Market Report:

Fact Checking Donald Trump on Insurance

Selling Across State Lines Not Likely to Drive Down Costs or Help Consumers

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Executive Summary

The presidential primary race and the supporting debates have brought many issues to light, including the high cost of insurance for American families. When asked about this, Donald Trump states that insurance companies should be allowed to sell across state lines in order to create more competition and drive down costs. Trump says this will help middle and lower income Americans and he promises to address this problem.

This report examines the assumption that selling across state lines would increase competition, thereby reducing insurance prices. While the belief that increased competition will have the effect of reducing prices is true in other industries, it does not necessarily apply to the insurance industry. In fact, there may be unintended consequences that would have a negative effect on consumers.

This report starts by identifying the negative consequences consumers could experience if carriers begin selling across state lines. Next, the report demonstrates that more providers of insurance does not necessarily translate into more competition and lower prices, Finally, the report concludes with a recommendation for the best approach for driving down the cost of insurance for consumers.

The Negative Impact on Consumers

Consumers of insurance do not enjoy the benefits of federal consumer protection laws. While the SEC oversees the securities industry and the Department of Treasury oversees banking, there are no federal laws or agency protecting consumers of insurance. When it comes to insurance, states have the final say. This is unlikely to change due to legislation passed over 70 years ago that has stood the test of both time and legal challenges.

At the state level, consumer protection is often not a priority. As a simple example, consider how few consumers of auto, home or health insurance know the industry maintains a database on them that is shared among all providers, much like a credit report is shared among creditors. While such databases exist, mandating consumers be informed is based on federal law. Many states and insurance commissioners have opted not to implement the communication protocols at the state level that are necessary for consumers to be as informed about these databases as they are about credit reports. While somewhat minor, this is an example of consumers being unaware and uninformed because state regulators did not share the information.

Without proper controls and new regulations, selling across state lines could disadvantage consumers of insurance. If insurance companies were allowed to

domicile and operate from states with the weakest consumer protection laws, consumers could not only be forced to fight lawsuits remotely, but could also be faced with weaker consumer protection laws. Consumers are inherently disadvantaged when it comes to insurance-related issues. Insurers have the experience, the attorneys and the financial means to make recovering loss compensation a difficult for consumers. Selling across state lines could make this problem much worse.

More Insurance Providers Does Not Necessarily Mean Lower Prices

There are two reasons that selling across state lines may not result in lower insurance prices:

1. The companies that desire to sell in all states are already selling in all states. The current regulatory environment is not preventing insurance companies from selling into other states. This means that selling across state lines would not yield the desired result of more providers and therefore more competition.
2. While being counter-intuitive, in the U.S., more providers of insurance does not necessarily result in downward pressure on the price of products sold.

Addressing point one, increasing the number of companies selling into other states requires enticing regional carriers to expand into more states. However, this is not the business strategy of regional carriers. Needing to be licensed in additional states in order to sell there is not preventing regional carriers from expanding their target market and creating more competition. This means that allowing companies to sell across state lines without being licensed in the state does not solve the stated problem of enhancing the competitive dynamic of the market.

For point 2 above, let's examine the multi-peril home insurance market. This market is in excess of $80 billion per year, nationally, and is served by 313[1] insurance companies. The top ten companies represent 61%[2] of the market. The variation by state is a minimum of 24 insurance groups selling multi-peril home insurance in a state. The maximum is 107 insurance groups selling multi-peril home insurance within a state.

This is a large enough difference that one would expect a material difference in both higher average prices and lower loss ratios in states with fewer insurance companies. As the number of suppliers' increases, the price would be expected to trend down while the amount paid out in claims (Paid Loss Ratio, or PLR) would trend up.

Chart 1 below plots the average price for multi-peril home insurance as the number of insurance groups selling in the state increases. The analysis is done for the year 2012, the most recent year that state-by-state average pricing has been published by the Insurance Information Institute website (iii.org).

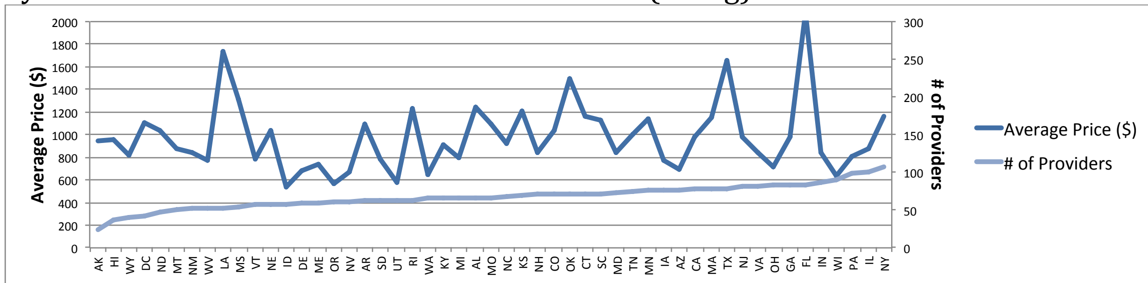


Chart 1 above does not show a downward trend in price as the number of providers' increases. In fact, the price[3] trend is upward as the number of home insurance companies[4] increases.

