Collaborative Presentation on Fundamentals of Insurance and Risk Management

What is NCOIL

The National Council of Insurance Legislators

-is a national, bipartisan, legislative organization, founded in 1969

-legislators serving on state “insurance” committees.

NCOIL

-only legislative organization that writes Model Laws in insurance

- -TNC Model; Credit Model; Sandbox Model

-works to preserve the state jurisdiction over insurance per McCarran-Ferguson Act of 1945

-works to assert the prerogative of legislators in making state insurance policy

-serve as an educational forum for public policy makers & interested parties.

NCOIL Structure

- All states are Members of NCOIL
- Vermont is among "Contributing Member" states and has long, active history at NCOIL
- NCOIL has seven (7) Policy Committees
- The Committees meet at NCOIL national meetings three (3) times per year as well as interim Zoom meetings
  - Stipends/Scholarships
- 2023 National Meetings:
  - NCOIL Spring Meeting – San Diego, CA – March 9th – 12th
  - NCOIL Summer Meeting – Minneapolis, MN July 19th – 22nd
  - NCOIL Annual Meeting – Columbus, OH November 15th – 18th

NCOIL Membership

- NCOIL Meetings typically have between 275 – 375 registrants
  - This includes attendance from about 60 legislators from 30 states and several state Insurance Commissioners.
- Great time to be involved
  - In 2022, 109 legislators attended NCOIL National Meetings along with 20 Insurance Commissioners. Annual Meeting broke all time attendance record.
- NCOIL Meetings are truly bipartisan and representative of America
  - At our most recent Summer Meeting, 27 Republicans and 21 Democrats attended, a split of 56-44%. 23 legislators of gender or racial diversity attended, representing 48% of the total.

Thank you

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Griffith Foundation and NCOIL Collaborative Relationship

- The Institutes Griffith Foundation and NCOIL have collaborated to educate policy makers for more than two decades. In recent years, the collaborative effort has included educational webinars and inperson training programs at NCOIL meetings.

The Institutes Griffith Foundation

An Overview

MISSION

The Institutes Griffith Insurance Education Foundation seeks to empower public policymakers and their staff members through a greater understanding of insurance and risk management by providing unbiased educational programs.

Public Policymaker Education (PPE)

- Rationale
  - RMI Plays a Critical Role in the Financial Security of Our Country.
  - Informed Risk Management Serves as Catalyst for a More Secure Future.
  - Better Informed Policymakers are Better Equipped to Make Sound Decisions.

Public Policymaker Education (PPE)

- Methods
    - Delivered via: live webinar, on-demand playback; and traditional in-person sessions (greater focus on remote programming in recent years given pandemic)
    - Many programs offered in collaboration with complementary organizations
    - Lecture, Interview-based sessions, and panel presentations

The Griffith Insurance Education Foundation, an affiliate of The Institutes, is a 501(c)(3) non-profit, non-partisan, and non-advocative educational organization dedicated to the teaching and study of insurance and risk management.

In keeping with the non-partisan, non-advocative mission of The Griffith Foundation, comments and contributions to today's session will be unbiased and purely educational.

Fundamental Principles of Risk Management and Insurance

Presentation for:
Vermont State Lawmakers
Montpelier, VT
Feb. 1, 2023

Presentation by:
David M. Pooser, Ph.D.
Associate Professor
St. John's University

Understanding Risk and Risk Management

What is Risk?

