

including insurance, of the enterprise that he is contemplating is more than he is willing or able to pay. Possibly it will be desirable as a matter of public policy that the enterprise be subsidized by other policyholders or by society in general. When that is the case, it can be accomplished by techniques similar to those used in the past. Open competition should alleviate the need for these methods but it will not completely eliminate it.

THE CONSUMER AND THE EDUCATOR

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“Open-competition” rating laws include all rate regulatory laws that prohibit agreements among insurers (except those under common control) and rating organizations to adhere to certain rates or rules. In early 1970 eleven states had such laws. In varying degrees these laws assign a greater role to competition in the determination of insurance price levels and price structures than other rate regulatory laws and involve the state insurance department less directly in ratemaking.

In five states insurers need not even file their rates — California, Florida, Idaho, Illinois (where filing may be required by regulation), and Montana. Three require filing within a stated period after the rates become effective — Connecticut, New York, and Wisconsin. In the other three — Georgia, Minnesota, and Oregon — insurers must file rates no later than their effective date. In some of these states the commissioner has the authority to impose more severe filing requirements if he finds the existing price competition to be insufficient or irresponsible.

The Consumer Viewpoint

Intelligent consumers will judge open competition rating laws primarily on their ability to provide an adequate supply of insurance at reasonable prices consistent with a “fair” profit for “efficient” insurers. If open competition laws work perfectly, each insured should pay a premium that is reasonable, adequate, and not unfairly discriminatory, in the private equity sense. An adequate supply of insurance should be forthcoming for all insureds at some price. If one insurer is inefficient necessitating high expense charges, earns excessive profits, or overcharges one group of insureds relative to

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others, competition should force this insurer to improve its practices or withdraw from the field. Of course, perfect competition is no more to be expected in insurance than in other areas of business.¹ Consumer knowledge is not perfect; even with complete price information consumer choice would still be extremely difficult because of product and service heterogeneity. The supply of insurance for some insured will be too small because of the risk involved or the lack of insurer interest in certain markets.

Open competition laws will clearly not be acceptable to insureds unless there is active, effective price competition of which the consumer is aware. The public expects government regulators to check constantly on the nature and degree of price competition, to encourage more competition when it is insufficient, and to stop irresponsible practices. The consumer's interest in a continuing review of the status of price competition will be strongest in those states that stipulate different filing and approval requirements, depending upon the regulator's findings. However, it will not be sufficient for the regulator to make such reviews. He must communicate his findings to the public with sufficient documentation so that his conclusions may be evaluated.

Among the types of information to be developed in this review are the following:²

1. Number of insurers and premium volume in the state classified by:
 - a. Line of insurance
 - b. Type of insurer
 - 1) Domicile
 - 2) Legal form of organization
 - 3) Marketing system (independent agency or direct writer)
 - 4) Pricing system (bureau prices or other prices)
2. Degree of concentration by line
 - a. Present status
 - b. Trends

¹ For a classic treatise on the problems associated with maintaining price competition, see Arthur R. Burns, *The Decline of Competition* (New York: McGraw-Hill Book Company, Inc., 1936).

² See, for example, the section on the competitive structure of the property-liability insurance business in New York in *The Public Interest Now in Property and Liability Insurance Regulation* (New York: State of New York Insurance Department, January 7, 1969), pp. 83-94.

3. Entry and exit
 - a. Number of insurers entering and existing during recent period
 - b. Growth patterns of new insurers
 - c. Insolvencies and their causes
4. Price structures
 - a. Role of rating organizations
 - b. Frequency distribution of prices
 - c. Price elasticity — share of market controlled by low-cost insurers; effect of share of business controlled by individual insurers as their price position changed for selected classes
5. Contract variations and improvements
6. Marketing methods
7. Underwriting practices
8. Non-price competition
9. Insurer loss and expense experience (loss ratios, expense ratios, and profits)
 - a. Average and frequency distribution
 - b. Latest year and trends
10. Specific market studies — e.g., the competitive characteristics of:
 - a. Automobile insurance for young drivers
 - b. School property insurance
 - c. Property insurance on urban core properties
 - d. Malpractice liability insurance
 - e. Insurance for farmers
11. Special problems and how they were handled:
 - a. Insufficient competition, including an inadequate supply of insurance
 - b. Irresponsible competition

