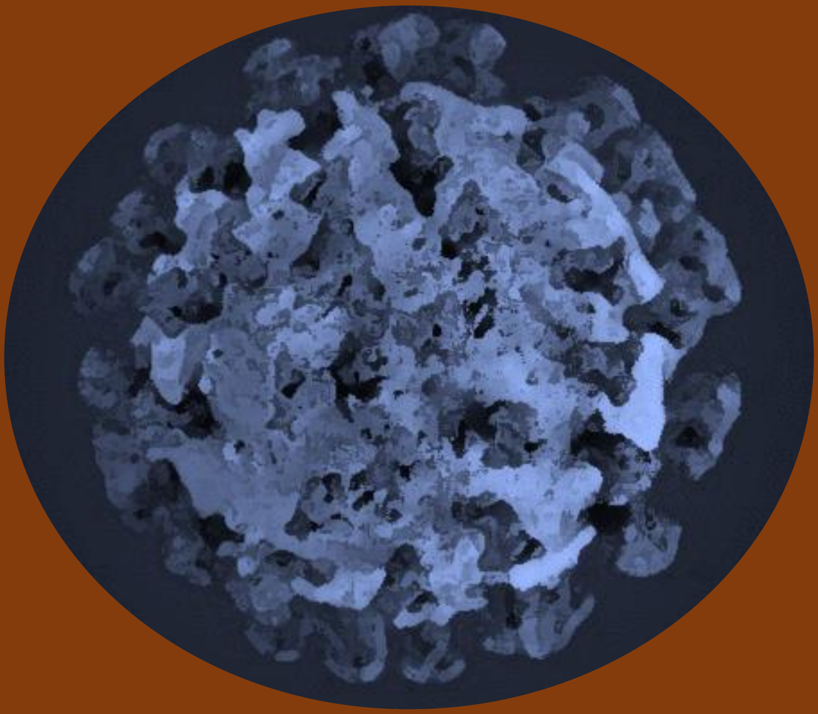


COVID-19 and Auto Insurance:

Evaluating the impact of COVID-19 on the Auto Insurance industry and embracing potential opportunities

Updates to Part 1 & 2

Phil Wintering

OUTPERFORM ASSOCIATES

Abstract

In Parts 1, 2, and 3 we examined how COVID-19 economic shutdowns have and will create revenue pressures throughout the auto insurance industry, as well as the potentially dramatic, yet uneven, impact of shutdowns on market segments and distribution channels. We also discussed the need for each company to quickly build tailored strategies driving decisive actions to limit negative impacts from COVID-19 shutdowns and take advantage of potential opportunities generated by the pending market uncertainty and upheaval. This document considers recent developments and any potential shift in market direction and conclusions from Parts 1 and 2.

Methodology

This series is predicated on OutPerform's experience in the auto insurance space and extensive research into the present environment due to the COVID-19 pandemic. The challenges and hypotheses discussed in these articles were created in conjunction with CEOs, Presidents, and EVPs of more than a dozen companies in the auto insurance space, including executives from a Top 5 auto insurer, Mid-Sized Standard auto carriers, Non-Standard auto carriers, MGA's, and Insurtechs. More recently, we have also interviewed multiple national and regional independent agency executives to gain a greater perspective.

In our interviews with these executives, we found general agreement on some topics and stark differences on others. Most of these differences correlate to the respondent's position in the marketplace (e.g. capitalization, rate adequacy, customer profile, state footprint, etc.). Based on all of these inputs, we have developed the most probable outcome(s). As a final note, due to the novel nature of our current environment, it's worth noting that the challenges we address here, and our recommended solutions, may change over the coming months.

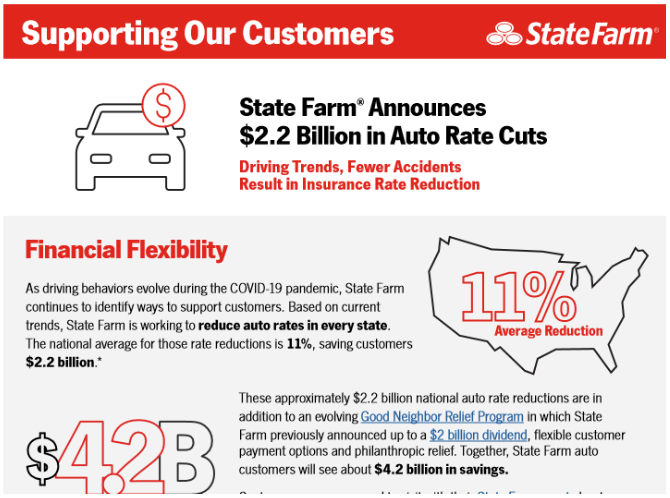
Given the sensitive nature of some responses, our contacts asked that their comments be anonymized. We appreciate the input of all of the executives that shared their thoughts and time.

