

## THE PERSONAL INSURANCE PRODUCT (29-1)

### EOs 1 + 2. PERSONAL INSURERS' GOALS:

1. MAINTAIN PROFITABILITY--The personal insurance business generates profit through underwriting income (premium earned during the accounting period minus losses and expenses incurred during that period) *and* investment income (the sum of the profits from the investment of policyholders' surplus and loss reserves).

#### Factors affecting personal lines profitability:

- a. Underwriting guidelines--specify the characteristics of acceptable insureds.
  - b. Catastrophe--is an event (such as a hurricane, earthquake, or riot) that causes insured losses over \$25 million *and* affects a significant number of policyholders and insurers. **To reduce the financial effects of catastrophe losses, insurers** spread their risk over diverse geographic areas, use reinsurance, increase premiums for policies with catastrophe exposures, limit policy writing in areas with catastrophe exposures, and increase policy writing in products lines unaffected by catastrophic losses. Catastrophe modeling uses a computer model to predict possible losses resulting from catastrophes.
  - c. Claims consciousness--refers to the increased public awareness of insurance as a source of reimbursement for losses.  
Consumers are more likely to buy coverage, *but* they also make more frequent claims.
  - d. Extracontractual liability--is an insurer's obligations beyond the policy terms.  
*Example:* A plaintiff's attorney sues to recover losses the insurer claims are not covered. If the court orders payment of the claim, the insurer is liable to insureds for payments beyond the scope of what the insurer anticipated (resulting in inadequate premiums).
2. PROVIDE SERVICE--Insurers balance customer service demands against the costs of providing services. Some insurers pursue relationship building as a service goal.  
Relationship building uses an extensive customer database to identify customers' loss exposures, coverage needs, and service needs. Insurers use the relationship-building database to engage in event marketing, in which the computer identifies life events that create loss exposures.  
A virtual team (group of insurance employees who share database information) coordinates services to meet all a customer's needs resulting from a triggering event.
  3. MEET STAKEHOLDERS' NEEDS--**Insureds** want coverage as agreed.  
**Stockholders** in stock insurers expect increasing stock values and returns on investment.  
**Policyholders** of mutual insurers expect dividends and increases in surplus.  
**Employees** have many personal goals, such as income, career opportunities, and social outlets.  
**Producers** want insurers to provide products appropriate for the producers' target clients.

**PERSONAL INSURERS MUST BALANCE THEIR THREE GOALS.** If an insurer emphasizes customer service without considering profits, the insurer will go bankrupt. If the insurer emphasizes today's profit at the expense of customer service, it will lose customers. Dissatisfied stakeholders (be they employees, shareholders, producers, or insureds) will shift their allegiance to the insurer's competitors.

### EO 3a. FOUR CUSTOMER EXPECTATIONS FOR PERSONAL INSURANCE:

1. Affordability--Customers expect insurance to be affordable, but many find it to be too expensive. Dissatisfaction arises when customers do *not* perceive the value of the promise and the value of the security. Insurance professionals justify its 'high' cost by describing the protection and peace of mind it affords and by explaining the high claim settlement costs which include medical fees, replacement of damaged property and lost income, and legal expenses.
2. Availability--People unable to get insurance through the voluntary market (insurers that willingly provide insurance to applicants who meet their underwriting guidelines) must get coverage through the residual market which has less strict underwriting guidelines and higher premiums.

Residual market schemes for auto insurance vary among the states, but most require the driver first to be rejected by the voluntary market. Higher premiums in the residual market cause many residual market customers to feel affordable insurance is unavailable. Homeowners insurance is hard to get in areas subject to abnormal risk exposures. **FAIR** (Fair Access to Insurance Requirements) **plans** make insurance available to homeowners in urban areas. Unavailability problems also arise for homeowners in coastal areas who face a high risk of windstorm damage.

3. **Service**--Customers expect the same type of automated, 24-hour service offered by other financial service industries, but insurers have traditionally compared their service to that of other insurers. Customer satisfaction may also be judged by **the ten dimensions of service**:
  - a. **Access**--reflects the ease with which a customer can contact the appropriate service provider.
  - b. **Communication**--requires the ability to send a clear message to the customer.
  - c. **Competence**--describes the service provider's knowledge and skills.
  - d. **Courtesy**--includes politeness, patience, friendliness, and respect.
  - e. **Credibility**--consists of believability backed up by trustworthiness and competence.
  - f. **Reliability**--reflects consistent adherence to an expected professional standard.
  - g. **Responsiveness**--involves helpful and timely responses.
  - h. **Security**--consists of the insurer's financial strength and the peace-of-mind created by the insurance.
  - i. **Tangibles**--are the physical surroundings and physical aspects of the service, such as the appearance of the agent's office and the neatness of his written correspondence.
  - j. **Understanding the customer**--requires the service provider to identify and address each customer's needs.
4. **Fair treatment**--Customers expect coverage availability, renewability, and price to be decided based only on fair and objective factors. **Perceptions of unfairness occur in**
  - a. **underwriting**--as when urban homeowners face affordability or availability problems due to hazards beyond their control;
  - b. **nonrenewal or cancellation**--as when insureds with good driving records have their policies cancelled after a first traffic violation; **and**
  - c. **the claim process**--as when insurers delay claim settlement, fail to communicate with the insured, or improperly deny a claim.

