Epilogue

Our history of International Insurance in Bermuda has, for the moment, come to a pause in its narration. No doubt the reader will give a sigh of relief, and yet our story will continue in the years to come, now that a beginning has been made. One word of advice, however, to those who would follow. Don't wait too long in the telling. Many strong voices that it would have been wonderful to hear had already been silenced by mortality before this book was begun. We have only a little time for storytelling. Let's not lose the voices of today. It will be much more difficult to capture them when they are history tomorrow.

The writing of this book was a task that first turned into a pleasure and then became an unimaginable odyssey through time. As a Bermudian I was naturally proud of my homeland, and as one who grew up in the insurance industry I was proud of my profession, and when asked to undertake this history I was flattered and excited but it was not until I set out to research and compile the material that I had any conception of the story that I had been called upon to tell, nor of the range it would encompass, whether in dramatic content or in human experience. Now that it is finished, in so far as any such work can ever be said to be complete, I find myself even more intensely proud of what our island has achieved and of the position we now hold in the world, of where we stand, facing the future today.

This history shows that although, at the beginning of its involvement with the international insurance market, Bermuda was originally thought of as a tax haven, it has grown into something much more complex, layered and justified than that. Despite its miniscule size, compared to other insurance centres around the world, and despite its remoteness from any major port, Bermudians have developed an all too rare survival instinct by staying in touch with world affairs. In some instances, Bermuda has managed to anticipate world trends and even at times to initiate them.

The Bermuda insurance industry continues to help maintain in balance the highly complex global financial infrastructure. No longer can countries expect to reap the benefits of globalisation on the one hand, while on the other myopically threatening to punish the very companies that take advantage of that same globalisation. Misplaced and misguided patriotism can have no place in today's global market. No one part can work effectively and efficiently except in collaboration with every other. Here, in Bermuda, we recognise the importance of working with others. Paradoxical though this may seem, the remote isolation of our little island would of itself demand as much even if nothing else did so.

Then why is Bermuda so successful? The answer is quite simply that Bermuda has had to find its own remedies and solutions in the upheavals of the modern world. Instead of squaring off in a conflict of rival vested interests, our government and our international insurance industry have chosen to work together, as partners in helping to establish Bermuda as a secure and credible, reputable and responsive centre for the global insurance industry. Bermuda has become an incubator for new ideas and has the added benefit of a support system in place that allows these ideas to become realities with the least intrusion by bureaucrats who typically have little or no working knowledge of the complexities of the corporate world. Our strategic location in the North Atlantic is an added advantage, because it developed in us a mindset that encouraged us to mediate between the continents and to serve as a fulcrum for international finance. Another very attractive aspect of Bermuda has always been that our legal system is based upon British law. Thereby corporations in Bermuda are to some extent shielded from the occasionally aggressive stance of the United States justice system, which has been known to bankrupt even some of the strongest companies by assessing against them punitive damages disproportionate to the level of complaint.

Another reason for Bermudian success is that we have usually acted with a keen though proper sense of our own self-interest. We recognise that the insurance industry is our lifeline and we have done everything within our powers to keep out the bad apples because we know that one bad apple can easily spoil the whole barrel. As Bala Nadarajah says, our government process is not a 'catch-me-if-you-can' type of regulation; rather the emphasis is on self-disclosure, in utmost good faith.[902] After all, good faith is what insurance is all about.

Bob Clements is what one might call 'the Founding Father' of the new wave of carriers who came to Bermuda after 1985 and some ten years further on Clements was talking with the late Kevin Stevenson. 'The reason we came to Bermuda was because regulation, as it's practiced in the United States, was an effective impediment to the start-up of a new business," Clements told him. In an article based on their discussion and published in *Bermudian Business* Stevenson recalled the conversation and reviewed the prior history of the industry—

> 'Well into the 20th century, the insurance industry in the US had been a *de facto* cartel, which led to gross inefficiencies, represented by unnecessarily high overheads, adversarial relationships with customers, and intolerance for innovative leadership. The US Supreme Court effectively broke up the cartel in the mid-1940s, when it ruled that insurance was interstate commerce—a position the insurance industry had long opposed. Notwithstanding this ruling, and as a result of the insurance industry's influence in Washington, the US Congress passed the McCarran-Ferguson Act, which concluded that although insurance was interstate commerce, the federal government would delegate its responsibility to regulate the industry to individual states.
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> 'The result was that even though US insurance was truly engaged in interstate commerce, which should have put it under federal control, the way it was regulated constituted a barrier to entry for new companies. Because as many as 50 independent authorities controlled the industry, insurance regulation inadvertently distorted the commercial insurance marketplace by restricting new entrants and obstructing competition. It was what insurance people decried as the "50 state problem".
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> 'No form of regulation in the world is more intrusive than American regulation,' said Clements. 'The system is marginally adequate for the personal insurance business, but in the commercial insurance business, which is a wholly different industry, American regulation is the most expensive and least effective.
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> 'If we had attempted to start ACE and XL as American insurance companies, we would still be working on getting the approval of some state—first, getting a license, second, getting a contract approved, and third, getting the rate approved. The decision to come to Bermuda didn't have anything to do with income tax. At the time that ACE was located in Bermuda, the average tax for the US property/casualty insurance business for the preceding 10 years was zero.
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> 'And even today, the US federal excise tax, at four per cent of premiums paid to non-US insurers, creates more tax revenue for the US federal government than income taxes paid by licensed domestic companies do when measured as a percentage of premiums. In other words, out of the policyholder's dollar, a bigger percentage goes to the federal government in taxes paid in connection with a placement in Bermuda than would the average dollar placed in the licensed American market.'
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> 'But Clements readily agreed it was not just regulation that kept new companies in Bermuda. It was also the significant strides the Island had taken in improving the level of service in the financial services sector. There were drawbacks, but overall, the Island remained the premier offshore insurance domicile. There was also the growing realisation that the steadily decreasing importance of national boundaries as delineators of marketplaces gives offshore locations like Bermuda a greater advantage. 'There is a need to be responsive to customers whose needs can't be compartmentalised according to national boundaries,' said Clements. 'The Bermuda insurers are wonderful examples of that. A lot of them do a truly global business in a way that no American company other than the American International Group does.'[903]

[902] Interview with Bala Nadarajah, 21 May 2002

[903] *The Bermudian*, Focus on Business, January 1995, 'Fathers of Fortune', by Kevin Stevenson, pp. 2-4, 6-7, 12

As early as the 1930s and with remarkable long-range foresight, the fathers of our international business astutely began to move our economy away from dependence on the island's limited natural resources, in order to find another pillar on which to build our future. The present contribution of international business to our Gross Domestic Product, in particular the contribution made by the international insurance industry, proved that their foresight was absolutely right, because in the present day we have no physical resources to speak of that we could trade with the rest of the world.

Our tourism industry has waned on account of several interconnected causes. The commercial air travel network now makes even the most remote corners of the globe accessible. The relatively low cost of airline tickets has opened a world of travel to those who would not have been able to afford it in the past. When a couple of weeks in Greece or Hawaii cost little or nothing more than the same length of time in Bermuda, the average New Yorker in need of a holiday is likely to look to the farther fields. At the luxury level of tourism an unprecedented number of wealthy people around the world demand ever more exotic attractions. By contrast a widespread fear of terrorism has prompted many to stay near home, people who might otherwise have continued to travel abroad. Faced with all this, on a small and now densely developed island, and with a hotel industry that has found itself unable to remain competitive, the economy of Bermuda has needed a new, substantial and sophisticated source of income to make up for the tourism dollars that seem to be on the decline every year. The international insurance sector has provided that lifeline.

As it stands today, Bermuda is supplying key components to the insurance industry and is providing capacity to everyday operations globally. Consequently, Bermuda's formula for success is being copied in other parts of the world. In some states in the United States, including Vermont and New York (actively looking to create a captive market), captives have been created. And in other parts of the states, many are looking to change state laws to allow captives to operate there. The success of the Bermuda captive market will not lead to its demise but rather to more competition from other domiciles. In some ways the fact that many in the United States are working to emulate the Bermuda insurance infrastructure helps to legitimise what is happening in Bermuda. If states are willing to endorse Bermuda legislation then it is reasonable to suppose that they view with approval the way Bermuda operates.

The chain of events that began in the maelstrom of September 11, 2001 is too lengthy for inclusion here. Since then the changes not only to the global economy but also to its insurance industry have been many and far reaching. We must confine ourselves now to saying that once again Bermuda was able to respond fast, favourably and effectively to difficult world conditions. After the attacks, faced with what might have degenerated into chaos, many corporations were in critical need of assistance and infrastructure if they were to pull through and continue to function. Bermuda was able to provide this. The island became centre stage for the global insurance industry, post September 11, as new companies opened in rapid succession to try to replace capital that had been lost to the industry. Bermuda also attracted the attention of those outside the industry by virtue of the high profile investment community that was investing money here. Bermuda's economy boomed just as other economies faltered. The island had once again emerged as the jewel in the crown of the global insurance industry. This caused many of the jurisdictions that suffered to look unfavourably or, with envy upon Bermuda.

