

Consumers' Insurance Literacy

- Cude survey (2005) finds that many consumers do not understand insurance disclosures, and admit that they do not read them.
- National Association of Insurance Commissioners (2010) survey found that only one-third of consumers believed they have a good understanding of their insurance policies.
- Survey and focus group evidence show that word-of-mouth and informal sources are the dominant information-gathering strategies for insurance consumers (Schwarcz, 2010; Tennyson, 2011).

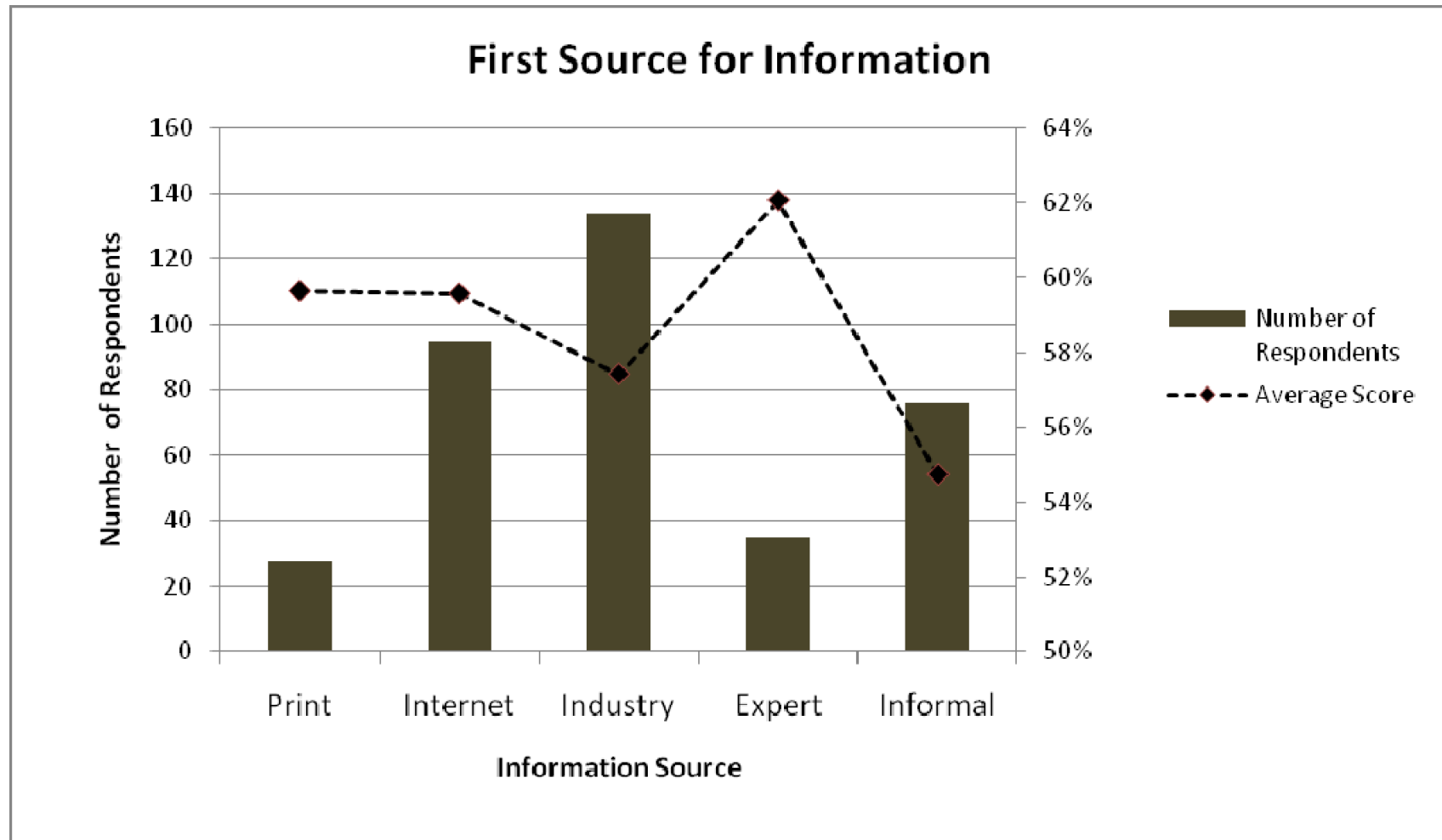
Common Misperceptions

- Based on focus groups (7) with a total of 66 participants fielded by Tennyson and Bristow (2002).
- Most focus group participants had significant experience with insurance purchase, and a majority characterized themselves as somewhat or very knowledgeable about insurance.
- Yet, through discussion, some misconceptions about insurance were demonstrated.
 - Purchasing insurance that is arguably not needed because the monthly premium was low
 - Believing that automobile insurance premiums one has paid over time should “add up” to pay for the accident losses one experiences
 - Believing that experiencing a loss indicates insurance was needed, while experiencing no loss indicates that insurance premiums were wasted
 - Believing that the insurance needs of all consumers are the same.

