

## Functions of Insurers

Insurers operate in much the same manner as other financial institutions

⇒ however several unique features to the contract create special functions:  
reporting requirements

## Characteristics

⇒ ① long term contract  
Aleatory in nature

② Acquisition of funds with  
promise to perform a  
financial service

③ Actuarial Adequacy

vs.  
Accounting Attest function

Major Activities of All Insurers:

- ① Production
- ② Underwriting
- ③ Rate Making
- ④ Loss-Settlement
- ⑤ Finance

Production (Agency) Dept.  $\Rightarrow$  markets  
the company's products. Supervises the  
external portion of the sales effort

Two Systems in general  
Direct Marketing  
Independent Agency  
New form: Exclusive Agency

## Underwriting:

The process of selecting: Clarifying exposure. Unless the company selects applicants that are capable of producing claim experience in line with actuarial projections there will be adverse selection.

⇒ Underwriting does not have as a goal the selection of risks that will not have loss  
⇒ but tries to select risks that avoid a disproportion  $\neq$  of bad risks/losses  
goal is to have actual loss approximate expected loss

## Agent's role in underwriting

Field Agent Collects info.  
and is the source for making  
underwriting decisions.

Agents may be compensated based on  
the quality of their policyholder loss  
experience.

## Underwriting Policy

Underwriters at home office set a  
policy - framework for accepting/rejecting  
risks.

Desk underwriter applies the policy  
does not set framework, but carries out  
decision on whether to accept the  
applicant.

The underwriting policy must be  
consistently applied.

## The Underwriting Process

The underwriter must obtain as much info about the prospective insured within the

Constraints of

- ① time & cost of additional information

- ② Regulatory Restrictions

There are 5 Basic Sources of Information

- ① The Application Itself (Entire Contract)
- ② Info. from Agent/Broker
- ③ Investigations
- ④ Information Bureaus
- ⑤ Physical Exams/Inspections

The Application - Answers to questions designed to give underwriter enough info. to accept/reject or require the gathering of more information

Agent/Broker: Recommendation based on Agent/Broker experience with prospective insured - may be an "accommodation risk" particularly with respect to rating issue.

Investigations - An inspection report may deal with specific issues - type of building, financial status of individual or firm, past history (claim experience - related to hazards)

# Rate Making

Insurance Rate / Unit of Insurance Coverage

Note:

In insurance, unlike other industries, the cost of production is not known when the contract is sold, and will not be known until some time in the future.

When the actuary prepares rate use is made of historical claim experience loaded for deviations away from expected results.

Information Bureaus: Seek data from  
Cooperative Information Bureaus such as  
MIB (Med. Info. Bureau) maintains  
Centralized files concerning medical  
treatment for applicants -

Physical Exams : Inspections

In life insurance - deals with current  
health of applicant, blood test / bp  
Medical director - sets policy for agents  
and desk workers on under what  
circumstances physical exams are  
required. (Attending Physicians  
Statement)

APS



The Final Premium charged to a policyholder is called the Gross Premium.

$$\begin{aligned}\text{Gross Premium} &= \text{Net Premium} \\ &+ \text{Loading} \\ &= \text{Net Premium} \\ &+ \gamma (\text{Net Premium}) \\ &= (1 + \gamma) \text{Net Premium}\end{aligned}$$

In the Property/Casualty field, rates are made cooperatively through rating bureaus.

Larger insurers utilize their own actuarial staffs.

Loss Settlement: Payment of losses that have occurred is a function of the Claims dept.

⇒ An insurer will distinguish itself in terms of prompt, courteous & fair Claim Service

The adjuster - one who investigates losses, determines liability, decides amount of payment to settle claim.

Many agents may have "draft authority"  
⇒ They can issue company checks to pay for losses up to some stated amount.

⇒ Speed Settlement process

Most companies employ salaried adjusters - if volume is small, insurers may contract out adjusting. Adjustment Bureaus will provide adjusting services for most casualty losses. Another alternative - insurer hires an independent adjuster who does not work for a bureau.

A public adjuster is employed by the insured to settle a claim in dispute. In return for a fee, the public adjuster will perform the actions required of the insured to settle the claim.

# Course of Action in Claim Settlement

- ① Pay the Claim
- ② Contest the Claim

## 2 Grounds for Denying a Claim

- ① The loss did not in fact occur
- ② The policy does not cover the loss

## Adjustment Process:

In determining whether to pay or contest a claim - the adjuster uses the following set procedure

- ① Notice of loss
- ② Investigation
- ③ Proof of Loss
- ④ Payment or Denial of Claim

## Notice of Loss

Some Policies require that notice of loss be in writing - usually it is best to phone the agent immediately and then follow up with a letter.

## Investigation

To determine whether a covered loss occurred.

- ⇒ Was the policy in effect at time of loss?
- ⇒ Is there insurable interest?
- ⇒ Is there a possibility the insured may have violated a condition in the Contract?
- ⇒ Is the peril that occurred one that is covered in the policy?

## Proof of Loss

After giving notice of loss, the insured is required to give proof of loss within a reasonable time period (usually 30 days)

⇒ Statement as to time, place, circumstances of loss, estimate of loss - giving amount of claim

In the case of life insurance - death certificate sufficient for proof of loss

However - missing person determined by Court of law - usually takes

7 years.

## Investment Function

Life insurers accumulate large amounts of money through premiums on long term obligations for insurance —

Policyholder Reserves are invested in long term investments: Bonds, Mortgages

What an insurer makes on investment can be used to reduce the cost of insurance or pay Shareholders.