

Travel Insurance



TRAVEL INSURANCE AN ACTUARIAL PERSPECTIVE

American Academy of Actuaries
Travel Insurance Task Force



AMERICAN ACADEMY *of* ACTUARIES

Objective. Independent. Effective.™

ACTUARY.ORG

SEPTEMBER 2018

The American Academy of Actuaries is a 19,500-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.



AMERICAN ACADEMY *of* ACTUARIES

Objective. Independent. Effective.

AMERICAN ACADEMY OF ACTUARIES
1850 M STREET NW, SUITE 300, WASHINGTON, D.C. 20036
202-223-8196 | WWW.ACTUARY.ORG

© 2018 American Academy of Actuaries. All rights reserved.

Travel Insurance An Actuarial Perspective

SEPTEMBER 2018

American Academy of Actuaries Travel Insurance Work Group

Daniel Roth, MAAA, FCAS—*Chairperson*

Robert Daino, MAAA, FCAS

Karen Daley, MAAA, FCAS

Aaron Fezatte, MAAA, ACAS

Julie Hall, MAAA, ACAS

Michael B. Smith, MAAA, FCAS, FSA

William Stanfield, MAAA, ACAS

Marc Rosenberg, Senior Casualty Policy Analyst

Kevin Ryan, MAAA, FCAS, Senior Casualty Fellow

Contents

Executive Summary	1
Defining Travel Insurance and Travel Protection	2
What Is Travel Insurance?	2
What Is Travel Protection?	4
Consumer Information and Resources	5
How Travel Insurance Is Sold and Serviced	6
Bundled Property/Casualty Insurance (P&C) and Accident & Health Insurance (A&H)	6
Group Coverage	6
Competitive Landscape	7
Insurer Perspective	9
Distributor Perspective	10
Free Insurance	11
Illusory Coverage	11
Market Segmentation and Distribution	12
Product Attributes	13
Intermittent	13
100% New Business	13
Discretionary	14
Relatively Low Premiums and Loss Ratios	14
Take-All-Comers	15
Cancellation Provisions	15
Actuarial Perspectives	16
Data	16
Financial Reporting	18
Risk Classification	21
Conclusion	23

Executive Summary

This monograph is presented to inform the traveling public, travel providers and distributors, state policymakers and regulators, actuaries, agents, and other insurance professionals about the manner in which travel insurance is designed, filed, priced, sold, and serviced, so that they may contribute to the public dialogue on the evolving commercial and regulatory environment regarding travel insurance.

As airlines, hotels, tour organizers, and other travel service providers have increased their low-cost non-refundable options, they also have promoted the purchase of travel insurance. Consumers have become more aware of this product and travel insurance questions now come up with greater frequency.

State regulators and legislators have recently published suggested new guidelines for how travel insurance may be regulated. This paper hopes to provide sufficient background and understanding of how travel insurance works in the marketplace, including explanations of how travel insurance differs from other forms of insurance, so that all parties to these continuing efforts remain well informed.

Travel insurance differs from other lines of insurance in several ways, including:

- Sales are “take-all-comers” and are not individually underwritten.
- Policies are typically short, with varying durations.
- Policies are rarely, if ever, sold on a renewable basis.
- Products are typically marketed as an ancillary purchase along with travel, rather than as a stand-alone purchase.
- The distributors of travel insurance are typically travel retailers whose sales are overseen by licensed producers rather than insurance agents.
- Products are often sold in a package that includes non-insurance travel assistance services and/or travel cancellation waivers along with the travel insurance policy.
- Travel insurance often includes both Property & Casualty (P&C) and Accident & Health (A&H) coverages in a single policy.
- Many product premiums are small compared to traditional personal lines of insurance.
- Policies can be sold on a group basis, even when the primary risks are P&C risks.
- Risk rating tends to focus on the trip (e.g., length, destination, etc.), although traveler age is often considered.

Defining Travel Insurance and Travel Protection

What Is Travel Insurance?

State regulations typically provide definitions for the different lines of insurance that may be offered in that state in order to provide a framework for clear regulatory guidance. These regulations also address all aspects of each line of the business, including ratemaking, financial reporting, assessments, taxation, etc.

Prior to the adoption of the Limited Lines Travel Insurance Act¹ by the National Council of Insurance Legislators (NCOIL), few state statutes provided a definition of “travel insurance,” resulting in inconsistencies among states, and sometimes even within a state, on various travel insurance-related issues.

In 2016, the Property and Casualty Insurance (C) Committee of the National Association of Insurance Commissioners (NAIC) convened the Travel Insurance (C) Working Group to draft a model law for travel insurance. The working group completed the model law draft² in June 2018 and placed it on a path toward consideration for approval by the NAIC. Partly due to this effort, states are defining travel insurance more consistently, and some states have already updated their regulations to include clearer definitions and guidelines.

The models referenced above incorporate definitions reflecting that travel insurance policies typically include multiple coverages packaged together. Common coverages that may be included in these packages are:

- **Trip Cancellation:** Reimbursement of costs previously paid, and not otherwise refunded, for a trip canceled prior to departure.
- **Trip Interruption:** Reimbursement of additional costs, or of unused prepaid costs (e.g., excursions, hotel, etc.), incurred due to returning from a trip earlier than expected.
- **Travel Delay:** Reimbursement of costs incurred because travel did not occur at the time expected.
- **Baggage Damage or Loss:** Payments to replace personal items damaged or lost while on a trip.
- **Baggage Delay:** Reimbursement of additional costs incurred to replace personal items that did not arrive at the intended destination when expected.
- **Emergency Medical or Dental:** Reimbursement of unexpected medical costs incurred due to injury or illness while traveling.

