# FN241
# Risk Management and Insurance
# Insurance Operations

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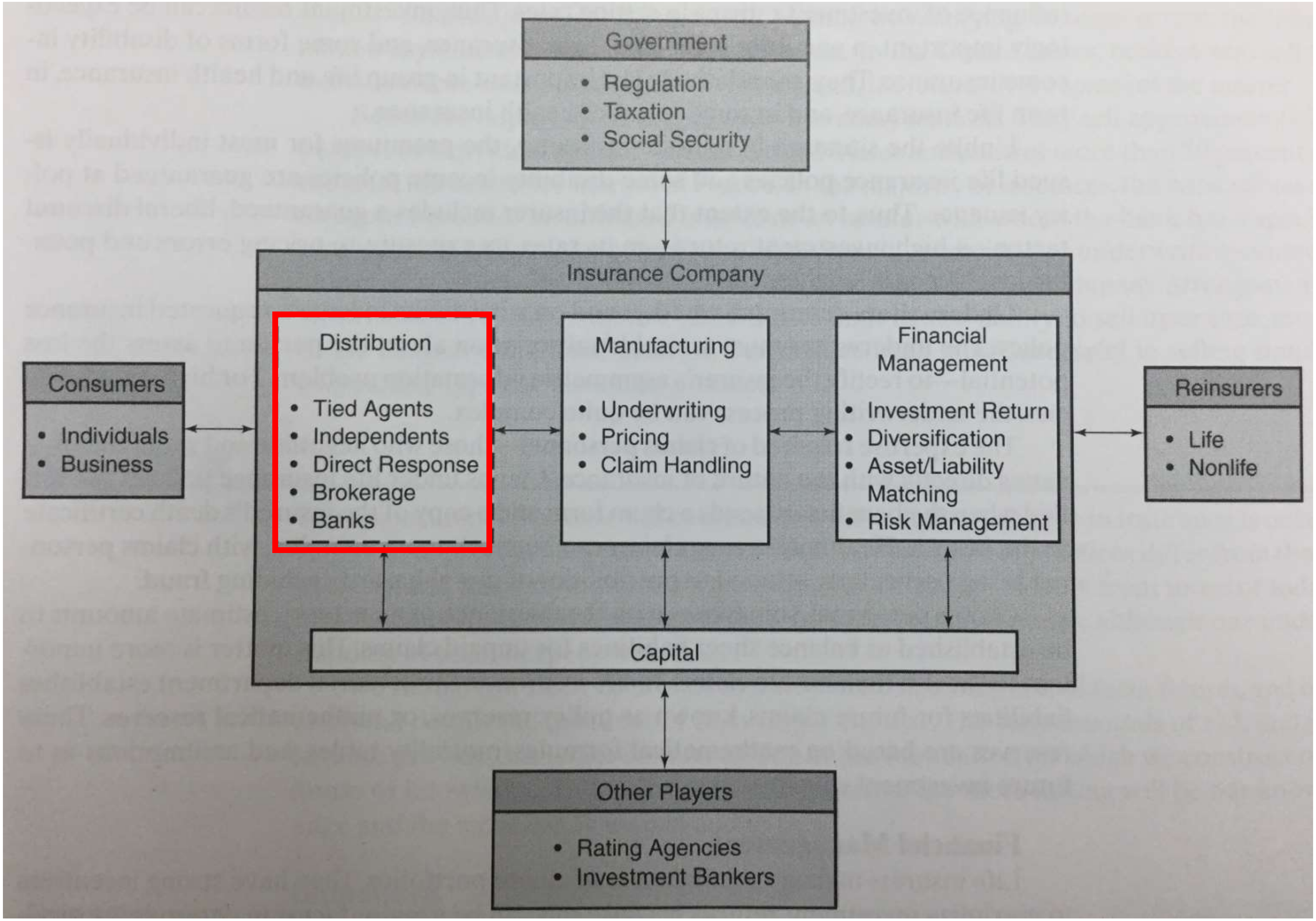
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Consumers
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Business
Reinsurers
Life
Nonlife
Capital
Other Players
Rating Agencies
Investment Bankers

# Life Insurance Marketing

- The majority of life insurance policies and annuities sold today are through **personal selling distribution systems**
  - Commissioned agents solicit and sell life insurance products to prospective insureds
  - <u>Captive, exclusive, or tied-agents</u> are full-time agents who usually represent one insurer and are paid on a commission basis
  - <u>Independent agents</u> are independent contractors who represent several insurers
  - <u>Brokers</u> are independent agents who do not have an exclusive contract with any single insurer

# Life Insurance Marketing

- Many insurers today use **commercial banks and other financial institutions** as a distribution system

- A **direct response system** is a marketing system by which insurance products are sold directly to consumers without a face-to-face meeting with an agent
  - Acquisition costs can be held down, but complex products are difficult to sell this way

