

Arizona Department of Insurance

2014 Market Monitoring

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Private Passenger Automobile Insurance

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I. Rate System:

Arizona's "open competition" law, applicable to Private Passenger Automobile ("PPA") insurance, prohibits insurers from charging excessive, inadequate or unfairly discriminatory rates, or rates that will have the effect of destroying competition, or establishing a monopoly. By statute, a rate is not excessive if "a reasonable degree of price competition" ("RDPC") exists at the consumer level. The law presumes a competitive market exists unless the Director, after a public hearing, determines that a RDPC does not exist in the market.

II. Market Monitoring Methodology:

The Department relies upon annual statements filed with the Department, insurers' responses to an annual Department survey, current trade press articles, and A.M. Best data to monitor the market.

The purpose of market monitoring is twofold: to assist the Director in determining whether competition exists; and to assist consumers with their questions and concerns about the availability of insurance.

III. Annual Statement Data:

The 2013 annual statements for all PPA segments evidence that:

- In 2013, insurers' direct written premiums increased 5.57% from 2012 and their direct incurred loss ratio increased by 2.58%.
- Only 19 insurers wrote more than 1% of the market.
- There are 298 insurers that reported PPA data in 2013, but of these only 125 are actively seeking new business.
- The Top 25 PPA insurers wrote 77.41% of the market.

Historical Experience (All Insurers' Arizona State Page, Lines 19.1, 19.2 and 21.1, Annual Statement Data, Year Ending December 31)

| | 1 | 2 | 3 |
|------|-----------------|------------------------------------|-----------------|
| CY | Written Premium | Earned Premium | Paid Losses |
| 2013 | \$3,561,661,054 | \$3,497,933,533 | \$2,214,153,319 |
| 2012 | \$3,373,608,055 | \$3,325,621,512 | \$2,084,364,945 |
| 2011 | \$3,269,648,568 | \$3,281,922,687 | \$2,037,060,148 |
| 2010 | \$3,347,849,636 | \$3,377,615,518 | \$2,137,914,516 |
| | 4 | 5 | |
| CY | Incurred Losses | Incurred Loss Ratio (Col 4/ Col 2) | |
| 2013 | \$2,280,123,492 | 65.18% | |
| 2012 | \$2,081,911,255 | 62.60% | |
| 2011 | \$2,062,313,040 | 62.80% | |
| 2010 | \$2,176,416,207 | 64.44% | |

IV. Survey Responses:

In 2014, 177 insurers responded to the Department's PPA survey. These insurers had a 2013 market share of 99.14%. Overall, their response regarding current PPA market conditions was favorable and positive.

- **The majority of surveyed insurers said that:**
 - Competition is intense in the PPA market;
 - Price is important;
 - Coverage availability is not a problem;
 - Current pricing levels are just about right; and,
 - Reinsurance is not problematic for 50.07% of the market.
- **The majority of the surveyed insurers said that their particular company:**
 - Considers the PPA line to be very important to their presence and success in Arizona;
 - Is competing in the market with much intensity;
 - Has had neither historical underwriting profitability nor unprofitability in PPA in Arizona;
 - Will maintain their current underwriting and risk-eligibility approach at least through year-end 2014;
 - Is actively seeking new business;
 - Has not materially increased its declinations in 2014 as compared to 2013;
 - Considers Arizona's "open competition" rate law to be highly or very effective; and
 - Considers PPA to be a major line nationally.

V. Major PPA Market Trends:

Trend # 1. PPA market concentration continues in the Top 25 insurers and their market share increased slightly in 2013. The Top 25 market share increased to 77.41%, an increase of .47% from 2012. All three insurers maintained their position. State Farm Mutual Automobile IC and Progressive Advanced IC increased market share (.28% and .09% respectively), while Farmers IC of AZ decreased its market share by .54%.

The top three 2013 insurers' market share rank is as follows:

| Rank | Company | 2013 Market Share |
|------|---------------------------|-------------------|
| 1. | State Farm Mutual Auto IC | 15.43% |
| 2. | Farmers IC of AZ | 8.57% |
| 3. | Progressive Advanced IC | 5.85% |
| | Total: | 29.85% |

The top three insurers' 2013 market share (29.85%) is down from 30.02% in 2012.

