INSURANCE ANALYTICS REPORT

troubles in the energy and credit markets ham-
mered equities.
Energy prices continued their long move up-
Tough times

During the Recent Recession, Did Americans Assume More Risk to Reduce Their Auto Insurance Costs?

Quality Planning

INTRODUCTION

As of the writing of this report in March 2011, the United States may be turning the corner on one of its worst recessions in recent history. Millions of Americans struggled through this period, and the effect on spending and consumption patterns has had far-reaching effects that have forever shaped the storefront landscape of Main Street.

For auto insurers, the period from 2006 through 2011 has meant falling profit margins, constant customer churn and annual declines in the average policy premium.

There’s no doubt that the recession has changed —perhaps irreversibly— consumer spending patterns, attitudes to risk, and overall consumption, but what effect has the recession had on consumers’ attitudes to risk when it comes to auto insurance?

In this report, Quality Planning, a Verisk Analytics company that specializes in the validation of policyholder information, examines how consumer attitudes to coverage type and level of deductible changed between 2006 and 2010.

> “Between 2006 and 2010, Americans spent an average of $721 per vehicle to insure it.”

EFFECT ON TYPE OF COVERAGE

CONCLUSION: the number of consumers who saved on their auto insurance by opting to not purchase **collision** and **comprehensive** insurance rose sequentially from 2006 to 2010, especially for older vehicles.

ANALYSIS: Between 2006 and 2010, American consumers spent an average of $721 per vehicle to insure it. During that period, the average insurance cost for new (current model year) vehicles was $913 — significantly higher than the average insurance cost of $528 for older vehicles (defined as a vehicle that is ten or more years older than the year under study.)

A typical auto policy consists of three major components: liability, collision, and comprehensive coverage.

- Comprehensive Coverage (COMP): covers the insured's vehicle for losses resulting from incidents other than collision (for example, theft, fire, vandalism, hail).
- Collision Coverage (COLL): covers damage to the insured's vehicle.
- Liability Coverage: typically required by law, it includes both Bodily Injury (BI) insurance (covers another person's bodily injuries or death when the insured is at fault); and Property Damage (PD) insurance (covers damage to another person's property—such as another vehicle, fence, or house—when the insured is at fault). For the purposes of this study we have grouped BI & PD together.

Of the three major components, **Liability Coverage** is the most expensive.

Figures 1 and 2 show the national average for auto-insurance costs for new and older vehicles between 2006-2010.

> "The average percentage of older vehicles without collision or comprehensive coverage increased from 53 percent to 63 percent."

Figure 1: National Average Breakdown of Auto-Insurance Cost for New Vehicles

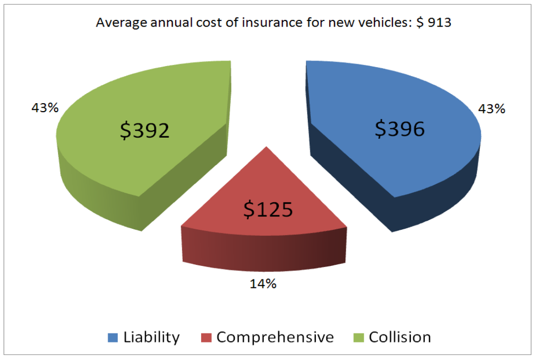
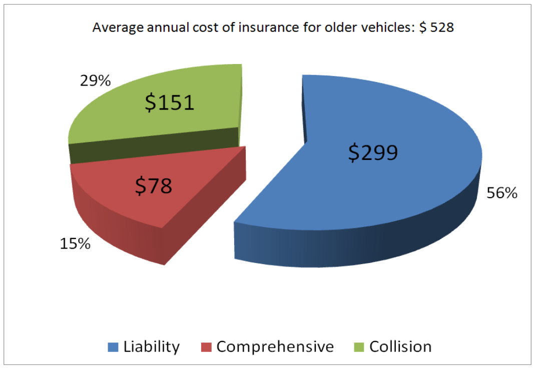


Figure 2: National Average Breakdown of Auto-Insurance Cost for Older Vehicles



Quality Planning found that the age of the insured vehicle determined whether consumers elected to reduce coverage and assume more risk.

For new vehicles, most policyholders purchased complete coverage: liability, collision, and comprehensive. There were very few instances where optional coverage types, namely comprehensive and collision, were dropped as a cost-cutting measure. This is likely because lien holders (such as banks and credit unions) required those coverage types or because new vehicle owners were more risk-averse and did not wish to risk losses on their newer and more expensive vehicles.

