

10.4 Value of Insurance

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- A) Pool many people w/ the same independent risk
- B) IF Pool is large, aggregate risk is negligible

$$\hookrightarrow \text{Total } Ew = n \cdot Ew$$

$$\hookrightarrow W \text{ Prob} = 1$$

- C) Individuals accept CE in trade for their bundle
- D) Insurance company pays $Ew - \text{admin} + \text{transaction costs}$
- E) Gains from trade are $N(Ew) - (E) - \text{Admin costs}$
 $N(RP) - \text{Admin costs}$

IF ins markets are perfectly competitive
- Premiums are such that individuals get
 $W_{\text{certain}} = Ew - \text{admin costs}$

Diversification: