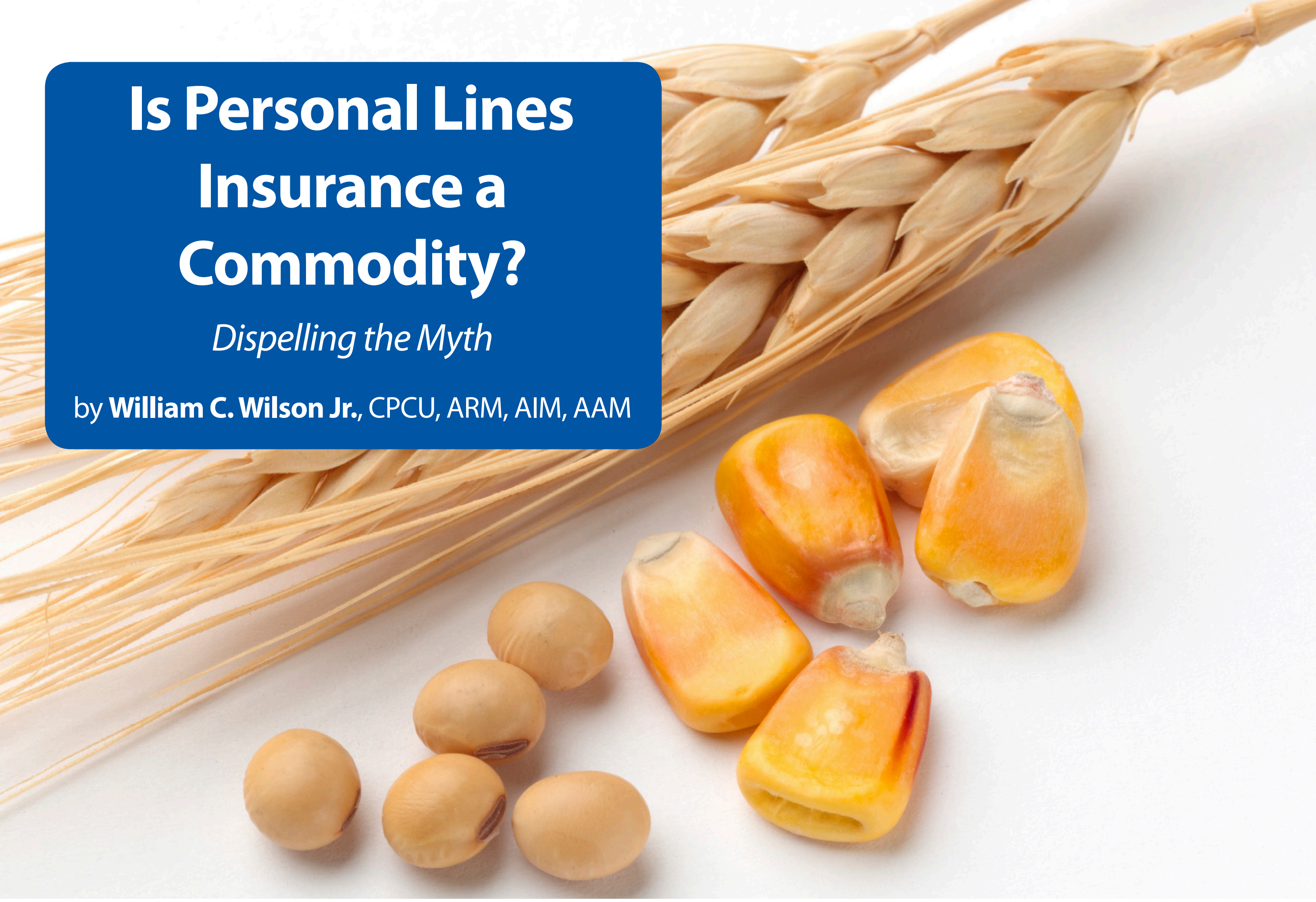

Is Personal Lines Insurance a Commodity?

Dispelling the Myth

by **William C. Wilson Jr.**, CPCU, ARM, AIM, AAM

Has personal lines insurance—particularly auto insurance—become a commodity? If you believe what you see in much of the personal lines insurance advertising, and you accept what some researchers have claimed in recently published reports, then the answer is likely, "Yes." However, if your feet are firmly planted in reality AND you've ever read more than one specific insurance policy, the answer is a resounding "No."

