How are Premiums Determined?

Before examining specific lines of insurance, it's important to understand how carriers determine a policy's premiums. These figures represent the amount of risk an insurer accepts on behalf of a client, and change based on an underwriter's belief of how likely each client will make a claim and how much those claims will cost.

Policyholders control some of the factors that can influence premiums, including risk management plans, selecting policy limits and deductibles, and claims history). However, many external factors can drive insurance rates up or down:

- **The cost of reinsurance**—Simply put, reinsurance is coverage for insurance companies. Carriers often buy reinsurance for risks they can't or don't wish to retain fully, including those for severe weather events like hurricanes and wildfires. As a result, reinsurance helps to stabilize the premiums for regular businesses by making it less of a risk for insurance carriers to write a policy. However, insurers often shift the price for reinsurance to their commercial insurance policyholders, raising their rates.
- **Inflation**—Insurers will often adjust premiums to keep pace with inflation. For 2019, the inflation rate across North America is expected to remain steady.
- **Investment income**—Nearly every insurance carrier uses the funds it receives from premiums to invest in other markets, such as real estate and securities that accumulate interest. If these other investments generate large returns, carriers may be more likely to offer lower insurance rates.
- **Underwriting profitability**—Insurers use combined ratios to measure their underwriting profits. These figures are calculated by dividing the sum of incurred losses and operating expenses by premiums. A combined ratio of 100 per cent represents a level of total equality between losses and the number of policies an insurer is covering, and a higher or lower ratio respectively means that a carrier is losing or making money. Although the average combined ratio approached 100 per cent at the end of 2018, most insurance carriers remained profitable.

Insurers use combined ratios to measure their profits from their insurance policies, and are calculated with this formula:

$$\frac{\text{Operating expenses} + \text{Losses over a specific time period}}{\text{Premiums collected over the same period of time}}$$