20 lines having a maximum liability of 30,00,000 and 50,00,000 respectively. Considering the nature of the risk, Amphi Insurance have decided their net retention as under:

Risk No.	Sum Insured	Net retention
1.	2,00,000	2,00,000
2.	3,00,000	1,00,000
3.	12,00,000	2,00,000
4.	30,00,000	3,00,000
5.	65,00,000	2,00,00

Calculate the following:

(a) Cession under 1st surplus and 2nd surplus treaty for each risk.

Ans:

Risk No.	Sum Insured (Rs.)	Net retention (Rs.)	1 st surplus Max. Rs.30,00,000 10 lines Rs.	2 nd surplus Max. Rs.50,00,000 20 lines Rs.	
1.	2,00,000	2,00,000	Nil	Nil	
2.	3,00,000	1,00,000	2,00,000	Nil	
3.	12,00,000	2,00,000	10,00,000	Nil	
4.	30,00,000	3,00,000	27,00,000	Nil	
5.	65,00,000	2,00,00	20,00,00	40,00,000	3,00,000 surplus

(b) Is there a surplus which cannot be ceded in the treaty? What are the options Amphi Insurance has to deal with the above?

Ans:

In Risk No.5, there will be Rs.3,00,000 surplus

Therefore it is advisable to arrange facultative reinsurance

(c) There is a claim under risk number, which Amphi Insurance has settled for Rs. 10,00,000. How much will Amphi Insurance recover from surplus treaty reinsurers?

Ans:

In Risk No.4

Net retention = Rs. 3,00,000 = 10% sum insured

1st surplus = Rs. 27,00,000 = 90% sum insured

∴ claim will be Rs. 1,00,000 on net retention

Rs. 9,00,000 on 1st surplus treaty

11. Explain the meaning of any **five** of the common terms in Reinsurance listed below:

- (a) Slip
- (b) Retention
- (c) Reserves
- (d) Profit Commission
- (e) Bordereaux
- (f) Portfolio
- (g) Overriding Commission
- (h) Line

Ans:

- a. **Slip**: A document showing details of reinsurance proposed to be offered which is circulated to the reinsurers by the brokers /ceding company
- b. **Retention**: The amount of liability, the ceding company keeps for its account on a risk.
- c. **Reserves**: The portion of premiums/losses retained by the insurer for due performance of the obligations of the reinsurer under the treaty.

- d. **Profit commission**: An additional commission payable by the reinsurer to the ceding company as a percentage of profits derived from the business.
- e. **Bordereaux**: A tabular statement of risks, premium and /or losses supplied by a ceding company to a reinsurer under a contract.
- f. **Portfolio** : this refers to unearned premiums and outstanding claims –entry and withdrawal of which made under treaties operating on clean-cut basis
- g. **Overriding Commission**: Commission payable in addition to the original commission.
- h. **Line**: The amount of retention of the direct insurer; Reinsurer may accept one or more lines or a fraction of a line

12. Explain the features that exemplify the Reinsurance Market.

Ans:

The features that exemplify the reinsurance market are as follows:

1. Stability factor
2. Availability of Knowledge Capital
3. Matured Financial Markets
4. The Role of Economy
5. The Arbitration Factor
6. Infrastructure Facilities
7. Domestic Markets
8. The Location Advantage
9. The Role of Foreign Reinsurers.

Stability factor:

Reinsurers have an impact on their performance due to economic stability, social and political factors. If the economy is inconsistent, then there will be an adverse affect on the performance of reinsurance companies. There should also be a consistency not only in regulatory environment but also in legal environment so that it would be helpful for the augmentation of the reinsurance market.

As reinsurance is not a daily business, so both the parties should be sure that the market remains stable and they are not affected by the changes in the market.

Availability of Knowledge Capital:

For the reinsurance market to be thriving, there should be personnel with widespread knowledge about the industry. Tasks like underwriting which the reinsurer has to take on depends upon the proficient knowledge the staff possess.

Matured Financial Markets:

The scope for the reinsurers to raise the resources depends upon the maturity of the country's financial markets. If the financial markets are more matured then there reinsurance markets will be more benefited. The reinsurers can easily access the market and can maintain their business.

The Role of Economy:

The economies, which have high inflation, are not favored as it adversely affects the reinsurer's costs like staffing cost etc. Reinsurers are fascinated in setting up their shops in a steady market.

The Arbitration Factor:

In reinsurance if any dispute arises then it is referred to arbitration. So if the market provides good arbitration with appropriate legal framework then the disputes between the parties can be settled very easily. So arbitration plays very significant role in the development of the reinsurance industry.

Infrastructure Facilities:

As reinsurance is a global industry and reinsurance players are from developed countries so they should have an excellent infrastructure facilities.

Domestic Markets:

If the insurance players generate good business in the domestic market then the reinsurers can at least expect that the Insurers can take reinsurance coverage. Thus the reinsurers can do the business in the country. The reinsurers would prefer to do the business outside the country if the market is dull.

The Location Advantage:

Location advantage plays a very important role in case of reinsurance business. If the country has well-developed reinsurance market, then reinsurance business can be expanded to the countries that are less developed.

The Role of Foreign Reinsurers:

If there are foreign players in the reinsurance market then it would be helpful for the domestic players as there would be knowing about various techniques like underwriting, marketing etc of the foreign players. This would lead to the development of the domestic reinsurance industry.

