Market Report:

Lack of Transparency Cost Consumers $101 Billion for Car Insurance

State of the Auto Insurance Industry

November 18, 2016

ValChoice®

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Executive Summary

A previous ValChoice Market Report concluded that an economic conflict exists between policyholders and shareholders of insurance companies. This report analyzes the private passenger auto insurance market in more detail to quantify the magnitude of the conflict. The analysis was performed for the five-year period from 2011 to 2015.

The conclusion of this study is that there is a material difference in the value offered based on the organization of insurance companies. The study shows that on average, American families either paid an extra $1,191, without receiving additional benefits, received less protection for an equivalent price or some combination of the two. The cost was calculated based on the difference in value between dividend-paying mutual companies and all other car insurance companies. This total cost translates into as much as $101 billion over the five–year period of this study.

The Companies Compared

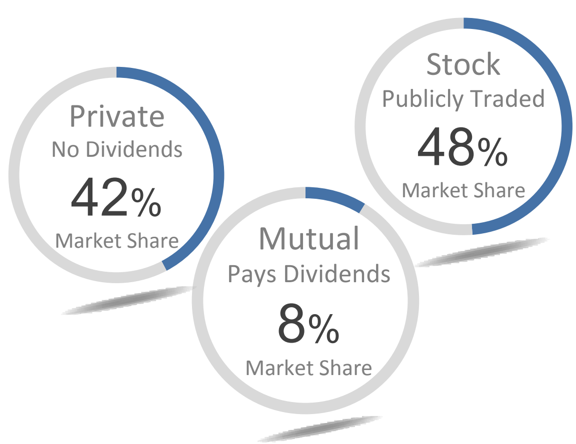
The analysis is based on the 312 suppliers of U.S. private passenger auto insurance that actively sold insurance to consumers during the five-year period from 2011 to 2015. These companies represent 98.4% of the market. The companies were grouped into three categories:

1) Stock (publicly traded) corporations
2) Private companies. This category includes closely held stock companies and mutual companies[1] that do not pay dividends to members. These two organization types are combined due to their similar operating characteristics.
3) Mutual companies that pay dividends to members

Excluded from the study were non-profits and government entities. The non-profit and government entity categories represented approximately 1% of the market. This was not deemed to be material or significant, so was excluded from the study.

The market share for each of these three categories in 2015 is shown below:

- Publicly traded corporations represented 48.2%[2] of the market.
- The private category includes both closely held stock corporations and mutual companies that do not pay dividends. This category represented 42.3% of the market.
- Mutual companies that paid dividends to their members insured 7.9% of the market.



The Analysis

First, each of the 312 U.S. private passenger auto insurance companies that sold car insurance in the last five years was assigned to one of the three categories identified above. The analysis then compared the percentage of earned premiums net of dividends to policyholders, per year, that were paid out in loss compensation. This ratio is the Paid Loss Ratio (PLR).

Chart 1 plots the PLR for each of the three categories of companies over the five-year period. A higher paid loss ratio represents a better value for the consumer while a lower paid loss ratio represents a worse value.

The chart to the right, chart 1, shows a consistent stratification, by company type, with publicly held stock companies offering the least value as shown by having the lowest PLR. Dividend-paying mutual companies offered the best value to consumers.

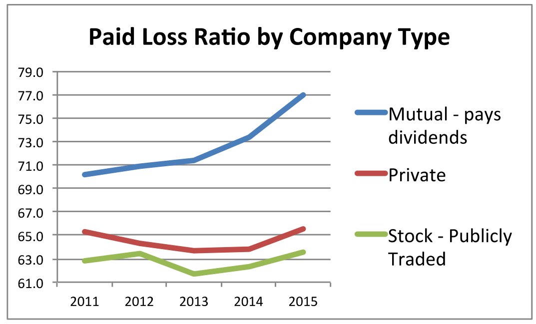


Chart 1: PLR for each of the three company types is shown in this chart. Publicly held stock companies have the lowest PLR. The private company category, made up of closely held stock companies and non-dividend-paying mutual companies, had a slightly higher PLR than publicly traded companies. Dividend-paying mutual companies had a noticeably higher PLR than any other category, showing they offer the best value.

Changes in Market Conditions Over the Five-Year Period

The industry experienced increasing losses in the years 2014 and 2015. Reasons for increasing losses can be more insured losses (accidents to cover), more aggressive pricing or a combination of the two.

In terms of accidents, passenger car miles driven in the U.S. took a downturn in the second half of 2007 and didn't recover until the summer of 2014[3]. This led to fewer accidents and insured losses during that timeframe.

