Appendix G – Glossary of Insurance Terms

Overview

This Appendix presents a glossary of commonly used insurance terms. Although not exhaustive, this glossary will provide you with basic assistance on understanding some terms and expressions systematically used in ADS.

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A

Accident Year (AY): The year in which an accident occurs. For statistical analyses, claims are often grouped based on the accident date into Accident Years. Assuming one-year policies, losses from Accident Year (n) will be associated with policies from Policy Year (n) and (n-1).

Acquisition Expenses: The cost of acquiring business. Examples are the expenses of our sales departments, the commissions we pay to agents and brokers, and marketing and advertising expenses. Statutory accounting requires the immediate recognition of acquisition expenses.

Actual Cash Value (ACV): The cost of repairing or replacing damaged property with property of the same kind and quality and in the same physical conditions; commonly defined as replacement cost less depreciation.

Actuary: an insurance professional whose primary functions include the determination of rates and rating methods, evaluation of reserves and other statistic-related responsibilities.

Additional Insured: An individual or organization covered by an insurance policy other than the policyholder. In an automobile policy, anyone who drives the car with the owner's consent is an additional insured, although in most cases, the additional insured must be named in the policy.

Additional Living Expense: Any necessary increase in living expenses incurred by the insured, so the household can maintain its normal standard of living while a home damaged by an insured peril is being repaired.

Adjuster: A person who seeks to determine the amount of loss suffered when an insurance claim is submitted and who attempts to settle the claim.

Admitted Assets: All funds, property, goods, securities, rights of actions, or resources of any kind that are included in an insurance company's financial statements to measure surplus as determined in accordance with state insurance laws. By contrast, "non-admitted assets" (premiums over ninety days past due, furniture and equipment, prepaid expenses, etc.) do not contribute to surplus.

Agent: An agent sells insurance, representing one or more insurance companies. Agents have contractual agreements with and some authority to issue coverage with the insurers they represent. Agents typically work with either individual customers or smaller commercial customers, and are usually paid through a percentage of the insurance premium called a commission.

Allied Lines: A term for forms of insurance allied with fire insurance. They cover perils such as sprinkler leakage, water damage and earthquake.

Allocated Loss Adjustment Expense (ALAE): Also known as Defense & Cost Containment (DCC). Generally, Loss adjustment expenses that can be assigned directly to a particular claim, such as attorney fees, court costs, managed care costs, etc. ALAE is often treated like loss in terms of insurance and reinsurance coverage.

Annual Statement Line of Business: Identifies the Annual Statement Line of Business; the type of insurance or the coverage involved.

Appeal Bond: A bond filed in court by a party against whom a judgement has been rendered, in order to stay execution of the judgement pending appeal to a higher court, in the hope of reversing the judgement. The bond guarantees that the judgement will be paid if the appeal fails.

Applicant: A person who fills out and signs a written application for insurance.

Application: A written statement by a prospective policyholder that gives the information the company relies upon when evaluating the applicant and issuing the policy.

Apportionment: The dividing of a loss proportionately among two or more insurers that cover the same loss.

Appraisal: A survey by a Liberty Mutual Claims Representative or Claims Appraiser to determine a property's insurable value or the amount of a loss.

Appurtenant Structures: Buildings on the same premises as the main building insured under a property insurance policy.

Arbitration: A binding procedure to settle a dispute between an insurance company and an insured over a claim settlement by placing the decision in the hands of an appraiser appointed by each party to the dispute and a third disinterested person selected by the two appraisers.

Arson: The willful and malicious burning of, or attempt to burn, any structure, or other property, often with criminal or fraudulent intent.

Assessment: The extra premium a mutual or reciprocal insurer's policyholder may be required to pay in the event the insurer's losses are greater than anticipated.

Assume: When one company reinsures a second company, it "assumes" a portion of the premiums and losses of the second company.

Assumed Premium: Premium that an insurance company assumes (receives) as a result of reinsuring a second insurance company.

Auto Insurance: Line of insurance that includes several types of coverage: Bodily Injury, Property Damage, Medical Payments Insurance, Uninsured/Underinsured Motorist Insurance, Collision Insurance, and Comprehensive Insurance.

Auto Loan/Lease Coverage: See Gap Coverage.

