# The McGovern Pricing Philosophy: Avoid a Broken Travel Protection Program

The vast majority of revenue from travel insurance represents **bottom line income** for the travel supplier. Pricing your travel insurance plan properly helps maximize profits.

Determining the travel insurance price for the passenger should take into account one fundamental element: **Adverse Selection.**

Adverse Selection refers to the tendency of those highest at risk to purchase insurance, while those for whom the risk is lowest, have less incentive to purchase coverage.

To illustrate, let's take a one-price insurance product for all passengers.

Passengers in the most expensive tours - those who will have the highest claims in the event of cancellation - have a


stronger incentive to purchase insurance than their counterparts on lower-cost tours.

While such pricing is easier to understand and communicate to travel agents and the consumer, it does not take into account wide differentials in tour prices. ie: A $199 insurance premium for all tours is set.

**Scenario I** - a passenger may pay a brochure rate of $3,500 for a 21 day European Vacation. The premium for that passenger would represent 5.5% of the passenger's trip cost ($199/$3,600).

**Scenario II** - a passenger on a Hawaiian tour, paying $1,000, would pay 19.9% of his/her tour cost for the same coverage.

If the passenger in Scenario II cancels his/her Hawaiian tour, the claim cost to the insurer would be far less than the passenger in the more expensive accommodations. And, chances are greater that the passenger with the more expensive tour will buy the insurance, as it represents a far greater "value" given the cost of the overall vacation.

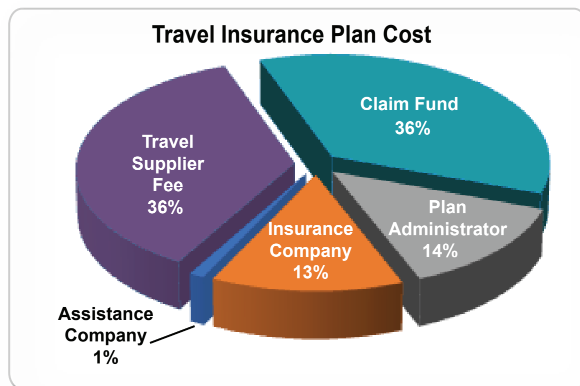
**Why Adverse Selection is Important to Tour Operators:** <u>Adverse Selection can undermine your entire insurance program</u>. As more passengers on expensive trips continue to buy the insurance and file claims, the insurance ledger becomes unbalanced, with

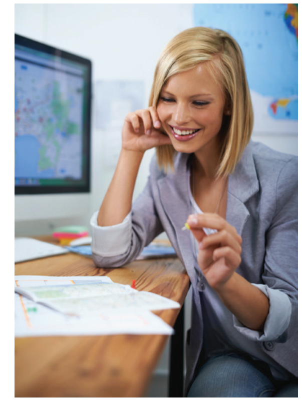

**more revenue flowing out** for trip cancellation claims than is coming in from premiums. The insurance company continues to pay out increasing numbers of claims; thus the travel insurance provider continues to increase the plan cost **year after year.** This serves to aggravate the problem, as

passengers on the lower priced tours have less of an incentive to purchase insurance. This is known to insurance actuaries as a **"broken program".**

**What happens to the tour operator's profits when the market cannot withstand any additional premium increases?** Generally, the plan cost (to the consumer) may be broken down as follows:

Typically, fees to the



assistance company, insurance company, and the plan administrator remain relatively flat.

However, the claim fund and tour operator's fee change <u>inversely</u> when the plan cost can no longer increase.

**This results in the tour operator to continually lose travel insurance revenue during the time the program is broken.**

**"We are driven by an uncompromising dedication towards serving our clients exclusively for their travel insurance plans."**

**- Bill McGovern, President**

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