With the bursting of the dot.com bubble and the devastation of September 11 the market-watcher's perception of what was real and what was not real might be expected to have forever altered. At least for a time there is little, if any capacity left, for being surprised or taken aback. If nothing else was learned from the events of that September, we may come to realise that the security, the well-being, the wealth, the prominence and indeed even the survival of our society as we had known it could no longer be taken for granted. Suddenly it seemed that nothing was impossible and too much was probable. There were no easy or obvious solutions any more.

Perhaps that is why, when rumours surfaced that Enron, the large and well-respected Texan energy company, had been doctoring its books for years, the public immediately demanded answers. If there was no solution in sight to problems such as global terrorism, the public needed at least something that could be readily understood and resolved. The media jumped on the Enron story because for a time it took people's minds off 9/11 and in any case they were fascinated to find out how Enron could have kept up such a farcical scam for so long.

As news surfaced that many of Enron's employees stood to lose their pensions, there was a public outcry for better regulation of corporate accountability and governance. The response was the Corporate Governance rules, known as the Sarbanes-Oxley Act, which to this day some find very difficult to follow. This piece of legislation has proven to be a nightmare for industry, because it has led to the increased threat of lawsuits against companies suspected of inflating their balance sheets. As a result of changes in attitudes towards the reporting of performance and of the new corporate governance rules, some companies in the US and the London market pulled out of writing Director's and Officer's liability. Once again, the Bermuda market stepped in to fill the vacuum.

It is usual that a nation sensing itself to be in peril should attempt to summon its courage and rally its moral forces by an upsurge of patriotism and a metaphorical 'closing of the ranks'. However these natural and healthy responses can only too easily be perverted by unscrupulous vested interests into chauvinism and xenophobia, for purposes that have to do not with any interest of society at large but only with private gain or the settling of private scores. On the one hand positive responses beneficial to the social good and on the other hand paranoid malignancies that fed on fear were both to be observed at work in the weeks and months after 9/11.

Bermuda became a target. This should not have come as a surprise. The relation between boardroom and newsroom is no secret. There were plenty of corporations headquartered in the US that were glad to have somebody take a whack at the so-called 'offshore tax haven'. There were plenty of politicians immediately ready to jump on a bandwagon by labelling as 'unpatriotic' any company that had taken its headquarters offshore.

Because Bermuda had gained such a reputation as a reputable and effective place in which to do business, many companies had chosen to reposition their headquarters to Bermuda through a perfectly legal process called 'corporate inversions'. It so happens that corporations headquartered in the US are at a competitive disadvantage, as compared to those headquartered outside the US, because the US is one of the few countries in the world that taxes the incomes of its taxpayers regardless of where that income is earned. It is this aspect of the US tax system that prompts companies to 'invert' their corporate headquarters in order to be able to compete with non-US corporations. Such were the corporations that undertook to invert their headquarters to Bermuda, simply in order to bring some profitability back to their books, so as to meet shareholder expectations, to preserve jobs and to remain competitive as compared to their non-US counterparts. However it is always easy to provoke anger by arousing jealousy and resentment. As a result of the inversions, certain US politicians and activist groups who sought to gain political mileage dubbed Bermuda 'the scum of the earth'. Given the stressful state of public opinion at the time, such a level of disparagement may have passed without comment, but as cooler thoughts prevailed it would be seen for the scurrilous nonsense that it was.

The global reinsurance industry, which had been showing marginal results as a result of the sustained soft market prior to 9/11, saw many companies go into the red thereafter. By the early part of 2001, recalling the speech given by Brian Duperreault, Chairman, CEO and President of ACE, to ICAP on 21 June 2001, the number of reinsurers had reduced from 65 to 33 globally, with the top four accounting for 57 per cent of the total reinsurance placed by the industry. With the reduced number of reinsurers, and an even smaller number reinsuring the bulk of the world's exposures, it is no wonder that accumulation problems became more evident than ever. With such a small number of reinsurers writing so much of the reinsurance placed, it was to be expected that they would become lax in managing their aggregates, as many companies had expanded, over the years, from direct insurance to reinsurance to providing reinsurance to reinsurance companies known as retrocessionaires.

In addition, as reported by the 2002 SEC statement filed by Axis Specialty, the insurance industry was impaired by an estimated $228 billion to $248 billion in potential and realised underwriting investment losses in 2002, which equates to about 35 per cent of the approximately $700 billion in committed capital at the end of 2000. All of these factors indicate that the global insurance industry is in serious trouble. Not only have small regional companies been affected by the downturn in the industry, so have highly respected insurers like Gerling Global and Scor Re (large European reinsurers), the Hartford, and Kemper (large US insurers).

In order that the $50 billion and more which the industry lost in capacity after 9/11 should be replaced as quickly as possible, the majority of the reinvestment in the insurance industry was conducted in Bermuda because of our favourable regulatory environment. Over 100 insurance companies have incorporated in Bermuda since September 11, 2001.

The next thing for which Bermuda got the blame was for keeping the rates down across the industry because of all the new capacity that had found its way here. What the industry did not take into consideration is that the events of 9/11 were an enormous, brutal, learning experience for the entire insurance industry. Because those events impacted on virtually everyone in some way or another; the insurance industry was catapulted to the forefront and people desperately needed a better understanding of how it worked. Risk Managers could no longer afford to be caught out underinsured or inadequately covered for certain exposures. Their learning curve for the intricacies of the market was exponential. It had to be, if they were to survive. That is part of the reason that rates have not gone through the roof. It has little to do with the new capacity in the industry but more to do with the increased sophistication of the insurance buyer.

Despite the flow of capital coming into the Bermuda international insurance industry, we have not been completely spared from the volatility that afflicts the global insurance industry. Bermuda likewise has witnessed the failure of some high profile companies in the wake of a changing global perspective on company performance, of a continued bear market and of a weak global insurance industry. To name a few—one highly regarded company, Mutual Risk Management, was forced to file for bankruptcy, as a result of unrecoverable reinsurance; Commercial Risk announced it was no longer accepting business; Centre Solutions announced it was restructuring the company and laying off several employees; Overseas Partners Limited (OPL) was placed into runoff; Annuity Life & Reinsurance Re (ALRe) ran into serious financial difficulties, and recently Trenwick filed for bankruptcy.

All that notwithstanding, in the year 2003, Bermuda's international insurance industry had approximately $164 billion in assets, aggregate capital and surplus of more than $60 billion, and annual gross premiums of approximately $48 billion. In addition, we have some 12 insurers with more than $1 billion in capital and surplus, second only to the US. Clearly, with numbers like these, the international insurance industry in Bermuda is a significant contributor to the global insurance industry. Yet more importantly still, the continued success of the industry in Bermuda is vital to us as Bermudians if we are to maintain the standard of living and sophistication to which we have become accustomed, a standard that is due in large measure to the inflows of capital into our economy from the international insurance industry, not to mention the jobs that these companies provide for Bermudians.

It is therefore my opinion that of all the issues facing us in the Bermuda marketplace we must consider these to be of paramount concern—

First is the internal threat—there is a real and imminent danger that our society will implode in chaos if we do not successfully address the problem of sustainable development. This is a tiny island, now built up near to capacity. We have no hinterland, virtually no agriculture or fisheries left, and less and less tourism every year. Yet our expectations keep on growing, our demands for living space keep on growing, we want more and more from our island, and we go on building as though we had unlimited land for development at our backs.

Second is the need for a better-informed appreciation of where we are at the moment in our ongoing island story and in particular the need to accommodate changes that are already upon us. The international insurance industry has for a long time already played an increasingly significant role in our story. It is now becoming the central, supporting pillar in the stability of our economy. Whatever adjustments the industry needs to make to Bermuda, and Bermuda needs to make to the industry, some of which have been addressed in this book, these adjustments must be made in a spirit of equity, amity and community. This industry is by now a vital part of Bermuda and Bermuda is of integral importance to the global insurance industry. Where will this international insurance industry in Bermuda go from here? Bermuda's future in the industry lies delicately balanced between the influences of the external global forces and our continued ability to respond in a timely and responsible fashion to them.

Third, is the fact that the global insurance industry itself is under great pressure. The 300-year-old grandfather of insurance, Lloyd's of London, is being tested severely right now, given the state that the global insurance industry finds itself in after 9/11. Edward Lloyd could never have foreseen the immensity of the problems his little coffee house would be facing, so many generations later. Compared to Lloyd's, the Bermuda industry is very new to the global insurance scene. We must take care that we do not make serious mistakes ourselves, if we are to preserve our premier status in the global insurance ranks. The international insurance industry in Bermuda can ill afford to become complacent or lax in its professionalism because, in days of adversity, it is only professionalism that wins every time.