Examining price alone is insufficient since there is some possibility that states with the greatest number of insurance companies serving the market could also be the states that have the greatest number of catastrophic events. While this seems unlikely since insurance companies are naturally reticent to have a large exposure in high-risk geographies, looking at the PLR provides a measure of the competitive environment based on both price and risk.

Chart 2 below plots the PLR by state for multi-peril home insurance as the number of insurance groups selling in the state increases. The analysis is done for the ten-year period from 2004 to 2013.

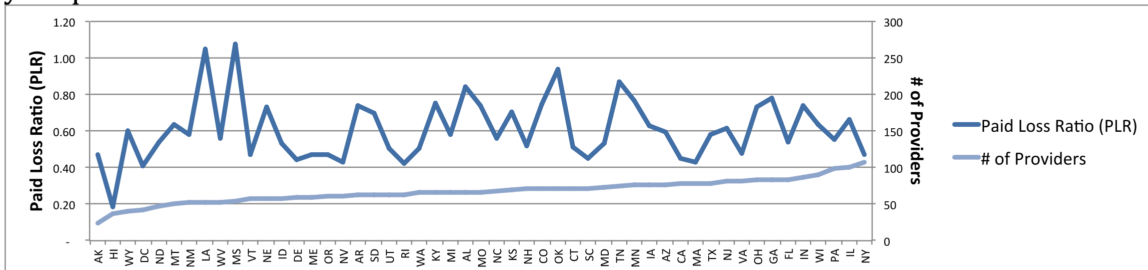


Chart 2 above shows a flat PLR, even as the number of suppliers per state increases nearly five-fold. The notable outlier is Hawaii with a ten-year PLR of only 18.5% despite having 37 insurance groups actively selling insurance during this period. This chart leads to a conclusion contrary to what logic would predict, which is that in insurance, more providers does not necessarily lead to an upward trend in PLR.

While the competitive dynamics of the health insurance market is similar to other insurance markets, the same type of analysis cannot be used for the reason that the Medical Loss Ratio (MLR) is mandated under the PPACA (Obamacare). MLR is a similar metric to the PLR examined in chart 2 above. Mandating a minimum MLR

value has the effect of MLR appearing as a flat line, and not providing a good measure of competitiveness.

Mandating MLR also creates an unusual dynamic for an American business. When the loss ratios are legislated, as they are with health insurance, an effective way to increase profits is for insurance companies to let costs increase on the insured services. Using 80% as an example mandated MLR, 20% remains available to fund corporate overhead and become retained profit. The images in chart 3 and chart 4 pictorially show the linear relationship between increasing costs and the resulting increase in corporate profits.

