

Introduction to Financial Management in Insurance

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Designed as a quick-reference guide for students, new hires, or anyone needing a concise overview.

1. Core Objectives of Financial Management in Insurance

Objective	What It Means	Why It Matters
Profitability	Generate surplus after claims, expenses, and taxes.	Ensures the insurer can grow, pay dividends, and meet regulatory capital requirements.
Liquidity	Maintain enough cash and liquid assets to pay claims promptly.	Protects policyholders and preserves market confidence.
Solvency	Keep assets > liabilities (including a safety margin).	Required by regulators; prevents insolvency and protects policyholder interests.
Risk Management	Identify, measure, and control underwriting, market, credit, and operational risks.	Reduces volatility of earnings and supports stable long-term performance.
Value Creation	Increase shareholder/equity holder wealth (e.g., ROE, ROA).	Aligns management incentives with owners and attracts capital.

2. Key Financial Statements in Insurance

Statement	Primary Components	Typical Insurance? Specific Items
Balance Sheet (Statement of Financial Position)	Assets, Liabilities, Equity	• Technical reserves (IBNR, claim reserves) • Unearned premium reserves • Reinsurance recoverables

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Statement	Primary Components	Typical Insurance? Specific Items
Income Statement (Statement of Operations)	Revenue, Expenses, Net Income	• Earned premiums (net of reinsurance) • Policy acquisition costs • Losses and loss adjustment expenses (LAE) • Cash paid for claims
Cash Flow Statement	Operating, Investing, Financing cash flows	• Premiums received • Reinsurance premiums paid/received
Statement of Changes in Equity	Opening equity, net income, dividends, other comprehensive income	• Impact of actuarial gains/losses • Capital injections or withdrawals

3. Fundamental Ratios & Metrics

Category	Ratio	Formula	Interpretation
Profitability	Loss Ratio	$(\text{Incurred losses} \div \text{Earned premiums})$	Lower = better underwriting discipline.
	Expense Ratio	$(\text{Underwriting expenses} \div \text{Earned premiums})$	Shows cost efficiency.
	Combined Ratio	$\text{Loss Ratio} + \text{Expense Ratio}$	$< 100\%$ = underwriting profit.
Liquidity	Cash-to-Claims Ratio	$(\text{Cash \& cash equivalents} \div \text{Claims payable})$	Ability to meet near-term claim obligations.
Solvency	Solvency Ratio	$(\text{Eligible capital} \div \text{Required capital})$	> 1.0 indicates regulatory compliance.
	Risk-Based Capital (RBC)	$(\text{Total adjusted capital} \div \text{Total RBC})$	Used in many jurisdictions to gauge capital adequacy.

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Category	Ratio	Formula	Interpretation
Investment Performance	Investment Yield	$\frac{\text{Investment Income}}{\text{Average invested assets}}$	Returns generated on the investment portfolio.
	Return on Equity (ROE)	$\frac{\text{Net income}}{\text{Average shareholders' equity}}$	Profitability for owners.
Return Measures	Return on Assets (ROA)	$\frac{\text{Net income}}{\text{Average total assets}}$	Overall efficiency of asset use.

4. The Insurance Value Chain & Financial Management Touchpoints

1. Product Design & Pricing

- Actuarial models ? premium rates.
- Financial managers assess profitability thresholds and capital impact