

# Market Report:

Publicly Traded Auto Insurance  
Companies Cost Consumers \$19  
Billion by Overcharging and  
Underpaying Claims.

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State of the Auto Insurance Industry

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January 26, 2016

The logo for ValChoice features a grey swoosh above the word "Val" in a grey sans-serif font, followed by "Choice" in a bold, dark blue sans-serif font with a registered trademark symbol (®).

**ValChoice**<sup>®</sup>

## Executive Summary

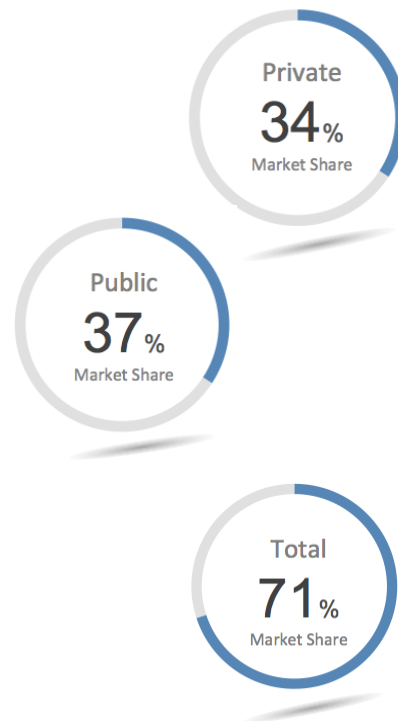
This Market Report analyzes the U.S. private passenger auto insurance industry to determine whether the economic conflict between insurance company policyholders and shareholders results in higher prices and/or lower claims payments compared to private companies that have less conflict. The study was undertaken to provide consumers of insurance better information on how to best protect themselves with insurance. The analysis was performed for the five-year period from 2010 to 2014.

The conclusion of this study is that there is a clear conflict between corporate shareholders and policyholders of publicly traded insurance companies. Over the five-year period, this conflict cost auto insurance policyholders \$18.9 billion in increased auto insurance, \$12.4 billion in unpaid claims or some combination of the two.

## The Companies Compared

The analysis is based on the top-ten suppliers of U.S. private passenger auto insurance. The top-ten suppliers are evenly split with five private/mutual companies<sup>1</sup> and five publicly traded companies.<sup>2</sup> These ten companies are a good proxy for the industry based on:

- Similar market representation: The five private/mutual companies insure 34.2%<sup>3</sup> of the market.
- The five publicly traded companies insure 36.5%<sup>4</sup> of the market in the most recent year of the study.
- The total market share of the top-ten companies is approximately 71% of the market. With a strong majority of the market, the sampling of the top-ten companies is representative of what the majority of consumers' experience.

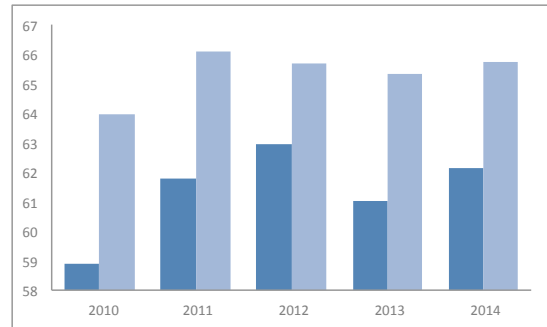


This study does not differentiate among the various types of non-publicly traded companies. Whether the company is mutual, non-profit, or some other structure is not considered. All these companies are included in the category of “private/mutual.”

## The Analysis

The analysis first compared the percentage of earned premiums collected that were paid out in loss compensation during each year of the five-year period. This ratio is the Paid Loss Ratio (PLR). The comparison was done for both the five publicly traded companies and the five private/mutual companies. In each of the five-years, the private/mutual companies had a larger PLR than the publicly traded companies. The chart to the right shows the relative PLR for each of the five years studied; taller bars are better for consumers. The weighted average across the five-year period was a 6.5% increase in PLR for private/mutual companies as compared

to publicly traded auto insurance companies.



■ Publicly Traded ■ Private/Mutual

Chart 1: The PLR of Private/Mutual companies was 6.5% more than that of Publicly Traded auto insurance companies.

