Insurance: The Essential Guide to a Bewildering Industry

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The property/casualty insurance industry is one of the most important yet least understood industries in the nation.

Every person and business in America needs insurance but few understand how it works.

As a result, the industry can make extraordinary claims and demands on policymakers – and policyholders – that go nearly unchallenged.

We're here to help. Here are a few basic essentials for understanding the property/casualty insurance industry.

(And by the way, if you want to see insurance lobbyists scamper out the room, just hold up a copy of this and start reading.)

Let's go!

Crying All the Way to the Bank

How do insurers make money? By pocketing and investing the premiums you pay them.

Insurers make their money primarily from investment income, investing the premiums they receive from policyholders. In fact, in only a quarter of the last 50 years have insurers achieved an underwriting profit (*i.e.*, when premiums taken in are more than "losses" and underwriting expenses). In many lines of insurance, an underwriting profit would produce a wildly excessive overall profit because the investment yield is so great. Today's strong stock market has pushed up the industry's massive insurer investments to create a record-breaking surplus – the money held above whatever is already reserved to pay claims.

A Loss is Not a Loss

When insurance companies say they've lost money, they haven't. It's just an accounting trick.

The unique accounting practices of the insurance industry allow companies to identify "losses" that are not really losses at all. To an insurance company, the word "loss" is short for the term "incurred loss." When a company has an "incurred loss," this does not mean the insurer has actually paid out this money. This figure includes estimates of future claims that they know about (reserves) and claims they do not even know about yet, called "incurred but not reported" (IBNR). Some of these claims may never exist and others may take years to payout. In fact, when researchers look back over years of data, it is clear that high premiums have often been charged while paid claims actually were dropping.

Hiding Wealth with Tricks and Loopholes

When the insurance industry says it's suffering losses it's usually massively prospering.

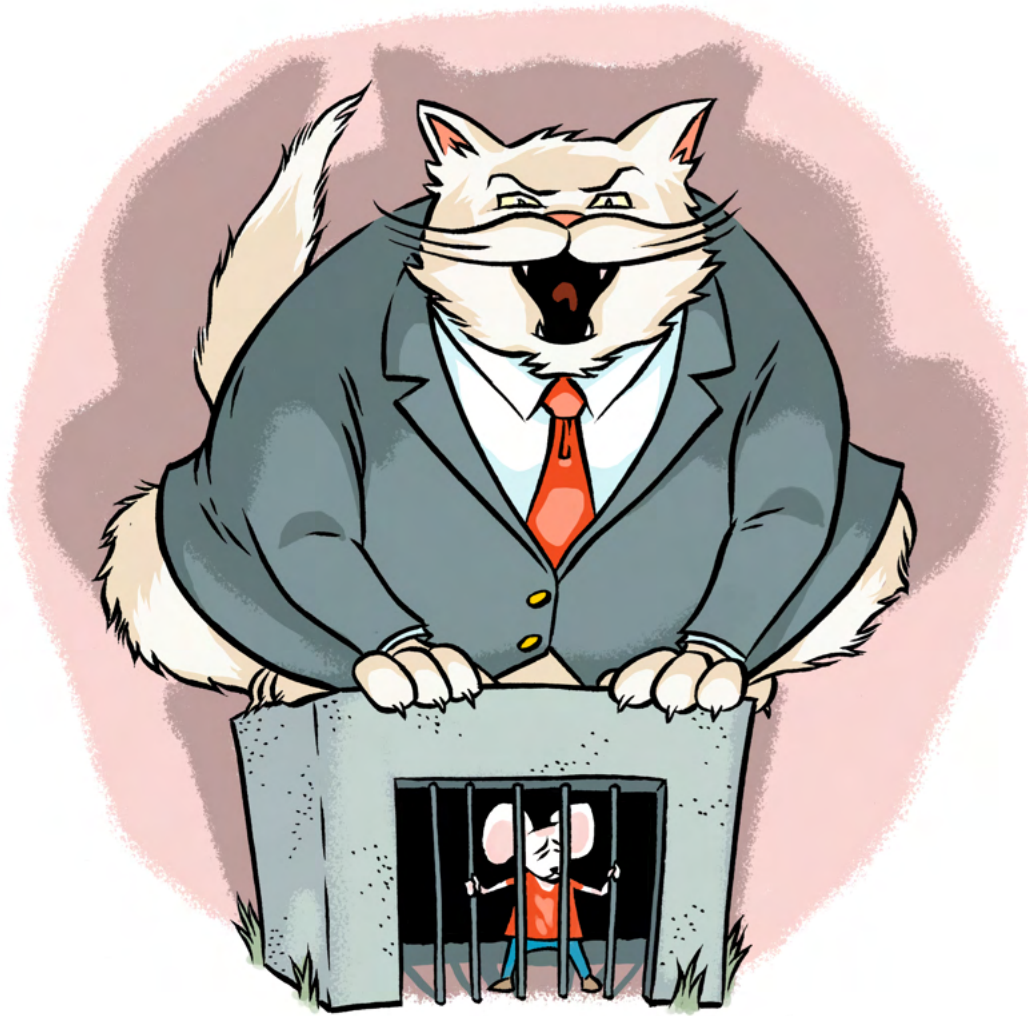
When the industry argues that it needs to raise rates or else it will risk financial peril, this is easily proven untrue. For example, while recently arguing for rate hikes, insurers' surplus ballooned, doubling from 2004 to 2018, quadrupling since 1994, rising by more than 5,000% over the past 60 years reaching all-time record levels. The insurance industry also inflates losses by manipulating its own claim reserves at key moments to justify rate hikes. Raising reserves is used not only to raise rates but also to lower tax liabilities at times of significant profits.