¹ Revised as [Travel Insurance Model Act](#), National Conference of Insurance Legislators, updated version approved July 15, 2017.

² [Travel Insurance Model Act](#), National Association of Insurance Commissioners, April 30, 2018.

- **Emergency Evacuation:** Providing specialized transportation (e.g., air ambulance), typically in response to a medical emergency or severe medical need.
- **Repatriation of Remains:** Providing transport for an insured who dies during travel from the travel destination to a family-designated funeral home.
- **Rental Car Collision Damage:** Reimbursement of amounts paid to a rental car agency due to damage to, or loss of, a rental car.

Numerous other types of coverage may be offered, either on a reimbursement basis (i.e., insurance pays according to specific costs incurred) or as an indemnity benefit (i.e., insurance pays a fixed amount when a specific travel disruption occurs, such as tarmac delay, carrier change in itinerary, etc.).

For most products, each of the coverages associated with travel insurance has specific triggers (“covered reasons”) that limit the range of events that will result in reimbursement. These triggers can vary widely among carriers and between policies for each carrier. For example, one policy might provide coverage when only the traveler becomes ill, while another policy might also provide coverage when the traveler’s relative, traveling companion, or caregiver becomes ill.

Although each of the coverages falls within the broad definition of travel insurance, state regulators have had varying interpretations of how or whether these coverages must be packaged in order to constitute travel insurance. Several states have specified that a policy must contain trip cancellation or trip interruption coverage in order to be considered travel insurance, while others have not imposed such conditions.

Another characteristic of travel insurance is the potential overlap with other insurance products. For example, automobile insurance may provide rental car collision damage insurance, homeowners insurance may cover lost or damaged baggage, and health insurance may cover emergency costs while traveling. Even in cases where a traditional policy may provide a benefit, travel insurance remains distinctive because it only covers exposures related to travel, and is usually tied to a specific trip.

What Is Travel Protection?

The NAIC draft Travel Insurance Model Act defines a Travel Protection Plan as a product that provides one or more of the following: Travel Insurance, Travel Assistance Services, and Cancellation Fee Waivers. This definition highlights a unique feature of travel insurance in that it is typically sold as a package product that includes non-insurance travel services and benefits. These benefits are provided by an entity separate from the insurance company. These entities may be affiliates of the insurance company or may be third parties that partner with the insurance company to offer these products. Some of these benefits may be provided on a conditional basis (e.g., cancellation fee waivers), which could create potential confusion and/or gaps in regulatory oversight when not treated as insurance.

By treating these benefits outside the insurance realm, visibility into the cost of travel insurance may be reduced for regulators and consumers, and the potential for wider variation in product prices may be greater, because prices for the non-insurance portions of travel protection plans may be driven by market forces more so than by actuarial or regulatory considerations.

These non-insurance benefits can be broadly categorized into three groups:

1. Concierge and Valet Services

Including making reservations (hotel, restaurant, tee times, etc.), purchasing flowers, securing tickets to local celebrations or events, etc.

2. Assistance Services

Including assisting travelers in responding to unexpected emergencies, such as:

Finding a local doctor or hospital;

- Translating medications into the local language (and vice versa);
- Organizing all components of a medical evacuation or repatriation;
- Finding a local lawyer; and
- Replacing lost travel documents, etc.

3. Cancellation Fee Waivers

These product features help strengthen the relationships between travel providers and their customers by alleviating the inconvenience to customers whose travel plans change due to unforeseen events. A cancellation fee waiver allows customers the right to cancel their trip without incurring a penalty otherwise applicable according to the travel provider's refund policy.

Another approach travel providers use is to offer different fares, such as a higher refundable fare vs. a lower non-refundable fare. Although this is rarely characterized as a cancellation fee waiver, the effect is the same.

Potentially complicating matters further for consumers, regulators, and insurers is the varied ways in which these travel protection plans are packaged, priced, and sold. For example, sometimes all the pieces (insurance, travel assistance, and cancellation fee waiver) are offered as one package for one price, and other times the pieces will be offered in different configurations—e.g., the cancellation fee waiver may be offered as a separate purchase option alongside an offer for a package of insurance and travel assistance.

Consumer Information and Resources

Because of the emerging and evolving nature of travel insurance and the resulting variety of product offerings among carriers, it is important that consumers have the resources to be informed so they are better able to understand what coverages they are purchasing and evaluate whether the coverages and coverage triggers being purchased meet their needs.

The information available to consumers regarding coverages, providers, pricing, claims, etc. has increased over time thanks to the internet and competition among providers.

The website Wikitravel provides a reasonably comprehensive overview of travel insurance, including how it works, where to buy, when to buy, what to buy, and how to make a claim.³ There are also several travel blogs and websites that offer articles about travel insurance and reviews from consumers.

While these resources provide good practical guidance, they are by no means exhaustive. Many travel insurance carriers provide informational content to their current and potential customers, and this content is typically updated as carriers enhance their product offerings.

