NAMIC®
NATIONAL ASSOCIATION OF
MUTUAL INSURANCE COMPANIES

UNDERSTANDING INSURANCE–
AN INTRODUCTORY GUIDE

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UNDERSTANDING INSURANCE

WHAT IS INSURANCE?

Insurance is the contractual transfer of a defined risk of loss, from one person or entity to another, in exchange for a payment, if a defined event takes place. Insurance hedges against future risks, known as “perils,” reduces financial uncertainty, and makes accidental loss manageable. Individuals and organizations pay closely regulated insurance companies premium in exchange for a promise to pay when a loss stemming from the covered risk occurs.

POOLING OF RISK

The law of large numbers enables Insurers to provide this protection by pooling funds from many insured entities to pay for the losses that some may incur. When a specific covered loss occurs, an insurance company uses a portion of its earned premium to fulfill its obligation and compensate the insured.

TYPES OF INSURANCE

Generally, insurance is bucketed into four different categories:

- **PROPERTY** - Coverage protecting the policyholder against loss or damage to real or personal property from a variety of perils, including but not limited to fire, lightening, business interruption, loss of rents, glass breakage, tornado, windstorm, hail, water damage, explosion, riot, civil commotion, rain, damage from aircraft or vehicles, among others.
- **CASUALTY** - A form of liability insurance providing coverage for negligent acts and omissions such as workers compensation, errors and omissions, fidelity, crime, glass, boiler, and various malpractice coverages.
- **LIFE** - Provides financial protection for loved ones should the policyholder die.
- **HEALTH** - Insurance indemnifying or reimbursing for losses caused by bodily injury or illness including related medical expenses.

HIGHLY QUANTITATIVE INDUSTRY REGULATED BY THE STATES

Insurers use a host of factors and quantitative analysis techniques to assess the amount of risk that an individual or entity presents. The rate that an insurance companies charges a policyholder must be enough to pay claims for future loss events, pay business operating expenses, and make a profit without violating detailed state laws governing either excessive or inadequate rates. Ultimately, the price U.S. insurance companies charge for a specific coverage is subject to robust regulatory standards established at the state-level by state insurance commissioners and over 12,000 career regulators who work for them.

INSURANCE PROVIDES FINANCIAL SECURITY AND PEACE OF MIND

Without insurance, the economy as we know it could not function. Insurance helps individuals reduce their risks, especially where the most significant purchases for many people are concerned – an automobile, a home, or a business, for example. In the 21st century, homeowners, car owners, and businesses have a broad array of insurance products available, many of which have become essential for the functioning and success of the global economy.

STANDARD COMPONENTS OF INSURANCE

Generally, property/casualty insurance policies are legally binding contracts that establish the following:

PREMIUM - The amount of money an individual or business pays for an insurance policy to transfer their risk for a set period of time. Premiums paid for insurance are not designed to be "paid back" one day to the insured by way of claims. Over the course of a lifetime, claims paid out may in fact exceed premiums paid due to catastrophic losses.

DEFINITIONS – What the words in the policy mean.

POLICY TERM – When coverage starts and stops.

POLICY LIMIT - The maximum amount of money an insurance company will pay for a covered claim.

DEDUCTIBLE - An amount of money that an individual or organization is responsible for paying toward an insured loss. When a disaster strikes your home or you have a car accident, the amount of the deductible is subtracted, or "deducted," from your claim payment.

EXCLUSIONS – What is specifically not covered.

DECLARATION PAGE – The plain English explanation of the policy coverage.

INSURANCE PERILS

In insurance, a peril is a specific cause of damage or injury, that may be covered by a specific insurance policy. For instance, perils covered by a standard homeowners insurance policy typically include:

- Fire and smoke
- Lightning
- Windstorms and hail
- Ice, snow, or sleet
- Theft
- Explosion
- Vandalism

Some perils are covered only in specific situations, such as water damage, and others may be excluded from insurance entirely – in each instance, coverage depends on the insuring agreement.

UNDERWRITING AND MATCHING RATE TO RISK

Underwriting is the process by which an insurance company evaluates risk and determines whether to accept the risk, classifies the risk, and determines the appropriate rate for the coverage provided.