Consumer Knowledge

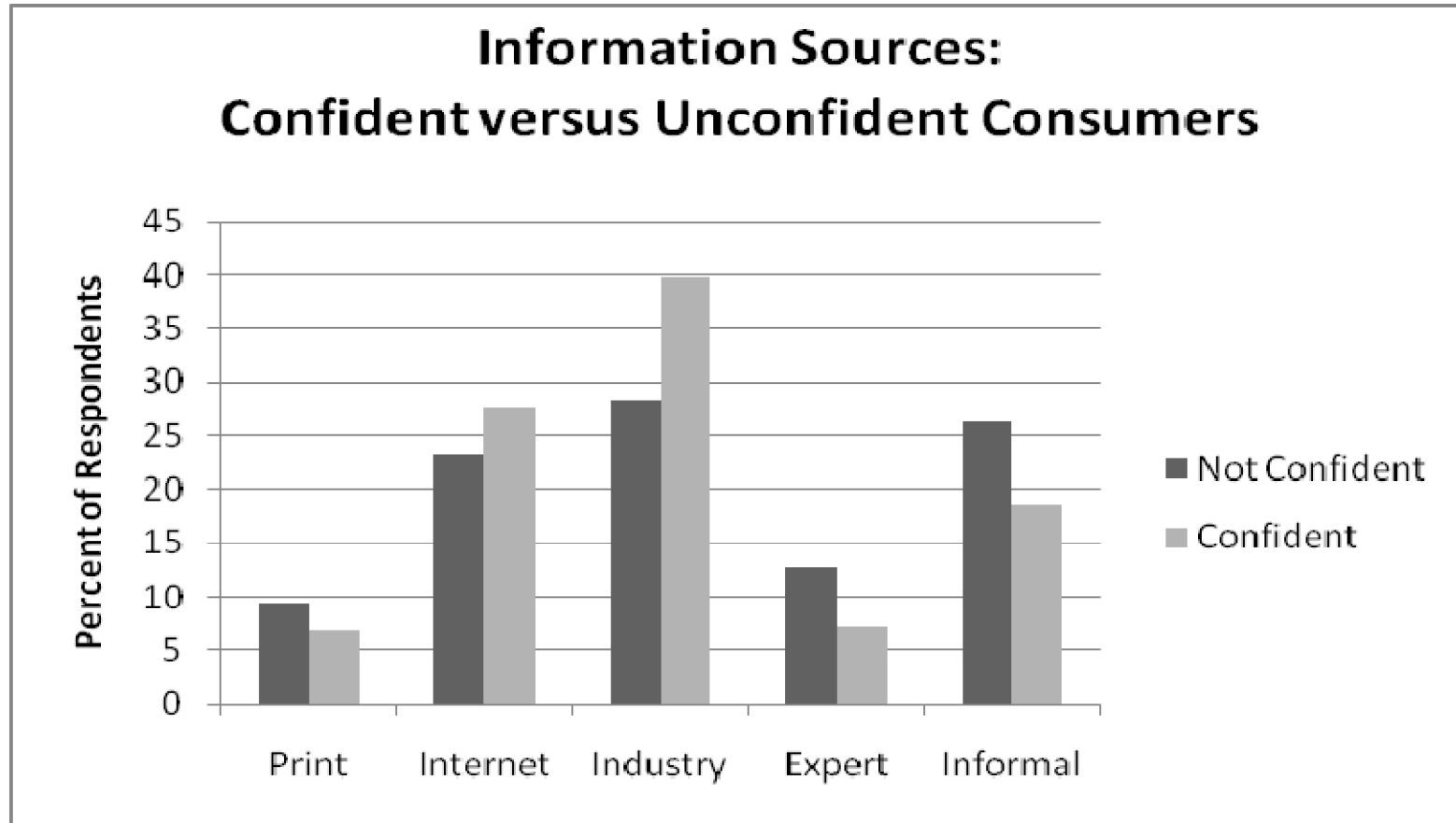
- Two recent surveys have attempted to assess insurance literacy more generally, using samples of adults of all ages.
 - See National Association of Insurance Commissioners (NAIC, 2010) and Tennyson (2011)
- Results:
 - The average consumer is not very well informed, mean scores on these assessments are less than 60 percent.
 - The average consumer is better able to answer questions regarding insurance principles and insurance terminology than questions regarding terms and conditions of specific policies.