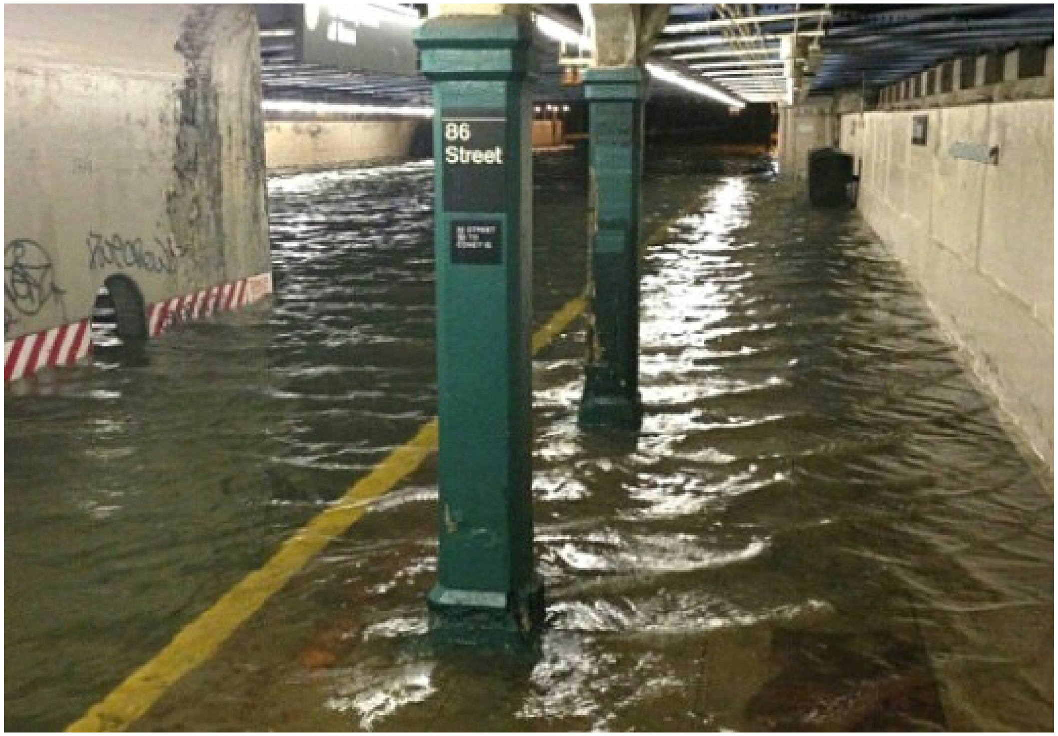
Uncertainty concerning the occurrence of a loss

What is Risk?

Uncertainty concerning the occurrence of a loss

- Skydiving
- Driving to work
- Building a new home

Comparing “riskiness” to “ambiguity”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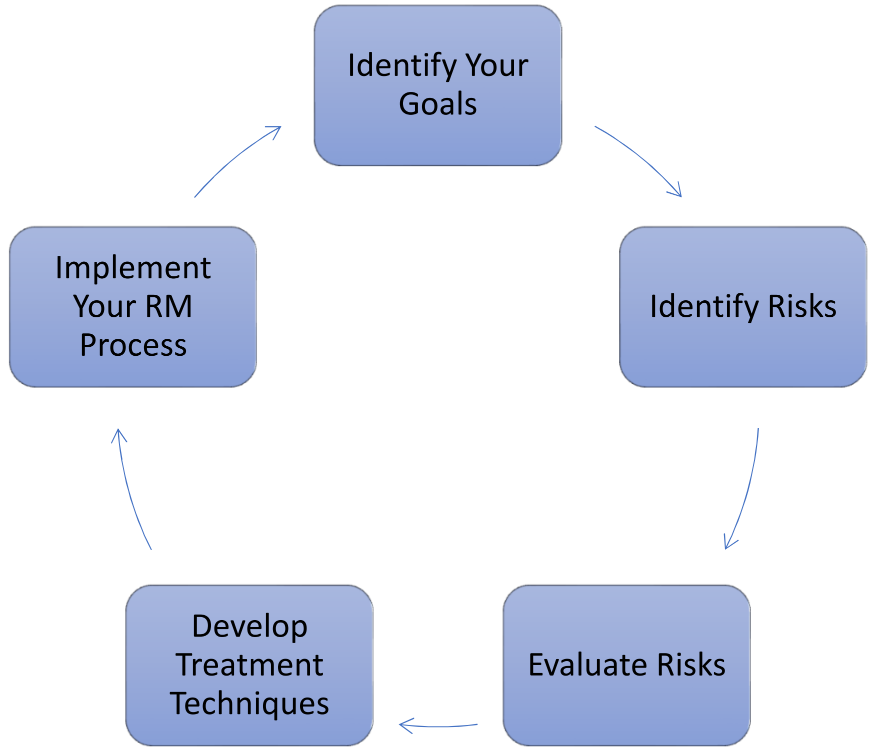
The Risk Management Process