Whether or not personal lines insurance is a commodity is more than just an academic discussion. If consumers are led to believe that the only material difference among insurance products and insurance providers is price and if that assertion is NOT true, then millions of Americans could be exposed to significant and potentially catastrophic coverage gaps that they have assumed in order to save a few dollars in insurance premiums.

Take a real-life example. A boomerang child lost his job and was forced to move back home with his parents. Two months later, while driving his mother's car, he negligently struck another vehicle, causing several thousand dollars in property damage but, fortunately, no bodily injury. The parents' personal auto insurer denied the claim, citing an exclusion in their policy that required any new household members to be reported to the insurer within thirty days of their residency.

This claim clearly would have been covered by an ISO-standard policy (the 2005 Personal Auto Policy of industry advisory organization Insurance Services Office, Inc.), which, absent an exclusion to the contrary, covers any resident family members for the ownership, maintenance, or use of any declared or nonowned auto. The carrier involved in the claim cited above, however, has dozens of provisions in its policy that are at variance with the ISO policy form—as do many other policies in the marketplace.

Despite these differences, however, the insurer advertises that it offers the "same coverage, better value" as other insurers.

What Is a Commodity?

The traditional definition of commodity is best expressed by Wikipedia's characterization that the term

> …is specifically used to describe a class of goods for which there is demand, but which is supplied without qualitative differentiation across a market. A commodity has full or partial fungibility; that is, the market treats its instances as equivalent or nearly so with no regard to who produced them.

Merriam-Webster defines commodity a "a good or service whose wide availability typically leads to smaller profit margins and diminishes the importance of factors (as brand name) other than price."

By these definitions, things like wheat, salt, coal, and other products may be viewed as commodities, though how many varieties of salt are available? Does insurance in any form meet these qualifications? There is perhaps an argument that a standardized form such as a National Council on Compensation Insurance (NCCI) workers compensation policy or National Flood Insurance Program (NFIP) policy could be considered a commodity; however, keep in mind, for example, that flood insurance can encompass more than an NFIP policy if a business or consumer is in an area where an ISO or proprietary flood policy or endorsement may be sold.

What Researchers and Purported Experts Say

In June 2013, the McKinsey & Company report, *Agents of the Future: The Evolution of Property and Casualty Insurance Distribution*, all but predicted the demise of the local insurance agent selling and servicing personal lines insurance. According to the report:

> *Perhaps most disruptive to the traditional agent value model, auto insurance—which accounts for 70 percent of personal lines premiums—is fast becoming commoditized...Insurance may never be a pure commodity like copper or wheat, but personal auto is edging closer to this territory.*

In September 2013, the A.M. Best Special Report, *Distribution Trends* Continue to Shift in the Private Passenger Automobile Market, was announced via a press release that included the statement, "In the highly commoditized private passenger automobile (PPA) segment…."

> *In October 2013, a Nomura Equity Research report touting the success of direct sales marketing of auto insurance was quoted in the Insurance Journal as stating, "For a commoditized product, low cost and effective marketing are keys to share gain."*

Going back to 2011, a "Gartner Predicts 2012 Research" series addressed evolving insurance distribution channels. One ReadWrite.com article that commented on the series noted the following:

> In their report, they advise insurers to plan now for the commoditization of their products and services, implying that they should perhaps be sold through portals the way cloud service customers purchase bandwidth and virtual machines today.

So, are these researchers correct, that auto insurance, for example, is or is becoming a commodity? Again, based on the predominant form of advertising of auto insurance, you would have to think that the insurance industry itself believes this from the perspective that pricing is pretty much all that matters. Likewise, the media and non-experts seem to have bought into this as well.

What the Media and Nonexperts Say: Comparing Apples to Apples

Many of the hundreds and hundreds of articles on how to save money on car insurance caution consumers to make sure, when getting premium quotes, that they are comparing "apples to apples." What they mean by this is to make sure you are comparing the same limits of liability, medical payments, uninsured motorist, and perhaps no-fault coverage and the same deductibles for physical damage coverage. It is the exceedingly rare article that points out that the actual fine print in the form of policy terms, conditions, and exclusions is where, pardon the pun, the rubber meets the road. Most consumer reporters are oblivious to the fact that insurance policies can be dramatically different in what they do or don't cover.