Insurance companies strive to accurately match a policyholder's rate to the risk that he or she presents and reflect this risk in the price of an insured's premium. A homeowners insurance underwriter, for example, must consider numerous variables when rating a homeowner's risk and determining the price of the policy. For homeowners insurance, an underwriter initially evaluates homes or rental properties for conditions and hazards such as:

- Deteriorated roofs and foundations;
- Unfenced swimming pools;
- Cracked sidewalks; or
- Dead or dying trees on the property.

These conditions and hazards represent risks that an insurance company would assume part of if they provide coverage to a policyholder.

OBTAINING A POLICY: AUTO INSURANCE CASE STUDY

1. INDIVIDUAL EXPRESSES INTEREST IN OBTAINING AUTO INSURANCE

You have just purchased a brand-new 2020 Ford Fusion and you need to obtain an auto insurance policy to keep you covered in case you get in an accident. Through word of mouth, you heard about a locally licensed insurance company that sells auto policies and you either visit a local agent's office or fill out the online form to receive a price quote, often that same day.

2. COMPANY CREATES RISK PROFILE

After receiving your information, the company begins analyzing what you provided. This information allows the insurance company to develop your risk profile which helps determine the price of your policy. No two risk profiles are the same because underwriting factors vary from person to person. Auto insurance underwriting factors[1] often include:

- Type and amount of coverage – The limits on your basic auto insurance, the amount of your deductible, and the types and amounts of policy options (such as collision) that are prudent for you to have all affect how much you will pay for coverage.
- The car you drive – The cost and safety features of your car.
- How much you use your car – The more miles you drive, the more chance for crashes.
- Location – Drivers in areas with higher rates of vandalism, theft and crashes, generally pay a higher price .
- Your driving record – The better your record, the lower your premium.
- Your age – In general, mature drivers have fewer accidents than less experienced drivers.
- Your gender – Statistically, women tend to get into fewer accidents, have fewer driver-under-the-influence accidents (DUIs) and have less serious accidents than men.
- Your insurance score – Your credit-based insurance score is a statistical tool that predicts the likelihood of filing a claim.
- NEVER race or religion – It is illegal to use race or religion in insurance underwriting.

*Underwriting factors and their relative weight can and will vary depending on the insurance company.

[1] Insurance Information Institute. https://www.iii.org/article/what-determines-price-my-auto-insurance-policy

3. INSURANCE COMPANY DETERMINES PRICE OF POLICY

Once the insurance company has thoroughly analyzed the information you supply, and agreed to take on your estimated risk, they will provide a quote for your premium which is the amount that you will pay (typically annually or semi-annually) if you proceed with purchase of the coverage.

4. SELECT THE POLICY OR CONTINUE SHOPPING

Once you have heard back from the company, you can agree to pay the premium for coverage or continue to shop around for policies that more adequately fit your specific needs.

In Short, Acquiring Insurance Looks Like This[2]

[2] Corporate Finance Institute. https://corporatefinanceinstitute.com/resources/knowledge/finance/property-and-casualty-insurers/

FILING A CLAIM: AUTO INSURANCE CASE STUDY

1. CAR CRASH SCENARIO

You are heading home from work during rush hour in your Ford Fusion and your eyes are drawn to a provocative political campaign billboard. You turn your attention back to the road and you notice that the Toyota Camry in front of you has come to a complete stop, but you cannot stop your vehicle in time – and you end up rear-ending the Toyota. Fortunately, you and the other driver are both uninjured and a bystander approaches you and says that she has already called the police.

2. TAKE PHOTOS AND GATHER DETAILED NOTES OF CRASH SITE

You immediately notice that the damage to both vehicles is substantial and you take several photos of the cars in order to document the incident. As you wait for the police to arrive, you exchange insurance information with the other driver. In addition to taking photos, you write down the exact location of the accident, the weather conditions, and jot down the contact information of the witness who called the police. When the police officer arrives, he first asks if you are okay and then asks you and the other driver for details regarding the crash for the incident report that he will file upon returning to the police station. All of this information will be used by your insurer when you file a claim. Be sure to ask the officer for a business card for follow-up and to obtain a copy of the crash report.

