

Assignment 10

Responding to Social and Regulations Issues of Personal Insurance

EDUCATIONAL OBJECTIVES REVIEW

Time Required for Educational Objectives Review:

60 minutes

Note to Instructor: This exercise has been designed to help you direct a class discussion of the Educational Objectives (E.O.s) for this assignment. While leading the discussions, be sure to stress the importance of the E.O.s to the students.

Divide the class into groups of three or four, with a leader for each group.

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|---------------|--|
| E.O. 1 | a. Explain how regulatory limits on profits affect the availability and affordability of insurance. |
| | b. Describe strategies insurers use to generate a profit while satisfying regulatory requirements. |

ASK: How do insurance regulators control insurers' profits to keep insurance available and affordable to consumers?

How do insurers make a profit within these regulatory boundaries?

INSTRUCT: Ask the groups to select either question that you have posed (write the questions on a white board or flip chart if it is helpful). Using the text as a guide, the groups should summarize in their own words their responses to the questions.

DEBRIEF: Have the leaders report their responses. Make sure both questions are covered.

CHECK: Bring the discussion back to the E.O., and check for understanding of the ways regulators control insurers' profits and the ways insurers make profits within these boundaries.

E.O. 2 Explain how actuarial analysis and political pressure affect the distribution of the cost of insurance among insurance customers; give examples of how regulation influences the distribution of insurance costs.

ASK: Insurance companies have expenses that must be distributed among their customers. How are those costs distributed, and how does regulation affect that distribution?

INSTRUCT: Assign the following topics to the groups:

- actuarial analysis
- political pressures

Instruct the groups to (1) summarize in their own words the effect the topic has on the distribution of insurance cost among customers, and (2) provide an example. (Allow 3 minutes for discussion.)

DEBRIEF: Have the leaders report the summaries and examples.

CHECK: Bring the discussion back to the E.O., and check for understanding of the actuarial and political pressure that affect the distribution of insurance costs among customers.

E.O. 3 Describe the costs associated with insurers' filing of rates, and explain how these costs affect the amount and timing of rate changes.

ASK: What expenses does an insurer have when filing rates? How do these costs affect the frequency and timing of rate changes?

INSTRUCT: Instruct the participant to select either of the questions you have asked (write them on the white board or flip chart if that is helpful). Instruct the participants to prepare an answer to their selected question. (Allow 3 minutes for discussion.)

DEBRIEF: Have the leaders report the answer to the question they have selected. Make sure both questions are covered.

CHECK: Bring the discussion back to the E.O., and check for understanding of the expenses involved in rate filings and the timing of rate changes.

E.O. 4 Distinguish between fair and unfair discrimination in insurance rating classification, sales representation, and underwriting guidelines; give examples of fair and unfair discrimination.

ASK: How can you differentiate between fair and unfair discrimination in insurance rating classes, sales representation, and underwriting?

INSTRUCT: Instruct the participants to select one of the following:

- insurance rating classes
- sales representation

- underwriting

For the selected item, each group should prepare a summary in their own words of (1) the difference between fair and unfair discrimination, and (2) an example of each.

DEBRIEF: Have the leaders report their summaries and examples. Make sure each of the bulleted items is covered.

CHECK: Bring the discussion back to the E.O., and check for understanding of the primary functions of communication.

E.O. 5 Explain how differences in state regulatory practices affect the willingness of insurers to offer coverage.

ASK: What insurance regulatory features in a state make it attractive or unattractive to an insurer looking to write policies?

INSTRUCT: Instruct the participants to turn to page 2-22 of the reading assignment. At the bottom of the page is a bulleted list of items that are introduced with the following paragraph:

State differences in regulation affect loss experience, pricing, and insurer willingness to write business in a state. The following are factors of state regulation that increase insurer willingness to offer coverage:

Instruct the participants to assume the role of an executive staff member for an insurance company. Their companies are reviewing various states to determine whether they should obtain licenses and begin writing personal insurance coverages within the state. Each group should select two of the bulleted items and assume these are regulatory features of the states they are considering. Prepare a description of the selected features, and explain whether the feature is attractive or unattractive. (Allow 5 minutes for discussion.)

DEBRIEF: Have the leaders report about their selected items. Make sure all of the items are addressed.

CHECK: Bring the discussion back to the E.O., and check for understanding of the regulatory features of various states and the appeal these features have to insurers.

E.O. 6 Describe the potential benefits of no-fault laws, and explain why no-fault has not met the expectations of its proponents.

ASK: What was no-fault supposed to accomplish, and why hasn't it met expectations?

INSTRUCT: Assign the following bulleted items to the groups:

- The objective of no-fault insurance laws
- The potential benefits of no-fault laws

- Reasons why no-fault has not met expectations

Instruct the participants to summarize their assigned item in their own words. (Allow 4 minutes for discussion.)

DEBRIEF: Have the leaders report their summaries.

CHECK: Bring the discussion back to the E.O., and check for understanding of the no-fault objectives, potential benefits, and failure to meet expectations.

E.O. 7 Describe how the cost of insurance is distributed among large and small numbers of customers, and illustrate how rating criteria and relative weights assigned to rating criteria affect the distribution of the cost of insurance among insurance customers.