This fourth major challenge comes from external threats and problems, such as issues of taxation, nationalism, protectionism, and a world that is changing at a rate just as fast as the rate of change in Bermuda itself. It seems that no sooner have we secured and consolidated a new position than some unforeseen competitor or opponent makes a countermove to offset what we have just achieved. If our competitor intends to become as flexible as Bermuda in the formation of companies, then we must conceive of flexibilities in other ways. Much of what happens will in any case remain beyond our control. We have one great advantage, in this tiny place. That great advantage is, in a word, flexibility. We have had to be flexible and adaptable to survive. On an island with no fresh water we perfected the skills of collecting rain. Many generations later our island became a pearl of great price, out here in the limitless Atlantic. That says it all. We learned to be self-sufficient, and equally we have learned to be citizens of the world. Placed as we are, we have had to learn to reinvent ourselves every time the world around us changes.

All we can do is to think as our forefathers did, so long ago. They found themselves alone, on an uninhabited island, immeasurably far from land, with little but their own wit and courage. They were content with what they found and happy enough to let themselves become 'held captive'. From that beginning has arisen the island that we know and love today. If we can be worthy of their example and of what their descendants have built and left for us, then we need have no fear of the future. We shall survive and prosper, QUO FATA FERUNT, wherever the fates may lead us.

Brian R. Hall, O.B.E.

It is only natural that Brian Hall should have been the chief mover behind the creation and publication of this book. For nearly half a century Mr Hall has been active in the Bermuda insurance industry and ever since the start of that involvement he has been one of the most outstanding players in the field. He was one of the architects of the industry, as we know it today, and among the first of the pioneers to make themselves expert in the concept, creation and management of captive companies. He has been exceptionally successful in his own right, both as a founder and proprietor of companies, and as an executive and CEO. He has also earned a well-deserved reputation as a spokesman and ambassador for the industry, both to government in Bermuda and to the highest echelons of international business abroad. Furthermore Mr Hall has envisioned a wide perspective for the industry in time and place, as witness his initiatives in the education and training of young persons to be the future of insurance in Bermuda.

Born in Manchester, England, Mr Hall was a graduate of Saltus Grammar School in Bermuda. He started his career in the Bermuda insurance industry when he joined American International in 1958. He moved to International Risk Management Ltd. in 1964, developing experience in captive concepts and management. In 1969 he founded InterOcean Management Ltd., which entered into an association with Johnson & Higgins in 1970. InterOcean grew to become Bermuda's largest management company and Johnson & Higgins acquired its business in 1979. At that time Mr Hall was appointed President of Johnson & Higgins (Bermuda) Ltd. and was later to become Chairman of that company. Mr Hall was responsible for J&H's Global Captive Management operation, which represented facilities around the world. He became a Director of Johnson & Higgins in 1989 until 1997, when he retired subsequent to the merger of Johnson & Higgins and Marsh & McLennan, Inc. After his retirement Mr Hall reestablished InterOcean Management Ltd, of which he is still President.

A long time member of the Insurance Advisory Committee of the Bermuda Ministry of Finance, Mr Hall served as its Chairman from 1985 to 1998, and in that capacity represented the IAC on the Premier's International Business Forum. He was appointed to the Board of Governors of the Bermuda College and Stonington Beach Hotel Ltd. in January 1997, and became Chairman of the Board in January 1998, a role that was concluded at the end of that year. He served as founding President of the Bermuda Insurance Managers Association.

Mr Hall launched the Bermuda Foundation for Insurance Studies, and continues as Chairman of its Board of Trustees. A Fellow of the British Institute of Management, he is also a graduate of the Harvard Business School International Senior Managers' Program. In August 1999, he was appointed a Director of RenaissanceRe Holdings Ltd., a company posted on the NYSE, and serves as Chairman of the Audit Committee. He was awarded the Bermuda Insurance Institute's Lifetime Achievement Award in 2000.

On 31 December 1998, in Her Majesty the Queen's New Year's Honours List, Mr Hall was named an Officer of the Most Excellent Order of the British Empire.

Catherine R. Duffy

'Cathy', as she is known to the Bermuda insurance industry, brings to the authorship of this book a unique combination of qualities. A long history of varied professional achievement has in no way dulled her fascination with the singular world of which she writes. She combines youth and enthusiasm with a maturity of judgement that has been learned in the exercise of serious responsibility. Her wit, her good humour, and her compassionate interest in what motivates people, are tempered by a cool appraisal of the marketplace in all its stern impersonality. The freshness and topicality of her style and expression are upheld by the most painstaking and rigorous historical research, much of it in archives hitherto unexplored.

In short she has the technical command of an expert in her chosen field, the journalist's flair for the encapsulation of the passing moment, the historian's reach for a long perspective, and the dramatist's delight in a cast of lively characters. These aptitudes and endowments have made Cathy Duffy uniquely qualified to undertake what has proven, in the course of its completion, to be a monumental task, namely this account of the international insurance industry in Bermuda—source book, reference book, and a continuous running narrative that frames a vast array of archival and documentary material. It is Cathy's single most important work of historiography to date.

Born and brought up in Bermuda, Cathy Duffy was educated at the Berkeley Institute and went on to obtain her BA in Business Administration at Howard University, Washington, DC, in 1984, her major subject for her degree being, of course, Insurance. She spent the early years of her insurance career first as a Senior Underwriter with the Hartford Insurance Company, of Alexandria, Virginia, next with American Home Assurance in New York, and then as a Senior Analyst with USF&G in Baltimore.

In 1988 Cathy was one of the first underwriter trainees to be hired by XL Insurance, Hamilton, Bermuda, and duly rose from Assistant Underwriter to Vice President, responsible for new business, COAXL products, broker relations and training courses for new recruits. She is also believed to have been the first Bermudian woman to obtain her CPCU designation (Chartered Property and Casualty Underwriter).

In 1995 Cathy was appointed Vice President at Starr Excess, Hamilton, where she achieved some remarkable increases in business before being invited in 1996 to become Senior Vice President of Zurich Global Energy, there to set up and run the Casualty side of the operation in Bermuda.

In 1999 she left the corporate world to devote herself to domestic life but she still made time to establish herself as a freelance writer. Among other assignments she authored a widely appreciated weekly column of Insurance opinion for *The Royal Gazette*. Her husband, Nick, her young son Raven, and now her infant daughter, Sedona, have of late been obliged to vie for her attention with the demands of researching and authoring a major work of scholarship. She finds that these are at times less rational and always every bit as bothersome as the demands of wifeliness and motherhood.

Glossary

The contents of this glossary were made possible through the kind permission of the Insurance Information Institute in New York to excerpt terms from their glossary, which may be found *at www.iii.ore*

ACTUARY
An insurance professional skilled in the analysis, evaluation, and management of statistical information. Evaluates insurance firms' reserves, determines rates and rating methods, and determines other business and financial risks.

ADJUSTER
An individual employed by a property/casualty insurer to evaluate losses and settle policyholder claims. These adjusters differ from public adjusters, who negotiate with insurers on behalf of policyholders, and receive a portion of a claims settlement. Independent adjusters are independent contractors who adjust claims for different insurance companies.

ADMITTED COMPANY
An insurance company licensed and authorized to do business in a particular state.

ADVERSE SELECTION
The tendency of those exposed to a higher risk to seek more insurance coverage than those at a lower risk. Insurers react either by charging higher premiums or not insuring at all, as in the case of floods. (Flood insurance is provided by the federal government but sold mostly through the private market.) In the case of natural disasters, such as earthquakes, adverse selection concentrates risk instead of spreading it. Insurance works best when risk is shared among large numbers of policyholders.

AGENT
Insurance is sold by two types of agents: independent agents, who are self-employed, represent several insurance companies and are paid on commission, and exclusive or captive agents, who represent only one insurance company and are either salaried or work on commission. Insurance companies that use exclusive or captive agents are called direct writers.

ALIEN INSURANCE COMPANY
An insurance company incorporated under the laws of a foreign country, as opposed to a foreign insurance company that does business in states outside its own.

ALTERNATIVE DISPUTE RESOLUTION I ADR
Alternative to going to court to settle disputes. Methods include arbitration, where disputing parties agree to be bound to the decision of an independent third party, and mediation, where a third party tries to arrange a settlement between the two sides.

ALTERNATIVE MARKETS
Mechanisms used to fund self-insurance. This includes captives, which are insurers owned by one or more non-insurers to provide owners with coverage. Risk-retention groups, formed by members of similar professions or businesses to obtain liability insurance, are also a form of self-insurance.

ANNUALSTATEMENT
Summary ol an insurers or reinsurer's financial operations for a particular year, including a balance sheet. It is filed with the state insurance department of each jurisdiction in which the company is licensed to conduct business.

ANNUITY
A life insurance company contract that pays periodic income benefits for a specific period of time or over the course of the annuitant's lifetime. These payments can be made annually, quarterly or monthly.

