AUTO INSURANCE REPORT

The Authority on Insuring Personal and Commercial Vehicles

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INSIDE

THE GRAPEVINE

Trump Victory May Further Slow Federal Insurance Office

Property and casualty insurance may be the last thing on anyone's mind in Washington, D.C., right now, but that doesn't mean the election of **Donald Trump** as president won't have an impact on the industry. The most likely outcome of the election for insurers is a further slowing of the influence of the slowly evolving **Federal Insurance Office**. Created in 2010 as part of the response to the financial crisis, the FIO has engaged in a few topics, such as international capital regulations, but has steered clear of challenging state-based regulation. Under a Republican president Senate and House of Representatives, it seems unlikely that the FIO's charter will be expanded. AIR

It's Possible to "Hack" Insurance, But Newcomers Not Likely to Win

Last month 1,500 people descended on the Las Vegas Convention Center to revel in the wonders of InsureTech, a vague notion that the insurance is hopelessly behind the times and can be remade through the wonders of startups fueled by technology, venture capital and, importantly, leadership devoid of the brain-poisoning experience of having worked for an insurance company.

The people in the room were right: there are indeed opportunities to remake insurance. And they were wrong: the startups coming from outside insurance are highly unlikely to participate in the change.

It is always dangerous to be a defender of entrenched interests, especially in a world littered with businesses that

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Legal and Legislative Issues Beyond Auto Insurance Gaining Insurers' Attention in Ohio

For auto insurers in **Ohio**, the actual business of writing insurance continues to be competitive and favorable, but heading into 2017, issues outside the auto-insurance world could be larger factors than pricing and claim trends.

Of course, insurers in Ohio are contending with national auto trends like rising claim frequency and severity, and they are raising rates accordingly. But state-specific developments have centered more specifically on the potential transformation in the makeup of the **Ohio Supreme Court**.

Insurers remember a time when Ohio's Supreme Court handed down what the industry considers activist decisions, creating a difficult environment for doing business. Perhaps no such decision is more well known in the state than the 1999 *Scott-Pontzer v. Liberty Mutual* ruling, which allowed employees, and their families, to collect from their employers' auto insurance policies even if the accident occurred in

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failed to see the arrival of new, more effective models fueled by technology and unencumbered by legacy operations, as reflected by **Netflix** replacing **Blockbuster** and **Amazon** replacing **Borders**. It is with the awareness of such risk that we argue property and casualty insurance is a unique business that will not be transformed by the kind of outside disruption that has been so prevalent in other industries.

What is it that InsureTech companies are trying to bring to insurance? There are three primary promises: better distribution, new products and/or a better business model.

We must confess that the startups we have seen possess more attractive websites than those representing large insurance companies. They even have nifty names like **Bungalow**, **Bunker**, **Trōv**, **Slice**, **Lemonade**, **Quilt** and **Swyfft** – with equally nifty logos.

Some insurance technology startups aim to create new product categories – and that's a good thing.

We believe a number of these startups will survive. After all, online insurance brokerage is a proven model, and quality execution is always a welcome path to success. But is it possible that an insurance startup has any structural advantage over existing players? Other than a good location (**California** and New York City for example) and the offer of organic snacks, they do not.

Indeed, there are many "startups" that are transforming insurance already, although they're far more closely linked to the insurance industry than they are to the efforts of outsiders to revolutionize the business. Quilt, Slice, Bunker and Swyfft, for example, have plenty of founders who come from insurance.

And there are several would-be disrupters that come directly from the industry. Comparison shopping online is as close to "hacking" insurance as you can get, breaking through the model of agent distribution, or single-company direct sales. **Compare.com**, **Goji**, **Zebra**, and **Coverhound** and the like all feature seasoned insurance leadership, not to mention sometimes direct backing from established insurance companies.

For example, **American Family Ventures**, the investment arm of the giant insurer, is a backer of both Bunker and Coverhound, among others.

In distribution, by creating quality websites with shrewd search engine optimization, upstart startups believe they can capture the customer before anyone else. For the most part, these startups don't want to be an insurance company. Actually providing insurance is a messy thing, especially when it comes to claims. And who needs to be in charge of all that capital?