Even though the regulator may be able to satisfy himself and the public that price competition is effective under the open competition law, there remains the question whether, from the consumer's point of view, superior results might be achieved under some other approach. Consequently the report on the performance of open competition rating laws should include comparisons with other similarly situated jurisdictions except for their approach to rate regulation.

Consumers expect that regulators will not only review and report what insurers do, but that they will take steps to make price competition more effective. The information on price structures in the report outlined above should explode the still common belief that all insurers charge the same price for all forms of property and liability insurance. A more debatable issue is whether the regulator should distribute charts showing the rates charged by each licensed insurer for selected classes and lines of insurance. As long as (1) the selected classes are changed over time to prevent insurers from paying special attention to selected classes and (2) insureds are alerted to the limitations of the data presented, such charts should improve greatly consumer knowledge and thus make price competition more effective. Georgia has pioneered this approach and its experience deserves further study.³ Insurers anxious to preserve open competition may themselves take the initiative to improve consumer information. In Great Britain an independent body, the Consumer Council, has recommended that insurers set up local insurance centers where consumers can shop for policies sold by all insurers and obtain comparative price information.⁴ Other changes that might improve the ability of consumers to make wise price choices (but which might have offsetting disadvantages) would include the adoption of standard policies, standard rating territories, and other standard rating factors.

Perfect operation of open competition laws, however, will not satisfy another objective of government regulation, the socialization of risk, a goal which is receiving increasing support. From the viewpoint of society, it may be desirable for some consumers to subsidize other consumers; from a broad point of view, this socialization may be in the best interests of the consumers who provide the subsidy.⁵ For example, middle-aged drivers may be asked to (and may be willing to) subsidize young drivers in order to increase the proportion of insured young drivers; dwelling-owners in prosperous suburbs may be asked to (and may be willing to) subsidize owners of urban-core property subject to special environmental hazards. Socialization of risk in this way is inconsistent with open competition goals. If one insurer were to

³ According to the Georgia study, the consumer could save many dollars by shopping around. For example, in 1968 a 45 year old male garaging his car in Atlanta could, depending upon other characteristics, pay a premium for automobile liability insurance (10/20 and 10 limits) ranging from \$35 to \$83.

⁴ "Council Calls for Insurance Markets in U.K.," *Journal of Commerce*, April 14, 1970, pp. 1, 6.

⁵ A. F. Whitman and C. A. Williams, Jr., "Environmental Hazards and Rating Urban Core Properties," forthcoming issue of *Journal of Risk and Insurance*.

charge rates based on the socialization of risk, but the others were to price competitively, that insurer would soon be driven out of business. Consequently some modification of open competitions laws is necessary. Depending upon (1) the relative emphasis assigned to socialization of risk as opposed to private equity and (2) the extent of the hazard costs to be socialized, the solution may be the complete abandonment of open competition or some special arrangements for these special hazard costs to be socialized.

If socialization of risk is a primary objective and most hazard costs are to be socialized, the simplest solution is to abolish private insurance and have the government pay losses out of general revenues. A closely related alternative would be a compulsory government insurance program operated by an exclusive government insurer or serviced by private fiscal intermediaries. Another possibility is compulsory insurance written by private insurers, all of whom charge the rates established by a mandatory rating bureau, coupled with a plan to share undesirable business.⁶

If private equity is preferred for most insureds and most hazard costs, but a degree of socialization of some risk is desired, less drastic steps may be satisfactory. At present, some socialization of risk is achieved under open competition laws through assigned risk plans or pools whose members are subsidized by other insureds. In most cases the subsidy is implicit in general rate increases which reflect any underwriting losses on the plan or pool. The subsidy costs are distributed among insureds according to their rate relativities. In property insurance, for which there is a special riot and civil disorder surcharge, the cost allocation formula is more complex.