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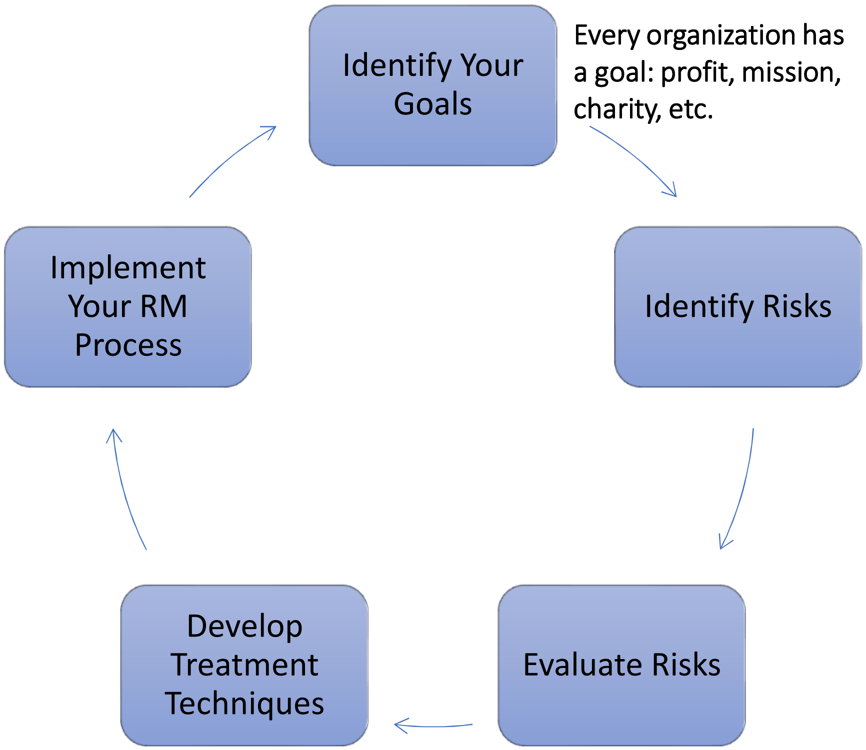

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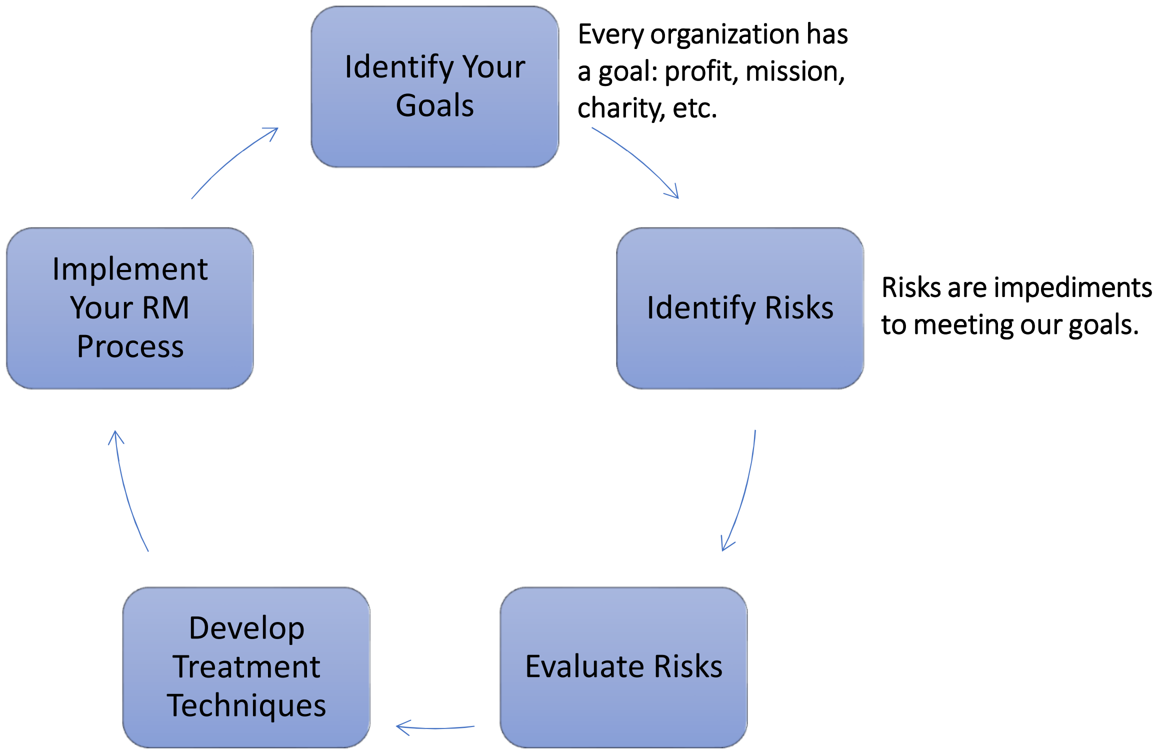