Our conclusion about startups that provide online shopping experiences is that while the concept is revolutionizing insurance, it is nothing new, and the stodgy old insurance industry has been engaged in it for years. To the extent that experienced insurance hands become frustrated by the pace of change at the entrenched insurers where they work, then leave their jobs and forming new businesses, that represents the industry revolutionizing itself.

Some of these operations are striving to create new product categories, and this is a most welcome development. Bunker has developed insurance for contract employees, a project greatly advanced by the experience of its CEO,

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Chad Nitschke, who comes out of commercial insurance underwriting and product development at **Travelers**, **CUNA Mutual** and **Axis Capital**.

Likewise, Slice is working to create better insurance coverage for the people who rent their properties out on **AirBnb** and similar platforms, or drive for **Uber** and **Lyft**. Slice, also led by experienced insurance executives, has strong backing from **Munich Re**.

Both of these new product startups make complete sense – finding a gap in products being offered and filling it – and the markets might be so small that their specialization will overcome the offerings of bigger insurers. But this is not a revolution. This is controlled and thoughtful working on the industry's existing edges, not unlike a company such as **Hagerty**, which saw an industry failure many years ago to fully serve owners of classic cars and moved to fill it.

The entirely new business model is the biggest bid to change the insurance industry, and two companies stand out in this regard: Lemonade and Trōv. Both of these companies are currently focused on property risks.

Lemonade burst onto the scene about a year ago with $13 million in venture backing and a promise to completely "hack insurance" through the creation of a "peer-to-peer" insurance company. (See AIR 12/21/15) The "P2P" idea captured the fancy of the media and investors. They loved the revolutionary concept of having people pool their interests together so they can share in their fortunes and misfortunes, reducing the incentive of insurers to deny claims to boost earnings and the incentive of insureds to file fraudulent claims that would take money out of the pockets of their selected peers.

Alas, this idea is not new – it reaches back centuries to ancient Greek burial societies and is partially alive today in mutual insurance companies. It has another problem – it really doesn't work any more. Though Lemonade pushed the P2P idea hard as it was being formed, once the business plan was announced that aspect of the business was tweaked enough that we have a hard time calling it P2P.

Lemonade is not just a broker, but a "full-stack" insurance company, to take a hip term from Silicon Valley describing a company that both manufactures a product and distributes it. So far, Lemonade has no plans for the auto insurance market, selling homeowners and renters insurance, recently starting in **New York**.

Lemonade takes a 20% fee from premium off the top, and uses the rest to pay claims, buy reinsurance, pay loss adjustment expenses, etc. The idea is that by taking a (lucrative) flat fee Lemonade does not have an incentive to be stingy while paying claims. Instead of a dividend as paid by a mutual, any money left over is given to a charity designated by the customer, diminishing the incentive to commit insurance fraud since doing so would steal from a favorite charity rather than a faceless insurance company. The P2P part, Lemonade says, comes from the pooling of loss experience of customers who choose the same charity in order to determine the size of a donation, if any.

Maybe we're missing something, but while this approach is unique, it hardly seems revolutionary enough that consumers will reject other insurers and flock to Lemonade. And it misses an important fact: if Lemonade is too generous paying claims, it will have to charge prices so high that no one will pay them. They'll soon find there is a reason insurers take care in paying claims. What is more, if consumers decide they like this model, existing insurers, with much lower costs of capital and much more efficient operations, can simply start offering this form of P2P product, without fear of cannibalizing their existing business the way Blockbuster feared if it emulated Netflix.

Another new business model is "on-demand" insurance. This makes a great deal of sense in the case of Slice working with AirBnb, or insurers

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an employee's own car on his or her own time.

Early last decade, though, the makeup of the court changed through elections, creating a shift toward judicial restraint. In November 2003, the Ohio Supreme Court significantly limited Scott-Pontzer with its ruling in *Westfield Insurance Co. v. Galatis*, which held a corporate motor vehicle and umbrella policy provided uninsured/underinsured motorist coverage to employees only for injuries they sustain "in the course and scope of their employment."

