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Auto Insurance

# Driving Value

A new study reveals the characteristics and strategies of high-performing auto insurers.

by Bill Pieroni

## Key Points

**What Was Examined:** The study was designed to answer three key questions: How should value creation be measured across P/C carriers? Which strategies and tactics lead to sustained value creation? What key capabilities and execution imperatives drive sustained value creation?

**Additional Focus:** The study also conducted additional analysis to evaluate the impact of auto lines and identified the characteristics of high performers.

**Major Conclusion:** One consistent finding across ACORD's studies was that high performers were able to effectively and simultaneously execute against the four fundamental insurance strategies: customer intimacy, product leadership, innovation and operational excellence.

Achieving and sustaining value creation in the U.S. property/casualty market is a challenging task for most carriers, particularly across personal and commercial auto lines.

In order to better understand critical operational and strategic imperatives, ACORD annually performs a comprehensive value analysis of the 100 largest U.S. property/casualty carriers, leveraging A.M. Best data, interviews and extensive market research. The 2018 *ACORD U.S. P&C Value Creation Study* was specifically designed to answer three key questions:

- How should value creation be measured across P/C carriers?
- Which strategies and tactics lead to sustained value creation?
- What key capabilities and execution imperatives drive sustained value creation?

Ultimately, ACORD identified the strategic and tactical imperatives supporting high performance among P/C carriers. These included a carrier's ability to execute across four discrete but interrelated areas of strategic focus.

As an extension to the broader property/casualty study, ACORD conducted additional detailed analysis of personal and commercial auto lines. Using the original data and insights as a base, ACORD conducted additional analysis to evaluate the impact of auto lines and identified the characteristics of high performers. While some results were remarkably consistent across lines of business, others showed a material difference between lines.

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### Value Creation in Property/Casualty

The *ACORD U.S. P&C Value Creation Study* is based on an analysis of the statutory financial filings of the largest 100 carriers over a 10-year period. Using A.M. Best's Financial Suite, ACORD applied a proprietary cash flow model to measure value creation in terms of timing, magnitude, duration and sources. First, the level of free cash flow generated by each carrier was aggregated across underwriting and investment activities. The cash flow was then measured against a required capital charge determined by applying an annual required rate of return to total invested capital. Based on the level and source of value generated, carriers were segmented into three discrete categories:

- **Sustainable Value Creators:** Insurers meeting required returns through underwriting and investment activities.
- **Hollow Value Creators:** Insurers meeting required returns through investment activities, but failing to generate value through underwriting.
- **Value Destroyers:** Insurers failing to generate required returns over the study period.

The 43 carriers identified as Sustainable Value Creators generated $158 billion in value and achieved a combined ratio of 95.3, well below the Top 100 average of 100.3. While the *ACORD U.S. P&C Value Creation Study* did not seek to predict total shareholder return, it was nonetheless uncannily accurate. The insurers categorized by ACORD's model as Sustainable Value Creators outperformed every major stock index by a material amount. As a group, the Sustainable Value Creators that were publicly traded delivered a total shareholder return of 118%, more than twice the average of the S&P 500 over the study period—no small feat in a bull market.

Further research was conducted on the operational attributes of these carriers in order to determine how key characteristics—including business mix, channel strategy, scale, and digital maturity—correlated with performance. In this way, ACORD identified common drivers of success among Sustainable Value Creators.

### Personal and Commercial Auto Analysis

More recently, ACORD performed a detailed extension focused on personal and commercial auto lines. This study evaluated performance across these lines—individually and in relation to one another—specifically among the carriers classified as Sustainable Value Creators. Based on whether auto lines were accretive to overall value creation, the Sustainable Value Creators were further segmented into Superior Performers, Investors and Value Diluters for each line of business.