ASK: The cost of insurance is distributed among those who buy it. How do insurers distribute these costs?

INSTRUCT: Assume the role of an underwriting manager for an insurance company. You are working with your company's actuarial staff to determine how to divide the cost of insurance among your policyholders. Select one of the following insurance coverages/products:

- flood insurance
 - earthquake insurance
 - auto liability
1. How will you spread the cost of insurance among your customers for the selected coverage or product?
 2. What rating criteria will you use to help you accomplish this cost spread? (Allow 3 minutes for discussion.)

DEBRIEF: Have the leaders report their responses to the questions.

CHECK: Bring the discussion back to the E.O., and check for understanding of the ways the cost of insurance is spread among insurance customers.

E.O. 8 Explain why nonstandard and residual auto insurance markets are needed.

ASK: Why are alternative auto markets (nonstandard and residual) needed to meet all customers' needs?

INSTRUCT: You are instructing part of an orientation for new employees within your organization. One of the new employees has asked you the following question:

"I don't really understand how auto insurance is made available. Some people I know pay ten times the price I pay for the same

auto coverage. Some people can't buy insurance from regular companies; they have to buy coverage from the state. How does this auto market work?"

Respond to this question by addressing the need for various auto insurance markets, including standard, nonstandard, and residual. (Allow 5 minutes for discussion.)

DEBRIEF: Have the leaders report their responses.

CHECK: Bring the discussion back to the E.O., and check for understanding of the need for nonstandard and residual auto markets.

E.O. 9 Describe the benefits and drawbacks of "pay-at-the-pump" auto liability insurance, and explain why is it unlikely to be approved in the United States.

ASK: What is pay-at-the pump auto insurance, and why hasn't it been made available in the U.S.?

INSTRUCT: Assign the following among the groups:

- the way pay-at-the pump insurance was intended to work
- the benefits and drawbacks of pay-at-the-pump
- the reason why pay-at-the-pump hasn't become available in the U.S.

Instruct the participants to prepare a summary regarding their assigned topic.

(Allow 3 minutes for discussion.)

DEBRIEF: Have the leaders report their summaries.

CHECK: Bring the discussion back to the E.O., and check for understanding of the concept of pay-at-the-pump insurance.

E.O. 10 Explain how the following exposures affect insurance coverage availability:

- lead paint
- radon gas
- sinkhole and mine subsidence
- flood
- windstorm
- earthquake

ASK: How do special exposures affect the availability of personal lines insurance?

- INSTRUCT:** Instruct the participants to select one (or two) of the bulleted subjects in the E.O. Instruct the participants to summarize how the topic affects the availability of insurance coverage. (Allow 3 minutes for discussion.)
- DEBRIEF:** Have the leaders report their summaries.
- CHECK:** Bring the discussion back to the E.O., and check for understanding of the availability of insurance when special hazards (bulleted in the E.O.) exist.

ADDITIONAL EXERCISES

Note to Instructor: These additional exercises have been provided to supplement the material found in this assignment. Students should be encouraged to use these exercises as a review of what they have learned in the assignment.

TRUE/FALSE EXERCISE

Time Required for True/False Exercise:

5 minutes to complete the exercise; 10 minutes to review the exercise

Indicate with a check whether the following statements are **TRUE** or **FALSE**.

TRUE **FALSE**

- | | | |
|--------------------------|--------------------------|--|
| <input type="checkbox"/> | <input type="checkbox"/> | 1. Insurers add to their policyholders' surplus each year by earning premium greater than the total of losses and underwriting expenses. |
| <input type="checkbox"/> | <input type="checkbox"/> | 2. Because the limitation of profit for insurance companies is controversial, most state regulators do not attempt to regulate insurers' rates. |
| <input type="checkbox"/> | <input type="checkbox"/> | 3. When insurers decide to implement a rate change, they determine a desired effective date. This date usually includes the amount of time the insurer expects that the state needs either to approve the rates or to deem the rates approved. |
| <input type="checkbox"/> | <input type="checkbox"/> | 4. Discrimination based on credible differences in loss exposure is considered unfair. |
| <input type="checkbox"/> | <input type="checkbox"/> | 5. Without fair discrimination, all customers would pay the same rate. |
| <input type="checkbox"/> | <input type="checkbox"/> | 6. States that set actuarially sound rates for high-risk markets reduce the amount of money that must be contributed by standard insurers to support customers with higher-than-average loss exposures. |
| <input type="checkbox"/> | <input type="checkbox"/> | 7. The objective of no-fault insurance laws is to quickly move insurance claims through the adjustment process with minimal proof of who caused the damages. |
| <input type="checkbox"/> | <input type="checkbox"/> | 8. No-fault laws have produced the significant savings originally anticipated. |
| <input type="checkbox"/> | <input type="checkbox"/> | 9. The special-form homeowners policies provide coverage for the removal of lead paint hazards. |
| <input type="checkbox"/> | <input type="checkbox"/> | 10. Building codes can be created or modified to require new and replacement construction to contain engineering features that improve resistance to perils like windstorm and earthquake. |

COMPLETION EXERCISE

Time Required for Completion Exercise:

5 minutes to complete exercise; 10 minutes to review exercise

Complete each sentence with the appropriate word or phrase.

