# INSURER STRATEGIES, INSURED BEHAVIOURS, AND THE GREAT RECESSION: A UNITED STATES PERSPECTIVE

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**Abstract**

*This paper examines the impact of the severe economic recession from late 2007 to the middle of 2009, along with the jobless recovery of 2010. Specifically, we analyze the behavior of insureds during significant economic slowdowns, and the strategies of insurance companies with respect to asset management and marketing campaigns. Despite the largest economic downturn since the Great Depression, individual behavior regarding personal lines of insurance has been manageable. Policy lapse rates have increased, but not significantly. There is concern that the lack of a strong rebound in the economy accompanied by robust job growth could create conditions that promote fraudulent behavior, especially in the area of claims. While U.S. automobile manufacturers have faced daunting challenges such as legacy costs, the industry worldwide is somewhat stable. The lower demand for automobiles in the U.S. is seen as primarily cyclical and will not have a major effect on automobile insurance. There is concern about the length and depth of the drop in the housing market, however, and its impact on homeowners insurance over the long run could be significant.*

## Introduction

The failure of major investment banker Lehman Brothers in September 2008, coupled with serious systemic issues involving the issuance of subprime mortgages and compounded by negative ramifications throughout the financial industry, were clear reminders that economies are both cyclical and at times fragile. With the notable exception of AIG, most of the U.S. insurance industry survived the largest economic downturn since the Great Depression in relatively good shape, especially when compared to money center banks (which is how the nation's largest banks are often called, meaning that they are global and have a heavy involvement in wholesale banking with major clients). In AIG's case, a relatively small division had taken

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immense risks by writing credit default swaps totaling hundreds of billions of dollars, resulting in the company eventually collecting $182 billion in federal bailout funds (all monetary amounts referred to in this paper are in U.S. Dollars).

In America, insurance is unique in the financial services field because, unlike banking and investments, which are regulated largely (although not entirely) by federal agencies such as the Securities and Exchange Commission, insurance is regulated primarily at the state level. This means that insurance firms must deal with up to 50 different sets of state regulations and 50 different state regulatory agencies. Given the interdependent dynamic of the global economy, examining the influence of a severe economic downturn on the insurance industry is warranted. In this paper we examine some of the consequences of a significant recession on the insurance industry. Focusing on the most recent recession, dubbed by some as "The Great Recession", and the subsequent recovery accompanied by negligible job growth and a historic slump in the housing market, we consider the response by the insurance industry, specifically in the areas of marketing and portfolio management, for surviving and even thriving in this environment. The influence of the economic downturn on the behavior of insureds, primarily in the personal lines of insurance, is also examined.

## Overview of Recessions since 1970

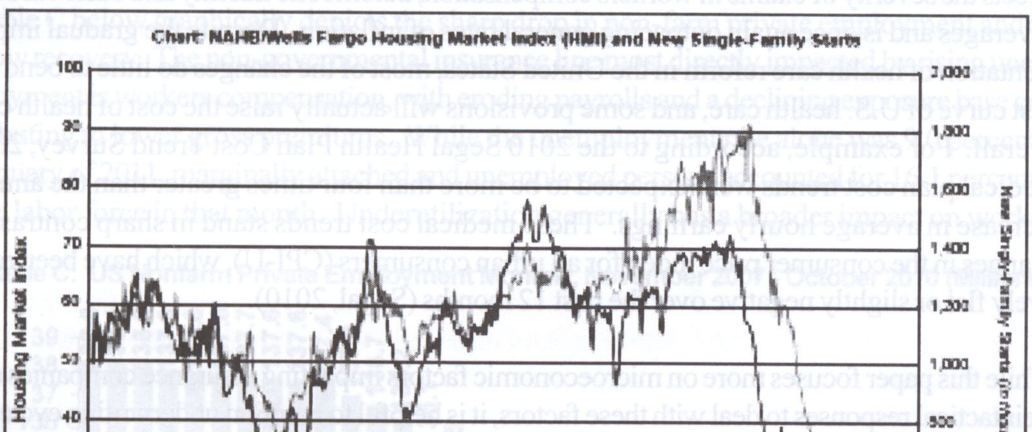
The definition of a recession, according to the National Bureau of Economic Research, is "a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real gross domestic product (GDP), real income, employment, industrial production, and wholesale-retail sales" (NBER, 2009). To put the most recent recession in context, we briefly examine the causes and results of U.S. recessions over the last 40 years.