For older vehicles, Quality Planning found that policyholders were more willing to drop comprehensive and collision coverage. For the period 2006 to 2010, Quality Planning found that the average percentage of older vehicles without collision or comprehensive coverage increased from 53 percent to 63 percent. For consumers, this yielded a monthly out-of-pocket savings of $19 a month, or $229 annually.

The study revealed an eye-opening statistic:
On average, between 2006 and 2010, 58 percent of older vehicles being driven on the road lacked both comprehensive and collision insurance coverage.

2010 saw the highest average percentage at 62 percent, a 17 percent increase from the 2006 baseline of 53 percent. The bottom line for drivers of older vehicles was a monthly out-of-pocket savings of $19 a month (or $229 annually).

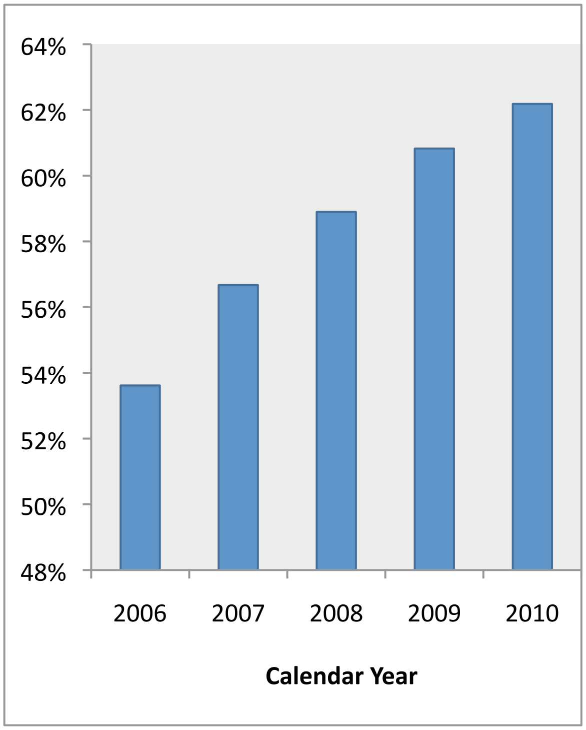
As shown in Figure 3, the average percentage of cars without comprehensive and collision coverage has been rising steadily at an annual rate of 4 percent (from a base of 53 percent in 2006 to 63 percent in 2010, over the course of four years).

We speculate this can be attributed to two main causes:

1. Difficult economic times. The financial turmoil of recent years resulted in job losses, a decline in gross domestic product (GDP), and a plummeting of consumer confidence. These trends led many Americans to seek ways of shedding non-mandatory expenditures wherever possible, even at the cost of taking on greater financial risk.
2. Insurance-savvy consumers. Newspaper articles, financial publications and, most assuredly, the internet all contributed to a wealth of knowledge about auto insurance – how it works, how different coverage types are applied, what is required versus what is optional, the true cash value of older cars, the cost of repairs versus the cost of insurance, and a clearer understanding of assumed risk (loss or major damage to one's own vehicle) versus reward (premium dollars saved). Taken in aggregate, these facts may have contributed to a significant decline in the purchase of full auto insurance coverage.

The downside, of course, is that by not electing to purchase collision and/or comprehensive coverage and, as a result being "under-insured", *some* consumers are taking on an enormous financial risk. For many households, the car or truck is often the single largest asset and they can ill-afford a major repair or replacement vehicle should they be involved in an at-fault accident.

Figure 3: Percentage of Older Vehicles without Comprehensive or Collision Coverage



> "On average, 58 percent of older vehicles being driven on the road lacked both comprehensive and collision insurance coverage."

EFFECT ON POLICY DEDUCTIBLE

SUMMARY: when consumers elected to purchase collision and comprehensive insurance, Quality Planning found significant increases in the number of consumers who opted for **higher deductibles**, thereby reducing their immediate out-of-pocket auto insurance costs but placing them at risk of economic hardship in the event of a loss.

ANALYSIS: Another cost-cutting insurance tactic available to households is the collision coverage "deductible," i.e. the amount the policyholder must pay out-of-pocket before the insurance policy begins to pay.

