

TRAINING DOCUMENT



Mu Sigma

Insurance 101

Chicago, IL
Bangalore, India
2011
www.mu-sigma.com

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Agenda

Basic Insurance Concepts

Key Insurance Processes

Financial Analysis of an Insurance Company

Basic Insurance Concepts

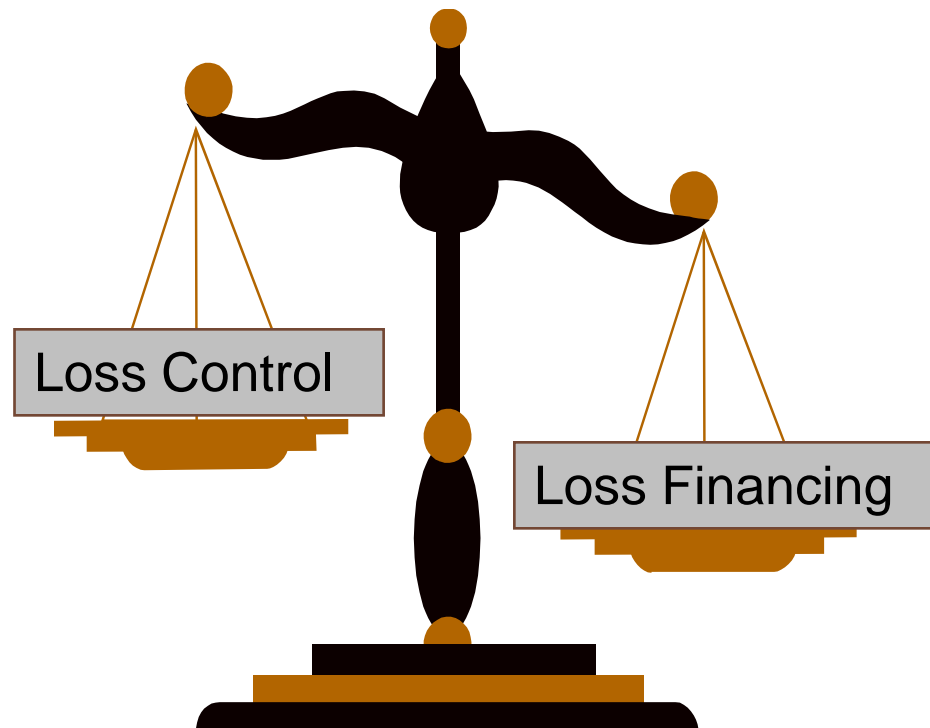
Why do we need Insurance?

- ▶ Risk of Financial Loss or Hardship

- ▶ Damage to property
- ▶ Damages or money you become “legally obligated to pay”
- ▶ Loss of income

Basic Insurance Concepts

There are two ways to handle risk.



Basic Insurance Concepts

Loss control serves to reduce the chance or magnitude of a loss.

Loss Prevention

Measures taken to decrease the probability of loss

- ▶ Don't build house on fault line
- ▶ Don't drive in bad weather

Loss Reduction

Measures aimed at reducing the severity of a loss

- ▶ Install automatic sprinklers in case of fire
- ▶ Buy a car with airbags and antilock brakes

Basic Insurance Concepts

Losses can be financed in several ways.

Retain the risk

- ▶ Planned retention/ self insurance
 - ▶ Risk is identified
 - ▶ May set aside money specifically to pay for losses if they occur
- ▶ Unplanned retention
 - ▶ Risk not identified
 - ▶ No money is set aside
 - ▶ Burden if loss occurs

Transfer the risk

- ▶ Non Insurance Transfers
 - ▶ Transfer risks through contracts (e.g. rental leases)
- ▶ Insurance
 - ▶ Transfer risk through insurance contract

Basic Insurance Concepts

We need insurance to reduce uncertainty and to finance our losses.

Insurance

As a Mechanism:

- ▶ Insurance company agrees to accept risk by “pooling” or combining many similar exposures
- ▶ All people in the pool must contribute to the fund
- ▶ Insurance **indemnifies** the pool members for their losses

As a Product:

- ▶ A promise to pay in the event of a loss

Basic Insurance Concepts

The insurance market is divided into two main segments.

Property & Casualty

Property:

Protects insured from financial loss due to damage of physical property from perils such as fire, lightening & wind

Casualty:

Protects insured from financial loss due to liability or other legally owed funds

Life:

Provides income for the survivors of an insured when he/she dies or to provide funds needed for the future.

Health:

Policies that pay benefits such as dismemberment; disability income; basic and major medical expense.

Life & Health

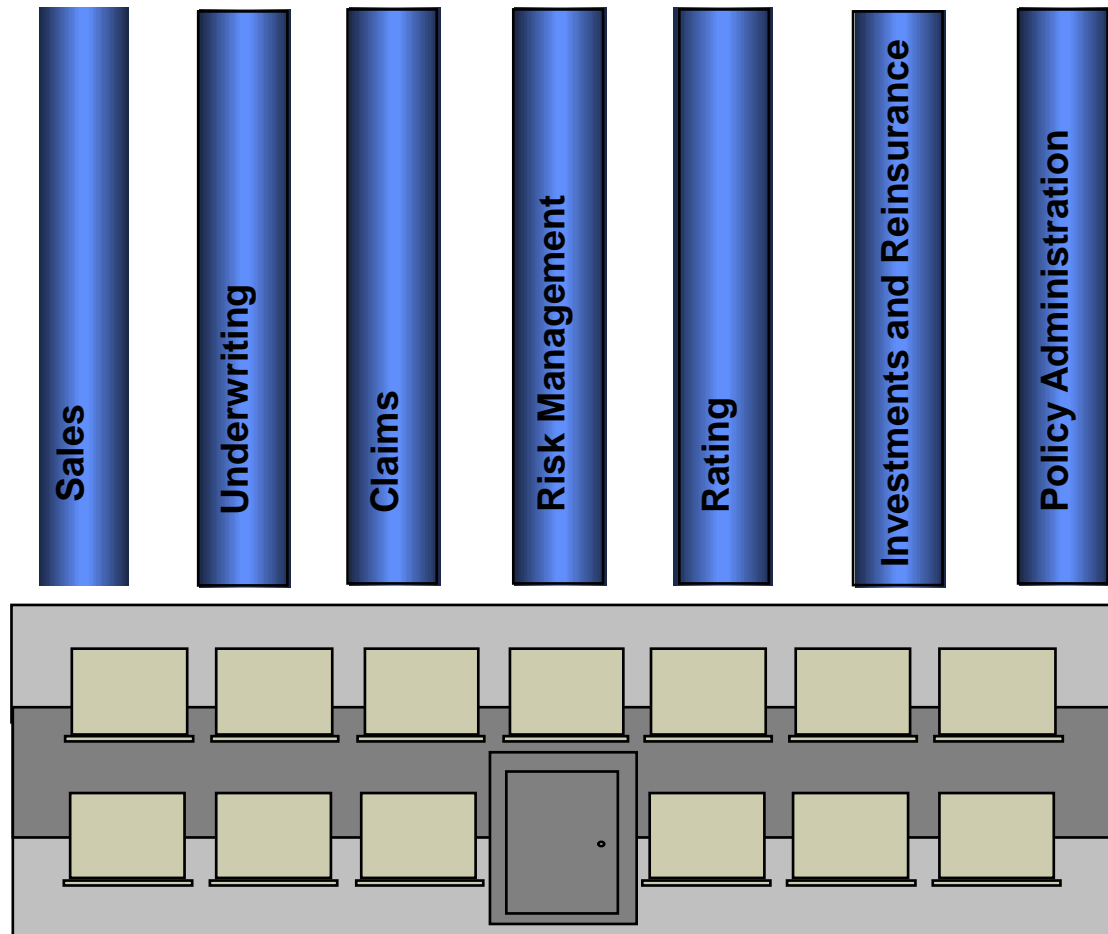
Basic Insurance Concepts

The ownership structure in insurance companies varies.

Types of Insurance Organizations	
Stock Insurers	<ul style="list-style-type: none">▶ Owned by shareholders<ul style="list-style-type: none">▶ Allstate▶ SAFECO
Mutual Insurers	<ul style="list-style-type: none">▶ Owned by policyholders<ul style="list-style-type: none">▶ State Farm▶ Pacific Mutual
Reciprocal Exchanges	<ul style="list-style-type: none">▶ Owned by policyholders administered by an attorney in fact (management organization)<ul style="list-style-type: none">▶ Farmers▶ CSAA▶ USAA