The first recession since 1970 was from November 1973 to March 1975, resulting in an overall decrease of 3.2 percent in Gross Domestic Product (GDP). Oil prices quadrupled and there was a high level of government spending mainly due to the Vietnam War. This was accompanied by an especially severe market downturn in 1973-1974. The period from January 1980 to July 1980 marked another recession. Its genesis is normally attributed to the time when Paul Volcker, chairman of the Federal Reserve Bank at the time, increased interest rates considerably in order to offset historically high inflation that began in the 1970s. This period is also sometimes referred to as a double-dip or W-shaped recession. A double dip recession occurs when the economy has a recession, emerges from the recession with a short period of growth, but quickly falls back into recession. The second dip was from July 1981 to November 1982. A relatively short recession took place from July 1990 to March 1991. GDP decreased 1.4 percent, primarily due to some new banking regulations. Otherwise, the 1990s were the longest period of growth in American history. However, the collapse of the speculative dot-com bubble in the early 2000s, coupled with the September 11, 2001 terrorist attacks on U.S. soil brought the decade of growth to an end. This recession lasted from March 2001 to November 2001. Despite the internet bubble and the "black swan" event of the September 11 terrorist attacks on the World Trade Center and the Pentagon, this recession was brief and shallow.

The next recessionary period was the worst economic downturn since the Great Depression of the 1930s. According to the National Bureau of Economic Research, a private nonprofit research group that is considered the official arbiter of economic contractions and expansions, this recession began in late 2007 and officially ended in June of 2009. While corporate profits have rebounded significantly from 2008 lows, unemployment has remained persistently high, and still exceeds 9 percent as of early 2011. Many economists have expressed concern that the $14 trillion debt, exacerbated by federal government intervention efforts through such programs as the Troubled Asset Relief Program, easing by the Federal Reserve, and various other bailout and stimulus endeavors, will eventually dampen future economic growth and create an environment that results in a major inflationary cycle.

Two areas of the economy that have affected personal lines of property insurance in the U.S. are the automobile and housing industries. New auto/light truck sales fell to the lowest level

**Table A**



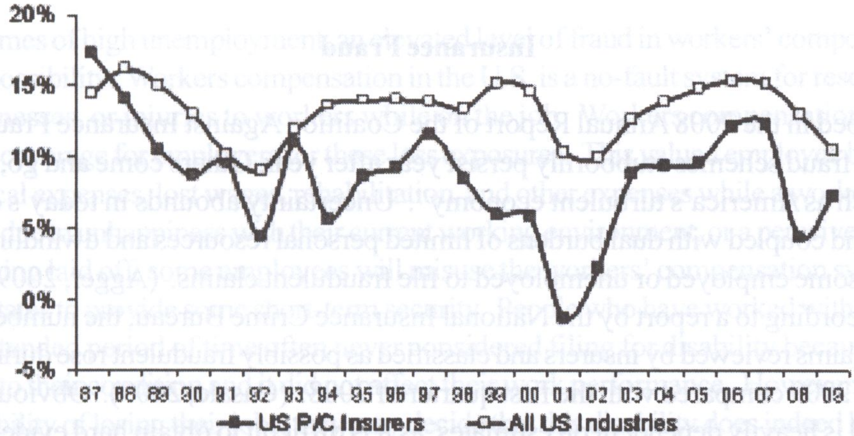
since the late 1960s. The forecast for 2010-11 is for a recovery in auto sales, but still far below the 1999-2007 average of 17 million units (U.S. Department of Commerce, 2010). Fewer automobiles mean less loss exposures to insure, and older vehicles could result in more insureds dropping their comprehensive and collision coverage, and retaining only liability coverage. However, economists at the Insurance Information Institute posit that falling auto sales will have a relatively smaller effect on auto insurance exposure growth than problems in the housing sector will have on homeowners insurance companies. The housing situation has been just as severe, if not more so. The Housing Market Index, an index of over 300 home builders, shows the demand for new homes. The index runs from 0-100, so a rating of 50 would mean that demand for new homes was average. As seen in Table A above, housing has experienced a historic drop in prices and demand.

New home starts plunged 72 percent from 2005 to 2009. This was a net decline of 1.49 million units, the lowest since records began in 1959. According to estimates by the Insurance Information Institute (I.I.I.), each 100,000 decline in housing starts costs home insurers $87.5 million in new exposures, i.e., gross premiums. Using these calculations the net exposure loss in 2009 versus 2005 is estimated to be about $1.3 billion (Hartwig, 2010).

The insurance industry also has to remain attentive to inflationary pressures. Inflation in general affects the severity of insurance claims. Medical cost inflation in particular, dramatically affects the severity of claims in workers compensation, automobile liability and other casualty coverages and is once again outpacing general rates of inflation. Despite the gradual implementation of health care reform in the United States, most of the changes do little to bend the cost curve of U.S. health care, and some provisions will actually raise the cost of health care overall. For example, according to the 2010 Segal Health Plan Cost Trend Survey, 2010 medical plan cost trends were expected to be more than four times greater than the annual increase in average hourly earnings. These medical cost trends stand in sharp contrast to changes in the consumer price index for all urban consumers (CPI-U), which have been relatively flat or slightly negative over the past 12 months (Segal, 2010).