The 100 largest P/C insurers were screened through a multistep process for commercial auto lines, and then separately for personal auto lines:

1. **Did the carrier write this line at all?** If not, they were obviously not examined.
2. **Did the carrier create sustainable value overall?** Only those insurers identified as Sustainable Value Creators in the study were examined. Hollow Value Creators and Value Destroyers, though their metrics contributed to the study average, were not further segmented by performance.
3. **Was this auto line accretive to value?** An operating ratio less than 100 was considered value-accretive. Carriers failing to satisfy this criterion were classified as Value Diluters—that is, the auto line in question negatively impacted the carrier's otherwise high performance.
4. **Was auto underwriting accretive to value?** Carriers achieving a combined ratio (less policyholder dividends) of under 100 were classified as Superior Performers across the auto line in question. Carriers failing to satisfy this criterion, although the auto line overall was value-accretive, were classified as Investors—that is, this line only created value by offsetting underwriting loss with investment income.

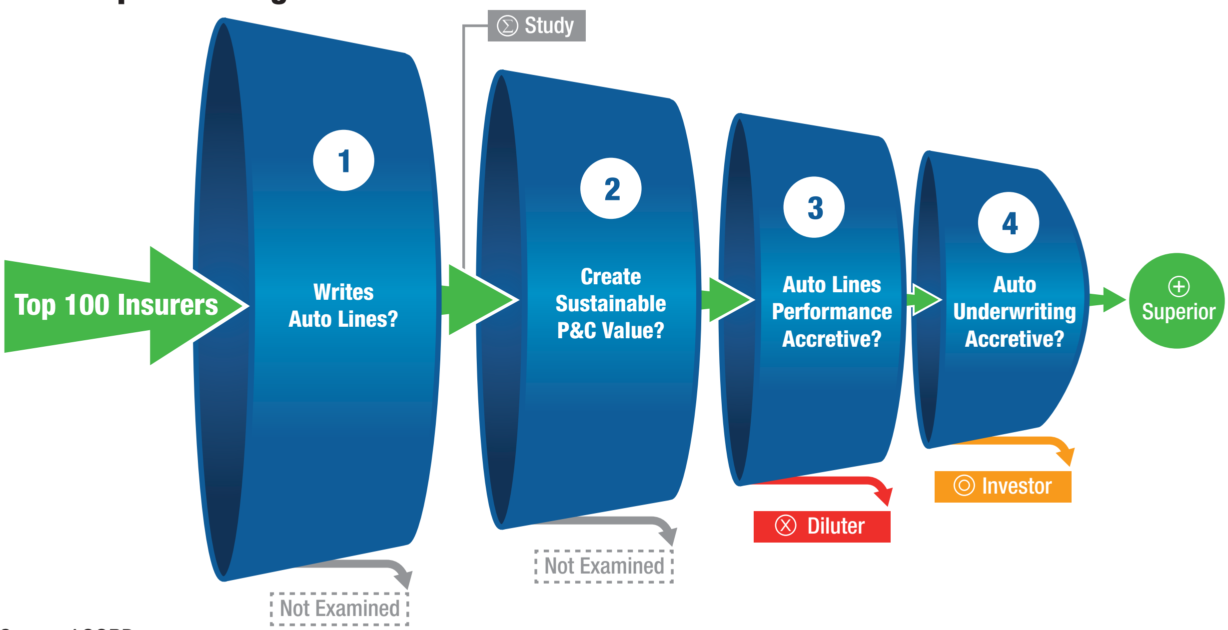
Carriers in each category were then examined across multiple characteristics to identify the strategies and capabilities associated with high and low performance in auto lines.

### Top 100 U.S. Property/Casualty Insurers

| | | 2017 NPW | | 10 Year Results (2007 – 2017) | |
|---|---|---|---|---|---|
| | Number of Carriers | (US$ billions) | (%) | Combined Ratio (%) | Value Created / Destroyed (US$ billions) |
| Sustainable Value Creators | 43 | 261 | 52 | 95.3 | 158 |
| Hollow Value Creators | 27 | 103 | 21 | 105.8 | 18 |
| Value Destroyers | 30 | 133 | 27 | 104.8 | -36 |
| Top 100 | 100 | 497 | 100 | 100.3 | 140 |

Source: ACORD research using A.M. Best and proprietary data.