Trend # 2. Market concentration has not discouraged new insurers from entering the Arizona market. Two of the 177 insurers responding to the survey have been writing in Arizona less than three years. However, of the 298 insurers reporting data on their annual statements in Arizona, 173 are latent insurers that could reenter the market.

Trend # 3. The majority of the market is actively seeking new business. In 2014, 92.29% of the market responded that it was highly or intensely seeking new business.

Trend # 4. Intense competition continues. The majority of the market (95.50%) responded in 2014 that market competition is high. The market share of nonstandard insurers has decreased (8.94%, 2013; 10.20%, 2012). The continued low level of activity in the Arizona Assigned Risk Plan (the involuntary market) indicates the nonstandard market is writing risks that would otherwise go into the Assigned Risk Plan. There is only one PPA policy written in Arizona's Assigned Risk Plan in 2013. This is the renewal of the one policy written in 2012.

Trend # 5. It appears that a few large groups will dominate the market and smaller, non-group affiliated insurers will have difficulty competing with them. All Top 25 insurers are members of 12 groups. In 2013, there was an overall market share net gain of .47% for the Top 25 insurers.

Trend # 6. Total written premiums and rates increased for Arizona's insurers in 2013, while insurer participation diminished. In 2013, Arizona's Direct Written Premium (DWP) increased 5.57% compared to an increase of 3.18% in 2012. Insurer rate changes during 2013 resulted in a weighted average total rate change of 4.35%, down from the 5.43% in 2012. Increased DWP and rates, coupled with diminished insurer participation suggests a tightening of the market.

Trend # 7. The average policy premium decreased. In 2013, the average policy premium decreased to \$1,123 from \$1,130 in 2012. However, the average premium per vehicle increased from \$782 in 2012 to \$785 in 2013.

Trend # 8. More insurers report historical unprofitability for the PPA line. In 2014, 12.39% of the market viewed PPA as unprofitable, compared to 5.80% of the market in 2013. The overall PPA incurred loss ratio increased from 62.60 % in 2012 to 65.18% in 2013; however, the combined loss ratio decreased from 113.50% in 2012 to 104.73% in 2013.

Trend # 9. Frequency of losses increases, while severity decreases. The number of paid losses and the amount of paid losses increased, while the average dollar amount of paid claims decreased. This could be due, in part, to a 3.3% increase motor vehicle traffic fatalities as reported in the National Highway Traffic Safety Administration's (NHTSA) 2012 Fatality Analysis Report. According to the NHTSA's Fatality Analysis Reporting System, 2012 was the first year with a year-to-year increase in fatalities since 2005.

Another possibility comes from a study from the Insurance Research Council (IRC) which reveals a growth in medical care costs and a shift toward more expensive treatment and diagnostic alternatives, as well as, dramatic increases in billed charges for visits to many types of medical providers. The use of pain clinics, attorney involvement and claim abuse were also found to exacerbate the increases in medical care expenses in spite of the fact that the severity of the injuries themselves remain on a downward trend.

Trend #10. Underwriting is becoming less liberal. Insurers (2.24%, 2014; 5.46%, 2013) continue to take a less liberal underwriting stance as losses and underwriting expenses continue to climb. More insurers are turning to predictive analytics and other innovative technologies to help analyze risk selection,

better identify and price risks, fight fraud, retain profitable customers, and attract new customers and growth. Insurers have begun modernizing policy administration systems, establishing web-based portals and mobile platforms, offering high-tech mobile applications and telematics devices/services to attract and develop stronger customer relationships. Competition and underwriting both have an effect on insurers and the approach they take to increase their market share while remaining profitable.

VI. Conclusions:

The Arizona PPA market remains healthy and competitive, and insurers view the Arizona market favorably. This environment attracts new insurers to enter the market, even though the intense competition makes it more difficult for new, independent insurers to write sufficient premium volume to offset expenses, pay claims, and remain profitable.

Competition among the Top 25 and insurer groups is intense. The public is benefiting from rates that remain relatively stable and from competition for increased market share. Very few drivers need to seek coverage in the higher priced Assigned Risk Plan as the standard and nonstandard marketplace is willing to insure the higher rated risks.