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How the Insurance Business Works

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Simply put, insurance companies help consumers manage their risk. In exchange for a constant stream of premiums, insurance companies offer to pay consumers a sum of money upon the occurrence of a predetermined event, such as a natural catastrophe, a car crash, or a doctor's visit

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More broadly put, insurance companies create value by pooling and redistributing various types of risk. It does this by collecting liabilities (i.e. premiums) from everyone that it insures and then paying them out to the few that actually need them. The insurance company can then effectively redistribute those liabilities to entities faced with some sort of event-driven crisis, where they will ostensibly need more cash than they currently have on hand. As not everyone within the pool will actually suffer an event requiring the total use of all of their premiums, this pooling and redistribution function lowers the total cost of risk management for everyone in the pool.

Insurance companies theoretically make money in two ways:

- By charging enough premiums to cover the expected payouts that they will have to cover over the life of the policy
- By earning investment returns ("the float") using the collected premiums

In actual practice, most insurance companies pay out almost all of their premiums in order to attract larger customer volumes and liabilities. Chief earnings focus is thus placed on investment returns.

Insurance is extremely important. You will need Commercial Liability coverage to protect yourself in case of damage done to a client's property. It would be a good idea to have any equipment/tools insured as well. I'm assuming you will be carrying Worker's Comp. You may want to inquire about Stop Gap coverage to be added to your commercial policy. It will pay any difference that Worker's Comp does not pay. You'll need to add your vehicles that will be driven for business on a commercial auto policy. If you have payroll, you will also need to pay into your State's Unemployment Fund.

Domestic Insurance Regulation Within the US

Insurance companies regulated at the state level.

External Resources

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