Update – Part 1: Revenue Pressure and Preservation

Revenue Impact:

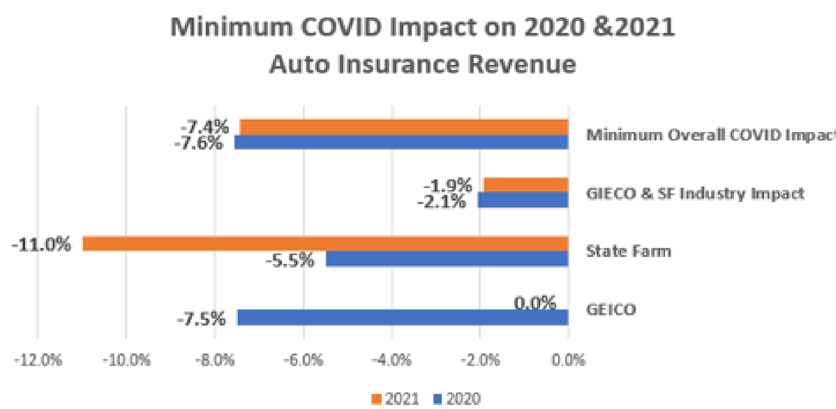
In Part 1 of this series, we documented the anticipated impact of COVID on industrywide auto insurance revenue in 2020, including an increase in bad debt resulting from state insurance departments' mandates and guidance on cancellations, short-term premium givebacks by carriers due to reduced driving, the potential of consumers reducing coverages, and an increase in uninsured motorists. We expected this would result in an industrywide drop in 2020 written premium of at least 5% - 6%, with the potential for as much as 11% - 13%; since publishing Part 1 in May, it has become clear that these estimates were **understated**.

Two of the four largest auto insurers (GEICO and State Farm), representing 32.3% of all auto insurance written premium, have announced significant premium reductions:



- GEICO has announced a 15% premium giveback on all new and renewal policies for both six- and twelve-month policies. This will result in a $2.67 billion reduction in GEICO's 2020 revenue.[1]
- State Farm has announced it is filing a premium reduction in all states averaging 11% due to evolving "driving behaviors during the COVID-19 pandemic."[2][3] State Farm indicates this will result in a reduction in 2020 premium of $2.2 billion, which would imply an average implementation date in mid-July. This will have an even greater impact on 2021 premium, reducing State Farm's annual revenue by $4.64 billion.

The combined effect of these actions will impact auto insurance written premium through at least 2021. We will discuss potential motivations for these actions and the impact of this on pricing and the potential of a soft market later in this document.

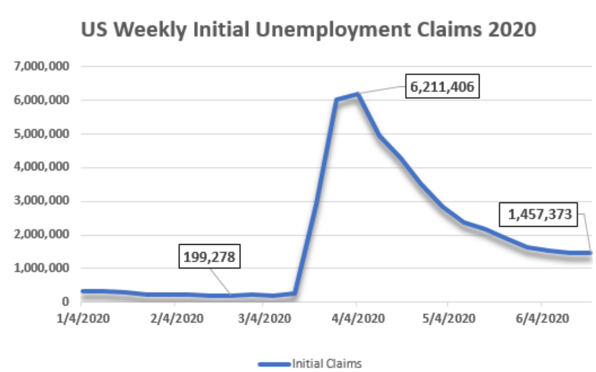


Retention and Price Sensitivity:

Our discussion on declining retention and increased price sensitivity in Part 1 was heavily predicated on 33.5 million COVID layoffs to that point. This raises two questions:

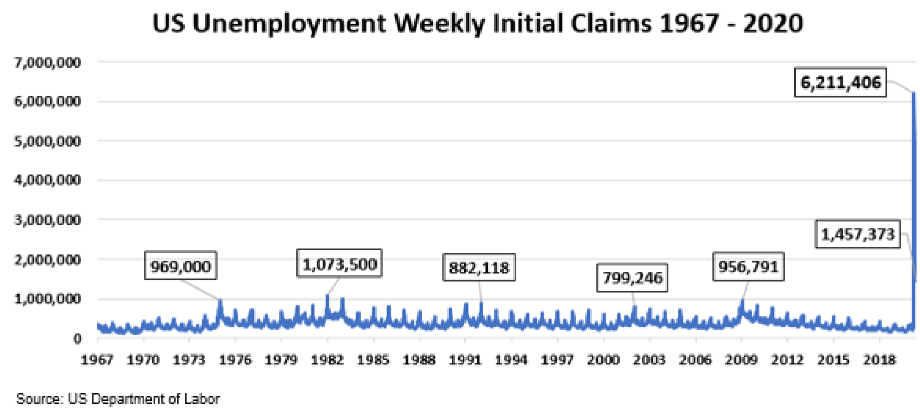
1. Will layoffs continue?
2. Will there be a rapid economic recovery or will unemployment claims continue long time?

If economic lockdowns are lifted quickly, employees return to work, and layoffs return to pre-COVID-19 levels before the massive government subsidies run out, the most severe increases in auto insurance price sensitivity and reductions in retention will be avoided. This will certainly not happen by the end of July when subsidies run out. Consequently, the road ahead will not be smooth without continued subsidies and may resemble more of a roller coaster.

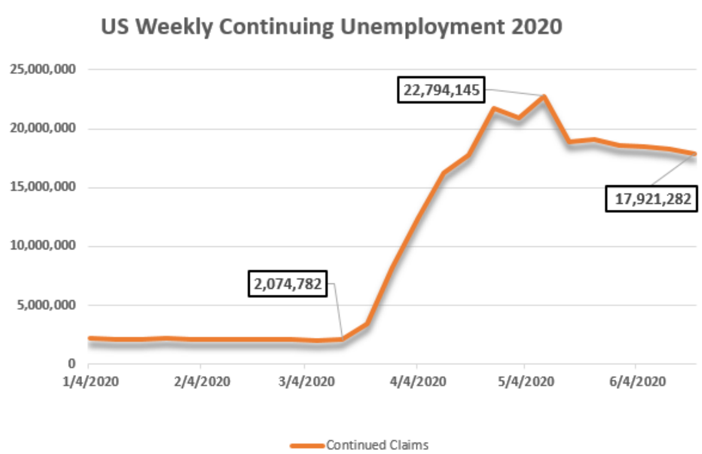


The economy has been showing some substantial signs of improvement, as weekly jobless claims have come down by 75% from the COVID-19 shutdown peak of 6.2 million in the first week of April. While this is definitely positive news, as of June 27th weekly layoffs still remained at approximately seven-times the pre-COVID-19 level; and, the total number of jobless claims have risen from 33.5 million to 44.7 million. As COVID lockdowns have eased, this has resulted in significant short-term improvements to the unemployment rate dropping 1.3% in May to 13.2% and another 2.1% in June to 11.1% with a net increase of 4.8 million jobs in June.[4] Unfortunately, this is still dramatically higher than February's unemployment rate of 3.5%.

To provide some perspective on the severity and impact of weekly jobless claims, reviewing all significant economic downturns since 1967, including the 1975 oil crisis, 1980-82 recession, 1992 recession, the .com bust, and the Great Recession, only one week had job losses exceeding 1 million (January 9, 1982); through June 27th, we have now had 15 straight weeks with job losses exceeding 1.4 million!



Yet, the partial reopening of the economy in many states and shifts to other means of conducting commerce have reduced the total number of jobless workers, with active jobless claims dropping 21.4% between April and June to 17.9 million. The key to how COVID-19 affects auto insurance is how many employees remain off of work at any point going forward. In this respect, it is a little bit of a "mixed bag"; while the numbers have been moving in the right direction, there is still significant unemployment and the recent spike in COVID-19 cases nationally is creating additional uncertainty over future employment numbers. Unfortunately, there does not appear to be a straight line to returning to pre-COVID-19 unemployment numbers and a full economic recovery does not appear probable until the virus is more fully contained.