Party Like It's 1999

When the industry complains that claims have increased, it never adjusts its data for inflation or population, masking the fact that adjusted claims have been stable for decades.

Since 1999, total commercial insurance payouts have never spiked and have generally tracked the rate of inflation and population. Premiums and reserves, however, have gone up and down in sync with the industry's economic cycle and are not reflective of any trends in paid claims. The economic cycle happens because insurers make most of their profits from investment income. During the "soft" phase of the cycle, companies engage in fierce competition for premium dollars to invest for maximum return. Rates stay low. During the "hard" phase of the cycle which follows, either those cumulative price cuts have gotten too severe, and/or investment income has dropped. The industry always responds by (often suddenly and dramatically) increasing premiums. While state regulators could help modulate this cycle, they don't.

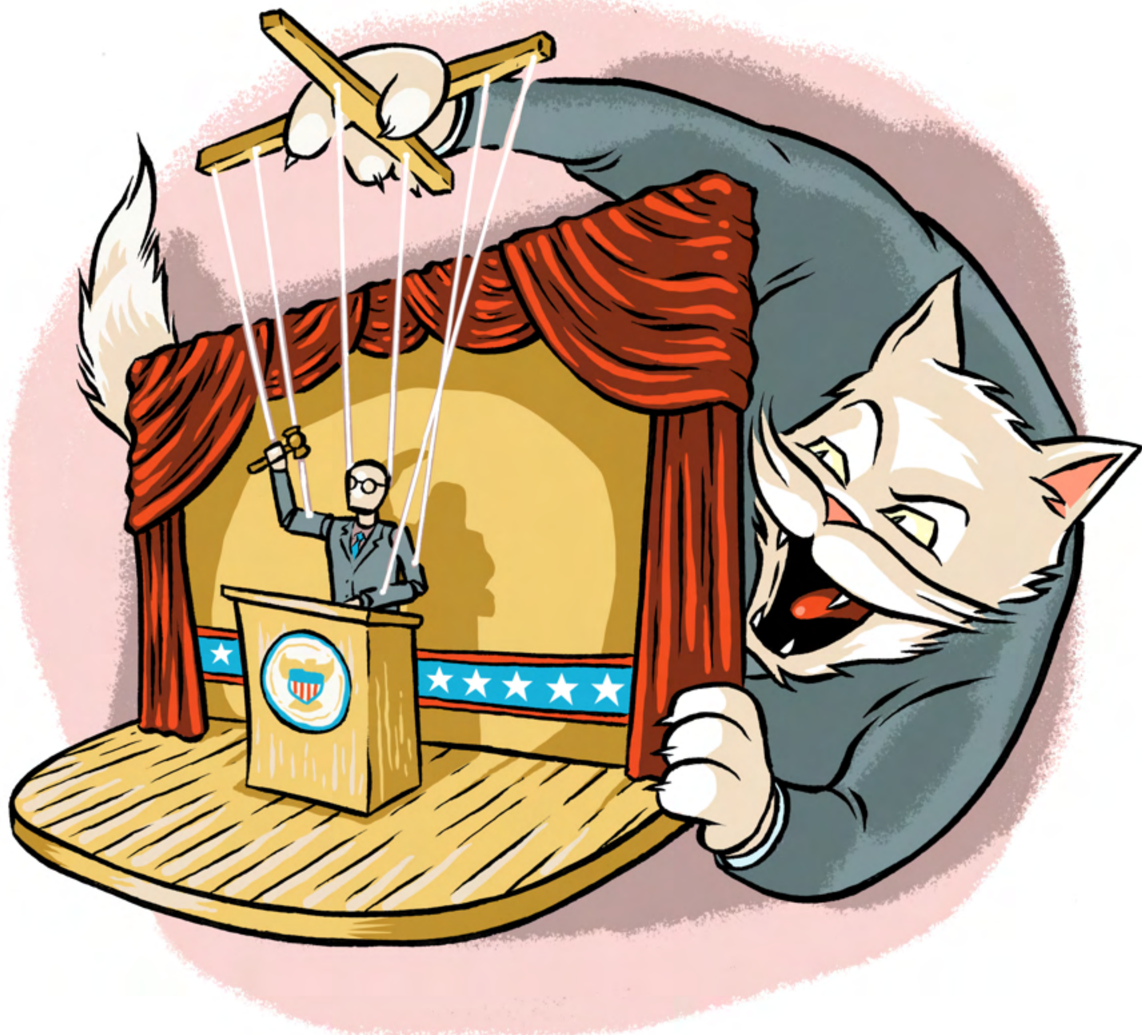
Anyone Else Would Go to Jail



For insurance companies, price-fixing (coordinating with others as to what they'll charge you) is perfectly legal. They collude, and you get price-gouged. For any other industry, this would be a crime.

In 1944, Congress passed the McCarran-Ferguson Act, a law that exempts the insurance industry from anti-trust laws and allows the industry to collude on important components of insurance prices, an anti-competitive practice that is illegal for other industries.

No One's Watching



Government oversight over insurance pricing and coverage barely exists. Insurers mostly do what they want.

Congress has prohibited any federal regulation of insurance. It delegated insurance regulation to the states, with no standards and no oversight. Most state insurance departments have weak or non-existent authority over insurance rates through prior approval or rejection of requests for rate increases. Most state insurance departments also lack adequate investigators, auditors and other professionals, preventing them from recommending appropriate insurance rates and coverage. In other words, with few exceptions, state insurance departments have neither the authority nor the funding to exercise proper control over insurance industry pricing.

When Words Aren't What They Are

Insurance words are more like terms of art. A special kind of art. Like the fraudulent kind, sold to you by a dealer who told you it was something it wasn't and then charged you full price. Here are some favorite examples:

Incomprehensibly Comprehensive

"Comprehensive" auto insurance coverage is the most narrow and least comprehensive of all.