## Multistep Screening Process




Source: ACORD

### Commercial Auto Lines

Of the 37 Sustainable P/C Value Creators who wrote commercial auto lines, more than half (21) qualified as Superior Performers. Of the remaining carriers, 10 were Investors and six were Value Diluters for commercial auto lines. While this may give the impression that it is relatively easy to create value in commercial auto lines, this is not the case. It must be recognized that in order for the commercial auto book of business to be evaluated, the carrier had to be a Sustainable Value Creator overall. Interestingly, for those carriers identified as Superior Performers, these lines represented less than 5% of the book. Among lower-performing carriers, commercial auto lines accounted for a significant proportion of total premiums. One might think that when a line is a small part of the overall book, it will receive less attention and perform less well—but this is clearly not the case here.

Another somewhat counterintuitive result was the correlation between size and performance. The Superior Performers accounted for 57% of the carriers studied, but wrote 73% of all premium dollars—clearly there are benefits of scale. Historically, small carriers outperformed their larger competitors, but this expectation appears to no longer hold true. ACORD has seen this fundamental shift in multiple performance studies, and it appears to indicate the fruition of committed investment in technology. In particular, the *ACORD Insurance Digital Maturity Study* found that those who were willing and able to devote the resources to developing digital capabilities captured tangible benefits.

These benefits include an unprecedented ability to underspend in both pure loss and loss adjustment expense (LAE) simultaneously. In fact, Superior Performers in commercial auto had lower-than-average operating ratios in not only both of these categories, but all other expenses as well—except for one. Superior Performers showed higher commission expenses than Investors and Diluters. While the exact nature of this correlation between high commission ratios and performance is not entirely clear, it would seem that Superior Performers are willing to spend to leverage agent and broker expertise in selecting favorable risk and high-lifetime-value customers.

## Commercial Auto

| | | 2017 Commercial Auto Net Premiums Written | | 2012-2017 Average Ratios (%) | | |
|---|---|---|---|---|---|---|
| | Number of Carriers | (US$ billions) | (%) | Loss & LAE | Underwriting Expense | Combined* |
| Superior Performers | 21 | $11 | 73% | 71.3 | 27.1 | 98.5 |
| Investors | 10 | 3 | 20 | 81.8 | 32 | 113.8 |
| Value Diluters | 6 | 1 | 7 | 79.8 | 33.7 | 113.5 |
| Study Total | 37 | 15 | 100 | 78.2 | 29.4 | 107.7 |

*Includes policyholder dividends
Source: ACORD research using A.M. Best and proprietary data.

Ultimately, what strategies and capabilities resulted in superior performance in commercial auto lines? One obvious characteristic was that they all excelled at core insurance activities: underwriting, claims and service. Beyond this *sine qua non*, the study found that all Superior Performers matched at least one of four profiles:

- **Scale reinsurers.** These companies benefited from "flight-to-quality" in a soft market cycle, coupled with price parity as a result of reinsurance's ability to "price-to-market."
- **Commercial/personal line synergy.** This was not a result of cross-learning, but a more indirect effect. Having strong personal lines bolstered an insurer's branding, positioning and attractiveness to talent.
- **Strong agent relationships.** As shown above, the willingness to invest in agents and brokers was a key component of superior performance.
- **Hyper-specialized underwriting focus.** Commercial auto includes opportunities for carriers to focus on niche segments and develop focused expertise in business that others shy away from.

### Personal Auto Lines

Personal auto lines showed more mixed results across Sustainable P/C Value Creators. Of the 36 who wrote personal auto, there was a relatively uniform distribution among Superior Performers (14), Investors (12), and Value Diluters (10). Although having strong personal lines led to success in commercial auto for many carriers, the reverse was not necessarily true—personal auto presented its own difficulties.