The greatest impact on auto price sensitivity and policy retention, however, will be felt after federal subsidies are exhausted at the end of July. Without further federal action on COVID-19 relief, rapidly increasing price sensitivity, increased quoting, and declining policy retention remains highly probable between August and December of this year. Worse, we expect this condition to persist into 2021.

It should also be noted that this situation may be exacerbated when funds from the PPP loans designed to keep employees on payrolls are exhausted, which could cause a new spike in unemployment claims. The complexity of the political, economic, and medical environments make it difficult to predict the full extent of the pandemic's impact and require continuous monitoring of the situation over the coming months.

Soft Market – Price War:

In our continuing discussions with an expanding group of carrier executives, the prospect of a soft market remains a hotly debated topic. Some believe the industry has become far more disciplined in pricing, while others believe a soft market is inevitable. While the situation isn't entirely clear, there are some early developments that may provide hints on where this is headed.

To start with, if a price war erupts it will be triggered by one or both of two factors:

- Declining policy retention rates and the need to retain the written premium scale necessary to cover fixed costs
- Prolonged reductions in loss costs due to reduced driving

These factors will be driven by the rate of continuing unemployment, the availability of federal relief funds for the unemployed, the duration of economic shutdowns, the percentage of people continuing to work from home, etc. These drivers will vary both by state and by market segment. Consequently, we expect the probability and severity of a soft-market will also vary by state and market segment.

Some early developments could be possible indicators of a soft and reveal motivations of carrier actions.

Large carriers seem poised to grab market share: Three of the four largest carriers have taken significant action beyond what was discussed in Part 1. As indicated above, State Farm is taking a rate reduction of 11% nationwide and GEICO is providing a one-time, 15% premium giveback on a full policy term for all new and renewal policies. Progressive on the other hand has not reduced rates or provided a premium giveback beyond their initial effort in April. Instead, they are making an aggressive move to further dominate the IA channel through significant agent incentives, with some national agents reporting a $100 bounty per policy above target new policy count thresholds.

Price discipline has held to this point (mostly): To date, the only national carrier that has announced significant, nationwide rate decreases is State Farm. There are also more localized rate reductions reported for some national and regional carriers. For example, Progressive reduced rates in Indiana by 10%, effective June 10th. Other carriers are providing additional short-term premium relief in an effort to limit any drop off in policy retention. GIECO's 15% premium giveback on new and renewal policies is an example of these efforts, but this this not limited to the largest carriers. For example, State Auto is providing a 5% reduction in renewal premiums as of June 1st, which appears to be an effort to shore-up renewals and limit the revenue impact of premium givebacks to loyal customers. In our expanded conversations with carriers, as well as national and local agents, there were no other reports of broad-based rate reductions to this point. There were also very few reports of rate increases. It is still too early to know if there will be a sustained impact from COVID-19 on the two factors that could drive a soft market. Over the next 3 – 6 months as federal unemployment subsidies end, and a deeper understanding of changes to driving patterns and loss costs are better understood we will have a much clearer picture with regard to a soft market. The degree of this clarity is dependent upon some level of consistency in the prevailing environmental factors. E.g. Knowing if federal unemployment subsidies will be extended, a flattening in daily COVID-19 cases, continuing improvements in treatments and death rates, continued reductions in the level of economic shutdown, etc.

Non-standard soft market more probable: A higher probability of a soft market in the non-standard and middle market segments appears to be emerging in our discussions with agencies and NSA carriers. Some NSA carriers have indicated they may be seeing the beginnings of higher non-payment cancellations as cancellation moratoriums end and agents report increasing numbers of consumers opting to go uninsured in the NSA segment. Given the number of thinly capitalized carriers and MGA's in the NSA segment, an expansion of these consumer behaviors may force rate reductions in an effort to maintain the necessary operational scale for these companies.