There are lots of ways that car insurance policyholders may be confused by the coverage they've purchased. For example, you may think that "comprehensive auto insurance" covers a lot. It doesn't. It *does not* cover injuries to people you hit or people hurt in your car, and it *does not* cover damage to your car or to the cars and property of others. It only covers things like theft, vandalism and storm damage. This may be important if your car is new, but make no mistake – it is hardly "comprehensive."

Risky Business

"All risks" mean some risks; "all perils" means some perils.

"All risk" and "all perils" policies are not what they seem. If you purchase property insurance with "all risks" coverage, you're covered for all losses – except the ones that are excluded. Huh? As to "all perils" coverage, you're covered for losses – as long as the cause is listed. So, not all.

Hurricane Warning

Signing a "hurricane endorsement" doesn't mean you have hurricane coverage.

The common understanding of a hurricane is a windstorm generating copious amounts of water. Homeowner policyholders who want to make sure they're covered if a hurricane hits often sign "hurricane endorsements" with clearly labeled "hurricane deductibles," thinking they have full coverage beyond the deductible in the event of a hurricane. They would be wrong. Elsewhere in those very same policies, insurers will expressly exclude payment for flood damage – even if connected to a hurricane! To get flood insurance, homeowners must purchase separate policies from the federal flood insurance program. Except if you're living in an actual flood plain, your insurance agent probably won't explain any of this to you.

Business, Interrupted

The business interruption insurance virus rip-off.

If there's one thing insurance companies know how to do, it's hold onto your money. Take the COVID pandemic and businesses interruption (BI) insurance. BI is meant to cover business losses if business operations are, well, interrupted. Many businesses dutifully paid premiums for this coverage for years, fully expecting that a lockdown would be just the kind of situation that might warrant a BI claim. But insurers won't pay these claims, saying either that the fine print in policies exempts virus-related business losses entirely, or even if it doesn't, still limits what they owe because these businesses have no physical damage from a virus. The fight continues.

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For more information, including sources and backup, see *How the Cash Rich Insurance Industry Fakes Crises and Invents Social Inflation* (March 2020), https://centerjd.org/content/study-how-cash-rich-insurance-industry-fakes-crises-and-invents-social-inflation

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