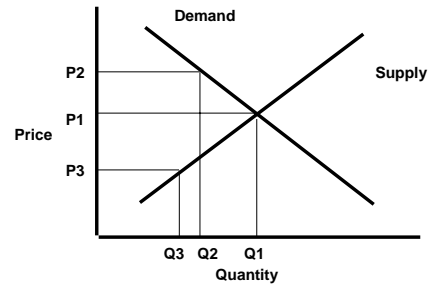


INSU 2500 Chapter 6

Feb. 16, 2006

The Law of Supply and Demand



4

The Insurance Market

Three Major Players:

1. **Sellers:** insurers, agents and brokers.
2. **Buyers:** almost everyone.
3. **Government/regulators.**
 - Courts
 - Commissioner
 - Laws
 - » Mandatory purchase of liability auto insurance.

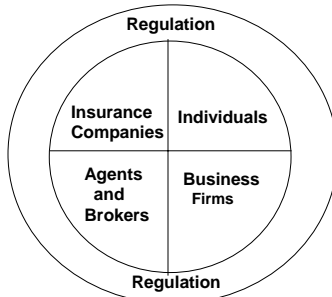
2

Supply-Demand

- **Monopoly:**
 - Prices are higher than the equilibrium price.
 - Consumers are hurt because they are paying more.
 - Consumers are hurt because some cannot afford products/services at P₂.
- **Non-monopoly:**
 - Prices are lower than the equilibrium price.
 - Consumers are still hurt because of short supplies.
 - Providers could be in financial distress if prices remain low.

5

Buyers, Sellers, and Regulators



3

Insurance Industry Critics

Critics of the Industry Charged

- **Collusion**
 - leading to higher prices and monopoly type pricing.
- **Bad business practices**
 - leading to wasted dollars and therefore higher prices.
- **Inadequate rate regulation**
 - lack of sufficient state oversight.
- **Irresponsible investment practices**
 - Taking too much risk on their investment portfolios.

6

Insurance Industry Response

Costs have gone up due to:

- Increased medical costs, automobile repair costs, and legal expenses.
- More thefts, accidents, and insurance fraud.
- **Courts imposing more frequent and higher punitive awards.**
- Social inflation - due to liberal legal conclusions.
- Investment rates of return are historically low

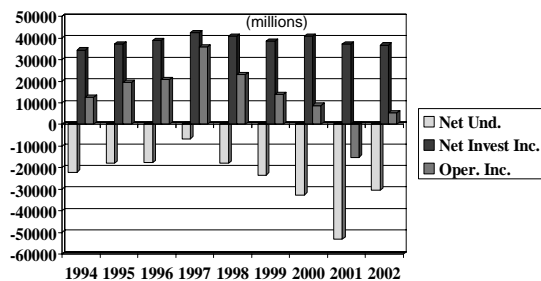
7

How AIP Works

- Insurers voluntarily accept a **proportionate** number of applications from the “unwanted” drivers.
 - If an insurer provides 10% of the state’s auto insurance, it is required to accept 10% of the bad drivers.

10

Operating Results: Property/Casualty Insurers



8

FAIR Plans

- Mandate provision of property insurance in inner cities areas.
- FAIR plans guarantee an inspection of a person’s property. The owner is given a list of improvements that must be made to make the property insurable.
 - FAIR plans have lost money in most states in most years.
- **Subsidization** occurs
 - Who is bearing all the costs?

11

Automobile Insurance Plans

- **Assigned risk automobile insurance plans** provide insurance for poor (bad) drivers who are no longer accepted by the voluntary market.
- Some subsidization occurs to the extent that inadequate rates are charged, and companies are forced to assume some of this business.
- Joint Underwriting Association (JUA):
 - Finance/subsidize a pool of bad drivers.

9

The Insurance Consumer

1. **The insurance consumer is not well informed because of:**
 - a. The cost of obtaining information
 - b. The legal complexity of the contract – industry explains that this is a necessity under our legal system.
2. **Inability** to ask the right questions and understand technical answers – this general leads to poor information and unimproved products because of the lack of ability to discriminate.