Low gas prices beginning in 2014 led to an increase in miles driven and in 2015 the miles driven surpassed the record previously set eight years earlier[4]. The result of the increase in miles driven is that there were more accidents, and consequently, more insured losses. This can be clearly seen in the increasing PLR that companies experienced in 2014 and 2015.

Market Share by Company Type

Chart 2 shows market share by company type in the last year of the study[5]. The chart shows that publicly traded companies were the largest market segment. Closely held stock companies combined with mutual companies that do not pay dividends were the second largest and dividend-paying mutual companies were the smallest segment of the market.

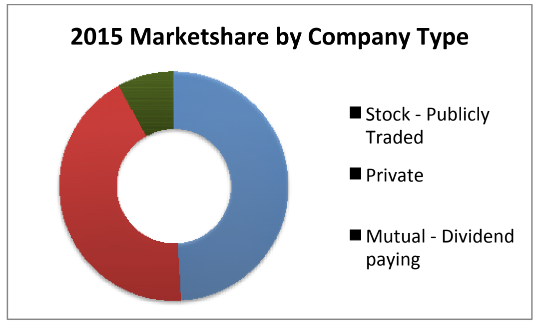


Chart 2: Market share by company type.

During the study period, State Farm did not pay dividends to members in the years 2014 or 2015. In order for this analysis to best reflect the characteristics of the each category of company, State Farm has been assigned to the non-dividend paying category for the entire period of the study. This change was made in order to give the best possible indication of performance for the companies that currently comprise each category of company type.

Chart 3 shows the relative, five-year average, PLR for each of the three categories of companies. For this chart, the PLR of the Publicly Traded Stock Companies has been assigned a value of zero, making the relative increase for each of the other company types easy to visualize.

The closely held stock companies and non-dividend paying mutual companies provided a better value to policyholders, having a five-year average PLR 2.8% higher than publicly traded companies. Offering the best value in car insurance were dividend-paying mutual companies. This category of company had an average PLR 15.6% higher than public stock companies.

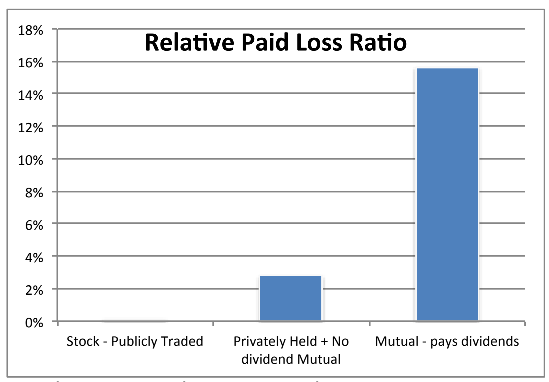


Chart 3: Relative PLR by Company Type

The GEICO Effect

Focusing on the largest market segment; the 48% of the market represented by publicly traded stock companies. GEICO is removed from this market segment for the reason that they are aggressively working to gain market share and they have now reached 24% of this market segment.

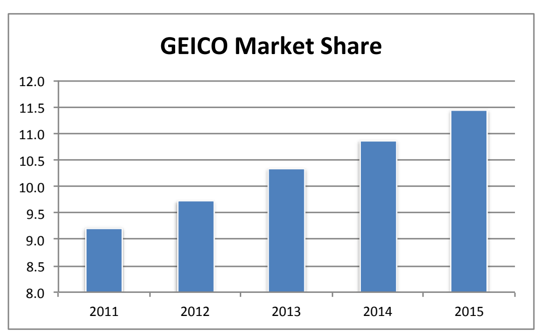


Chart 4: GEICO market share growth[6].

The combination of GEICOs size and their aggressive pursuit of market share growth skew the performance of this market segment and therefore necessitates disaggregation to fully understand how the segment performs.

Paid Losses (PLR) of Publicly Traded Companies

Chart 5 shows the PLR for publicly traded stock companies declining during the five-year period of the study. During a period of an industry-wide upward trend in PLR, publicly traded car insurers – excluding GEICO - were the only group of companies with a downward trend in PLR. There are a few possible explanations for this: a) as a group, these companies rapidly increased prices, offsetting the increase in insured losses, b) publicly traded car insurers serve a materially different group of consumers that are lower risk or c) this group of companies may have been more aggressive in their handling of claims than other company organization types.

