

# Assignment 2

## The Personal Insurance Market

### 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.

<b>E.O. 1</b>	<b>Describe the characteristics of the personal insurance market.</b>
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ASK:	What are the characteristics of the personal insurance market?
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INSTRUCT:	Instruct the students to turn to pages 2-3 through 2-4 in their textbooks, and review the bulleted list of characteristics that are unique to the personal insurance market.
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Divide the bulleted list among the groups, and ask the groups to develop *in their own words* a one-sentence summary that describes each of the assigned characteristics (Allow 5 minutes for discussion.)

DEBRIEF:	Have the group leaders report their summaries. During the debriefing, pay careful attention to the following characteristics to ensure understanding:
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- *Personal insurance supply:* Supply is the amount of insurance that insurers are willing to offer. This will significantly affect the underwriting cycles that are addressed in the next Educational Objective. Personal lines insurers will only offer products if they can make a profit, and the margin for profit is

becoming increasingly narrow. As a result, personal lines insurers must find ways to compete while dealing with narrow profit margins. They currently do this through market segmentation, technology, and strategic alliances, which are discussed later in the chapter. However, personal lines insurers' methods for dealing with narrow profits are continually changing as insurers innovate to compete.

- *Inelastic demand:* The demand for personal insurance does not change significantly if prices go up or down because most individuals and families must purchase auto insurance and homeowners insurance, which are the two largest product lines in the property and liability insurance industry. This characteristic will also have a role in the underwriting cycles addressed in the chapter.

CHECK: Bring the discussion back to the E.O. Have the students summarize the characteristics of the personal insurance market.

**E.O. 2 Describe underwriting cycles and their effects on personal lines insurance; explain the importance of understanding underwriting cycles.**

ASK: What are underwriting cycles, and why should you know about them?

DISCUSS: Instruct the students to open their texts to page 2-5 to make notes on Exhibit 2-2. Draw the shape of the cycles represented in the exhibit on a paper flip chart or “white board” if it is helpful.

As a group, plot the following activities on the peaks and troughs:

- Insurers' profitability declines until it reaches a trough (note that these are the downward slopes for either Cycle 1 or Cycle 2).
- Profitability is too low for insurers to continue to write insurance policies. Some insurers withdraw from markets, discontinue writing new policies, or become bankrupt (*note that these are the bottom of the troughs*).
- As some insurers drop out of the market, the supply of insurance shrinks, the demand stays the same, and insurers are able to charge higher premiums for their policies (*note that these are the upward slopes in Cycle 1 or Cycle 2*).
- As premiums increase, profitability increases and more insurers enter or return to the market until some insurers begin to compete for policies by lowering their premiums (*note that these are the tops of the peaks*).

INSTRUCT: Instruct the students to assume the following role:

You are the executive staff for a large personal lines insurance company. Your company is currently making an adequate profit for auto and homeowners insurance. Two new insurers have just entered the market offering premiums that are 20 percent below your premiums. They are selling their coverage through the Internet, so their expenses are low enough to offer the reduced premiums and remain profitable.

Your company has begun losing policies as your customers rewrite their coverage with the new insurers.

Develop a survival strategy for your company. The bulleted list on page 2-8 through 2-9 might be helpful in this development.

(Allow 5 minutes for discussion.)

**DEBRIEF:** Have the group leaders report their group's strategies. Note that there are many correct answers. The following are some possibilities:

- Reduce expenses and reduce premiums. This can be dangerous because a downward slide into a trough in the underwriting cycle can follow. If your company lowers its premium, so will other companies as well as the new insurers.
- Develop a market segment that the new insurers have not addressed. For example, retirees and affluent clients might not be attracted to lower prices or Internet sales.
- Withdraw from the personal automobile and homeowners markets until the pricing reduction frenzy passes. Knowing what you know about insurance cycles, it will probably pass. You will have to reduce expenses as you wait.

**CHECK:** Bring the discussion back to the E.O. to confirm understanding of the underwriting cycles and the importance of understanding the cycles.

**E.O. 3** Describe the stages in market development; explain the importance of understanding stages in market development.

**ASK:** What are the stages in market development, and why should you understand them?

**INSTRUCT:** Instruct the students to again assume their roles as the executive staff members for a personal lines insurance company. As executive staff members, they are faced with the following problem:

- You have discovered a new coverage need expressed by your customers. Many of your customers have home businesses, and almost all of these businesses depend on a personal computer and an Internet connection. Your customers have problems keeping up-to-date with software changes, maintaining off-site back-ups of their data, and accessing current software virus protection.

