Determining an Insurance Company's Financial Strength and Stability

There are three important indicators that you can look at to help determine an insurance company's financial strength and stability. These factors are net income, combined ratio and policyholder surplus.

Net income is a company's total earnings. It is calculated by subtracting total expenses from total revenues. If the number is a positive, there is profit. If the number is a negative, there is a loss.

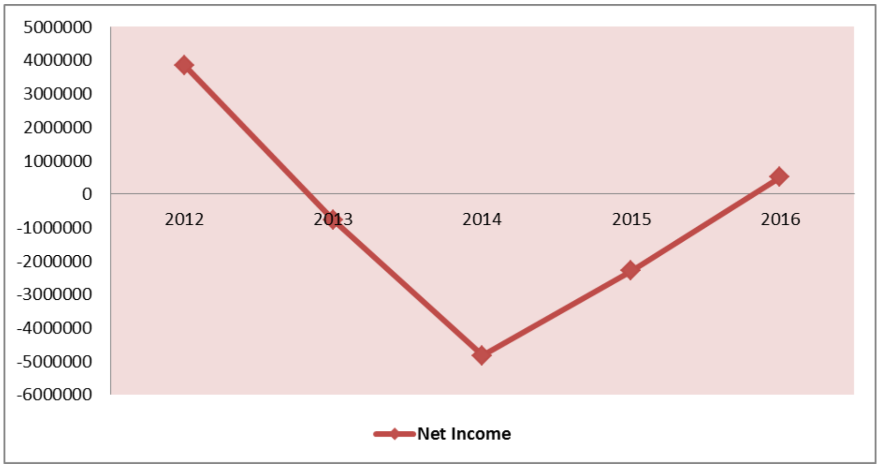
Combined ratio is a measure used by insurance companies to help determine their profitability. The ratio is calculated by taking the total of both losses and expenses and then dividing them by the premium. To make it a bit easier to understand, all you really need to know is that a ratio below 100 percent indicates the company is making an underwriting profit while a ratio above 100 percent means the company is paying out more in claims than the premiums it is taking in.

Policyholder surplus is the difference between an insurance company's assets and its liabilities. In the simplest of terms, it's an insurance company's net worth.

A Case in Point

There is currently an insurance company offering malpractice policies to CRNAs at unusually low premiums. Let's look at these indicators for this particular company.

In 2012, this company had a net income of $3,836,000. In 2013, 2014, 2015, and 2016 this company's net income was -$788,000; -$4,834,000; -$2,297,000; and $506,000 respectively. So, for the four years of 2013, 2014, 2015, and 2016 this company lost a total of $7,415,000.



In 2012, this company's combined ratio was 85.5 percent; that means the company was making an underwriting profit. In 2013, 2014, and 2015, the company's combined ratios were 115.3 percent, 135.7 percent and 130.8 percent respectively. Since the combined ratios for 2013, 2014 and 2015 were greater than 100 percent, this company was not making an underwriting profit. For 2015, the company was spending over $1.30 for every $1 in premium it took in. As a point of reference, the average combined ratio for the malpractice industry in 2015 was 104.4 percent.

	Combined Ratio	Industry Average
2012	85.5	93.9
2013	115.3	92.8
2014	135.7	92.3
2015	130.8	104.5
2016	156.7	102.9

In 2012, this company had $20,490,000 in policyholder surplus. In 2013, 2014, 2015, and 2016 this company's policyholder surplus was $20,862,000; $13,498,000; $9,736,000; 7,666,000 respectively. That means over a four-year period from 2012 to 2016, this company's net worth dropped by $12,824,000, or more than 63 percent.