Not Shopping for Insurance Can Lead to Overcharges

Summary

Consumers today are inundated with catchy advertising campaigns encouraging them to switch insurance companies to save money. A study conducted by The Office of Public Insurance Counsel (OPIC) strongly supports the idea that shopping your policy can yield savings. According to our data, the longer a policyholder stays with the same company, the more they are likely to be overcharged. On average, policyholders who have been with the same company for more than eight years could save over 19% on their annual auto premiums by switching to a new company. At the average full coverage auto premium of $1,022, that's at least $194 in savings a year. [1]

Background

Insurance companies have very high policyholder retention rates. According to a 2010 report by Deloitte Research, 39% of auto policyholders and 42% of homeowner's policyholders have been with their company over ten years. Almost 60% of policyholders say they rarely or never shop their policy for a better deal. A variety of reasons are offered for the high level of retention. Insurance shopping can be difficult or tedious. Package pricing requires consumers with multiple policies to shop them all. In addition, surveys suggest that nearly all major carriers boast high satisfaction rates. Consumers may also have a good relationship with their agent. Whatever the reason, high retention is a fact of life and less than 10% of consumers say they are likely to switch companies.

Insurance markets in Texas are considered fairly competitive. Competition is what allows consumers to switch companies and save. Supporting this view are the results from a recent review of HelpInsure.com, an insurance shopping tool sponsored by OPIC and the Texas Department of Insurance (TDI). Following are the results from a middle class zip code in north Austin: [2]

Table 1

Austin - 78728	**High Quote**	**Low Quote**
Homeowners	$1,744	$743
Auto	$886	$223

Consumers can also save money by switching due to the nature of the current insurance market. Insurers compete aggressively for certain types of new business and, in some cases, are willing

[1] NAIC 2008/2009 Auto Insurance Database Report, combined average premium for Texas.
[2] Auto profile used was Travis County, zip = 78728, married female driver, age 25-65, average credit, no violations, basic liability limits 30/60/25. Homeowners profile used was Travis County, zip = 78728, claims free 5 years, average credit, frame construction, $200,000 home.

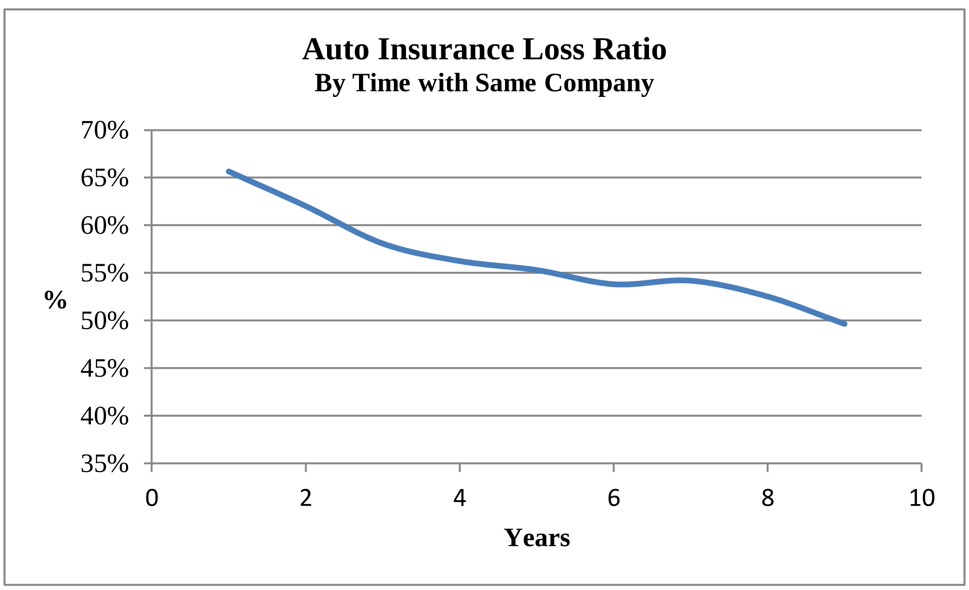
to write new business at a short term loss (often called a “loss leader”). The shortfall can be made up over time if policyholders remain with the company. An unfortunate result is that the longer policyholders remain with a company, the more likely they are to be overcharged.