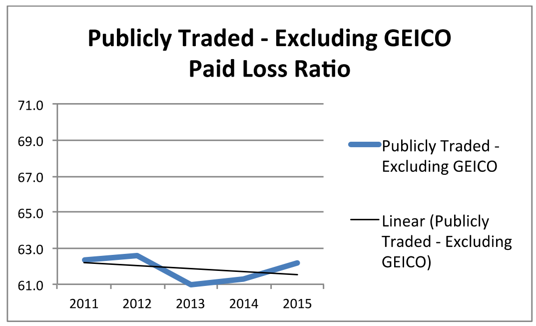


Chart 5: PLR of Publicly traded companies trending down.

Understanding Why Publicly Traded Companies Had a Declining PLR

We next applied a similar analysis to determine if there was uniqueness to the business model of publicly traded car insurance companies that would lead to a declining PLR when the same ratio was increasing for the rest of the industry. To do this, we analyzed the incurred loss ratio[7] (ILR) during this same five-year period. The findings are shown in chart 6. This analysis is an indicator of whether the risk pool for publicly traded car insurers was materially different than the risk pool of the other company types.

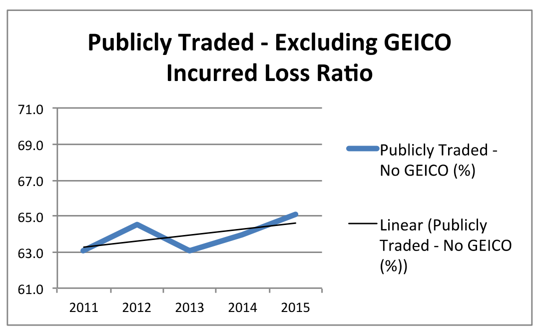


Chart 6: The ILR of public companies trended upward similar to other company types.

The conclusion was that the business model of publicly traded companies is not unique and that incurred losses did in fact trend upward. Based on a belief that it's unlikely any category of company could respond to increasing losses more rapidly than another, and knowing that incurred losses were increasing, it's possible these companies may have been more aggressive in denying claims than other types of companies. To conclusively prove if this is a factor requires a separate more specific analysis, including data that is not yet available. ValChoice plans to undertake a detailed analysis of this point in a future report.

Insurance companies have more flexibility in managing the tradeoffs of pricing, claims payment and market share than many consumer businesses for the simple reason that prices consistently increase. Unlike other markets, this enables insurers to lose market share, but improve overall financial performance based on price increases. This is a market dynamic that most consumer markets do not enjoy and that the current lack of transparency in the insurance industry facilitates.

Growth in Publicly Traded Insurance Companies

Despite being the worst value for consumers, the category of publicly traded insurance companies continues to grow. Chart 7 plots the growth in the number of publicly traded auto insurance companies (measured in groups, not in underwriting companies) from 1975 through 2015. The data includes all publicly traded companies as of 2015.[8]

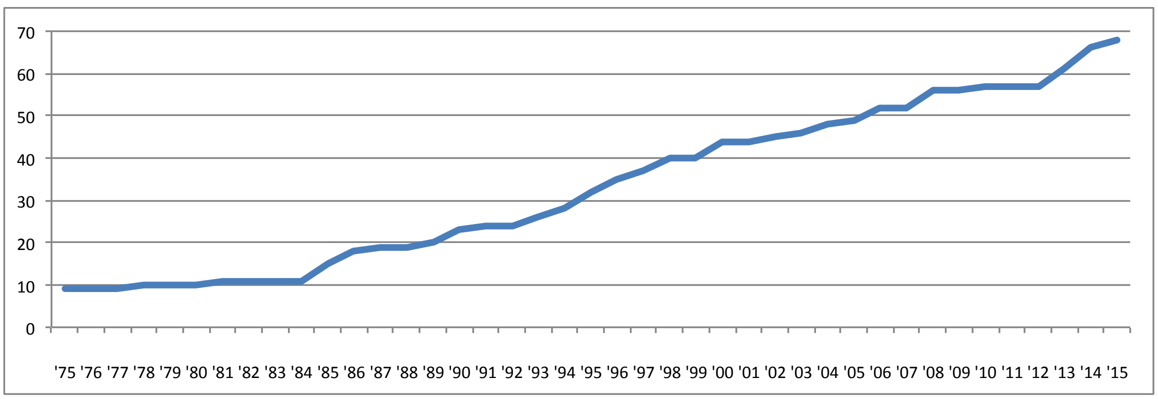


Chart 7: Long-term trend toward insurers becoming publicly traded

Steady and continuous growth in the number of publicly traded car insurance companies is evident in chart 7. This growth is a combination of Initial Public Offerings (IPO) and acquisition.