From a life insurer's viewpoint, an annuity presents the opposite mortality risk from a life insurance policy. Life insurance pays a benefit when the policyholder dies. An annuity pays benefits as long as the annuitant lives. With both products, the insurer's profit or loss depends on whether it made correct assumptions about the policyholder's life expectancy and the company's future investment returns.

Annuity investments are tax-deferred; taxes are not due until income payments begin. Annuities are often used as a form of retirement savings and some allow tax-free loans. They can be bought on a periodic schedule or through a one-time payment. There are fixed-income annuities, which invest in a general insurer's account and offer a fixed benefit payment, and variable annuities, where individuals can choose their own investments from a menu of funds offered by the insurance company including bond and stock funds. The account value of a variable annuity reflects the performance of the investments offered by the company and selected by the annuitant whereas fixed annuity payments are guaranteed, regardless of the performance of the insurance company's investments.

ARBITRATION
Procedure in which an insurance company and the insured or a vendor agree to settle a claim dispute by accepting a decision made by a third party.

ASSET-BACKED SECURITIES
Bonds that represent pools of loans of similar types, duration and interest rates. Almost any loan with regular repayments of principal and interest can be securitized, from auto loans and equipment leases to credit card receivables and mortgages.

ASSETS
Property owned, in this case by an insurance company, including stocks, bonds, and real estate. Insurance accounting is concerned with solvency and the ability to pay claims. State insurance laws therefore require a conservative valuation of assets, prohibiting insurance companies from listing assets on their balance sheets whose values are uncertain, such as furniture, fixtures, debit balances, and accounts receivable that are more than 90 days past due. (See Admitted asset§)

AVIATION INSURANCE
Commercial airlines hold property insurance on airplanes and liability insurance for negligent acts that result in injury or property damage to passengers or others. Damage is covered on the ground and in the air. The policy limits the geographical area and individual pilots covered.

BALANCE SHEET
Provides a snapshot of a company's financial condition at one point in time. It shows assets, including investments and reinsurance, and liabilities, such as loss reserves to pay claims in the future, as of a certain date. It also states a company's equity, known as policyholder surplus. Changes in that surplus are one indicator of an insureros financial standing.

BINDER
Temporary authorization of coverage issued prior to the actual insurance policy.

BODILY INJURY LIABILITY COVERAGE
Portion of an auto insurance policy that covers injuries the policyholder causes to someone else.

BOND
A security that obligates the issuer to pay interest at specified intervals and to repay the principal amount of the loan at maturity. In insurance, a form of suretyship. Bonds of various types guarantee a payment or a reimbursement for financial losses resulting from dishonesty, failure to perform and other acts.

BOND RATING
An evaluation of a bond's financial strength, conducted by such major ratings agencies as Standard & Poor's and Moody's Investors Service.

BOOK OF BUSINESS
Total amount of insurance on an insurers books at a particular point in time.

BROKER
An intermediary between a customer and an insurance company. Brokers typically search the market for coverage appropriate to their clients. They work on commission and can sell both commercial and personal insurance. In life insurance, agents must be licensed as securities brokers/dealers to sell variable annuities, which are similar to stock market-based investments.

BUSINESS INTERRUPTION INSURANCE
Commercial coverage that reimburses a business owner for lost profits and continuing fixed expenses during the time that a business must stay closed while the premises are being restored because of physical damage from a covered peril, such as a fire. Business interruption insurance also may cover financial losses that may occur if civil authorities limit access to an area after a disaster and their actions prevent customers from reaching the business premises. Depending on the policy, civil authorities coverage may start after a waiting period and last for two or more weeks.

BUSINESS OWNERS POLICY / BOP
A policy that combines property, liability and business interruption coverages for small- to medium-sized businesses. Coverage is generally cheaper than if purchased through separate insurance policies.

CAPACITY
The supply of insurance available to meet demand. Capacity depends on the industry's financial ability to accept risk. For an individual insurer, the maximum amount of risk it can underwrite based on its financial condition. The adequacy of an insurer's capital relative to its exposure to loss is an important measure of solvency.

A property/casualty insurer must maintain a certain level of capital and policyholder surplus to underwrite risks. This capital is known as capacity. When the industry is hit by high losses, such as after the World Trade Center terrorist attack, capacity is diminished. It can be restored by increases in net income, favorable investment returns, reinsuring more risk and or raising additional capital. When there is excess capacity, usually because of a high return on investments, premiums tend to decline as insurers compete for market share, As premiums decline, underwriting losses are likely to grow, reducing capacity and causing insurers to raise rates and tighten conditions and limits in an effort to increase profitability. Policyholder surplus is sometimes used as a measure of capacity.

CAPITAL
Shareholder's equity (for publicly-traded insurance companies) and retained earnings (for mutual insurance companies). There is no general measure of capital adequacy

for property/casualty insurers. Capital adequacy is linked to the riskiness of an insurers business. A company underwriting medical device manufacturers needs a larger cushion of capital than a company writing Main Street business, for example. (*See Risk-based capital; Surplus; Solvency*

CAPITAL MARKETS
The markets in which equities and debt are traded. (See Securitization of insurance ris~)

CAPTIVES
Insurers that are created and wholly-owned by one or more non-insurers, to provide owners with coverage. A form of self-insurance.

CATASTROPHE
Term used for statistical recording purposes to refer to a single incident or a series of closely related incidents causing severe insured property losses totaling more than a given amount, currently $25 million.

CATASTROPHE BONDS
Risk-based securities that pay high interest rates and provide insurance companies with a form of reinsurance to pay losses from a catastrophe such as those caused by a major hurricane. They allow insurance risk to be sold to institutional investors in the form of bonds, thus spreading the risk. (See Securitization of insurance risk

CATASTROPHE DEDUCTIBLE
A percentage or dollar amount that a homeowner must pay before the insurance policy kicks in when a major natural disaster occurs. These large deductibles limit an insurer's potential losses in such cases, allowing it to insure more property. A property insurer may not be able to buy reinsurance to protect its own bottom line unless it keeps its potential maximum losses under a certain level.

CATASTROPHE FACTOR
Probability of catastrophic loss, based on the total number of catastrophes in a state over a 40-year period.

CATASTROPHE MODEL
Using computers, a method to mesh long-term disaster information with current demographic, building and other data to determine the potential cost of natural disasters and other catastrophic losses for a given geographic area.

CATASTROPHE REINSURANCE
Reinsurance (insurance for insurers) for catastrophic losses. The insurance industry is able to absorb the multibillion dollar losses caused by natural and man-made disasters such as hurricanes, earthquakes and terrorist attacks because losses are spread among thousands of companies including catastrophe reinsurers who operate on a global basis. Insurers' ability and willingness to sell insurance fluctuates with the availability and cost of catastrophe reinsurance.

After major disasters, such as Hurricane Andrew and the World Trade Center terrorist attack, the availability of catastrophe reinsurance becomes extremely limited. Claims deplete reinsurers' capital and, as a result, companies are more selective in the type and amount of risks they assume. In addition, with available supply limited, prices for reinsurance rise. This contributes to an overall increase in prices for property insurance.

CLAIMS-MADE POLICY
A form of insurance that pays claims presented to the insurer during the term of the policy or within a specific term after its expiration. It limits liability insurers' exposure to unknown future liabilities. *(See Occurrence Policy)*

COINSURANCE
In property insurance, requires the policyholder to carry insurance equal to a specified percentage of the value of property to receive full payment on a loss. For health insurance, it is a percentage of each claim above the deductible paid by the policyholder. For a 20 percent health insurance coinsurance clause, the policyholder pays for the deductible plus 20 percent of his covered losses. After paying 80 percent of losses up to a specified ceiling, the insurer starts paying 100 percent of losses.

COMBINED RATIO
Percentage of each premium dollar a property/casualty insurer spends on claims and expenses. A decrease in the combined ratio means financial results are improving; an increase means they are deteriorating. When the ratio is over 100, the insurer has an underwriting loss.

COMMERCIAL GENERAL LIABILITY INSURANCE I CGL
A broad commercial policy that covers all liability exposures of a business that are not specifically excluded. Coverage includes product liability, completed operations, premises and operations, and independent contractors.

COMMERCIAL LINES
Products designed for and bought by businesses. Among the major coverages are boiler and machinery, business interruption, commercial auto, comprehensive general liability, directors and officers liability, fire and allied lines, inland marine, medical malpractice liability, product liability, professional liability, surety and fidelity, and workers compensation. Most of these commercial coverages can be purchased separately except business interruption which must be added to a fire insurance (property) policy. *(See Commercial multiple Peril Policy*

COMMERCIAL MULTIPLE PERIL POLICY
Package policy that includes property, boiler and machinery, crime, and general liability coverages.

COMMERCIAL PAPER
Short-term, unsecured, and usually discounted promissory note issued by commercial firms and financial com-

panies often to finance current business. Commercial paper, which is rated by debt rating agencies, is sold through dealers or directly placed with an investor.