Consumers who switch after a long time with a company not only save by avoiding these overcharges but, in the short term, save even more because the new company rate might be a loss leader. While anyone can potentially save money by switching, the largest savings on average will likely be seen by those who have stayed with a company the longest. However, individual circumstances can vary dramatically. For that reason, we encourage all policyholders to frequently test the market by seeking quotes. There is no downside. Even policyholders who have been with a company just a short time can often realize large savings.

Analysis

OPIC asked TDI’s statistical agent to compile premium and loss data from the 10 largest auto insurance companies depending on how long the policy had been in force. For simplicity, and to avoid distortions in the data due to weather, we asked that the analysis be limited to just the following lines of coverage: bodily injury liability, property damage liability, and collision. As shown below, the analysis showed a reasonably steady decline in the loss ratio the longer a policy was in force with a company. [3] The lower the loss ratio becomes, the more profitable that group of policies is.

Chart 1



We then attempted to calculate the average percentage savings in premium policyholders could realize by switching companies. The savings are based on the assumption that the new policy would be priced to obtain the average historical auto insurance profit in Texas. The loss ratio used for this calculation would not be applicable in every case because expense structures and

[3] Data reflect bodily injury, property damage and collision coverage only for the largest Texas auto insurers.

commissions differ widely among insurance companies. The calculation is therefore a hypothetical average and subject to some degree of error and subjectivity.

The following table illustrates the level of projected savings. [4]

Table 2

Average Auto Insurance Savings By Switching Companies

Time With Company (Years)	Auto Insurance Loss Ratio	Average Percentage Savings
Up to 1	65.7%	None
1-2	62.0%	None
2-3	58.1%	5.2%
3-4	56.2%	8.2%
4-5	55.3%	9.8%
5-6	53.8%	12.2%
6-7	54.2%	11.6%
7-8	52.5%	14.3%
8-9	49.6%	19.0%

As the table indicates, savings are generally greater for those policyholders who have remained with the same company a long time. Savings will differ dramatically from person to person and some policyholders may find the savings minimal or even non-existent. Other policyholders might find much higher savings than indicated. On average however, most policyholders are likely to benefit. Also, the analysis assumes the new policy is priced for a profit rather than as a loss leader which can often be the case. It's therefore possible the overall savings estimates are conservative.

Although this study relates only to auto insurance, there is no reason to believe the pattern wouldn't apply to other lines as well, such as homeowners insurance. Analyzing homeowners insurance is more difficult however because of volatile weather losses and changes to homeowners insurance policies. Multi-line policyholders need to keep in mind that moving one line of coverage, for example their auto insurance, to another company might not be the best approach. Most insurance companies have very substantial multi-policy discounts that are often 20% or higher. Moving only the auto policy to another company might result in the savings being offset by the loss of the multi-policy discount on their homeowners insurance. For this reason, a better strategy is to shop both policies at the same time.

[4] Average Percentage Savings assumes that the premium charged for the new company's policy is based upon a 61.3% loss ratio. This is our estimate of the loss ratio at which a historical average profit is realized. Expenses are based on the 2010 Insurance Expense Exhibit for the private passenger auto liability and physical damage lines. Historical profit is based on data from the NAIC Report on Profitability by Line by State 2010. Differing estimates of the "reasonable" loss ratio would yield differing savings results.

We encourage all policyholders to make use of HelpInsure.com to view the general range of rates that are available in the market. Additionally, we encourage policyholders to utilize OPIC's policy comparison tool to make sure their policies have the provisions and features they need. You can find these tools and more useful information on our website at www.opic.state.tx.us.