General Insurance FAQs

Q: What are the differences among the major types of insurers in the United States?The insurance industry is typified by insurers with a number of different organizational forms. Stock insurers are corporations owned by the shareholders of the firm. The shareholders hire managers to run the company and the insurance product is sold to customers who may or may not be shareholders in the firm. Mutual insurers are companies which are owned by their customers. Any policy owner of the company also owns a portion of the company. Reciprocal insurers or reciprocal exchanges are insurance companies where the policy owners of the exchange agree to insure one another. They are very similar to mutual companies.

Lloyd's associations are insurance companies where the manager who makes the decisions for the firm also has his/her own personal wealth at stake in the firm. Q: Should I care which type of insurer I purchase insurance from?From the customer's point of view, the company which offers you the product and service you want, at the quality you desire, for the lowest cost should be the company you purchase insurance from regardless of their organizational form. Economists have tried in numerous studies to identify which one of its organizational forms can provide the insurance product at the lowest cost and the answers are mixed. Therefore, potential customers should probably base their purchasing decisions on other factors such as the financial quality of the firm. Q: Some insurance brokers I talk to say they are paid employees of the insurance company while other brokers says they are independent business people -- why the difference? Should I care which one I purchase insurance from?Insurers deliver their insurance products to policy owners primarily through independent brokers or through exclusive brokers. Historically, almost all insurance brokers were independent business people paid on commission. More recently, any insurance companies have adopted a system where the broker is a paid employee of the firm rather than an independent business person. These brokers are referred to as exclusive brokers.

Economists who have studied the differences between these two types of distribution systems have long argued that the independent agency system is a less efficient method of getting the insurance product to the customer as measured by statistics such as the ratio of expenses incurred to premiums written. However, the most recent studies suggest that the reason for the higher expenses by independent brokers is that they offer better quality service to policy owners through more personalized service, more advice on policy limits, more help when a claim is filed with the company, etc. Q: What do I give up by not using a broker to purchase insurance?Many life insurance and personal lines property-casualty insurance products can be purchased without the use of a broker. Typically potential policyholders will either be contacted through the mail or they can call a 1-800 number to apply for the insurance product. The advantage of this type of distribution system is that the expenses of selling the product are usually much lower because there are no broker commissions to be paid. These savings may then be passed onto the consumer through lower premiums. The main disadvantage is that the policyholder does not receive as much, or sometimes any, personal service either purchasing the product or in filing a claim. Due to complexity, commercial lines do not offer this option. Q: I understand there are organizations that assign financial ratings to insurance companies. Who are they and what do they do?Insurance is a product where the insurance company promises to make future loss payments in return for a premium you pay today. It is therefore important that you know the financial health of the insurer when you are deciding how much you are willing to pay for the product. For example, holding all other things equal, people should pay slightly more for a life insurance policy from an insurance company with a higher financial rating, or should pay slightly less for the same policy from a company which is not as financially strong.

In order to make this kind of informed purchasing decision, a number of private organizations, called rating agencies, rate the financial stability of insurance companies. Major insurance rating agencies include the A.M. Best Company, Standard & Poor's, Weiss Research, Duff and Phelps, and Moody's. Each of these companies uses data obtained from various sources to rate the financial strength of insurance companies. It should be noted, however, that each organization has its own rating standards and therefore the financial grades from two different rating agencies may be different. The best advice usually given to insured's is to check the financial rating of the insurer from as many rating agencies as possible to determine the range of opinions of the financial health of the company. Q: Where can information be found on the largest insurance companies in the United States?The monthly publication Best's Review (Property and Casualty Edition) provides certain statistical information on large property-casualty companies. This information is published by the A.M. Best Company in Oldewick, N.J. Public libraries in cities of medium to large size frequently subscribe to this publication. Q: What kinds of questions should I be expected to answer when I am applying for an insurance policy? Why do insurers ask all of these questions?When you apply for an insurance policy, you will be asked a number of questions. For example, the broker will ask you a number of demographic questions such as your name, age, sex, address, etc. In addition to these demographic questions, you will be asked a number of other questions which will be used to determine what type of risk you are. For example, when an insurance company is deciding whether or not to offer auto insurance to a potential policy owner, it will want to know about the person's previous driving record, whether there have any recent accidents or tickets, what type of car is to be insured and various other types of information.

All of this information will be used for two purposes. First, based upon the responses to these questions, the insurance company will decide whether the profile of the applicant is consistent with the type of risks the insurer is trying to attract. Some insurers specialize in offering insurance to only very safe drivers and therefore will only accept applications from people who fit the profile of a safe driver. Once the insurer has decided that your risk profile is consistent with the types of risks it accepts, the answers to the questions will be used to determine which rate to charge you. For example, the insurance company will decide whether you should be offered insurance at the high risk driver rate or the low risk driver rate.

Collectively, this entire process is known as the underwriting process. The primary function of the underwriting department in an insurance company is to decide whether or not to offer insurance to a person who has completed an application. If the answer is yes, then the underwriting department seeks to determine the "quality" of that risk so that the proper premium can be charged. That is, high risk