PROPERTY & CASUALTY INSURANCE COMPANY ORGANIZATIONAL STRUCTURES & RATING PRACTICES[1]

This brief description of insurers will help you improve your insurance knowledge.

Property & Casualty insurance companies are divided into a number of groups. The most common types that provide Personal (homeowners) and Commercial (business) Lines insurance are:

Stock Companies [Proprietary]
Mutuals [Cooperative]
Lloyd's Companies [Proprietary]
Residual Markets: Joint Underwriting Associations/FAIR Plans/ Pools [Governmental]

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

Property & Casualty insurance is divided into two types: Personal Lines and Commercial Lines. Personal Lines insurance includes products such as homeowners insurance, flood insurance, earthquake insurance, renters insurance, automobile insurance, life insurance, disability insurance, umbrella insurance and health insurance.

Commercial Lines insurance includes products such as commercial auto insurance and workers compensation insurance as well as specialty lines of insurance such as flood insurance, aircraft insurance, ocean marine insurance and medical malpractice insurance. Commercial Lines property insurance can be divided into Commercial Multi-Peril (CMP), Commercial Package Policy (CPP), Monoline Policies, or even a Business Owners Policy (BOP). Available coverages and premium costs vary by business/building type, size and location.

INSURANCE ORGANIZATIONS

Stock Companies

Stock companies are organized as profit-making ventures. Insured losses are covered by premium payments and capital invested by stockholders. The insured has no other interest beyond compensation

[1] The Metal Building Manufacturers Association (MBMA) provides these insurance bulletins as informational guides. The information contained in these bulletins is general in nature and is not intended to serve as legal advice. Readers are advised to consult with their own counsel and/or insurance broker on matters specific to them.

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STOCK COMPANIES

MUTUAL COMPANIES

LLOYD'S COMPANIES

RESIDUAL MARKETS:

- JOINT UNDERWRITING ASSOCIATIONS (JUAs)
- FAIR PLANS
- POOLS

for incurred damage in the event where he/she suffers 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.

Lloyd's Companies

Lloyd's of London (Lloyd's) does not issue insurance policies. Insurance is written by individual underwriters who are members of the Lloyd's corporation. The underwriter is backed by personal wealth or may join with other Lloyd's underwriters in a syndicate. Like stock companies, Lloyd's are organized as profit-making ventures.

A firm insured by Lloyd's works through an insurance broker. The broker circulates a description of the risk among the Lloyd's underwriters who indicate how much their syndicate is willing to commit. Lloyd's 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. Traditionally, direct insurance from Lloyd's through a broker is limited to large companies or high-value locations that are rated on their unique risk characteristics.

In Texas, as a result of state insurance regulations, numerous U.S. insurers created Lloyd's-styled subsidiaries, referred to as "Texas Lloyd's." These companies write both Personal and Commercial insurance using the Lloyd's business model.

Residual Markets: Joint Underwriting Associations (JUAs) / FAIR Plans / Pools

Residual Markets are state-sponsored mechanisms that provide an insurance alternative when coverage is not available through traditional private-sector insurance companies. These are sometimes known as a *property insurance market of last resort*. Examples of Joint Underwriting Associations (JUAs) include Fair Access to Insurance Requirements (FAIR) plans for urban centers; Wind, Coastal and Beach Plans; and "Citizens"-type corporations in natural catastrophe-prone areas. These plans provide insurance for locations that have been denied insurance due to high risks associated with location, exposure, occupancy or other factors.

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The idea behind the alternative/Residual Market concept is that the government facilitates coverage of a pooled group of relatively high-risk policyholders by:

- Creating a mechanism in which insurers share in the deficits and surpluses of the residual market.
- Limiting the scope of coverage provided (only done in some states).
- Charging higher risk-based rates.

Regardless of the specific structure, insurers doing business in a given state generally must participate in these programs, typically by assuming their fair share of the Residual Market's operating results. When a deficit occurs, a variety of mechanisms are in place, on a state-by-state basis, to cover the losses. These include:

- Participating private insurers are assessed to cover deficits.
- Assessments are either recouped through increased premiums in future years or by direct policyholder surcharges that are outside of the premium.
- Post-event revenue bonds are used to improve cash flow, fund deficits, defray expenses, purchase reinsurance or fund any other expense or liability.

Wind pools, such as the Texas Windstorm Insurance Association (TWIA), issue insurance policies like an insurance company; however, such entities also function as pooling mechanisms.

- All property insurers licensed in Texas are required to become TWIA members as a condition of doing business in the state.
- An insurer that becomes a member is subject to participation in insured losses and operating expenses.

RATING PRACTICES

Most stock companies and many of the mutual insurers use Property & Casualty insurance loss data developed by the state rating bureaus or insurance advisory organizations as a basis for establishing premiums. Lloyd's, self-insurers and some of the mutuals set their own rates.

State rating bureaus or insurance advisory organizations have established two methods of rating property: Class Rating and Specific Rating. For the Class Rating method, loss costs (LC) are published in the rating organization's rating manual. LCs are applied by an insurance company without a detailed analysis of the risk. The Class Rating method is most often used with residential and small commercial properties (less than 25,000 square feet). ISO and the American Association of Insurance Services (AAIS) are examples of insurance advisory organizations that provide LC data used for establishing insurance rates.

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Some states (Hawaii, Idaho, Mississippi, New York, North Carolina and Washington) have created their own rating bureaus, each of which establish LC values and ratings. In the majority of states, insurers set their rates by multiplying the LC provided by the rating organization by their specific company's loss cost multiplier (LCM) to determine that company's rate. LCMs are usually subject to approval by the state department of insurance.

LC x LCM = Rate

The other method used is Specific Rating. With this method, a detailed analysis is made of the risk including construction, occupancy, protection and exposures. Specific Ratings are used for more complex buildings and take into account unique features. Following a required field survey (inspection), ISO, AAIS or the state bureau will provide rates that are applicable to that individual property. The insuring company then has the option of using an advisory organization or bureau rate or the insurer can calculate its own Specific Rate.

ISO (formerly the Insurance Services Office) is an insurance advisory organization that provides statistical and actuarial information to insurance companies. ISO is a wholly-owned subsidiary of Verisk.

Insurance rates may be adjusted for strategic business reasons and are influenced by the business goals of the insurer, not solely by the characteristics of the building and the relevant risks. For example, insurers may set rates somewhat lower for regular customers or types of buildings that they have decided to pursue as a matter of business strategy. Any rates used herein are for comparison purposes only and should not be treated as actual rates that might apply within any rating jurisdiction.

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