

Risk Management

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MGM510



Lec.5 : Types of Insurers and Marketing Systems

Types of Insurers and Marketing Systems

“Insurers are increasingly using multiple distribution

Channels to sell their products.”

Insurance Information Institute



Lecture objectives

After studying this chapter, you should be able to

❖ Describe the major types of private insurers, including the following:

- Stock insurers
- Mutual insurers
- Reciprocal exchanges
- Lloyd's of London
- Blue Cross and Blue Shield plans
- Health maintenance organizations

❖ Describe the major distribution systems for selling life insurance, including

- Personal selling systems
- Financial institution distribution systems
- Direct response system
- Other distribution systems

❖ Describe the major distribution systems in property and casualty insurance, including the following:

- Independent agency system
- Exclusive agency system
- Direct writer
- Direct response system
- Mixed systems

General Background

- ❖ This chapter discusses the role of private insurance companies in the financial services industry. Topics discussed include an overview of the financial services industry, the major types of private insurers, the major marketing methods for selling insurance, and the role of agents and brokers in the sales process.



Overview of Private Insurance in the Financial Services Industry

The financial services industry consists of thousands of financial institutions that provide financial products and services to the public. Financial institutions include 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, various government-related financial institutions, finance companies, and other financial firms.

Types of Private Insurers

- ❖ There are various ways of classifying insurance companies. In terms of legal ownership and structure, the major types of private insurers can be classified as follows:
- ❖ Stock insurers
- ❖ Mutual insurers
- ❖ Lloyd's of London
- ❖ Reciprocal exchanges
- ❖ Blue Cross and Blue Shield plans
- ❖ Health maintenance organizations (HMOs)
- ❖ Other types of private insurers



Stock Insurer

stock insurer is a corporation owned by stockholders. The objective is to earn profits for the stockholders.

The stockholders elect a board of directors who, in turn, appoint executive officers to manage the corporation.

The board of directors has ultimate responsibility for the corporation's financial success. If the business is profitable, dividends can be declared and paid to the stockholders; the value of the stock may also increase.

Likewise, the value of the stock may decline if the business is unprofitable.



Mutual Insurers

A mutual insurer is a corporation owned by the policyholders. There are no stockholders. The policyholders elect a board of directors who appoint executives to manage the corporation. Because relatively few policyholders bother to vote, the board of directors has effective management control of the company.

A mutual insurer may pay dividends to the policyholders or give a rate reduction in advance. There are several types of mutual insurers, including the following:

- ❖ Advance premium mutual
- ❖ Assessment mutual
- ❖ Fraternal insurer

Advance Premium Mutual

Most mutual insurers are advance premium mutuals. An advance premium mutual is owned by the policyholders; there are no stockholders, and the insurer does not issue assessable policies. Once the insurer's surplus (the difference between assets and liabilities) exceeds a certain amount, the regulations will not permit a mutual insurer to issue an assessable policy. The premiums charged are expected to be sufficient to pay all claims and expenses. Any additional costs because of poor experience are paid out of the company's surplus.

Changing Corporate Structure of Mutual Insurers

The corporate structure of mutual insurers—especially life insurers—has changed significantly over time. Three trends are clearly evident:

1. Increase in company mergers.
2. Demutualization : it means that a mutual insurer is converted into a stock insurer.
3. Mutual holding company :is a company that directly or indirectly controls an authorized insurer.

Fraternal Insurer

A fraternal insurer is a mutual insurer that provides life and health insurance to members of a social or religious organization. This type of insurer is also called a fraternal benefit society.

To qualify as a fraternal benefit society under the state's insurance code, the insurer must have some type of social or religious organization in existence. In addition, it must be a nonprofit entity that does not issue common stock; it must operate solely for the benefit of its members or beneficiaries; and it must have a representative form of government with a ritualistic form of work. Examples include the Knights of Columbus, Woodmen of the World Life, and Thrivent Financial..

Lloyd's of London

Lloyd's of London is not an insurer, but is the world's leading insurance market that provides services and physical facilities for its members to write specialized lines of insurance. It is a market where members join together to form syndicates to insure and pool risks. Members include some of the world's major insurance groups and companies listed on the London Stock Exchange, as well as individuals (called Names) and limited partnerships..