While this paper focuses more on microeconomic factors impacting insurance companies and their tactical responses to deal with these factors, it is helpful to mention underwriting cycles in the context of the economy. Over the last 35 years there have been roughly three hard markets in the United States – 1975-78, 1984-87, and 2000-03. While a few studies have been conducted examining the relationship between underwriting cycles and economic cycles, most conclusions point to a low level of correlation between the two. During the Great Recession, net written premiums (NPW) among property-liability insurers fell 0.7 percent in 2007, which was the first decline since 1943. This was followed by a decline of 2.0 percent in 2008 and 4.2 percent in 2009. The 2007-2009 time frames represented the first time NPW has dropped three years in a row since the Great Depression back in the 1930s. According to Robert Hartwig, President and Economist at the Insurance Information Institute, cyclicality is primarily driven by the industry's own underwriting cycle and not the economy. He also points out that the measure of total surplus exhibits little cyclicality, but surplus leverage ratios do influence cycles (Hartwig, 2010b).

Table B

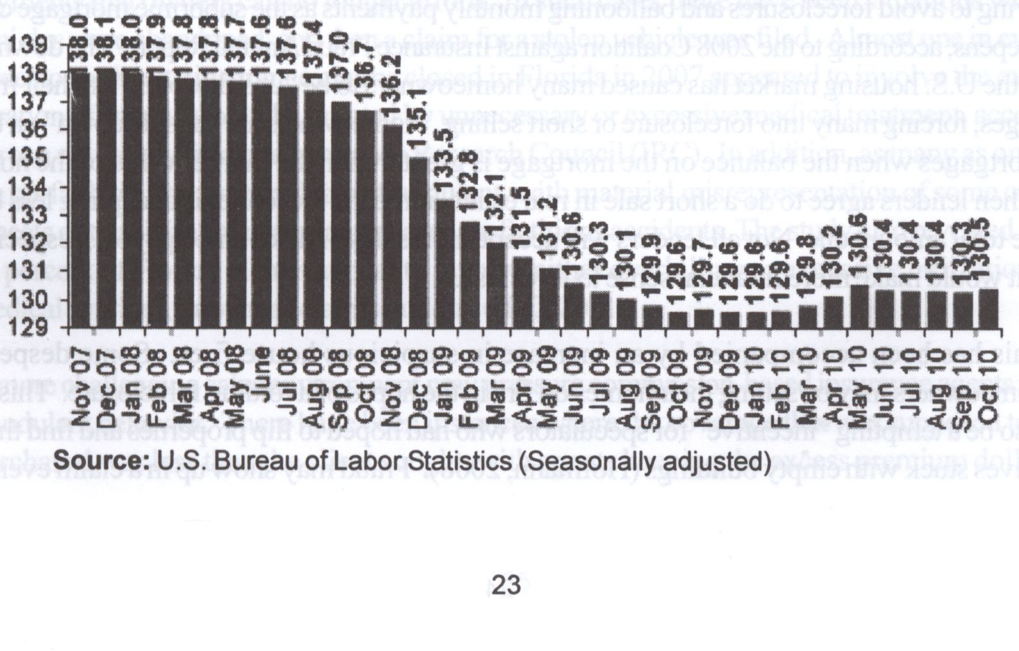



**Source:** Insurance Information Institute, National Association of Insurance Commissioners

## High Unemployment, Declining Housing, and the Behavior of Insureds

From December of 2007 to December of 2009, the U.S. economy lost about 8.4 million jobs. Table C below graphically depicts the sharp drop in non-farm private employment and the slow recovery. The non-governmental insurance line most directly impacted by rising unemployment is workers compensation, with eroding payrolls and a declining exposure base contributing to lower gross premiums. While the unemployment rate alone was 9.0 percent in January of 2011, marginally attached and unemployed persons accounted for 16.1 percent of the labor force in that month. Underutilization generally has a broader impact on workers

**Table C: US Nonfarm Private Employment Monthly, November 2007 - October 2010 (Millions)**




**Source:** U.S. Bureau of Labor Statistics (Seasonally adjusted) compensation and other commercial exposures. However, there are additional microeconomic implications of high unemployment which adversely affect personal lines of insurance and will be addressed in this section.