One online auto insurance quoting service has a YouTube channel with clever videos that include claims such as this:

> *All auto insurance is exactly the same. It doesn't matter what company you get it from. It's just a question of finding the lowest rate. But the reason these companies spend so much on advertising is that there are millions of idiots in this country who actually believe that there is a difference between competing brands of auto insurance. These people have not yet figured out that they are being lied to, that all auto insurance is the same…The distinctions, typically made via mass advertising, that big insurance brands attempt to draw between each other, are baldfaced lies. Insurance is a commodity.*

When you read claims like this, along with consumer articles, and even "expert" reports, one wonders whether any of these people have ever read their own auto policies, much less compared the actual terms of two or more policies.

Refuting the Myth

So, at this point, we can probably agree that many researchers believe auto insurance is a commodity or is fast becoming one. Unquestionably, this is the view of most of the media and consumers. And even within our own industry, based on the dominant form of advertising, auto insurance is presented as a generic product differing mainly in how cheaply it can be sold, how quickly it can be sold, or how funny its marketing is.

But does that make it a commodity? No. Just because auto insurance is positioned as a commodity and just because it is generally perceived as a commodity doesn't mean it is a commodity. When I was a child, my mother insisted there was a tooth fairy—so I unquestionably believed there was a tooth fairy. After all, who is more trustworthy than your mother? However, once we are able to reason as adults, we learn that, just because someone tells you something is true, that doesn't mean it's true. And just because we believe something to be true doesn't mean that it is indeed true.

At the beginning of this article, we provided an actual claims example where a boomerang child discovered he had no coverage while driving his mother's car. Briefly, here are three more examples, one of which is based on a recently litigated court case:

- A Florida insured's auto was in the shop, so she rented a car and later loaned it to someone, who loaned it to someone else, who had an at-fault accident that killed a child and seriously injured other children. The claim against the operator and named insured was denied by the insurance company on the premise that the vehicle was not a "temporary substitute" and the operator was not a "permissive" user, as defined in this insurer's personal auto policy.
- The son of a friend of an insurance agency owner was street racing when he crashed, seriously injuring himself and his passenger. The claim was denied by the insurance company based on its interpretation of its personal auto policy's racing exclusion.
- A church allowed a member to park his car in its heated bus barn. While exiting, the member wrecked the car, causing structural damage to the building. The claim was denied by the insurer, citing the care, custody, or control" exclusion in the personal auto policy.

What do each of these claims have in common, other than denial by the insurance company? All of them would have been covered if the policyholder had purchased an ISO-standard personal auto policy rather than the policy in question.

With regard to the Florida claim, the ISO personal auto policy defines "temporary substitute" and "permissive use" much less restrictively than the policies that were in effect. The named insured might have saved money when she purchased her auto policy, but it proved to be a bad deal when she had to take her claim to the Florida Supreme Court to recover. And in the court's reversal of the court of appeals' ruling favorable to the insurer, the rationale for coverage was less about the policy language that appeared to support the insurer's claim denial and more about Florida's rather unique dangerous instrumentality doctrine.

In the street-racing claim, the ISO personal auto policy excludes injury that arises from accidents that take place "inside a facility designed for racing," while the auto policy in question excludes almost any racing activity, including one taking place on a public street.

The ISO personal auto policy has a care, custody, or control exclusion, but it makes an exception for damage to a private garage. The policy in in the bus barn claim has the same exclusion but no such exception—not to mention the fact that it's unlikely that the barn was actually in the driver's care, custody, or control. So both the policy itself and the insurer's interpretation of the exclusion were faulty from the insured's perspective—rendering the carrier's advertising slogan, "Same coverage, better value" highly questionable.

A Dozen More Examples

If the four claims examples thus far are not enough to convince the reader that auto policies differ (as may adjusters' interpretations of identical policy language), here are a dozen variations in auto policies that are currently being sold in the marketplace:

1. **Undisclosed household residents are excluded.** How many of your insureds have boomerang kids living at home that you're not aware of?
2. **Business use of nonowned autos is excluded.** Have you ever borrowed a neighbor's car or made a business stop in a dealer's loaner auto?
3. **Business use of ANY auto is excluded.** Do you ever run to Staples or the post office on business for your employer?
4. **Use of ANY nonowned auto is excluded.** Better not drive anyone's car but your own!
5. **Vehicles over 10,000 pounds in gross vehicle weight are excluded.** Have you ever rented a U-Haul truck or an RV thinking your liability coverage extended to the rental?
6. **Any type of delivery is excluded.** Denied claims can involve delivery of pizza, newspapers, Mary Kay cosmetics, and, yes, even insurance policies to customers by an agency producer.
7. **Permissive users only get minimum limits.** This can apply to people who borrow your car or even to unlisted household drivers.
8. **Street racing is excluded.** Google "street racing" and see how often people are killed or critically injured in the process.
9. **Criminal acts are excluded or limits reduced.** DUIs or even speeding tickets may preclude coverage.
10. **Medical payments only include fees from licensed physicians.** One insured incurred a $25,000 "life flight" helicopter fee that would not be covered, even in part, by a policy with this exclusion.
11. **Theft without evidence of forced entry is excluded.** One insured had a four-figure vehicle theft loss denied because he had left his keys in the car.
12. **Sales tax is not covered under loss settlement.** This cost one "same coverage" insured more than $2,000 out of pocket for sales tax on a replacement auto.