3. FILING A CLAIM

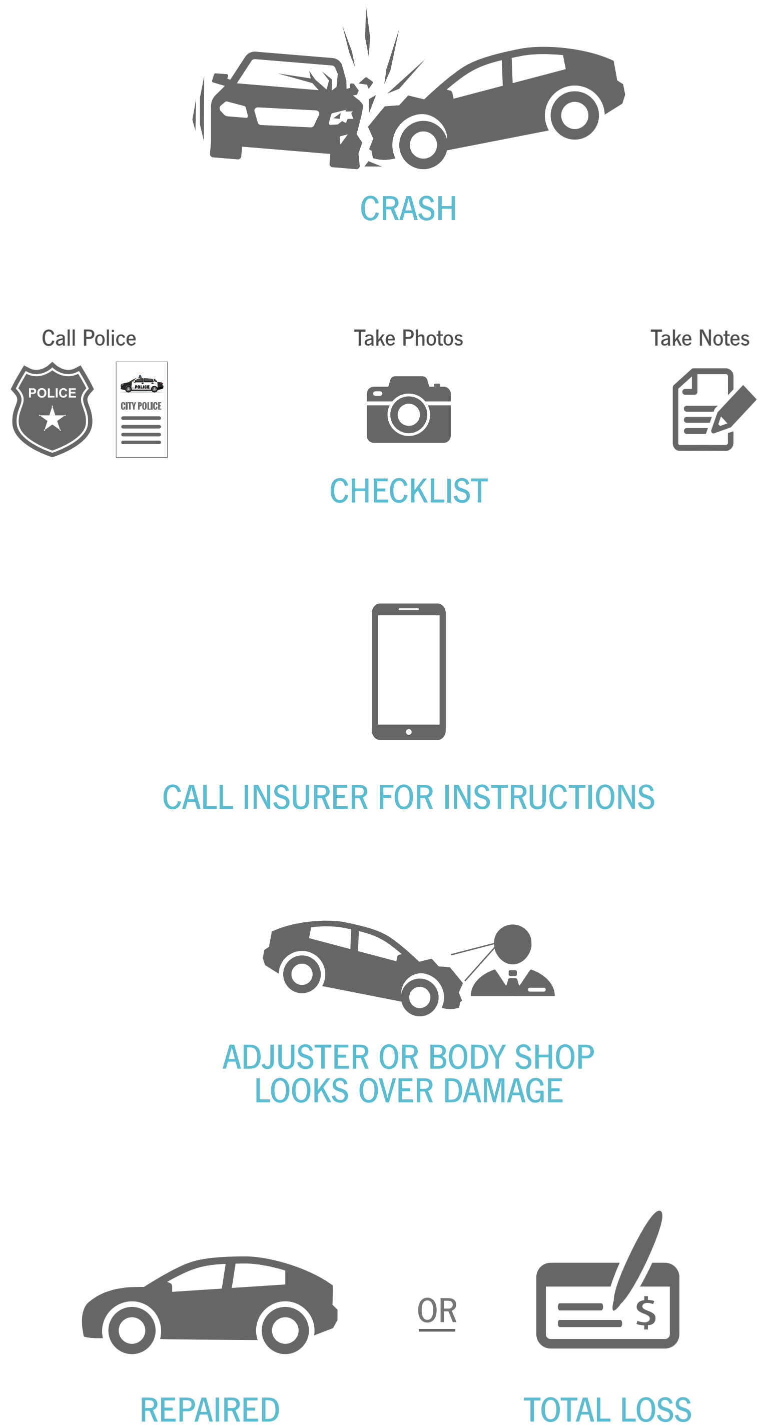
When you arrive at the repair shop, you promptly call your insurance company to let them know about the incident and begin your claim. Your insurer will likely ask you for:

- Insurance policy number
- Date, time and location of the accident
- Description of how the accident occurred
- Insurance and contact info of the driver involved
- Name of the police department involved and the police report number (Note that this information may not be available for several days and may involve visiting the police department for copies.)

4. CLAIMS ADJUSTER DETERMINES COST OF REPAIRS

After filing a claim, your insurance company may refer you to a claims adjuster. While every insurance company is different, typically, the adjuster will review the information you have submitted, ask for a detailed account of the accident, visit the scene of the accident, examine your car for damages, review the officer's police report, and get in touch with medical providers (if there were injuries), among other things. Ultimately, the adjuster verifies the loss, identifies whether you are covered for this type of accident under your policy, assesses the vehicle damage, and subsequently works with the body shop to see what it will cost to repair your Ford Fusion. If you are covered, the insurer then pays to have the car repaired; or if the cost of the repair exceeds the total value of the car the insurer declares the vehicle a "total loss" and writes you a check for the value of the vehicle.