COMMISSION
Fee paid to an agent or insurance salesperson as a percentage of the policy premium. The percentage varies widely depending on coverage, the insurer, and the marketing methods.

COMPLETED OPERATIONS COVERAGE
Pays for bodily injury or property damage caused by a completed project or job. Protects a business that sells a service against liability claims.

CONTINGENT LIABILITY
Liability of individuals, corporations, or partnerships for accidents caused by people other than employees for whose acts or omissions the corporations or partnerships are responsible.

COVERAGE
Synonym for insurance.

CREDIT
The promise to pay in the future in order to buy or borrow in the present. The right to defer payment of debt.

CREDIT DERIVATIVES
A contract that enables a user, such as a bank, to better manage its credit risk. A way of transferring credit risk to another party.

CREDIT ENHANCEMENT
A technique to lower the interest payments on a bond by raising the issue's credit rating, often through insurance in the form of a financial guarantee or with standby letters of credit issued by a bank.

CREDIT INSURANCE
Commercial coverage against losses resulting from the failure of business debtors to pay their obligation to the insured, usually due to insolvency. The coverage is geared to manufacturers, wholesalers, and service providers who may be dependent on a few accounts and therefore could lose significant income in the event of an insolvency.

CREDIT LIFE INSURANCE
Life insurance coverage on a borrower designed to repay the balance of a loan in the event the borrower dies before the loan is repaid. It may also include disablement and can be offered as an option in connection with credit cards and auto loans.

DERIVATIVES
Contracts that derive their value from an underlying financial asset, such as publicly-traded securities and foreign currencies. Often used as a hedge against changes in value.

DIRECT WRITERS
Insurance companies that sell directly to the public using exclusive agents or their own employees, through the mail, or via Internet. Large insurers, whether predominately direct writers or agency companies, are increasingly using many different channels to sell insurance. In reinsurance, denotes reinsurers that deal directly with the insurance companies they reinsure without using a broker.

DIRECTORS AND OFFICERS LIABILITY INSURANCE/D&O
Covers directors and officers of a company for negligent acts or omissions, and for misleading statements that result in suits against the company, often by shareholders. Directors and officers insurance policies usually contain two coverages: personal coverage for individual directors and officers who are not indemnified by the corporation for their legal expenses or judgments against them - some corporations are not required by their corporate or state charters to provide indemnification; and corporate reimbursement coverage for indemnifying directors and officers. Entity coverage for claims made specifically against the company may also be available.

DIVIDENDS
Money returned to policyholders from an insurance company's earnings. Considered a partial premium refund rather than a taxable distribution, reflecting the difference between the premium charged and actual losses. Many life insurance policies and some property/casualty policies pay dividends to their owners. Life insurance policies that pay dividends are called participating policies.

DOMESTIC INSURANCE COMPANY
Term used by a state to refer to any company incorporated there.

EARNED PREMIUM
The portion of premium that applies to the expired part of the policy period. Insurance premiums are payable in advance but the insurance company does not fully earn them until the policy period expires.

EARTHQUAKEINSURANCE
Covers a building and its contents, but includes a large percentage deductible on each. A special policy or endorsement exists because earthquakes are not covered by standard homeowners or most business policies.

ECONOMIC LOSS
Total financial loss resulting from the death or disability of a wage earner, or from the destruction of property. Includes the loss of earnings, medical expenses, funeral expenses, the cost of restoring or replacing property, and legal expenses. It does not include noneconomic losses, such as pain caused by an injury.

ELECTRONIC COMMERCE / E-COMMERCE
The sale of products such as insurance over the Internet.

EMPLOYEE RETIREMENT INCOME SECURITY ACT I ERISA
Federal legislation that protects employees by establishing minimum standards for private pension and welfare plans.

EMPLOYMENT PRACTICES LIABILITY COVERAGE

Liability insurance for employers that covers wrongful termination, discrimination, or sexual harassment toward the insured's employees or former employees.

ENDORSEMENT
A written form attached to an insurance policy that alters the policy's coverage, terms, or conditions. Sometimes called a rider.

ENVIRONMENTAL IMPAIRMENT LIABILITY COVERAGE
A form of insurance designed to cover losses and liabilities arising from damage to property caused by pollution.

EQUITY
In investments, the ownership interest of shareholders. In a corporation, stocks as opposed to bonds.

ERRORS AND OMISSIONS COVERAGE / E&O
A professional liability policy covering the policyholder for negligent acts and omissions that may harm his or her clients.

EXCESS AND SURPLUS LINES
Property/casuafty coverage that isn't available from insurers licensed by the state (called admitted insurers) and must be purchased from a non-admitted carrier.

EXCESS OF LOSS REINSURANCE
A contract between an insurer and a reinsurer, whereby the insurer agrees to pay a specified portion of a claim and the reinsurer to pay all or a part of the claim above that amount.

EXCLUSION
A provision in an insurance policy that eliminates coverage for certain risks, people, property classes, or locations.

EXPENSE RATIO
Percentage of each premium dollar that goes to insurers' expenses including overhead, marketing, and commissions.

EXPERIENCE
Record of losses.

EXPOSURE
Possibility of loss.

FACULTATIVE REINSURANCE
The portion of premium that applies to the expired part of the policy period. Insurance premiums are payable in advance but the insurance company does not fully earn them until the policy period expires.

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FACULTATIVE REINSURANCE
A reinsurance policy that provides an insurer with coverage for specific individual risks that are unusual or so large that they aren't covered in the insurance company's reinsurance treaties. This can include policies for jumbo jets or oil rigs. Reinsurers have no obligation to take on facultative reinsurance, but can assess each risk individually. By contrast, under treaty reinsurance, the reinsurer agrees to assume a certain percentage of entire classes of business, such as various kinds of auto, up to preset limits.

FEDERAL RESERVE BOARD
Seven-member board that supervises the banking system by issuing regulations controlling bank holding companies and federal laws over the banking industry. It also controls and oversees the U.S. monetary system and credit supply.

FIDELITY BOND
A form of protection that covers policyholders for losses that they incur as a result of fraudulent acts by specified individuals. It usually insures a business for losses caused by the dishonest acts of its employees.

FIDUCIARY BOND
A type of surety bond, sometimes called a probate bond, which is required of certain fiduciaries, such as executors and trustees, that guarantees the performance of their responsibilities.

FIDUCIARY LIABILITY
Legal responsibility of a fiduciary to safeguard assets of beneficiaries. A fiduciary, for example a pension fund manager, is required to manage investments held in trust in the best interest of beneficiaries. Fiduciary liability insurance covers breaches of fiduciary duty such as misstatements or misleading statements, errors and omissions.

FINANCIAL GUARANTEE INSURANCE
Covers losses from specific financial transactions and guarantees that investors in debt instruments, such as municipal bonds, receive timely payment of principal and interest if there is a default. Raises the credit rating of debt to which the guarantee is attached. Investment bankers who sell asset-backed securities, securities backed by loan portfolios, use this insurance to enhance marketability. *(See Municipal bond insurance)*

FINITE RISK REINSURANCE
Contract under which the ultimate liability of the reinsurer is capped and on which anticipated investment income is expressly acknowledged as an underwriting component. Also known as Financial Reinsurance because this type of coverage is often bought to improve the balance sheet effects of statutory accounting principles.

FIRE INSURANCE
Coverage protecting property against losses caused by a fire or lightning that is usually included in homeowners or commercial multiple peril policies.

FIXED ANNUITY
An annuity that pays the annuitant a guaranteed, fixed return every month for a fixed premium. The guarantee is based on the expected return of the underlying investments of the insurance company. *(See Annuit)*

FOREIGN INSURANCE COMPANY
Name given to an insurance company based in one state by the other states in which it does business.

FRAUD
Intentional lying or concealment by policyholders to obtain payment of an insurance claim that would otherwise not be paid, or lying or misrepresentation by the insurance company managers, employees, agents, and brokers for financial gain.

FREQUENCY
Number of times a loss occurs. One of the criteria used in calculating premium rates.

FRONTING
A procedure in which a primary insurer acts as the insurer of record by issuing a policy, but then passes the entire risk to a reinsurer in exchange for a commission. Often, the fronting insurer is licensed to do business in a state or country where the risk is located, but the reinsurer is not. The reinsurer in this scenario is often a captive or an independent insurance company that cannot sell insurance directly in a particular country.

FUTURES
Agreement to buy a security for a set price at a certain date. Futures contracts usually involve commodities, indexes or financial futures.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLESIGAAP
Generally accepted accounting principles (GAAP) accounting is used in financial statements that publiclyheld companies prepare for the Securities and Exchange Commission. *(See Statutory accounting principles /SAP)*

GRAMM-LEACH-BLILEY ACT
Financial services legislation, passed by Congress in 1999, that removed Depression-era prohibitions against the combination of commercial banking and investment-banking activities. It allows insurance companies, banks, and securities firms to engage in each others' activities and own one another.