## Insurance Fraud

As described in the 2008 Annual Report of the Coalition Against Insurance Fraud, "Some insurance fraud schemes stubbornly persist year after year. Others come and go, fueled by trends such as America's turbulent economy". Uncertainty abounds in today's economic climate, and coupled with dual burdens of limited personal resources and dwindling savings may lead some employed or unemployed to file fraudulent claims. (Agger, 2009). For example, according to a report by the National Insurance Crime Bureau, the number of questionable claims reviewed by insurers and classified as possibly fraudulent rose during the first quarter of 2009 compared with the first quarter of 2008. (Casale, 2009). Obviously, insurance fraud is heavily dependent on estimates, as it is difficult to obtain hard evidence on the actual level of fraud. The number of fraudulent claims is likely to be much higher than predicted because there are some schemes that still haven't been discovered (Bradford, 2009). American anti-fraud laws require every insurer to include the following statement on all applications and claims forms: "Any person who knowingly presents a false or fraudulent claim for payment of a loss or benefit or knowingly presents materially false information in an application for insurance may be guilty of a crime and may be subject to fines and confinement in prison" (Agger, 2009). In the remainder of this section we review some of the more common fraud tactics that may be correlated with the economic shock of a recession.

### *Mortgage-related Arson*

Fraud investigators are girding for an expected rash of arsons by cash-strapped homeowners trying to avoid foreclosures and ballooning monthly payments as the subprime mortgage crisis deepens, according to the 2008 Coalition against Insurance Fraud Annual Report. The downturn in the U.S. housing market has caused many homeowners to be "upside down" on their mortgages, forcing many into foreclosure or short selling. Homeowners are "upside down" on their mortgages when the balance on the mortgage is greater than the market value of the house. When lenders agree to do a short sale in real estate, it means the lender is accepting less than the total amount due. Not all lenders will accept short sales or discounted payoffs, especially if it would make more financial sense to foreclose.

This has been accompanied by an increase in suspicious house fires. Some desperate homeowners may be setting their homes on fire in the hopes of avoiding foreclosure. This can also be a tempting "incentive" for speculators who had hoped to flip properties and find themselves stuck with empty buildings (Hofmann, 2008). Fraud may show up in a claim even if a fire was not intentionally set, as immoral policyholders sometimes exaggerate the business interruption or property loss.

***Worker's Compensation and Disability***

During times of high unemployment, an elevated level of fraud in workers' compensation is a distinct possibility. Workers compensation in the U.S. is a no-fault system for resolving accidents, illnesses, or injuries to workers while on the job. Workers compensation insurance provides coverage for employers for these loss exposures. This valued employee benefit pays for medical expenses, lost wages, rehabilitation, and other expenses while a worker recovers. Whether due to unhappiness with their current working environment, or a perceived increased risk of being laid off, some employees will misuse the workers' compensation system in the United States to provide some short-term security. People who have worked with a disability for an extended period of time often never considered filing for disability because they had adjusted to their condition and it did not affect their work performance. However, faced with the possibility of losing their jobs, they may decide that this disability does indeed hinder them and file for disability (Agger, 2009). Another interesting statistic is that during the first quarter of 2009, the number of slip-and-fall claims under commercial policies was up 77 percent compared with the first quarter of 2008. And, the number of workers' compensation-related suspected fraudulent claims was up 71 percent during the first quarter of 2009 compared with the previous year (Casale, 2009). Economic recessions may also tempt employers in the area of workers compensation. For example, to keep premiums artificially low, employers may fraudulently classify workers as independent contractors rather than employees, understating the payroll base used for ratemaking.

***Other Types of Fraud***

Other types of fraud that may increase during economic downturns include those involving car payments that owners can no longer afford. In such cases there have been situations where vehicles were abandoned, and then a claim for a stolen vehicle was filed. Almost one in every three no-fault auto insurance claims closed in Florida in 2007 appeared to involve the exaggeration of an injury or to be inflated by unnecessary or excessive medical treatment, according to a new study from the Insurance Research Council (IRC). In addition, as many as one in ten no-fault claims appeared to be fraudulent, with material misrepresentation of some or all aspects of the claim, such as claims based on fictitious accidents. The study also revealed that 30 percent of Florida claims appear to involve either overbilling or excessive utilization of medical services, known as claims buildup (IRC, 2011).

A more challenging sales environment may pressure commission-based insurance agents into fraudulent behavior. There have been instances where the coverage that was supposed to be purchased was less than the client sought, with agents keeping the excess premium dollars.

Some agents did not buy the coverage they were instructed to buy and kept the excess amount of the premiums. A few have even gone as far as scamming elderly clients into giving up perfectly appropriate life insurance policies for expensive new policies, i.e. churning (Coalition, 2008). As mentioned earlier, there are also the cases where the claim is legitimate, but the amount of the loss is fraudulently inflated. This is sometimes accomplished through a coordinated effort with providers such as chiropractors, physicians, lawyers, auto body repair shops, etc. in an attempt to violate the principle of indemnity and at a minimum, cover the amount of any applicable deductible.

## Lapse Rates

A policy lapses when the premiums due are not paid by the end of the grace period. As discussed in this section, when a policy lapses, the consequences are often unfortunate for the insurance company and the policyholder. Policyholders have different reasons for terminating their policies, sometimes using cash values to address financial emergencies or achieve long-term goals.

