Insurance Operations – Services provided, functional areas and measures of strength and profitability of the insurance enterprise.

Insurer services are defined by the covered contingencies

Property/ Casualty Insurers -- indemnify financial losses for physical damage, consequential loss, and Liability

Physical damage --- loss of physical property from an insured peril such as , fire, wind, hail, theft --- a peril as an insured event that gives rise to loss

Consequential [indirect] loss --- loss that is subsequent to physical damage loss which involves the financial consequences of the inability to use property until it has been restored – e.g. additional living expense caused in having to rent a home when your insured dwelling has been completed destroyed and you are waiting for it to be rebuilt in the next six months [Parkersburg, Iowa Tornado], loss of income due to an physical damage that prevents gainful employment or the continuation of a business [BP oil disaster, loss of income for restaurants, motels along the coast, lost revenues for the fishing industry], additional expenses caused in having to acquire temporary property such as renting a car if your own car is damaged in an accident.

Liability – damages that are imposed in a court of law due to a civil wrong --- breach of contract, failure to perform, or performing an activity that gives rise to injury to another. Note- liability involves financial consequences of injury to another individual or entity, it does not directly arise from a criminal wrong --- a wrong against society. In other words, liability insurance will not defend someone who has committed a crime.

Life insurers --- cover the financial consequences resulting from premature death, superannuation [old age, and the insured outliving their financial resources] or health/disability

Functional Areas:

Marketing/ Sales ------

Agency System --- Direct Writing, Independent Agency, Exclusive Agency

Direct writing – agent is a salaried employee of the insurer, has the authority bind coverage and waive portions of the insurance contract, agent can only sell their employer's coverage, insurer owns the list of policyholders - e.g. .State Farm

Independent Agency – the agent owns his own business and the list of policyholders, income is derived from commission, agent may sell any one of a number of different insurers policies, the agent does not have the authority to bind coverage or waive portions of an insurance contract – e.g. AFLAC, St. Paul, EMC

Exclusive Agency --- a hybrid type of agency system whereby an agent may be a direct writer for most insurance coverages, but be able to sell competing insurance company products if the direct writing company does not have a policy in that area --- e.g. Prudential single premium deferred annuity [Les Eslick Case in Cincy]

Underwriting:

An underwriter has the responsibility of determining whether a proposed insurance application meets the standards and guidelines set by the insurer to adequately cover policyholder losses out of the premiums and accumulated investments. The goal is to write a profitable book of business that is not so restrictive as to deny coverage to good risks or is so liberal as to accept coverage for poorer than average applicants.

Claims:

Serves in a role that is the opposite of underwriting --- a claims representative seeks to determine whether a loss is covered under an insured contract using guidelines established by the company incorporating the legal definitions and insuring agreements found in the insurance policy.

Loss Control:

The insurer has a responsibility to prevent losses if possible and mitigate the damages should an insured loss occur. From an economic standpoint, preventing or reducing losses reduces the amount of capital [financial and human] to settle claims leaving more money available for an insurer to invest in society.

Reinsurance:

The process of transferring risk exposures from a primary insurance carrier to another insurer for purposes of: (1) risk diversification and/or (2) preservation of limited capital [small insurer lacking in capital will reinsure with a larger carrier to allow them to continue to grow their business]

Types of Reinsurance Arrangements:

Facultative versus Automatic Insurance Agreements

Proportional versus Stop-Loss Contracts

Actuarial

The actuary is responsible for collecting all relevant information that goes into the calculation of a credible premium for covering a company's insurance policy, determining the adequacy of reserves to meet the firms obligations to policyholders under the contracts they have issued, development of new policies that will be of benefit to the insurer, assist corporate management in developing the strategic plan, establishing goals and objectives and meeting the firm's external obligations to regulatory authorities [statutory statement, GAAP financial report]

Investments

The investment department is responsible to shareholders and/or policyholders to secure the highest possible return on premium dollars commensurate with the preservation of principal. This department is required to keep sufficient liquid assets to meet claim costs as they arise.

Legal

This department provides legal assistance to the insurer in: (a) choosing outside attorneys who will defend the policyholder on any legal liability claim covered under the insurer's policies (b) determining legal language to the insurance contact which adheres to the law and is clear to the policyholder (c) defending the insured in a case involving the denial of a claim or in cases where an employee is suing the company over some breach of contract or duty (d) assisting the insurer in meeting its compliance obligations to state and federal authorities.

Information Technology

The ITS department provides: (a) information about insurance policies, claims, underwriting, investment returns, payroll, sales, and premium collections that allow decision makers to be able to make reasoned choices on a timely basis (b) reports that will be of assistance in filing statutory and tax returns to the state and federal government (c) customized date bases for use by the various departments within the insurance enterprise [actuarial, marketing, investments, legal, claims, and underwriting] (d) develop systems that will permit the insurer to better serve policyholders as customers of the services provided under their insurance policies.

Accounting

This department is responsible for the annual filing of the insurer's statutory financial statement in each of the states where insurance is being provided. In addition, the accounting department will complete a GAAP statement to be filed with the SEC on a quarterly and annual basis when the insurer has a stock form of ownership. Accountants may also assist the actuarial department in documenting any changes to the premiums on policies being underwritten, with a filing to each of the state insurance commissioners where those alternations are to take place.

Interdependence Among Functions:

Marketing and Underwriting
Underwriting and Loss Control
Loss Control and Marketing
Claim Settlement and Underwriting
Actuarial and All Other Departments
Information Technology and All Other Departments

One issue insurers face today --- Should you have separate decentralized departments[the traditional method] or given the rise of information technology, should departmental functions be centralized with teams addressing issues [e.g. policy marketing team – with an actuary, agency, underwriting, and legal representative working as one unit] as they come up in the organization.

Measuring Insurer Strength and Performance

Role of Rating Agencies: AM Best's Life and Health Reports and AM Bests' Property Casualty Reports

Financial Strength Rating, Management Rating, Financial Size

Life Insurers --- Amount of In-Force Life Insurance, Capital Ratio:

Capital or Policyholder Surplus/ Policyholder Reserves

Policyholder reserves are the largest liabilities on the life insurer balance sheet

Casualty Insurers – Amount of Annual Earned Premiums, Capital Ratio

Capital or Policyholder Surplus/ Claim Reserves

Expense Ratio =➔ expenses/premiums

Loss Adjustment Expense Ratio➔ loss adjustment expenses/earned premiums
Commission Expense Ratio ➔ Commissions paid/earned premiums

Loss Ratio ==➔ Incurred losses/earned premiums which measures how well the insurer controls the amount of insured losses, but may vary dramatically based on past underwriting [e.g. rapid rise in malpractice insurance losses in the past decade] or due to he underwriting cycle [Prudential Auto Insurance in Florida in the 1990's – capturing the market when your rates are below the cost of coverage is not a good thing!]

Combined Ratio ➔ Loss Ratio + Expense Ratio

CR<100% ==➔ the insurer earned an underwriting profit on its insurance operations based on current information about losses and expenses relative to earned premiums.

CR>100% =➔ an underwriting loss, however based on investment returns an insurer may be able to generate a profit even when CR>100% sometimes known as cashflow underwriting.