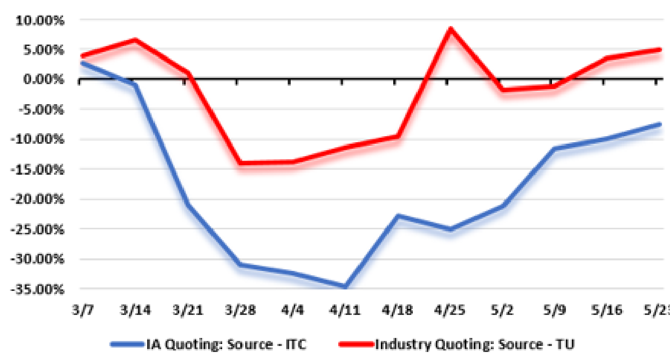
Update – Part 2: Distribution – Impact by Market Segment

We discussed ITC's April 27th report[5] outlining the expectation that auto insurance quoting by independent agents would continue to lag expectations due to COVID-19 and that at least some of this quoting appeared to be moving online. These initial findings appear to be corroborated by comparing ITC's most recent weekly COVID-19 "weather report[6]" with TransUnion's June 12, 2020 snapshot report on auto insurance shopping volumes[7].

> **"The Forecast**
>
> *ITC predicts that quoting volumes will continue to remain below the expected quote activity settling between 24% and 27% for the week."*
>
> *ITC*, State of Insurance Rating COVID-19 Weather Report #5, April 27, 2020

TransUnion provides more than 40% of all insurance scores for quoting to the auto insurance industry; consequently, TransUnion's quoting trends are an excellent proxy for tracking trends in overall insurance quoting. Similarly, ITC provides agents with over 60 million auto insurance rates a month and is therefore an excellent proxy for tracking trends in IA quoting. As the COVID-19 impact increased and shutdowns began it appears that some quoting initially shifted from agencies to online quoting. This quickly converted to a rapid slide in all auto insurance quoting as uncertainty increased, lockdowns spread, and layoffs began. The impact on consumer interactions with local agents was far more severe than the overall market impact and remains so even as overall auto insurance quoting is now above the 2019 benchmark. In the most recent week studied, TU found overall quoting has increased 5% year-over-year while ITC found quoting by local agents is still off by over 7%. This represents a significant shift in the share of quotes generated by online and sales center quoting. As previously noted, we anticipate the volume of insurance quotes to increase substantially in the months to come unless the expanded unemployment benefits of $600 per week are extended past the end of July.

Auto Insurance Quoting Trend Due To COVID -19 IA Channel v. Industry Chart Title



Sources: 1) ITC – State of Insurance Rating COVID-19 Weather Report #1 – #10, March 30 – June 8, 2020
2) TransUnion – Insurance Shopping Snapshot Report, June 12, 2020

These developments support our hypothesis that COVID-19 is accelerating the shift of quoting traffic to online and call center platforms. We believe these trends will continue throughout the pandemic and may become permanent.

Conclusion:

Our observations and findings on the impact of COVID-19 in Parts 1 and 2 of this series have been reinforced by intervening events and we believe will maintain their validity in the months to come as the revenue impact to the industry continues expanding, continued unemployment remains high threatening policy retention and increasing price sensitivity, the trend toward direct purchasing continues, and the largest companies begin to focus on increasing market share.

We continue to believe it is essential that every auto carrier and MGA assess their unique situation and how this crisis will affect the company in order to develop a strategy and executable plan to address the challenges and opportunities from COVID-19

Where necessary, OutPerform can provide critical assistance in assessing current capabilities, market position, key challenges and opportunities, and building a unique strategy to address the impact of COVID. We look forward to discussing this further should you have the need.

About OutPerform Associates:

We provide guidance and assistance to P&C insurance carriers in building, implementing, and optimizing winning distribution and operational strategies.

Contact Information:

Email: info@outperformassociates.com
Phone: 440-725-8110
Web Site: OutperformAssociates.com

Citations

(1) https://www.geico.com/about/coronavirus/
(2) https://newsroom.statefarm.com/auto-rate-cuts-total-2-billion-savings/
(3) https://newsroom.statefarm.com/state-farm-decreases-il-auto-rates-2020/
(4) https://www.bls.gov/news.release/pdf/empsit.pdf
(5) https://resources.getitc.com/itc-blog/state-of-insurance-rating-covid-19-weather-report-5
(6) https://resources.getitc.com/itc-blog/state-of-insurance-rating-covid-19-weather-report-10
(7) https://content.transunion.com/v/ins-shopping-june-snapshot-report