# FIRE INSURANCE COMPANY ORGANIZATIONS AND RATING PRACTICES

*"By understanding your clients' insurance options, you can help them make wise design/build decisions."*

*Jay Johnson, LEED AP,*
*MBMA Director of Architectural Services*

... this brief discussion of insurers will help you improve your fire insurance knowledge.

Fire insurance options are divided broadly into seven groups:

Stock Companies
Mutuals
Lloyds
Reciprocals
Self insurance
Fair Plans
Joint Underwriting Associations (JUA's)

While you can generally expect that your customers will be insuring through just one of the stock or mutual insurance companies, this brief discussion of insurers will help you improve your fire insurance knowledge.

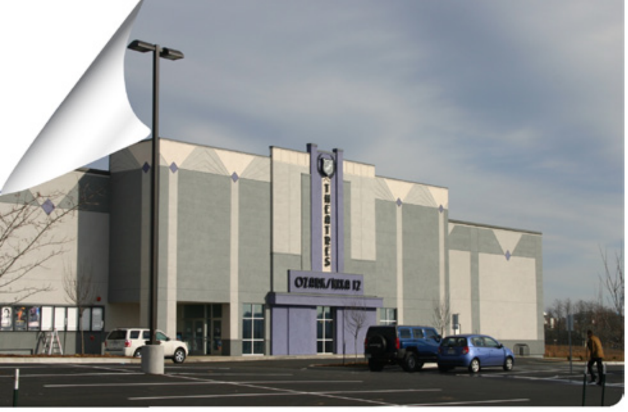
## INSURANCE ORGANIZATIONS

**Stock Companies**

Stock companies and Lloyds are non-cooperative in their operations. That means, the insureds have no ownership in the funds out of which losses are to be paid. Stock companies are organized as profit making ventures. Insured losses are covered by premium payments and capital invested by the stockholders. The insured has no other interest beyond the indemnification in the event of a loss. The insured receives no benefits or dividends from the earnings of the company and pays no assessment or additional premiums should the company suffer an underwriting loss.

**Mutual Companies**

The mutual insurance companies, on the other hand, are corporations owned, operated and controlled by their





policyholders. Every policyholder is a member of the company and there are no stockholders. Some mutual companies require the insured to deposit an advance premium. At the end of the policy period, deductions are made from the advance premium for expenses and actual losses paid. The balance is sometimes returned to the insured in the form of a discount on future premiums.

Mutual companies generally issue two types of policies, assessable and non-assessable.

An insured with an assessable policy is subject to an assessment to meet the losses and expenses when the resources of the company have been exhausted. Assessment liability is usually limited to one additional premium. A non-assessable policy requires the mutual company to be financed and backed in a manner similar to a stock company. Most all mutual companies will write non-assessable policies.

**Lloyds**

Lloyds (London), as a corporation, does not issue insurance policies. Insurance is written by individual underwriters who are members of the Lloyds corporation. The underwriter is backed by personal wealth or may join with other Lloyds underwriters in a syndicate.

A firm insured by Lloyds works through an insurance broker. The broker then circulates a description of the risk among the Lloyds underwriters who can indicate how much their syndicate is willing to commit.

Lloyds' primary business activity is to provide reinsurance to primary insurance companies, either on their entire portfolio or on individual locations that may exceed their risk expectations. Direct insurance from Lloyds through a broker is usually limited to large companies and/or high value locations that are rated on their unique risk characteristics.

**Reciprocals**

Reciprocal insurance, while a mutual of sorts, is actually a cooperative. Subscribers are required to accumulate reserves over a period of years, which equates to a multiple ranging from two to five annual premiums. A separate account is maintained for each subscriber. If losses exceed the total reserve, each member of the group is obligated to contribute to the insurance fund in an amount proportional to the subscriber's annual premium. Each subscriber appoints a manager, or "attorney in fact," to carry out transactions.

In a reciprocal that engages in no fire protection engineering activities, the compensation of the manager or "attorney in fact" represents the entire cost of the business other than loss payments.

### Self Insurance

Self insurance companies set up a private fund to pay losses. This is not "no insurance" but "self insurance." Self insurance is typically the least expensive of all forms of insurance but few organizations have the necessary wide distribution of risks to accommodate such a plan.