HARD MARKET
A seller's market in which insurance is expensive and in short supply. *(See Property/casualty insurance cycle)*

HOMEOWNERS INSURANCE POLICY
The typical homeowners insurance policy covers the house, the garage and other structures on the property, as well as personal possessions inside the house such as furniture, appliances and clothing, against a wide variety of perils including windstorms, fire and theft. The extent of the perils covered depends on the type of policy. An all-risk policy offers the broadest coverage. This covers all perils except those specifically excluded in the policy.

Homeowners insurance also covers additional living expenses. Known as Loss of Use, this provision in the policy reimburses the policyholder for the extra cost of living elsewhere while the house is being restored after a disaster. The liability portion of the policy covers the homeowner for accidental injuries caused to third parties and/or their property, such as a guest slipping and failing down improperly maintained stairs. Coverage for flood and earthquake damage is excluded and must be purchased separately. *(See Flood insurance; Earthquake insurance*

INCURRED BUT NOT REPORTED LOSSES I IBNR
Losses that are not filed with the insurer or reinsurer until years after the policy is sold. Some liability claims may be filed long after the event that caused the injury to occur. Asbestos-related diseases, for example, do not show up until decades after the exposure. IBNR also refers to estimates made about claims already reported but where the full extent of the injury is not yet known, such as a workers compensation claim where the degree to which work-related injuries prevents a worker from earning what he or she earned before the injury unfolds over time. Insurance companies regularly adjust reserves for such losses as new information becomes available.

INCURRED LOSSES
Losses occurring within a fixed period, whether or not adjusted or paid during the same period.

INDEMNIFY
Provide financial compensation for losses.

INSOLVENCY
Insurer's inability to pay debts. Insurance insolvency standards and the regulatory actions taken vary from state to state. Men regulators deem an insurance company is in danger of becoming insolvent, they can take one of three actions: place a company in conservatorship or rehabilitation if the company can be saved or liquidation if salvage is deemed impossible. The difference between the first two options is one of degree -regulators guide companies in conservatorship but direct those in rehabilitation. Typically the first sign of problems is inability to pass the financial tests regulators administer as a routine procedure. *(See Liquidation; Risk-based capital)*

INSTITUTIONAL INVESTOR
An organization such as a bank or insurance company that buys and sells large quantities of securities.

INSURABLE RISK
Risks for which it is relatively easy to get insurance and that meet certain criteria. These include being definable, accidental in nature, and part of a group of similar risks large enough to make losses predictable. The insurance company also must be able to come up with a reasonable price for the insurance.

INSURANCE
A system to make large financial losses more affordable by pooling the risks of many individuals and business entities and transferring them to an insurance company or other large group in return for a premium.

INSURANCE REGULATORY INFORMATION SYSTEM I IRIS
Uses financial ratios to measure insurers' financial strength. Developed by the National Association of Insurance Commissioners. Each individual state insurance department chooses how to use IRIS.

INSURANCE-TO-VALUE
Insurance written in an amount approximating the value of the insured property.

INVESTMENT INCOME
Income generated by the investment of assets. Insurers have two sources of income, underwriting (premiums less claims and expenses) and investment income. The latter can offset underwriting operations, which are frequently unprofitable.

JUNK BONDS
Corporate bonds with credit ratings of 1313 or less. They pay a higher yield than investment grade bonds because issuers have a higher perceived risk of default. Such bonds involve market risk that could force investors, including insurers, to sell the bonds when their value is low. Most states place limits on insurers' investments in these bonds. In general, because property/casualty insurers can be called upon to provide huge sums of money immediately after a disaster, their investments must be liquid. Less than 2 percent are in real estate and a similarly small percentage are in junk bonds.

KEY PERSON INSURANCE
Insurance on the life or health of a key individual whose services are essential to the continuing success of a busi-

ness and whose death or disability could cause the firm a substantial financial loss.

KIDNAPIRANSOM INSURANCE
Coverage up to specific limits for the cost of ransom or extortion payments and related expenses. Often bought by international corporations to cover employees. Most policies have large deductibles and may exclude certain geographic areas. Some policies require that the policyholder not reveal the coverage's existence.

LAW OF LARGE NUMBERS
The theory of probability on which the business of insurance is based. Simply put, this mathematical premise says that the larger the group of units insured, such as sport-utility vehicles, the more accurate the predictions of loss will be.

LIABILITY INSURANCE
Insurance for what the policyholder is legally obligated to pay because of bodily injury or property damage caused to another person.

LIFE INSURANCE
See Ordinary life insurance; Term insurance; Variable life insurance; Whole life insurance

LIMITS
Maximum amount of insurance that can be paid for a covered loss.

LINE
Type or kind of insurance, such as personal lines.

LIQUIDATION
Enables the state insurance department as liquidator or its appointed deputy to wind up the insurance company's affairs by selling its assets and settling claims upon those assets. After receiving the liquidation order, the liquidator notifies insurance departments in other states and state guaranty funds of the liquidation proceedings. Such insurance company liquidations are not subject to the Federal Bankruptcy Code but to each state's liquidation statutes.

LIQUIDITY
The ability and speed with which a security can be converted into cash.

LLOYD'S OF LONDON
A marketplace where underwriting syndicates, or mini-insurer's, gather to sell insurance policies and reinsurance. Each syndicate is managed by an underwriter who decides whether or not to accept the risk. The Lloyd's market is a major player in the international reinsurance market as well as a primary market for marine insurance and large risks. Originally, Lloyd's was a London coffee house in the 1600s patronized by shipowners who insured each other's hulls and cargoes. As Lloyd's developed, wealthy individuals, called "Names," placed their personal assets behind insurance risks as a business venture. Increasingly since the 1 990s, most of the capital comes from corporations.

LLOYDS
Corporation formed to market services of a group of underwriters. Does not issue insurance policies or provide insurance protection. Insurance is written by individual underwriters, with each assuming a part of every risk. Has no connection to Lloyd's of London, and is found primarily in Texas.

LOSS
A reduction in the quality or value of a property, or a legal liability.

LOSS ADJUSTMENT EXPENSES
The sum insurers pay for investigating and settling insurance claims, including the cost of defending a lawsuit in court.

LOSS COSTS
The portion of an insurance rate used to cover claims and the costs of adjusting claims. Insurance companies typically determine their rates by estimating their future loss costs and adding a provision for expenses, profit, and contingencies.

LOSS OF USE
A provision in homeowners and renters insurance policies that reimburses policyholders for any extra living expenses due to having to live elsewhere while their home is being restored following a disaster.

LOSS RATIO
Percentage of each premium dollar an insurer spends on claims.

LOSS RESERVES
The company's best estimate of what it will pay for claims, which is periodically readjusted. They represent a liability on the insurer's balance sheet.

MALPRAC11CE INSURANCE
Professional liability coverage for physicians, lawyers, and other specialists against suits alleging negligence or errors and omissions that have harmed clients.

MARINE INSURANCE
Coverage for goods in transit, and for the commercial vehicles that transport them, on water and over land. The term may apply to inland marine but more generally applies to ocean marine insurance. Covers damage or destruction of a ship's hull and cargo and perils include collision, sinking, capsizing, being stranded, fire, piracy, and jettisoning cargo to save other property. Wear and tear, dampness, mold, and war are not included. *(See Inland marine and Ocean marine)*

MCCARRAN-FERGUSON ACT
Federal law signed in 1945 in which Congress declared that states would continue to regulate the insurance business. Grants insurers a limited exemption from federal antitrust legislation.

MEDIATION
Nonbinding procedure in which a third party attempts to resolve a conflict between two other parties.

MEDICAL MALPRACTICE INSURANCE
See Malpractice insurance

MUTUAL HOLDING COMPANY
An organizational structure that provides mutual companies with the organizational and capital raising advantages of stock insurers, while retaining the policyholder ownership of the mutual.

MUTUAL INSURANCE COMPANY
A company owned by its policyholders that returns part of its profits to the policyholders as dividends. The insurer uses the rest as a surplus cushion in case of large and unexpected losses.

NAMED PERIL
Peril specifically mentioned as covered in an insurance policy.

NET PREMIUMS WRITTEN
See Premiums written

NON-ADMITTED ASSETS
Assets that are not included on the balance sheet of an insurance company, including furniture, fixtures, past-due accounts receivable, and agents' debt balances. (See Asset

NON-ADMITTED INSURER
Insurers licensed in some states, but not others. States where an insurer is not licensed call that insurer non-admitted. They sell coverage that is unavailable from licensed insurers within the state.

NOTICE OF LOSS
A written notice required by insurance companies immediately after an accident or other loss. Part of the standard provisions defining a policyholders responsibilities after a loss.

NUCLEARINSURANCE
Covers operators of nuclear reactors and other facilities for liability and property damage in the case of a nuclear accident and involves both private insurer's and the federal government.