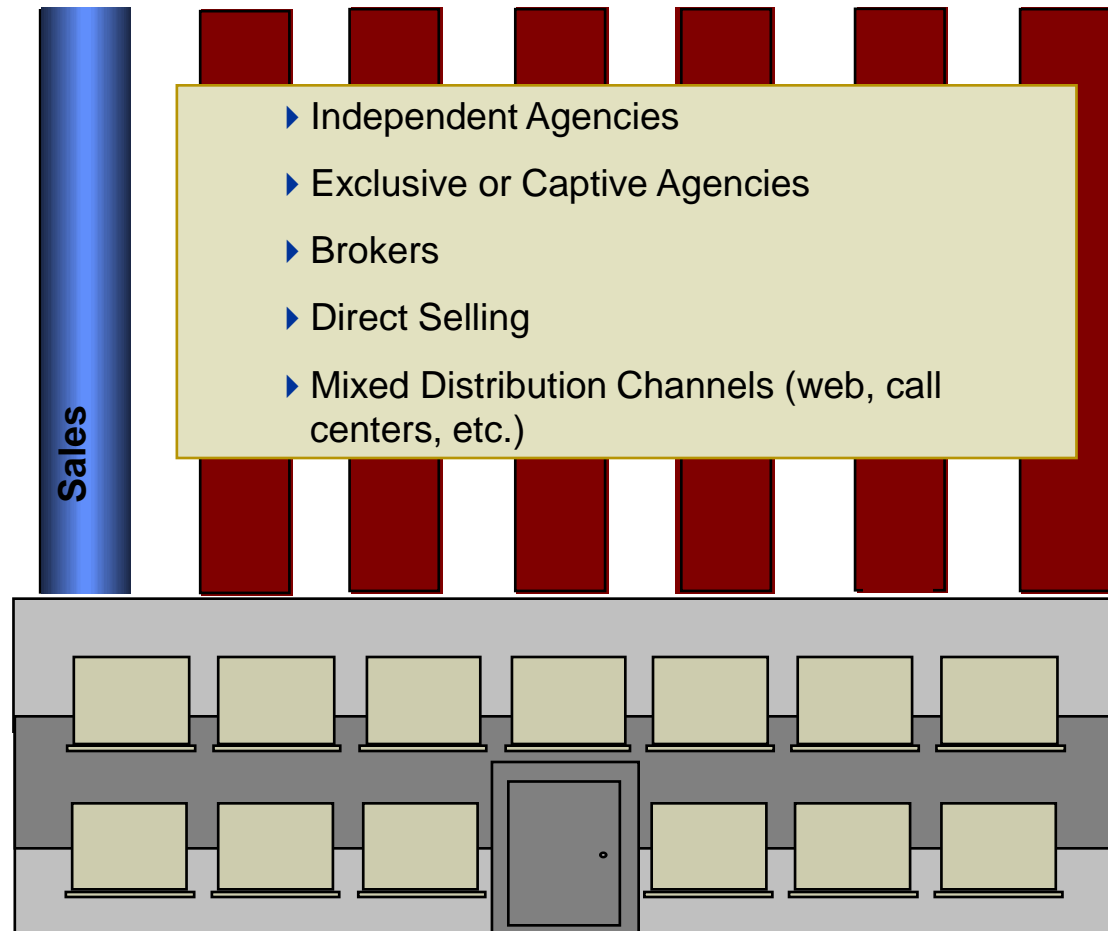
Basic Insurance Concepts

An insurance organization typically has seven major functional areas.



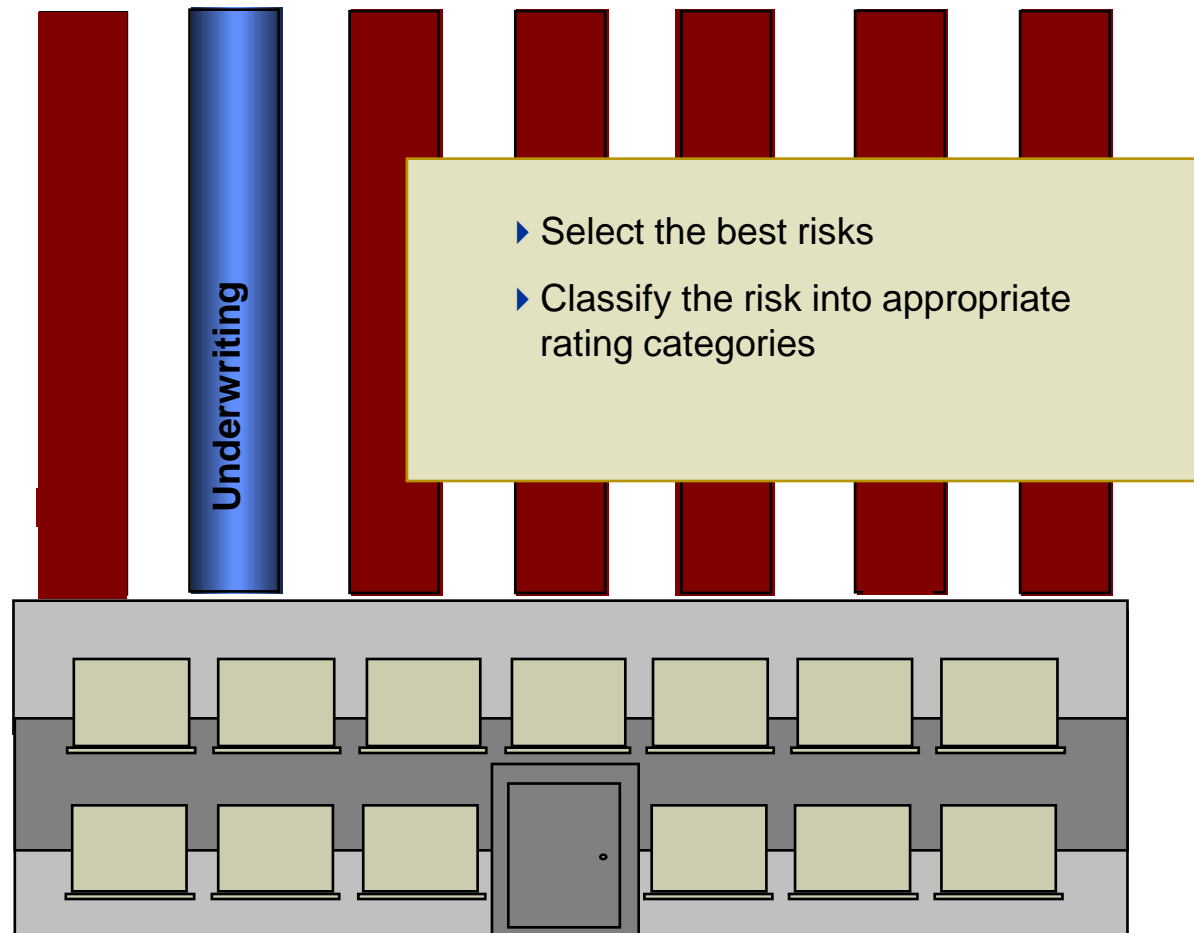
Basic Insurance Concepts

Sales generates revenue for the insurance company through various distribution channels by offering various insurance products to customers.



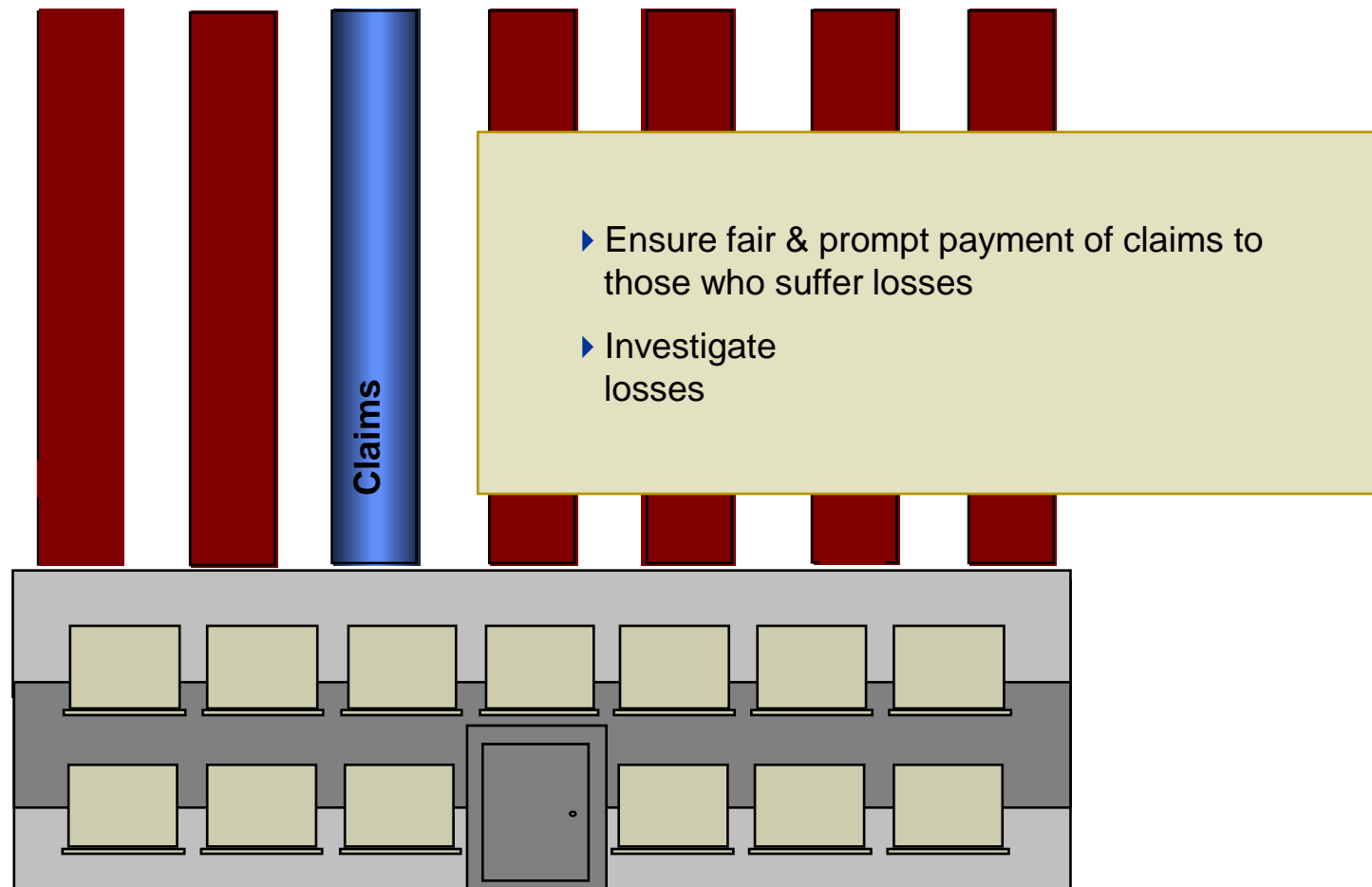
Basic Insurance Concepts

Underwriting is the selection & classification of the insured.