1. An underwriting profit = Net earned premium – Net incurred losses _____.
2. When a state government defines or limits insurance rates, it is influenced by two major forces: actuarial analysis of losses and expenses, and _____.
3. California's Proposition 103, a public referendum, required insurers to stop using rates that had been filed and approved and to begin using lower rates that were previously in use. That kind of requirement is called a _____.
4. Political pressure to limit insurance costs has encouraged more regulatory control. Consequently, the current trend is toward a _____ approach to rate regulation.
5. A potential source of _____ occurs when insurers fail to sell their products with equal emphasis in all potential markets.
6. Legislative action intended to restrict lawsuits for negligence is often called _____.
7. _____ require auto owners to buy and insurers to offer coverage for medical expense and sometimes loss of earnings resulting from an auto accident.
8. _____ frequently offer policies with liability limits lower than are typically sold by standard market insurers.
9. _____ can result when underground water acts on limestone or soft minerals over time to weaken the earth's structure under the soil.
10. _____ can be created or modified to require new and replacement construction to contain engineering features that improve resistance to perils like windstorm and earthquake.

MATCHING EXERCISE

Time Required for Matching Exercise:

5 minutes to complete exercise; 10 minutes to review exercise

Match each term with the appropriate definition.

- | | |
|--------------------------|---|
| A. Operating profit | 1. ____ A redistribution of one group's costs among the members of another group |
| B. Underwriting profit | 2. ____ Any legislative action intended to restrict lawsuits for negligence |
| C. Social equity | 3. ____ $\text{Net earned premium} + \text{Net investment income} - \text{Net incurred losses} - \text{Underwriting expenses}$ |
| D. Subsidization | 4. ____ Occurs in land areas that have been filled with soil to extend the land area for new construction or in areas when the earth's structure under the soil has been weakened |
| E. Fair discrimination | 5. ____ Charging higher-than-average auto liability insurance rates to a driver who was involved in a DUI accident is an example |
| F. Unfair discrimination | 6. ____ An alternative approach proposed for funding auto liability insurance through a tax on every gallon of gasoline |
| G. Tort reform | 7. ____ Monetary and verbal are two examples |
| H. Tort thresholds | 8. ____ An example is higher rates charged to auto owners in some communities despite lower insurance losses in those communities |
| I. Pay-at-the-pump | 9. ____ Provides a comparable level of social benefit to all citizens regardless of their ability to pay for it |
| J. Sinkhole | 10. ____ $\text{Net earned premium} - \text{Net incurred losses} - \text{Underwriting expenses}$ |

SHORT ANSWER QUESTIONS

Time Required for Short Answer Questions:

20 minutes

Note to Instructor: The following short answer questions have been provided for your use as an exam in class or as an exercise that the students may take with them for further work.

1. Insurers prefer that premium from each state, territory, and line of business be sufficient to support their own losses and expenses. However, the loss experience in some territories is so costly that residents could not afford to buy insurance if price were based solely on actuarial analyses.

Describe *one* method insurance regulators apply to distribute insurance costs among customers to make insurance affordable.

2. Identify and describe *two* costs associated with an insurer's filing of rates.

3. State differences in regulation affect loss experience, pricing, and insurer willingness to write business in a state.

Describe *two* factors of state regulation that would increase an insurer's willingness to offer coverage in that state.

ANSWERS TO THE ADDITIONAL EXERCISES

TRUE/FALSE

1. T
2. F
3. T
4. F
5. T
6. T
7. F
8. F
9. F
10. T

COMPLETION

1. underwriting expenses
2. political interests
3. rate rollback
4. prior-approval
5. unfair discrimination
6. tort reform
7. add-on no-fault laws
8. nonstandard insurers
9. sinkholes
10. building codes

MATCHING

1. D
2. G
3. A
4. J
5. E
6. I
7. H
8. F
9. C
10. B

SHORT ANSWER QUESTIONS

Based on	Text Pages	Possible Answer
1. E.O. 10.2	2-11	<p>Social equity provides a comparable level of social benefits to all citizens regardless of their ability to pay for it. Under social equity insurance rates are distributed among all territories to make affordable insurance available to all individuals regardless of their exposure to loss. Subsidization is a redistribution of one group's costs among the members of another group.</p>
2. E.O. 10.3	2-13 to 2-17	<p>(1) Insurers incur significant costs for actuaries, underwriters, marketers, and managers to analyze detailed information before agreement is reached on implementing a rate change.</p> <p>(2) Preparing that information according to each state's prescribed format adds administrative costs.</p>
3. E.O. 10.5	2-22	<p>(1) States with average exposure to loss that permit insurers to substantiate their need for rate changes are attractive to insurers because an average frequency and severity of losses is predictable and rate adjustments can be based on stable experience.</p> <p>(2) States that limit lawsuits for negligence are preferred by insurers because they tend to lower the average severity of liability loss payments.</p>