Heading into the 2016 election, insurance industry representatives worried the court might shift its philosophy again, reverting back to how it had been through the 1990s. The reason: four out of the seven current justices will be replaced through elections over the next two years. Two seats were up for grabs in last week's election, and two more will hang in the balance in 2018.

Industry fears of a major Supreme Court

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Ohio Personal Auto Insurers

Groups Ranked by Total 2015 Direct Premium Written (000)

Group Name	2015 Premium	Mkt share 2015	Loss Ratio 2015	2014 Premium	Mkt share 2014	Loss Ratio 2014	2013 Premium	Mkt share 2013	Loss Ratio 2013
State Farm Mutual	$1,173,933	19.6%	64.7%	$1,104,996	19.3%	63.2%	$1,029,509	18.9%	64.0%
Progressive Corp.	$734,398	12.3%	61.2%	$735,857	12.8%	64.8%	$691,878	12.7%	63.6%
Allstate Corp.	$641,196	10.7%	57.7%	$593,695	10.3%	53.5%	$552,125	10.1%	53.1%
Nationwide Mutual Group	$544,271	9.1%	58.6%	$538,530	9.4%	55.7%	$529,406	9.7%	55.6%
Berkshire Hathaway/Geico	$373,293	6.2%	68.7%	$337,704	5.9%	70.4%	$299,243	5.5%	68.9%
Grange Mutual Casualty Co.	$325,182	5.4%	60.1%	$310,003	5.4%	57.1%	$294,768	5.4%	56.1%
Liberty Mutual	$275,704	4.6%	52.5%	$247,776	4.3%	54.8%	$227,186	4.2%	55.8%
Erie Insurance Group	$180,771	3.0%	68.7%	$165,635	2.9%	64.3%	$151,365	2.8%	64.2%
American Family Insurance Group	$160,618	2.7%	50.6%	$159,312	2.8%	52.2%	$157,076	2.9%	55.5%
Westfield Group	$155,952	2.6%	56.9%	$151,881	2.7%	54.6%	$148,615	2.7%	52.8%
USAA Insurance Group	$152,987	2.5%	81.0%	$140,162	2.4%	74.0%	$126,447	2.3%	70.5%
Cincinnati Financial Corp.	$130,087	2.2%	62.6%	$128,201	2.2%	57.7%	$128,478	2.4%	58.3%
Farmers Insurance Group	$128,728	2.2%	56.4%	$125,668	2.2%	53.3%	$139,101	2.5%	58.4%
Auto-Owners Insurance Co.	$94,533	1.6%	61.5%	$94,001	1.6%	59.4%	$94,216	1.7%	64.8%
Motorists Insurance Group	$82,662	1.4%	56.3%	$87,339	1.5%	61.0%	$88,929	1.6%	53.2%
Travelers Companies	$70,870	1.2%	62.1%	$63,129	1.1%	60.4%	$50,982	0.9%	59.3%
Safe Auto Insurance Co.	$65,919	1.1%	66.5%	$62,323	1.1%	60.1%	$54,951	1.0%	61.1%
Ohio Mutual Insurance Group	$61,100	1.0%	64.4%	$61,406	1.1%	59.6%	$62,125	1.1%	54.1%
State Auto Insurance Companies	$60,187	1.0%	58.4%	$63,417	1.1%	55.7%	$69,644	1.3%	52.3%
Western Reserve Group	$57,555	1.0%	60.9%	$57,202	1.0%	61.0%	$56,691	1.0%	55.6%
Hartford Financial Services	$47,478	0.8%	57.7%	$48,203	0.8%	61.1%	$47,763	0.9%	61.4%
MetLife Inc.	$45,329	0.8%	55.2%	$43,665	0.8%	50.4%	$42,556	0.8%	49.9%
Pekin Insurance Group	$34,797	0.6%	84.6%	$32,782	0.6%	71.3%	$29,638	0.5%	70.3%
Statewide Totals	$5,994,227		61.8%	$5,739,009		60.3%	$5,448,768		60.1%

Source: SNL Financial, by permission, and the *Auto Insurance Report* database.
Loss ratio = incurred losses/direct premium earned and does not include dividends or loss adjustment expense.