B

Bail Bond: A bond which guarantees the appearance of a person in court, and which is subject to forfeiture if that person violates the provisions of the bond.

Bailee: One who has temporary possession of property belonging to another.

Balance Sheet: The statement of financial position at a point in time.

Basic Form: A package policy providing coverage against a limited number of special perils.

Basic Limits: The lowest coverage amount, as prescribed by law or the company, for which an insurance policy can be written. Basic Limits primarily prescribe limits of liability.

Bodily Injury: Injury to the body of a person. People often refer to Bodily Injury as the coverage afforded for financial protection against injury of a person resulting from an accident.

Bond: An agreement whereby one party, called the *surety*, obligates itself to a second party, called the *obligee*, to answer for the default to a third party, called the *principal*.

Broad Form: A package policy providing coverage for the same perils covered in the basic form, plus specified additional perils.

Broker: The legal representative of the insurance customer, on whose behalf the broker may seek appropriate coverage among many insurance providers. A broker may be paid through a commission negotiated with the insurers or through a fee negotiated with the customer. Large commercial and/or customized policies most often are purchased through a broker rather than an agent.

Burglary: Breaking and entering into another person's property with felonious intent.

Buy-Out Policy: A professional liability policy covering future claims resulting from incidents which occurred during the period that an expired claims-made policy was enforced.

C

Cancellation: Termination of an insurance policy before its expiration date. Unearned premium is returned if the policy is cancelled by the insurer. A charge for administrative costs is made if the policy is cancelled by the policyholder.

Capacity: A measure of the amount of insurance that an insurance company is able or prepared to assume on particular risks.

Captive Insurer: An insurance company set up by a company or group of companies to insure their own risks or risks common to the group.

Case Development: The fact that case incurred loss amounts, although representing the claims handlers' best judgement and the information available, tend to be too low in aggregate. This is because the group of claims that ends up being settled for more than the estimate tends to outweigh the group of claims that ends up being settled for less than the estimate.

Case Incurred Loss: Also called loss cost estimate, is the sum of paid losses plus the case reserve. Represents the claim handler's estimate of how much a particular claim will cost.

Case Reserve: A reserve established by the claims department that represents their best estimate of the future costs associated with a particular reported claim. An aggregate amount of case reserves for all claims is held as a liability category in an insurance company's balance sheet. Case reserves are one kind of loss reserve, the other being Incurred But Not Reported (IBNR) reserves.

Cash Flow: The difference between the cash we collect (primarily premium and investment income) and the cash we spend (paid losses and paid expenses).

Cash Flow from Operations: Cash from underwriting results including net investment income and federal income taxes, excluding cash from investments and financing.

Casualty Insurance: Also known as third party insurance because it protects the policyholder against losses of other persons for which the policyholder is legally liable (responsible by law). Payments are made on behalf of the policyholder to those who have been injured or whose property has been damaged.

Catastrophe: A severe loss involving many policyholders and many insurance companies. The Property Claim Services division of the American Insurance Services Group collects the necessary loss data and declares an event to be a catastrophe when there is at least $25 million of insured property damage. *Catastrophe losses* are the costs and directly identified expenses resulting from catastrophes.

Cede: When one company reinsures a second company, the second company "cedes" a portion of its premiums and losses to the reinsuring company.

Ceded Premium: Premium that an insurance company cedes (gives up) as a result of being reinsured by a second insurance company.

Claim: A demand for payment under an insurance policy for the estimated or actual amount of loss.

Claims-Made Form: A type of liability policy that covers claims that occur and are reported while the policy is in effect. See buy-out forms.

Coinsurance Clause: A provision in an insurance policy under which the insured, for a reduced rate, agrees to maintains insurance on the property at least equal to a stipulated percentage of its value in order to collect partial losses in full. If the insured fails to carry the necessary amount of insurance, he or she assumes a proportionate share of the loss.

Collision Insurance: Collision insurance laws may vary by state, but generally, this component of auto insurance covers a loss to the insured's vehicle caused by its impact with another vehicle or object, or as a result of turning over. If another driver is at fault, the insurer will pay the claim less the deductible and then may subrogate, seeking reimbursement from the other driver's insurer. If successful, the insurer will reimburse the policyholder for the deductible amount.