12

Industrial Organization Theory

“The more informed the consumer, the higher the quality of information that will be provided by the producer. If uninformed, producer will maintain the status quo and not provide the information for consumers to differentiate based on real facts.”

13

Selecting a Good Insurer

- **Financial strength**
 - A.M. Best Company (longest history of evaluating insurers).
 - Standard and Poors
 - Moody’s Investor’s Services
 - Duff & Phelps
 - Weiss Research (objective)
- **Service and loss settlement practices** very important considerations.

16

Insurance Consumer Choices

- **The Company**
 - Financial Strength (most important)
 - Service and loss settlement practices
- **The Policy**
 - Meets needs
 - **Proper** amount of coverage.
 - The right price
 - Lowest price not necessarily the best price!
- **The Agent**
 - Trust and understand
 - Professional designations and education

14

Financial Ratings Firms

- The ratings firms may not agree on a specific insurance company’s merits.
- Even ratings firms that historically have been right (or wrong) about the insurers they rate, can and have made mistakes.
- One letter grade cannot accurately sum up an insurance company’s operations. Slight differences in letter grades probably do not make a sound basis for choosing one insurer over another.

17

PRACTICAL INSURANCE SHOPPING: One Possible Approach

- Know which policy and amount of coverage you need.
- Call several insurance agents for quotes.
 - Write down ALL information they give you, including:
 - Type of policy quoted
 - Coverage limits, total premium, any discounts you were given, and premium payment options
 - Specific name of insurer that will be providing coverage
- Choose your INSURER first.
 - Check financial ratings in the library and via the TDI
 - A.M. Best
 - Standard & Poor
 - Duff & Phelps
 - Moody’s
 - Weiss
 - Call the TDI for complaint history of insurer
 - Evaluate the company’s reputation for service
 - Eliminate any insurers (and their agents) that are unacceptable
- From the insurers you are interested in, evaluate the agents.
 - Want a trustworthy, capable agent who provides good service!
 - You like Insurer X but not the agent who gave you the quote? Check a phone book for other agents who represent the insurer.
 - Talk to the agents over the phone. Be sure you are comfortable with the agent.
- Find the price that suits you AFTER you have found the right insurer and agent!

15

Financial Ratings Firms

- Companies with high ratings can sell policies that are not the most financially and contractually efficient choices.
- Ratings are estimates and the ratings provide no guarantee of the future.

18

Selecting a Good Insurer

- Fairness and promptness in processing claims and providing service before and after the loss is important. Also service before and after the loss may be valued.
- Texas Dept. of Insurance
- Other information is available from Consumer Reports and a variety of business and consumer publications.

19

Choosing an Agent

- You like Insurer X but not the agent who gave you the quote? Check a phone book for other agents who represent the insurer.
- Talk to the agent over the phone. Be sure you are comfortable with the agent.

22

Selecting a Good Insurer

1. Check the financial ratings in the library and via the TX Dept. of Insurance (www.tdi.state.tx.us).
2. Call the TDI for complaint history of the insurer.
3. Evaluate the company's reputation for service.
4. Eliminate any insurers (and their agents) that are unacceptable.

20

Choosing the Policy

- A function of needs. Until one has carefully analyzed the needs the policy can't be intelligently chosen.
- Should be read, understood and conditions complied with. Good agents can offer valuable advice.

23

Selecting a Good Agent/Broker

- Somebody you can trust and understand. Someone who can demonstrate knowledge. Somebody who is highly recommended by respected friends or acquaintances.
- Professional designations: **CPCU**, **CFP** and **CLU**.
- E-commerce and buying insurance products. Just because a company / agent is represented on the Internet is not proof of being reputable.

21

Choosing the proper amount of insurance

- Insure first those exposures to loss **most likely** to cause the **greatest** amount of damage.
- **Never** expose to loss more than you can afford to lose. This rule means that if you cannot afford to lose the value of the asset, there is a requirement to insure or handle appropriately the exposure.
- **Never** risk a great loss (a high percentage of your assets) in ex-change for a small gain (saving the insurance premium).