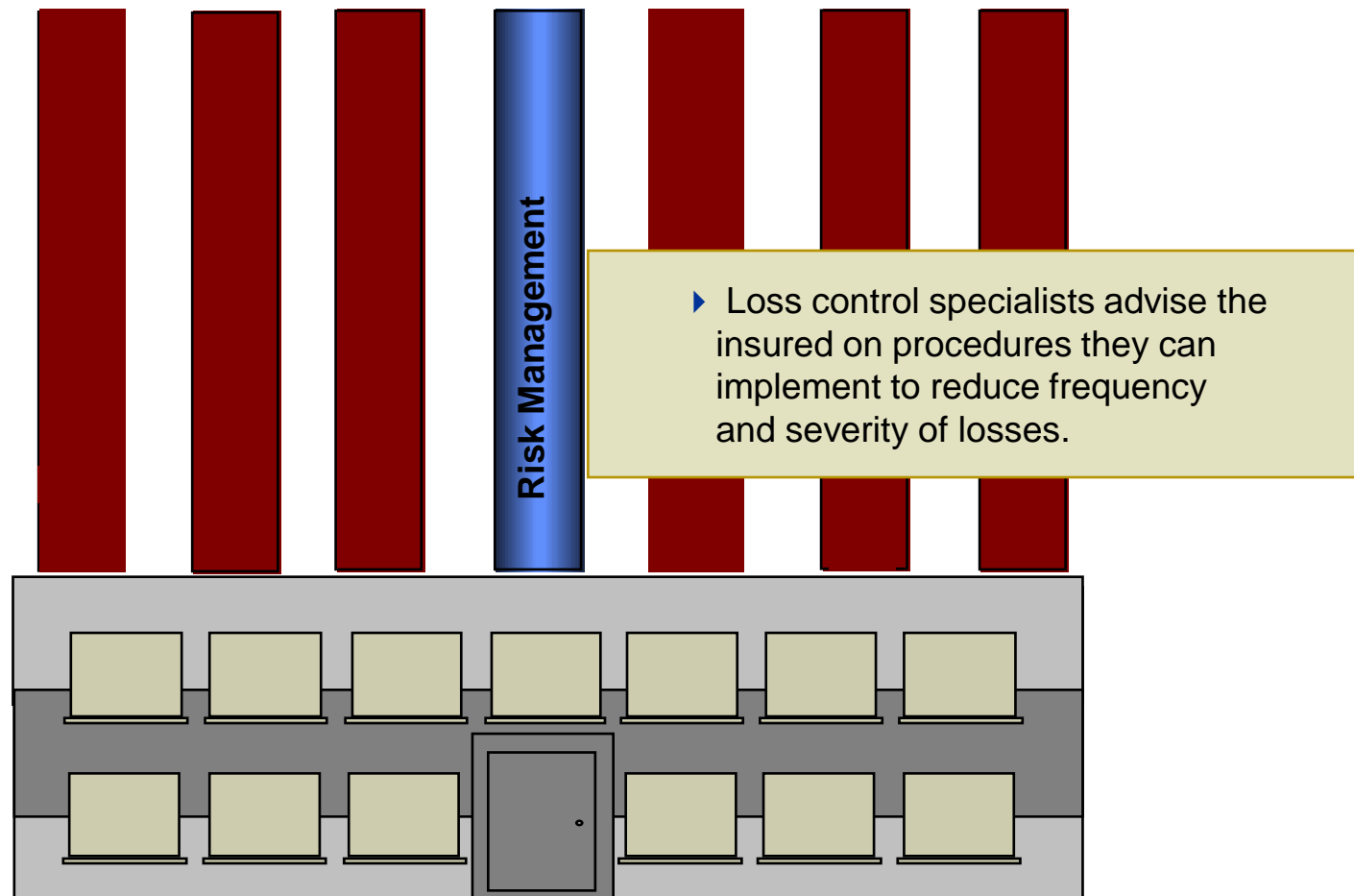
Basic Insurance Concepts

Claims ensures that the insurance company fulfills its contractual promise to provide protection.



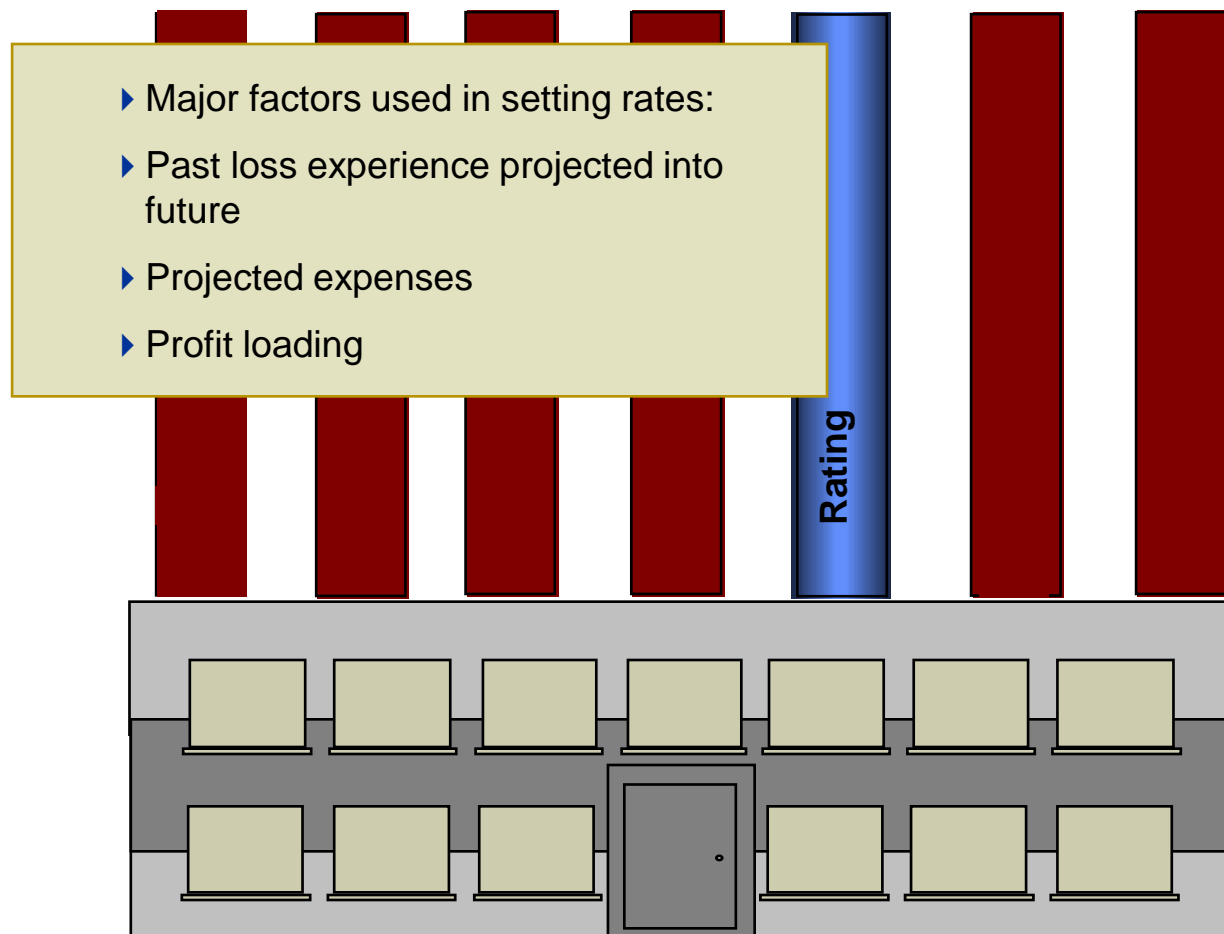
Basic Insurance Concepts

Risk management is responsible for loss control.