Combined Ratio: The sum of the loss ratio and expense ratio. A combined ratio of 100% indicates underwriting results are "break even" before consideration of investment income and federal income taxes. In other words, the relationship between combined ratio (R_C), underwriting profit (U), and premium (P) is: $1-R_C = U/P$

Company Line of Business: Identifies the line of business; the type of insurance or the coverage involved.

Comparative Negligence Laws: Some states have laws that limit the amount a person injured in an accident may recover in a lawsuit in proportion to the percentage of negligence attributed to each of the persons involved. See also contributory negligence laws.

Compulsory Auto Injury Laws: Laws which make it illegal to operate a vehicle without first having proof of the ability to pay for a judgement that may result from an accident.

Comprehensive Insurance: Comprehensive insurance laws may vary by state, but generally, this component of auto insurance protects against any loss or damage to an automobile except those caused by collision or by upset; for example, glass replacement, towing and labor coverage, or coverage against fire or theft.

Conditions: Provisions that set forth the rights, duties, and responsibilities of the parties to an insurance contract. Conditions may be found anywhere in the policy.

Contributory Negligence Laws: Some states have laws that bar a person injured in an accident from recovering damages if he/she is attributed any negligence. See also comparative negligence laws.

Costs: Insurance companies categorize costs as losses and expenses.

Covered Persons: Those insured under the policy.

Covered Autos: Any vehicle shown in the policy declarations, or in some cases, a substitute vehicle used temporarily because of breakdown or repair of the insured's own covered vehicle.

D

Damages: A sum of money that a party is legally obligated to pay to another as compensation for injury.

Declarations: The part of the policy that provides detailed information about the insured, the insurer, and the coverages, as well as the maximum dollar limit that the insurer will pay in the event of a claim.

Deductible: The amount of a claim that the policyholder has agreed to pay. This amount is deducted from a claims payment. By offering deductibles, insurance companies are able to reduce the premium of the policies because they are relieved of the obligation of handling a multitude of relatively small claims – those less than the deductible amount. In addition, deductibles provide the policyholder with an incentive for loss control.

Deferred Acquisition Costs (DAC): A GAAP adjustment to statutory underwriting results to defer some acquisition expenses over the life of the policy. This adjustment matches expenses with the associated revenues.

Depreciation: A decrease in a property's value over time.

Direct Assignment: A mechanism in which a carrier takes its share of the Involuntary Market up-front by directly writing the risks and retaining the involuntary business. The carrier is generally assigned a percentage of the involuntary premium in proportion to its market share but covers those losses specifically associated with the policies they write. A carrier would accept direct assignment when it believes its services are superior and would result in lower losses than their share of the aggregate from the pool.

Direct Earned Premium (DEP): Earned premiums before reinsurance (without inclusion of assumed premiums or deduction for ceded premiums).

Direct Written Premium (DWP): Written premiums before reinsurance (without inclusion of assumed premiums or deduction for ceded premiums).

Discount Rate: Interest rate used to discount cash flows in a Net Present Value (NPV) calculation.

Discretionary Pricing: The use of an underwriter's judgement in exposure rating. An example is schedule rating, where adjustment factors are applied to a policy's rate based on the policyholder characteristics (e.g. driving record, effectiveness of safety program). Other examples are company placement decisions and the use of dividend plans.

Dividend Ratio: The ratio of policyholder dividends incurred to net earned premium.

Drive-In Claims Services: Automobile insurer's facility to which an insured may bring a damaged vehicle to facilitate the settlement of damages.

E

Earned But Not Reported Premium (EBNR): Additional premium expected due to premium audits (standard EBNR) or retrospective rating (retro EBNR). EBNR is held as an asset on the balance sheet of an insurance company

Earned Premium: The portion of premiums that applies to the expired portion of the policy period. From an accounting point of view, computed as written premium minus the change in unearned premium during the period plus the change in EBNR premium due during the period. Upon and after the expiration day, the earned premium for a policy is equal to the written premium. See direct earned premium and net earned premium.

Effective Date: The date the coverage begins under an insurance contract (policy).

Embezzlement: Fraudulent use or taking of another's property or money which has been entrusted to one's care.

Endorsement: An amendment to the policy written especially to cover unique items. An endorsement is also a change to the policy that is made during the policy's term. An endorsement is attached to the policy to modify its terms.