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shakeup were eased this past Election Day, as Republican Judge **Pat DeWine** defeated Democratic Judge **Cynthia Rice** for an open Republican seat. Additionally, Republican Judge **Pat Fischer** narrowly defeated Judge **John O'Donnell**, a Democrat, for an open Republican seat.

Chief Justice **Maureen O'Connor** was also up for re-election this year, but ran unopposed. And so, after last week's election, Republicans held their 6-1 majority on the Supreme Court.

The industry will now look to 2018, when Democratic victories could swing the court to – from the industry's perspective – a less favorable 4-3 Republican majority. It's important to note Ohio's Supreme Court general elections are non-partisan. The party affiliations are based on the primary elections, which are partisan.

Industry representatives hope legal stability prevails in the end, and they are trying to raise awareness about the importance of elections that perhaps not many Ohioans closely follow. The **Ohio Insurance Agents Association** (OIA), for example, ran a story on its website in August about the importance of Supreme Court rulings asking readers to remember "the Scott-Pontzer chaos" when thinking about this year's elections.

"In a crowded election year, it is easy for important issues to get lost, and what matters most to your business future could be buried in mayhem of messaging," OIA states. Since Supreme Court races in Ohio are non-partisan, many voters, says OIA, "simply opt out of this race if they don't recognize a name." In 2010, half a million more Ohioans voted for governor than for a chief justice, according to the agents' group.

"When it comes to legal stability for the insurance community, and indeed many other industries crucial to Ohio's economic vitality, there are no races more important than the Ohio Supreme Court," OIA says. At least in 2016, it appears the message resonated with enough voters to maintain the current makeup of the court.

Another evolving issue concerns amendments passed with the 2015 budget that changed

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Ohio
Auto Insurance Profit Margins
Ten-Year Summary, Percent of Direct Premiums Earned

Line of Business	2014 Total Profit	2013 Total Profit	2012 Total Profit	2011 Total Profit	2010 Total Profit	2009 Total Profit	2008 Total Profit	2007 Total Profit	2006 Total Profit	2005 Total Profit	Avg Total Profit
Personal Auto Liab	9.2	8.0	7.9	9.2	9.9	7.3	8.8	12.1	14.7	13.4	10.1
Personal Auto Phys	6.5	6.7	5.5	-0.4	8.3	8.5	3.7	6.9	10.3	11.5	6.7
Personal Auto Total	8.0	7.4	6.9	5.1	9.3	7.9	6.6	9.9	12.9	12.7	8.7
Comm. Auto Liab	14.6	17.6	17.2	21.4	25.3	20.6	22.5	26.2	27.5	21.6	21.4
Comm. Auto Phys	3.7	5.3	0.5	-5.9	0.9	9.4	7.6	11.8	12.9	15.3	6.1
Comm. Auto Total	11.9	14.5	13.0	14.9	19.6	17.8	18.8	22.7	23.7	20.0	17.7
Total All Lines*	16.8	16.8	8.1	7.6	13.5	9.3	4.9	16.5	19.1	16.1	12.9

*Auto; Home, Farm & Commercial Multiperil; Fire; Allied; Inland Marine; Med Malpractice; Other Liability; Workers Comp; All Other

Note: Profit calculations are by *Auto Insurance Report* using data from the National Association of Insurance Commissioners. Calculations are estimates, some based on national averages.

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subrogation language in Ohio. A statute that took effect in September 2015 stipulates that the amount an insurer can recover in subrogation is reduced in the same proportion that the "full value" of the insured's tort action was diminished for such things as comparative negligence. It also reduces recovery due to limited liability insurance "or any other cause." For Ohio insurers, the ambiguous language in particular raised concerns about legal interpretations.

Dean Fadel, president of the **Ohio Insurance Institute** (OII), notes the law's impact is still uncertain. "It does impact how insurers are able to subrogate claims," he notes, but he adds it's still to early to have a clear sense of the net effect. He also believes there may be an effort to roll back the statute early next legislative session, as he notes House members were not happy about how the issue was initially handled.

Ohio also passed a transportation network companies law last year that resembles the national compromise model bill developed by TNCs and insurers. Gov. **John Kasich** signed the bill, House Bill 237, in December.