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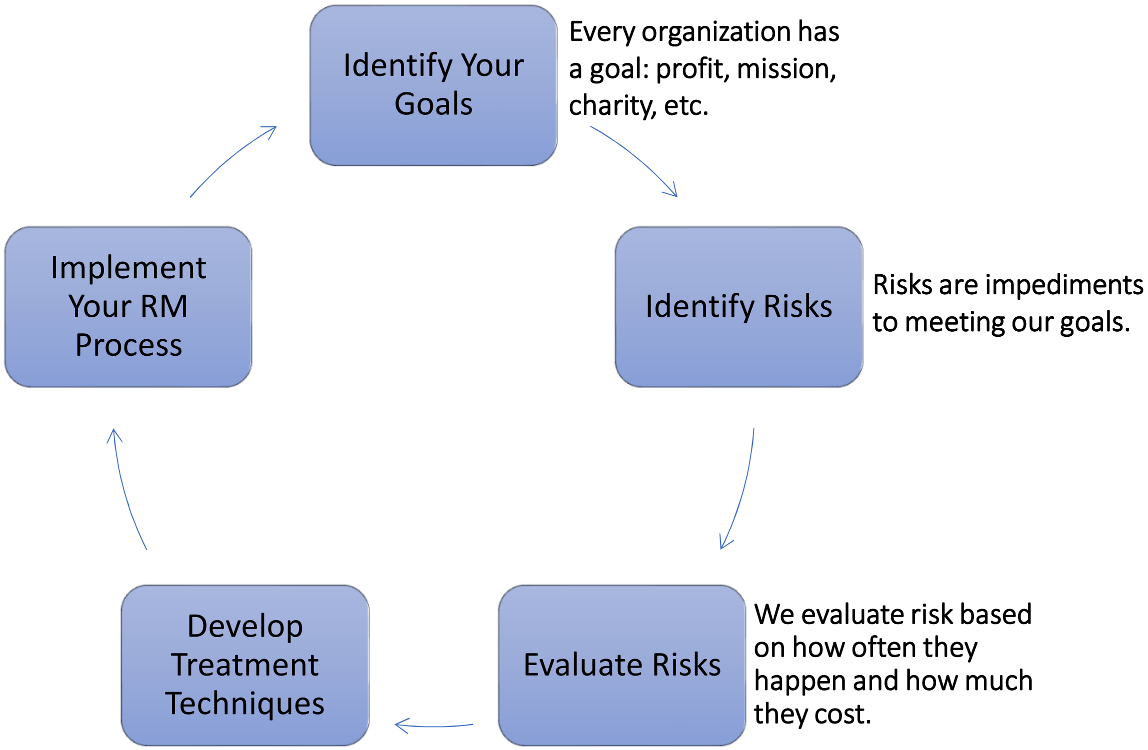

