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Strategy: Reshaping auto insurance

The insurance industry in 2013

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Strategy: Reshaping auto insurance

Several factors aimed at road and vehicle safety are increasingly likely to reshape the auto insurance industry. From numerous advancements in car and truck technologies, to federal and state legislation on driver behavior, to government investments in roads, highways and intersections, insurers should prepare for a changing landscape – though not necessarily fewer opportunities.

State of the art technologies, such as automatic braking, telematics, location awareness, vehicle-to-vehicle (V2V) communications, improved stability control for large commercial vehicles, collision avoidance sensors and technologies, and driverless cars, promise considerable reductions in the frequency and severity of auto collisions. This could significantly reduce auto insurance premiums – in fact, the ongoing evolution of previously unavailable technologies is causing many to wonder if auto insurance will go the way of the Edsel.

At least for the foreseeable future, we think that business will continue more or less as normal for the industry. Better vehicle design, anti-lock braking, stability control, airbags, back-up cameras, and other features are now common throughout model lines, yet the cost of auto insurance held steady with inflation in the US for the decade leading up to 2009.[1] While telematics have the potential to reduce premiums for some drivers – early adopters in particular are likely to be less risky customers and receive the greatest discounts – they actually may help the industry price policies more effectively overall.

A series of cost factors and adoption resistance will continue to buoy premiums: high repair costs for increasingly complex vehicles, increasing medical costs for injuries, more frequent and devastating natural disasters, consumer advocates raising potential privacy risks, and electronic malfunctions that fail to reduce accidents. Moreover, customers are often slow to adopt new technologies as they evolve because they do not fully understand them, high purchase costs, or the natural inertia of wanting to fully utilize durable products for much of their lengthy lifecycle. In fact, the age of American cars and trucks on the road recently reached a record high of 10.8 years.[2]

In terms of government action, the recent passage of Graduated Driver Licensing legislation, which includes federal incentives and state-level implementation, focuses directly on teen driver safety; it increases practice hours and the minimum ages for permit and licensing, and imposes limitations on numbers of passengers and night driving. This ideally will reduce young driver accidents and could eventually lead to lower premiums.

Another safety initiative, installation of cameras to monitor the running of red-lights and speeding, appears not to have its intended impact yet, both in terms of the installation rate (given high costs) and results (which, per follow-on effectiveness studies, have been mixed). A Federal Highway Administration study of 132 treatment sites found that red-light cameras do reduce right-angle crashes but increase rear-end collisions, a fact which could hamper adoption.[3] As far as speeding cameras are concerned, a recent study revealed that areas with cameras experience an eight to 49 percent reduction in all crashes.[4] This is good news for safety, but installing more speed cameras could have a dual effect on insurance premiums. On one hand, speed cameras could provide an incentive for drivers to drive more cautiously, which would reduce the number of accidents and therefore place downward pressure on auto insurance premiums. Conversely, premiums could climb as the number of speeding tickets increase, and carriers penalize those who receive them for their risky behavior.

All of this is not to say that there will not ultimately be a significant reduction in driver premiums, but significant environmental forces and natural inertia mean that they will not occur overnight.

1 National Association of Insurance Commissioners, 2009, available on www.iii.org

2 USA Today, "Our cars are getting older, too: Average age now 10.8 years," January 2012. Available at http://usatoday30.usatoday.com/money/autos/story/2012-01-17/cars-trucks-age-polk/52613102/1

3 Available at: http://www.fhwa.dot.gov/publications/research/safety/05049/

4 Cochrane Database of Systematic Reviews, "Do speed cameras reduce road traffic crashes, injuries and deaths?", May 2010. Available at http://summaries.cochrane.org/CD004607/do-speed-cameras-reduce-road-traffic-crashes-injuries-and-deaths

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Future scenarios

Although current technology and legislation are still very much works in progress, there are strong forces that do stand to reshape the sector, including shifts to new types of coverage, alternative distribution channels, and redefined customer segments. We envision three highly possible evolutionary changes to the personal auto insurance industry's products, distribution, and customers, as well as one more truly transformative change that, if it occurs, would significantly affect the shape and size of the industry as we know it.

