

of these differences, each function is closely linked to all the other functions, and none is performed in a vacuum. The interaction of these core and other functions is vital to an insurer's survival and success.

Core Functions

Although insurers may use varying organizational structures, three core functions exist within the structure of a typical insurer. These core functions—marketing and distribution, underwriting, and claims—form the basis of an insurer's business.

Marketing and Distribution

Marketing and distribution involves determining what products or services customers want and need, advertising the products (communicating their value to customers), and delivering them to customers. The marketing and distribution function contributes significantly to an insurer's goals of earning a profit and meeting customers' needs. The insurer cannot make a profit if it does not provide the products and services customers need.

The goals of the marketing and distribution function must be balanced with other insurer goals. For example, the objectives of the marketing and distribution function should support the insurer's overall growth and customer retention goals. If the insurer has targeted specific regions or lines of business as growth areas, the marketing and distribution function needs to align its efforts for overall growth and customer retention. An imbalance between the marketing and distribution function's goals and the goals of any other department within the organization may reduce the efficiency of the insurer.

Underwriting

The process of selecting insureds, pricing coverage, determining insurance policy terms and conditions, and then monitoring the underwriting decisions made.

Book of business

A group of policies with a common characteristic, such as territory or type of coverage, or all policies written by a particular insurer or agency.

Underwriting guidelines (underwriting guide)

A written manual that communicates an insurer's underwriting policy and that specifies the attributes of an account that an insurer is willing to insure.

Adverse selection

In general, the tendency for people with the greatest probability of loss to be the ones most likely to purchase insurance.

Underwriting

Once the marketing and distribution function has developed a relationship with potential customers, it is the job of the **underwriting** function to determine whether and under what conditions the insurer is willing to provide insurance products and services to the potential customers. The goal of underwriting is to write a profitable **book of business** for the insurer, which supports the insurer's profit goal. This is accomplished by developing appropriate **underwriting guidelines**, which underwriters use to evaluate risk. Underwriting serves both insurers and insurance buyers by helping the insurer avoid **adverse selection**. Avoiding adverse selection assists an insurer with remaining profitable and keeping premiums reasonable for insureds.

Claims

An insurance policy is a promise to make a payment to, or on behalf of, the insured if a covered event occurs. The purpose of the claims function is to fulfill the insurer's promise. To that end, the claims function is staffed by employees who are trained in the skills necessary to evaluate and settle claims



and to negotiate or litigate the settlement of claims by or against insureds through the claim handling process.

The claim handling process is designed to achieve a fair settlement in accordance with the applicable insurance policy provisions. Claim settlements that exceed the amount payable under the policy increase the cost of insurance for all insureds. Settlements that are less than the coverage amount deprive the insured of benefits to which he or she is entitled under the insurance policy. Insurers have developed expertise in claim handling in all categories of loss exposures. Therefore, many insurance industry practitioners view claim handling as the primary service that insurers provide.

Supporting Functions

To support the core functions of marketing and distribution, underwriting, and claims, insurers provide a variety of supporting functions, including risk control, premium auditing, actuarial functions, reinsurance, and information technology. Although most insurers are able to provide these supporting functions in-house, many are available through third-party providers as well. These functions are not only necessary to the efficient operation of insurers, but are also used by a variety of other risk financing organizations, such as captives, pools, risk retention groups, and self-insurers:

- **Risk control**—An insurer’s risk control function provides information to the underwriting function to assist in selecting and rating risks. The risk control function also works with commercial insureds to help prevent losses and to reduce the effects of losses that cannot be prevented. Insurers may also market their risk control services as a stand-alone product to third parties who have not purchased insurance policies from the insurer.
- **Premium auditing**—Although the premium for many types of insurance is known and guaranteed in advance, the premium is variable for some lines of insurance and cannot be precisely calculated until after the end of the policy period. For example, the premium for workers compensation insurance policies is calculated using wages paid during the policy period. Other commercial insurance policies may use rating variables such as sales or revenue to calculate the premium. Premium auditors ensure equitable treatment of insureds by reviewing the insureds’ records to obtain accurate information on rating variables.
- **Actuarial**—Actuarial functions include calculating insurance rates, developing rating plans, estimating loss reserves, and providing predictive modeling services. The actuarial function also conducts sensitivity analysis to determine the financial security of the insurer. Furthermore, the actuarial function coordinates with the accounting and finance functions in developing reports for regulators to ensure that the insurer is adhering to all regulatory requirements.
- **Reinsurance**—When an insurer accepts a risk that is larger than it is willing or able to support, it can transfer all or part of that risk to other



insurers through reinsurance transactions. Many insurers have a separate reinsurance department that arranges reinsurance and maintains reinsurance agreements.

- Information technology—The information technology function provides the infrastructure that supports all of an insurer's internal and external communications. Insurers use information technology to conduct their daily operations, manage marketing efforts, underwrite policies, track investments, and pay claims. Information systems are especially important to insurers because of the vast amounts of data associated with insurance operations.

Other Common Functional Areas

In addition to the core and supporting functions, insurers perform a host of other functions or outsource them to an external organization. Some common functions include investments, accounting and finance, customer service, legal and compliance, human resources, and special investigation units (SIUs).

- Investments—An insurer's investment operations enable it to earn investment income on the funds generated by its underwriting activities. This investment income enables the insurer to reduce the premium that it must charge in exchange for the risks it assumes. The nature of the insurance risks that an insurer assumes is a factor in determining the types of investments it acquires. For example, liability losses are paid out over a longer period than property losses. Therefore, liability policies can support more long-term investments, such as corporate bonds with long maturity periods, whereas property policies need to be supported by more liquid and short-term investments. An insurer that assumes only moderate underwriting risks might be able to assume greater investment risks with potentially higher investment yield, whereas an insurer that assumes high underwriting risks might need to be more conservative in its investment strategy.
- Accounting and finance—The primary responsibilities of the accounting and finance function are to ensure that the organization has funds to meet its obligations and to fairly and fully disclose the financial position of the insurer in conformance with generally accepted accounting principles (GAAP). Insurers, like all other types of businesses, use accounting to record, analyze, and summarize their financial activities and status. Once the information has been accumulated, an accountant must evaluate, interpret, and communicate the results to all stakeholders.
- Customer service—The customer service function can include an array of responsibilities that vary among insurers. Some insurers have customer service personnel assigned to specific work areas such as customer billing, claims services, underwriting support, agency relations or billing, agency technology support, customer Internet support, and information technology support services for internal users. The customer service function