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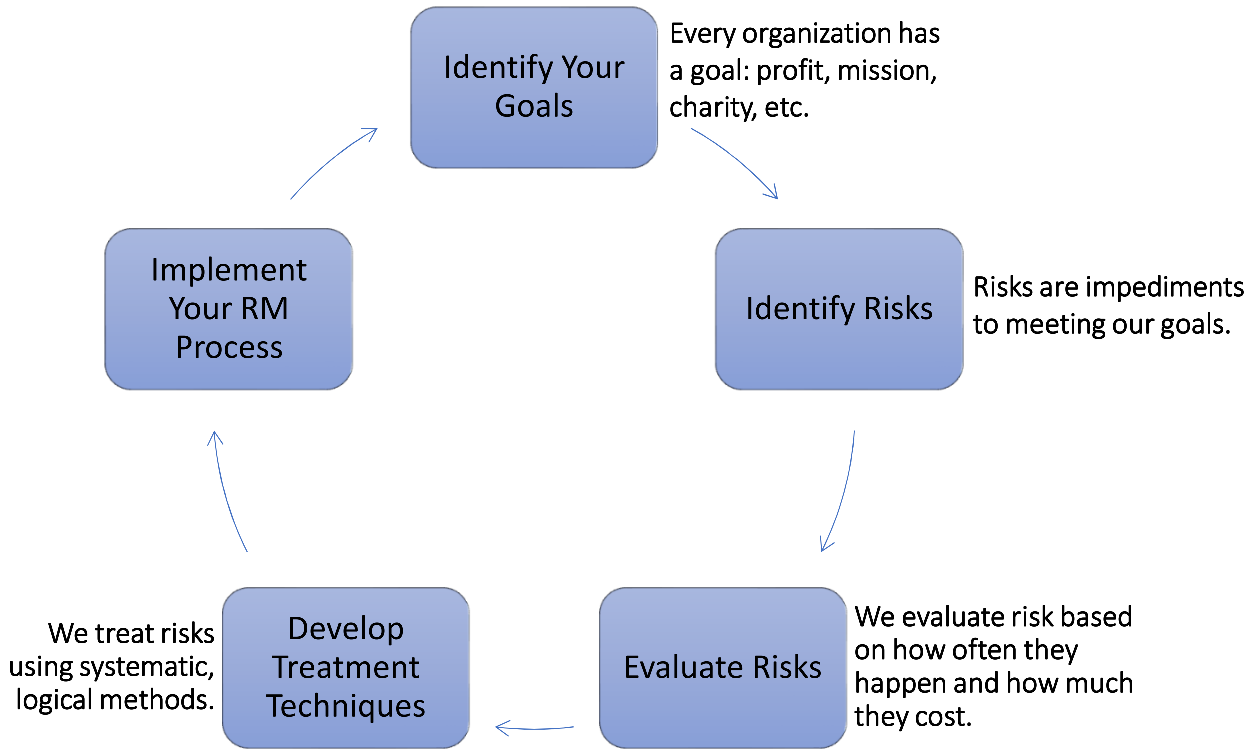

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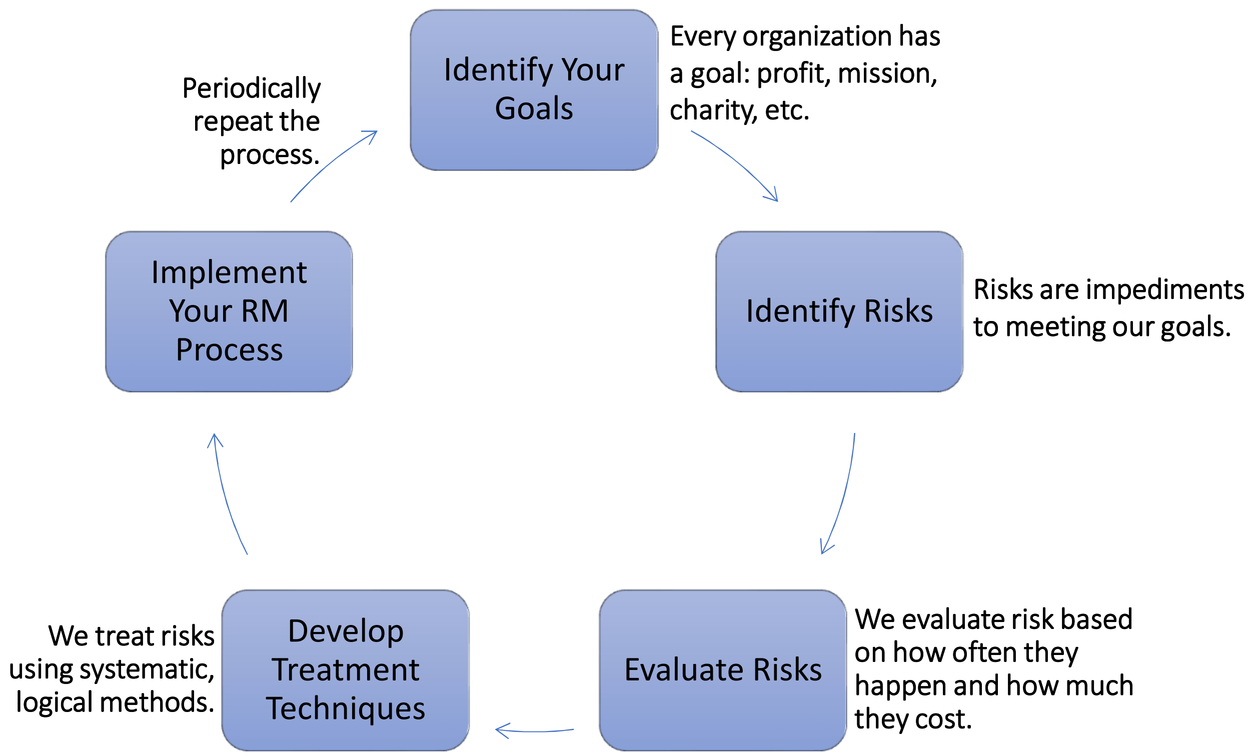

Risk Terminology

Defining Risk

Pure Risk

A situation in which the only outcomes are loss or no loss.