# Life Insurance Marketing

- **Other forms** of life insurance distribution include:
  - Worksite marketing
  - Stock brokers
  - Financial planners

# Thailand Life Insurance Market Shares by Distribution Channels

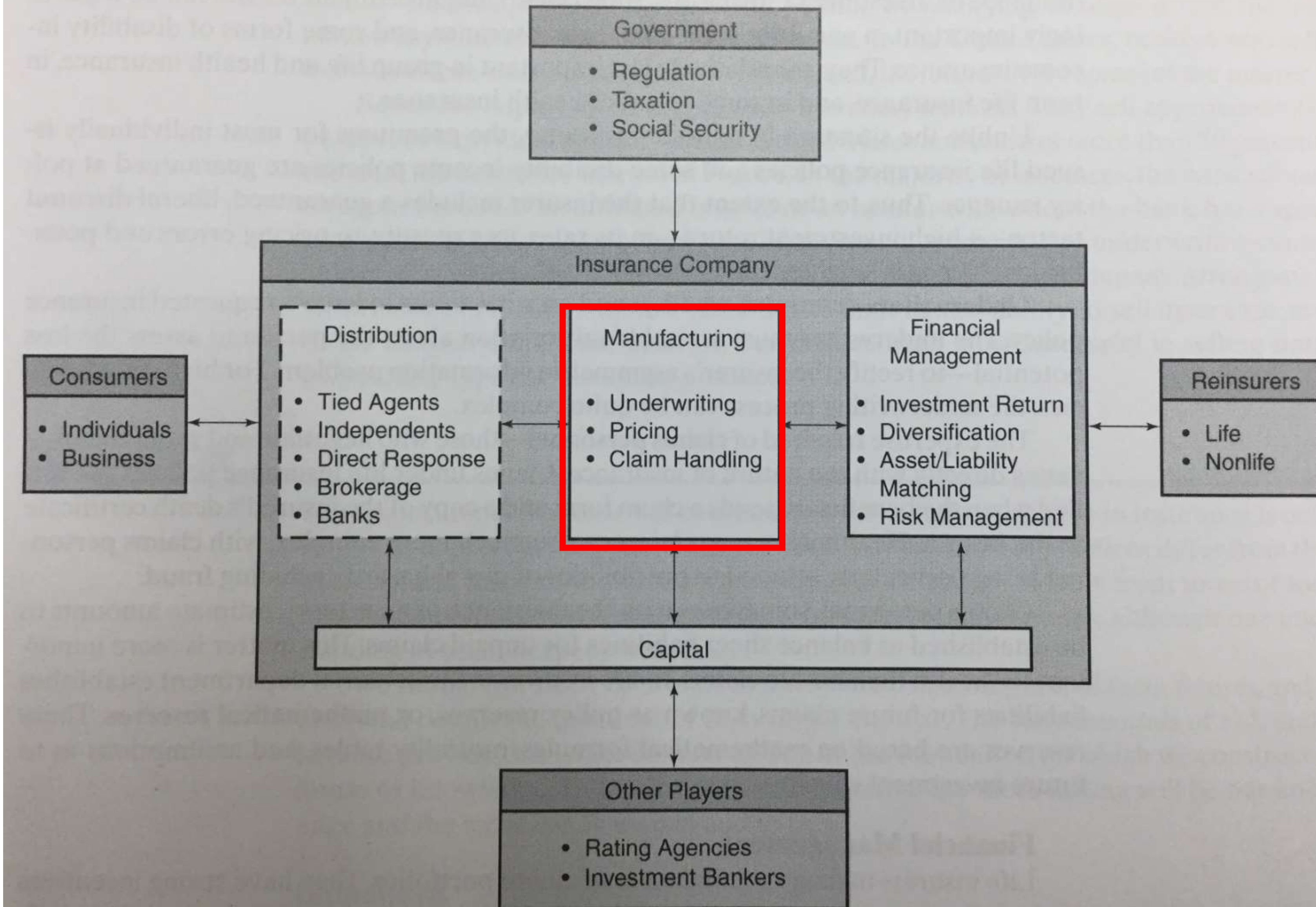
| No. | Players | New Business Premium | Total Premium |
|---|---|---|---|
| 1 | AIA | 72% 22% 4% 3% | 91% 5% 2% 2% |
| 2 | MTL | 18% 79% 1% 2% | 21% 75% 1% 3% |
| 3 | TLI | 55% 30% 1% 15% | 75% 19% 5% |
| 4 | SCBLife | 6% 94% 0% | 7% 90% 0% 2% |
| 5 | KTAL | 30% 55% | 37% 58% 5% |
| 6 | BLA | 17% 74% 9% | 24% 71% 5% |
| 7 | AZAY | 24% 40% 18% 18% | 41% 31% 16% 12% |
| 8 | PLT | 3% 92% 4% 1% | 4% 87% 8% 1% |
| 9 | FWD | 15% 74% 4% 8% | 25% 67% 4% 4% |
| 10 | OLIC | 84% 12% 4% | 89% 7% 3% |
| Industry | | 31% 60% 3% 7% | 45% 48% 3% 5% |

