Walton Lecture Explores Boundaries of Fair Insurance Pricing

At the 2016 Walton Lecture, students learned the importance of how distinctions can quickly become discriminatory if ethical practices are not followed. Keynote speaker Brian Steffel, Oregon Mutual Insurance Company president and chief executive officer, discussed the boundaries of fair pricing in the property and liability insurance industry.

Brian Steffel

Steffel structured his presentation around the concept of discrimination—the technical definition being the act or instance of making a distinction, or making a distinction in favor of or against a person or thing based on the group, class, or category to which that person or thing belongs rather than on individual merit.

THE ART OF DISTINCTION

To illustrate the concept of distinction, he asked students to examine their processes of distinguishing among products—from coffee to college. Starbucks versus Stumptown? Washington State University or University of Idaho? Distinctions are made based on criteria such as loyalty, cost, academic rigor, and the type of student body before committing to a product, he explained.

He offered a mix of historical and contemporary examples of how insurance companies become profitable based on making distinctions.

In the 17th century, Edward Lloyd's coffee house in London became recognized as the place for obtaining marine insurance, charging premiums to insure hull and cargo. Lloyds came up with a rate based on the experience and skill of the crew, the weather, the length and difficulty of the route, and the value and nature of the cargo. "Lloyds was successful based on the distinctions they made," he said.

“The key thing in the insurance industry is that discrimination is recognized by law,” he said. “But what is fair?”

UNDERSTANDING AND MEASURING RISK

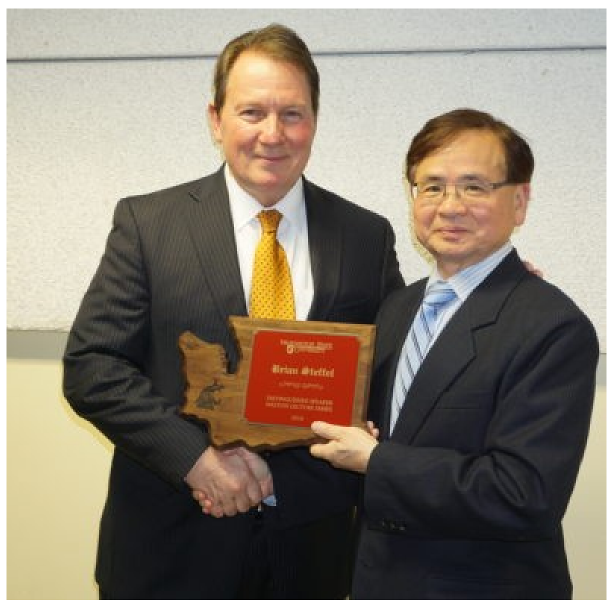
Steffel said for insurance companies, discrimination must be based on cost associated with risk. To be successful, insurers must determine rates that are profitable and discover preferred customers.

He pointed to the auto insurance industry as an example of an endless quest to understand and measure risk. For example, 40 years ago, auto insurance rates were based on seven distinctions, including the age of the driver, driving record, occupation, age and cost of vehicle, whether it was garaged, where it was primarily driven, and miles driven. Today’s distinctions include all of those plus nine others, including a household insurance “score,” claims activities reported by a national database, driver behavior, prior insurance coverage, and education, among others.

“If you are late on other payments or have a poor credit score, it can affect your insurance rate,” Steffel said. “Education is difficult to measure.”

ETHICAL AND UNETHICAL PRACTICES

To educate the audience on legitimate and unethical practices, Steffel touched on the disparate impact rule, the Fair Housing Act, that prohibits creating, perpetuating or increasing segregated housing based on race, color, religion, gender, handicap, familial status or national origin.



Brian Steffel & Gene Lai

He also outlined the consequences associated with insurance carriers who depend on big data to make adjustments. Acceptable practices include price optimization—using data and statistical modeling to determine how to charge the highest price while retaining customers and bundled product sales discounts, among others.

Unacceptable price optimization adjustments include adjustments based on consumers’ propensity to shop for insurance, ask questions, or file complaints.

Steffel concluded his presentation by advising future insurance professionals to avoid unethical practices and to consider the practices that have made Oregon Mutual successful.

“I know all of Oregon Mutual’s 190 employees by name, and I answer my own phone,” he said. “We know our backyard better than anyone else. Insurance carriers have to demonstrate and communicate value. Customer protection must be there.”

The Walton Lecture brings a distinguished leader in the insurance and risk management field to campus to share professional perspectives with students. The lecture is hosted by the WSU College of Business' Department of Finance and Management Science and made possible through an endowment from the Independent Insurance Agents and Brokers of Washington. The endowment honors Max Walton, the group's past president.

To learn more, contact Professor Mike McNamara at
509-335-5632 or mjmcnam@wsu.edu.

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