However, for those who performed well in personal auto, it was a key driver of their overall success. Unlike commercial auto, having a greater percentage of personal auto lines in a carrier's book of business tended to drive better results. For Superior Performers, personal auto was a significant part of their book—in fact, for most of them, it accounted for more than 50% of premiums. Investors and Diluters were underweight in personal auto by comparison.

Another difference between commercial and personal lines was evident in the carriers' operating ratios. While commercial Superior Performers underspent in every area except commissions, personal auto Super Performers were strikingly opposite. Superior Performers' lower underwriting expenses were almost entirely due to extremely low commission spend. Superior Performers actually showed higher-than-average operating ratios across most areas—from pure loss to LAE to acquisitions—but dramatically overcame this by underspending on commissions. Clearly, direct writers excelled in personal auto lines—in fact, they dominated the Superior Performer category.

One factor that was consistent between commercial and personal auto writers, however, was scale. Among Sustainable P/C Value Creators, absolute size drove higher performance in personal auto lines. The benefits of scale in such areas as marketing, technology enablement and data and analytics enabled larger carriers to outperform.

Superior Performers in personal auto fit into one or more of three categories:

- **Direct Writers.** As noted above, this included the majority of the Superior Performers. Their ability to underspend on commissions had a profound result on the bottom line.
- **Multi-multistrategy.** These carriers embraced a strategy which involved multiple brands, multiple products and multiple channels—all three were required for success.
- **High strategic focus.** These carriers maintained a tight and disciplined focus in product offerings, customer segmentation and/or geography.

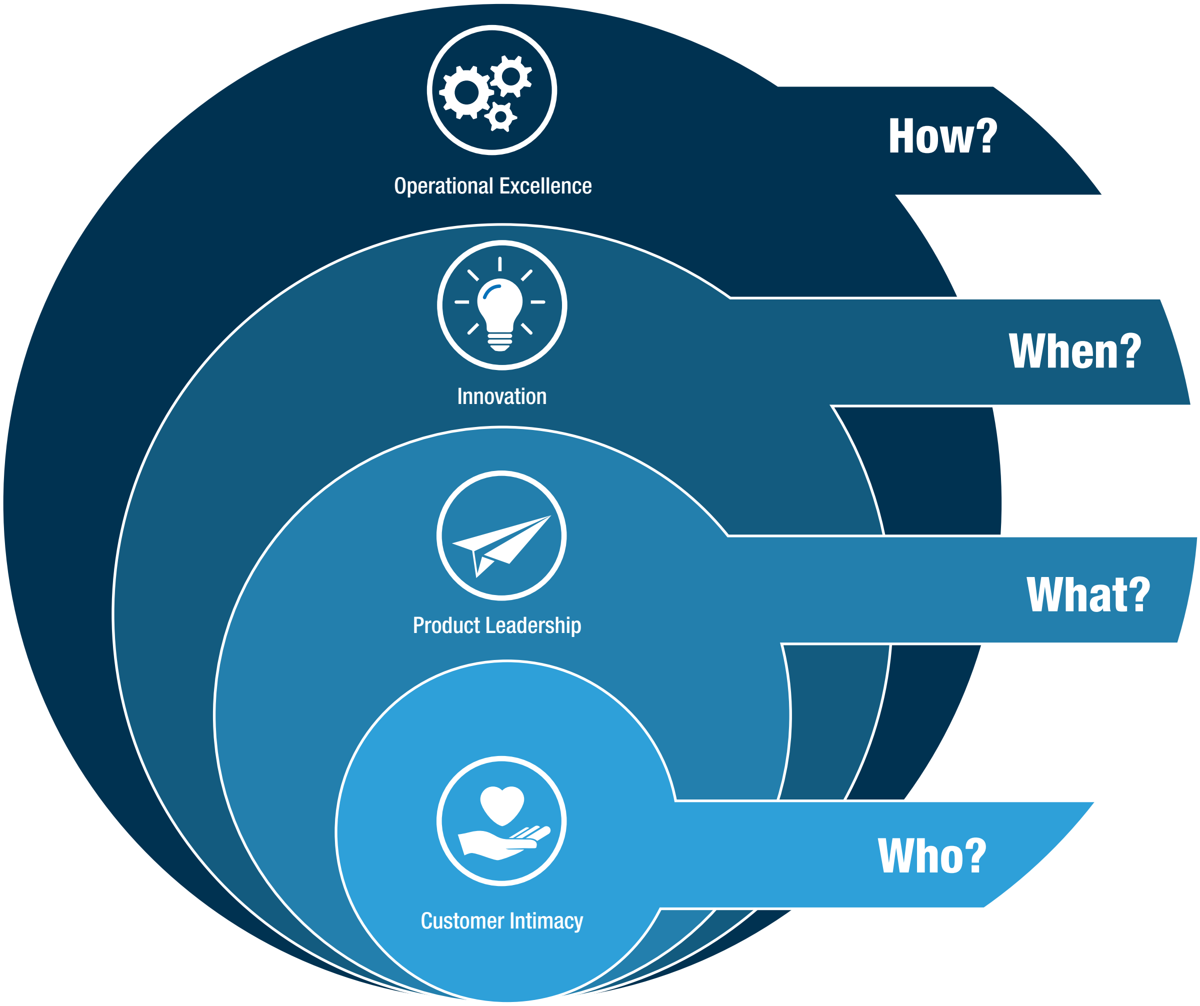
Across all of these categories, personal auto Superior Performers also universally maximized customer lifetime value (through expertise in cross-selling, retention, customer relationship management and other factors), and leveraged informational scale and scope economies. Again, the ability to devote resources to digitization had a material impact on performance.