Environmental Losses: Losses and loss adjustment expenses related to environmental, asbestos and mass tort activity.

Excess Coverage: Coverage against losses in excess of a specified dollar limit.

Exclusion: Part of the policy that that excludes coverage of certain perils, persons, property, or locations.

Expenses: The two major expenses for an insurance company are loss adjustment expenses and other expenses (such as general overhead, such as salaries and rent, advertising costs, commission payments to brokers, premium tax paid to states, etc).

Expense Ratio: The ratio of expense dollars to premium.

Experience Rating: A method of establishing insurance rates based on an individual policyholder's prior loss record.

Expiration Date: The termination date of an insurance contract (policy).

Exposure: The state of being subject to the possibility of financial loss due to an accident or other covered event; a loss potential as measured by the amount of risk a company insures. See also exposure base.

Exposure Base/Amount: A measure of the loss potential for the policies we write. Examples are the number of cars, a company's sales or payroll, etc.

Exposure Rating: The process of determining premium for a policyholder by applying rates to exposure amounts.

Extended Coverage: A provision in an insurance policy or in an endorsement that provides additional coverage for other hazards or risks than those provided under the basic policy provisions.

F

Facultative Reinsurance: Reinsurance purchased for an individual policy.

Fidelity Bond: A form of protection that reimburses an employer for losses caused by dishonest or fraudulent acts of employees.

Financial Management Line Code: Identifies the Financial Mgmt line of business; the type of insurance or coverage involved.

Financial Responsibility Clause: Clause that ensures that a policy conforms to the financial responsibility laws of any state or Canadian province in which the insured's vehicle operates.

Financial Responsibility Law: A law under which a person involved in an automobile accident may be required to furnish security up to certain minimum dollar limits.

Fire Insurance: Coverage for losses caused by fire and lightning, plus resulting damage caused by smoke and water.

First Party: The principal of the policy contract (policyholder). First-party claims are those where the claimant is the policyholder, such as property claims.

Floater: A form of insurance that applies to movable property, whatever its location, within the territorial limits imposed by the contract. The coverage "floats" with the property.

Flood Insurance: Coverage against damage caused by the rising or overflowing of bodies of water. This is available through a National Insurance program and must be bought separately (not included in home insurance packages).

Fraud: Deception or strategy used to deceive or cheat including misrepresentation or concealment.

Frequency: The number of claims occurring under a given coverage divided by the number of exposure units. Frequency and severity statistics are used to estimate expected losses for coverage and to establish premium rates.

G

Gap Coverage: Also known as Auto Loan/Lease Coverage. Provides coverage, in case of a total loss, for the 'gap' between the amount due under the terms of the vehicle's loan/lease and the actual cash value of the vehicle at the time of the loss.

General Expenses: Underwriting expenses not related to acquisition. These are primarily fixed costs, which are not directly related to corresponding revenue levels.

Generally Accepted Accounting Principles ("GAAP"): United States Generally Accepted Accounting Principles, with primary focus on the proper matching of revenues and expenses. This is the basis of accounting for most industries other than the insurance industry.

H

Hazards: Conditions that increase the chance that a peril will occur. A hazard may exist for some time before a peril such as fire or explosion occurs. Hazards can be *physical* (e.g. gas leak that increases the chance of explosion), *moral* (e.g. temptation to commit fraud that increases the chance of arson), or *morale* (e.g. carelessness in cleaning aisles in a store that increases the chance that someone may fall).

Home Insurance: A line of personal insurance. A Homeowners policy is a package policy including fire and other perils, theft insurance, and comprehensive personal liability. The premium is stated as one amount. Separate policies for specific perils are also available, such as fire insurance, flood insurance, etc.

I

Income Statement: The income statement views the results of the company, reflecting revenues and expenses, over a certain time period (one year, for example).

Incurred But Not Reported (IBNR) Reserve: Bulk reserve for estimated losses and loss adjustment expenses that covers both case development on reported claims and the costs associated with incidents that have occurred but have not yet been reported as claims. By bulk we mean that IBNR reserves are not associated with any particular claim. These reserves are often based on an expected ultimate loss projection. IBNR reserves are one kind of loss reserves, the other being case reserves.