Agent Bancassurance DM Others

Source: The Thai Life Assurance Association (1Q2016)

# Non-life Insurance Marketing

- The <u>independent agency</u> is a business firm that usually represents several unrelated insurers.
- Under the <u>exclusive agency system</u>, the agent represents only one insurer or group of insurers under common ownership.
- A <u>direct writer</u> is an insurer in which the salesperson is an employee of the insurer, not an independent contractor.
- A <u>direct response</u> insurer sells directly to the consumer by television or some other media.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# Rating and Ratemaking

- Ratemaking refers to the pricing of insurance and the calculation of insurance premiums
  - A rate is the price per unit of insurance
  - An exposure unit is the unit of measurement used in insurance pricing

$$premium = rate * exposure\ units$$

# Rating and Ratemaking

- Ratemaking refers to the pricing of insurance and the calculation of insurance premiums
  - Total premiums charged must be *adequate* for paying all claims and expenses during the policy period
  - Rates and premiums are determined by an *actuary*, using the company's past loss experience and industry statistics
  - Actuaries also *determine the adequacy of loss reserves*, allocate expenses, and compile statistics for company management and state regulatory officials

# Underwriting

- Underwriting refers to the process of selecting, classifying, and pricing applicants for insurance
- A statement of U/W policy establishes policies that are consistent with the company's objectives, including
  - Acceptable, borderline, and prohibited classes of business
  - Amounts of insurance that can be written
  - Rating plans to be used
  - Business that requires approval by a senior underwriter

# Underwriting Principles

- The basic principles of underwriting include:
  - Attain an underwriting profit
  - Select prospective insureds according to the company's U/W standards
    - Reduce *adverse selection* against the insurer
  - Provide equity among the policyholders
    - One group of policyholders should not unduly subsidize another group

# Steps in Underwriting

- Underwriting starts with the agent
- Information for U/W comes from:
  - The application
  - The agent's report
  - An inspection report
  - Physical inspection – P&C insurance
  - A physical examination and attending physician's report – life & health
  - MIB report (Medical Information Bureau report)

# Steps in Underwriting

- After reviewing the information, the underwriter can:
  - *Accept* and recommend that the policy be issued
  - *Accept subject to restrictions or modifications*, e.g. another policy offering, deductible, or higher insurance premium rate
  - *Reject* the application
- Many insurers now use computerized U/W for certain personal lines of insurance that can be standardized

# Underwriting Considerations

- Other factors considered in U/W:
  - Rate adequacy
    - Non-life insurers are more willing to U/W new business if rates are considered adequate
    - If not, U/W requires a more conservative approach
  - Availability of reinsurance – results in more liberal U/W
  - Whether policy can or should be cancelled or renewed
    - In life insurance, policies are not cancellable
    - In non-life insurance, most policies can be cancelled → if loss experience is unfavorable, the insurer may cancel or not renew the policy

# Claim Settlement

- The **objectives** of claims settlement include:
  - Verification of a covered loss
  - Fair and prompt payment of claims
  - Personal assistance to the insured

# Types of Claims Adjustors

- Major types of claims adjustors include:
  - An <u>insurance agent</u> often has authority to settle small first-party claims up to some limit
  - A <u>company adjustor</u> is usually a salaried employee who will investigate a claim, determine the amount of loss, and arrange for payment
  - An <u>independent adjustor</u> is an organization or individual that adjusts claims for a fee
  - A <u>public adjustor</u> represents the insured and is paid a fee based on the amount of the claim settlement

# Steps in Claim Settlement

1) The claim process begins with a *notice of loss*, typically immediately or as soon as possible after a loss has occurred.

