Auto Insurance Claims Costs Increasing

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American Property Casualty Insurance Association
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KEY POINTS

- Auto loss costs are surging as driving levels rebound to pre-pandemic levels.
- Higher severity along with rising claims frequency are pushing auto insurance costs up to levels not seen since 2017, which may impact consumer costs.
- Accelerating costs to repair or replace vehicles are among the top trends amid severe shortages of new and used vehicles.
- Drivers are encouraged to avoid risky driving to minimize potential losses and injuries.

SUMMARY

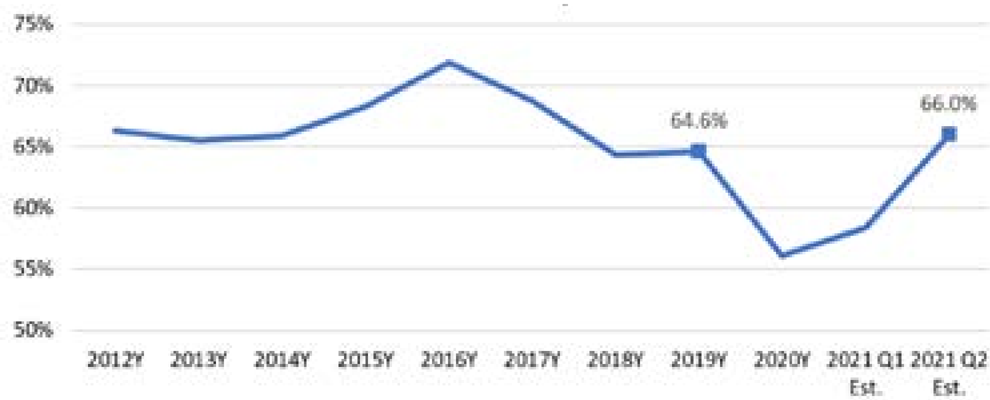
Auto loss costs are sharply rising in 2021, impacting families, individuals, and businesses. The intersection of an improving economy, increased careless and dangerous driving behavior, rising injury and vehicle costs due to severe supply and demand imbalances, and COVID-19 related global shipping challenges are together creating significant upward pressure on auto insurance pricing.

Following a brief decline in miles driven early in the COVID-19 pandemic, drivers have largely returned to the roads, albeit with new driving behaviors that may lead to more severe accidents and injuries. The rise in claims frequency has compounded injury-related costs that continued to steadily climb during the pandemic, while costs to repair or replace vehicles have recently skyrocketed amid severe vehicle and auto parts shortages. Demand for new and used vehicles has surged, depleting inventories at dealerships across the U.S. At the same time, auto manufacturing remains stalled, driven by semi-conductor chip shortages and ongoing global supply chain issues that have made critical auto parts scarce. The rapid spread of the delta variant is further stressing supply chains. The resulting increase in price for new and used vehicles, as well as rental cars, has contributed to rising inflation—leaving car buyers with fewer and more costly options. Inflationary pressures are expected to last well into 2022, if not longer.

The combined effects have alarmed insurers as current trends continue to accelerate costs higher. Insurers are cautioning drivers to avoid risky driving behaviors to reduce their risk of loss and to avoid potentially lengthy repair times as vehicle parts become more difficult to source or replace a vehicle.

Insurers are increasingly concerned about rising severity trends, for both accident-related injuries and costs to repair or replace vehicles, as auto claims frequency returns to pre-pandemic levels. While industry-wide data through Q2 is not yet available, early public data reported from leading auto insurers indicate private-passenger auto loss ratios surged in Q2, with multiple insurers indicating loss ratios reached levels not seen since at least 2017.

Personal Auto Industry Loss Ratio



Source: S&P Global Market Intelligence

Note: Premiums in the 2020 loss ratio calculation exclude premium refunds in the form of dividends and those accounted for as expenses. If these were accounted as reductions in premium the loss ratio would be higher.

The auto insurance industry experienced a lengthy period of unprofitability that extended through 2017. At the end of 2017, the industry further suffered significant losses following Hurricanes Harvey, Maria, and Irma, three of the four costliest Atlantic hurricanes, and resulted in significant auto losses following widespread flooding and devastation in Texas[1]. The prospect of returning to these levels has begun to alarm insurers. In public filings, insurers have noted rising severity and frequency are driving the increase. Damage and destruction from Hurricane Ida, which produced catastrophic flooding from Louisiana to New England and submerged thousands of vehicles, will substantially increase losses further.