CRASH SCENARIO



UNDERSTANDING INSURANCE

INSURANCE ECOSYSTEM

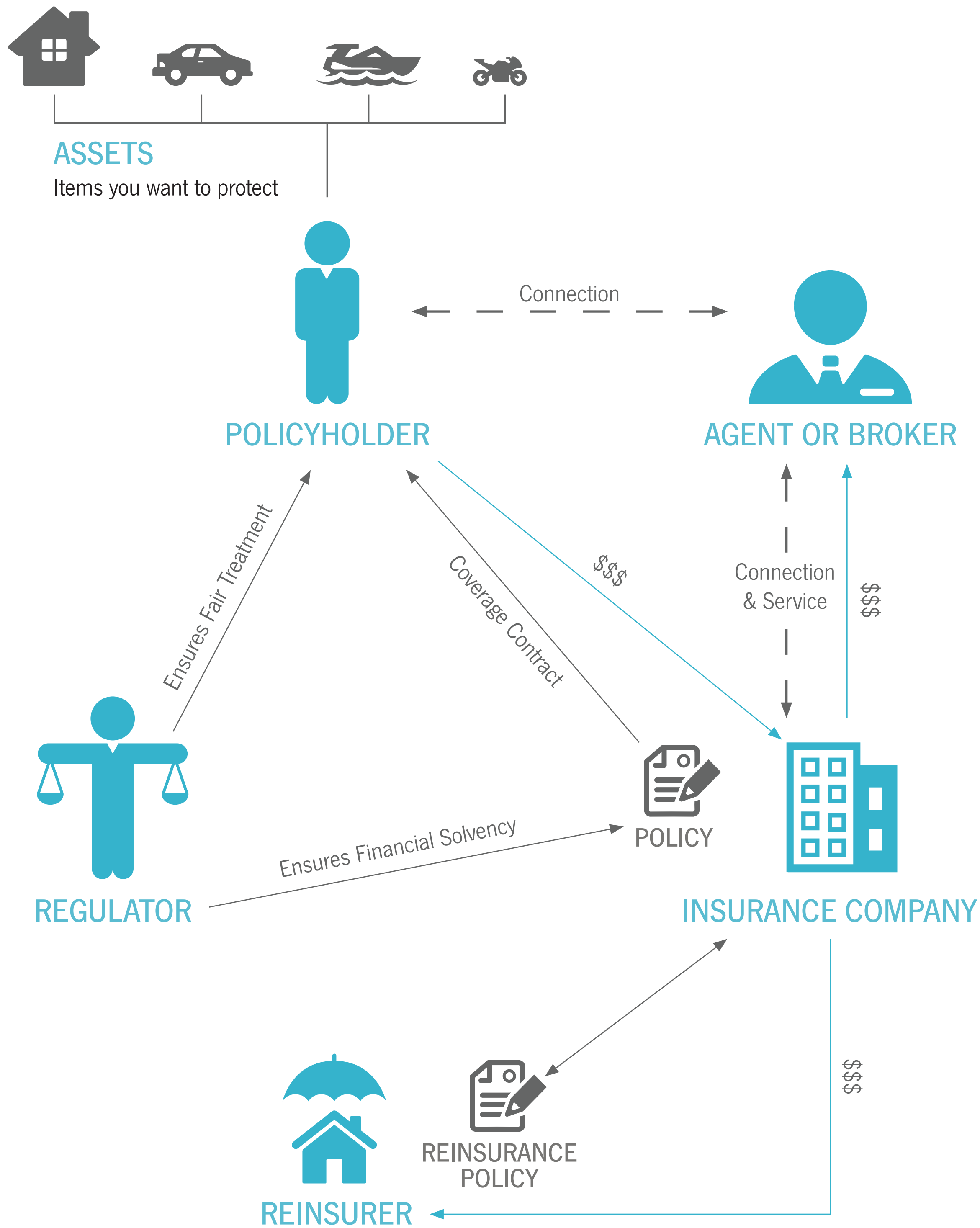
POLICYHOLDER
Owner of an insurance policy

INSURANCE AGENT
Agents represent insurance companies and can complete insurance sales to prospective policyholders

BROKER
An intermediary who represents an insurance buyer

INSURER
The provider of an insurance policy and/or product

REINSURER
A company that provides certain financial protections to insurance companies and manage risks that are too large for insurance companies to handle on their own.