### *Life and Health Insurance*

Rates of voluntary policy termination by policyholders vary considerably among life insurers. Each company's rate depends on many factors, including the types of policies written and the ratio of new policies to older ones in force with the company. The voluntary termination rate of individual life insurance policies reached 7.3 percent in 2009. Some policies that lapse still have a cash value, entitling the policyholder to some form of payment under a cash surrender value non-forfeiture option. All coverage under the policy terminates at the time of the surrender.

A policy lapse might not allow the insurer to fully recover their initial expenses, such as the cost of procuring the business, underwriting expenses, and issuing new business (Kuo, et al., 2003). Another cost that concerns the insurance company involves agent compensation. Insurance agents typically work on commission. The first-year commissions they earn on a life insurance policy are typically a lot higher percentage than for renewal premiums. These expenses are paid at or before the time of issue and then the profits are earned over the life of the contract. When the policyholder lets a policy lapse, the insurance company could incur a net loss.

A further concern is adverse selection. Policy lapse might involve adverse selection in the areas of mortality or morbidity. Policyholders with adverse health or other insurability issues tend to hang onto existing policies, which may cause an increase in claims that exceeds an actuarially fair premium, especially if lapse rates are high. In some circumstances the early surrender of policies could pose a liquidity threat to the insurer. The importance of lapse behavior cannot be overstated with regard to an insurance company's liquidity and profitability (Kuo, et al., 2003).

There are two hypotheses put forth to explain why people let their policies lapse. There is the emergency fund hypothesis and the interest rate hypothesis. The emergency fund hypothesis says that insureds use the cash surrender values of their policies in cases of emergency. It also says that when finances get tight, policy owners stop paying their insurance premiums and are inclined to terminate them. The interest rate hypothesis says that lapse rates go up when market interest rates increase because policyholders know they can earn money more elsewhere.

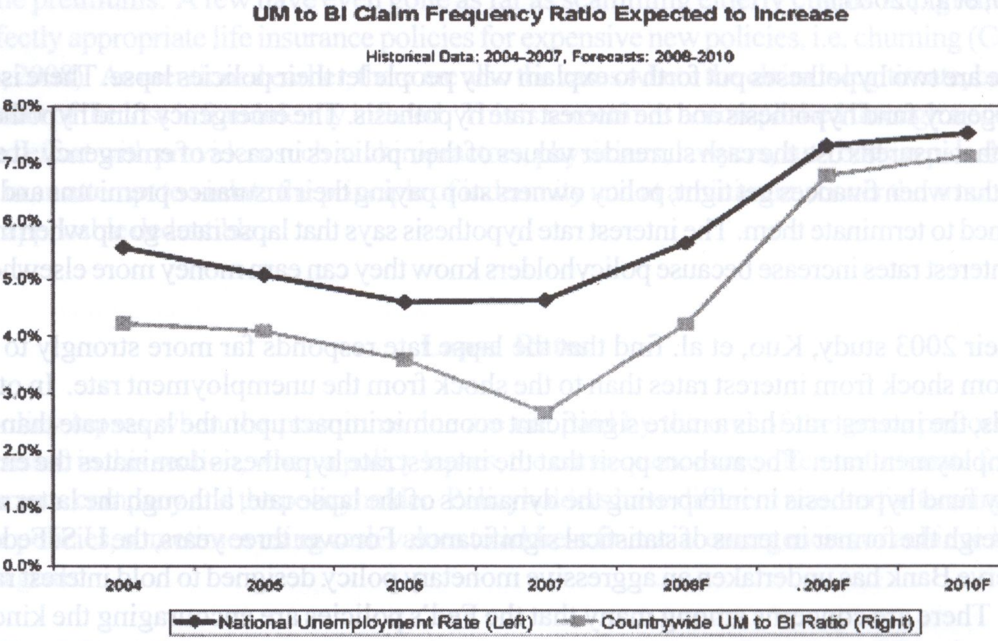
In their 2003 study, Kuo, et al. find that the lapse rate responds far more strongly to the random shock from interest rates than to the shock from the unemployment rate. In other words, the interest rate has a more significant economic impact upon the lapse rate than the unemployment rate. The authors posit that the interest rate hypothesis dominates the emergency fund hypothesis in interpreting the dynamics of the lapse rate, although the latter may outweigh the former in terms of statistical significance. For over three years, the U.S. Federal Reserve Bank has undertaken an aggressive monetary policy designed to hold interest rates low. There are concerns among many that the Fed's policies are encouraging the kind of unsustainable practices that will lead to a cycle of perpetual booms and busts. It will be interesting to see the effect of rising interest rates on lapse rates in the future.