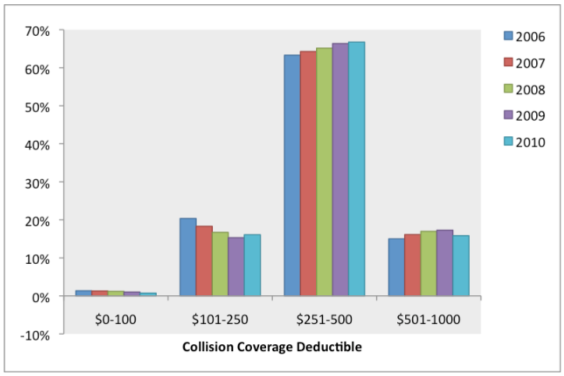
We sought to answer the question of how deductibles were being affected with respect to drivers who purchased collision coverage regardless of vehicle age:

- Were they changing the amount of their deductible to combat the difficult economic environment?
- Were they lowering deductibles to assume less risk?
- Or, were they increasing the deductible amount to save money while accepting greater risk?

Figure 4 shows the breakdown of collision coverage by the deductible amount during four-year study period, 2006-2010.

> "The percentage of vehicles with low collision coverage deductibles steadily declined at an average annual rate of approximately 9 percent."

Figure 4: Percentage of Older Vehicles without Comprehensive or Collision Coverage



Again, the research reveals a shift toward less expensive (but more risky) selections. From 2006 to 2009, Quality Planning found that the percentage of vehicles with low collision coverage deductibles ($0 to 100 and $101 to 250) steadily declined at an average annual rate of approximately 9 percent, while those vehicles with higher deductibles ($251 to 500 and $501 to 1000) steadily increased at an average of between 1.6 and 4.9 percent per year.

Most of the decline was in the $101 to 250 deductible bracket as consumers moved into higher deductible brackets.

However, in 2010, this downward trend changed noticeably. The percentage of vehicles with a $101 to 250 deductible actually *increased* slightly from its 2009 low point, offsetting a similar *decrease* in the percentage of vehicles with a $501 to 1,000 deductible. Owners of new cars often purchase lower deductibles to protect their sizable investment.

Although all model years continued to move toward higher deductibles, the 2010 spike in new car sales that resulted from the "Cash for Clunkers" program and other sales incentive programs sponsored by U.S. manufacturers caused the dip in the highest deductible category because2010 new cars represented a higher percentage of total vehicles than in previous years.

STUDY METHODOLOGY

For this study, Quality Planning examined policies from 2006 through 2010.

Relevant fields included vehicle model year, premium for each type of coverage, and respective deductible limits. For the full five-year period under study, the total sample size included 59.8 million vehicles.

With vehicle model year as the basis, QPC designated two categories of vehicles for the study:

- New vehicles — vehicles for which the model year was the same as the year of analysis. That is, when Quality Planning examined 2006 policy data, a new vehicle was one where the vehicle model year was also 2006.
- Older vehicles — vehicles for which the model year was up to 10 years older than the year under study. For example, if the year under study was 2008, then older vehicles were those of model years 1998 or older

Quality Planning is focused on providing rating integrity solutions to auto and home insurers. A member of the Verisk Insurance Solutions group at Verisk Analytics, Quality Planning works with insurance companies to identify areas of significant rating error using sophisticated database management, statistical analysis and modeling, customized survey design, and highly targeted customer interaction. Quality Planning helps clients work within their existing rating plans and charge fair prices to policyholders based on a true representation of risk. The company was founded in 1985 and is headquartered in San Francisco. For more information, visit www.qualityplanning.com

ENDNOTE

The rating information underlying most private passenger auto insurers' books of business can be seriously flawed. Policy information is often incorrect, outdated, or incomplete. As a result, insurers lose an enormous amount of premium each year. Our studies consistently show that U.S. insurance companies fail to collect about 10 percent of their auto insurance premiums because of rating error. If an insurer can recover even a small portion of that revenue, it yields meaningful bottom-line gains.

Quality Planning believes that information integrity leads to decision integrity. Only with complete and accurate information can insurers make consistently good business decisions. Quality Planning provides the tools underwriters need to select risks that meet their specific underwriting criteria, price the risks appropriately, and ultimately achieve premium integrity.

The Quality Planning Rating Integrity Solution™ offers a proven, effective, and economical way to combat rating error. Unlike in-house approaches or other commercial products, QPC combines decades of industry perspective and experience with advanced analytic techniques and exhaustive reference checks.

Our Rating Integrity Solution helps insurers:

- Focus on specific, high-value recovery objectives
- Determine the appropriate premiums for your risks
- Create a sustainable competitive advantage