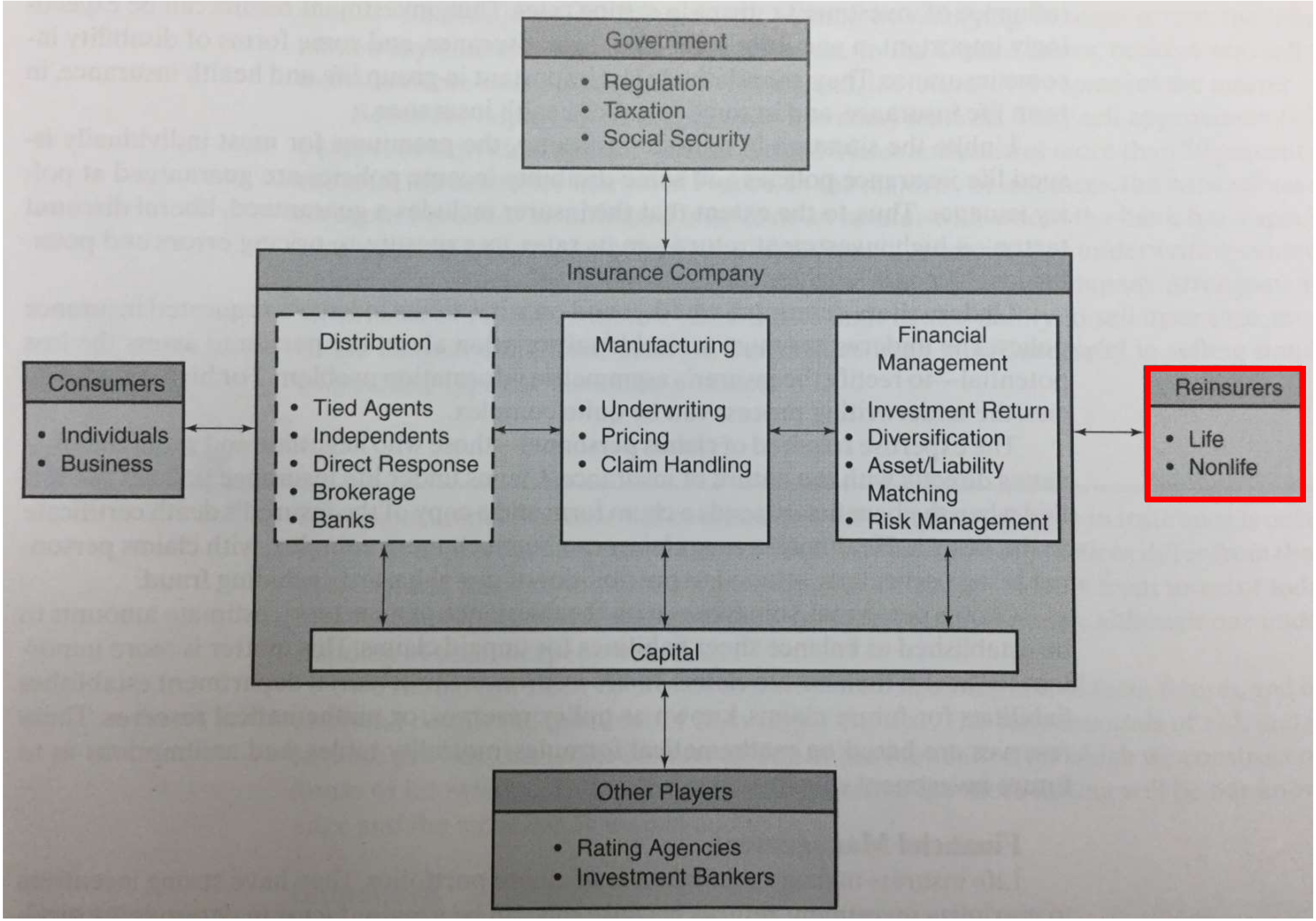
2) Next, the claim is *investigated*

- An adjustor must determine that a covered loss has occurred and determine the amount of the loss

3) The adjustor may require *a proof of loss* before the claim is paid

4) The adjustor decides if the *claim should be paid or denied*

- Policy provisions address how disputes may be resolved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# Reinsurance

- Reinsurance is an arrangement by which the primary insurer that initially writes the insurance transfers to another insurer part or all of the potential losses associated with such insurance
  - The primary insurer is the ceding company
  - The insurer that accepts the insurance from the ceding company is the reinsurer
  - The retention limit is the amount of insurance retained by the ceding company
  - The amount of insurance ceded to the reinsurer is known as a cession

# Reinsurance

- Reinsurance is used to:
  - Increase underwriting capacity
  - Stabilize profits
  - Reduce the <u>unearned premium reserve</u>, which represents the unearned portion of gross premiums on all outstanding policies at the time of valuation
  - Provide protection against a catastrophic loss
  - Retire from business or from a line of insurance or territory
  - Obtain U/W advice on a line for which the insurer has little experience

# Types of Reinsurance Agreements

1) Facultative reinsurance is an optional, **case-by-case** method that is used when the ceding company receives an application for insurance that exceeds its retention limit

- Often used when the primary insurer has an application for a large amount of insurance
- The insurer does not know in advance whether a reinsurer will accept any part of the insurance
- During periods of poor loss experience, reinsurance markets tend to tighten and facultative reinsurance may be more costly

# Types of Reinsurance Agreements

<u>2) Treaty reinsurance</u> means the primary insurer has agreed to cede insurance to the reinsurer, and the reinsurer has agreed to accept the business

- All business that falls within the scope of the agreement is automatically reinsured according to the terms of the treaty
- So there is no uncertainty or delay
- It is also economical because there is no need to shop around and negotiate reinsurance terms