ASSETS
Items you want to protect
POLICYHOLDER
Connection
AGENT OR BROKER
Ensures Fair Treatment
Coverage Contract
$$$
Connection
& Service
$$$
REGULATOR
Ensures Financial Solvency
POLICY
INSURANCE COMPANY
REINSURANCE
POLICY
REINSURER
$$$

PROPERTY/CASUALTY INSURANCE OVERVIEW

WHAT IS PROPERTY/CASUALTY INSURANCE?

Property/Casualty (P/C) insurance includes auto, homeowners, and commercial insurance, and is one segment (the other being life/health) of the insurance industry. P/C insurance covers damage to or loss of policyholders' property and legal liability for damages caused to other people or their property.[3] Property casualty insurance can be broken down into two major categories: personal lines and commercial lines:

PERSONAL LINES

Personal lines insurance refers to insurance that covers individuals against loss that results from death, injury, or loss of property.[4] These insurance lines generally protect people and their families from losses they either cannot or prefer not to cover on their own. Personal insurance lines make it possible to do things such as drive a car and own a home without risking financial ruin. Examples of personal lines insurance include:

- Homeowners Insurance
- Renters Insurance
- Personal Property Insurance (i.e. jewelry)
- Automobile Insurance

COMMERCIAL LINES

Commercial lines insurance includes property and casualty insurance products for businesses.[5] Commercial lines insurance helps keep the economy running smoothly by protecting businesses from potential losses they could not afford to cover on their own, which allows businesses to operate when it might otherwise be too risky to do so. Examples of commercial lines of insurance include:

- Commercial Auto Insurance
- Workers Compensation Insurance
- Fire Insurance
- Aircraft Insurance
- Commercial Property Insurance
- Business Interruption Insurance

[3] Insurance Information Institute Fact Sheets. https://www.iii.org/fact-statistic/facts-statistics-industry-overview
[4] Investopedia, https://www.investopedia.com/terms/p/personal-insurance-lines.asp
[5] Investopedia, https://www.investopedia.com/terms/c/commercial-insurance-lines.asp

Net Premiums Written, Personal And Commercial Lines, 2018
($billions)

Personal Lines	53.5%	$329.8
Commercial Lines	46.5%	$287.1
Total	**100.0%**	**$617.0**

Source: NAIC data, sourced from S&P Global Market Intelligence. Insurance Information Institute

Top 10 Writers of Property/Casualty Insurance By Direct Premiums Written, 2019
($000)

Rank	Group/Company	Direct Premiums Written (1)	Market Share (2)
1	State Farm Mutual Automobile Insurance	$65,615,190	9.3%
2	Berkshire Hathaway Inc.	$46,106,971	6.6%
3	Progressive Corp.	$39,222,879	5.6%
4	Liberty Mutual	$35,600,051	5.1%
5	Allstate Corp.	$35,025,903	5.0%
6	Travelers Companies Inc.	$28,016,966	4.0%
7	USAA Insurance Group	$23,483,080	3.3%
8	Chubb Ltd.	$23,388,385	3.3%
9	Farmers Insurance Group of Companies	$20,643,559	2.9%
10	Nationwide Mutual Group	$18,442,145	2.6%

(1) Before reinsurance transactions, includes state funds.
(2) Based on U.S. total, includes territories.

Source: NAIC data, sourced from S&P Global Market Intelligence. Insurance Information Institute

SCOPE OF THE PROPERTY/CASUALTY MARKET

INSURANCE IS INTEGRAL TO THE GLOBAL ECONOMY

The insurance industry is a global business and allows individuals and businesses of all shapes and sizes to conduct business amid many different kinds of risk. Worldwide, insurance premiums total $4 trillion and in the U.S., which contributes approximately 28 percent of the world's insurance business, premiums are more than $1 trillion.[6]

SCOPE OF P/C MARKET IN THE UNITED STATES

- U.S. insurance industry net premiums written totaled $1.22 trillion in 2018.[7]
- Premiums recorded by property/casualty (P/C) insurers accounted for 51 percent, according to S&P Global Market Intelligence.
- Net premiums for P/C written for the sector totaled $618.0 billion in 2018.
- In 2018, there were 2,507 P/C companies in the U.S.

