

Lives Change. Risks Change.
Keeping Pace with Lifestyle Dynamics.

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Why it's essential to base auto underwriting decisions on validated information, and how to do it right.



Introduction

Americans lead a fast-paced, dynamic lifestyle. Stop for a moment and consider your life. How many times have you moved? How many cars have you owned? How many jobs have you had? You're not alone. The time has long passed when a person landed a job right after school and stayed with the same company throughout his or her career. In fact, the average worker has held 10 jobs by the age of 36, and overall, 25 percent of workers change jobs every year.

Those changes have an impact on our personal and professional lives. And they also have a significant effect on our auto insurance profile. The information that drives underwriting decisions for auto policies is constantly changing, making personal auto insurance risk management a difficult, and rapidly moving, target.

Why should underwriters take note of this trend? Let's consider place of employment: If an individual's job changes, it's also likely to be associated with changes in vehicle usage, commute distance, and annual mileage. Similarly, other basic facts used to determine personal auto insurance premium are also in constant flux:

Every year:

- 52 percent of household auto policies experience a change of vehicles or drivers
- 30 percent of households add or replace at least one vehicle

Every hour of every day:

- 246 marriages begin
- 121 marriages end in divorce
- 28,227 vehicles are registered
- 167 drunk-driving arrests are made
- 4 traffic fatalities occur
- More than 2,800 auto insurance claims are paid
- 152 new driver's licenses are issued — to 16-year-olds.

Impact of lifestyle changes on rating integrity

Many of the lifestyle changes discussed thus far can be correlated with changes in vehicle-driver assignment, annual mileage, commute, and other primary rating factors. But are they always reflected in the rating decisions of insurers? Certainly, insurers provide various methods for their policyholders to report changes, but many changes aren't reported at all — which means they can go undetected for years.

And then there's forgetfulness and fraud. Do some policyholders withhold information that might increase their auto insurance premium? Our studies indicate that they do. Analyses conducted by Quality Planning show that drivers are significantly more likely to report life changes that reduce auto premium than report changes that increase premium. In one study of 2009 data, Quality Planning reviewed 337,543 policies from multiple carriers, analyzing what material changes policyholders actually reported. We found that some policyholders do report 'life changes' as they occur but often withhold the true impact of those changes. For example, when filing a change of address, 23.6 percent claimed that this would not change their annual miles driven, and 47.3 percent claimed this would not change their commute distance. Similar disparities were observed for mileage changes associated with adding or dropping a driver from the policy.

Type of change	% of individuals who stated "no impact"
Address change: impact on annual mileage	23.60
Address change: impact on commute	47.30
Added a driver: impact on annual mileage	30.80
Added a driver: impact on commute	56.00
Dropped a driver: impact on annual mileage	28.60
Dropped a driver: impact on commute	54.10

In general, we find that drivers report mileage decreases five times more often than they report mileage increases. A similar pattern is observed in changes to vehicle use: Drivers are three times more likely to report a change from 'commute' to 'pleasure use' (which is generally associated with a reduction in rates) as they are to report a change from 'pleasure use' to 'commute.'

Accurately tracking change is not a project. It's an ongoing commitment.

It's true that some people misrepresent facts to their insurer or a sales agent may allow some distortion of information. Whatever the reason, the reality is the rating of millions of policies are flawed due to incorrect rating factors. It's clear that auto insurance companies need to be more diligent in detecting change and then determining what the change really means.

Every day in the course of conducting policy reviews, Quality Planning uncovers countless examples of material lifestyle changes with direct rating consequences. For instance, younger drivers may retain the policy address of their parents in the suburbs long after they've moved to higher-rated territories in central cities. Or individuals may change jobs and extend their commute but fail to let their insurance company know.

Properly assessing a policy's risk is one of the most challenging aspects of auto insurance, and making sense of outdated data and misinformation can make a daunting task seem impossible. But it can be done. Auto insurers can keep track of all the changes that determine the risk profile of a policy if they implement a direct and proactive approach with policyholders. Through regular and positive contact with each policyholder, important lifestyle changes can and should be detected.

Customer contact and its benefits to insurance carriers

Targeted and regular customer contact can reduce errors in rating data and also help develop a more truthful partnership between policyholder and carrier. A commitment to ongoing customer contact offers two valuable benefits for the insurance carrier.

First, the policyholder feels that the insurance company cares about its customers and is striving hard to provide the best service possible by ensuring that lifestyle changes, such as marriage, teenage drivers, added drivers, territory changes, etc., are quickly reflected in the policy. This provides a full account of the household and results in smoother claims handling in the event of an accident or other loss. It's especially true of claims involving drivers not listed on a policy.

Second, a commitment to customer contact conveys the message that the company is keenly aware of individual factors used to calculate premium and closely monitors those factors to ensure fair treatment of all its policyholders. If this contact happens prior to a policy's renewal, it can boost the retention rate and overall customer loyalty. Policyholders who have been contacted by their insurance company are much less likely to use the four-to six-week pre-renewal period to competitively "shop" their auto insurance.

Another key finding from Quality Planning's study is that customers who have been contacted, and who renew their policies, are less likely to submit fraudulent and inflated claims for the same reasons as outlined above. Customers who may have been intentionally misreporting their policy information face substantial premium increases after being discovered. Such customers may consider switching to a less astute carrier. The switch represents the classic case of adverse selection. Those customers, who typically take an inflated loss ratio with them (25 to 80 percent higher than average!), often try to lower their premium by moving to insurance carriers who employ less stringent measures of data validation.

Accurate, updated policyholder information is the basis for rating integrity

As any auto insurance underwriting department is well aware, sound underwriting decisions can only be achieved with validated rating information. Since change is a fact of life, auto insurers must improve their ability to accurately detect a change in a policyholder's risk profile or suffer the consequences: flawed risk assessment and lower revenue due to underpriced premium. Last year, for example, auto insurers suffered almost \$16 billion in missed revenue due to rating errors — revenue that could be recovered by implementing the latest detection methods.

Quality Planning specializes in providing a comprehensive suite of analytic tools and methods to detect, fix, and continually review rating error. By adopting new approaches to correct existing rating errors, ensure accurate rating information at policy inception, and maintain good communications with policyholders, insurers can reduce premium leakage by as much as 60 percent in a single policy period and, in so doing, increase profits.

About Quality Planning

A Verisk Analytics company, Quality Planning is focused on providing rating integrity solutions to auto and home insurers. Quality Planning works with insurance companies to identify areas of significant rating errors through the use of sophisticated database management, statistical analysis and modeling, customized survey design, and highly targeted customer interaction. Quality Planning helps clients work within their existing rating plans and charge fair prices to policyholders based on a true representation of risk. The company was founded in 1985 and is headquartered in San Francisco. For more information, visit www.qualityplanning.com.