- You are considering offering a service contract to your home business customers. Purchasers will receive monthly software updates and a daily back-up of their data as well as a daily virus scan. If a personal computer becomes inoperable, you will either repair the computer or reimburse the customer for the cost of repairs.
- Some insurance regulators consider these service contracts to be a form of insurance, but these contracts do not currently fall within any of the regulations controlling insurance products.

You have heard that several other companies are considering offering similar products.

1. What stages can you expect within the development of this new market?
2. What might cause a breakdown stage? (Use your imagination.)

(Allow 7 minutes for discussion.)

DEBRIEF: Have the leaders report their expectations. Note that the following are the possible expectations:

- *Emergence.* The coverages and rates charged would not be standard, and they will change frequently. Some competitors will not survive.
- *Control.* If control systems are put into place, the rates and products will be standardized.
- *Breakdown.* This will occur only if a competitor has a significant development that does not fall within the control system established. For example, a competitor who performs services through a cable network might not fall within the control systems.
- *Reorganization.* If a breakdown occurs, the market will reorganize itself in a new way. Other competitors might begin offering similar products in specialty markets.

CHECK: Bring the discussion back to the E.O. to confirm understanding of the stages in market development and the importance of understanding those stages.

**E.O. 4 Explain how the personal insurance market is segmented. Describe benefits and limitations of market segments.**

ASK: What are the personal insurance market segments and the benefits and limitations of those segments?

INSTRUCT: Instruct the students to draw the following chart.

	Description	Benefits	Limitations
National Market			
Regional Market			
Customer Group Market			
Niche Market			

Assign the various markets segments among the groups. Instruct the groups to complete a brief description and to identify the benefits and limitations of the assigned market segment. (Allow 5 minutes for discussion.)

**DEBRIEF:** Have the group leaders report their group's descriptions, benefits, and limitations. Encourage the students to complete their charts as the leaders report.

**CHECK:** Bring the discussion back to the E.O. to confirm understanding of the market segments and the benefits and limitation of those segments.

**E.O. 5 Describe technology applied in personal insurance, and explain the effects of technology on the personal insurance market.**

**ASK:** How are personal lines insurers applying technology, and what benefits do the insurers and their customers get from that application?

**INSTRUCT:** Assign the following subjects among the groups:

- Automated processing
- Database applications
- Internet communications and sales

Instruct the participants to (1) describe the assigned subject and (2) identify what effect the assigned subject is having on insurance companies and customers. (Allow 5 minutes for discussion.)

**DEBRIEF:** Have the group leaders describe their group's subjects and identify their effects.

**CHECK:** Bring the discussion back to the E.O. to check understanding of the uses of technology in personal insurance and effects of that technology.

**E.O. 6 Explain why personal lines insurers seek strategic alliances.**

**DISCUSS:** In an open forum, discuss the alliances that the students have observed. If the students have not observed such an alliance, select the alliance described in the first paragraph on page 2-19

involving the alliance between credit card companies and insurance companies. The second paragraph on page 2-19 involving the alliance between banks and insurance companies is also a good topic of discussion.

Using the students' examples or those from the text, discuss why an insurer would want to form these alliances.

**CHECK:** Review the E.O. to confirm understanding of the strategic alliances insurers are involved in and why they seek these alliances.

**E.O. 7** Describe fraud in personal insurance, including the following issues:

- Public attitude toward insurance fraud
- Forms of fraud in personal insurance
- Antifraud measures

**ASK:** What does the public think about insurance fraud?

What forms does fraud take in personal insurance?

What are the insurance industry and its allies doing to stop insurance fraud?

**INSTRUCT:** Assign the question listed above among the groups. Instruct the groups to identify five key points from the text addressing their assigned questions. (Allow 7 minutes for discussion.)

**DEBRIEF:** Have the group leaders report their group's key points for their assigned questions.

**DISCUSS:** Why do personal lines insurers not take more aggressive actions against individuals they believe are committing insurance fraud?

**CHECK:** Review the E.O. to confirm understanding of public attitude toward insurance fraud, forms of fraud in personal insurance, and antifraud measures.