³ For an overview, see [wikitravel.org/en/Travel_insurance](https://www.wikitravel.org/en/Travel_insurance).

How Travel Insurance Is Sold and Serviced

Bundled Property/Casualty Insurance (P&C) and Accident & Health Insurance (A&H)

A distinctive aspect of travel insurance is that it often contains a bundling of both P&C and A&H coverages. Today, most states regulate such products as a P&C product exclusively because the P&C coverages (specifically trip cancellation) are generally the largest component of the product's expected claim cost. However, some domiciles continue to regulate the P&C and A&H components of travel insurance separately, creating challenges for all stakeholders. For the insurance company, this may result in the need to create an artificial split of P&C and A&H rates and forms to satisfy the filing and reporting requirements of the regulator. For the consumer and regulator, understanding how the two policies work together to provide coverage may be difficult, particularly if some of the terms and conditions, such as general exclusions, are treated differently by the insurance department's P&C and A&H reviewers.

Group Coverage

Another significant aspect of travel insurance is that coverage may be offered on either a group or individual basis. Historically, travel insurance was issued based on group insurance regulations and regulated by the A&H divisions of state department of insurance because the issuance of coverage on a group basis is more common for A&H than for P&C. Also, the early issuers of travel insurance tended to focus on A&H benefits (e.g., accidental death, emergency medical, etc.). Thus, the use of group coverage has been common in travel insurance for many years.

However, more recently, travel insurance has had a growing focus on property/casualty benefits (e.g., trip cancellation, travel delay, etc.). P&C statutes are often silent regarding group insurance, which can create challenges for insurers and regulators in ensuring form and rate compliance.

Generally, a group insurance structure may be permitted under the following conditions:

- The group to be insured has something in common other than being grouped for the purpose of obtaining insurance; and
- There is a master policyholder who will retain the documentation on behalf of the members and may deal with the members on behalf of the insurer.

One impetus for using a group rating approach is that a provider may face difficulty in rating individual policies in an environment where there is no formal insurance application process, as noted on page 15 (“Take-All-Comers”). For example, consider a situation where an insurer seeks to package a product for a cruise line to be offered to travelers on that cruise line. If all the insureds are on the same cruise itinerary, treatment as group may be more obvious than if the insureds are not on the same itinerary, even though each insured is using the same cruise line. In any case, the cruise line seeks to provide insurance options for all travelers in the group and may not have enough information on all the insureds to support individual rating.

Where coverage is written for all members of a group collectively—i.e., on a non-optional basis—this is a special case of group coverage often referred to as “blanket coverage.” A typical use of blanket coverage for travel insurance is to include travel insurance as part of the collection of benefits provided to holders of a particular credit card.

The NAIC model law draft provides clarity in the areas of group and blanket travel insurance by including a long list of “Eligible Groups” for the purposes of travel insurance.

Competitive Landscape

Consumer Perspective

Competition is an important characteristic of any insurance market. Data is not readily available to measure the degree of competition in the travel insurance/travel protection plan market. However, one indication of competitiveness is the range of consumer choice available.

For travel insurance, consumers have a wide range of choices, but they also have a wide range of preference with respect to how much time and effort they wish to expend in the purchase decision process. Below is a description of the different ways travel insurance is made available to consumers, arranged according to the amount of time and effort required for the consumer to determine what they wish to buy and complete their purchase, including a description of how much choice is perceived in those channels.

Easiest effort: Click or say “Yes.”

Many travel providers (hotels, airlines, cruise lines, tour operators, etc.) offer travel insurance as a potential integrated part of the travel purchase. These products are customized to the travel through a partnership between the travel provider and the travel insurance company. The only effort required by the consumer is to simply acknowledge the desire to include the travel insurance as part of their overall travel purchase.

The advantage for consumers is that such a transaction is very easy to complete, usually avoiding the need to enter any additional payment steps or personal information. Also, in the case of group travel, the coverage options have been designed to be relevant for that trip, so the product offered should meet the consumer’s insurance needs. However, these channels typically only display one product offer and the trip cancellation limit will only reflect the parts of the trip that are being purchased in this channel, which limits the range of choice and reduces the ability to compare prices or plans at that decision point. If the offer does not include the benefits that are sufficiently relevant for that particular consumer or does not provide the full amount of trip cancellation coverage needed, then the consumer would need to seek out alternative methods to purchase the necessary coverage(s).

Medium effort: Purchase from an aggregator or an agent.

There are travel insurance aggregator websites that allow consumers to enter their trip information once and receive quotes for many different product options from multiple insurers with a single click. These quotes may be a little easier to compare than individual quotes, but may still be affected by differences in benefits and coverage details.

Travel agents and insurance agents may offer travel insurance that can be purchased by consumers, whether or not the travel itself was purchased through a different provider. These travel agents may have more than one product available, sometimes from more than one insurance carrier, and provide consumers some choice while limiting the range of options to consider.

The amount of advice that a travel agent can provide to the consumer in making these decisions is affected by the agent’s license status. Some travel agents are fully licensed insurance agents, and so should be qualified to offer in-depth comparisons and make a recommendation. Others hold only a limited license, which allows them to offer and disseminate the product but does not allow them to sell, solicit, or negotiate. In the latter case, the burden is on the consumer for determining which product best meets their needs.