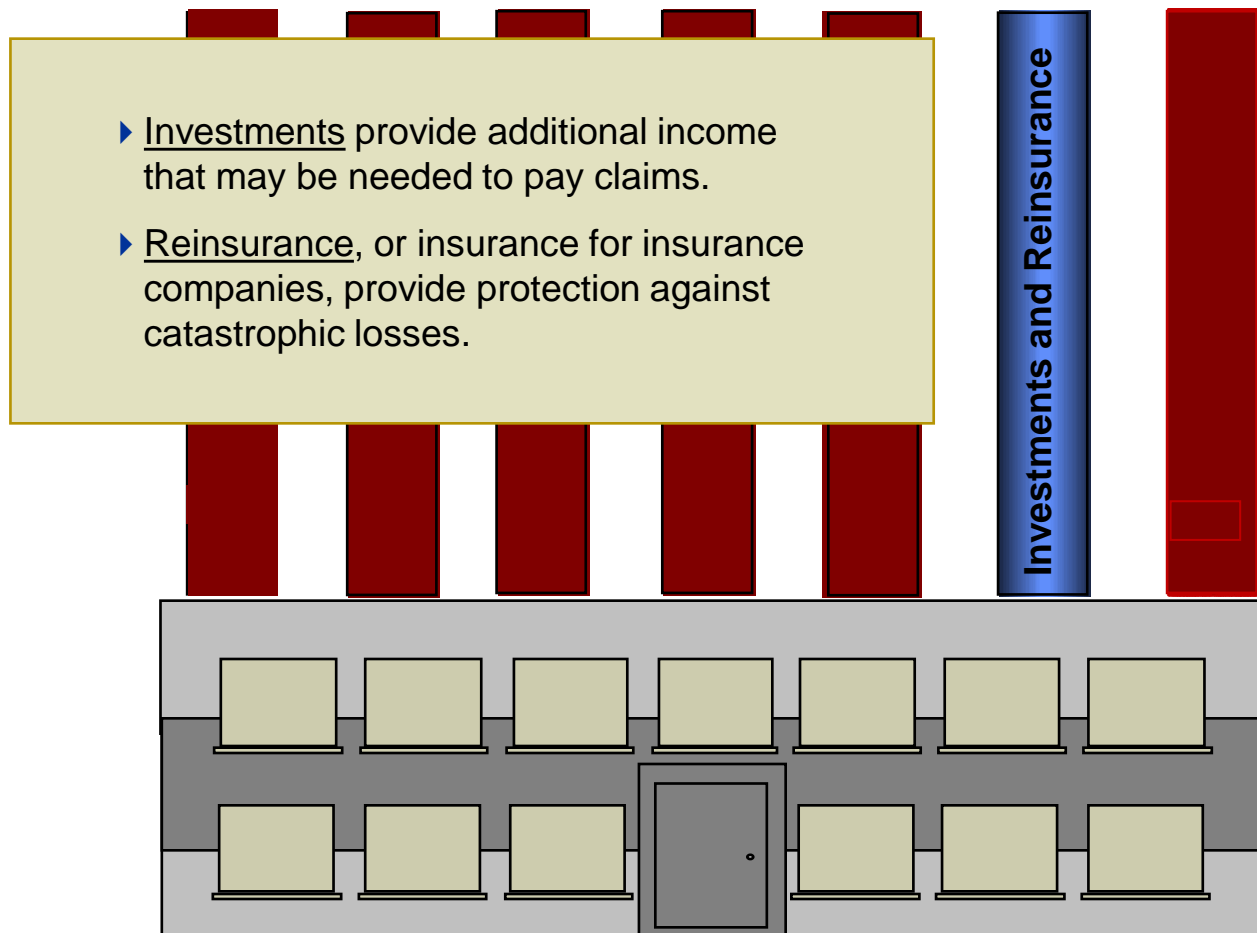
Basic Insurance Concepts

Rating determines rates based on past loss experience and projected expenses.



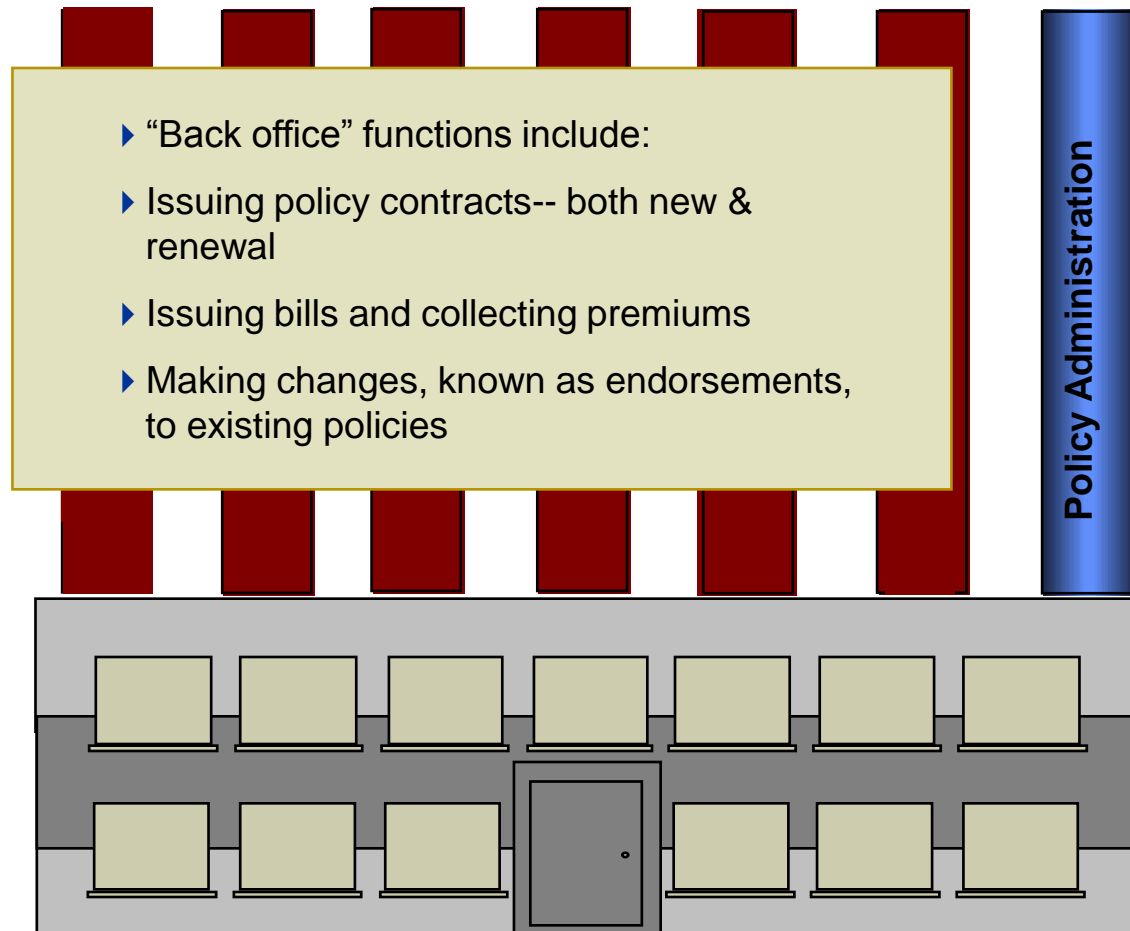
Basic Insurance Concepts

The investment and reinsurance functions help ensure the financial stability of an insurance company.



Basic Insurance Concepts

Policy administration handles the “back office” functions.



Basic Insurance Concepts

Insurance is a highly regulated industry to protect consumers.

Reasons:

- ▶ Insurer solvency
- ▶ Affordable rates
- ▶ Availability of insurance
- ▶ Complex contracts
- ▶ Prevention of abuses within industry

Who Regulates?

- ▶ Individual State Governments
- ▶ Federal Government

Implications:

- ▶ Restricted underwriting policies
- ▶ Controlled pricing changes
- ▶ Restricted freedom of investments
- ▶ Dictated coverage