SHIFTS IN DRIVING BEHAVIOR

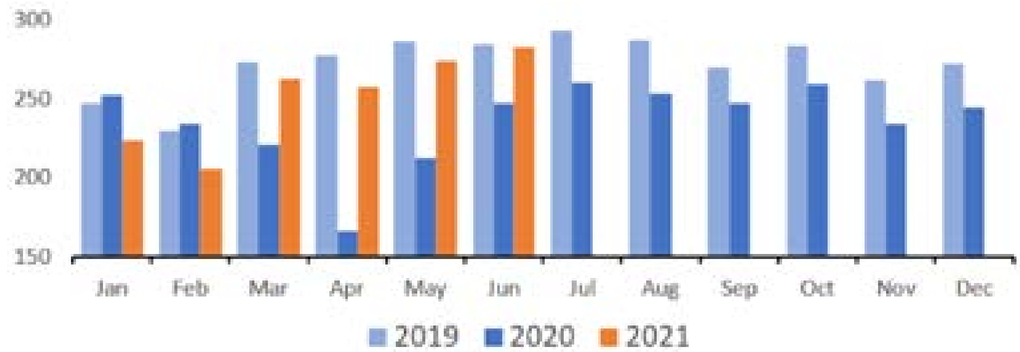
The jump in Q2 loss ratios is a shock to some, as early in the pandemic auto loss costs briefly dipped due to a significant decline in miles driven leading to fewer accidents and claims to be paid. In response to this downshift, auto insurance carriers returned an unprecedented $14 billion in premium relief to policyholders, according to the Insurance Information Institute[2].

However, as stay-at-home orders lifted, miles driven quickly returned to pre-pandemic levels. U.S. Department of Transportation data released in August indicated there was a less than 1 percent difference in Vehicle Miles Traveled (VMT) in June 2021, when compared to the same month in 2019.

1 The storms resulted in auto claim severity in Texas surging by 329.3 percent in Q3 2017 while claim frequency rose 26.1 percent (ISO Fast Track data for Comprehensive coverage)

2 https://www.iii.org/insuranceindustryblog/triple-is-chief-actuary-insurers-are-navigating-covid-19s-economic-fallout/

U.S. Vehicle Miles Traveled (in billions)



Source: U.S. DOT, Federal Highway Administration

CCC, a leading estimating vendor in the industry, similarly notes auto physical damage claims processed have been trending higher, including a large jump in Q2 2021, another early indicator that claims frequency may be approaching pre-pandemic levels.

Overall Claim Counts — Percent Change from Same Period Year
(2018 to Q2 2021)

Source: CCC Intelligent Solutions Inc., CCC National Industry

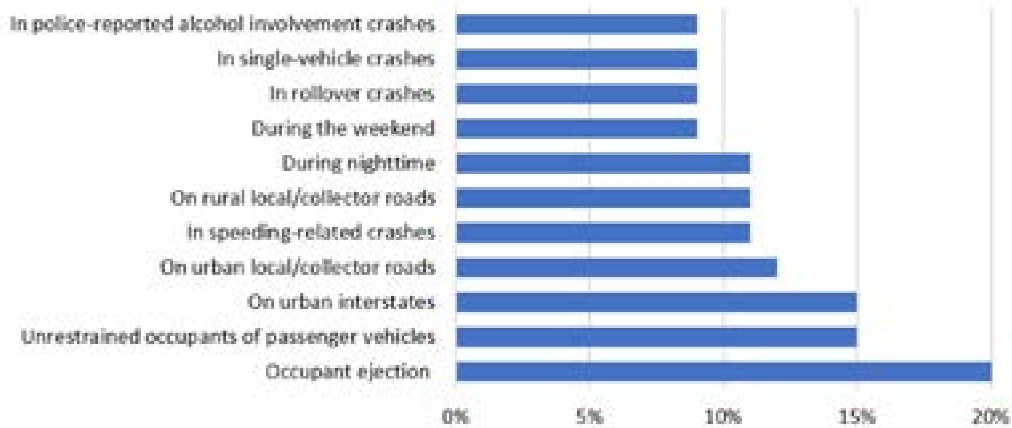
Note: This data does not constitute an industry survey, but is solely an aggregation of information collected by CCC Intelligent Solutions, Inc.

While many would expect auto loss costs to normalize as driving levels returned to more traditional levels, other trends have emerged pushing costs higher.