OCCUPATIONAL DISEASE
Abnormal condition or illness caused by factors associated with the workplace. Like occupational injuries, this is covered by workers compensation policies. (see Workers compensation

OCCURRENCE POLICY
Insurance that pays claims arising out of incidents that occur during the policy term, even if they are filed many years later. *(See Claims-made policy)*

OCEAN MARINE INSURANCE
Coverage of all types of vessels and watercraft, for property damage to the vessel and cargo, including such risks as piracy and the jettisoning of cargo to save the property of others. Coverage for marine-related liabilities. War is excluded from basic policies, but can be bought back.

OPERATING EXPENSES
The cost of maintaining a business's property, includes insurance, property taxes, utilities and rent, but excludes income tax, depreciation and other financing expenses.

OPTIONS
Contracts that allow, but do not oblige, the buying or selling of property or assets at a certain date at a set price.

ORDINARY LIFE INSURANCE
A life insurance policy that remains in force for the policyholder's lifetime. It contrasts with term insurance, which only lasts for a specified number of years but is renewable. *(See Term insurance)*

PENSIONS
Programs to provide employees with retirement income after they meet minimum age and service requirements. Life insurers hold some of these funds. Since the 1970s responsibility for funding retirement has increasingly shifted from employers (defined benefit plans that promise workers a specific retirement income) to employees (defined contribution plans financed by employees that may or may not be matched by employer contributions). *(See Defined benefit Plan; Defined contribution plan)*

PERIL
A specific risk or cause of loss covered by an insurance policy, such as a fire, windstorm, flood, or theft. A named-peril policy covers the policyholder only for the risks named in the policy in contrast to an all-risk policy, which covers all causes of loss except those specifically excluded.

POLICY
A written contract for insurance between an insurance company and policyholder stating details of coverage.

POLICYHOLDERS'SURPLUS
The amount of money remaining after an insurers liabilities are subtracted from its assets. It acts as a financial cushion above and beyond reserves, protecting policyholders against an unexpected or catastrophic situation.

POLITICAL RISK INSURANCE
Coverage for businesses operating abroad against loss due to political upheaval such as war, revolution, or confiscation of property.

POLLUTION INSURANCE
Policies that cover property loss and liability arising from pollution-related damages, for sites that have been inspected and found uncontaminated. It is usually written on a claims-made basis so policies pay only claims presented during the term of the policy or within a specified time frame after the policy expires. *(See Claimsmade poligy)*

PREMISES
The particular location of the property or a portion of it as designated in an insurance policy.

PREMIUM
The price of an insurance policy, typically charged annually or semiannually. *(See Direct premiums; Earned premium; Unearned premium)*

PREMIUM TAX
A state tax on premiums paid by its residents and businesses and collected by insurers.

PREMIUMS IN FORCE
The sum of the face amounts, plus dividend additions, of life insurance policies outstanding at a given time.

PREMIUMS WRITTEN
The total premiums on all policies written by an insurer during a specified period of time, regardless of what portions have been earned. Net premiums written are premiums written after reinsurance transactions.

PRIMARY COMPANY
In a reinsurance transaction, the insurance company that is reinsured.

PRIMARY MARKET
Market for new issue securities where the proceeds go directly to the issuer.

PRIVATE PLACEMENT
Securities that are not registered with the Securities and Exchange Commission and are sold directly to investors.

PRODUCT LIABILITY
A section of tort law that determines who may sue and who may be sued for damages when a defective product injures someone. No uniform federal laws guide manufacturer's liability, but under strict liability, the injured party can hold the manufacturer responsible for damages without the need to prove negligence or fault.

PRODUCT LIABILITY INSURANCE
Protects manufacturers' and distributors' exposure to lawsuits by people who have sustained bodily injury or property damage through the use of the product.

PROFESSIONAL LIABILITY INSURANCE
Covers professionals for negligence and errors or omissions that injure their clients.

PROPERTY/CASUALTY INSURANCE
Covers damage to or loss of policyholders' property and legal liability for damages caused to other people or their property. Property/casualty insurance, which includes auto, homeowners and commercial insurance, is one segment of the insurance industry. The other sector is life/health. Outside the United States, property/casualty insurance is referred to as nonlife or general insurance.

PROPERTY/CASUALTY INSURANCE CYCLE
Industry business cycle with recurrent periods of hard and soft market conditions. In the 1950s and 1960s, cycles were regular with three year periods each of hard and soft market conditions in almost all lines of property/casualty insurance. Since then they have been less regular and less frequent.

RATE
The cost of a unit of insurance, usually per $1,000. Rates are based on historical loss experience for similar risks and may be regulated by state insurance offices.

RATE REGULATION
The process by which states monitor insurance companies' rate changes, done either through prior approval or open competition models. *(see Open competition states; Prior approval states)*

RATING AGENCIES
Six major credit agencies determine insurers' financial strength and viability to meet claims obligations. They are A.M. Best Co.; Duff & Phelps Inc.; Fitch, Inc.; Moody's Investors Services; Standard & Poor's Corp.; and Weiss Ratings, Inc. Factors considered include company earnings, capital adequacy, operating leverage, liquidity, investment performance, reinsurance programs, and management ability, integrity and experience. A high financial rating is not the same as a high consumer satisfaction rating.

RATING BUREAU
The insurance business is based on the spread of risk. The more widely risk is spread, the more accurately loss can be estimated. An insurance company can more accurately estimate the probability of loss on 100,000 homes than on ten. Years ago, insurers were required to use standardized forms and rates developed by rating agencies. Today, large insurers use their own statistical loss data to develop rates. But small insurers, or insurers focusing on special lines of business, with insufficiently broad loss data to make them actuarially reliable depend on pooled industry data collected by such organizations as the Insurance Services Office (ISO) which provides information to help develop rates such as estimates of future losses and loss adjustment expenses like legal defense costs.

REINSURANCE
Insurance bought by insurers. A reinsurer assumes part of the risk and part of the premium originally taken by the insurer, known as the primary company. Reinsurance effectively increases an insurers capital and therefore its capacity to sell more coverage. The business is global and some of the largest reinsurers are based abroad. Reinsurers have their own reinsurers, called retrocessionaires. Reinsurers don't pay policyholder claims. Instead, they reimburse insurers for claims paid. (See Treaty reinsurance; Facultative reinsurance

REPLACEMENT COST
Insurance that pays the dollar amount needed to replace damaged personal property or dwelling property without deducting for depreciation but limited by the maximum dollar amount shown on the declarations page of the policy.

RESERVES
A company's best estimate of what it will pay for claims.

RESIDUAL MARKET
Facilities, such as assigned risk plans and FAIR Plans, that exist to provide coverage for those who cannot get it in the regular market. Insurers doing business in a given state generally must participate in these pools. For this reason the residual market is also known as the shared market.

RETENTION
The amount of risk retained by an insurance company that is not reinsured.

RETROCESSION
The reinsurance bought by reinsurers to protect their financial stability.

RETROSPECTIVE RATING
A method of permitting the final premium for a risk to be adjusted, subject to an agreed-upon maximum and minimum limit based on actual loss experience. It is available to large commercial insurance buyers.

RETURN ON EQUITY
Net income divided by total equity. Measures profitability by showing how efficiently invested capital is being used.

RISK
The chance of loss or the person or entity that is insured.

RISK MANAGEMENT
Management of the varied risks to which a business firm or association might be subject. It includes analyzing all exposures to gauge the likelihood of loss and choosing options to better manage or minimize loss. These options typically include reducing and eliminating the risk with safety measures, buying
insurance, and self-insurance.

RISK RETENTION GROUPS
Insurance companies that band together as self-insurers and form an organization that is chartered and licensed as an insurer in at least one state to handle liability insurance.

RISK-BASED CAPITAL
The need for insurance companies to be capitalized according to the inherent riskiness of the type of insurance they sell. Higher-risk types of insurance, liability as opposed to property business, generally necessitate higher levels of capital.

SECURITIES AND EXCHANGE COMMISSION / SEC
The organization that oversees publicly-held insurance companies. Those companies make periodic financial disclosures to the SEC, including an annual financial statement (or 10K), and a quarterly financial statement (or 1 O-Q). Companies must also disclose any material events and other information about their stock.

SECURITIES OUTSTANDING
Stock held by shareholders.

SECURITIZATION OF INSURANCE RISK
Using the capital markets to expand and diversify the assumption of insurance risk. The issuance of bonds or notes to third-party investors directly or indirectly by an insurance or reinsurance company or a pooling entity as a means of raising money to cover risks. *(See Catastrophe bonds)*

SELF-INSURANCE
The concept of assuming a financial risk oneself, instead of paying an insurance company to take it on. Every policyholder is a self-insurer in terms of paying a deductible and co-payments. Large firms often selfinsure frequent, small losses such as damage to their fleet of vehicles or minor workplace injuries. However, to protect injured employees state laws set out requirements for the assumption of workers compensation programs. Self-insurance also refers to employers who assume all or part of the responsibility for paying the health insurance claims of their employees. Firms that self insure for health claims are exempt from state insurance laws mandating the illnesses that group health insurers must cover.