24

Paying the Right Price

- **Lowest priced insurance contract** may **not** necessarily be the best alternative if it comes from a **financially weak insurer**, or one that provides only slight service, or one that is known for resisting or shorting payment on legitimate claims.
- Also, if **nonstandard insurance** is offered for the lowest price it may not provide the full set of protection needed by an insured.
- Insurance is merely a promise to provide a claims payment in the **future**. So the promise is only as good as the ability to meet those financial obligations.

25

Texas Guaranty Funds

- Two funds (one for P&C and one for L&H)
- Fund pays:
 - Valid claims left unpaid, but only up to the limits of the policy and certain maximum set by the fund (for example, \$300,000 on a homeowner claim or \$30,000 on an auto claim).
 - Partial refunds of unused premiums, up to \$25,000.

28

The Courts

- If the consumer feels promises not delivered, consumer may take the case to court.
- There are legitimate reasons for insurers to deny claims.
- **Doctrine of stare decisis** – *common law*. If a prior case with the same facts are being litigated, the court is obligated to decide the same way. Means: let the decision stand. If the facts are somewhat different, the court conclusion can deviate based on the new facts.
- **Doctrine of reasonable expectations** – could argue that the consumer had the reasonable expectations of coverage based on the insurer's actions, etc. This is why the words "comprehensive" and "all risk" have been eliminated from insurer policy²⁶ construction and literature.

How Guaranty Funds Work

- If Commissioner finds insurer is not salvageable, he orders that company be liquidated.
- May get another insurer to take over policies of the defaulting insurer.
- The fund pays any debts remaining, and then becomes a creditor of the default insurer.

29

Regulation in TEXAS

- **The TX Dept. of Insurance (TDI)**
 - **Governor** appoints the commissioner.
 - Who is the current commissioner?
 - José Montemayor
 - Elton Bomer is the previous commissioner.
 - Commissioner enforces insurance laws and manages the TDI.

27

How Guaranty Funds Work

- If the policyholder is not fully reimbursed by the fund, the he/she becomes a creditor of the insurer also.
- Money for the fund is obtained from other insurers in the same line of insurance:
 - Assessments based on market share, but
 - Insurers do receive premium tax credits.

30

Other Activities of the TDI

- Handle complaints
- Educate the public
- Investigate any insurance fraud
- Maintain a web site to provide on-line information

31

Question 3

The book stated the most important choice a consumer must make when purchasing insurance is:

- a. The lowest price.
- b. The most coverage available.
- c. Coverage from a company of unquestioned solvency.
- d. Coverage from a company with the widest array of policy alternatives.

34

Question 1

All the following criteria are specified in the model for perfect competition **except**:

- a. Government regulation.
- b. Numerous independent sellers.
- c. Numerous well-informed buyers.
- d. Freedom of entry and exit.

32

Question 4

Stare decisis means:

- a. All things considered.
- b. To stand by decisions.
- c. Innocent parties prevail.
- d. It is impolite to stare.

35

Question 2

To make automobile insurance available to high-risk drivers, various states have used each of the following approaches **except**:

- a. JUAs.
- b. Federal mandatory plans.
- c. Assigned risk plans.
- d. Auto insurance plans.

33

Question 5

The chapter describes all the following parties as participants in the insurance market **except** (easy):

- a. insurance buyers
- b. insurance companies
- c. government regulators
- d. the Federal Reserve

36

Question 6

Insurance consumers can get information about the financial strength of insurance companies from:

- a. the Federal Reserve
- b. financial ratings firms
- c. credit information bureaus
- d. public policy organizations (PPOs)

37

Homework

- Read Chap. 7
- Attempt Chap. 6 Review Questions on pp. 120 of textbook.

40

Question 7

Which of the following designations is cannot be earned by insurance agents?

- a. CPU
- b. CLU
- c. CPCU
- d. CFP

38

Question 8

In most states the insurance commissioner is:

- a. elected
- b. impeached
- c. appointed by the Governor
- d. appointed by the President

39