Most effort: Visit various company websites individually.

Consumers might search different travel insurance company websites one at a time for the plans offered and then compare them. Although there is a wide range of products and companies for consumers to choose from, the opportunity to design their own policies by selecting specific coverages and limits is not widely available. Therefore, with rare exceptions, when visiting an individual travel insurance company website, the consumer choice will likely still be limited to a collection of prepackaged products.

In all cases, the wide variation in coverage combinations offered and the wide variation in each type of benefit (e.g., trip cancellation coverage is rarely exactly the same between carriers) can make it difficult to make an accurate comparison of coverage and price.

Insurer Perspective

Travel insurers create different products to meet the needs of different consumers for different trips. The level of sophistication in how these products are created varies significantly between companies and distribution channels. On one end of the spectrum are distributors that have only one to three product packages to offer. On the other end of the spectrum are distributors that may maintain a library of hundreds of different products, then use sophisticated market software to identify one offer, perhaps stratified based on consumer and trip demographics, that provides the most relevant match of product to trip as evidenced by purchase behavior.

The tendency for insurers to limit their product offerings to prepackaged options is driven by a number of factors, including:

- Travel insurance is offered on a take-all-comers basis. This prepackaging of benefits helps avoid adverse selection, where only those most likely to need a particular coverage buy that specific coverage, thus helping to keep the product affordable for all consumers.
- Ease of purchase: Offering prepackaged products reduces the number of steps consumers must take to finalize their purchase.
- System limitations: Unlike traditional insurance, there are no commercially available rating systems that can individually rate travel insurance. Also, many times the products are being offered through distributor systems rather than directly from the company. It would be difficult and expensive to build the capabilities for individual policy customization in these environments.

Distributor Perspective

Travel insurance is not required in order to travel. Also, as noted on page 13 (“100% New Business”), all sales are considered new business and do not create opportunities for renewals. Therefore, insurers must expend resources to create opportunities to purchase and to communicate the product’s value to consumers. Travel distributors are the most effective means for these purposes. These distributors, whose primary business is the sale of travel, not insurance, should be sufficiently incentivized to simplify the travel insurance transaction for consumers. As a result, the amount of compensation offered to travel insurance distributors has a direct impact on the types and prices of products offered to consumers. Further, this interplay between distributor compensation and product design plays out differently for different distribution channels.

For example, the vast majority of today’s travel purchases occurs online, either from a travel booking website or directly from a travel service provider website; therefore, this channel represents a highly sought-after avenue to offer travel insurance. As a result, the distributors of travel insurance in this channel command relatively higher compensation than distributors in other channels. Mitigating this effect on the end cost of insurance is that the types of travel purchased are relatively less complicated and thus relatively less expensive than travel purchased through traditional travel agencies. As a result, the per-policy dollar cost of travel insurance sold by internet travel providers is relatively low, and the distribution cost per policy, in dollar terms, is also relatively low.

Conversely, for travel purchased through traditional travel agencies, the trips tend to be more complicated and expensive, demanding more comprehensive and expensive travel coverage. In order for travel insurance to be priced at an acceptable rate for consumers, commission rates tend to be lower in this channel.

Another mechanism used to support distributor revenue needs is the use of net pricing. Many travel insurers partner with travel distributors to offer comprehensive travel protection plans to consumers. These plans can include cancellation fee waivers and travel assistance benefits along with insurance coverages. Where net pricing is permitted, the portion of the plan treated as “net” reflects only the amount needed by the insurer to cover claims and operational expenses. There is no explicit component for acquisition costs because the distributor usually includes these amounts along with the costs of the non-insurance components of the plan. Insurance plans developed in this way are referred to as “net priced” because the premium developed by the insurer will be net of any acquisition costs. Net pricing may be prohibited in some states.

Free Insurance

From a regulatory perspective, most states have a prohibition against free insurance, as well as prohibitions against providing incentives to purchase insurance. However, there are many avenues in which travel insurance is provided to consumers without direct payment for coverage. For example, certain credit cards automatically provide insurance coverage when travel is purchased using the card, or travel insurance may be included as one of many benefits of membership in a club (e.g., automobile club).

In these cases, the credit card issuer or the administrator of the club has paid some consideration to an insurer for providing the coverage, so the coverage isn't provided for free. Also, travel insurance is typically not the primary focus of the consumer purchase, so these arrangements do not violate the incentives restrictions.

In addition, some travel insurers have marketed products as "Kids are Free" or similar. However, these situations always require the direct purchase of coverage. Coverage is not being provided for free; rather, a lower overall premium is charged for families with children traveling together on a single policy relative to what the premium would be if separate policies were purchased for each traveler.

Illusory Coverage

Illusory coverage is a provision within an insurance contract that offers reimbursement for a contingent event that cannot occur. In travel insurance, concerns regarding illusory coverage arise because of the prepackaging of benefits, some of which might not apply to every trip for which coverage is purchased (e.g., coverage for delayed baggage when no baggage is checked on the trip). However, in general practice, a policy will not be deemed illusory coverage if the most substantive benefits provide actual coverage even if some benefits on the policy do not.

The NAIC model law draft seeks to clarify this issue by defining coverage as illusory only if a policy could never result in payment of any claims for any insured under the policy.