Agenda

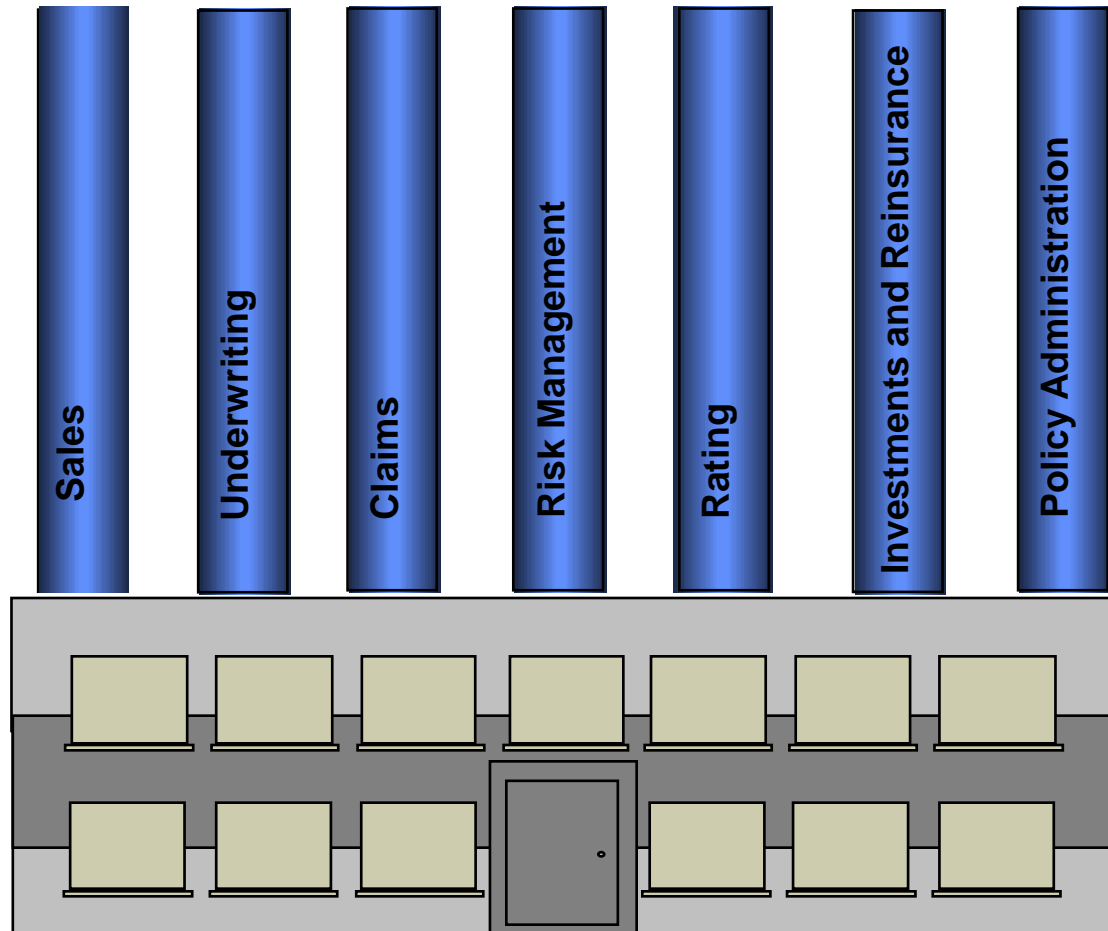
Basic Insurance Concepts

Key Insurance Processes

Financial Analysis of an Insurance Company

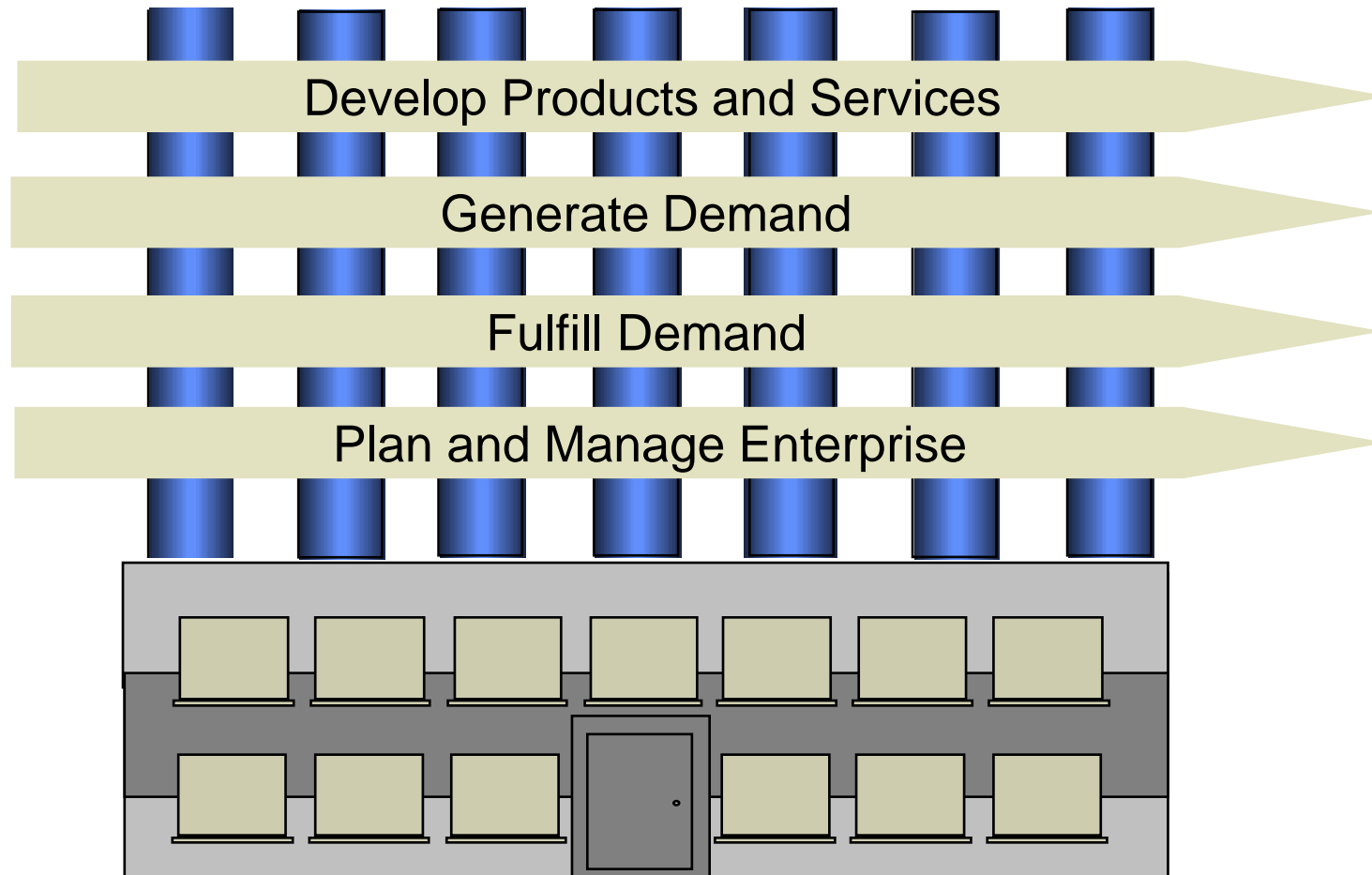
Key Insurance Processes

Traditionally, insurance companies organize by functional areas.



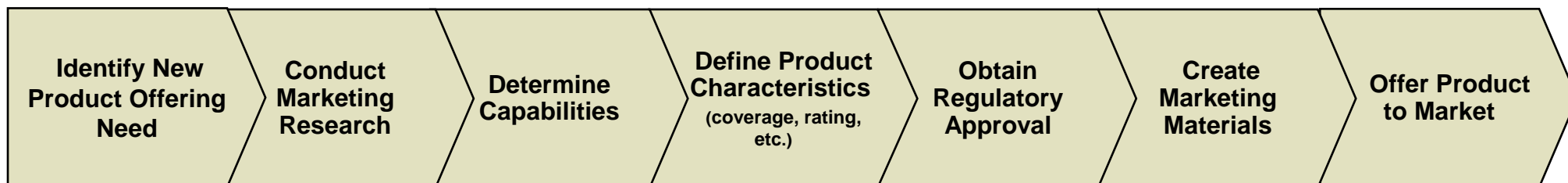
Key Insurance Processes

Within the insurance company, however, several core processes occur that focus primarily on the customer.



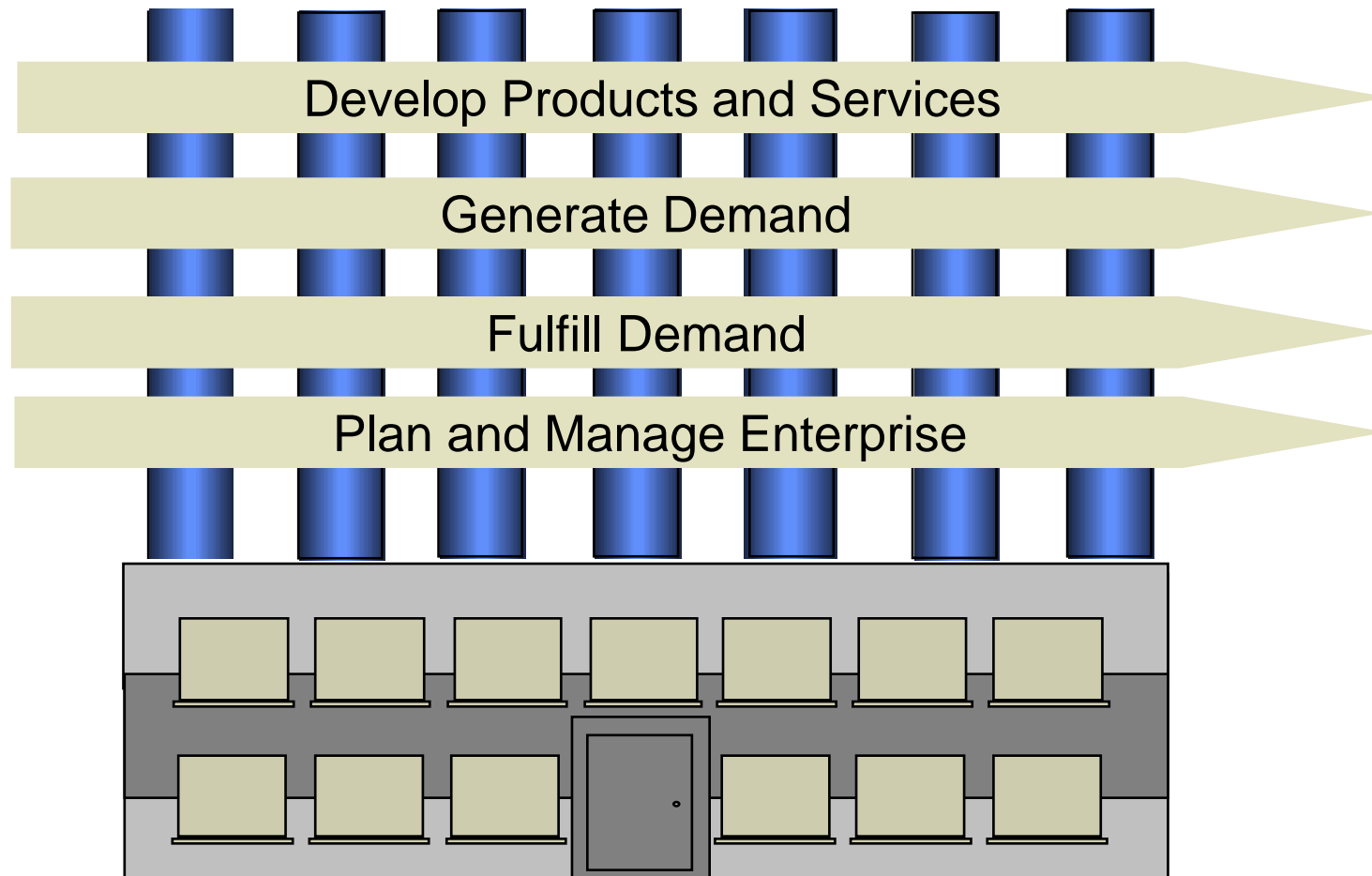
Key Insurance Processes

The process for Developing Product and Services is as follows:



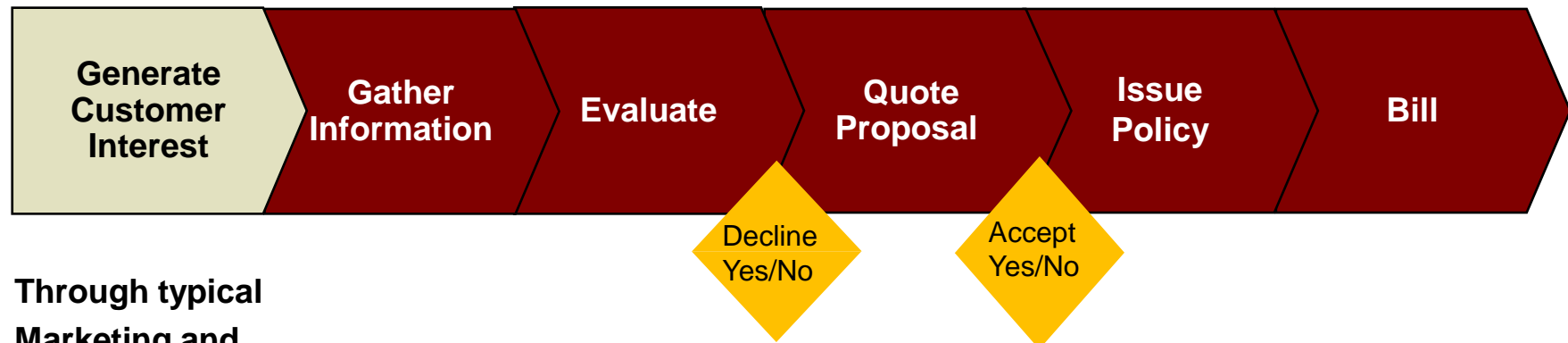
- | | | | | | | |
|--|--|---|---|---|---|--|
| <ul style="list-style-type: none"> ▶ Determine need for new product | <ul style="list-style-type: none"> ▶ Determine market opportunity ▶ Determine risk opportunity ▶ Determine if risk is aligned with Insurance Company's risk appetite/strategy | <ul style="list-style-type: none"> ▶ Determine if Insurance Company has capabilities to efficiently manage this risk ▶ Determine if insurance company has the experience to effectively understand the type of risk | <ul style="list-style-type: none"> ▶ Define Product Characteristics <ul style="list-style-type: none"> ▶ LOB ▶ Coverage ▶ Rating ▶ Commission strategy for agents ▶ Etc. | <ul style="list-style-type: none"> ▶ Create and submit regulatory approval documentation | <ul style="list-style-type: none"> ▶ Create marketing and sales materials to support product development launch ▶ Create internal communications materials for agents | <ul style="list-style-type: none"> ▶ Launch Product |
|--|--|---|---|---|---|--|

Key Insurance Processes



Key Insurance Processes

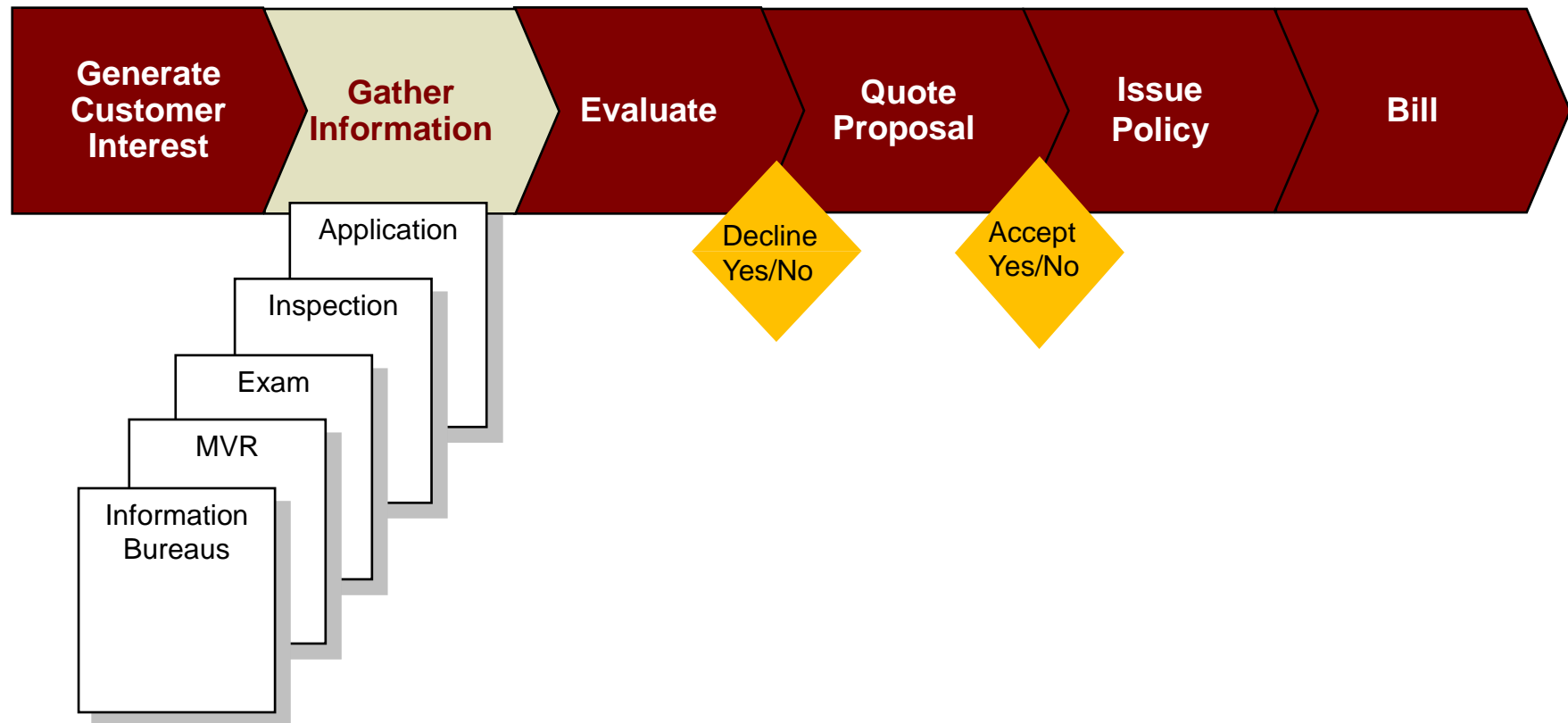
The processes for Generating and Fulfilling Demand is as follows:



Through typical
Marketing and
sales activities

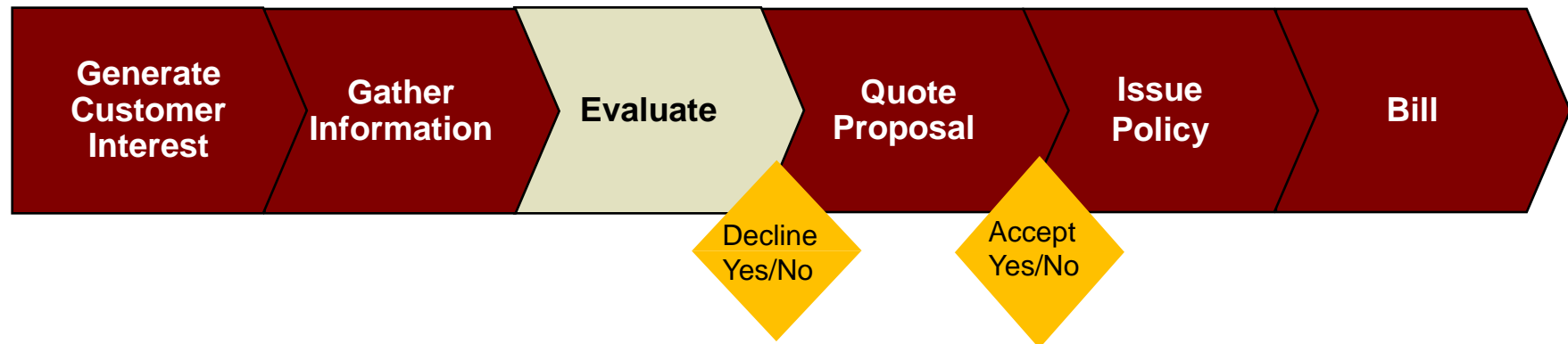
Key Insurance Processes

The second step is to gather information pertinent to rating and evaluation of the risk.



Key Insurance Processes

Once the initial information is gathered, the underwriter proceeds to evaluate the risk.

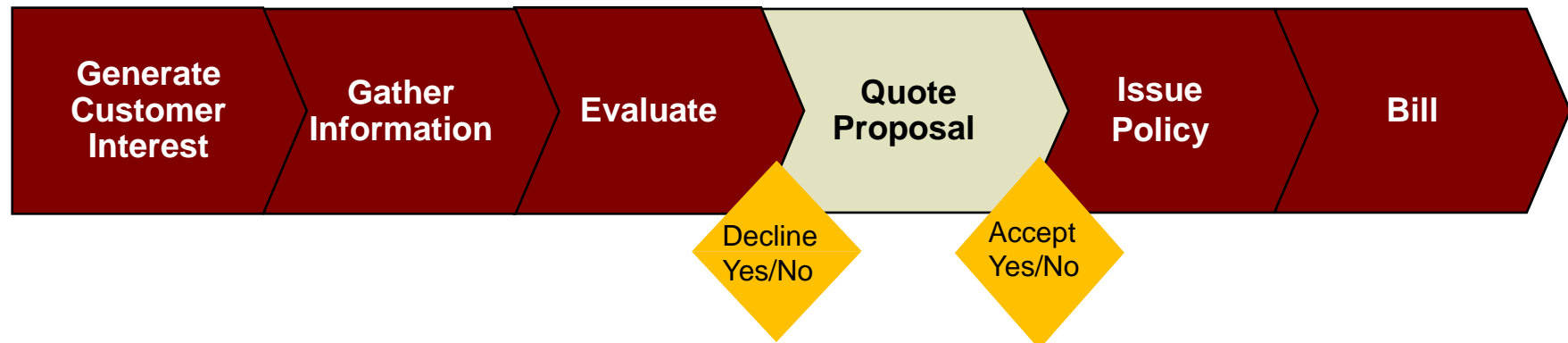


Will the risk be profitable?