## \$18.9 Billion in Over-Charging for Auto Insurance?

Assuming the entire sum of money was based on higher insurance prices, the total amount over-charged for the five-year period equals \$18.9 billion. This translates into \$243 per insurance policy. This is an amount unlikely to be accepted in a competitive market. Therefore, we conclude some of the difference in business models is necessarily explained by an increased level of under-payment in loss compensation on the part of the publicly traded companies. If the entire sum of money were attributed to under-payment, the total for the five-year period would equal \$12.4 billion.

## Is the Difference Between Publicly Traded and Private Narrowing?

Chart 1 shows a slight trend toward an increase in the PLR of publicly traded companies. If there's truly an economic conflict between shareholders and policyholders, a convergence should not exist since such a convergence implies the different operating models may be a temporary phenomenon. To understand the change over time, we examined each company independent of the others, and found what we call the "GEICO Effect."

## The “GEICO Effect”

The results would be more lopsided if not for one single publicly traded company – GEICO. In any business, companies working to gain market share operate differently than companies maximizing profits. The insurance industry is not unique in this respect. GEICO has been the most aggressive in their quest to gain market share and the results show this concerted effort. Chart 2 shows a steady increase in GEICO market share during the five-year period of this study.

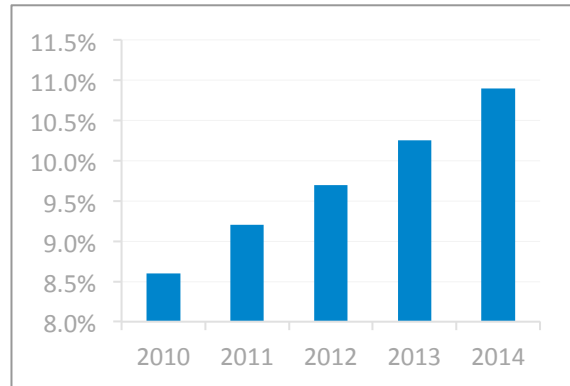


Chart 2: A five-year market share increase of 26% resulted in GEICO becoming the largest publicly traded auto insurance company.

In the first year of the analysis, GEICO represented 8.6% of the U.S. auto insurance market. By the final year, that number had increased an impressive 26% to become the largest publicly traded auto insurance company, commanding a 10.9% market share in the U.S. Their market share gains can be explained through aggressive marketing and low pricing, and thus a very high PLR – a good value for consumers.

Referring back to chart 1 showing a convergence between the PLR of publicly traded vs. private companies, we now chart the data again, but exclude GEICO from the analysis. As can be seen from chart 3, there is no longer a convergence between the two business models. Instead, GEICO working aggressively to gain additional customers and their increasing size had a significant influence on the weighted results of the total group of five publicly traded companies. If GEICO adopted the public company business model, the cost to consumers would be an additional \$6.1 billion. \$6.1 billion translates into a 32% increase in the amount publicly traded insurance companies overcharge for auto insurance.



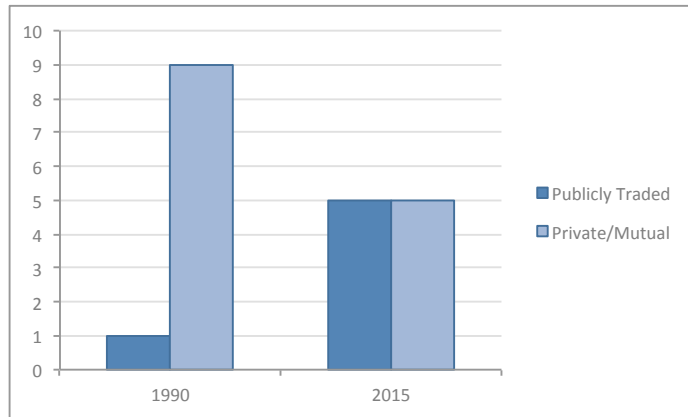
Chart 3: Removing GEICO from the analysis resulted in a significant drop in PLR of public companies.



### Growth in Publicly Traded Insurance Companies Hurting Consumers

The chart below and to the right shows the change in the number of publicly traded vs. private/mutual auto insurance companies between 1990 and 2015. The chart considers the same top 10 auto insurers included in the analysis above.

Looking more broadly at the largest companies in the property/casualty industry, the trend toward public companies is even stronger, showing a rapid transition from a private/mutual structure to a publicly traded, stock-based, corporate structure.