Market Segmentation and Distribution

Travel insurance products tend to be developed for two types of markets, often referred to as retail and wholesale. These terms describe the nature of the distributor rather than the nature of the purchase. In either market, each sale is the choice of the consumer to either accept or reject the product offered.

Retail insurance is travel insurance that is:

- Generally comprehensive (both pre- and post-departure coverages);
- Sold through a variety of channels, travel agents, online insurance aggregators, or direct to consumers through carrier or MGA websites; and
- Not necessarily connected to any particular travel product.

Wholesale insurance is travel insurance which is:

- Focused on post-departure coverages that will be sold alongside pre-departure coverage offered via some other mechanism (e.g., waiver), though smaller wholesale groups may offer comprehensive products similar to retail;
- Sold specifically in conjunction with an underlying travel product;
- Sold only in conjunction with that travel product; and
- Offered only to those individuals purchasing the underlying product.

Wholesale travel insurance is highly integrated with the underlying travel product. Further, because the channel is customized to one travel product, data credibility is increased, which facilitates ratemaking and creating a channel specific rate. Because the wholesaler is aware of which coverages its travelers need (and which they do not), the wholesaler can design a product with a more tailored combination of features.

The unique characteristic of the wholesale market is the control the wholesaler has of the distribution channel. Consequently, wholesale markets tend to have the following characteristics:

- Above-market compensation rates;
- Exclusivity of travel insurance provider;
- Tailored benefits or coverage limits; and
- Less transparency for both consumers and regulators regarding the prices paid for each element of the travel protection package.

Product Attributes

The overwhelming majority of travel insurance purchases are for a specific trip (“per-trip” policies), although annual travel plans are available and purchased by some consumers. Per-trip policies exhibit a number of differences from policies in traditional insurance lines of insurance, described below.

Intermittent

Per-trip coverage generally begins when the traveler purchases the policy and ends when the traveler returns home. This is much different than the standard approach of maintaining continuous coverage for most lines of insurance. Consequently, policy periods may range from only one day to multiple years in length.

100% New Business

Because per-trip policies are bought specifically for the trip being taken at the time, renewals are not applicable. For each trip taken, the travel insurance consumer would need to purchase a new policy. This results in 100% of policies considered to be new business. Even consumers who purchase travel insurance from the same insurer every time they travel are considered new business from the perspective that each trip is different and has a different probability and expected severity of a loss occurrence. Further, because each trip is different, it often is the case that the coverage purchased is different, even when buying a policy from the same carrier for coverage purchased on a previous trip. This is in clear contrast to traditional lines of insurance, where policies usually may be renewed continuously from one year to the next, often with the same carrier and with the same coverages. For travel insurance, each individual purchase is an independent decision, and, as noted elsewhere, the choice of carrier is often determined by how the consumer purchases travel.

This new-business feature has a number of implications with respect to rate analysis and the consumer/company relationship, such as:

- No opportunity for renewal discounts for consumers;
- More heterogeneity of data used in actuarial analyses; and
- Relatively low consumer loyalty to specific travel insurers.

Discretionary

As mentioned above, policies in most traditional P&C insurance lines may be renewed continuously, often because that insurance coverage is mandated either by law or by a lender. For example, automobile liability insurance is mandatory by law in most states and automobile physical damage coverage is required by most lenders. Such requirements to carry insurance to cover travel do not exist, thus making its purchase completely at the consumer's discretion.

This results in several effects:

- Greater need to identify effective distribution mechanisms. Because customers might not always know to seek out the coverage, insurers must find ways to bring coverage offers easily within customers' reach.
- Greater effort and expense by insurers to educate consumers to highlight the value of travel insurance and encourage them to purchase travel insurance.
- Greater risk of adverse selection—increased risk that consumers who are more likely to experience a compensable loss are more likely to purchase the insurance.
- Potential for increased consumer price sensitivity. Because travel insurance is not required, consumers' acceptable price point for their risk/reward tradeoff may be lower for travel insurance than for mandatory coverages.
- Potential for confusion with respect to the treatment of pre-existing medical conditions. In contrast to major medical health insurance plans, pre-existing medical conditions may be excluded from coverage under travel insurance. Many products contain provisions that waive this exclusion under certain circumstances, allowing many claims for pre-existing medical conditions to be covered, but not necessarily all such claims.

Relatively Low Premiums and Loss Ratios

Another way that travel insurance differs from more traditional lines of insurance is its relatively low premiums. For instance, average annual premiums for private passenger automobile insurance are about \$900⁴ while the average travel insurance premium is around \$70.⁵

The low premium level is a cause of relatively high expense ratios because of the fixed nature of some operational expenses for travel insurance. The claims tail is short, which means that there is little to no investment income available, as is often the case in other lines, implying a need for a relatively higher underwriting profit. Compensation paid to

⁴ National Association of Insurance Commissioners, *Auto Insurance Database Report 2014/2015*, December 2017, page 7.
⁵ U.S. Travel Insurance Association, *2014-16 Market Survey*: \$2.8 billion, 42.6 million insureds.

travel insurance distributors is often higher than in traditional insurance, both due to the nature of the distribution mechanism, as described in “Distributor Perspective” on page 10, and the fact that all business is new business, as described in “100% New Business” on page 13. The combined effect of these forces is that travel insurance tends to generate low loss ratios compared to other lines of business at comparable profit levels.

