INSURANCE CUSTOMERS' NEEDS AND PERCEPTIONS (28-1)

EO 1. **PERSONAL INSURANCE (aka personal lines)** includes life, health, property, and liability insurance bought by individuals and families. An insurer's **portfolio (aka its book of business)** is a group of its policies with at least one common characteristic, such as geography or type of coverage.

THE IMPORTANCE OF PERSONAL INSURANCE TO

1. **THE ECONOMY**--Personal lines insurance represents about one-half of total written premiums in the US. Insurers create jobs and protect property and income. In its role as a **financial intermediary** (entity that redirects money from lenders and investors to borrowers and businesses), the insurer collects premiums, pools the money, and distributes capital in the form of claim payments. Insurer investments provide capital for businesses and for governments.
   In 1994, personal lines generated over $8 billion in premium tax revenue to the 50 states.
2. **SOCIETY**--Personal insurance protects individuals and families from financial ruin and it promotes public safety through safety-related studies and programs.
3. **PERSONAL INSURANCE CUSTOMERS**--Insurance reduces insureds' uncertainty and provides them financial security, stability, and peace of mind.

EO 2. **COMPULSORY PERSONAL INSURANCE** protects the public in exchange for a privilege. **Compulsory auto insurance laws** increase the number of financially responsible drivers by requiring proof of insurance before a motor vehicle may be operated.
Despite the compulsory laws, many drivers remain uninsured because they can't afford insurance, don't understand the benefits, resent the coercion, see others ignore the law, or expect any penalties to be waived.

SEMI-COMPULSORY PERSONAL INSURANCE, such as auto physical damage and homeowners insurance, is required by the lending institution as a condition of the loan. Consumers often confuse lending institutions' requirements with compulsory insurance requirements. Other negative perceptions arise from loan provisions requiring the insurance policy to satisfy the loan after a total loss of the secured auto or home, creating the customer's perception that he receives nothing in exchange for his insurance payments.

EO 3. **PROFESSIONAL ETHICS** dictate what one ***should*** do. They relate to good versus evil, right versus wrong. As **fiduciaries** (entities with the duty to act on the behalves of others to benefit them), insurers are held to high ethical standards. **This series of questions helps determine if an action is ethical:**

1. **Is it legal?**--Remember that some legal acts are still unethical.
2. **Is it fair?**--Is it balanced, or does it benefit one person at another's expense?
3. **How would it look?**--Would you want your family, friends, and the world to know about it? Would you want it reported on '60 Minutes'? Would your parents approve?
4. **How would it feel?**--Would ***both*** parties to the action be glad the act was done?

TECHNICAL COMPETENCE is the mastery of all skills required by one's occupation. An insurance specialist without technical competence has lower self-esteem and deprives his customers of thorough, accurate advice. Our rapidly changing industry requires constant effort to maintain technical competence. Most states (about 47) require insurance producers to engage in continuing education before their licenses may be renewed.

EO 4. **FIVE RISK MANAGEMENT TECHNIQUES FOR INDIVIDUALS AND FAMILIES:**

1. **Insurance**--transfers to an insurer the financial consequences of loss.
2. **Retention**--keeps or bears the financial consequences of loss.
   Unintentional retention results from the failure to identify an exposure before a loss occurs.
   Intentional retention results from the use of deductibles, underinsurance, coinsurance, a less broad policy form (fewer perils), or the decision to neither avoid nor transfer an exposure.

3. **Avoidance**--totally avoids a loss exposure or eliminates an existing exposure.
   Avoidance results in zero loss probability, but is often difficult to practice.
4. **Loss control--reduces loss frequency and/or severity, but does *not* eliminate the exposure.**
   a. **Loss prevention**--reduces the **frequency** (probability or chance) of loss without affecting loss severity.
      Examples: anti-lock braking systems, deadbolt locks, and fences around swimming pools.
   b. **Loss reduction**--reduces the **severity** (size or scope) of loss without affecting loss frequency.
      Examples: air bags and fire extinguishers.
   c. **Separation**--divides assets or activities into two or more distinct units. Separation decreases loss severity, but increases loss frequency.
      Examples: storing valuables off-premises, removing flammable materials from ignition sources, and sending school buses home with their drivers rather than garaging them together at night.
   d. **Duplication**--creates a backup or spare asset to be used if the primary asset is damaged or destroyed. It reduces loss severity without affecting frequency.
      Examples: keeping a spare pair of eyeglasses, extra keys, and copies of important documents.
5. **Noninsurance contractual transfer**--transfers the legal responsibility for performing an activity to another entity.
   Examples: include rental contracts, leases, and **hold harmless agreements** (promises to hold others harmless for their tort liabilities).

