What Is an Insurance Company and What Is Their Role?

Insurance Companies: Insurance companies can be categorized in many ways. One is by the size of their policyholder surplus or capital. The larger the policyholder surplus, the more risk they can assume. The smallest companies have less than $1 million in surplus and the largest more than $2 billion. Most fall into the $250 million and under policyholder surplus category. Insurers can also be divided according to premiums, which are roughly equivalent to revenues. The largest have premiums in excess of $10 billion.

Most commercial insurers are stock companies owned by their stockholders, but some are mutuals, which are owned by their policyholders, and a few are reciprocal insurance exchanges. Reciprocals are an old form of insurance entity where members or subscribers provide insurance to one another; share profits, losses and expenses; elect a board; and appoint an attorney-in-fact, which may be an individual or a corporation, to manage the operation.

An insurance company may be a single entity or a holding company with subsidiaries. Subsidiaries may be organized to operate in a single state, sell different insurance products from the parent organization or cater to a non-standard market. Some parent companies are domiciled outside the United States and some insurers have non-insurance related parents. Large commercial insurers generally operate in most states and some have global operations. Smaller or specialized insurers may focus on a specific geographical area or specific states.

With so many different kinds of businesses seeking insurance, it's not surprising that insurers tend to specialize. Specialization facilitates the accumulation of expertise. In addition, insurance works best where an insurer has a large number of policyholders with similar exposures to loss. The more policyholders of the same type there are, the better the insurer is able to predict losses for that type and price the coverage accurately, according to a mathematical premise known as the law of large numbers.

The law of large numbers works best for personal lines insurers with thousands of similar auto and homeowners policies and in commercial lines for small Main Street type businesses. These smaller firms tend to be similar in size and loss exposures and are generally covered by a standard policy known as a Business Owners policy, (see Types of Policies at http://www.iii.org/commerciallines/whatitdoes/types/). By contrast, larger

firms vary widely in their exposure to loss. Nevertheless, many commercial insurers concentrate on certain types of businesses or insurance coverages or both. They may target firms in the energy or transportation fields, for example, building contractors or financial services institutions. They may be specialists in directors and officers liability insurance, medical malpractice liability insurance, surety bonds, crop insurance or workers compensation, sometimes covering other incidental risks as well. Many personal lines insurance companies offer commercial insurance but generally only to typically small, low-risk, kinds of businesses and many commercial insurance companies offer personal lines insurance as well as life insurance and other financial services products.

Commercial insurers that have been licensed or “admitted” to do business in a state by the state insurance department are generally willing to cover most business risks. (The term “risk” in the insurance industry can mean a peril insured against, such as the risk of fire, and also the entity insured.)

However, some risks are hard to place in the standard market because they don’t meet licensed companies’ underwriting criteria. Among the most difficult to place are: unusual or unique risks that are hard to price if the insurance industry has no prior experience with them, such as tattoo and body piercing shops when they first began to appear; risky or substandard risks, such as fire coverage for a business with a prior history of fires; businesses whose operations are very complex, such as an offshore oil rig; and exposures that require higher limits than most companies are willing, or able under regulatory guidelines, to provide. (To safeguard an insurer’s financial stability in the event of a total loss, insurers cannot devote more than a certain amount of their underwriting capacity to insure any one risk.) In such cases, part of the risk may be insured in the standard market and the remainder, or “excess” in the surplus lines market.

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