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# Standardization: Opportunities and Obstacles – A View on Insurance, from the U.S.

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## *Presentation Outline*

- 1. Definitions of Standardization**
- 2. Why We Care Whether Insurance is Standardized**
- 3. Opportunities**
- 4. Obstacles**
- 5. Recommendations**



## What Do We Mean by “Standardization”?

1. Interchangeability resulting from standardization.
  - a) This can mean interchangeability of people, physical assets, or organizational values and functions. For examples of the advantages of each of these, see Rosabeth Moss Kanter’s article in the January 2008 issue of *Harvard Business Review*.
2. The process of defining and applying the conditions necessary to ensure that a given range of requirements can normally be met, with a minimum of variety, in a reproducible and economic manner based on the best current techniques.
3. The use of common products, processes, procedures, and policies to facilitate attainment of business objectives.



## What Do We Mean by “Standardization”?

4. To promote conformity by means of a standard or to establish criteria for uniform practices.
5. The selection, approval, and dissemination of one or more terms by a recognized standardizing body, for the purpose of promoting preferred usage or discouraging deprecated usage in the target community.
6. **Standardization is the process of establishing a technical standard among competing entities in a market, where this will bring benefits without hurting competition.**
7. Standardization can imply a single standard or an accepted family of standards (e.g., standards for “small,” “medium,” and “large”)



## Why We Care Whether Insurance Is “Standardized”

### Standardization...

- Reduces producer/consumer confusion
- Helps allocate scarce regulatory and business resources to higher priority needs
- Reduces marginal cost of production
- Facilitates securitization

### But it

- Inhibits innovation within the industry
- Encourages/hastens commoditization
- Narrows competition within the industry
- Invites outsiders to innovate and take market share
- In the US, potentially subjects insurers to additional antitrust scrutiny
  - As a practical matter, insurers in the US are often precluded from even discussing policy provisions, claims handling, rates and forms



## Opportunities: Standardize Insurance Products to Benefit Companies and Producers

- In order to act in the customer’s best interest, producers should be familiar with their own and competing companies’ products
  - this is difficult without substantial standardization
- With substantial standardization, producers can devote more time to identifying and satisfying customers’ needs and less to explaining policy provisions
- Standardization increases the likelihood that court (and other regulatory) interpretation of policy provisions will be clear and consistent



### *Opportunities: Standardize Insurance Products to Benefit Consumers*

Standardization increases the likelihood that

- Consumers will understand their policies' benefits and limitations. This leads to
  - Fewer claims disputes
  - Better tailoring of additional coverage purchases (beyond standardized provisions) to customer needs
- Companies will compete more on price than before as product is increasingly viewed as a commodity



### *Opportunities: What Could Be Made Better with "Standardization"?*

- Insurance-linked securities
  - Transparency – the Missing Ingredient in the "Subprime Mortgage" crisis
    - A standardized "assembly" process rather than standardized provisions?
    - A Black-Scholes-type pricing mechanism? These securities must be able to be readily priced every day and easily sold in secondary markets if they are ever to succeed as a new "asset class" for additional investment diversification
  - A main reason to-date for the slow development of these products, both life and non-life, is that each one is constructed virtually uniquely
    - This is why today many insurance-linked securities require a "wrap" to provide enough confidence to attract buyers in the capital market



## *Opportunities: What Could Be Made Better with “Standardization”?*

- P/C Insurance contract provisions
  - For example, “hurricane deductibles” in HO policies
    - Currently, many of the companies with the largest market share have unique definitions of when this deductible is “activated”
    - As a result, it can be difficult for producers and consumers to compare prices for otherwise comparable policies
    - This extreme variation enables critics of the industry – and hostile regulators – to contend that the industry’s method of operation is obscure, arbitrary, and not customer-friendly



## *Opportunities: What Could Be Made Better with “Standardization”?*

- L/H Insurance contract provisions
- For example, “Indexed Annuities”
    - This product has been attacked for its complexity, which is partly attributable to the great variety of provisions
      - From carrier to carrier and
      - Within a given carrier’s indexed annuity product portfolio.
    - As a result, it is very difficult for producers and consumers to understand how the product is likely to operate and to compare prices and provisions for competing policies
    - This led one state attorney general to bring a class-action lawsuit against the leading seller of this policy – and resulted in new, more extensive disclosure and monitoring requirements for that company – likely to become a model for the reset of the industry



## *Obstacles: What Could Impede “Standardization”?*

- Anti-Trust Laws
  - If companies cooperate to achieve standardization without government guidance (regulation or law), do anti-trust issues arise? That is, under these circumstances are the participating companies open to punishment (or at least adverse publicity) for having “conspired to suppress competition”?
- Any company’s desire to innovate to meet a perceived consumer need and for competitive advantage



## *Innovation Cannot Be Stopped*

Innovation will happen outside the industry even if it cannot happen internally. It will be driven by

- Emerging consumer wants/needs
- New (or new uses for old) technologies, processes
- Unforeseen events that highlight unmet needs or unserved populations
- Changing societal values (e.g., in the US, views on the importance of universal—or more nearly-universal—health insurance)

The challenge will be to find ways to enable/encourage innovation with as little “damage” as possible to standardization.



## *Recommendations*

### How Can The Industry Best Achieve “Standardization”?

- Overcoming Anti-Trust Laws
  - Announce publicly and then convene a meeting of companies to arrive at standard policy/contract provisions with the overriding purpose of benefiting consumers.
    - Perhaps have an academic group – spearheaded by the Geneva Association? – prepare an initial document/proposal that attendees can respond to
  - Invite regulators, rating agencies, and consumer advocacy groups to attend and participate in the meeting.
  - Invite the media to attend and participate in the meeting.