Take-All-Comers

Consumers of typical P&C insurance such as automobile or homeowners are nearly always subject to underwriting eligibility requirements of the insurer. In the event of rejection by an insurer, the consumer would need to seek coverage from another carrier or go uninsured. In contrast, travel insurance policies are usually sold on a take-all-comers basis without application or individual underwriting. Two primary reasons for the take-all-comers approach are convenience and cost. First, travel insurance is most often offered to the consumer in conjunction with the purchase of a trip. It would be inconvenient for both the consumer and the travel provider to interrupt the purchase of the trip to navigate a formal application and underwriting process. Second, due to the low cost nature of travel insurance, it may not be cost effective for the insurer to individually underwrite each policy, partially due to the additional administrative processes for handling underwriting exceptions and denials which may result. Instead, travel insurance is sold to anyone who wishes to buy it and insurers manage their underwriting risk through product design and pricing.

Cancellation Provisions

Generally, most personal P&C insurance policies can be renewed, canceled by the insured, or canceled by the insurer. Additionally, the written premiums for these policies usually earn on a pro-rata basis from policy effective date to policy expiration. Travel insurance tends to have special treatment for each of the above situations.

Travel insurance policies have unique qualities that impact policy cancellations: They are nonrenewable (except for rare renewable annual policies), usually are non-cancelable by the insurer, have unusual premium earning patterns, and often have “Free Look” provisions that allow the policy to be canceled within the first several days after purchase with a full refund of premium.

Cancellation by the insurer: Except in cases of fraud, etc., travel insurance policies are not cancelable by the insurer. Travel insurance is provided without individual underwriting, for short policy terms and sold on a single use basis. Because of these features, as well as the nonrenewable nature of travel insurance and average severities often being fairly low, there is less exposure to the insurer for carrying unprofitable policies with no recourse.

Cancellation by insured: As noted above, many travel insurers sell their policies with a Free Look provision. Generally speaking, after this Free Look period the policy is nonrefundable. Nevertheless, cancellation policies vary by carrier and some states require carriers to provide mid-term cancellation provisions for travel insurance.

Actuarial Perspectives

Data

For many insurance lines, there are established data reporting requirements, which result in a level of uniformity in how data elements are considered and captured, and also facilitate doing analyses at an industry level. Travel insurance does not have such structures or reporting requirements, and so there is less visibility into the size of the market, insurance company performance, etc. There also is no broadly accepted travel insurance statistical plan, creating the potential for more variation in how data are captured and making a comparison of statistics between companies difficult, even where data are available.

Some examples of where this lack of reporting requirements presents itself in travel insurance are described below:

Exposure

Exposure is generally the quantity used to determine relative level of risk. For example, in automobile insurance, exposure is often measured in “car years,” which is the exposure to loss of one car insured over the course of a 12-month period. In commercial general liability, exposure is sometimes measured in terms of the insured’s annual revenue, sales, receipts, square footage, and so forth. Travel insurance also differs from many traditional lines because exposure is not uniformly defined among insurance companies and also because the exposure base can vary among different coverages on a single policy.

Some potential exposure measures in travel are number of trips, number of travelers, trip days, or trip costs. For example, for rental collision damage insurance the number of rental days is typically the preferred exposure because coverage doesn't begin until the car is rented and ends when it is returned. For a policy including only pre-trip cancellation, exposure would be limited to the time from when coverage is purchased until travel begins, so trip cost would be a more meaningful measure of exposure than number of trip days, because there is no risk exposure to pre-trip cancellation while the insured is traveling.

Although exposure will vary among coverages on a travel insurance policy, oftentimes the policy is quoted at a composite price (e.g., percentage of trip cost) for convenience. This treatment can create challenges for the actuary analyzing travel insurance data for coverages with exposures that don't typically vary with trip cost, such as emergency medical coverage.

Premium

Premium data can be organized and analyzed on an insurance purchase date, departure date, or other basis depending on the goals of the analysis. As with exposure, an actuary may vary the organization of premium data based on the coverages being analyzed. For example, premium data for emergency medical coverage may be organized by departure date to coincide with the beginning of the exposure period. Similarly, an actuary might organize premium data for trip cancellation by insurance purchase date because this is the beginning of the exposure period.

Loss

An important consideration in analyzing loss data, particularly for calculating loss ratios, is an accurate matching of earned premium and incurred losses. As with other types of insurance, matching can be done at the policy level or by matching exposure period to accident period. As noted above, travel insurance presents unique challenges in defining exposures, and, therefore, presents similar challenges in matching loss experience to those exposures.

Another consideration in deciding which approach to use is the level of granularity and completeness of various data elements. As noted elsewhere, travel insurance is distributed in many different ways, with each manner of distribution allowing for more or less data capture at the insured or policy level. Sometimes the ideal manner of matching premium and loss data is not possible because the data elements that would facilitate the matching are not available.

Data Capture Limitations

Because travel insurance is almost always sold on a take-all-comers basis without a formal application or individual underwriting process, the data collected about the risk may not be as detailed or complete as is seen in other lines of insurance. For example, an international trip for many weeks could include venturing to additional countries, which may be riskier than the original flight destination. One-way flights can also present challenges for policies including medical coverage because the duration of the travel is unknown. Sometimes, the purchaser of the travel insurance is not the traveler and the data captured may not reflect the true underlying risk (e.g., parents purchasing travel, and travel insurance, for children). Collecting additional data to better understand the underlying risk can be challenging, so underwriting or ratemaking solutions may be needed if the insurer is unwilling to take the risk. Monitoring this exposure can provide better insights into whether more sophisticated methods of pricing or underwriting are worth the investment to the insurer.