EO 5. **CHOOSING RISK MANAGEMENT TECHNIQUES involves consideration of**
1. **economic concerns**--budgetary constraints on the ability to pay premiums and to retain losses;
2. **critical consequences**--financial consequences of loss that would cause severe financial impairment;
3. **affordable consequences**--financial consequences of loss that would ***not*** cause severe financial impairment;
4. **objective and subjective decisions--based on**
   a. **objective probability** (the statistical chance of loss) versus
   b. **subjective probability** (opinion about the chance of loss);
5. **subjective risk** (uncertainty based on state of mind)**--based on the difference between the**
   a. **risk averse** (those uncomfortable with any level of risk) ***and***
   b. **risk takers** (those willing to bear risk); ***and***
6. **utility analysis**--which disproportionately compares the value placed on some gains (or losses) to the amount of those gains (or losses).

POTENTIAL LOSS FREQUENCY AND LOSS SEVERITY determine the appropriate risk management technique. **The frequency-severity matrix** presents combinations of frequency and severity and proposes appropriate risk management techniques for each combination.
Techniques are listed from most to least appropriate.
1. **High frequency/high severity losses**--Avoid, prevent, reduce, insure, or retain these major losses.
2. **High frequency/low severity losses**--Prevent and retain these minor losses.
3. **Low frequency/high severity losses**--Prevent, reduce, and insure these major losses.
4. **Low frequency/low severity losses**--Retain and prevent these minor losses.

Three general rules for selecting risk management techniques:
1. **Don't retain more than you can afford to lose**--How large can a loss be? Can you absorb the loss? Does the loss occur frequently? If so, can you absorb the aggregate losses?
   Set an upper limit on your retention and use it to help choose your deductible.

2. **Don't retain a lot to save a little--**Spend a little more premium to transfer a large exposure. Buy a personal umbrella policy.
3. **Don't spend a lot to protect a little**--Use **maximizing behavior** (Choose the option with the greatest payoff.). Compare the **probable cost** (the expected loss frequency times the average loss severity) of the exposure to the cost of the risk management treatment technique.
   Don't buy contact lens or no deductible auto comprehensive insurance.

EO 6. **THE SERVICE-RELATED EXPECTATIONS OF INSURANCE CUSTOMERS:**

1. **Inherent expectations**--are created by the nature of the good or service. Insurance customers expect prompt, accurate, courteous, professional, helpful, friendly service. Businesses improve customer perceptions and good will by meeting, and even exceeding, customer expectations.
2. **Spontaneous expectations**--develop in the customer's mind during the transaction. Meeting and exceeding spontaneous expectations requires flexibility and authority to act on spontaneous ideas.

Specialists add value by determining and then exceeding customers' inherent and spontaneous expectations.

EO 7. **PERCEPTIONS OF INSURANCE COSTS**--Many customers think insurance costs too much because they fail to understand the value received in exchange for their premiums. Instead, they focus on the disparity between their premium payments and their claim settlements. That perception of disparity causes unfulfilled expectations. **Insurance premiums are based on** expected losses, plus loss adjustment expenses, underwriting expenses, and profit margins. The expense for losses is the largest of those components, by far. **Insurance premiums *have* increased due to the increased costs of** auto body repairs, human body repairs, home repairs, litigation expenses, and lawsuit settlements.

EO 8. **CONSUMER ADVOCATES' CONCERNS ABOUT PERSONAL INSURANCE:**

1. **Andrew Tobias, *The Invisible Bankers* (1982)**--As financial intermediaries, banks and insurers both collect money and lend it to others. ***But***, there are important differences.
   A bank lets each customer withdraw 100% of the amount he deposited ***and*** pays him interest! The amount any individual withdraws from his insurer depends on his bad luck. Insurers pay out for losses, on average, only about 65 to 70% of premiums. Finally, although banks handle more 'transactions' and control more money, banks require fewer employees since each of their transactions is ***far*** less complex. *[Andrew Tobias' The Invisible Bankers is the funniest, best written, most informative book I've ever read about our industry. It's more fun than Seinfeld.]*
2. **Ralph Nader and Wesley J. Smith, *Winning the Insurance Game* (1990)--Insurance inflicts three types of pain on consumers:**
   a. **Overpayment relative to benefits**--resulting partly from problems in the system and partly from consumers' failure to comparison shop.
   b. **Lack of understanding about purchases--**leading to duplicated coverage with resulting overpayment.
   c. **Lack of understanding about coverage *not* bought**--leading to coverage gaps.
3. **Harvey Rosenfield, "Proposition 103: The Consumer's Viewpoint" in *The Impact of Consumer Activism on the Insurance Industry* (1991)**--Insurance is a financial institution focusing on profits rather than on risk-sharing. Rates are a function of the financial marketplace as insurers seek higher profits. During periods of high interest rates, insurers reduce rates and lower underwriting standards to get more capital for investment.
   During periods of low interest rates, insurers increase premiums. Under the current cost-plus system, insurers pass costs on to consumers along with a markup for overhead and profits. Accordingly, insurers get more funds for investment (and higher profits) when accident and claims levels increase, letting them charge higher rates.

EO 9. **TO APPLY RISK MANAGEMENT TECHNIQUES, PROFESSIONAL ETHICS, AND TECHNICAL COMPETENCE IN YOUR WORK,** simply apply what you learned this assignment.