A comment on "The interaction between risk classification and adverse selection: evidence from California’s residential earthquake insurance market"

Kili C. Wang
Department of Insurance, Tamkang University
The main findings of this paper:

This paper find that risk classification ability of CEA is limited by government. Hence, there is substantial variation in seismic risk within one constant rate area, and cause cross subsidy and adverse selection within one area. The coexisted private insurers cherry-pick the lower-risks by using finer geographic risk classification.
Three main contributions:

- First contribution: This paper uses objective risk when testing adverse selection.
- Second contribution: This paper adds to the catastrophic insurance demand analysis literature by emphasizing the role of objective risk.
- Third contribution: This paper provides empirical evidence of public and private sectors coexisting, and speaks to the debates on the role of government and the degree of privatization in the market.
Comment on 1st contribution

- This paper uses PGA as objective risk:
  - This can help to avoid the missing observations on individual’s risk from deductible or pseudo-deductible.
  - This can minimize the possibility of moral hazard.

- Individual’s earthquake hazard perception can not be solely and completely represented by PGA. Individuals will also percept the earthquake hazard from other information, such as:
  - types of construction
  - story
  - soil situation
  - year built
  - use of property

- Purely use PGA to test adverse selection is problematic
Comment on 2nd contribution

- CEA has used some of the above information to pricing
- Although these information which have been used in pricing can not be used for the representation of private objective risk to judge adverse selectin, we still have to control them in regression.
Comment on 3rd contribution

- What factors make the coarse risk classification public insurer coexists with the finer risk classification private insurer without shrink and gradually disappear?
- The market share does not decline from year 2003 on. But, it declines from year 2007 to year 2009.
  - Does private insurer coexist with CEA from the beginning of CEA funded?
  - Is there any structure change on the rate calculation, or finer classification in private insurer?
- Furthermore, how much is the welfare lost under this intervention from the government?
Some clarifying questions:

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- "Only homeowner’s policies are included in at this study, any renters, condominium, mobile home, or dwelling fire policies are excluded" What is the exact meaning behind this sentence? Do you mean that these excluded policies also can be further attached by earthquake insurance? Are there some residents have purchased earthquake insurance with these policies?
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- Do you use random effect model or fixed effect model to deal with your panel data? Why you do not control the year dummy variables in regressions?