The National Highway Traffic Safety Administration (NHTSA) released early estimates for 2020 noting “an estimated 38,680 people died in motor vehicle traffic crashes—the largest projected number of fatalities since 2007. This represents an increase of about 7.2 percent as compared to the 36,096 fatalities reported in 2019.”

One area of concern for insurers is recent data that shows since the start of the pandemic Americans have embraced riskier driving behavior, such as impaired driving, speeding, and failure to wear a seatbelt, leading to an increase in fatalities.

Accident Characteristics Driving Increase in Fatalities



Source: NHTA (crash factors and demographics reviewed showing largest increase, 2020 vs 2019)

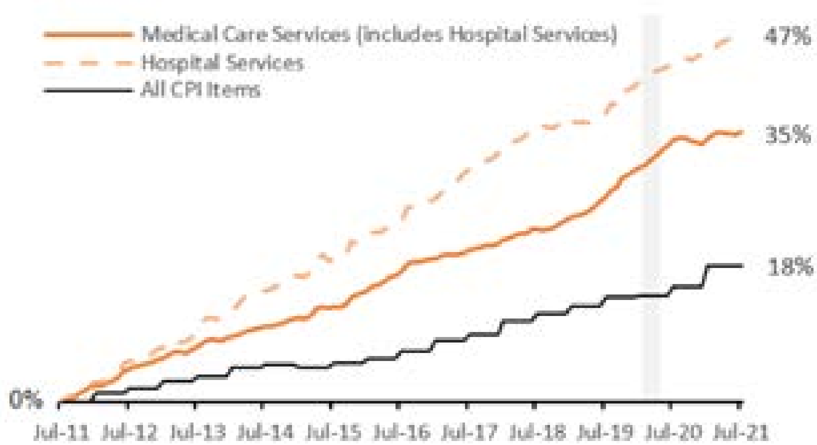
However, a bigger concern for insurers is the combined impacts of rising frequency with increasing severity trends for injuries and vehicle costs.

INJURY SEVERITY COSTS OFFSET REDUCTION IN MILES DRIVEN

Injury severity trends have been steadily outpacing frequency in recent years. Since 2016 and through Q1 2021, bodily injury frequency decreased -30.4 percent while severity increased 37.8 percent. As severity trends continued to accelerate during the pandemic, they have largely offset the reduction in miles driven that briefly led to lower accident frequency.

Prior to the pandemic, rising injury costs had been heavily driven by lawsuit abuse and rising medical costs. Over the last ten years medical costs climbed at nearly double the rate of inflation, with prices for hospital services rising even faster.

Cumulative Price Changes — U.S. City Averages



Source: U.S. Bureau of Labor Statistics (shaded area indicates U.S. recession)
fred.stlouisfed.org (data as of Aug 11, 2021)

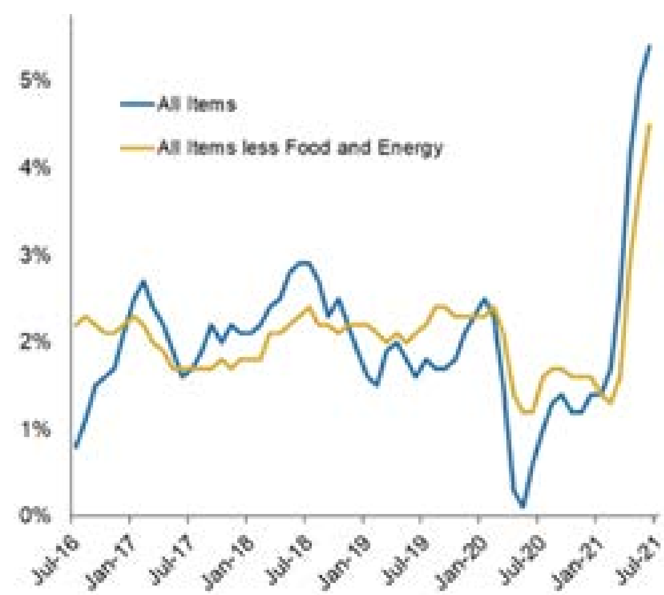
A new report from the Geneva Association observed notable increases in U.S. civil litigation activity in recent years, as well as higher average compensation awards. The report notes a "combination of adversarial legal procedures and a litigious culture" have led to the increase in lawsuits and high jury awards or settlements[3].

Injury trends continue to be a major concern for insurers, however, the bigger headline in 2021 has been the surge in costs to repair or replace an auto.

VEHICLE REPAIR AND REPLACEMENT COSTS SURGE

The U.S. economy is undergoing the biggest surge in inflation since 2008 as the economy struggles to reopen following the COVID-19 pandemic. According to the U.S. Department of Labor, in June the consumer price index jumped 5.4 percent from a year earlier, the largest increase since before the worst of the financial crisis. Data further showed excluding the volatile food and energy categories, inflation increased 4.3 percent, the largest move since September 1991.

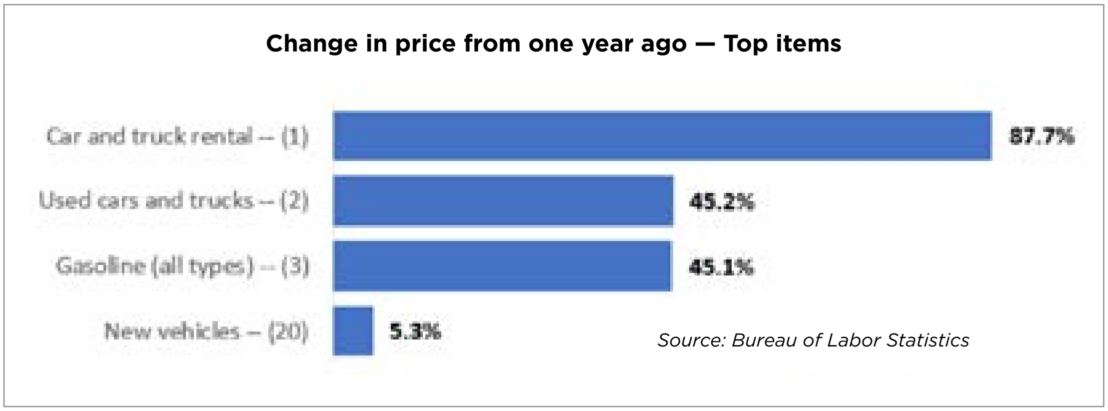
Year-Over-Year Price Changes



Source: Bureau of Labor Statistics

According to Labor Department data, most of the inflation jump can be blamed on three key areas — housing, used cars, and gas[4]. While price increases for transportation-related items are up across the board, car rentals and used cars posted the highest year-over-year price change of all categories tracked[5]. Pent up demand, depleted vehicle and parts inventories and a series of global supply chain snafus in a post-pandemic era have created a myriad of issues rippling across the auto industry.

3 https://www.propertycasualty360.com/2021/08/20/drivers-of-social-inflation-for-the-insurance-industry/
4 https://www.politico.com/interactives/2021/inflation-spike-used-cars-gas/
5 https://www.cnbc.com/2021/07/13/surging-prices-for-used-cars-gasoline-food-and-airfares-are-driving-the-jump-in-inflation.html



Demand for Autos on the Rise

Demand for cars and trucks has experienced a similar yo-yo effect since the start of the pandemic. As lock-downs abruptly ceased most travel and commuting, many vehicles across the U.S. were parked. Following a sharp drop in cash flow and the logistical challenges and costs associated with storing over a million rental cars, to survive the crisis rental car companies opted to liquidate fleets in 2020, selling off more than half a million cars, about a third of the industry's fleet[6]. Hertz, which includes Dollar and Thrifty rental brands, was forced to declare bankruptcy and sold more than 200,000 of its fleet, just over 40 percent of its supply.

This initially flooded the used car market with inventory; however, the excess supply would be short lived. A shift to remote work during COVID-19 drove up demand for larger space, sending city dwellers searching for larger homes in the suburbs—and cars to fill their garages. For those returning to the office, longer commutes and COVID-related health concerns with public or other shared transportation options, combined with stimulus checks and low interest rates, have led to a spike in demand for new and used cars. With many Americans still hesitant to fly, personal automobiles and rental vehicles are filling the void for some longer journeys. These shifts coincided with rental car companies also looking to replenish their fleets as leisure and business travel resumed, depleting inventory. Bare showroom floors and an overall lack of inventory have become the norm at new and used car dealerships across the country, as the auto industry struggles to match supply with demand.

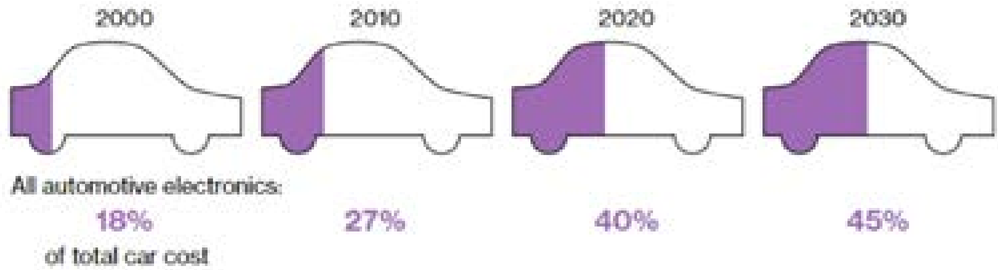
Supply Chain Buckles Amid Chip Shortage and Shipping Snafus

A global semi-conductor chip shortage was already brewing prior to the pandemic, impacting auto manu-facturing for new vehicle models. As autos rely more on electronics that include semiconductors[7], they are competing for a limited supply of chips also needed for an increasing list of other products, such as doorbells, dishwashers, refrigerators, and lightbulbs, as well as cloud computing and crypto currency mining. The chip shortage was also exacerbated by a sharp increase in demand for computers, monitors and other electronic devices needed to help workers and students rapidly switch to remote work and study.

6 https://www.cnn.com/2021/03/25/business/rental-car-shortage-price-spike/index.html
7 https://www.bloomberg.com/news/articles/2021-08-05/no-team-biden-carmakers-chip-crisis-isn-t-getting-any-better

From Horsepower to Chip Power

Modern cars are relying more on electronics that include semiconductors



Source: IHS, Deloitte analysis, via Bloomberg (forecasts as of April 2019)

Auto manufacturing plants have repeatedly "been idled by a semiconductor crisis that's costing tens of billions of dollars in lost revenue, while materials from seating foam to metal to plastic resin are also becoming harder to find.[8]" When parts do become available, manufacturers report challenges maintaining production lines as workers are forced to remain home due to COVID-19 infection or close exposure to others infected. Port backlogs and natural disasters have posed additional challenges adding upward pressure on costs and extending lead times for delivery of goods, including critical auto parts and components[9]. Indeed, global containerized-freight costs are up more than five-fold since 2019[10]. Recent natural disaster such as the Texas winter freeze in February and major flooding events in the U.S. and overseas further compounded parts shortages, such as chips, components, and plastics, as well as damaged assembly plants along with key transportation infrastructure[11].

A Bloomberg article in April highlighted the auto industry, "which has long relied on just-in-time manufacturing to reduce costs, is finding it has limited flexibility to deal with supply chain disturbances wrought by the pandemic," and further noted that while companies in virtually every market are grappling with shortages, "perhaps no industry is being hit harder than autos.[12]" Pressure to rebuild inventories will run well into 2022 and likely into 2023, ensuring pricing pressures will remain significant well into the future.

Auto Costs Spike Amid Perfect Storm

Auto manufacturers have tried to adjust by removing components or features dependent on chips, as well as discontinuing smaller vehicles such as sedans to prioritize critical parts for in-demand trucks and SUV's. For example, "GM has cut back on features like wireless cellphone charging, smart mirrors, HD radio and some fuel-saving features in trucks as it tries to meet the strong customer demand at dealerships where lots are running near-empty." However, the inventory shortage has continued to grow, pushing up the average new car price in July to now $42,000.

8 https://www.autoblog.com/2021/04/17/automaker-rubber-shortage/
9 https://www.businessinsider.com/shipping-delays-shutdown-at-chinese-port-threatens-send-prices-higher-2021-8
10 https://www.economist.com/finance-and-economics/a-perfect-storm-for-container-shipping/21804500
11 https://wolfstreet.com/2021/03/17/shortages-of-semiconductors-plastics-backlogs-at-container-ports-and-the-texas-freeze-wreak-havoc-on-automakers/
12 https://www.autoblog.com/2021/04/17/automaker-rubber-shortage/

Empty show room floors have also led to increased demand for used cars, with used car prices now averaging $25,000, up 45 percent in last 12 months, according to Cox Automotive[13]. Repair and maintenance costs have similarly climbed higher as individual parts become more costly and difficult to source, in addition to a surge in demand to repair older cars creating an industry-wide labor shortage at repair facilities.