EO 3b. **INSURERS' DIFFICULTIES IN MEETING CUSTOMER EXPECTATIONS** arise because, although the customer expectations are universal, their requirements to meet expectations vary. Expectations vary based on each customer's definition of **satisfactory service** (value received from the insurer) and the customer's interest, time, **and** mood at the time of contact.

EO 4. **FOUR FORCES THAT AFFECT PERSONAL INSURANCE:**

1. **SOCIAL PRESSURES**--When a significant number of consumers experience a similar problem with our industry, that problem becomes a social issue that creates pressure on insurers to solve the problem.
2. **LEGISLATION**--When insurers fail to address a social issue, constituents pressure their legislators to address the problem.  
The insurance commissioner and the commissioner's staff interpret and enforce insurance laws.
3. **INSURANCE REGULATION--Insurance regulation has two goals:**
  - a. Ensure insurer solvency.
  - b. Protect insurance consumers from unfair treatment.The NAIC model Unfair Trade Practices Act prohibits those acts defined as unfair trade practices. **Rate regulation seeks to ensure that rates are fair, stable, and understandable.**  
If regulators do **not** approve an insurer's requested rate increase, the insurer may decide to withdraw the product line from the state.

4. **JUDICIAL DECISIONS**--Case law can change policy interpretation, claim handling, insurance activities, and the insurance product. *Example:* An insured brings a lawsuit to resolve a coverage dispute. If the court holds coverage is broader than the insurer had intended, that decision broadens coverage for all insureds with that policy. If the extracontractual coverage is significant, the insurer might restrict future policy writings, eliminate coverage, or increase premiums.

EO 5. **REINSURANCE** allows a primary insurer to insure itself with a reinsurer. Reinsurance helps the primary insurer remain solvent through significant fluctuations in loss experience. An insurer reinsures for the same reasons an insured insures: to substitute a small known loss (the premium) for possible catastrophic loss. The reinsurer compensates the primary insurer for extreme losses, thus giving the primary insurer financial stability. The availability and affordability of insurance is affected by pressures that reinsurers place on primary insurers. *Examples:* Reinsurance prices reflect losses in specific geographic areas or coverage lines. The availability of primary insurance coverage depends on the availability of reinsurance coverage.

EO 6. **CASE STUDY: HURRICANE ANDREW**--In August 1992, Hurricane Andrew hit south Florida, causing about \$16 billion of insured losses (double insurers' previous worst-case estimates for hurricanes). Immediately after Andrew, insurers reevaluated their exposures to catastrophic property losses. Many insurers reduced the number of policies they wrote in disaster-prone areas--both nonrenewing existing policies and refusing new policies. The shrinking coverage availability created pressures on the legislature. The Florida legislature passed the 1993 Property Insurance Moratorium Act, which created a moratorium on nonrenewals of residential insurance and insurance on condominium associations. When the moratorium prevented insurers from withdrawing from the market, they increased their rates to cover their losses.

In addition, insurers faced possible extracontractual liability. Under Florida law, any residence located in a flood plain and sustaining damage in excess of 50% of market value must be elevated above the flood plain. Insurers used the ordinance or law exclusion to deny coverage for the increased cost of elevating homes of insureds who had not bought the optional Ordinance and Law Coverage endorsement. Dade County filed against the insurers, claiming that the exclusion was ambiguous and against public policy and that Guaranteed Replacement Cost coverage should pay the extra cost of elevating a home. Unless the decision is reversed on appeal, the inadequacy of premiums to cover this exposure will significantly impair the financial stability of those insurers. *[Remember, when a court holds that coverage is broader than the insurer had intended, that decision broadens coverage for all insureds with that policy. If the extracontractual coverage is significant, the insurer might restrict future policy writings, eliminate coverage, and/or increase premiums.]*

The Florida Residential Property and Casualty Joint Underwriting Association (**JUA**) provides insurance for homeowners who can *not* find coverage in the voluntary market. Some homeowners are dissatisfied with the JUA because the policies do *not* cover some types of property covered by policies issued by private insurers. Insureds are also concerned about the financial status of the JUA.

After Hurricane Andrew, reinsurers raised the price of reinsurance coverage and restricted the limits of coverage they would provide to primary insurers. Primary insurers were forced to limit the amount of insurance they would sell *or* forced to retain the exposure to losses over the reinsurance limit.

#### **THE EFFECT OF HURRICANE ANDREW ON**

1. **INSURERS**--Insurers suffered significant financial losses. When the moratorium prevented them from leaving the market, they increased prices.
2. **CUSTOMERS**--Insureds were dissatisfied with affordability, availability, and fair treatment.
3. **REGULATORS**--Both legislatures and regulators imposed controls on the insurance industry. Judges required extracontractual liability for ordinance or law exposures.
4. **REINSURERS**--Reinsurers raised rates and restricted coverage for primary insurers.