Lloyd's of London

Lloyd's of London has several important characteristics :

First, as stated earlier, Lloyd's technically is not an insurance company; rather, it is a group of members (corporations, individuals, and limited partnerships) who underwrite insurance in syndicates.

Second, as stated earlier, the insurance is written by the various syndicates that belong to Lloyd's.

Third, new individual members, or Names, who belong to the various syndicates now have limited legal liability.

Fourth, corporations with limited legal liability and limited liability partnerships are also members of Lloyd's of London.

Fifth, members must also meet stringent financial requirements. Individual members are high-net worth individuals.

Finally, Lloyd's is licensed only in a small number of jurisdictions in the United States.

Reciprocal Exchange

A reciprocal exchange is another type of private insurer. A reciprocal exchange (also called an interinsurance exchange) can be defined as an unincorporated organization in which insurance is exchanged among the members (called subscribers). In its basic form, insurance is exchanged among the members; each member of the reciprocal insures the other members and, in turn, is insured by them. Thus, there is an exchange of insurance promises—hence, the name reciprocal exchange.

Most reciprocals are relatively small and account for only a small percentage of the total property and casualty insurance premiums written. In addition, most reciprocals specialize in a limited number of lines of insurance. However, a few reciprocals are multiple-line insurers that are large.

Blue Cross and Blue Shield Plans

- ❖ **Blue Cross and Blue Shield plans** are another type of insurer organization. Blue Cross plans initially were organized as nonprofit, community-oriented prepayment plans that provided coverage primarily for hospital services. Blue Shield plans earlier also were organized as nonprofit, prepayment plans that provided coverage for physicians' and surgeons' fees and other medical services. Today, most Blue Cross and Blue Shield plans have merged into single entities.
- ❖ Cross and Blue Shield plans are considered nonprofit organizations that receive favorable tax treatment and are regulated under special legislation.

Health Maintenance Organizations

- ❖ **Health maintenance organizations, or HMOs,** are organized plans of healthcare that provide comprehensive healthcare services to their members. The HMOs provide broad healthcare services to a specified group for a fixed prepaid fee; however, many HMOs today also have cost-sharing provisions, such as deductibles and copayments. Cost control is heavily emphasized.

Other Private Insurers

- ❖ In addition to the preceding, other types of private insurers merit a brief discussion. These include captive insurers and savings bank life insurance:
- ❖ Captive Insurers As noted in Chapter 3, a captive insurer is an insurer owned by a parent firm for the purposes of insuring the parent firm's loss exposures. There are different types of captive insurers.
- ❖ A single-parent captive (also called a pure captive) is an insurer owned by one parent, such as a corporation.
- ❖ The captive can be an association captive, which is owned by several parents. Captive insurers are becoming more important in commercial property and casualty insurance, and thousands of captive insurers exist today.

Savings Bank Life Insurance

Savings Bank Life Insurance (SBLI) refers to life insurance that was sold originally by mutual savings banks in three states:

- ❖ Massachusetts
- ❖ New York
- ❖ Connecticut.

Today, SBLI is also sold to consumers over the phone or through websites in those states, and to consumers who reside in other states as well, including Maine, New Hampshire, New Jersey, Pennsylvania, and Rhode Island. The objective of SBLI is to provide low cost life insurance to consumers by holding down operating costs and the payment of high sales commissions to agents.

Agents and Brokers

A successful sales force is the key to success in the financial services industry. Most insurance policies sold today are sold by agents and brokers.



Agents

An agent has the authority to represent the insurer based on express authority, implied authority, and apparent authority.

Express authority refers to the specific powers that the agent receives from the insurer.

Implied authority means the agent has the authority to perform all incidental acts necessary to exercise the powers that are expressly given.

Apparent authority is the authority the public reasonably believes the agent possesses based on the actions of the principal.

Agents

The agent is acting within the scope of his or her authority granted or implied by the principal.

There is an important difference between a property and casualty insurance agent and a life insurance agent. A property and casualty agent has the power to bind the insurer immediately with respect to certain types of coverage.