Timing

The prepackaging of travel insurance offerings and the lack of individual underwriting allow for situations in which the distributor selling insurance is not directly tied via electronic means with the insurer. The need for a transfer of information from distributor to insurer can create delays as well as mismatches in timing of reporting premium and claims. It may even result in a situation in which a claim is submitted before the insurer is aware that the policy has been sold. This characteristic of travel insurance creates additional challenges for actuaries estimating premium and claim reserves.

Financial Reporting

The distinctive characteristics of travel insurance have implications for financial reporting that require thoughtful consideration to ensure complete and accurate presentation in financial statements.

These implications can be found in the following areas:

Premium Earning Patterns

Because the risk exposures covered by travel insurance policies tend to be non-uniform across the policy period, simple formula methods (e.g., pro-rata) might produce misleading unearned premium estimates. For example, if a policy includes only benefits that cover post-departure exposures (e.g., trip interruption, medical), there is no risk exposure between the policy purchase date and the departure date. Consequently, no premium should be earned for the pre-departure period.

For trip cancellation coverage, which typically reimburses costs when a trip is canceled due to illness, not only does all the exposure expire at departure (i.e., unearned premium for this coverage should be \$0 as of the departure date), examination of claim data will generally reveal a marked rise in incurred loss propensity as the departure date approaches. To understand why this occurs, consider the situation of a traveler who becomes ill during the pre-departure period. If the illness occurs well in advance of the departure date, the likelihood of the traveler recovering and being able to take the trip (and thus not making a trip cancellation claim) is much higher than if the illness were to occur very close to the departure date. Claim severity may also be affected by timing within the pre-departure period. For example, a cruise cancellation close to the departure date will likely incur higher penalties for the consumer than an earlier cancellation.

To accommodate this appropriately, a travel insurer might employ systems and methodologies that capture the written premium separately by benefit and then earn that premium according to the emergence of the risk exposure. This approach would ensure that the emergence of loss ratios throughout the loss development period are not distorted by mismatched accounting treatments of losses and premiums.

Annual Statement Line of Business

Currently, there is no annual statement line of business for travel insurance in either the P&C annual statement or the A&H annual statement. As a result, states have different rules regarding the treatment of travel insurance. In most states, all travel insurance premium, including both the P&C and A&H components, is recorded under the inland marine line of business. In some states, the travel insurance premium is split between its P&C and A&H insurance components, and reported accordingly (i.e., the P&C portion typically going to inland marine). In one state, travel insurance is reported under the miscellaneous casualty line of business. Travel insurers offering rental car damage insurance may need to be mindful of states requiring these premiums to be reported under personal automobile lines of business.

This treatment of travel insurance creates a number of implications for companies offering this coverage:

- Because most insurance companies sell many types of insurance that fall under the inland marine definition, it can be difficult for readers of company financial statements to understand the performance of the company's travel insurance program.

- For many travel insurance rate filings, it is not possible to rely on the company's Insurance Expense Exhibit (IEE) to support the expense assumptions in the filing because the IEE data will reflect a mix of products with expenses that can vary markedly from the expenses required to support travel insurance.
- State regulations that limit the level of expense allowed in rate filings based on annual statement line of business could result in inadequate rates for travel insurance, because, as noted above, expense percentages for travel tend to be higher than for other lines, including other inland marine types of coverage.
- Submission of form/rate/rule filings may follow different rules than premium reporting. For example, even where all premium is reported in one line of business, a state may require separate filings be submitted for the P&C and A&H coverages.
- The P&C risk-based capital (RBC) formula includes a component that relies upon insurance industry average loss ratios by annual statement line of business. By including travel insurance on the inland marine line, which tends to have higher average loss ratios in total, companies writing significant amounts of travel insurance may be pressed to hold levels of capital inconsistent with the nature of the underlying risks in order to satisfy RBC requirements.

Premium and Sales Taxes

Travel insurance is usually offered as part of a travel protection plan including one or more non-insurance components, which can create potential differences in treatment of funds received from consumers. In particular, states may take different approaches regarding which components of a travel protection plan should be considered “travel insurance” upon which premium tax should be paid. For those states that recognize the distinction between the insurance and non-insurance components for premium tax purposes, the insurance portion is reported as premium, with appropriate premium tax paid, and the non-insurance portion is reported as revenue to the travel assistance company, which may be subject to state sales taxes. The NAIC model law draft brings clarity to this area by specifically providing for how premium taxes are to be paid in the individual, group, and blanket travel insurance policy contexts.

Where “net pricing” is allowed (see “Distributor Perspective” on page 10), premium reporting and the determination of premium tax (and sales tax) may be even more complex. In addition to the “net price” being a combination of insurance and non-insurance, the total amount paid by the consumer includes acquisition costs attributable to both the insurance and non-insurance components. In some states, regulators may require that insurance-only acquisition costs be captured as part of the insurance premium for premium tax purposes. Therefore, if the distributor is not providing the insurer amounts paid by each

consumer for insurance inclusive of insurance-only acquisition costs, then the distributor would need to provide that information in some aggregated manner separately. Ultimately, it is the responsibility of all parties involved (distributor, insurer, and travel assistance provider) to understand the state requirements and ensure that all financial reporting is done appropriately and premium (and sales) taxes are accurately remitted to the proper authorities.

