COVID-19 and Insurance Economics: Implications for U.S. Personal Auto

WHITE PAPER

The current COVID-19 outbreak and mitigation efforts around the globe have impacted nearly every part of life, and P&C insurance is no exception An immediate impact is on operations, as insurance companies—like other industries—have shifted to a work-from-home model. A second implication of the crisis is on insurers' balance sheets: low interest rates affect net investment income and earnings. And finally, the economic slowdown reduces exposures in many key lines of business, such as workers' compensation and personal auto, and dampens the revenue line for P&C. But the slowdown can also increase business interruption and cyber-related claims in others.

Although many industry experts have hypothesized about the overall implications for the P&C sector, and while insurers are analyzing their books of business, we at Guidewire are extrapolating from transactional data to better understand emerging patterns.

We have focused on a single set of implications for P&C insurance during the pandemic: the effects on personal auto lines of business. With vast numbers of people in the United States working from home, sheltering in place, and driving much less, the resulting reduction in exposure from these mitigation strategies is significantly impacting bottom lines for personal auto insurance.

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COVID-19 Auto Claims Trends and Insurer Responses in the United States

While staying at home means increased entertainment streaming, puzzle-playing, and family time, it also means less time on the road and fewer miles driven. On March 24, 2020, Arity (an Allstate company) announced that the number of cars on the road was normal through March 10 but dropped more than 25% in the next two weeks. Root Insurance, a mileage-based auto insurer, looked at its own data to find that the miles driven from March 1 through the first half of April was down from 22% to 34% across the 29 states in which the company writes business. Root's analysis indicated that the shift was due to a decrease in both the number and duration of car trips.

Without question, fewer cars on the road and fewer miles driven result in the filing of fewer accidents and claims. Because premiums in traditional auto insurance are charged based on expected driving patterns, insurers are now adjusting loss expectations. In fact, many have already announced special programs to return expected indemnity savings to policyholders.

As of April 17, 2020, Chubb, State Farm, Farmers, USAA, Progressive, and Travelers have all announced credits ranging from 15% to 35% on charged monthly premiums. Most insurers are applying the credits to April and May premiums, but we assume that some insurers may extend the credits if circumstances persist. In fact, GEICO has announced 15% credits on the full term of the next policy renewal.

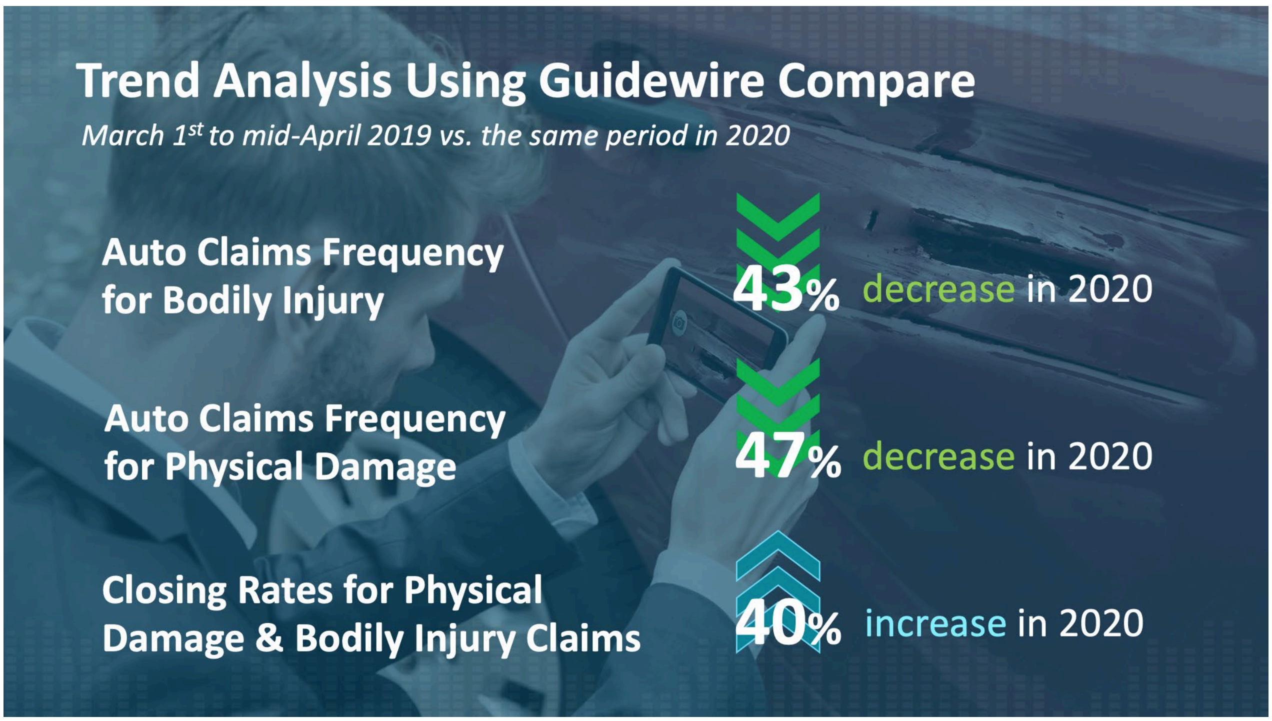
Instead of credits, Allstate (and Esurance), Liberty Mutual (and Safeco), American Family, and Nationwide have announced refunds—cash returned directly to policyholders. The details vary, with Allstate and Liberty announcing 15% refunds for April and May premiums, while American Family and Nationwide are sending $50 per vehicle or policy, respectively.