Pure risk scenarios are generally those we can insure.

E.g., car crash, home damage, premature death

Risk Exposure

A situation in which loss is possible, regardless of whether or not it occurs.

E.g., owning a home, operating a car, hiring workers

What causes a loss?

Hazard

A condition that creates or increases the chance of a loss

Peril

The cause of a loss

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Risk Application – Pricing Example

Evaluating Risk

Loss Frequency

The expected number of losses in a time period

Loss Severity

The expected size of a loss (should it occur)

Expected Loss Costs =

Loss Frequency X Loss Severity

Risk Pricing Example

Sugar Maple Indemnity Co. writes auto insurance coverage for 10,000 drivers in Vermont. In an average year, 300 of those drivers are expected to experience a car crash. The average crash costs $15,000. What does Sugar Maple Indemnity Co. need to charge each customer in order to pay claims in an average year?

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300 accidents (frequency)

$15,000 per accident (severity)

Expected Losses = frequency X severity

Expected Losses = 300 X $15,000 = $4,500,000

$4,500,000 ÷ 10,000 drivers = $450 / driver

What about the insurer's expenses?

Insurance Market Fundamentals

What is Insurance?

Insurance

The pooling of fortuitous losses by transfer of such risks to insurers, who agree to indemnify insureds for such losses, to provide other pecuniary benefits on their occurrence, or to render services connected with the risk