Incurred Loss: The cost of claims covered by insurance policies, including those claims that have not yet been paid or even reported to the insurer. Losses incurred during a calendar period equal paid losses during the period plus the change in loss reserves during that period. (A similar calculation applies for any incurred expense.)

Indemnity: See principle of indemnity.

Insurance: A system under which a group of individuals, businesses, and other organizations and entities, in exchange for payment of a premium, are guaranteed compensation for losses resulting from certain causes under specified conditions. The basic function of insurance is the transfer of risk.

Insurance Department: A state's department that has responsibility for the enforcement of the state's insurance code. It is charged with the supervision and licensing of insurance companies and agents and the general administration of insurance laws of the state.

Insurance to Value: The amount of insurance written on property that is approximately equal to its value. An insured almost always wants to insure all property to value.

Insured: A person who is protected by the policy.

Insurer: The company that issues a policy to a policyholder; the party in the insurance contract that promises to pay losses and render services.

Investment Income: The portion of an insurance company's revenue that is derived from its investments, including interests and dividends earned on stocks and bonds. Since premium is collected during the policy period but associated claims are often paid over a period of many years, there is an opportunity to earn Investment Income.

Investment Income Ratio: Investment income divided by premium.

Involuntary Market: Mechanism to insure risks that could not obtain their desired or required coverage from the Voluntary Market. These risks are usually very small (high expense ratio) or have high loss potential (high loss ratio). Depending on the state, carriers may have the options of participating in Reinsurance Pooling or taking Direct Assignments. Some states have State Funds to handle the Involuntary Market.

L

Leverage measures: See premium to surplus ratio and reserves to surplus ratio.

Liability: Any legally enforceable obligation. Liability insurance pays for property damage or bodily injury losses the policyholder may cause to third parties.

Limit: The maximum amount of benefits that an insurer agrees to pay in the event of a loss.

Loss(es): The cost of claims covered by a policy. They represent the dollars an insurance company spends to pay for damage or injury suffered by the claimants. See paid losses and incurred losses.

Loss Adjustment Expense: The cost of handling and settling claims, both reported and unreported. These costs include the salaries and cost of claims staff, legal and outside adjuster costs, and allocations of expenses from other areas.

Loss Cost Estimate: The sum of paid losses plus case reserve. Represents the claim handler's estimate of how much a particular claim will cost.

Loss Payable Clause: A policy condition that enables an insured to direct the company to pay any loss that may be due to a third party.

Loss Of Use Insurance: A component of Auto insurance that compensates the policyholder when s/he has lost the use of his/her vehicle; for example, an automobile rented to replace one that is stolen.

Loss Prevention (LP): Engineering and inspection work done by an insurance company or independent organization with the aim of reducing hazards.

Loss Rating: The process of determining premium for a policyholder by adding up its components: expected losses for the risk, plus expected expenses, plus target underwriting profit. In particular, under loss rating the expected losses are based on the insured's past loss and exposure history.

Loss Ratio (LR): The ratio of losses incurred to premiums. Losses here may or may not include loss adjustment expense.

Loss Reserve: An amount representing an insurer's estimated liability for unpaid insurance claims or losses that will have to be paid in the future. There are two kinds of loss reserves: case reserves and Incurred But Not Reported (IBNR) reserves.

M

Malicious Mischief: The willful damaging or destruction of another person's property.

Market of Last Resort: See Involuntary Market.

Medical Payments Insurance: In certain states, a component of auto insurance under which an insurer agrees to pay, up to a specified limit, medical, surgical, hospital, and funeral expenses, regardless of the liability of the insured.

Mobile Home Insurance: A special policy designed to meet the needs of mobile home owners or occupants, covering physical damage to the home, contents, and personal liability while the home is used as a permanent residence.

Mortgagee Clause: A provision in an insurance policy that makes a claim jointly payable to the policyholder and the party that holds a mortgage on the property.

Mutual Insurance Company: A company with no capital stock that is owned and controlled by its policyholders.

N

Negligence: Failure to use the degree of care that a person of reasonable prudence would use under given or similar circumstances. Persons may be held responsible under the law for payments to those who have been injured or whose property has been damaged as result of their negligence.