1. **Risk shifting** – Advanced automotive technologies that reduce collisions, such as location awareness and automatic braking, will increasingly shift the risk of driver error to the risk of mechanical malfunction. This would shift driver liability to manufacturers and result in a new form of auto insurance that could be packaged with cars that rely on these technologies. In turn, this would shift the key buyer from the end-consumer to the manufacturer, and fundamentally change the entire value chain, from product definition to pricing, marketing, distribution, underwriting, service, and claims. If carriers decide to market this coverage to consumers, then they would do so either at the point of sale, or perhaps try to increase market share by co-marketing with the manufacturer and/or dealer.
2. **Risk sharing** – Smartphone apps and social networking have already started to play a role in collision reduction. In addition, the dramatic rise in social networking has enabled individuals to develop new affinities wherein people with similar attitudes, interests, and behaviors can pool resources to share risk and lower overall costs. For example, there are new carriers that combine social networking with insurance by connecting customers to form insurance networks that promise significantly lower premiums. These carriers claim that their models allow insurers to access new customers virally, decrease process costs, and reduce claim ratios. While, on the one hand, this represents the potential for lower rates for more groups, on the other hand, it also could make insurance more affordable for some and therefore lead to premium growth.
3. **Risk slicing** – Urban living and the increasing availability of automotive time-sharing suggests a future in which premiums move from 24-hour asset coverage to a pay-per-use model. Over 80 percent of the US and over 50 percent of the global population is considered urban; understandably, car sharing is rapidly growing. According to a Frost & Sullivan research estimate that Forbes reported in March 2012, the global car sharing market could exceed $10 billion by 2020, and the North American car sharing market alone could surpass 4.4 million members and $3 billion by 2016. As a result, an increasing number of low-frequency drivers is likely to mean at least some reduction in individual premiums.

   However, this scenario does not necessarily represent only lost premiums. Most of the people do not choose to own cars will need to rent them at least occasionally; accordingly, car sharing can expand the market for alternative buyers of insurance.

4. **Risk reduction** – Unlike the above scenarios that represent significant change but not necessarily extreme disruption to the insurance industry, driverless cars equipped with the latest awareness technologies could completely change the industry as we know it. Google, Inc.'s auto research investments are hastening the eventual, widespread availability of driverless cars. Google's driverless, laser-equipped vehicles have logged over 300,000 miles without an accident; moreover, the company has begun investing in the research and development that initially sets and then drives down the costs of new technologies. Driverless cars are now legal on California roadways, and Google's US spending on advocacy of driverless vehicles exceeded $9 million in just the first half of 2012.[5] Google estimates that the technology can reduce traffic accidents, the number of cars, and wasted commute time and energy by 90 percent, thereby resulting in savings of $2 trillion per year for the US economy.[6]

   Moreover, in March 2012, J.D. Power and Associates found 37 percent of US consumers were interested in autonomous driving technology. More impressively, the first phase of the NHTSA's Safety Pilot revealed that 9 out of 10 drivers who experienced V2V technology "have a highly favorable opinion of its safety benefits and would [value] V2V safety features on their personal vehicle."

Driverless cars equipped with the latest awareness technologies could completely change the industry as we know it.

Implications

- Mobile telematics and recent automotive safety features are helping insurers price and manage risk better and definitely are the wave of the future. However, until more drivers utilize them (e.g., through the purchase of a new vehicle), their effect on insurers will be minimal.
- Legislation that ostensibly promotes driver safety so far has had a limited effect on insurers and premiums. Any future developments could cut both ways – a reduction in premiums for safe drivers and an increase for more frequently penalized ones – and result in consistent premiums revenue overall.
- The rise of affinity groups could lead to more risk-sharing; while this could lower prices per premium, increased policy affordability could lead to overall premium growth.
- Risk slicing has the potential to reduce the need for more traditional coverage, but could lead to an increase in the market for alternative coverage.
- Self-driving vehicles have the potential to significantly disrupt the traditional auto insurance industry. While the vehicles currently are on the roads, their widespread use – as well as the infrastructure to support them – is not likely to become a reality for many years.

Whatever the future holds, the automotive insurance business *is* going to change. Despite some doomsday predictions for the industry, there are opportunities for insurers to develop innovative new products, alternative distribution approaches, and new customer segments which can help them thrive, not just survive. The carriers that can think creatively about new markets and potentially drastic changes to automotive technology and ownership will be the ones who are most likely to successfully navigate the path to the future.

5 Wall Street Journal Online, "Google's Driverless Car Draws Political Power," October 12, 2012

6 Forbes, Jan 22, 2013, Fasten your Seatbelts: Google's Driverless Car is Worth Trillions (Part 1), Chunka Mui. Available at http://www.forbes.com/sites/chunkamui/2013/01/22/fasten-your-seatbelts-googles-driverless-car-is-worth-trillions/

Auto insurance

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