AUTO PREMIUMS ARE CLIMBING! ARE THEY AFFORDABLE?

JEFF DUNSAVAGE

JANUARY 8, 2020

Car insurance premiums have risen steadily since 2009 at a faster pace than inflation, according to a recent paper in the *Journal of Insurance Regulation*.

When you hear a stat like that, what's your instinctive response? To blame "greedy insurers" who are making money hand over fist and still aren't satisfied? It might be, if you don't follow insurance profitability trends. If you do, you know they've been losing money on auto insurance for years, despite increasing rates.

Rising rates have caused some to call for regulation to help make car insurance more affordable. Transportation is essential to opportunity in the United States, and most Americans rely on cars. Cost of driving, therefore, isn't a trivial issue.

But the authors of the paper – Cost Trends and Affordability of Automobile Insurance in the U.S. – found rate regulation could do more harm than good.

Frequency and severity

The year 2009 was the beginning of the end of the "Great Recession." In a recovering economy, more people drive – to work, stores, restaurants, et cetera. More vehicles traveling more miles means more accidents and more insurance claims.

The insurance term for this is "frequency." In addition to more cars on the road, the report finds, distracted driving due to use of digital devices may contribute to increased accident frequency.

Another key term is "severity" – the average cost of claims. Severity has been high for several reasons:

Safety and fuel efficiency are expensive. Cars are safer and cheaper to operate than ever before thanks to sensors and computers and new materials, all of which are expensive to repair or replace after an accident. This affects loss costs which are reflected in premiums.

Medical costs are on the rise – especially for hospitalization. The paper cites U.S. Bureau of Labor Statistics data showing that medical and auto insurance inflation growth track closely and hospital cost inflation by far outstrips both. Since many crash victims wind up in the hospital, it's possible these costs aren't fully reflected in insurance rates. The paper also cites research indicating that hospitals may charge insurers more than other payers.

Litigation and generous juries. The report doesn't go into detail about litigation, but the trend known as "social inflation" – marked by growing jury awards and "litigation funding," in which investors pay plaintiffs to sue large companies in return for a share in the settlement – is well documented.

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These factors drive up rates as insurers seek a return that justifies risk taking and operational spending. Nevertheless, the report finds no correlation between rising rates and insurer profitability.

Cracking the affordability nut

Literature on insurance affordability is diverse with little consensus on the key term. The paper cites research that strongly suggests aggressive rate regulation actually reduces affordability.

"When rate regulation suppresses costs for the riskiest insureds," the study states, "average premiums, losses, and injuries increase."

So, what might improve auto insurance affordability?

Some contributors to rising rates – such as repair costs – "should partially self correct over time," the paper says. Others, like medical costs and "non-economic" damages (pain and suffering awards) could be addressed through changes in personal injury protection (PIP) laws, antifraud efforts, transparency in medical pricing, or civil justice reform.

Stricter "distracted driving" laws and improved enforcement of existing ones could help reduce losses and premiums.

Insurers are investing in technology and improved analytics to streamline their workflows, improve service, and bolster their bottom lines. Some are even discussing getting out of auto entirely. If it should become a trend it would not bode well for affordability or availability.

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