As for the business of writing auto insurance in Ohio, insurers are largely satisfied with a highly competitive state that enjoys a relatively light touch from regulators and legislators.

According to the Ohio Insurance Department, auto insurance rates increased 2.3% among the state's top-10 insurers in 2015, the smallest increase in four years. Data from **SNL Financial's** RateWatch shows that so far this year, rates have increased 2.1%.

The average auto insurance expenditure in 2013 – the most recent year for which data is

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Ohio
Commercial Auto Insurers

Groups Ranked by Total 2015 Direct Premium Written (000)

Group Name	2015 Premium	Mkt share 2015	Loss Ratio 2015	2014 Premium	Mkt share 2014	Loss Ratio 2014	2013 Premium	Mkt share 2013	Loss Ratio 2013
Cincinnati Financial Corp.	$79,168	8.8%	59.2%	$77,815	9.2%	64.0%	$73,881	9.4%	51.0%
Westfield Group	$62,024	6.9%	63.0%	$60,496	7.2%	64.6%	$57,023	7.3%	56.9%
Progressive Corp.	$59,584	6.7%	48.8%	$51,683	6.1%	43.0%	$47,543	6.1%	66.7%
Nationwide Mutual Group	$54,925	6.1%	59.6%	$53,823	6.4%	72.8%	$47,603	6.1%	49.3%
Travelers Companies Inc.	$46,059	5.1%	52.1%	$44,244	5.2%	44.5%	$45,820	5.9%	56.3%
Motorists Insurance Group	$35,381	4.0%	72.4%	$32,171	3.8%	35.7%	$29,697	3.8%	55.3%
Zurich Insurance Group	$33,766	3.8%	47.5%	$31,598	3.7%	51.1%	$30,638	3.9%	30.1%
Erie Insurance Group	$29,781	3.3%	55.9%	$26,622	3.2%	71.1%	$23,234	3.0%	59.0%
Auto-Owners Insurance Co.	$29,357	3.3%	48.9%	$26,521	3.1%	50.2%	$25,075	3.2%	63.9%
Liberty Mutual	$28,708	3.2%	54.1%	$28,756	3.4%	39.7%	$29,853	3.8%	61.6%
Old Republic International Corp.	$27,975	3.1%	65.5%	$21,738	2.6%	69.7%	$19,984	2.6%	37.0%
American International Group	$27,057	3.0%	77.9%	$27,555	3.3%	63.5%	$21,398	2.7%	64.8%
Acuity Mutual	$26,173	2.9%	67.1%	$24,274	2.9%	68.4%	$20,962	2.7%	58.2%
State Auto Insurance Companies	$24,859	2.8%	67.0%	$24,589	2.9%	50.6%	$23,112	3.0%	46.5%
Grange Mutual Casualty Co.	$24,534	2.7%	94.0%	$26,865	3.2%	75.6%	$24,719	3.2%	47.9%
Statewide Totals	$896,031		60.0%	$846,471		55.3%	$781,884		52.1%

Source: SNL Financial, by permission, and the *Auto Insurance Report* database.
Loss ratio = incurred losses/direct premium earned and does not include dividends or loss adjustment expense.

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available – was $659, good for 12th lowest in the U.S. The average expenditure rose about $24 from 2012, compared to an increase of around $26 for the United States.

The statewide loss ratio of 61.8% was highest since 2011, when it was 62.4% and much lower than the national average of 68.3%. For perspective, it's important to note loss ratios for Ohio auto insurers, on average, have outperformed the nation as a whole in every year since 1997.

All told, Ohio auto insurers wrote just over $5.7 billion in premiums in 2015, a 4.4% increase compared to 2014, according to SNL Financial data. That is below the 5.5% national average increase in written premiums in 2015.

As insurers enjoy the competitive auto insurance market, they are keeping a careful eye on legislation that would implement the NAIC Corporate Governance Annual Disclosure Act. The disclosure act is the third leg of the NAIC's response to the financial crisis, following Holding Company Model enhancements, effective 2014, and Own Risk and Solvency Assessment (ORSA), effective 2015.