So, if you believed personal auto insurance was pretty much a commodity product when you began this article, what do you think now?

A Wake-Up Call

Industry advertising focusing on price is fine, but not if the premise is that price is the only (or even the major) difference between policies and insurers. Consumers need to know that there is often a material difference between insurers' products and claims practices. In fact, it may be a good idea not only to make this point, it might be the law.

Tennessee's Unfair Trade Practices statute, for example, includes reference to "an advertisement, announcement or statement containing any assertion, representation or statement with respect to the business of insurance…that is untrue, deceptive or misleading."

It is also fair to say that, just because one auto policy is cheaper than another, it doesn't necessarily mean that the coverage of the less-expensive policy is inferior to that of the pricier policy—but that is often the case. To quote legendary sales guru Morty Seinfeld, "Cheap fabric and dim lighting. That's how you move merchandise."

Recall that the Merriam-Webster definition of commodity may refer to a good or service whose wide availability typically leads to smaller profit margins. To remain viable, a company must offset decreasing profit margins with a reduction in costs. In the case of insurance, if operating costs are at minimal levels—and we're led to believe that selling insurance via the Internet should reduce an insurer's operating costs—then that leaves loss costs as the only variable that can address diminishing returns. The logical conclusion is reduced coverage and/or fewer or smaller claim payments.

So, one presumption is that when insurance products are sold almost exclusively on the basis of price, as competition intensifies, there is a tendency for policies to provide less and less coverage and/or for policy terms to be applied more restrictively. When consumers are oblivious to this, they subject themselves and their families to great uncertainty and the potential for great financial and emotional loss, all to save a few dollars.

Personal lines insurance is NOT a commodity by any reasonable definition of that term. The differences among auto insurance policies are many, varied, and potentially catastrophic. As insurance educator John Eubank, CPCU, ARM, says, "The bitterness of no coverage is remembered long after the sweetness of low price has been forgotten."

William C. Wilson, Jr., CPCU, ARM, AIM, AAM *is director of the Virtual University of the Independent Insurance Agents & Brokers of America (IIABA). He was the Director of Education & Technical Affairs for the Insurors of Tennessee from 1988-1999. Prior to 1988, he was employed by Insurance Services Office, Inc. as the manager of their field operations in Tennessee and Kentucky. Before that time, he was a bag boy at H.G. Hill food store #25.*

Bill is a graduate of the Illinois Institute of Technology with a B.S. degree in Fire Protection & Safety Engineering. He was a licensed insurance and surplus lines agent, and his professional affiliations have included past president of the Middle Tennessee Chapter of CPCU, board member of the national CPCU Society, PMLG of the Honorable Order of Blue Goose, International, member of the Independent Insurance Agents of America (IIABA) National Education Committee, member of the Certified Insurance Service Representative (CISR) National Advisory Committee, member of the Society of Insurance Trainers and Educators (SITE) and its SITE Journal editorial committee, member of the National Writers Association, chairman of the Tennessee Insurance Commissioner's Education Advisory Committee, member of the Middle Tennessee State University Insurance Liaison Committee, member of the Nashville State Technical Institute's Financial Services Advisory Committee, member of the National Underwriter's FC&S Editorial Advisory Board, and an instructor for insurance and risk management programs for Tennessee State University and Nashville State Technical Institute. He is listed in the International Who's Who of Professionals™.

He has served as a trainer and speaker for various organizations, including the Independent Insurance Agents of America (IIABA national conventions and state convention programs and seminars), the CPCU Society national convention, National Leadership Conference and chapter programs, the National Association of Insurance Women (NAIW), the Southern Agents Conference, and the Risk & Insurance Managers Society (RIMS).For more information, please contact Bill Wilson at bill.wilson@iiaba.net or go to www.independentagent.com/Education/VU/Pages/featured-resources/Commodity/default.aspx