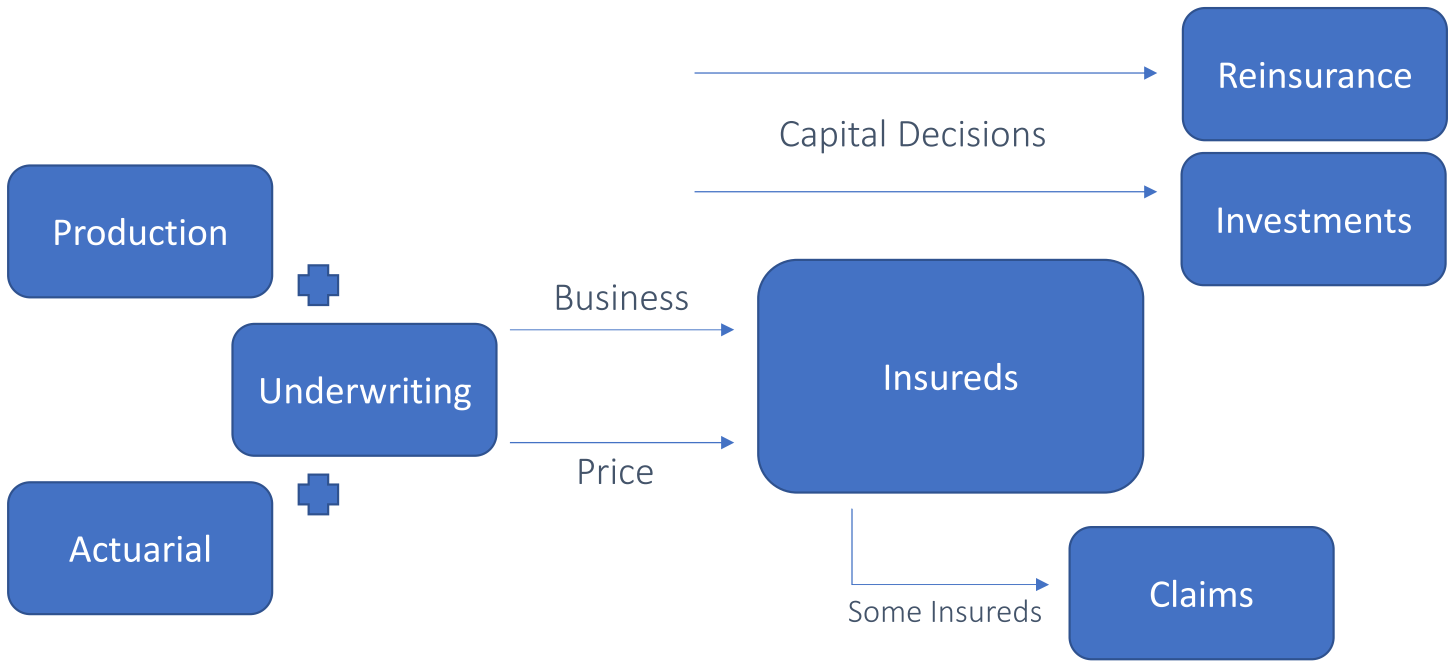
Insurer

Insured

Characteristics of Insurance

- Pooling of losses
- Risk transfer
- Indemnification
- Payment of fortuitous losses

How does an insurer operate?



A Brief Synopsis of U.S. Insurance Regulation

The Foundation of US Insurance Regulation

Each state:

- Lawmakers create and pass laws which govern insurance companies and transactions.
- Insurance Offices / Departments execute those laws and oversee insurance company operations.

Purposes of regulation

- To protect policyholder interests
- To minimize economic costs of insurer failures
- To ensure fair premiums and coverage

The Rationale for US Insurance Regulation

Can you describe the insurer’s business model?

- Use contrast to understand an insurer’s product: Henry’s Doughnut Shop

What do insurers sell? – A promise

What do insureds stand to lose if an insurer fails?

- Home
- Savings
- Livelihood

How did we get here?

Paul v. Virginia (1869)

Supreme Court rules that insurance is not inter-state commerce and can be regulated by the state

Southeastern Underwriters Association (1944)

Supreme Court rules that insurance can be regulated under the Commerce Clause (subject to federal regulation)

McCarran-Ferguson Act (1945)

Congress passes law that ensures state regulation and taxation of insurance businesses

Some exceptions – PPACA (congress votes to suspend Mc-F); NARAB II

Challenges and New Risks in Insurance

Insurance Market Challenges

Adverse Selection

Rates should be equitable

E.g., A New York driver registers his car with a Vermont relative to get less expensive auto insurance coverage.

Moral Hazard Problems

Cost drivers for the insurance pool

E.g., tailgating a semi-truck on I-91 because your insurance will pay for a replacement windshield.

Controlling Insurance Challenges

Adverse Selection

- Strong underwriting to accurately price insureds
- Use risk-based premiums so that prior losses have an impact on future prices

Moral Hazard

- Use deductibles so that insureds “feel” the loss
- Claims process to ensure losses are covered by contract

Some “Food for Thought” in the Insurance Market

Emerging Risk: Driverless car technology

Changes to the business model:

- Insurtech (Application – the Direct-to-Consumer sales approach)
- AI for pricing and claims
- New forms of analytics and underwriting

Driverless Cars / Autonomous Vehicles

Driverless Cars / Autonomous Vehicles – Disrupting Insurance

Driverless vehicles are expected to reduce accident frequency by a significant amount (conservative estimates are 70-80%).

- How will the insurance industry respond? Auto makes up >40% of P&C insurance premiums.

Who bears the risk of driverless car crashes?

What types of coverages will be needed for driverless cars?

- Owner
- Passengers
- Manufacturer
- Software manufacturers
- Infrastructure manufacturers

Insurtech – Direct-to-Consumer Marketing

Direct insurance sales have grown substantially in certain insurance lines since the 1990s. Why?

- Pricing
- Ease-of-access

Policymaker concerns:

- Insurance should be widely available
- Insurance offering should be non-discriminatory
- Consumers should be well-informed

How can DTC Insurtech address these concerns?

- No physical presence
- Online knowledge base?

U.S. Insurance Industry Statistics

Property & Casualty
- Gross Premiums - $798 billion (2021)
- Total Investments - $2.2 trillion (2021)
  - Investment Income - $56 billion
  - Net Income Before Tax - $63.4 billion

Life & Health
- Gross Premiums - $819 billion (2021)
- Invested Assets - $5.2 trillion (2021)
  - Investment Income - $201 billion
  - Net Income After Tax - $37.4 billion

Source – 2022 Federal Insurance Office Annual Report

Thank you for your interest!

Questions / Comments?