# Overview of Insurance Operations

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## CLASSIFICATIONS OF INSURERS

Insurance is a system under which participants (such as individuals, families, and businesses) make payments in exchange for the commitment to reimburse for specific types of losses under certain circumstances. Insurers, which are organizations within the financial services industry, may be classified in various manners.

The insurance organization or the entity that facilitates the pooling of funds and the payment of benefits is called an insurer. Participants in this mechanism, called insureds, benefit through reimbursement of covered losses that occur, reduction of uncertainty, additional services provided by the insurer to reduce the frequency or severity of losses, and financial protection against legal liability for damages to others. Additionally, insureds can benefit from the potential availability of credit from lenders, which may help enable them to purchase property. Because the risk of loss to property is transferred to the insurer, lenders are willing to loan money to insureds with greater confidence that the loan will be repaid.

The principal function of every insurer is the same: the acceptance of risks that others transfer to it through the insurance mechanism. This task is divided into core operations consisting of underwriting, claims, and marketing, which, in turn, are supported by several other functions. These operations are described in other sections.

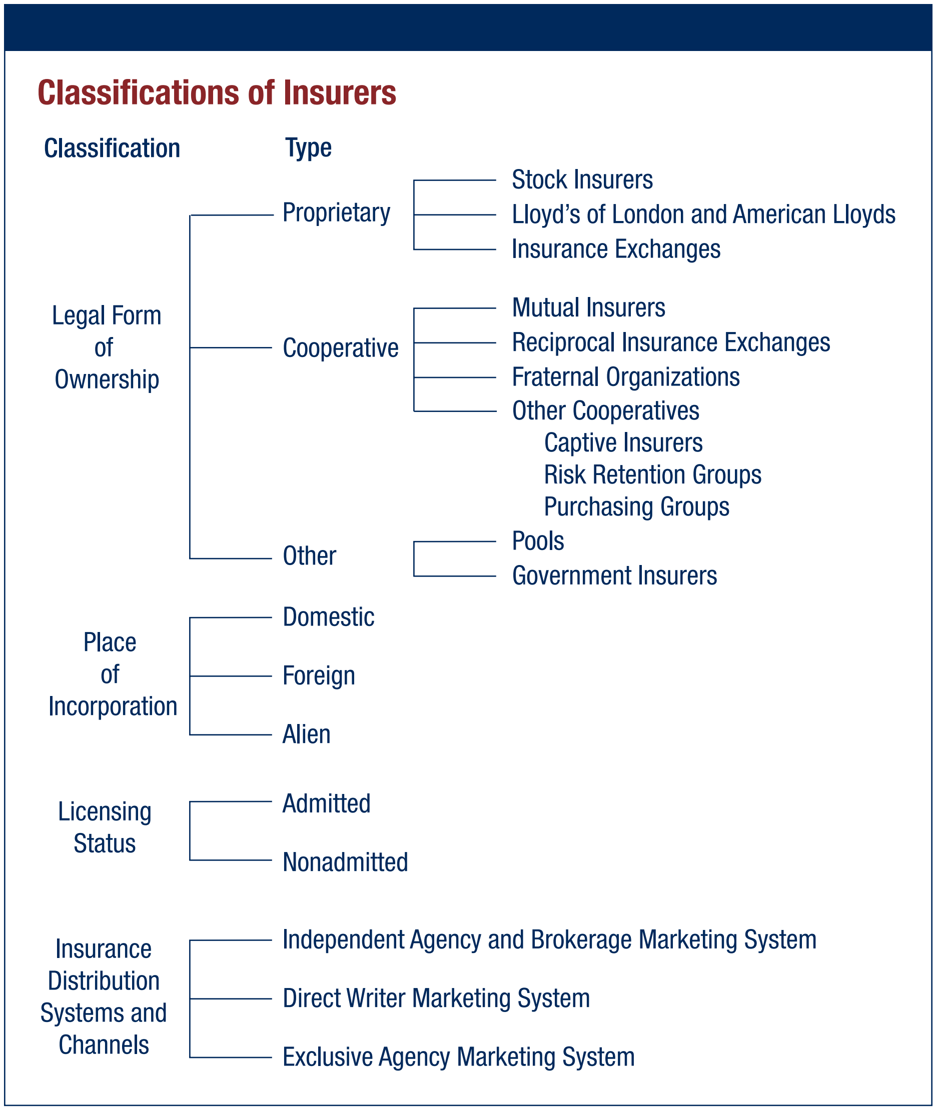
Property-casualty insurers can be classified in these four ways:

- Legal form of ownership
- Place of incorporation
- Licensing status
- Insurance distribution systems and channels

The exhibit shows the general classifications of insurers. An insurer might be further classified by what types of insurance it writes or its specialty. See the exhibit "Classifications of Insurers."

### Legal Form of Ownership

The first classification of insurers is by legal form of ownership. The two major types of insurers in this classification are proprietary and cooperative insurers.

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## Proprietary Insurers

**Proprietary insurer**
Insurer formed for the purpose of earning a profit for its owners.

**Proprietary insurers** include stock insurers, Lloyd's of London and American Lloyds, and insurance exchanges.

Stock insurers are the most prevalent type of proprietary insurer in the United States. These insurers are owned by their stockholders. By purchasing stock in a for-profit insurer, stockholders supply the capital needed to form the insurer or the additional capital the insurer needs to expand its operations. Stockholders expect to receive a return on their investment in the form of stock dividends, increased stock value, or both.

Stockholders have the right to elect the board of directors, which has the authority to control the insurer's activities. The board of directors creates and oversees corporate goals and objectives and appoints a chief executive officer (CEO) to carry out the insurer's operations and implement the programs necessary to operate the company.

Among the proprietary types of insurance ownership is a unique type known as Lloyds. Two types of Lloyds associations exist: Lloyd's of London and American Lloyds.

Lloyd's of London (Lloyd's) is technically not an insurer. However, it does provide the physical and procedural facilities for its members to write insurance. It is a marketplace, similar to a stock exchange. The members are investors who hope to earn a profit from the insurance operations.

In the past, all of the insurance written at Lloyd's was written by or on behalf of individual members, and the insurance each member wrote was backed by his or her personal fortune. Individual members were not liable for the obligations assumed by any other member. Today, a declining proportion of Lloyd's accounts are still underwritten and secured by individuals. A larger portion of Lloyd's members today are corporations, and the liability of each of these members is limited to the amount that the member agrees to write. Lloyd's provides coverage for many unusual or difficult loss exposures and underwrites much of the global marine and aviation insurance.

American Lloyds associations are smaller than Lloyd's of London, and most are domiciled in Texas because of the favorable regulatory climate. Most of these associations were formed or have been acquired by insurers. Like most investors of Lloyd's of London today, members (called underwriters) of American Lloyds are not liable beyond their investment in the association.

An insurance exchange is a proprietary insurer similar to Lloyd's because it acts as an insurance marketplace. Exchange members underwrite any insurance or reinsurance purchased on the exchange. Members can be individuals, partnerships, or corporations, and they have limited liability. Members belong to syndicates and delegate day-to-day operations to the syndicate manager.

For example, INEX (formerly the Illinois Insurance Exchange) was formed in 1979. This exchange serves as an excess and surplus lines market, writing various types of insurance. Member syndicates operate as separate businesses that focus on a particular group of loss exposures.

## Cooperative Insurers

Cooperative insurers are the second type of insurer in the legal form of ownership classification. This type of insurer is owned by its policyholders and is usually formed to provide insurance protection to its policyholders at minimum cost. This classification includes mutual insurers, reciprocal insurance exchanges, fraternal organizations, and other cooperatives.

**Mutual insurers** constitute the largest number of cooperative insurers and provide low-cost insurance to their policyholders, who are the owners of the

**Mutual insurer**
An insurer that is owned by its policyholders and formed as a corporation for the purpose of providing insurance to them.