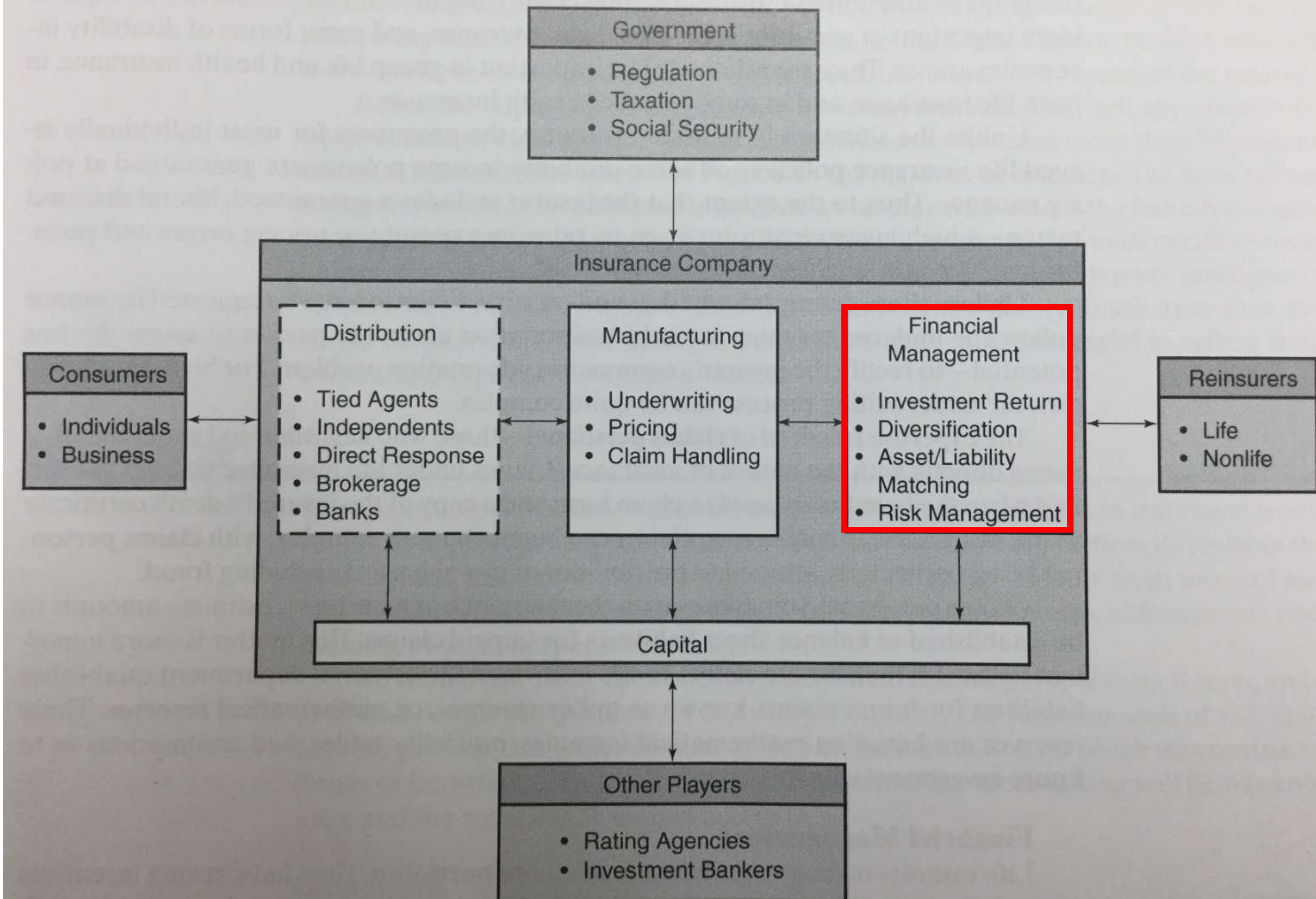
# Types of Reinsurance Agreements

- 2 basic methods for sharing losses:
  - Under the Pro rata method, the ceding company and reinsurer agree to share losses and premiums based on some proportion
  - Under the Excess method, the reinsurer pays only when covered losses exceed a certain level

# Alternatives to Reinsurance

Use of capital markets

- Securitization of risk means that an insurable risk is transferred to the capital markets through the creation of a financial instrument, such as a catastrophe bond or futures contract
- Catastrophe bonds are corporate bonds that permit the issuer of the bond to skip or reduce the interest payments if a catastrophic loss occurs
  - Cat bonds are growing in importance and are now considered by many to be a standard supplement to traditional reinsurance