- **Better than the average loss experience**
- **Appropriate rates available for exposures**

Key Insurance Processes

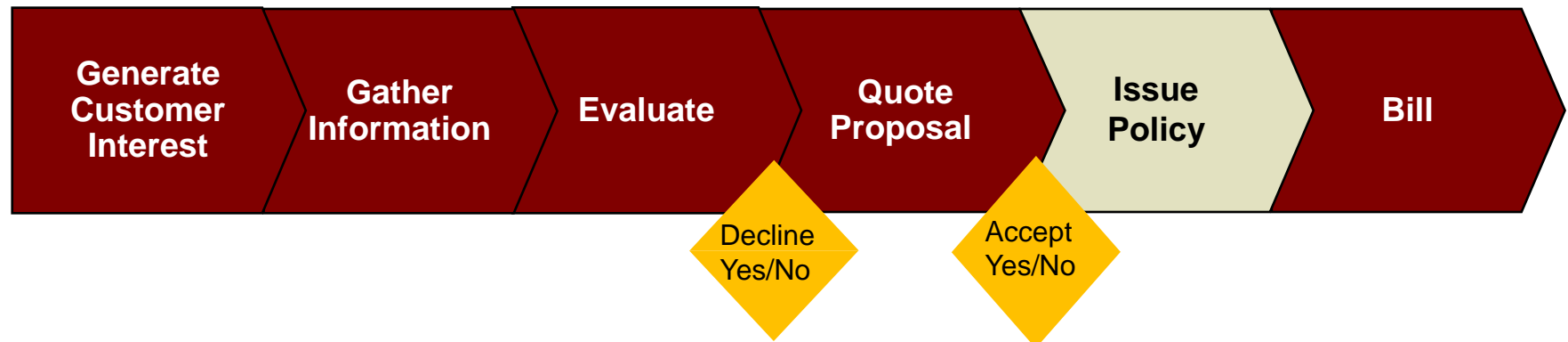
If the risk is acceptable, the underwriter prepares a quote.



Quote and propose the price of the policy

Key Insurance Processes

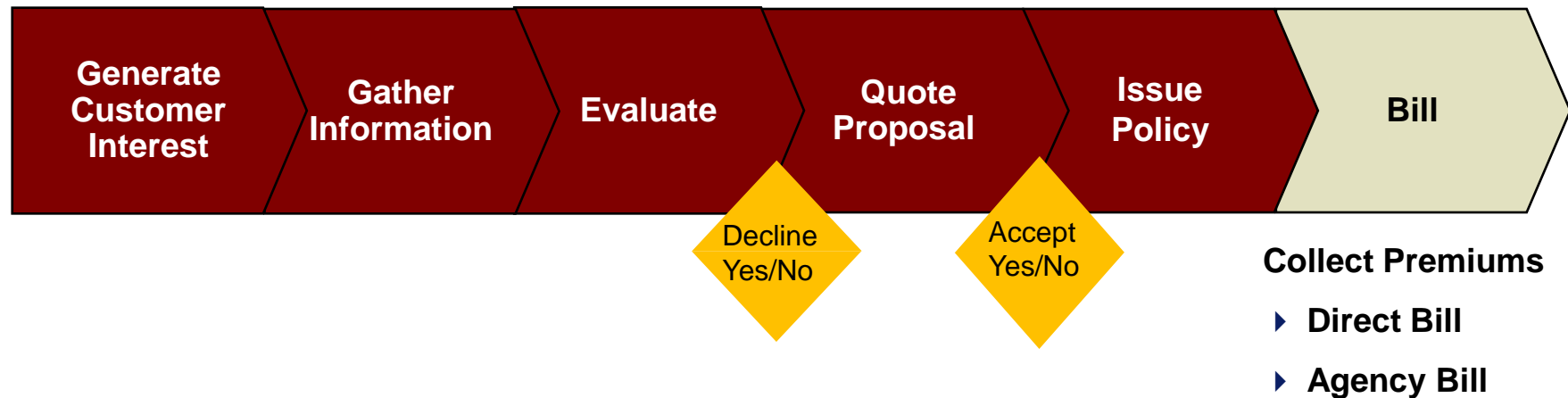
Once the customer accepts the quote, the policy is issued.



Send insurance contract to policyholder/ customer

Key Insurance Processes

The last step in the process is to issue a bill for the premium due.



Key Insurance Processes

The claims process represents the delivery of the insurance product -- the promise to pay.



Key Insurance Processes

The first step after receiving notice of a claim is to verify coverage.



- ▶ Make sure the loss is covered
- ▶ Set initial reserves



Key Insurance Processes

The details of the claim must be grouped and investigated.



Discover and describe
the details of an event



Key Insurance Processes

The information gathered in investigation is evaluated.



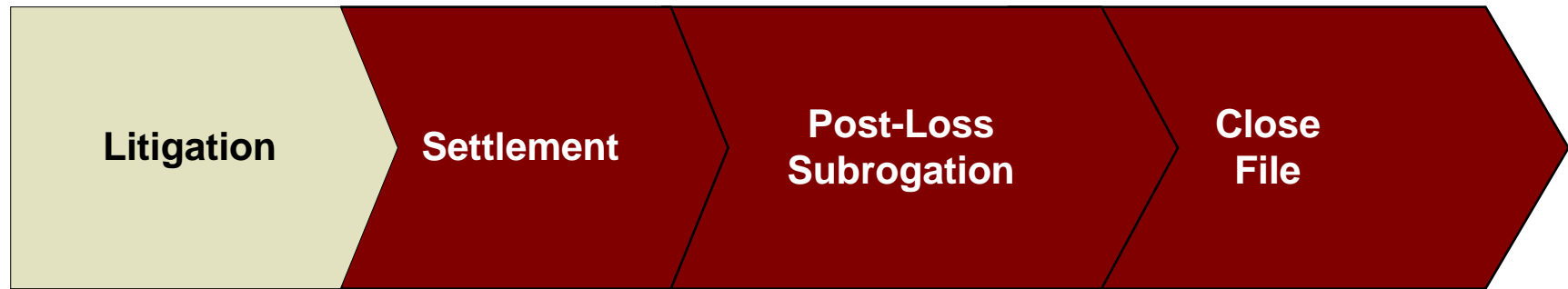
Key Insurance Processes

An offer is made based on the results of the evaluation (which then may be negotiated).



Key Insurance Processes

If an agreement cannot be reached, the claim may go to litigation.



The case is heard in a court of law

Key Insurance Processes

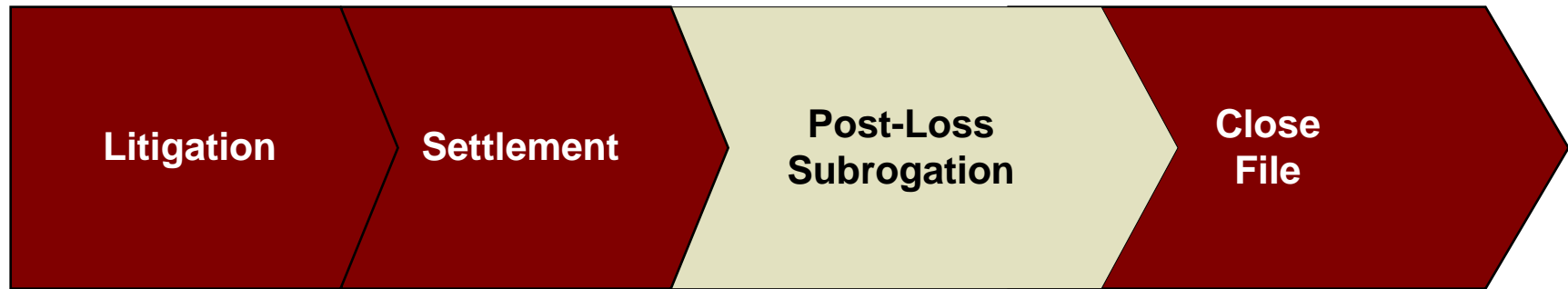
Once an agreement is reached, a settlement is made.



Agree on terms of
payment or
indemnification for
policy benefits

Key Insurance Processes

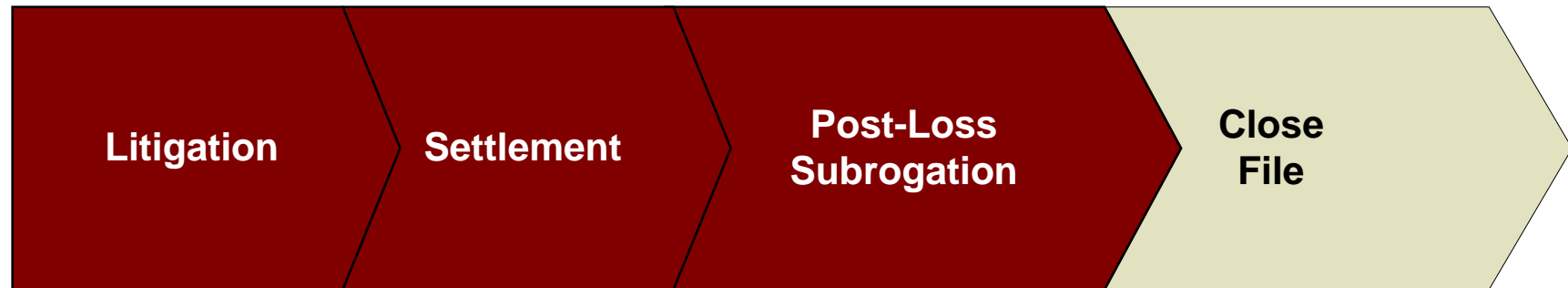
An insurance company may recover from third parties involved in the claim through subrogation.



Recover any damages
owed by third parties

Key Insurance Processes

Once all the money is settled, the claims file is closed.