Many Americans receive their health insurance as a group benefit from their employer. Of the 13.7 million American adults who lost their jobs in the current economic recession, an estimated nine million also lost the health insurance coverage previously provided by their employer (Collins, 2010). Adults earning less than 200 percent of the federal poverty level were much more likely to have become uninsured than those whose income was higher than this level (70 percent versus 42 percent). It is hoped that refinement of the major health care reform legislation currently being implemented will reduce those numbers, although the impact on the private health insurance industry remains highly indeterminate.

***Automobile Insurance***

A study by the Insurance Research Council predicted that the recent state of the economy would trigger a sharp rise in the percentage of uninsured motorists. The IRC report finds a strong correlation between the percentage of uninsured motorists and the unemployment rate (see Table E below), determining that an increase in the unemployment rate of one percentage point is associated with an increase in the uninsured motorist rate of more than three-quarters of a percentage point. Paying claims involving uninsured motorists negatively impacts insurance company reserves. Insurance companies reserves are derived from premiums paid. A portion of these premiums earned are set aside to pay losses, claims, or expenses that are anticipated to be paid on the policies.

## Table D




This in turn affects many other facets of the insurance business. Insurance providers experience a higher frequency and severity of claims, as an increasing number of claims involve uninsured/underinsured motorists. Uninsured/underinsured motorist insurance typically covers any liability that will not be covered by the person with whom you had an accident. As mentioned earlier, some households are changing their liability coverage to the minimum limit required by state law. Their limits may not be high enough to fully compensate you for your losses or they may not have any insurance at all. Such claims experiences eventually lead to higher premiums.

Insurance.com, a web site that provides tracking of insurance price quotes, reported that an eight percent surge in the cost of auto insurance, coupled with growing economic woes, has resulted in a fourfold increase of drivers who let their policies lapse (IRC, 2008). Although nearly all of the 50 states in the U.S. have some type of mandatory automobile insurance law on the books, the percentage of uninsured motorists is still troubling, and regulators are continually seeking the most effective enforcement mechanisms.

Another way households are dealing with a slowing economy is delaying when teenagers can start driving. U.S. households with teen drivers pay an average of $3,100 a year for expenses including insurance and gas. Parents have cut spending in other areas such as entertainment, and many are now requiring children to work part-time to help with the rising bills. In the U.S., adding a teenager to an insurance policy can increase premiums by as much as 50 percent to 100 percent. According to the Federal Highway Administration, only about 31 percent of 16-

year-olds were licensed to drive in 2009, down from 37 percent in 1999. In contrast, drivers as a percentage of the U.S. population, excluding children under age 14, increased from 72 percent to 86 percent over the same time period (Shah, 2011).

## Investment Strategies

The U.S. insurance industry is one of the major providers of capital to the American economy. Investment earnings are also an important component of the overall insurance business. There are some years in which insurance companies are able to show a profit, despite underwriting losses, due to investment gains. Property and health insurers generally need a higher level of liquidity and are relatively limited in the area of long-term investments as compared to life insurance companies and certain types of liability coverage. For example, life insurers know that more of their funds can be invested long-term as many claims may not arrive until years into the future (Baranoff, 2003). However, the life insurance industry can experience volatility too. For example, Metropolitan Life, America's largest life insurer, went from a formidable $3.2 billion profit in 2008 to a staggering $2.2 billion loss one year later.

The asset management aspect of the insurance industry in the United States is highly regulated, and promotes sound investment decision-making. Statutory Accounting Principles (SAP) is a set of accounting rules for insurance companies set forth by the National Association of Insurance Commissioners (NAIC). Generally, they are considered even more conservative than Generally Accepted Accounting Principles (GAAP). Consideration of risk-based capital, through such regulations as the Insurance Regulatory Information System (IRIS) ratios, provides an improved system of detecting increased insurance company default risk. FAST, the Financial Analysis Tracking System, is an early warning system that looks at more ratios than IRIS, assigns scores for each ratio and calculates an aggregate score. Insurers receive regulatory attention if their score is too low. Regulatory oversight through these ratios and other regulations primarily developed by the NAIC has provided numerous incentives for the insurance industry to invest conservatively.

According to a Conference Board report, the economic recession and stock market volatility did not alter investment strategies of institutional investors. Insurance companies remained fundamentally committed to their pre-credit crunch investment policies (Pensions, 2009). In the property casualty insurance industry, recent investment gains consisted primarily of interest, stock dividends, and realized capital gains and losses that rebounded well after a sharp drop after 2007. Specifically, investment gains were $55.7 billion in 2006, $64.0 billion in 2007, then fell nearly 50 percent to $31.7 billion in 2008, improved to $39.0 billion in 2009 due to smaller realized capital losses but declining investment income investment gains, and were already recovering significantly at $39.5 billion in the three quarters of 2010 (Hartwig, 2011).

