Understand Insurance

http://understandinsurance.com.au/what-do-insurers-do

What do insurers do?

Insurers perform a series of functions, many of them really important roles in our society.

The key role of insurers is to help their policyholders manage risk efficiently through providing insurance products, and paying the claims covered by their insurance policies.

In fact, according to the Financial Ombudsman Service [http://www.fos.org.au/centric/home_page.jsp] (FOS), insurers pay out more than 97 per cent of the claims they receive*.

Insurers have the ability to help individuals and communities recover after natural disasters. They are also large direct and indirect employers and are a vital part of the Australian economy. Insurers are large institutional investors, helping to fund economic activity such as infrastructure projects. Insurance also plays an essential role in the operation of the Australian economy because it encourages people and businesses to make high-value investments, such as committing to buying a house or spending money on infrastructure for a business.

A robust insurance industry is the hallmark of a modern society and economy.

* Financial Ombudsman Service General Insurance Code of Practice Overview for the Year 2011-12 [http://www.fos.org.au/centric/home_page/about_us/codes_of_practice/general_insurance_code_of_practice.jsp]

Pooling insurance premiums

Insurance is all about pooling the resources of a large number of people with similar risks to make sure that the few who experience loss are protected.

When you pay an insurance premium [http://understandinsurance.com.au/premiums-explained] , you are putting a little of your own money into a pool.

With general insurance, pooling resources through the payment of a premium may allow you to avoid paying the full cost of replacing, repairing, rebuilding or restoring valuable things if they are lost, stolen, damaged or destroyed, or being saddled with a large debt or liability.

If your property is accidentally lost, stolen, damaged or destroyed, and you have a policy that covers the property for those risks, you can make a claim and draw on that pool of money to help pay for repairs or replacement costs.

However, insurance is not the same as banking. When you pay an insurance premium, you will have access to the pool of money only if you claim a loss that is covered by your insurance policy.

It is possible that a person who has paid an insurance premium for many years might never make a claim.

When you buy an insurance policy, your insurer promises it will pay you for the type of loss stipulated in the policy – such as an accident, theft, loss or catastrophe – by funding repairs or replacement of items, up to the limit of your policy, or sometimes by providing a cash settlement. Each insurer’s policies have different rules about what the policy will cover. Exclusions may apply, so you should read your policy carefully and seek advice if you’re not sure what your policy will cover.

What is underwriting?

Underwriting is the way an insurer works out how much to charge for each risk they cover for each person who buys an insurance policy and under what terms.

When preparing a policy, insurance underwriters will calculate:

- How much they will agree to pay for a loss
- Under what circumstances they will make a payment
- How much the premium will be

Underwriters think about a number of different things when working out the price of a particular risk for insurance. For example, car insurance premiums may vary depending on the age, sex and driving record of the main drivers, location and the type and age of the car.

Every insurer has its own set of underwriting guidelines to help the underwriter determine whether or not the company should accept the risk of a particular situation.

In some cases, an insurer may decide it won’t cover a particular risk. This often opens the market up for other insurers.

Underwriting involves working out a premium that is low enough to attract a good number of buyers, and high enough so that there will be enough money in the pooled funds to pay all the claims that might be made, plus make a profit for the insurer's shareholders.

What is reinsurance?

Reinsurance is like insurance for insurers. It can be used to cover different risks for insurers. For example insurers may use reinsurance to make sure they can pay a large number of claims if a big disaster, such as a cyclone or flood, happens. This is usually called catastrophe cover to cover the big volumes of claims that may occur if there is a natural disaster.

Insurers may also use reinsurance to cover situations where they experience claims from policyholders that are higher than a certain value, which has been agreed beforehand with the reinsurer.

Reinsurance involves a number of insurers, often from different geographic regions, that pool together to share their risk exposure.