Brokers

In contrast to an agent who represents the insurer, a broker is someone who legally represents the insured even though he or she receives a commission from the insurer. A broker legally does not have the authority to bind the insurer. Instead, he or she can solicit or accept applications for insurance and then attempt to place the coverage with an appropriate insurer. But the insurance is not in force until the insurer accepts the business.

A broker is paid a commission by insurers where the business is placed. Many brokers are also licensed as agents, so that they have the authority to bind their companies when acting as agents.

Brokers are extremely important in commercial property and casualty insurance. Large brokerage firms have knowledge of highly specialized insurance markets, provide risk management and loss-control services, and handle the accounts of large corporate insurance buyers.

Brokers

Brokers are important in the surplus lines markets. Surplus lines refer to any type of insurance for which there is no available market within the state, and the coverage must be placed with a non admitted insurer.

A non admitted insurer is an insurer not licensed to do business in the state. A surplus lines broker is a special type of broker who is licensed to place business with a non admitted insurer.

A surplus lines broker has the authority to place the business with a surplus lines insurer if the coverage cannot be obtained in the state from an admitted company.

Brokers are important in the area of employee benefits, especially for larger employers.

Brokers also play a major role in the marketing of property and casualty insurance to large national accounts.

Types of Marketing Systems

Marketing systems refer to the various methods for selling and marketing insurance products. These methods of selling are also called distribution systems.

Insurers employ actuaries, claims adjusters, underwriters, and other home office personnel, but unless insurance policies are profitably sold, the insurer's financial survival is unlikely. Thus, an efficient distribution system is essential to an insurance company's survival.



Life Insurance Marketing

Distribution systems for the sale of life insurance have changed dramatically over time. Traditional methods for selling life insurance have been substantially modified, and new marketing models have emerged. It is beyond the scope of the text to discuss all distribution methods in detail. However, the major life insurance distribution systems used today can be classified as follows:

- ❖ Personal selling systems
- ❖ Financial institution distribution systems
- ❖ Direct response system
- ❖ Other distribution systems.

Personal Selling Systems

The majority of life insurance policies and annuities sold today are through personal selling distribution systems, which are systems in which commissioned agents solicit and sell life insurance products to prospective insureds. Life insurance and annuities are complex products, and knowledgeable agents are needed to explain and sell the various products. Personal selling distribution systems include the following:

- ❖ Career agents.
- ❖ Multiple Line Exclusive Agency System.
- ❖ Independent Property and Casualty Agents.
- ❖ Personal-Producing General Agent (PPGA).
- ❖ Brokers.

Career agents.

Career agents are full-time agents who usually represent one insurer and are paid on a commission basis. These agents are also called affiliated agents because they sell primarily the life insurance products of a single insurer.

Under this system, insurers recruit new agents and provide financing, training, supervision, and office facilities. Commissions on the sale of life insurance typically range from 40 to 90 percent of the first-year's premium. Renewal commissions for policies in force are much lower, such as 2 to 5 percent, and are paid for a limited number of years. Despite aptitude tests, the attrition rate for new life insurance agents is high. The five year retention rate is typically less than 15 percent for many insurers.

Multiple Line Exclusive Agency System.

Under the multiple line exclusive agency system, agents who sell primarily property and casualty insurance also sell individual life and health insurance products.

These agents are also called captive agents. Under this system, agents represent only one insurer or group of insurers that are financially interrelated or under common ownership. For example, an agent may sell an auto or homeowners policy to a client. Depending on the client's needs and insurance products available, the agent can also sell life insurance, health insurance, annuities, mutual funds, individual retirement accounts, and other products as well. State Farm Mutual and Allstate are examples of this system.

Independent Property and Casualty Agents

Independent property and casualty agents are independent contractors who represent several insurers and sell primarily property and casualty insurance. In addition to property and casualty insurance, many independent agents also sell life and health insurance to their clients..

Personal-Producing General Agent (PPGA)

Some independent agents place substantial amounts of business with one insurer and enter into a special financial arrangement with that insurer.

A personal-producing general agent (PPGA) is an independent agent who receives special financial consideration for meeting minimum sales requirements.