Risk Classification

The purpose of risk classification is to segment insureds into groups with similar exposure to loss for purposes of rating. Rates differ by segment in proportion to expected loss. In travel insurance, insureds can be segmented based on many different criteria.

Insurers may not receive the information necessary to segment risks by risk classification. For example, when travel insurance is purchased at point-of-sale as an integrated part of the travel sale, limited information may be provided to the insurer, such as only the trip cost and number of travelers. As a result, travel insurance rating manuals must be flexible enough to allow for averaging across multiple risk characteristics or to allow the use of a default rating factor when information for a particular risk classification is not available. Various packages offered to a single insured may differ in terms of risk classifications used.

Some classification criteria are based on policyholder characteristics. However, most criteria used to classify risks for travel insurance are based on characteristics of the trip. Travel insurance is typically a multi-coverage package product and the rate for each coverage within the package can be impacted by different criteria, or by the same criteria to a different degree. As a result, risk classification plans often vary by coverage.

The following are common risk classification criteria used in travel insurance.

- **Age**—Exposure to loss for trip cancellation, trip interruption, emergency medical expense and emergency evacuation varies by age. Older insureds typically have higher expected losses than younger insureds, reflecting that older insureds are more likely to sustain injuries or contract illnesses that affect travel before or during their trip than younger insureds. The majority of trip cancellations and trip interruptions result from illness or injury to the insured. As a result, many travel insurers vary their base rates for trip cancellation, trip interruption, emergency medical expense, and emergency evacuation by age, typically charging more for older insureds.

- **Trip Cost**—Manual rates for trip cancellation and trip interruption are often quoted as a rate per \$100 of trip cost or coverage limit. However, the rate per \$100 may not be uniform across all trip costs or limits.
- **Trip Length**—The exposure to loss for trip interruption, emergency medical/dental coverage, and emergency evacuation increases with trip length, because the longer insureds are on a trip, the more exposure the insureds have to potential illness or injury that would cause them to interrupt their trip or require medical attention/evacuation. As such, insureds are often grouped by trip length, and insureds traveling on trips of longer durations may be charged higher rates for these coverages than travelers on shorter trips.
- **Destination**—Exposure to loss varies by destination for nearly all travel coverages. However, the impact of destination on expected losses is not uniform across coverages. Destinations that require multiple flight connections may increase the exposure to travel delays or baggage delays. Similarly, conditions at some destinations may affect the exposure to loss due to trip cancellation or trip interruption, such as locations prone to natural disasters or severe weather; or emergency medical, such as locations prone to disease. Therefore, insureds may be grouped by destination for purposes of rating and the rating factors by destination group may differ by coverage.
- **Departure Window (or Booking Window)**—The amount of time between the date travel is booked and the date insureds depart on their trip is often referred to as the departure window. The length of the departure window impacts expected losses for trip cancellation coverage: The longer the departure window, the longer the exposure period for trip cancellation. Insurers may group insureds by length of departure window and differentiate rates by group, charging more for longer departure windows.
- **Departure Month/Travel Season**—Exposure to trip cancellation losses varies by departure month and/or travel season mainly due to weather, which is typically a covered cause of trip cancellation. As a result, insurers may group insureds by departure month and charge more for trip cancellation coverage when insureds depart in winter or during hurricane season. Departure month may also affect expected losses for baggage delay and travel delay, perhaps because delays may be more common during peak travel months like June and July (summer vacation) and November and December (holidays). Therefore, insurers may apply rate differentials by departure month for these coverages that differ from those that apply to trip cancellation coverage.

- **Number of Destinations**—Multiple-destination trips are more likely to require multiple travel segments on common carriers, which increases the exposure to travel delays, baggage delays, or loss/theft of baggage. Insurers may, therefore, group insureds by the number of destinations for purposes of rating these coverages, charging more for insureds whose trips involve multiple destinations.

There is potential for correlation between risk characteristics in travel insurance. For example, trip length and trip cost are likely to have some correlation because longer trips typically cost more due to daily expenditures like hotel rooms and rental cars. Similarly, destination and trip cost may be correlated as overseas travel is likely to result in higher flight costs. It is advisable to consider the potential for these correlations, measure them, and account for them in the selection of rating factors by risk characteristic.

Conclusion

Although every line of insurance has aspects that differentiate it from other lines of insurance, travel insurance may be unique in the range of elements requiring special consideration not present in traditional lines of insurance, including risk evaluation, product design, regulatory oversight, pricing, marketing, and financial reporting. As the market for travel insurance continues to grow and as new questions may arise, the American Academy of Actuaries stands ready to assist legislators, regulators, and consumers to understand this business.



AMERICAN ACADEMY *of* ACTUARIES

Objective. Independent. Effective.™

AMERICAN ACADEMY OF ACTUARIES
1850 M STREET NW, SUITE 300, WASHINGTON, D.C. 20036
202-223-8196 | **ACTUARY.ORG**

© 2018 American Academy of Actuaries. All rights reserved.