BREAKDOWN OF P/C LINES IN THE U.S.

- In 2018 private passenger auto insurance was the largest line of insurance, making up 39 percent of all P/C insurance (commercial and personal combined) and 73 percent of personal insurance.
- Homeowners multiple peril insurance is the second largest line, accounting for 14 percent of total P/C insurance and 27 percent of personal lines.
- Commercial Liability is the largest commercial line and third-largest P/C line. It represented 10 percent of all P/C net premiums and 20 percent of all commercial premiums.

[6] Insurance Information Institute, https://www.iii.org/publications/commercial-insurance/introduction
[7] Insurance Information Institute, https://www.iii.org/fact-statistic/facts-statistics-industry-overview

CONTRIBUTION TO U.S. ECONOMY

- Insurance carriers and related activities contributed $564.5 billion, or 2.8 percent, U.S. GDP in 2018, according to the U.S. Bureau of Economic Analysis.
- Total P/C cash and invested assets were $1.7 trillion in 2018.
- P/C insurers paid out $49.5 billion in property losses related to catastrophes in 2018, according to the Property Claim Services (PCS) division of Verisk Analytics.
- The U.S. insurance industry employed 2.8 million people in 2019 (Department of Labor).
    - Of those, P/C insurers employed 647,000 workers.

INSURERS INVEST CAPITAL IN MANY FACETS OF ECONOMY

As trustees of policyholder and stockholder funds, insurers are major investors and suppliers of capital to the economy. Because insurers perform a capital formation function - similar to banks – policyholders can concurrently transfer risk, and they can obtain capital funds from insurers. This comes through the sale of stocks and bonds, and other financial instruments through which insurers invest funds. In March 2019, the U.S. Chamber of Commerce published a report which details the myriad ways insurance investments contribute to the domestic and global economies.

MUTUAL INSURANCE COMPANIES

PURPOSE OF MUTUAL INSURANCE COMPANIES

The sole purpose of a mutual insurance company is to provide insurance coverage for its policyholder members, who retain the right to select management. Mutual insurance companies make investments in diverse portfolios, with profits returned to members as dividends or a reduction in premium. Because there are no stockholders in a mutual insurance company, the interests of the policyholders are always served first.

BEN FRANKLIN – FOUNDING FATHER...OF MUTUAL INSURANCE

In 1752, a generation before he would become a Founding Father of the United States, Benjamin Franklin helped establish the first successful mutual insurance company in America around the principles of mutuality that still apply today. For more than 250 years, mutual insurance companies have been – and still are – about people coming together to protect themselves in a common need.

THE MEDIAN-AGE MUTUAL HAS BEEN AROUND SINCE BEFORE WWI

For more than 250 years, mutual insurance companies have been, and still are, about people coming together to protect themselves by sharing common risks. The median age of a mutual insurance company in the U.S. is 120 years.

COMPOSITION OF MUTUAL INSURERS

Mutual insurance companies range in size from small local providers to national and international insurers. Some companies offer multiple lines of coverage including:

- Property and casualty
- Life
- Health
- Other specialized markets

MUTUALS AND FINANCES

- Generally, mutual insurance companies are managed by a Board of Directors and assets are held for the benefit and protection of the policyholders and their beneficiaries. The assets of mutual insurers may include:
  - Contingency funds
  - Surplus
  - Reserves
- Mutual insurance companies not only are a part of and insure Main Street, they invest in Main Street – the industry is among the largest investor in municipal bonds in the U.S.

POLICYHOLDERS MAY RECEIVE ANNUAL DIVIDENDS

- Management and the board of directors determine what amount of operating income is paid out each year as a dividend to the policyholders. While not guaranteed, there are companies that have paid a dividend every year, even in difficult economic times.

STATE REGULATION AND STRONG PROTECTION AGAINST INSOLVENCY

- Mutual companies must adhere to state insurance regulations and are covered by state guaranty funds in the rare event of an insolvency.
- During the financial crisis in 2009, 140 banks failed , and 157 failed in 2010, while the mutual insurance industry remained solvent and protecting its policyholders.

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