The competing interests of policyholders and shareholders is particularly important in the insurance markets for the reason that the existence of insurance companies is solely for the purpose of protecting customers. As shown by this analysis, the customer - the sole purpose for being in business -- are becoming second-class citizens behind corporate shareholders.

Loss compensation is the largest expense of any insurance company. That means the easiest approach to increasing profits is to reduce the loss compensation or increase the price. Competition dictates that prices are similar across various companies. However, despite mandating that consumers buy insurance, no government body provides information on the level of protection -- effectively a Return on Investment (ROI) -- for insurance. This leaves insurance companies free to manage loss compensation largely as they wish with minimal oversight from regulatory bodies.

### What's the Offsetting Benefit?

The benefit of being publicly traded includes access to capital markets, enabling insurance companies to make acquisitions and finance growth. Realistically, cash rich companies in a slow growth industry shouldn't need access to capital markets to finance organic growth. Accepting that argument leaves acquisition as a primary reason for becoming a publicly traded. However, if the cost of financing acquisitions is less protection for the policyholder, one must question whether becoming publicly traded is the right objective for insurance companies.

### The Long-Term View

There is currently no evidence suggesting the trend toward insurance companies transitioning to publicly traded companies is likely to change. With compelling evidence that a material conflict exists between shareholders and policyholders, protection for policyholders must be improved.



Some favor federal involvement in the regulation of insurance. However, changes to the regulatory system are unlikely. The effect of limitations imposed by the now obsolete McCarran-Ferguson Act of 1945 is that the insurance industry is exempt from federal anti-trust laws, consumer protection laws and regulatory oversight. Congressional action is necessary for federal involvement in the regulation of insurance.

The combination of large lobbying budgets and campaign contributions by the insurance industry make the federal involvement near zero percent probability. The insurance industry spends hundreds of millions of dollars annually to lobby the federal government<sup>5</sup>. In addition to these lobbying costs, the average contribution to federal campaigns for elected office -- U.S. Senate, House of Representatives and President -- is more than \$110,000 per elected position. With the federal government having no oversight of the insurance industry, one plausible explanation of this generosity is the preservation of the protected status passed in 1945.

## Conclusion

On average, the publicly traded auto insurance companies analyzed in this report (comprising more than 70% of the market) offer less protection to policyholders, with no apparent offsetting benefit. The material difference in the cost of protection compared to private/mutual companies was \$19 billion over the five-year period from 2010 to 2014. The recent high rate of insurance companies transitioning to publicly traded companies could result in this problem worsening with time.

Consumers have historically purchased insurance largely based on tradition -- recommendations of family and friends -- and more recently, based on advertising. Brand awareness as an approach to customer acquisition has worked very effectively for insurance companies. Unfortunately for consumers, the insurance industry is changing rapidly and the result of the change is a negative impact on the financial security of consumers. Consumers are not aware of this negative impact because regulators have not made the information available.

Transparency into how insurance companies operate is imperative for the protection of consumers. Consumers need insurance regulators to embrace transparency. Embracing transparency includes improving the data collection process characterizing insurance company behavior after claims are filed. This data needs to be shared directly with consumers, or made available to third parties specializing in the presentation of data to consumers. These actions by regulators to increase transparency will benefit both the insurance industry and consumers.

Consumer advocates, whether government agencies or independent organizations, must help consumers learn how to ensure they are receiving the protection they deserve. Only by creating awareness will consumers learn better, more effective ways of protect themselves and their loved ones.

## About ValChoice

ValChoice® is the only company to provide consumers, agents and advisors with information on which home and auto insurance companies offer the best price,



protection and service. The company's advanced analytics platform collects and analyzes over 1.5 million financial and complaint data points and delivers the results in an easy-to-use service that Forbes Magazine describe as "Carfax for insurance." Using ValChoice, consumers are finally able to shop for insurance based on value rather than making decisions blindly based on price or advertising campaigns.

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<sup>1</sup> Top five private/mutual suppliers include: State Farm, USAA, Liberty Mutual, Nationwide and American Family.

<sup>2</sup> Top five publicly traded companies include: GEICO, Allstate, Progressive, Farmers Insurance and Travelers.

<sup>3</sup> Source: © AM Best Company -- Used by Permission

<sup>4</sup> Source: © AM Best Company -- Used by Permission

<sup>5</sup> <http://www.opensecrets.org/lobby/indusclient.php?id=F09&year=2014&ind=2014>