Net Income: The result of operations computed as revenues minus expenses. Net income equals operating income plus realized capital gains (losses) from investment, minus federal income taxes.

Net Present Value (NPV): The current value of future discounted cash flows taking into account the time value of money.

Net Earned Premium (NEP): The portion of premiums that relates to the expired portion of the policy period, after reinsurance (direct earned premium plus assumed premium minus ceded premium).

Net Written Premium (NWP): Direct written premiums plus premiums assumed from other insurers or reinsurers less premiums ceded to reinsurers.

No-Fault Insurance: In certain states, No-Fault insurance permits automobile accident victims to be directly reimbursed for medical and hospital expenses and loss of income by their own insurance company regardless of who is at fault. In return, policyholders usually are required to waive their right to sue the other party, except under certain conditions referred to as the "threshold for suit".

Non-Renewal: A policy that the insurer does not continue after its expiration date.

O

Occurrence: An accident, including continuous or repeated exposure to substantially the same general harmful conditions, that results in bodily injury or property damage.

Operating Profit or Loss: Difference between revenue and costs for an insurer.

Operating Ratio: A measure of operating performance obtained by subtracting the investment income ratio from the combined ratio. An operating ratio below 100% indicates an operating profit -- underwriting costs are less than revenue. In other words, the relationship between operating ratio (R_O), operating profit (O), and premium (P) is: $1 - R_O = O/P$

P

Package Policy: A single insurance policy that includes several coverages.

Paid Loss: Amount already paid to the claimant.

Paid Loss Development: The fact that paid losses usually increase over time.

Partial Loss: A loss that does not completely destroy the insured property that is covered by an insurance policy.

Payroll Deduction: The policyholder authorizes his or her employer to deduct amounts from the employee's earnings to cover the premium.

Peril: The cause of a loss. Some perils that may cause an insured loss are fire, windstorm, hail, explosion and burglary. The fact that a peril may or may not happen creates uncertainty surrounding the risk of loss.

Personal Injury Protection (PIP): May also be referred to as No-Fault insurance. In certain states, this provides insurance that covers medical costs, loss of earnings, additional living expenses, and funeral costs for occupants of the insured automobile and pedestrians, other than those insured under other policies.

Personal Inland Marine Insurance: Also known as Personal Articles Floater, a worldwide coverage on an all-risk basis for scheduled valuable personal property.

Policy: The written statement of the insurance contract terms. That is, the agreement of an insurer to provide benefits or reimburse losses in return for a premium. The typical insurance policy has four sections: declarations, insuring agreement, conditions, and exclusions.

Policy Anniversary: Date on which a policy must be reinstated to remain in force.

Policy Year (PY): The year in which a policy is written. For statistical analyses, claims are often grouped based on the underlying policy effective date into policy years.

Policyholder (PH): The party to whom a policy is issued who agrees to pay a premium to an insurer in exchange for the insurance protection provided by a policy.

Pool: An organization of insurers through which particular types of risk are underwritten, with premiums, losses, and expenses, shared in agreed-upon amounts.

Premium: The amount that an insurer charges a policyholder. Considerations due on policies and contracts of insurance issued, renewed, or reinsured by an insurance company. In exchange for premium, the insurer provides financial protection and payment for losses (within the policy limits) should a specific event covered by the policy occur. Premium is one of the two sources of revenue for an insurance company, the other being Investment Income.

Premium Audits: Often the exposure amount is estimated before the beginning of the policy, and audited after the expiration date to determine what the actual exposure was during the policy period. The written premium is adjusted (generally increased) accordingly. Also see EBNR.

Premium Equivalents: The estimate of the premium difference between a fully insured product and a service only or large dollar deductible product.

Premium to Surplus Ratio: The ratio of net written premium to statutory surplus as of the measurement date. This ratio is often used as a measure of financial strength.

Pre-Tax Operating Income (PTOI): Net income excluding federal income taxes and realized capital gains.

Pre-Tax Operating Margin: The proportion of revenue that finds its way into PTOI.

Principle of Indemnity: Under this principle the insurer's responsibility is to pay the insured the actual cash value of the property damaged. The insured neither loses (providing he or she purchased enough insurance) or gains as a result of the loss, but is put as closely as possible in the same position as before the loss.