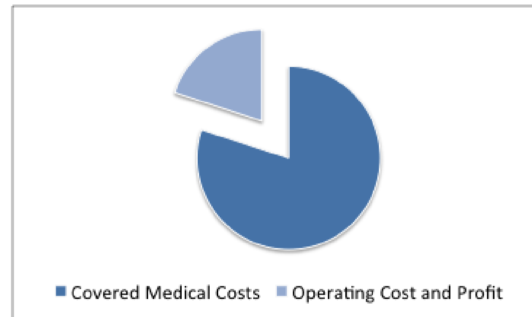
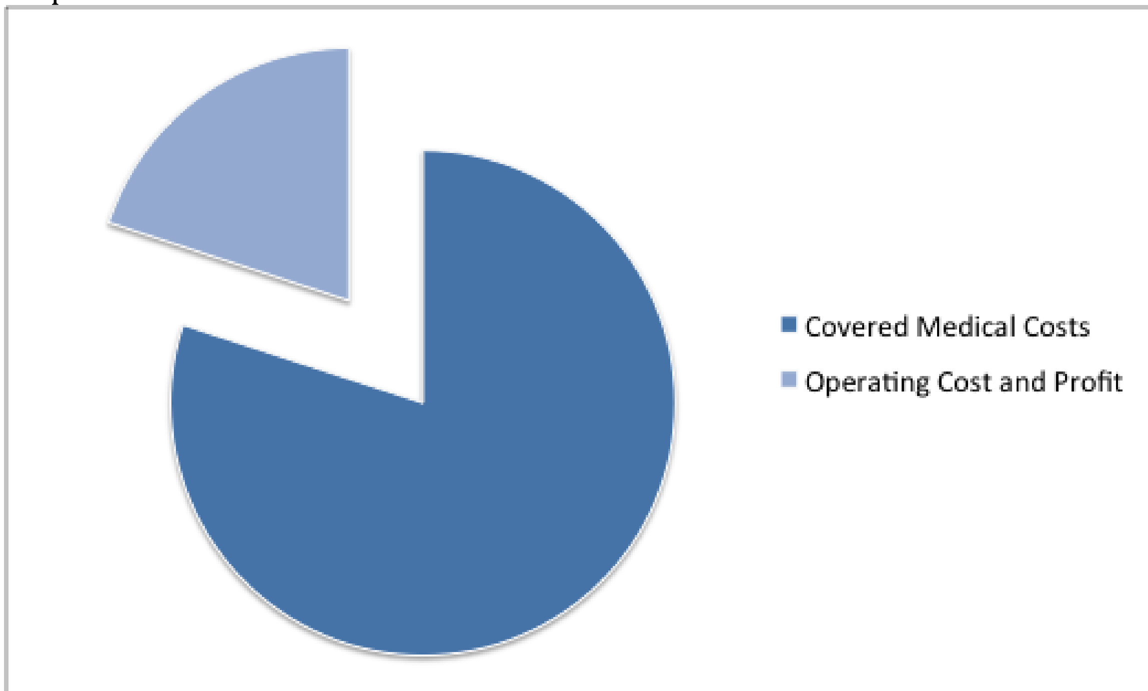


Chart 3: The small section of the pie chart represents the 20% allowed by PPACA legislation to cover operating costs and profit.

Chart 4: The operating cost and profit section of the chart is the same percentage of the total as it is in chart 3. In dollars, the 20% in chart 4 below is shown in a larger pie chart in order to represent a larger dollar volume, thereby increasing profits despite the minimum loss ratio mandate.



For a more detailed analysis of how legislating MLR affects the health insurance industry, read the post titled [Why Obamacare Will Fail?]

Given the fact that any company that wishes to sell insurance in another state can under the current system, there is no logical reason to conclude that selling across state lines would have any impact on the competitive dynamics within a given state. Furthermore, even if allowing companies to sell across state lines did lead to more suppliers, the analysis above shows that more suppliers does not ensure the increased level of competition will drive down prices.

Transparency is the Solution

The two facts contained in this report are that selling insurance across state lines would not lead to more suppliers, and more suppliers would not necessarily result in more competition, and consequently lower prices. Another fact that is beyond the scope of this report is that regulation has little effect on pricing. Price is most effectively managed through competition.

This reality leaves only one option for increasing the level of competition among providers of insurance - transparency. Insurance is one of the few remaining industries that operate with virtually no transparency. Consequently, there is little information available to consumers to help them purchase products that are the most cost-effective, while providing the best service and the best protection.

In the U.S., the consumers' relationship with the insurance industry is based upon trust. However, there is no data available for consumers to use when deciding which companies to trust. Unlike many consumer purchases, there also is no product to touch and feel. This makes the need for transparency greater in insurance than other industries. Unfortunately, there is less transparency than in most other industries.

Transparency into claims payment practices and financial data would enable consumers to make informed decisions and create the desired competition that results in insurance companies competing based on the quality of their product. Transparency is the best way to bring down prices, have more satisfied customers, reduce the cost of regulation and build a stronger healthier industry. Ideas and plans creating competition in the insurance markets must include a plan for creating transparency.

Trump is right in suggesting more competition is needed in the insurance industry. However, as seen in this report, more suppliers did not increase the level of competition, therefore, selling across state lines would not help consumers. The solution to the problem is transparency, which would result in a more efficient industry and more satisfied consumers.

About ValChoice

ValChoice® is the only company to provide consumers, agents and advisors with information on which home and auto insurance companies offer the best price, protection and service. The company's advanced analytics platform collects and analyzes over 1.5 million financial and complaint data points and delivers the results in an easy-to-use service that Forbes Magazine describe as "Carfax for insurance." Using ValChoice, consumers are finally able to shop for insurance based on value rather than making decisions blindly based on price or advertising campaigns.

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[1] Companies that have sold multi-peril home insurance in the U.S. continuously for the last ten years. Source, ValChoice, LLC

[2] Source: © AM Best Company -- Used by Permission

[3] Insurance Information Institute, iii.org.

[4] Source: © AM Best Company -- Used by Permission