

Brokers and the Insurance of Non-verifiable Losses

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How do insurance markets spread the risk when events are unknown or even unknowable? We argue that the insurance market is organized to write incomplete contracts such that these risks can be spread, even though complete contracts cannot be written. Both policyholders and insurers hostage their reputations when they engage in trade. The force of these reputation investments leads the parties to negotiate for a settlement when an event that is not covered by the insurance contract occurs. By choice of brokers, the parties can leverage the reputation stakes and thus influence the payoffs for un-contracted events. Thus, we see the role of *ex post* negotiation as helping to complete markets where otherwise insurance would not have been available. This view contrasts with other recent analyses in which *ex post* negotiation is seen as a degradation of the insurance market.