## Personal Auto Lines

| | | 2017 Personal Auto Net Premiums Written | | 2012-2017 Average Ratios (%) | | |
|---|---|---|---|---|---|---|
| | Number of Carriers | (US$ billions) | (%) | Loss & LAE | Underwrting Expense | Combined * |
| Superior Performers | 14 | $97 | 86% | 78.3 | 19.4 | 98.8 |
| Investors | 12 | 13 | 12 | 76.8 | 26.6 | 104.0 |
| Value Diluters | 10 | 2 | 2 | 71.8 | 36.4 | 108.2 |
| Study Total | 36 | 112 | 100 | 78.8 | 23.8 | 103.1 |

*Includes policyholder dividends
Source: Acord research using A.M. Best and proprietary data.

## Fundamental Insurance Strategies




Source: ACORD

### Strategic Imperatives

It should be remembered that the personal and commercial auto writers segmented by performance in this study were all classified as Sustainable Value Creators in the ACORD study—that is, even for those who may have diluted value through auto underwriting, their overall performance was high.

One consistent finding across ACORD's studies was that high performers were able to effectively and simultaneously execute against the four fundamental insurance strategies: Customer Intimacy, Product Leadership, Innovation, and Operational Excellence.

Historically, these strategic options tended to be mutually exclusive, with insurers focusing on only one option. However, ACORD found that this is no longer sufficient or aligned with superior performance. Regardless of other strategic and tactical dimensions, value creation in today's marketplace requires successful execution across all four fundamental strategies.

However, this does not simply require simultaneous execution of four discrete strategies. Rather, they must be viewed as a strategic hierarchy, with relative priorities chosen with an eye toward enabling success across multiple areas. High-performing insurers have learned how to focus on thoughtfully selected and mutually supportive elements of these four strategies.

This trend will continue. Over time, in mature markets, discrete areas of expertise will coalesce around these four interrelated strategic options—enabled by the leveraging of technology—as an absolute necessity for sustained value creation. BR