SEVERITY
Size of a loss. One of the criteria used in calculating premiums rates.

SOFT MARKET
An environment where insurance is plentiful and sold at a lower cost, also known as a buyers' market. *(See Property/casualty insurance cycle)*

SOLVENCY
Insurance companies' ability to pay the claims of policyholders. Regulations to promote solvency include minimum capital and surplus requirements, statutory accounting conventions, limits to insurance company investment and corporate activities, financial ratio tests, and financial data disclosure.

SPREAD OF RISK
The selling of insurance in multiple areas to multiple policyholders to minimize the danger that all policyholders will have losses at the same time. Companies are more likely to insure perils that offer a good spread of risk. Flood insurance is an example of a poor spread of risk

because the people most likely to buy it are the people close to rivers and other bodies of water that flood. *(See Adverse selection)*

STACKING

Practice that increases the money available to pay auto liability claims. In states where this practice is permitted by law, courts may allow policyholders who have several cars insured under a single policy, or multiple vehicles insured under different policies, to add up the limit of liability available for each vehicle.

STATUTORY ACCOUNTING PRINCIPLES / SAP

More conservative standards than under GAAP accounting rules, they are imposed by state laws that emphasize the present solvency of insurance companies. SAP helps ensure that the company will have sufficient funds readily available to meet all anticipated insurance obligations by recognizing liabilities earlier or at a higher value than GAAP and assets later or at a lower value. For example, SAP requires that selling expenses be recorded immediately rather than amortized over the life of the policy. *(See GAAP accounting; Admitted assetg)*

STOCK INSURANCE COMPANY

An insurance company owned by its stockholders who share in profits through earnings distributions and increases in stock value.

STRUCTURED SETTLEMENT

Legal agreement to pay a designated person, usually someone who has been injured, a specified sum of money in periodic payments, usually for his or her lifetime, instead of in a single lump sum payment. *(See Annuity*

SUBROGATION

The legal process by which an insurance company, after paying a loss, seeks to recover the amount of theloss from another party who is legally liable for it.

SUPERFUND

A federal law enacted in 1980 to initiate cleanup of the nation's abandoned hazardous waste dump sites and to respond to accidents that release hazardous substances into the environment. The law is officially called the Comprehensive Environmental Response, Compensation, and Liability Act.

SURETY BOND

A contract guaranteeing the performance of a specific obligation. Simply put, it is a three-party agreement under which one party, the surety company, answers to a second party, the owner, creditor or "obligee," for a third party's debts, default or nonperformance. Contractors are often required to purchase surety bonds if they are working on public projects. The surety company becomes responsible for carrying out the work or paying for the loss up to the bond "penalty" if the contractor fails to perform.

SURPLUS

The remainder after an insurer's liabilities are subtracted from its assets. The financial cushion that protects policyholders in case of unexpectedly high claims. *(See Capital; Risk-based caw Ual)*

SURPLUS LINES

Property/casualty insurance coverage that isn't available from insurers licensed in the state, called admitted companies, and must be purchased from a non-admitted carrier. Examples include risks of an unusual nature that require greater flexibility in policy terms and conditions than exist in standard forms or where the highest rates allowed by state regulators are considered inadequate by admitted companies. Laws governing surplus lines vary by state.

SWAPS

The simultaneous buying, selling or exchange of one security for another among investors to change maturities in a bond portfolio, for example, or because investment goals have changed.

TERM INSURANCE

A form of life insurance that covers the insured person for a certain period of time, the "term" that is specified in the policy. It pays a benefit to a designated beneficiary only when the insured dies within that specified period which can be one, five, 10 or even 20 years. Term life policies are renewable but premiums increase
with age.

TERRITORIAL RATING

A method of classifying risks by geographic location to set a fair price for coverage. The location of the insured may have a considerable impact on the cost of losses. The chance of an accident or theft is much higher in an urban area than in a rural one, for example.

TERRORISM COVERAGE

Included as a part of the package in standard commercial insurance policies before September 11, 2001 virtually free of charge. Since September 11, terrorism coverage prices have increased substantially to reflect the current risk.

THIRD-PARTY COVERAGE

Liability coverage purchased by the policyholder as a protection against possible lawsuits filed by a third party. The insured and the insurer are the first and second parties to the insurance contract. *(See First-party coverage)*

TORT

A legal term denoting a wrongful act resulting in injury or damage on which a civil court action, or legal proceeding, may be based.

TORT LAW

The body of law governing negligence, intentional interference, and other wrongful acts for which civil action can be brought, except for breach of contract, which is covered by contract law.

TORT REFORM
Refers to legislation designed to reduce liability costs through limits on various kinds of damages and through modification of liability rules.

TOTAL LOSS
The condition of an automobile or other property when damage is so extensive that repair costs would exceed the value of the vehicle or property.

TRANSPARENCY
A term used to explain the way information on financial matters, such as financial reports and actions of companies or markets, are communicated so that they are easily understood and frank.

TREASURY SECURITIES
Interest-bearing obligations of the U.S. government issued by the Treasury as a means of borrowing money to meet government expenditures not covered by tax revenues. Marketable Treasury securities fall into three categories - bills, notes and bonds. Marketable Treasury obligations are currently issued in book entry form only; that is, the purchaser receives a statement, rather than an engraved certificate.

TREATY REINSURANCE
A standing agreement between insurers and reinsurers. Under a treaty each party automatically accepts specific percentages of the insurers business.

UMBRELLA POLICY
Coverage for losses above the limit of an underlying policy or policies such as homeowners and auto insurance. While it applies to losses over the dollar amount in the underlying policies, terms of coverage are sometimes broader than those of underlying policies.

UNDERINSURANCE
The result of the policyholder's failure to buy sufficient insurance. An underinsured policyholder may only receive part of the cost of replacing or repairing damaged items covered in the policy.

UNDERWRITING
Examining, accepting, or rejecting insurance risks and classifying the ones that are accepted, in order to charge appropriate premiums for them.

UNDERWRITING INCOME
The insurer's profit on the insurance sale after all expenses and losses have been paid. When premiums aren't sufficient to cover claims and expenses, the result is an underwriting loss. Underwriting losses are typically offset by investment income.

UNEARNED PREMIUM
The portion of a premium already received by the insurer under which protection has not yet been provided. The entire premium is not earned until the policy period expires, even though premiums are typically paid in advance.

UNINSURABLE RISK
Risks for which it is difficult for someone to get insurance. *(See Insurable risk)*

UNIVERSAL LIFE INSURANCE
A flexible premium policy that combines protection against premature death with a type of savings vehicle, known as a cash value account, that typically earns a money market rate of interest. Death benefits can be changed during the life of the policy within limits, generally subject to a medical examination. Once funds accumulate in the cash value account, the premium can be paid at any time but the policy will lapse if there isn't enough money to cover annual mortality charges and administrative costs.

VALUED POLICY
A policy under which the insurer pays a specified amount of money to or on behalf of the insured upon the occurrence of a defined loss. The money amount is not related to the extent of the loss. Life insurance policies are an example.

VARIABLE ANNUITY
See Annuity

VARIABLE LIFE INSURANCE
A policy that combines protection against premature death with a savings account that can be invested in stocks, bonds, and money market mutual funds at the policyholder's discretion.

VOID
A policy contract that for some reason specified in the policy becomes free of all legal effect. One example under which a policy could be voided is when information a policyholder provided is proven untrue.

VOLATILITY
A measure of the degree of fluctuation in a stock's price. Volatility is exemplified by large, frequent price swings up and down.

VOLUME
Number of shares a stock trades either per day or per week.

WAIVER
The surrender of a right or privilege. In life insurance, a provision that sets certain conditions, such as disablement, which allow coverage to remain in force without payment of premiums.

WAR RISK
Special coverage on cargo in overseas ships against the risk of being confiscated by a government in wartime. It

is excluded from standard ocean marine insurance and can be purchased separately. It often excludes cargo awaiting shipment on a wharf or on ships after 15 days of arrival in port.

WEATHER DERIVATIVE
An insurance or securities product used as a hedge by energy-related businesses and others whose sales tend to fluctuate depending on the weather.

WEATHER INSURANCE
A type of business interruption insurance that compensates for financial losses caused by adverse weather conditions, such as constant rain on the day scheduled for a major outdoor concert.

WHOLE LIFE INSURANCE
The oldest kind of cash value life insurance that combines protection against premature death with a savings account. Premiums are fixed and guaranteed and remain level throughout the policy's lifetime.

WORKERS COMPENSATION
Insurance that pays for medical care and physical rehabilitation of injured workers and helps to replace lost wages while they are unable to work. State laws, which vary significantly, govern the amount of benefits paid and other compensation provisions.

WRITTEN PREMIUMS
See Premiums written

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