Property Damage: Damage to tangible property. People often refer to Property Damage as the coverage afforded for financial protection against damage to another's property resulting from an accident. In auto insurance, Property Damage pays the costs of claims that result when the policyholder or family member damages the property of others while driving the policyholder's car or someone else's car with permission.

Property Insurance: Also known as first-party insurance, indemnifies owners for the loss of (or damage to) their property caused by specified perils.

Protection: Coverage afforded by an insurance contract

Provision: The statements in a policy that explain the benefits, conditions, and other features of the insurance contract. The most common provisions for property/casualty policies are for cancellation, apportionment, appraisal, salvage, subrogation, deductibles, etc.

R

Rate: The cost of insurance per unit of exposure; used as a base for the determination of premium.

Rating: See loss rating, exposure rating, discretionary pricing, experience rating, and retrospective rating, and rating territories.

Rating Bureau: An organization, supported by insurers, which provides advisory, rating, statistical, and other services relating to property and casualty insurance.

Rating Territories: States are divided into rating territories with boundaries determined by such considerations as population density, traffic congestion, and other factors that affect exposure.

Real Property: The earth and all attached land and buildings also known as real estate.

Recovery: Money or other valuables that the insurance company obtains through subrogation, salvage, or reinsurance.

Reinstatement: Returning a lapsed policy to its full value after its termination as if it was never terminated.

Reinsurance: The acceptance by one insurer, called the *reinsurer* or assuming company, of a portion or all of the risk underwritten by another insurer, called the ceding company. The legal rights of the insured are generally not affected by a reinsurance transaction unless it is a "cut through reinsurance" agreement, in which case the reinsurer replaces the originating company as having primary liability.

Reinsurance Pooling: A mechanism in which the state selects Servicing Carriers to provide a specific line or lines of insurance to the Involuntary Market. Servicing Carriers are paid a fee by the state for writing the policies and handling the claims, but they cede the involuntary business to a pool. Any profit/loss is then allocated back to the voluntary insurance carriers in proportion to their voluntary market share.

Renewal: A policy issued to replace one that has expired.

Rental Reimbursement: In auto insurance, optional coverage that pays in the event the insured must rent a car because his/her car was out of service due to a covered loss.

Reported Loss: See loss cost estimate.

Replacement Cost: Coverage for replacing property with new material; depreciation is not taken into consideration. See also Actual Cash Value.

Reserves: Liabilities established by insurers to reflect the unearned revenue (unearned premium reserve) and the estimated cost of future loss payments, benefit payments and the related expenses that the insurer or reinsurer will ultimately be required to pay in accordance with the insurance it has written (loss reserves).

Reserves to Surplus Ratio: The ratio of net reserves to surplus as of the measurement date. This ratio is often used as a measure of financial strength.

Retention Ratio: The percentage of insurance policies that renew from one period to the next.

Return on Surplus (ROS): Net income divided by the beginning statutory surplus balance. Return on Capital (ROC) would include debt and surplus in the denominator.

Retrospective Rating: A method permitting adjustment (subject to maximum and minimum limits) of the final premium for a risk on the basis of its own loss experience. The indicated premium for a policy written on a retrospectively rated basis will change (usually grow) along with the estimate of the actual losses incurred under that policy.

Revenue: The sum of net earned premium, ceding commissions, investment income, realized gains (losses), fee income, finance charges, other income, premium and annuity income, securities commissions, investment management fees, mutual fund and administrative fees, and real estate management fees.

Risk: The word *risk* has a variety of meanings in insurance. Among the many meanings of this word are "probability or chance of loss", "uncertainty of loss", and "possibility of loss". It is even used to refer to insured property itself. Primarily, the word is used to mean the "chance or probability" of loss. Uncertainty exists when we do not know if an event resulting in financial loss *will* occur, or the amount of any financial loss if it should occur. The greater the uncertainty regarding the chance of loss, the greater the risk.

Risk-Based Capital (RBC): A method of measuring an insurer's capacity used by the NAIC which reflects asset risk, credit risk and underwriting risk.

Risk-free rate: 7-year Treasury rate.

S

Safe Driver Plan: A system for adjusting standard rates up or down according to good or bad driving records of the insureds.

