GUY CARPENTER

AUTOMOBILE LIABILITY MARKET

UPDATE & LOSS TRENDS ANALYSIS

For most U.S. property and casualty (P&C) insurance companies, automobile liability (auto liability) line performance has typically been one of the major factors adversely impacting overall profitability in recent years. Since the economic crisis of 2008, combined ratios for the auto liability line have steadily deteriorated, putting pressure on carriers to advance strategies to reverse this trend. These strategies need to be developed in order to address the major components that negatively impact auto liability loss ratios – inadequate rates for the risk assumed and marked increases in both frequency and severity of loss. In order to develop viable strategies, increased utilization of data and analytics will be paramount. Though the captured data set for auto liability is growing exponentially, the ability of carriers to mine usable, strategic information from that data and then integrate it into underwriting, pricing and claims strategies is being strained to the limits.

Guy Carpenter's Analytics and Strategic Advisory units are dedicated to providing clients with the latest market resources available in order to help them develop the necessary strategies. Guy Carpenter's October 2017 Insurance Risk Benchmarks Research report is a tool that includes the financial data and information necessary for important strategic decision-making. The report includes information covering all P&C lines of business in addition to details on the auto liability line.

2016

In 2016, the insurance industry's 10-year stretch of favorable prior period reserve development appeared to end, driven by continued deterioration in commercial and personal auto liability segments and significant reserve development from a small group of large, long-tail carriers. Commercial Auto Liability (CAL) saw a continuation of five consecutive years of adverse development as Personal Auto Liability (PAL) reserve development turned adverse for the first time in more than a decade. Other long-tail lines' favorable reserve development came in at lower levels than prior years.

The auto liability segment, including both personal and commercial lines, showed an increase in losses attributable to escalating frequency and severity trends. Only 10 and 30 of the top 100 PAL and CAL writers, respectively, booked underwriting profits in 2016. Normally considered a profitable line, the increase in PAL losses forced smaller companies to rethink strategy and mix of business as the larger writers continued to engage in a predictive modeling and marketing war.

CAL writers also faced difficult operating conditions in 2016. PAL and CAL writers had the highest median net combined ratios, each at 107 percent. While PAL and CAL carriers returned similar combined ratios, PAL was less profitable overall. Only 12 of 100 PAL writers booked a combined ratio under 100 percent, while 24 of 100 CAL writers achieved this mark. In both cases, increasing losses drove combined ratio increases as expense ratios remained relatively stable. Accident year frequency and severity increased for PAL while adverse reserve development on prior year's claims was a greater contributing factor to CAL performance.

Year over year, CAL writers experienced material reserve deficiencies, ranging from 2.3 percent to 7.3 percent since 2011. As rate reductions began to moderate, development trends decreased, but the potential for additional adverse development on prior accident years remained the same.

CAL performance, like other commercial casualty lines, experienced significant cyclicality over the last several decades. Though immature, recent accident year performance appeared to be flattening at the mean and improving for the highest loss ratio carriers due to recent rate increases. Loss ratios were still approximately 11 percent higher than 2003 to 2009 levels. Similarly, the majority of PAL loss ratios appeared to be well above the industry breakeven point.

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2017 & 2018

For 2017, combined ratios for PAL and CAL are estimated to be slightly above 2016 levels. Years 2018 and 2019 indications are for the beginning of a slow improvement trend in combined ratios – they will likely remain above 100 percent for several more years. The auto liability market and claims environment are evolving so rapidly that carriers need to stay on top of the latest data available.

Since we believe that expense ratios will continue to remain relatively stable, the primary driver behind loss ratio trends will be a continuation of the premium / rate increases that carriers began implementing in 2015. Year 2017 saw mid-high single digit auto liability rate increases (occasionally double digits on accounts with marginal experience) – all indications are that this will continue through 2018. In 2016 the CAL market posted its sixth consecutive year of underwriting losses and carriers are realizing that this is not a sustainable proposition.

The second driver of loss ratio trends are losses / claims costs. For a number of reasons, frequency and severity continue to increase, outpacing the rate increases that carriers are able to achieve in a competitive marketplace. All segments of the auto insurance industry are taking myriad steps to reduce this trend; however, any noticeable positive impact is still several years away. Improving auto liability loss ratios is a much more complex issue than pricing and consists of many factors that are constantly shifting. An unexpected change in any one of these factors could have a noticeable impact on combined ratios one way or the other. While there are many factors that impact the loss side of the equation, the most significant can be broken into two basic groups: negative factors and positive factors, each affecting both frequency and severity.

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Negative Loss Trend Factors

- Increase in number of registered vehicles on the road
- Increase in number of miles driven & Increase in traffic density
- Increase in serious accidents and fatalities
- Increase in number of years owners keep vehicles since the recent recession
- Significant increase in demand for trucking services from e-commerce
- Increase in average age of drivers
- Increase in distracted driving
- Increase in alcohol and substance abuse
- Increase in medical costs
- Increasing litigious environment & jury awards

Positive Loss Trend Factors

- Increase in auto insurance rates to achieve consistent profitability
- Increase in installation of advanced safety and monitoring technologies, including telematics, collision avoidance systems, advanced driver assistance systems
- Increased availability of driver assistance technology in private passenger vehicles and light trucks
- Better underwriting tools – credit scores, Central Analysis Bureau (CAB) data, available Commercial Auto Risk Scores (CARS), evolving real time and long term risk assessment models

Source: Guy Carpenter