As of 12/31/2009, invested assets in the property-casualty insurance industry totaled $1.26 trillion. Generally, the insurance industry invests conservatively, with over two-thirds of invested assets in bonds. Only 18 percent of invested assets were in common or preferred stock. It should be noted that about half of the property-casualty insurance industry's bond investments are in municipal bonds. Given the serious budget deficits in states such as California, Illinois, New Jersey, Nevada, Texas and others, it will be interesting to see if State and local governments can prudently address these shortfalls and lower the impact of default risk on the debt portion of insurer portfolios.

## Advertising Strategies

The insurance industry now spends $4 billion a year on advertising thanks to traditional companies like State Farm and Allstate having to combat aggressive and innovative companies like Progressive and GEICO. GEICO in particular has raised the stakes in insurance advertising, now accounting for roughly one-sixth of industry advertising expenditures. According to Best's Review, the top advertisers for 2008 were GEICO, State.Farm, Allstate, Progressive, and Nationwide with GEICO spending the most advertising dollars at $622.7 million. Eighty percent of that money was targeted at auto insurance advertising. This was a general trend for all of the top 5 advertising companies. Progressive spent nearly their entire advertising budget on auto insurance, at 95 percent. State Farm spent the lowest percentage on auto insurance promotion among the advertising leaders, at 53 percent (Chordas, 2010). Given the compulsory nature of automobile insurance regulations, the private passenger policy is often used as a gateway that allows the insurance company to offer products to meet the insured's other needs as well.

The economic downturn and stubbornly high unemployment have affected the general tone of insurance advertising campaigns. With recession-weary consumers apparently less inclined to laugh, Nationwide Insurance is trading in its humorous 'Life comes at you fast' for the tried-and-true tagline 'Nationwide is on your side'. It is not the only company making a change, as a host of advertisers from Home Depot to Visa and Nationwide rival Allstate Insurance switch to more-comforting messaging while the downturn grinds on (York, 2009).

The severe downturn in the stock market frightened many individual investors into selling near the market bottom, causing investors to become more risk adverse. New York Life is an example of a major life insurer that made a strategic decision in recognition of this change. Starting with a print advertising campaign that highlighted the financial benefits and long-term guarantees of its whole-life insurance product, this campaign was part of a 2009 advertising budget that increased by 24 percent from 2008's advertising budget. Previously, most of the industry was advertising variable annuities (Ackerman, 2010). This was due to a bullish equity market, which positively and significantly influenced both the performance and sales of variable products.

Because of increased volatility in the stock market from 2007 to 2009, the return to a risk-adverse mindset by consumers, especially those within a few years of retirement, is having an effect on the insurance industry. Insurance companies appear to be returning to their risk management core and generally forsaking get-rich products. For many years the focus was on accumulating wealth rather than protecting what you have, so this is generally seen as a healthy change.

### *Advertising expenses*

Advertising spending by property-casualty insurers increased by 170 percent or $2.74 billion from 2001 to 2008, before easing slightly in 2009. The upward trend could well resume as the economy improves and direct writers seek growth and big insurers seek to maintain share. As mentioned earlier, private passenger auto insurance accounts for the largest share of advertising expenditures.

**Table E: Property-Casualty Industry Advertising Expenditures**

| YEAR | IN BILLIONS (USD) | AS A PERCENTAGE OF NET PREMIUMS WRITTEN |
|---|---|---|
| 2003 | $1.88 | 0.46% |
| 2004 | $2.34 | 0.55% |
| 2005 | $2.97 | 0.70% |
| 2006 | $3.44 | 0.77% |
| 2007 | $4.12 | 0.92% |
| 2008 | $4.35 | 0.99% |
| 2009 | $4.15 | 0.98% |

**Source:** Insurance Information Institute, National Association of Insurance Commissioners

When all lines of insurance are included (some ads plug multiple products) spending for 2009 was $4.15 billion, more than double what the industry spent in 2000, according to industry-reported ad spending figures cited by J.D. Power & Associates. The top five spenders on advertising (in millions) in 2009 were: GEICO $827 (a 25-fold increase in its advertising budget since Berkshire Hathaway's Warren Buffet bought the company in 1996); State Farm $514; Allstate $418; Progressive $388; and Liberty Mutual $245. (Power, 2010)

Insurers are aggressively using every opportunity to gain exposure, including sponsoring PGA golf tournaments, NASCAR racing, and numerous other athletic events. Farmers Insurance recently agreed to pay $700 million over 30 years to put its name on a planned NFL stadium in Los Angeles -- and the city does not even have an American football team yet.

For most industries, 2009 was a year of scaling back on spending in the area of digital advertising. However, personal lines property/casualty insurers accelerated their spending -increasing their spending by 47 percent year-over-year to $591 million-in four major online advertising categories: paid search, online display ads, online leads and online video. Given this dramatic increase in spending, it appears insurers capitalized on an abundant online ad inventory, aggressive consumer shopping behavior, and record numbers of online consumers (there were more than 36 million unique visitors on insurance web sites in December 2009).