Salvage: (1) Property taken over by an insurer, which has paid a claim, to reduce its loss; (2) to save endangered property and to enhance the value of damaged property.

Scheduled Property: Listing specific personal property for a stated insured value. This is usually considered for valuable items that are subject to limited coverage.

Servicing Carrier: Insurance company selected by the state to provide a specific line or lines of insurance to the Involuntary Market. There is a bidding process in which insurers bid against one another. The selection is based on both the price (fee) and quality of services provided.

Severity: A measure of claim size, or loss dollars per claim. Frequency and severity statistics are used to estimate expected losses for coverage and to establish premium rates. The term is also used to define the ultimate cost of a claim under an insurance policy.

State Fund: A fund set up by a state government to provide a specific line or lines of insurance, such as Workers Compensation.

Statutory Accounting Principles (SAP): The basis of insurance accounting. The statutory accounting model focuses on liquidity or solvency rather than the going concern/revenue and expense-matching concept of GAAP. Statutory accounting requires the immediate recognition of certain expenses and the write-off of certain assets.

Strengthening: An increase in ultimate losses booked for exposure periods prior to the current period. This adverse development or reserve strengthening causes the calendar period loss ratio reported in financial statements to exceed the loss ratio for the current exposure period.

Subrogation: The right to attempt to collect amounts incurred as a result of bodily injury or property damage caused by the negligent acts of others normally belongs to the injured party. Insurance companies may have the right by law or subrogation provisions to recover an amount of the loss from the other person or their insurer.

Subrogation Provision: Policy provision that transfers to the insurance company the right to recover loss payments made under the policy from a third party whose negligence caused the loss. Subrogation provision in policies supports the Principle of Indemnity by preventing the insured from collecting twice for the same loss -- once from the insurance company, and again from the third party whose negligent actions caused the loss.

Surplus (statutory): The amount remaining after liabilities have been subtracted from admitted assets.

T

Tenants Policy: A form of homeowner policy sold to person(s) who rent their living quarters.

Threshold For Suit: Conditions that allow for lawsuit under a no-fault insurance policy. They usually include death and permanent injury or disfigurement.

Third Party: A person other than the policyholder who has a legal right to collect monetary damages from the policyholder. Third-party claims are those where the claimant is not the policyholder.

Tort: A wrongful act, resulting in injury or damage, on which a civil action may be based. Does not apply to a breach of contract.

U

Umbrella Liability: A form of insurance protection against losses in excess of the amount covered by other liability insurance policies; also protects the insured in many situations not covered by the usual liability policies.

Unallocated Loss Adjustment Expense (ULAE): Also known as Adjusting & Other (A&O). Loss adjustment expenses that cannot be directly assigned to a particular claim (e.g. various costs of running a claims department, such as salaries, rent, etc).

Underinsurance: A condition in which not enough insurance is carried to cover the insurable value.

Underwriting: The process of evaluating an applicant and his/her property against pre-established criteria for insurability to determine whether the applicant will be rejected or accepted for coverage and whether at standard or modified rates.

Underwriting Profit or Loss: Difference between premium and costs for an insurance company.

Unearned Premium: The portion of written premium that is allocable to the unexpired portion of the policy period. In other words, the portion of a premium that a company has collected but has yet to earn because the policy still has unexpired time to run. If the insurer cancels a policy mid-term it must return unearned premium to the policyholder (see unearned premium reserve).

Unearned Premium Reserve: A liability category on insurance company balance sheets that represents the total amount that the insurer would need to return to their policyholders in the event that the insurer decides to cancel all of its contracts and retire from business.

Uninsured or Underinsured Motorists Insurance: Pays for bodily injuries caused to the policyholder and family members by an uninsured or underinsured motorist or a hit-and-run driver.

V

Void: A term used to describe a policy contract that for some reason specified in the policy becomes free of all legal effect.

Voluntary Market: The market where one obtains insurance with no help from the state, through an insurer of their own selection. See Involuntary Market.

W

Waiver: The surrender of a right or privilege that is known to exist.

Weakening: A decrease in ultimate losses booked for exposure periods prior to the current period. This favorable development or reserve weakening causes the calendar period loss ratio reported in financial statements to be lower than the loss ratio for the current exposure period.

Written Premium: Full amount charged for a policy. See direct written premium and net written premium.