Consumers may not like either method of allocating environmental hazards or other losses not covered by the plan or pool rates. Insurers may find that when a new risk is to be socialized, unless there is a special loading collectible at the same time, they must bear any excess losses pending a general rate increase. On the other hand, with a special loading, some insurers may collect more than they need and others too little.

⁶ In a thought-provoking paper Professor John Hall has suggested that in "social insurance" lines such as automobile insurance the best approach would be a national mandatory rating bureau that would establish a uniform set of pure premiums, coupled with a plan for "unifying" underwriting experience. This uniform set of pure premiums could favor some insureds over others. Competition would be limited to expense and profit loadings which would differ among insurers. Competition on pure premium structures and underwriting selectivity would cease, but Professor Hall believes that this would be an advantage. See John W. Hall, *The Automobile Insurance Underwriting Problem* (Atlanta: The Center for Insurance Research, Georgia State College, July 1969).

In part insurer reluctance to extend FAIR plans to include theft and vandalism insurance stems from the fact that no satisfactory mechanism has been developed for distributing the cost of non-chargeable environmental hazards, which are substantial with respect to these perils. An alternative approach that might have some merit would be to identify those hazard costs that should be socialized and to seek government subsidies for them. This problem is too important and too complex to be solved by a brief comment in this paper, but the consumer will demand its solution in the near future.

The Educator's Viewpoint

Educators should engage constantly in the "search for truth." Consequently they should be interested in the effects of open competition laws on all types of insurers, consumers, and regulators. In addition they have a special obligation to comment on the overall impact of these laws from the viewpoint of an objective observer.

Of great interest to educators will be the influence of open competition laws on insurance pricing. Insurance literature currently suggests that full-cost pricing has been the rule in insurance. Actuaries have sought the estimated cost of providing protection and then added a profit and contingencies loading to determine the premium. Although in practice consumer demand and the prices charged by other insurers have undoubtedly been considered, they should become more important and more explicit pricing factors in the future. Strict adherence to bureau rates should decline, and company actuaries will have to develop more competence in market research and micro-economies. The development of new price policies should be a fruitful area for research by educators and for case studies in business decision-making. Educators will, of course, also be interested in effect of these laws on the nature and degree of competition in the insurance business and on marketing efficiencies.

Because regulators are much more commonly associated with the overall viewpoint than either insurers or consumers, educators have always been intensely interested in the objectives of regulation, the methods used to achieve these objectives, and the results of this regulation. Because open competition laws affect both the objectives and the methods, a whole new field of inquiry has been opened up. Educators will be interested in how regulators choose to measure the nature and degree of competition, the situations in which they will determine competition to be insufficient or irre-

sponsible, the action they will take in those situations, their experience under the various types of filing requirements, the ways in which they will improve the price information available to insureds, and the resources that must be devoted to the regulatory effort.

Because everyone is a consumer, everyone shares this viewpoint to some degree. In particular educators will study the effect of open competition laws on consumer buying practices and their satisfaction levels. For example, will increased price competition and knowledge of insurance prices cause consumers to shop more before buying? Will it lead to a more desirable emphasis on price or too much emphasis on price? Are the prices for some consumers much higher than they can afford to pay? Is the socialization of risk objective a strong one, and, if so, have some acceptable satisfactory arrangements been made to accomplish this objective?

Finally the educator, having studied the operation of these laws from the viewpoint of all three parties directly involved, should have the understanding and objectivity to assess the laws from society's point of view and to work with the other three groups for an improvement in the rate regulatory process.

The educator's work, in turn, needs to be supported and assessed by the other three groups. Educators often do not understand the total situation as well as others; they may tend to oversimplify problems and their solutions; and unfortunately they are not always objective. Open competition laws, therefore, by opening new areas for study and research, should increase interactions between educators and the other three groups.