## 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. Within the personal insurance market, the supply of insurance is inelastic.  |
| <input type="checkbox"/> | <input type="checkbox"/> | 2. Insurance contracts and services offered by an insurer are fairly standard; therefore, they can be easily automated.   |
| <input type="checkbox"/> | <input type="checkbox"/> | 3. Fraud is common in personal lines insurance because the high volume of insurance applications and claims processed increases the opportunities for misstatements and falsified documents to go undetected. |
| <input type="checkbox"/> | <input type="checkbox"/> | 4. One of the benefits to a personal lines insurer of selecting a customer group market is providing service in a limited geographic region.  |
| <input type="checkbox"/> | <input type="checkbox"/> | 5. Keys to niche marketing include an understanding of the customers and products customized to meet the customers' needs.  |
| <input type="checkbox"/> | <input type="checkbox"/> | 6. Over 50 percent of all insurance sales transactions are now accomplished over the Internet, and that percentage is increasing.   |
| <input type="checkbox"/> | <input type="checkbox"/> | 7. Insurers seek strategic alliances to reduce their expenses through outsourcing.  |
| <input type="checkbox"/> | <input type="checkbox"/> | 8. Based on a 1995 survey, almost a quarter of the respondents said that it is acceptable to pad their insurance claims to make up for their insurance premiums paid in previous years.                       |
| <input type="checkbox"/> | <input type="checkbox"/> | 9. According to the definition of insurance fraud, only the policyholder can commit insurance fraud.  |
| <input type="checkbox"/> | <input type="checkbox"/> | 10. Insurance companies assume the role of law enforcement agencies as they aggressively investigate and litigate suspected insurance fraud perpetrators.   |

## 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. The characteristic of the personal insurance market that reflects buyers' market intentions is \_\_\_\_\_.
2. Personal insurance products are perceived by many customers to be \_\_\_\_\_. As a result, many customers do not have brand loyalty.
3. During an underwriting cycle, the \_\_\_\_\_ is the point at which insurers increase their prices until the supply of insurance exceeds the demand.
4. One fundamental element of the underwriting cycle has remained constant. In personal lines, \_\_\_\_\_ have consistently influenced the supply of insurance.
5. \_\_\_\_\_ statistically map the relationships among data elements for a specific purpose. The resulting statistics can be used to predict outcomes, which can be used to guide decisions.
6. Some insurers seek strategic alliances to \_\_\_\_\_, while others seek strategic alliance to expand the array of services to their customers.
7. To control insurance fraud at the point of sale, \_\_\_\_\_ are a set of computer programs that can identify red flags that indicate possible fraud.
8. \_\_\_\_\_ determine facts about suspicious claims, provide evidence of fraud when it can be proven, avoid improper and unfounded accusations by insurers, and pay claims that the investigation deems worthy.
9. After insurers identify and document fraud, they turn their evidence over to the court system for action. Without effective \_\_\_\_\_, prosecutors have a difficult time in taking action against the perpetrators or winning severe-enough penalties to act as a deterrent.
10. \_\_\_\_\_ provide protection to insurance companies for the good faith exchange of information with law officials without fear of criminal or civil prosecution.

## 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. Inelastic             | 1. ____ Evolution that occurs in market development following a breakdown  |
| B. Control stage         | 2. ____ The sellers' market intentions   |
| C. Reorganization stage  | 3. ____ A group of customers with specialized needs  |
| D. Index systems         | 4. ____ An insurance company that forms a partnership with a bank is an example                                    |
| E. Capacity              | 5. ____ The stage of market development when regulators suppress competition and control supply                    |
| F. Demand                | 6. ____ Customers with the same occupation are an example  |
| G. Supply                | 7. ____ The sensitivity of demand in relationship to changes in price  |
| H. Strategic alliance    | 8. ____ Databases that provide access to a bank of information through search inquiries                            |
| I. Customer group market | 9. ____ The buyers' market intentions  |
| J. Niche market          | 10. ____ The volume of business that an insurer is able to handle relative to the size of its policyholder surplus |



## ANSWERS TO THE ADDITIONAL EXERCISES

### TRUE/FALSE

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

### COMPLETION

1. demand
2. homogeneous
3. peak
4. insurers' expectations of profits
5. predictive models
6. increase market share
7. expert systems
8. special investigative units (SIU)
9. legislation and law endorsement
10. immunity laws

### MATCHING

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

## Short Answer Questions

Based on	Text Pages	Possible Answers
1. E.O. 2	2-8 to 2-9	Even if the underwriting cycles have stopped, the forces that drove the cycles still exist, and they still affect the personal insurance market. Understanding the underwriting cycles helps an insurance student understand the market forces.
2. E.O. 4	2-13 to 2-14	An insurer in a regional market can gain more complete knowledge of local hazards, resulting in more effective risk selection and pricing. A regional insurer can become a powerful competitor based on this knowledge. In addition, a regional insurer has to deal with a limited number of state regulations and gain local recognition with lower costs than those of a national insurer.
3. E.O. 7	2-23	If the property has a mortgage, the insurer still owes claim payment for damages to the mortgagee up to the mortgagee's level of interest in the property.