The trend to self insurance to reduce insurance costs and increase cash flow has led corporations and associations to form insurance subsidiaries, known as captive companies. However, the risks insured by a captive must be substantial in order for its savings to outweigh the cost of forming and operating it.

### Fair Plans

Fair Plans or Fair Access to Insurance Requirement Plans are state programs often subsidized by insurance companies. These plans provide insurance for locations that were denied insurance due to high risks associated with location, exposure, occupancy or other factors.

### Joint Underwriting Associations

Joint Underwriting Associations (JUA's), subject to state departments of insurance rules, are usually unincorporated associations of insurance companies formed to provide a particular type of insurance to the public. Companies that insure through a JUA pay their premiums to the JUA plus any assessment necessary to fund association operations. While JUA's can set their own rates, these rates are still subject to insurance department rules including final rate approvals.

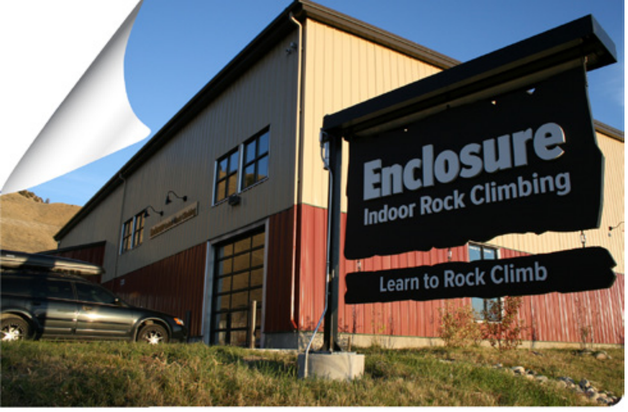
Fire insurance rates are set by rating bureaus or by insurance carriers...

## RATING PRACTICES

Most stock companies, many of the mutuals, the reciprocals and the JUA's, generally use fire insurance rates set by the rating bureaus as a basis for establishing premiums. Lloyds and self-insurers and some of the mutuals generally set their own rates.

The rating bureaus in each state establish two categories of rates.

One is the class or tariff rate which is a published rate within a rating manual. It can be applied by an insurance agent or company without detailed analysis of the risk. This category is most often used with residential and small (less than 15,000 sq. ft.) commercial properties. The Insurance Services Office (ISO), a member of the Verisk Analytics family of companies, is the source of data for establishing insurance rates in 47 states.




The remaining states typically use their own data. In most states, individual insurance companies use ISO loss cost data as a starting point and then apply their own loss cost multiplier (LCM) to develop a final rate. LCM's are usually subject to approval by the state departments of insurance.

The other category is specific rating. With this method, a detailed analysis is made of the risk including construction, occupancy, protection and exposures. Promulgated ISO or bureau rates are published, and the insuring company will either use the ISO or bureau rate or deviate from it.

Several companies have filed to write insurance on what is known as a "highly protected risk" (HPR) or a "superior" risk. Organizations of note that write such insurance include FM Global and large insurers such as Zurich Insurance, Travelers Insurance, and the Liberty Mutual Group. While FM Global is primarily an HPR insurer, the others do insure some HPR locations.

HPR insurers inspect properties to and produce loss prevention reports outlining recommendations to the insured. These help the insured maintain the HPR status of the protected property. Compliance with recommendations is generally a requirement for continued underwriting by any HPR insurer.

Zurich and Travelers are stock fire insurance companies and operate in a similar manner to other stock companies. Due to their stricter requirements, they generally write insurance at a lower rate.

The FM Global system is a mutual insurance company, as is Liberty Mutual. While a mutual, Liberty Mutual operates like a stock company. FM Global conducts inspections of the insured's properties in order to maintain the underwriting requirements of a highly protected risk. Liberty Mutual inspects properties using their own staff of loss prevention representatives.

FM Global operates laboratories for testing and approval of industrial fire protection equipment and materials. Generally, the other insurers rely on Underwriters Laboratories, Inc. (UL) to perform similar services. They may also use FM Guidelines where UL standards do not exist or if the National Fire Protection Association (NFPA) standards do not meet their requirements for a highly protected risk.