Agenda

Basic Insurance Concepts

Key Insurance Processes

Financial Analysis of an Insurance Company



Financial Analysis of an Insurance Company

The way an insurance company makes a profit differs substantially from other industries:

Insurance products sold = promise to perform in the future

Cost of doing business is unknown when the price for insurance products is set

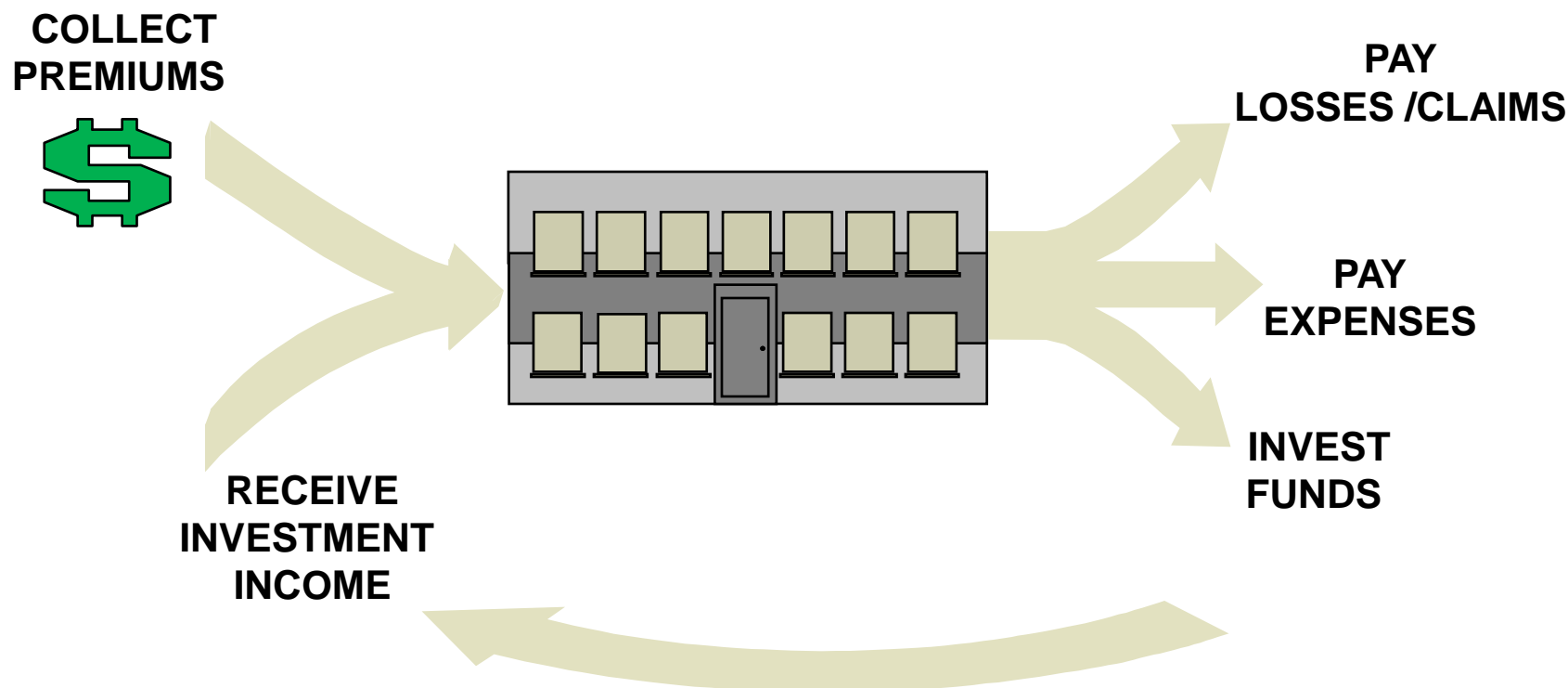
Results in various uncertainties in the cost of operations



Financial Analysis of an Insurance Company

Various economic events effect the profitability of an insurance company

— *Basic Economic Events of an Insurance Company* —





Financial Analysis of an Insurance Company

Income statements for insurance companies vary slightly from the standard.

– Basic Insurance Company Income Statement –

Net Premiums Earned (+)
Losses or Benefits Incurred (-)
Loss Adjustment Expenses (-)

Underwriting Expenses (-)

= Underwriting Income

Net Investment Income (+/-)

= Pre-tax Operating Income

Realized Capital Gains/Losses (+/-)
Policyholder dividends (-)

Taxes (-)

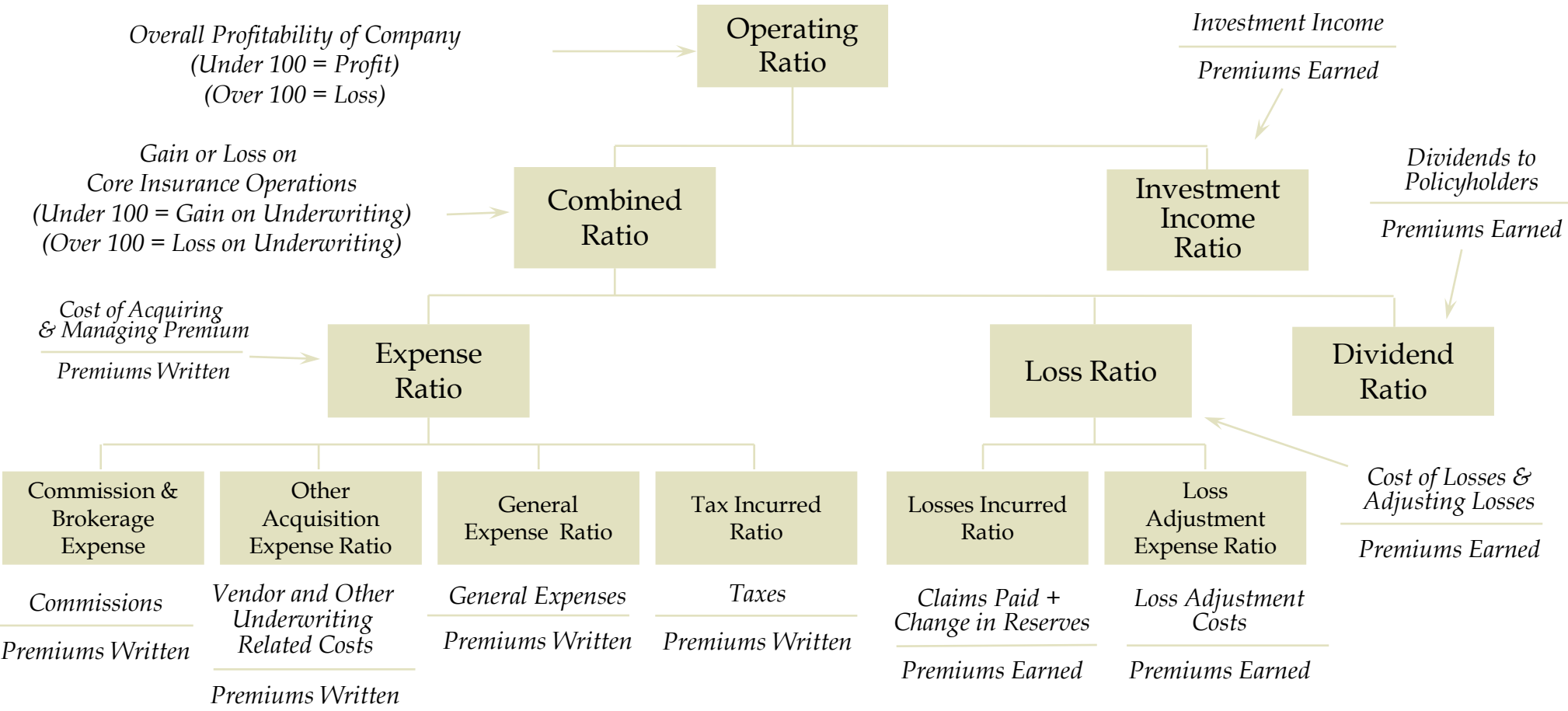
= Net Income



Financial Analysis of an Insurance Company

The insurance industry monitors key financial metrics calculated from the income statement and the balance sheet

– Key Performance Indicators –



P&C Result 2010 comparison

	P&C	State Farm	All State	Travelers	GEICO	Progressive	Plymouth Rock
Net Earned Premiums	420.5	32.4	28.12	21.4	14.3	14.3	0.256
Incurred Losses (Including loss adjustment expenses)	309.1	22.8	20.5	13.2	10.6	10.1	0.184
Expenses	119.5	11.6	7.1	7.2	2.5	2.88	0.076
Policyholder Dividends	2.3	-	-	-	-	-	-
Net Underwriting Gain (Loss)	-10.4	-2.07	0.22	1.4	1.17	1.32	-0.004
Investment Income	47.2	2.9	4.1	3	-	0.52	0.02
Other Items	1		-2.04	-0.1	-	-0.28	-0.003
Pre-Tax Operating Gain	37.8	0.815	2.06	4.3	1.12	1.56	0.013
Realized Capital Gains (Losses)	5.7	-	-0.94	-	-	0.01	-
Pre-Tax Income	43.5	0.815	1.13	4.3	1.12	1.57	0.013
Taxes	8.9	-0.136	0.2	1.1	0.4	0.5	0.005
Net After-Tax Income	34.7	0.95	0.91	3.2	0.73	1.07	0.008
Surplus (End of Period)	556.9		15.7	23.2	10.2	5	0.18
Premium to surplus			1.6		1.4	2.9	1.4
Loss Ratio	73.5	70.4	73	61	74.4	71.4	71.9
Expense Ratio	28.4	35.8	25.1	32.2	17.8	21.6	29.7
Combined Ratio	101.8	106	98.1	93.2	92.2	93	101
Policies in force						0.012	
Market Cap		Not Listed	14.8	22.1	Not Listed	13.2	Not Listed
No of employees			35,000	32,000	24,805	24,000	1,500