Brokers

Life insurance and annuities are also sold by brokers. Brokers are independent agents who do not have an exclusive contract with any single insurer or an obligation to sell the insurance products of a single insurer. Although brokers may place a substantial amount of business with a particular insurer, they have no obligation to sell a certain amount of insurance for that insurer. Brokers usually enter into separate agency contracts with each insurer in which business is placed.

Financial Institution Distribution Systems

Many insurers today use commercial banks and other financial institutions as a distribution system to market life insurance and annuity products. Commercial banks are becoming increasingly more important in the marketing of fixed and variable annuities, and to a lesser degree, life insurance .

Direct Response System

The direct response system is a marketing system by which life and health insurance products are sold directly to consumers without a face-to-face meeting with an agent. Potential customers are solicited by television, radio, mail, newspapers, and the Internet. Some insurers use telemarketing to sell their products; others advertise extensively on television. Many insurers have websites through which life and health insurance can be sold directly to the consumer.

The direct response system has several advantages to insurers. Insurers gain access to large markets; acquisition costs can be held down; and uncomplicated products, such as term insurance, can be sold effectively. One disadvantage, however, is that complex products are often difficult to sell because an agent's services may be required.

Other Distribution Systems

Life insurers also use a variety of additional distribution systems to sell their products. They include the following:

- ❖ **Worksite Marketing.** Under this system, individual producers go into a business firm, and, with the approval of management, conduct sales interviews on site with employees interested in purchasing life insurance products or annuities. There are few direct costs or fees to employers, and this method is especially appropriate for low-income and middle-income markets.
- ❖ **Stock Brokers.** Many stock brokers are also licensed to sell life insurance products and fixed and variable annuities. As a result, stock brokers can better meet both the investment needs and life insurance needs of clients.
- ❖ **Financial Planners.** Financial planners provide advice to clients on investments, estate planning, taxation, wealth management, and insurance.

Property and Casualty Insurance Marketing

The major distribution systems for marketing property and casualty insurance include the following:

- ❖ Independent agency system
- ❖ Exclusive agency system
- ❖ Direct writer
- ❖ Direct response system
- ❖ Multiple distribution systems

Independent agency system

which is sometimes called the American agency system, has several basic characteristics.

First, the independent agency is a business firm that usually represents several unrelated insurers. Agents are authorized to write business on behalf of these insurers and, in turn, are paid a commission based on the amount of business produced.

Second, the agency owns the expirations or renewal rights to the business. If a policy comes up for renewal,

the agency can place the business with another insurer if it chooses to do so.

Third, the independent agent is compensated by commissions that vary by line of insurance. The commission rate on renewal business generally is the same as that paid on new business.

Exclusive Agency System

Under the exclusive agency system, the agent represents only one insurer or a group of insurers under common ownership. Exclusive agents may be prohibited by contract from representing other insurers. However, some contracts may permit the agent to sell an insurance product of a competitor if the company she or he represents has no similar product.

Exclusive agents in the property and casualty industry are also called captive agents who represent a single insurer or a group of insurers under common management.

Direct Writer

the term “direct writer” generally applies to insurers that use certain marketing methods. Two examples are often cited in the trade press and professional literature.

First, the term “direct writer” is an insurer in which sales representatives are employees and not independent contractors, such as salaried representatives.

Second, a “direct writer” is a term to identify insurers that use the exclusive agency system for selling insurance products; as stated earlier, agents represent only one insurer or group of companies under common ownership or management.

Direct Response System

Property and casualty insurers also use the direct response system to sell insurance.

A direct response insurer sells directly to the public by television, telephone, mail, newspapers, and other media. Property and casualty insurers also operate websites that provide considerable consumer information and premium quotes.

The direct response system is used primarily to sell personal lines of insurance, such as auto and homeowners insurance. It is not as useful in the marketing of commercial property and casualty coverages because of complexity of contracts and rating considerations

Group Insurance Marketing

- ❖ Many insurers use group insurance marketing methods to sell individual insurance policies to members of a group. Employees typically pay for the insurance by payroll deduction. Workers no longer employed can keep their insurance in force by paying premiums directly to the insurer.
- ❖ Mass merchandising is a plan for selling individually underwritten property and casualty coverages to group members; individual underwriting is used; rate discounts may be given; employees typically pay for the insurance by payroll deduction; and employers do not usually contribute to the plans.



Thank You