Cumulative Price Changes — U.S. City Averages

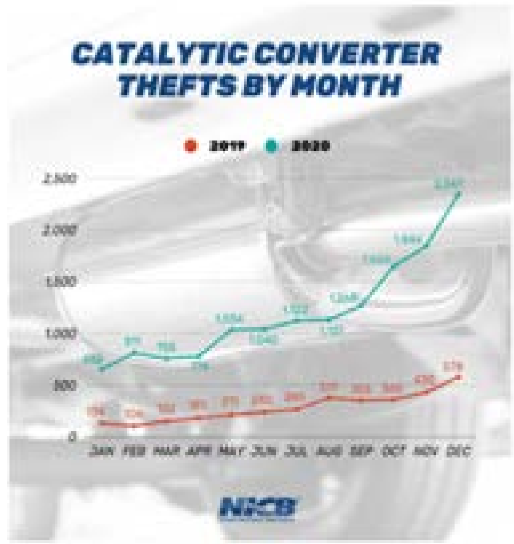
Source: U.S. Bureau of Labor Statistics (shaded area indicates U.S. recession)
fred.stlouisfed.org (data as of Aug 11, 2021)

For auto insurers, the return of higher frequency coupled with significantly higher auto repair and replacement costs will heavily impact claims. As of Q1 2021, vehicle damage severity, which includes Property Damage and Collision coverage, increased 26.6 percent since 2016 while frequency decreased 27.6 percent. Prior to the pandemic, frequency trends were declining, though at a much slower rate than Severity trends were climbing. As frequency has begun to reach pre-pandemic levels loss settlement costs have spiked. The increase in price for new and used vehicles, which significantly accelerated in Q2, is expected to further increase average severity as total losses (i.e., when the cost to repair exceeds the value of the vehicle) make up approximately 20 percent of all auto physical damage claims, according to CCC.

Rental costs have also skyrocketed amid the vehicle shortages, with rental car companies "buying used cars just to bring their fleets back in line with rising demand[14]". Kayak indicated rental car prices for the July 1-5 holiday weekend were up 70 percent compared to the same time in 2019, while AAA noted prices were up 86 percent compared to the same time in 2020[15]. Reports suggested daily rates averaged as high as $300/day and even up to $500/day in some of the hottest destinations during peak leisure travel periods. Higher rates combined with longer average repair times due to parts and labor issues have similarly pushed up claims costs. The increase in rental rates may also impact costs for Rental coverage over an extended period, for insurers approaching rental contract renegotiations.

13 https://www.reuters.com/world/the-great-reboot/inflation-risk-or-profit-engine-high-car-prices-are-both-2021-08-10/
14 https://www.consumerreports.org/buying-a-car/when-to-buy-a-used-car/
15 https://www.businessinsider.com/fourth-of-july-rental-car-prices-demand-record-high-2021-7

These emerging trends have compounded other issues that have recently led to higher auto insurance costs, including rising Comprehensive costs due to increased thefts for autos and auto parts. According to data from the National Insurance Crime Bureau, auto thefts reached their highest level in a decade in 2020, while catalytic converter thefts were more than four times higher in 2020 than the prior year.



Outlook Remains Grim as Trends Expected to Climb Higher

All indicators suggest elevated auto repair and replacement costs will stretch well into 2022. For example, rental car companies historically have been a major source for used car sales, however, Business Insider highlighted in August "rental companies like Avis and Hertz are hanging onto cars longer instead of selling them into the used market." A decade ago, 30,000 miles on a rental car was considered high, but average mileage climbed to 50,000 last year, and last month hit 88,000, according to Manheim[16]. A Kelly Blue Book article noted lower new-vehicle sales for several years during the Great Recession has also contributed to the limited availability of affordably priced 10-year-old vehicles. "Vehicles in the under $15,000 segment made up 18 percent of the used market last summer. This year, they comprise less than 1 percent.[17]"

Until light vehicle production improves restoring inventory in the new vehicle market, demand and in turn prices for used vehicles will remain at record levels. However, as the Delta variant spreads, including surging COVID-19 infections in southeast Asia where many semi-conductor chips are produced, auto manufactures around the globe have announced additional plant shutdowns in August[18], postponing the industry's efforts to bring supply and demand in balance.

Insurers continue to monitor the situation closely, though as frequency and severity continue to rise, insurers may be forced to pass these loss costs along to policyholders. Given the trends, insurers are strongly encouraging drivers to minimize their risk by avoiding risky driving behaviors that may result in a loss. Insurers are also advocating for better infrastructure, including reliable supply chains for critical auto parts and safer roads, that should result in fewer accidents and lower claims costs that help keep insurance premiums affordable for consumers.

16 https://www.businessinsider.com/used-car-price-increase-slowing-down-buying-one-still-difficult-2021-8
17 https://www.kbb.com/car-news/used-vehicle-prices-hit-all-time-high/
18 https://www.cnn.com/2021/08/19/business/auto-production-covid-surge/index.html

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