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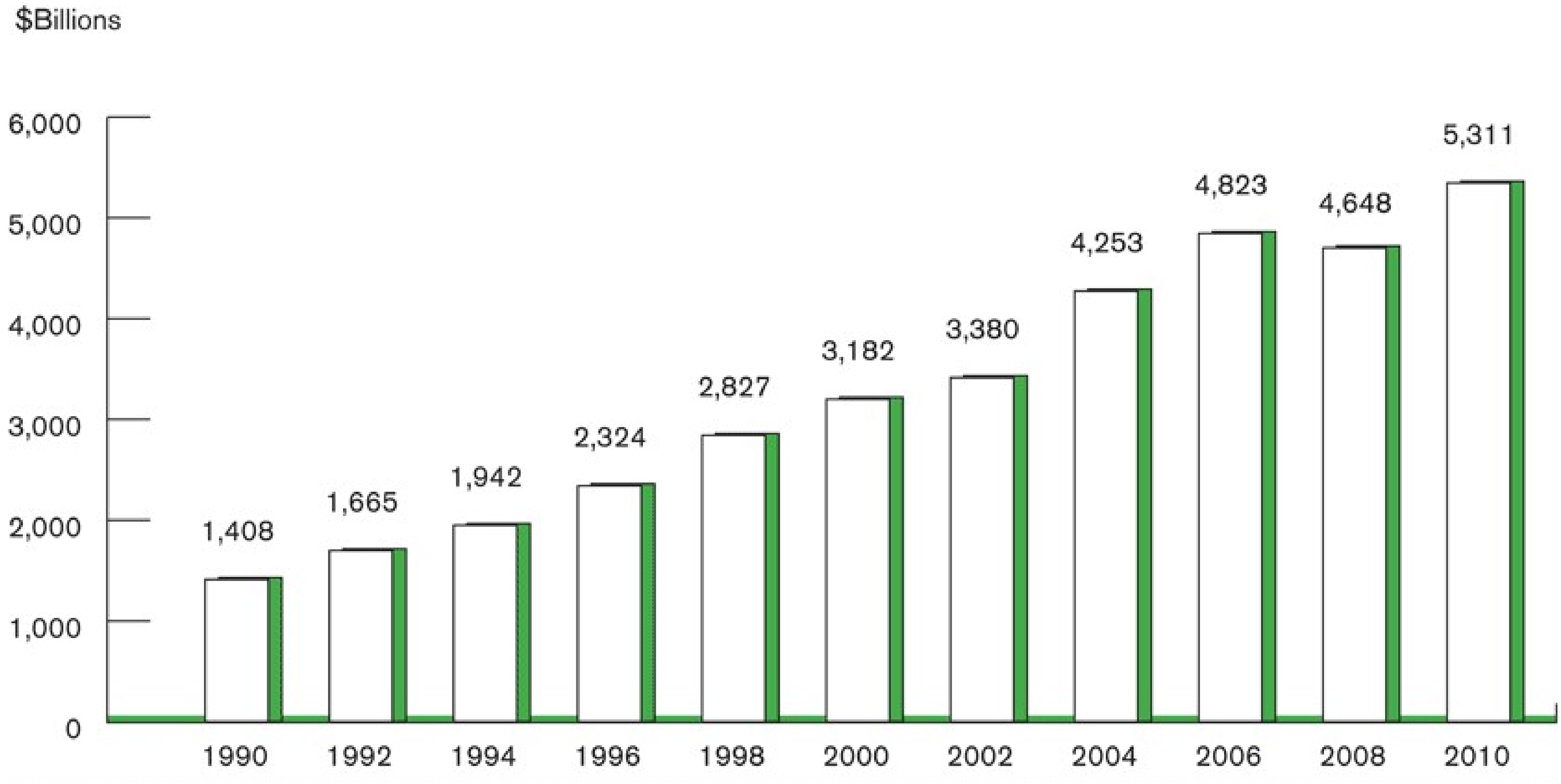
# Investments

- Because premiums are paid in advance, they can be invested until needed to pay claims and expenses
- Investment income is extremely important in reducing the cost of insurance to policyowners and offsetting unfavorable U/W experiences
- Life insurance contracts are long-term; thus, safety of principal is a primary consideration
- In contrast to life insurance, non-life insurance contracts are short-term in nature, and claim payments can vary widely depending on catastrophic losses, inflation, medical costs, etc.

