

## Fire Insurance Company Organizations and Rating Practices

### Company Organizations

Fire insurance carriers are divided broadly into five groups as follows:

- (1) Stock companies.
- (2) Mutuels.
- (3) Lloyds.
- (4) Reciprocal.
- (5) Self-insureds.

While you can expect that generally your customers will be insuring through one of the stock or mutual insurance companies, it is hoped that this brief discussion of other types of insurers will be of benefit to you in improving your general fire insurance knowledge.

### Stock Companies

The stock companies and Lloyds are noncooperative in their operations, that is the insureds have no ownership in the funds out of which losses are to be paid. The others are mutual in their nature. Stock companies are organized as profit making ventures with the funds out of which losses are to be paid received not only from premium payments but from capital invested by the stockholders. The insured receives a policy on the basis of a definitely established premium and as far as he is concerned, that is the only transaction. The insured has no other interest beyond the indemnification in the event he suffers a loss. He receives no benefits or dividends from the earnings of the company and pays no assessment or additional premiums should the company suffer an underwriting loss.

### Mutuals

The mutual insurance companies, on the other hand, are corporations owned, operated and controlled by its policyholders. Every policyholder is a member of the company, and there are no stockholders. Some mutual companies require the insured to deposit an advance premium. At the end of the policy period, deductions are made from the advance premium for expenses and actual losses paid, and the balance is returned to the insured. These companies generally issue two types of policies, assessable and non-assessable. An insured with an assessable policy is subject to an assessment to meet the losses and expenses when the resources of the company have been exhausted. Assessment liability is usually limited to one additional premium. A mutual company can also write a non-assessable policy. This would require the mutual company to be financed and backed in a manner similar to a stock company.

### Lloyds

Lloyds (London) as a corporation, does not issue insurance policies. Insurance in Lloyds, as it was in the original coffeehouse is still written by individual underwriters. These underwriters are members of the corporation but each for himself, undertakes a portion of the insurance. He is backed only by his personal wealth. A firm which wishes to be insured by Lloyds operates through an insurance broker. The broker then circulates description of the risk among the Lloyds underwriters and each underwriter who wishes signs a slip carried by the broker indicating the amount for which he will commit his syndicate.

## Reciprocal

Reciprocal insurance, while a mutual of sorts, is actually a cooperative. Subscribers (insureds) of a reciprocal are required over a period of years to accumulate reserves, thereby representing a multiple ranging from 2 to 5 annual premiums. A separate account is maintained for each subscriber and out of this is paid only his share of each loss. If the losses of members at any time exceeds the total reserve, each member of the group is obligated to contribute to the insurance fund an amount proportioned upon his annual premium. The subscribers appoint a manager to whom is entrusted the responsibility of carrying on the business, and he is known as an "attorney in fact." In a reciprocal that engages in no engineering operations, the compensation of the "attorney in fact" represents the entire cost of the business.

## Self-insurance

Self-insurance is a plan by which an individual or concern sets up a private fund out of which to pay losses. It should be noted that this is not "no insurance" but "self-insurance." Successfully carried out there can be no question but that self-insurance furnishes the least expensive of all possible forms of insurance. Few organizations have the necessary wide distribution of risks subject to the same hazards that lend themselves readily to a self-insurance plan.

The trend to self-insurance to reduce insurance costs and increase cash flow has led individual corporations and associations to form insurance subsidiaries or what is known as captive companies. However, the risks insured by a captive must be substantial in order for its savings to outweigh the cost of forming and operating it.

## Rating Practices

### Insurance Services Office (ISO)

The stock companies, many of the mutuals and the reciprocals, generally use as a basis for establishing premiums, fire insurance rates or loss costs set by the "rating" bureaus. The Lloyds and self-insurers and others of the mutuals generally set their own rates. The "rating" bureaus now generally under the banner of Insurance Services Office (ISO), establish two categories of rates or loss costs. One is the class or tariff rate or loss costs which is a published rate or loss costs within The Commercial Lines Manual (CLM) which can be applied by an insurance agent or company without detailed analysis of the risk. This category is most often used with residential and small (less than 15,000 sq. ft.) commercial properties. The other category is specific evaluation. With this method a detailed analysis will be made of the risk including construction, occupancy, protection and exposures. Loss costs are developed by use of the Specific Commercial Property Evaluation Schedule (SCPES). Promulgated ISO or bureau rates or loss costs are published, and the individual insuring company will either use the ISO or bureau rates or loss costs or deviate from it as outlined in its filings with the states in which it is licensed to operate.

"Loss Costs" are differentiated from "Rates" in that the loss costs do not factor in individual insurance companies overhead costs, profit and long term trended loss experience. These costs are added to the schedule produced loss costs, by the insurance company, to produce a rate. The rate is then applied to the amount of insurance to arrive at the insurance premium.

## Highly Protected Risk (HPR)

Several companies have filed to write insurance on what is known as a "highly protected risk" or a "superior" risk. Two organizations of note that write such insurance are the Industrial Risk Insurers (IRI) and the Factory Mutual System (FM).

## Industrial Risk Insurers (IRI)

The Industrial Risk Insurers is a stock fire insurance company and operates in a similar manner to other stock companies, but due to their underwriting requirements, they generally write insurance at a lower rate. The IRI, who has a nationwide staff of field engineers, inspects all properties they insure and produce loss prevention reports outlining recommendations to the insured to maintain his protected property. Compliance with these recommendations is generally a requirement for continued underwriting of the insurance by the IRI.

## Factory Mutual

The Factory Mutual System is, as its name implies, a mutual operation. The individual Factory Mutual companies are separate corporations owned by their policyholders. Similar to the IRI, the Factory Mutual System, through the Factory Mutual Engineering Corporation, conducts inspections of the insured's properties in order to maintain the underwriting requirements of a highly protected risk. In addition, the Factory Mutual System operates research laboratories and approving laboratories for the testing and approval of industrial fire protection equipment and materials (Generally, the IRI relies on Underwriters Laboratories, Inc. to perform similar services.)

### Additional Information:

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