

INSU 2500 Chapter 4

January 31, 2006

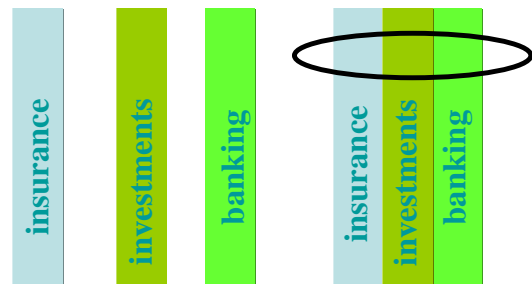
Gramm-Leach-Bliley Act

- a.k.a The Financial Services Reform Act of 1999.
- The act effectively eliminates the **Glass-Steagall Act** and allows convergence of banks and insurers into a – so-called - financial services industry. The Act has the potential of reshaping all of the organizations involved in the banking, investing and insuring industry.

The Glass-Steagall Act

- Glass-Steagall passed after the Great Depression regulated banks. Built a wall around banks so they could not provide other financial services including insurance products.
 - Why?
 - Wall built due to bank failures and risky activities such as investment banking, underwriting insurance and raising capital.

The GLB Effect



GLB Act

Impact of Bill

Removed Depression Barriers

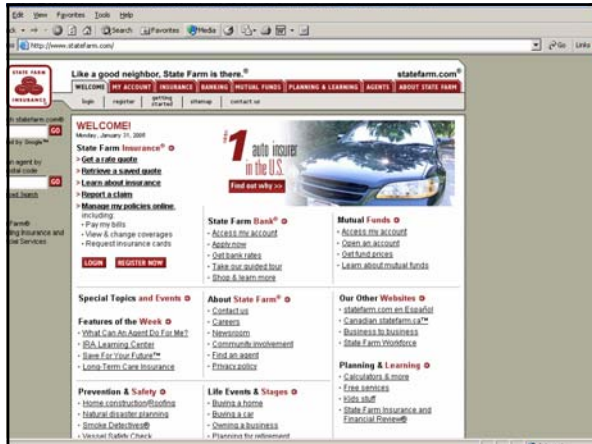
Financial Supermarket

Banks/Insurance/Brokers

Revised the Regulatory Landscape

The Financial Services Industry

- Holding companies are created.
 - Examples: State Farm, AllState, Wells Fargo,...
- Individual states supervise insurance companies.
- Federal Government oversees banks and securities firms.



The Largest FS Companies (Revenues)

8. Citigroup
10. AIG (American International Group)
14. Berkshire Hathaway, Inc.
18. State Farm
24. Bank of America
26. JP Morgan
36. MetLife

Important Types of Insurance Companies

- A single insurance company cannot sell both life and non-life insurance.
 - State Laws
- Multiple-line Insurers
 - Property insurers
- Insurance holding companies
 - Can combine both life and non-life insurance operations.

Stock Insurance Company

- Objective: Profit
- Owners of the company are shareholders.
- Many are listed in the NASDAQ.
- The largest stock insurance firms are listed on the New York Stock Exchange (NYSE).
 - Prudential, MetLife, AIG, John Hancock...

Mutual Insurance Companies

- Nonprofit corporations (does not mean charitable orgs!).
- Owners are the policy-holders insured by the corporation.
- Corporate governance works the same way as that of stock insurance companies.
 - Board of directors
 - Management
- Policyholders also vote on other issues.

Different Types of Mutual Insurers

- **Advance Premium Mutual**
 - Most important; high market share/volume.
 - How does it work?
- **Assessment Mutual**
 - How is this different from APM??
- **Factory Mutual**
 - Loss prevention services; highly protected risk
- **Perpetual Mutual**
 - History!
 - A large initial premium payment.

Demutualization

- The process of converting a mutual company to a stock form.
- **Advantages:**
 - There is a limit on the amount of participating dividends a mutual company may deduct for tax calculation purposes.
 - The need for more capital and flexibility.
 - The desire to be competitive internationally and be a corporate takeover target.

Demutualization

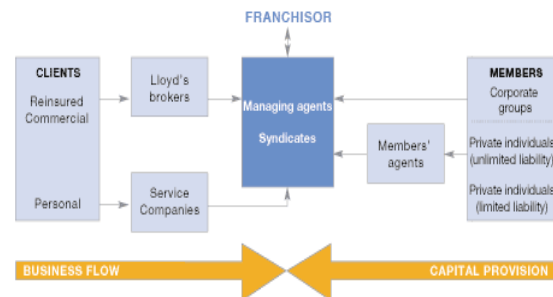
Problems:

1. How do you calculate the value of the mutual to distribute its value to the policy owners?
2. Once demutualization occurs, the company then must perform based on its stock price which may be a foreign concept to the organization.

Lloyd's of London

- Not an insurance company, but an insurance trading marketplace.
- A society of members, both corporate and individual, who underwrite in syndicates on whose behalf professional underwriters accept risk
 - Works in a way similar to the NYSE

Lloyd's of London



The Reciprocal Exchange

Not-for-profit, unincorporated,

Popular in the auto insurance market in the Western states.

This person is identified as the “attorney-in fact” and is responsible (and paid) for providing all the administrative services needed.

Fraternal Insurers

- Insurance (in particular life insurance) provided by fraternal order or societies.
- 2% of all life insurance written.
 - \$277 billion

Insurance Industry

- Large numbers of buyers and sellers
 - About 1,200 life insurance companies; 900 property insurers
- Little product differentiation - standard policy forms in use but service may be variable
- Employs over 2 million people (1.5 million administration, 750,000 marketing and service)

Insurance Industry

- Few barriers to entry into the industry
- Cost structure requires law of large numbers to work to generate accurate predictions – large number of buyers
- Declining cost industry

Question #1

The Gramm-Leach-Bliley Act is important to the insurance industry because:

- a. It provides for federal regulation of the insurance industry.
- b. It allows banks, insurance companies, and securities dealers to combine and form holding companies.
- c. It requires insurance companies to provide coverage at reduced cost to people that can't afford health insurance.
- d. It ends the ability of property insurers to share their loss data with rating bureaus.

Question #2

Stock insurance companies have all the following characteristics except:

- a. Ownership by people who are not necessarily insureds of the company.
- b. Management elected by owners.
- c. All profits and losses from insurance operations passed on to the insureds.
- d. Being incorporated.

Question #3

The largest and most frequently found form of mutual company is the:

- a. Assessment mutual.
- b. Factory mutual.
- c. Perpetual mutual.
- d. Advance premium mutual.

Question #5

The _____ mutual requires each insured to contribute a large initial premium, with no future premiums required.

- a. Perpetual
- b. Hybrid
- c. Multi-line
- d. Assessment

Question #6

Lloyd's of London remains a very important source of what type of insurance coverage?

- a. Fire
- b. Marine
- c. Life
- d. War

Question #7

The reciprocal exchange is managed by _____ .

- a. an attorney-in-fact
- b. an agency supervisor
- c. a superintendent of administration
- d. a director of insurance

Homework

- Read Chapter 5.
- Look at the Review Questions of Chapter 4 on pp. 75-76.