The logical targets for acquisition are those companies that most quickly contribute to profits. The methods for improving financial results include: increasing prices, reducing claims paid, cutting other costs or reducing competition. This reality has the effect of incentivizing companies that wish to be acquired to adopt the characteristics of publicly traded insurance companies.

What's the Offsetting Benefit?

There is no benefit for consumers to give their business to publicly traded insurance companies. The often-cited benefit of having easy access to capital markets is unnecessary in a cash-rich industry. Therefore, the motivating factor for having access to capital markets is to enable companies to make acquisitions. However, as seen from this report, publicly traded insurance companies offer less value. Therefore, financing acquisitions is detrimental to the value of the protection consumers are buying.

A Wide Performance Variation Within the Categories

While performance is distinctly different by company type, there is also a wide variety of company performance within categories of companies as well. Chart 8 shows the variation in PLR within the dividend-paying mutual companies. With the best-performing company in this category having a five-year average PLR a full 18% higher than the worst-performing company, it's clear that categorizing companies is insufficient as a method of communicating to consumers how to find the best value and the best protection.

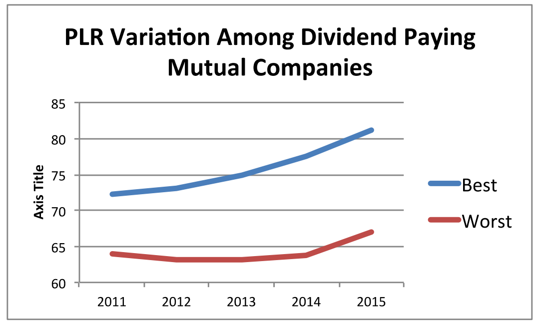


Chart 8 shows an 18% difference in PLR among the category of best companies.

Summary

This report demonstrates that the on-going roll-up of insurance companies into publicly traded companies is bad for consumers. Chart 7 shows the consolidation of the car insurance industry is an on-going trend.

In 2015 the U.S. car insurance industry was a $195 billion industry. Like other consumer insurance (health and home), purchasing insurance is mandatory in most states, but there is no meaningful information available to help consumers choose the best insurance company. This lack of information cost American households $101 billion over the last five years, and the problem is worsening. Nearly one-third (28%) of the cost was in the last year of the five-year study.

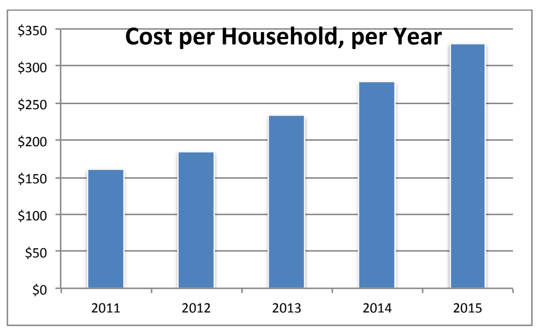


Chart 9: the problem is rapidly worsening

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 would be necessary for federal involvement in the regulation of insurance. However, large lobbying budgets and campaign contributions by the insurance industry make the federal involvement a near zero percent probability. The insurance industry spends hundreds of millions of dollars annually to lobby the federal government[9]. 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 limited oversight of the insurance industry, one plausible explanation of this generosity is the preservation of the protected status passed in 1945.

Conclusion

This study has conclusively demonstrated that:

- A material conflict exists between shareholders and policyholders
- The conflict is worsening
- Even among the best companies, the value delivered to policyholders varies widely

Transparency into how insurance companies operate is imperative for the protection of consumers. Consumers need lawmakers and regulators to embrace transparency. Data need to be collected and shared directly with consumers, or made available to third parties specializing in the presentation of data to consumers. These actions by lawmakers and regulators to increase transparency will benefit both the insurance industry and consumers.

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 millions of 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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[1] Reciprocal inter-insurance exchange companies are counted as mutual companies
[2] Market share data per company, Source: © AM Best Company -- Used by Permission
[3] http://www.transtats.bts.gov/OSEA/SeasonalAdjustment/
[4] https://www.fhwa.dot.gov/pressroom/fhwa1607.cfm
[5] Source: © AM Best Company -- Used by Permission
[6] Source: © AM Best Company -- Used by Permission
[7] Source: © AM Best Company -- Used by Permission
[8] Companies that were previously public and subsequently became privately held entities would not to accounted for as having been publicly traded in this study.
[9] http://www.opensecrets.org/lobby/indusclient.php?id=F09&year=2014&ind=2014