Also, some 48 percent of millennials turn to the web first, compared with 28 percent of baby boomers, according to J.D. Power & Associates' 2010 Insurance Shopping Study. Baby Boomers are generally considered to be those born between 1946 and 1964. There are no precise dates for when the Millennial generation starts and ends, but commentators have commonly used birth dates ranging somewhere from the mid-1970s to the early 2000s. Since many insurers are specifically targeting younger demographics, this is a natural stratagem for reaching those potential insurance consumers. Regardless of the reasons, the insurance industry experienced a first in 2009. The U.S. insurance industry exceeded all other American industries in terms of percentage of total advertising dollars allocated to online display advertising (Pickles and Thornton, 2010).

Life insurance companies are also major players in the world of advertising. In the fall of 2010, industry leader Northwestern Mutual announced it had increased its advertising budget by 30 percent to convince more consumers to buy policies. Because life insurance is a relatively mature category in the U.S., insurers must steal market share from one another in order to grow. Table F below illustrates the overall spending for advertising in the U.S. life insurance industry.

**TABLE F: Life Insurer Home- and Field-Office Advertising Expenses**

| YEAR | IN MILLIONS (USD) |
|---|---|
| 1999 | $1,732 |
| 2006 | $2,839 |
| 2007 | $2,876 |
| 2008 | $3,222 |
| 2009 | $2,702 |

**Source:** Life Insurers Fact Book, 2008 and 2010, American Council of Life Insurers

## Conclusion

A discussion of the relationship between the insurance industry and the economy is beneficial for a number of reasons. For those countries not as economically developed currently as some western nations, this provides a possible insight into their future alternatives as their insurance industries mature. One of the advantages cited in American risk and insurance textbooks for regulating insurance at the state level is that instead of implementing a major insurance reform nationwide, there are basically 50 state laboratories that can employ various solutions to insurance issues. Each state can look at the results from other states, and copy successful strategies while avoiding the mistakes made by others. It is conceivable to apply this same concept at the nation level. As a case in point, a number of developing countries have already engaged in collaborative arrangements with the National Association of Insurance Commissioners in an attempt to maximize the often competing objectives sought in insurance regulations.

As with many other industries, the insurance industry is influenced by general economic conditions. Despite the largest economic downturn since the Great Depression, individual behavior regarding personal lines of insurance has been manageable. Policy lapse rates have increased, but not significantly. There is concern among special investigative units (SIUs) in insurance companies that the lack of a strong rebound in the economy accompanied by robust job growth could create conditions that promote fraudulent behavior, especially in the area of claims. While the domestic automobile industry has faced daunting challenges such as legacy costs, the industry worldwide is somewhat stable. The lower demand for automobiles in the U.S. is seen as primarily cyclical and will not have a major effect on automobile insurance. There is concern about the length and depth of the drop in the housing market, however, and its impact on homeowners insurance over the long run could be significant.

Because of a highly regulated environment with regards to insurance company asset management, there has not been a significant change in investment strategies during this period. A few specific companies who accepted TARP funds such as Lincoln National, Hartford Insurance, and AIG were compelled to change their investment criteria in response to a dramatic revaluation of their respective portfolios. An aggressive and competitive advertising environment has caused insurance industry marketing budgets to increase with little regard to the overall economy.

Some future areas of potential research include looking at the relationship between the insurance industry and the general economy at the state level. Most insurance regulation at this point in time is still conducted by states, although efforts are underway to increase federal oversight. The Federal Insurance Office (FIO) is a new office within the US Department of Treasury under the Dodd-Frank Wall Street Reform and Consumer Protection Act, which President Obama signed into law on July 21, 2010. The FIO will advise the Secretary of the Treasury on major domestic and prudential international insurance policy issues and consult with the states and state insurance regulators regarding insurance matters of national and international importance. The Office will monitor all aspects of the insurance industry, including the availability of affordable insurance to traditionally underserved, low to moderate income, and minority persons and communities. It has the authority to identify issues or gaps in the regulation of insurance that could contribute to a systemic crisis in the insurance industry or the broader US financial system; and to make recommendations as to whether an insurer, including affiliates of an insurer, should be an entity subject to supervision by the Board of Governors of the Federal Reserve. The FIO will also play a role in the resolution of certain troubled insurance companies.

A study of insurance company strategies and insurer behavior after a full economic recovery with strong job growth for comparative purposes, would also be of interest. Of course, if those proclaiming current conditions are "the new normal" are correct, such research would be many years into the future. The study of the interrelationship between economic conditions, the stock market, and the insurance industry has a number of unanswered questions and should keep researchers busy for decades.

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