PRINCIPLES OF RISK MANAGEMENT AND INSURANCE

CLASS NOTES

Chapter 24 Types of Insurers and Marketing Systems

<u>Topics</u>

- Overview of Private Insurance in the Financial Services Industry
- Types of Private Insurers
- Agents and Brokers
- Types of Marketing Systems
- Group Insurance Marketing

Overview of Private Insurance in the Financial Services Industry

- The financial services industry consists of:
  - Commercial banks
  - Savings and loan institutions
  - Credit unions
  - Life and health insurers
  - Property and casualty insurers
  - Mutual Funds
  - Securities brokers and dealers
  - Private and state pension funds
  - Government-related financial institutions
- Changes in the financial services industry include:
  - <u>Consolidation</u> means that the number of firms has declined due to mergers and acquisitions
  - <u>Convergence</u> means that financial institutions now sell a wide variety of financial products that earlier were outside their core business area

Types of Private Insurers

- Insurers can be classified by their organizational form:
  - Stock insurers
  - Mutual insurers
  - Reciprocal exchanges
  - Lloyd's of London
  - Blue Cross and Blue Shield Plans
  - Health maintenance organizations (HMOs)
  - Other types of private insurers
- A <u>stock insurer</u> is a corporation owned by stockholders
  - Objective: earn profit for stockholders by increasing the value of stock and paying dividends
  - Stockholders elect board of directors
  - Stockholders bear all losses
  - Insurer cannot issue an assessable policy
- A <u>mutual insurer</u> is a corporation owned by the policyowners
  - Policyowners elect board of directors, who have effective management
  - Policyholders may receive dividends or rate reductions
  - There are three main types of mutual insurers:

    - An advance premium mutual is owned by the policyowners; there are no stockholders, and the insurer does not issue assessable policies
    - An assessment mutual has the right to assess policyowners an additional amount if the insurer's financial operations are unfavorable
    - A fraternal insurer is a mutual insurer that provides life and health insurance to members of a social or religious organization
- The corporate structure of mutual insurers is changing due to:
    - An increase in company mergers
    - Demutualization, whereby a mutual company is converted into a stock insurer by a pure conversion, merger, or bulk reinsurance
    - The creation of mutual holding companies
    - A holding company is a company that directly or indirectly controls an authorized insurer
- Lloyd's of London is not an insurer, but a society of members who underwrite insurance in syndicates
    - Membership includes corporations, individual members (called Names), and limited partnerships
    - New individual members now have limited legal liability
    - Corporations with limited legal liability and limited liability partnerships can also join Lloyd's of London
    - Members must meet stringent financial requirements
    - Lloyd's is licensed only in a small number of jurisdictions in the U.S.
- A reciprocal exchange can be defined as an unincorporated organization in which insurance is exchanged among the members (called subscribers)
    - Insurance is exchanged among the members; each member of the reciprocal insures the other members
    - It is managed by an attorney-in-fact
    - Most reciprocals are relatively small and specialize in a limited number of lines of insurance

Types of Private Insurers

- Blue Cross and Blue Shield Plans are generally organized as nonprofit, community oriented plans
    - Blue Cross plans provide coverage for hospital services
    - Blue Shield plans provide coverage for physicians' and surgeons' fees
    - Most plans have merged into one entity
    - Many sponsor HMOs and PPOs
    - Some plans have converted to a for-profit status to raise capital and become more competitive

- A Health Maintenance Organization (HMO) provides comprehensive health care services to its members
    - Broad health care services are provided for a fixed prepaid fee
    - Cost control is emphasized
    - Choice of health care providers may be restricted
    - Less costly forms of treatment are often provided

- A captive insurer is an insurer owned by a parent firm for the purposes of insuring the parent firm's loss exposures
  - A single parent, or pure, captive is an insurer owned by one parent
  - An association captive is owned by several parents
- Savings Bank Life Insurance refers to life insurance that is sold by mutual savings banks, over the phone or through Web sites

Agents and Brokers

- An agent is someone who legally represents the principal and has the authority to act on the principal's behalf
- Authority may be:
  - Expressed
  - Implied
  - Apparent
- The principal is legally responsible for all acts of an agent when the agent is acting within the scope of authority
- A property and casualty agent has the power to bind the insurer
  - A binder provides temporary insurance until the policy is actually written
- A life insurance agent normally does not have the authority to bind the insurer
  - The applicant for life insurance must be approved by the insurer before the insurance becomes effective
- A broker is someone who legally represents the insured, and:
  - solicits applications and attempts to place coverage with an appropriate insurer
  - is paid a commission from the insurers where the business is placed
  - does not have the authority to bind the insurer
- A surplus lines broker is licensed to place business with a nonadmitted insurer
  - Surplus lines refer to any type of insurance for which there is no available market within the state, and coverage must be placed with a nonadmitted insurer

Life Insurance Marketing

- The majority of life insurance policies and annuities sold today are through personal selling distribution systems
  - Commissioned agents solicit and sell life insurance products to prospective insureds
  - Career, or affiliated, agents are full-time agents who usually represent one insurer and are paid on a commission basis.
  - In a multiple line exclusive agency system, agents who sell primarily property and casualty insurance also sell individual life and health insurance products.
  - Independent property and casualty agents are independent contractors who represent several insurers and sell primarily property and casualty insurance
  - A personal-producing general agent (PPGA) is an independent agent who places substantial amounts of business with one insurer and has a special financial arrangement with that insurer

    - Brokers are independent agents who do not have an exclusive contract with any single insurer
- Many insurers today use commercial banks and other financial institutions as a distribution system
- A direct response system is a marketing system by which insurance products are sold directly to consumers without a face-to-face meeting with an agent
    - Acquisition costs can be held down, but complex products are difficult to sell this way
- Other forms of life insurance distribution include:
    - Worksite marketing
    - Stock brokers
    - Financial planners

Property and Casualty Insurance Marketing

- The independent agency is a business firm that usually represents several unrelated insurers
    - Agents are paid a commission based on the amount of business produced, which vary by the line of insurance
    - The agency owns the expirations or renewal rights to the business; it may bill the policyholders and collect premiums, but most insurers use direct billing
    - Agents may be authorized to adjust small claims and may provide loss control services to their insureds
- Under the exclusive agency system, the agent represents only one insurer or group of insurers under common ownership
    - Agents do not usually own the expirations or renewal rights to the policies
    - Agents are generally paid a lower commission rate on renewal business than on new business
    - Exclusive agency insurers provide strong support services to new agents

Marketing Systems in Property and Liability Insurance

- A direct writer is an insurer in which the salesperson is an employee of the insurer, not an independent contractor.
    - Employees are usually compensated on a "salary plus" arrangement
- A direct response insurer sells directly to the consumer by television or some other media
- Many property and casualty insurers use multiple distribution systems

Group Insurance Marketing

- Many insurers use group marketing methods to sell individual insurance policies to:
    - Employer groups
    - Labor unions
    - Trade associations
- Products are sold through group representatives, employees who receive a salary and incentive payments based on sales.
- Some property and liability insurers use mass merchandising plans to market their insurance
- Employees typically pay for insurance by payroll deduction. End./.