In the coming months, it will be interesting to see if a market consensus forms around preferred ways of sharing insurers' savings with customers. But one thing is clear: decisions regarding the size of rebates must be based on data for them to be credible and, indeed, to pass regulatory muster in the states that require it. Certainly, insurers can examine their own claims data between March 1 and mid-April of 2020, but looking at only 1.5 months of data provides only preliminary results. For this reason, we at Guidewire have used one of our business intelligence solutions—Guidewire Compare—to examine the current trends across the broader market.

Analyzing Post-COVID-19 Claims Trends by Using Guidewire Compare

Our analysis with Guidewire Compare shows that the frequency of claims across the U.S. decreased 43% for bodily injury and 47% for physical damage between March 1 and mid-April of this year compared to the same period in 2019. Based on frequency alone, personal auto claims could be decreasing even faster than the mileage numbers suggest.

Insurance economics are also driven by severity. Although based on undeveloped incurred amounts, our analysis of year-over-year claims for this same period suggests that severities in 2020 are up slightly compared to those in 2019. Interestingly, for claims that were filed from March through mid-April in 2020, the closing rates for both physical damage and bodily injury were up more than 40% from the same period in 2019. This could be because the 2020 claims are less complex, or because claims departments have fewer claims to process—with the result that caseloads per adjuster are smaller and close more quickly.



Of course, every insurer must analyze its own data to understand the implications of COVID-19 mitigation on its business. Our aim at Guidewire is to provide the data platform and analytics tools that provide the insight that leads to smart, agile decision-making.

Public Policy Implications

Based on our research, we expect premium rebates to continue—and to increase in size—if the patterns observed today persist throughout 2020. One reason is that regulators may force insurers' hands regarding rebates. On April 13, 2020, California's insurance commissioner ordered companies operating in the state to "return insurance premiums" for March and April (and May if the shelter-in-place order continues), though no specific percentage return was specified. This ruling includes a mandatory 60-day grace period on late payments. So far, this order is redundant to actions that insurers have already announced, but regulators are clearly interested in facilitating these rebates. California's order specified that the rebates will not require prior approval from the California Department of Insurance if certain procedures are followed.

In addition, regulators do not expect personal auto to be the only insurance line to experience changing claims patterns. In fact, California's mandate to return insurance premiums includes not only personal auto but also commercial auto, workers' compensation, commercial multi-peril, commercial liability, medical malpractice, and "any other insurance line where the risk of loss has fallen substantially as a result of the COVID-19 pandemic."

Implications for Usage-Based Auto Insurance

While much of this discussion has focused on traditional auto insurance, it's also interesting to consider usage-based insurance. Companies like Metromile and Root Insurance are focused solely on providing usage-based insurance, while larger companies such as Allstate, Nationwide, and Progressive provide usage-based insurance as just one of many offerings. Premiums for these policies are not fixed in advance of the policy term, as they are for traditional insurance; instead, premiums vary to a degree based on the number of miles driven. For this reason, rebates do not have to be explicitly given by the insurer because the next premium payment will reflect the lower usage.

We expect usage-based offerings to become more popular with auto insurance customers as they realize the implications of stay-at-home orders on their driving habits, but this does present unique challenges to insurers. If priced properly on a per-mile basis, premiums and claims should stay aligned, but expense ratios could soar if the average premium plummets, even though a portion of the premium is typically fixed to cover operating costs. Still, if usage-based insurers can prove that they can weather times such as these, we expect their long-term prospects to improve based on increased consumer interest.

Adapting to the "New Normal"

For the P&C industry in the U.S., what are the overall implications of the COCID-19 experience? Personal auto is an important line of business, but the overall economics are somewhat ambiguous.

Commercial multi-peril, D&O, BOP, construction, E&O, and other lines will each have their own patterns of implications from COVID-19 and its resulting mitigation efforts. And although it's a simple assumption to say that current experience is an aberration and previous frequencies and severities will return as life gets "back to normal," is that really true? Can we make that assumption with confidence and, if we can, how do we estimate the timing at which this will happen in different locations? There are many questions to be answered, but quick access to curated data (both internal and external) as well as sound industry benchmarks will provide the insights and agility needed to manage in the "new normal."

About Guidewire Software

Guidewire delivers the industry platform that Property and Casualty (P&C) insurers rely upon to adapt and succeed in a time of accelerating change. We provide the software, services, and partner ecosystem to enable our customers to run, differentiate, and grow their business. As of the end of our fiscal year 2019, we were privileged to serve more than 380 companies in 34 countries. For more information, please visit www.guidewire.com and follow us on twitter: @Guidewire_PandC.

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