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Risk. Reinsurance. People.

REINSURANCE…DON'T PUT ALL EGGS IN ONE BASKED

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A layman would understand reinsurance as ". . . insurance for an insurer." Insurance people define reinsurance as the transfer by a primary insurer - called a cedant - of part of the risk it accepts to another party - called a reinsurer. Reinsurers are specialists - they do not accept risks from the insuring public. They get their business from insurers directly, through reinsurance brokers, or from each other.

In many markets, new business is hard to come by. Our economies are dry of new insurance business due to inadequate foreign direct investments. You may wonder, then, why an insurer that has incurred expenses and gone through the hassles of securing business, voluntarily, transfers some of its business to a third party. There are several reasons.

Back in high school, my first lesson in etiquette - table manners – extra curriculum classes, under the supervision of the school's dame, inter alia, taught me never to throw food away. One could hear her say in sharp Welsh accent, ". . . if you feel the load in front of you is too much for your stomach, then share it with friends." She argued that throwing food away was a show of lack of respect for the server or cook and others who took the time to prepare the meal. In the future, they would be mean to us. But if we consumed the whole lot, it would be construed as an appreciation, and we would stand another chance of being served even more delicious meals in the future. She always encouraged us to share food with fellow diners.

Yes, owing to the narrow capacity of the human stomach, one has a limit as to how many pieces of nsima/ugali /nshima, one can take. Insurers, too, have a monetary limit for accepting risks. Oftentimes, insurers are asked to take huge risks that are above the amount they can comfortably retain. Based on their balance sheet. It will be inconvenient for you and me - as insured public - if the insurer just takes a portion of the risk that we propose for coverage.

What happens is that an insurer accepts to write a hundred percent of a risk regardless of its size.

They know that they will pass on to another party (a reinsurer) a part that they cannot afford to retain. In this regard, the reinsurer is taken as a provider of additional financial capacity to the insurer which aids the primary insurer to accept large risks that could initially not have been accepted.

Reinsurance is used to smooth out the profit fluctuations of an insurer. An insurer faces uncertainty regarding whether a loss will happen and, if it does, the extent of the resulting damage or loss. Rather than having to predict the frequency and severity of losses year on year, insurers agree with reinsurers that the latter should assume part of the losses when they occur. The reinsurer accepts risks from an insurer in the same way the insurer accepts risks from the insuring public. This reduces the level of uncertainty and consequently smoothens out losses. Part of the losses is passed to the reinsurer. This gives the insurer peace of mind. With reinsurance arrangements in place, the insurer thus continues to accept more and more risks but pays less in claims.

Our laws do not allow the insuring public in a certain country to insure risks outside their geographical scope or jurisdiction. Conversely, insurers are allowed to buy reinsurance outside the resident country. In other words, insurance is national whilst reinsurance is international. Insurers use reinsurance to spread the risks to other foreign risktakers. If, for example, country XYZ has only one reinsurer, it follows that most of its reinsurance programs will be placed offshore. This works to the local market's advantage. Placement of reinsurance programs with foreigners enables local insurers to reduce the concentration of risks within their market. Natural catastrophic losses emanating from cyclones, floods, tsunamis et cetera are greatly cushioned. On a lighter note - reinsurance enables us, as an economy, to share our miseries with foreigners, as exemplified in my etiquette lesson above.

Reinsurance may be used to run off business or terminate the underwriting of certain types of insurance covers. If an insurer wants to wind up, it can cancel all policies and return unearned premiums to an insured party. However, insurers often find it impossible to recoup all the expenses incurred when adding a business to their books. Through reinsurance, the insurer's liabilities are transferred to reinsurers, leaving the insured's insurance coverage undisturbed while allowing them to continue enjoying full protection. Reinsurance, therefore, brings mutual benefits to the insuring public, the insurer, and the reinsurer.

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