The disclosure model act calls for insurers and insurance groups to submit confidential corporate governance disclosures once a year to the insurance department. In general, the disclosures would describe an insurer's corporate governance framework and structure, such as its board and various committees, their duties and how they are governed.

The NAIC's accompanying model regulation gets into more specifics on what regulators might look for, such as specific policies and practices for both the board and senior management, including how compensation programs relate to company and individual performance over time.

Regarding the model's potential impact for

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Ohio Snapshot

Regulator: Lt. Governor and Insurance Director Mary Taylor
Rate regulation: file and use

Size of personal auto market: $6.0 billion (2015 DPW) Rank: 10th

Average policy expenditure: $659 (2013)
Rank: 40th
Auto Insurance Report PAIN Index rank: 30th (2013)
Property Insurance Report HURT Index rank: 34th (2013)

Auto registrations: 4.8 million (2014)
Truck registrations: 5.2 million (2014)
Vehicle miles traveled (VMT): 112.77 billion (2014)
Traffic fatalities: 1.65 per 100 million VMT; U.S.: 1.08 (2014)
Vehicle thefts: 155.4 per 100,000 residents; Region: 172 per 100,000 residents (2014)

Liability defense: modified comparative fault - 51% bar

Minimum Insurance Requirements:
BI: $25,000/$50,000 • PD: $25,000 •

Safety Laws
Texting ban for all drivers; cellphone ban for young drivers
Graduated licensing law
Secondary seat belt law
Motorcycle helmets required for riders under 18 and new riders

Demographics
Population: 11.6 million (2015 est.)
Change 2010-2015: +0.7%, U.S.: +4.1%
Median household income (avg. 2010-2014): $48,849; U.S.: $53,482
Population density: 282.3 per square mile; U.S: 87.4 per square mile (2010)

Sources: SNL Securities, NAIC, U.S. Dept. of Transportation, PCIAA, NAMIC, U.S. Census Bureau, IIHS, FBI

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covering Uber drivers, because the risks clearly shift from personal to commercial. But at Trōv, yet to open in the United States, the idea is to insure personal belongings for short periods of times, such as a weekend, with claims handled by automated "bots." We're hoping someone can explain to us how this will work in a way that the company won't be overwhelmed by fraudulent claims as people make claims for cameras and bikes that were never lost. Until then, we feel confident this is not the magic idea that will disrupt existing insurers.

At the end of the day, insurance industry disruption comes not from a single clever idea, but rather through a relentless application of superior operations. What does disrupting insurance really look like? Look to the big disrupter in the personal auto space: **Geico**. The conventional wisdom holds that Geico succeeded by eschewing insurance agents.

While it is true that Geico's direct model is critical to its success, this is not the real reason for Geico's disruption. Rather, success has been built almost entirely in the back office operations, the least exciting part of a business that is almost defined by its lack of excitement.

Before forcing its way up the market share table Geico spent decades selling without agents, along with a handful other direct insurers. If direct sales was the disruptive force, why didn't it take hold decades ago? No, the real disruption was the skilled application of hundreds of millions of dollars, and now $1 billion, in advertising spending at a time when even the biggest insurers were spending only a fraction of that amount. A large team of people carefully measuring performance, looking at loss ratios, and studying returns, won a ground war for attention. The ads were fun, but it was the hard work that cause the disruption.

"Disruption" is coming to insurance, but it is coming from within, hopefully helped along by the catalyst of outside ideas. AIR

AUTO INSURANCE REPORT

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insurers, Law firm **Day Pitney** in a March advisory, said insurers "should be preparing to share an unprecedented level of detail on corporate governance procedures with insurance regulators annually once the statutes are adopted." The advisory also says the model regulation includes some "surprisingly invasive" requests, such as board-member qualifications and compensation and clawback provisions if performance measures are restated. So far, 10 states have passed the model act, and four have adopted the accompanying model regulation.

In Ohio, a bill implementing the model act was introduced in the House after the Senate unanimously approved it in May. Fadel, president of the OII, says the bill's language closely follows the NAIC model, "which is a good thing from our standpoint." Noting his association has no issues with the bill, Fadel adds, "We're hopeful and the insurance department is hopeful it gets through the House in the lame duck session after the election." AIR