Information Source and Quiz Score



US data; 368 consumers; see Tennyson 2011

Agents as Information Source?



US data; 368 consumers; see Tennyson 2011

Regulations on Information Quality

- Product regulations
 - Content and form restrictions
 - Disclosure requirements
- Agent regulations
 - Fee arrangements
 - Disclosures of conflicts
 - Restrictions on information/illustrations
 - Licensing and registration
 - Professional liability

Insurance Regulation under EU

- **Fundamental goal of EU standardization is open markets: homogeneous rules throughout the EU**
- Eliminated rate regulation and content regulation of most insurance products
 - EU's Third Generation Insurance Directive (1994)
- Imposed uniform agent licensing requirements
 - EU Directive on Insurance Mediation (2002)

EU Changes to German Insurance

- Prior to EU, regulatory prior approval of product forms was mandatory in personal lines of insurance.
 - High level of product standardization and limited competition, albeit one with also a high level of transparency
- Prior to EU, there were no professional requirements for agents and brokers
 - Large number of agents, including part-time and casual agents, and information quality was low

Agent Licensing Requirements

- Entry requirements
 - Must provide proof of insurance expertise by passing a licensing test
 - Licensing information entered in the trade register
 - Must obtain professional liability insurance
 - Must have a good reputation – no crime in past 5 years
 - Must be in solid financial condition – no insolvency proceedings ongoing

Agent Licensing Requirements

- Behavioral standards
 - Must provide information about their license, their relationships with insurance companies and about consumers' rights under insurance contracts.
 - The customer's desires and needs must be taken into consideration when providing advice.
 - Advice must be given concerning the specifics of individual products.
 - Recommendations must be based on a sufficient number of insurance products, with independent agents required to provide a broader choice set than exclusive agents who only work for one company.
 - The entire process must be documented.

Impact on Agent Market

- Total number of agents fell from 400,000 in 2007 to 244,000 in 2009
- Impact at one insurer:

	2004	2005	2006	2007	2008	2009	2010
Number of all Agents	2,273	2,502	2,644	2,843	1,399	1,151	1,037
Number of all Exclusive Agents (EAs)	1,935	2,121	2,223	2,388	994	805	742
Professional	1,453	1,610	1,691	1,852	491	436	387
Office-worker	482	511	532	536	503	369	355

Did Agent Quality Improve?

- Preliminary evidence using customer cancellations suggests agent advice quality increases due to the regulations
 - Pre-regulation early cancellation rates were higher for exiting agents [sorting effect]
 - Post-regulation early cancellation rates of remaining agents decreases relative to rates in pre-regulation period and relative to rates of direct selling channel [incentive effect]

Response to Product Deregulation

- Rise of an “information market”
 - Independent product quality ratings provided by private firms
 - most important private agencies are Morgen & Morgen and Franke & Bornberg
 - these agencies grew out of insurance brokerage firms
 - ratings are largely targeted to insurance sales channels
 - rating products are accompanied by databases and software solutions provided to assist brokers in product comparisons

Verbal descriptions of ratings	M & M	F & B	Finanztest
excellent / outstanding / very good	*****	FFF FF+	0.5 - 1.5
very good / good	****	FF	1.6 - 2.5
average / satisfactory / still satisfactory	***	FF- F+	2.6 - 3.5
weak / sufficient	**	F F-	3.6 - 4.5
very weak / unsatisfactory	*	F--	4.5 - 5.5

Can Ratings Protect Consumers?

- Rating market governance:
 - Product rating market does not have problematic characteristics of the US credit rating market
- Specifically:
 - Rating agencies each rate all products
 - Insurer does not pay to generate the rating
 - Main customers for insurance product ratings are agents and brokers
 - Main consulting clients of the private rating agencies are insurance brokers and agents
- And: Intermediary regulations create agent incentives to provide consumers with data

	Finanztest 2013	Morgen & Morgen 2013	Finanztest 2013	Franke & Bornberg 2013*
Common observations	67		65	
Mean rating	4.716	4.403	4.692	4.708
Std.Dev. rating	0.598	0.818	0.635	0.458
Minimum rating	3	2	3	4
Maximum rating	5	5	5	5
Percent of ratings = 5	79.10	59.70	78.34	70.77
Pct of equal ratings	67.16		69.23	
Pct of government ratings exceeding private ratings	29.85		16.92	
Pct of private ratings exceeding government ratings	2.99		13.85	

Discussion

- Under some market conditions a useful private market for product ratings may arise in the absence of government product regulations.
- Professional agent/broker segment is an important supporting feature for this information market
- Existence of government ratings may also be an important supporting feature

References

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- Lex, C., and Tennyson, S. “Implementation of EU Intermediary Regulation: Intentions and Unintended Side Effects,” working paper