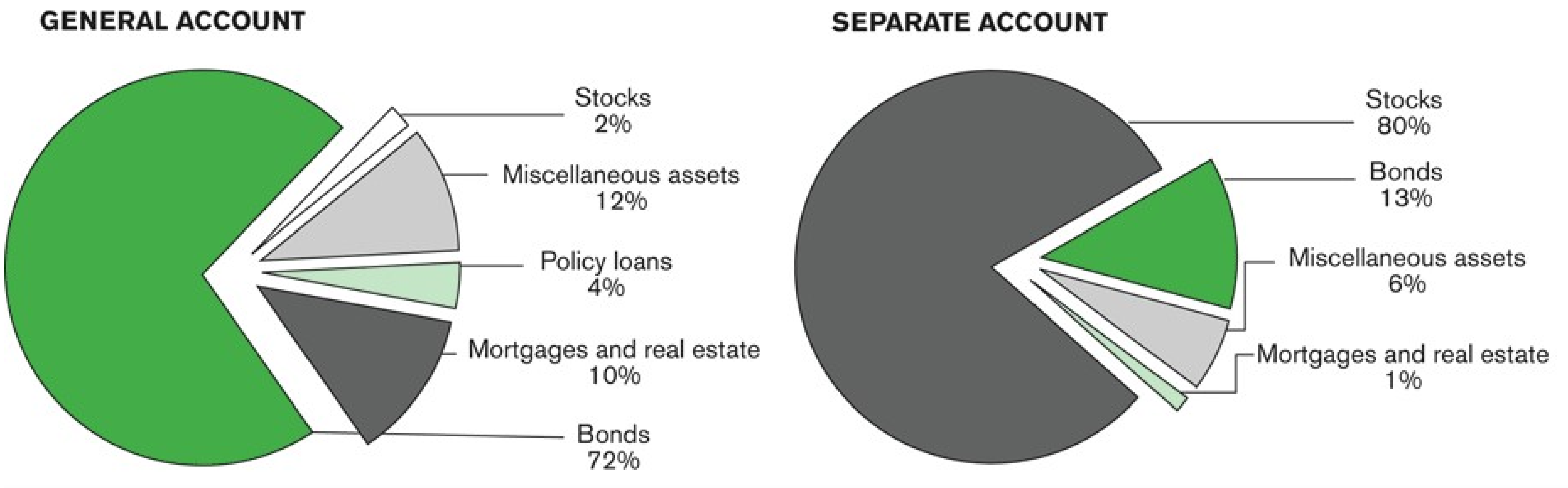
# Growth of Life Insurers' Assets




SOURCE: American Council of Life Insurers, *Life Insurers Fact Book 2011*, Figure 2.1

Source: RM Exhibit 6.1

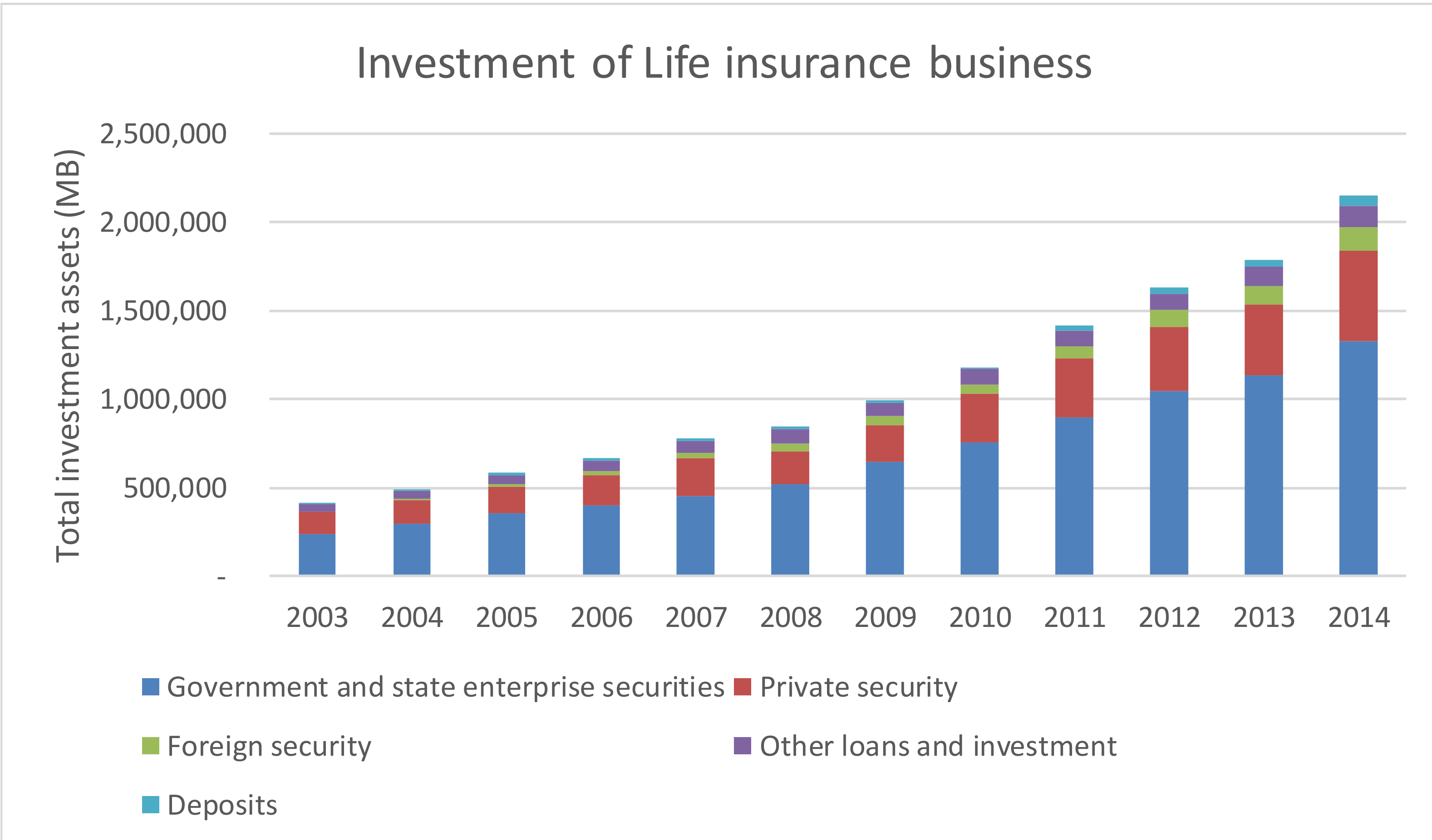
# Asset Distribution of Life Insurers in 2010




SOURCE: American Council of Life Insurers, *Life Insurers Fact Book 2011*, Figure 2.2.

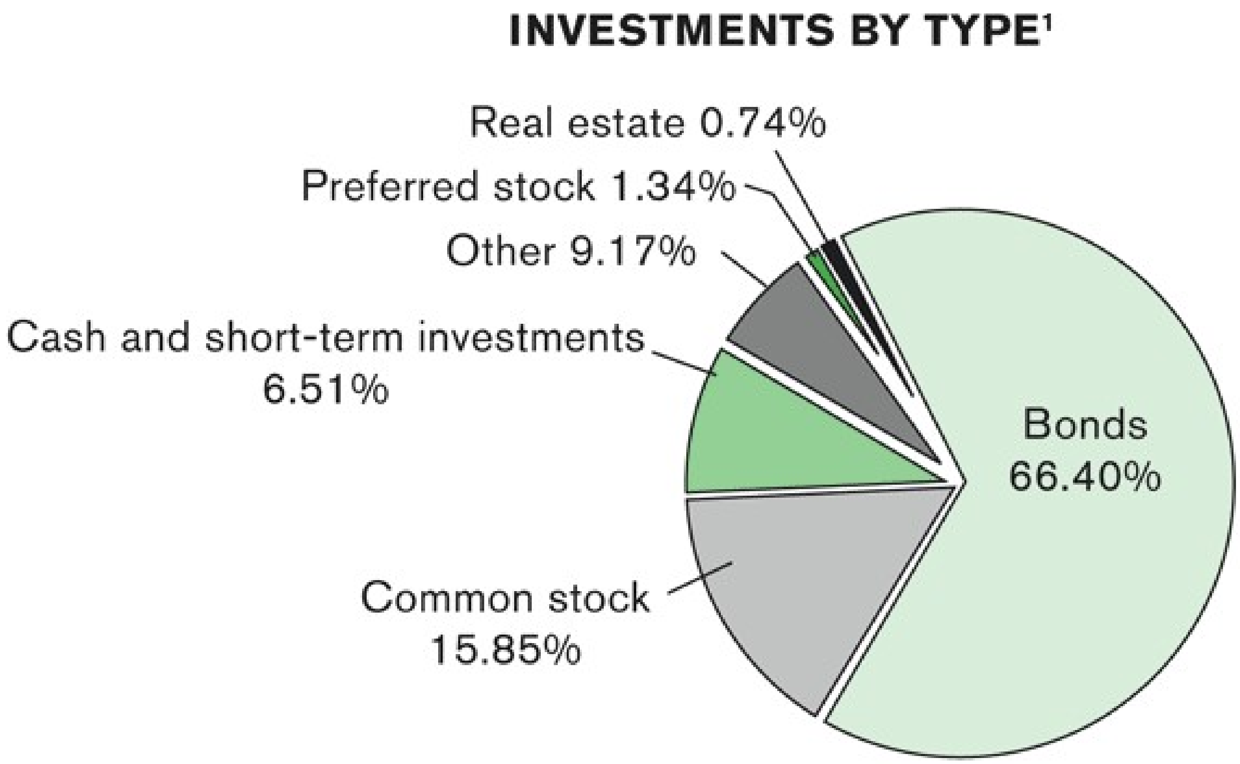
Source: RM Exhibit 6.2

# Life insurance in Thailand as source of investment funds




Source: Thai Life Assurance Association

# Investments, P&C Insurers, 2010




Source: National Association of Insurance Commissioners (NAIC) Annual Statement Database, via Highline Data, LLC. Copyrighted Information. No portion of this work may be copied or reproduced without the express written permission of Highline Data, LLC. Excerpted from Insurance Information Institute, *The Insurance Fact Book 2012*, p. 45.

Source: RM Exhibit 6.3

# Other Insurance Company Functions

- Information systems are extremely important in the daily operations of insurers.
  - Computers are widely used in many areas, including policy processing, simulation studies, market analysis, and policyholder services
- The accounting department prepares financial statements and develops budgets
- In the legal department, attorneys are used in advanced underwriting and estate planning
- Non-life insurers also provide many loss control services, e.g. alarm systems, fire prevention, occupational safety and health, etc.