Summary of Market Structure and Performance

Private Passenger Automobile Insurance
&
Homeowners Insurance

Missouri Department of Insurance, Financial Institutions, And Professional Registration

Statistics Section

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Summary

This report presents indicators through 2006 that capture key features of personal lines insurance markets in Missouri. All indicators suggest that Missouri's homeowners and private automobile insurance markets are robust and competitive, in spite of a significant increase in catastrophic weather related losses in recent years.

Among the findings are:

■ Cost of Insurance

▪ **The cost of insuring an automobile in Missouri has declined in recent years. In constant or inflation-adjusted 2006 dollars, the average price of obtaining a year of full coverage for one automobile was $578 in 2006, compared to the period high of $715 in 1998. Adjusted for inflation, the cost of coverage declined by an annual average rate of -1.9% between 1998 and 2006. Even without adjusting for inflation, costs declined during each of the last two years.**

In inflation adjusted terms, the cost of all automobile coverages has declined since 1997. The cost of $50k/$100k of liability coverage decreased on average by a one-half of a percent each year, while collision coverage declined at a rate of -3.4%, and comprehensive coverage at -2.5%.

▪ **The cost of homeowners coverage in Missouri has increased steadily since 1998, though average premiums declined in 2005 and again in 2006. Controlling for inflation, the average annual cost of policies with coverage limits of between $100,000 and $139,999 has increased from $549 to $624 (in constant 2006 dollars) between 1998 and 2006.**

On average, the cost of coverage increased annually at a rate of 1.6% in excess of the overall rate of inflation, with the bulk of the increase occurring in 2002 (11.0%) and 2003 (11.7%). The four largest increases in insurance costs during the past decade occurred every year between 2001 and 2004, with an average annual increase of 6.5 percent above inflation.

The 2001-2004 period was marked by a "hardening" of the homeowners insurance market, exacerbated by severe catastrophic losses. However, adjusted for inflation, the average cost of coverage declined in 2005 by 4.8% and in 2006 by 4.5%.

■ Structure and Performance of Insurance Markets in Missouri

Missouri's homeowners and private automobile insurance markets are robust and competitive. Key indicators show no or very moderate levels market concentration, relative ease of entry into and exit from Missouri markets, and a declining residual market.

The homeowners market in Missouri has remained resilient in the face of catastrophic weather related losses. In both 2001 and 2006, homeowners insurers paid out significantly more in claims than they collected in premium. Catastrophic losses resulted in a negative average annual return across the last decade. However, the market responded with moderate adjustments with no lingering structural contraction. The residual homeowners

market, or insurer of last resort for consumers who are unable to obtain coverage from private insurers, is negligible and in decline. In 2006, the market share of the FAIR Plan was less than 0.0%.

Private automobile insurance was impacted by catastrophic losses to a much lesser extent, and remained profitable throughout the decade. Automobile insurers earned an average annual return on net worth of 7.7% between 1997 and 2006, comparable to the countrywide figure of 8.2%. Similar to homeowners coverage, the automobile insurance market remains dynamic and competitive, characterized by declining rates, low to moderate market concentration, few barriers to entry or exit, and a negligible residual market.

Average Premiums

Average annual premiums represent the cost of coverage of one home or one auto for one year. Coverage levels are held constant across years to control for the effects of rising home values and auto prices, which drive coverage levels, on premiums. Home prices especially tend to rise more rapidly than the rate of inflation. This data series therefore measures the price of a relative uniform product over time, at least with respect to the amount of coverage.[1] For comparison, average premiums are also presented for all coverage levels combined.

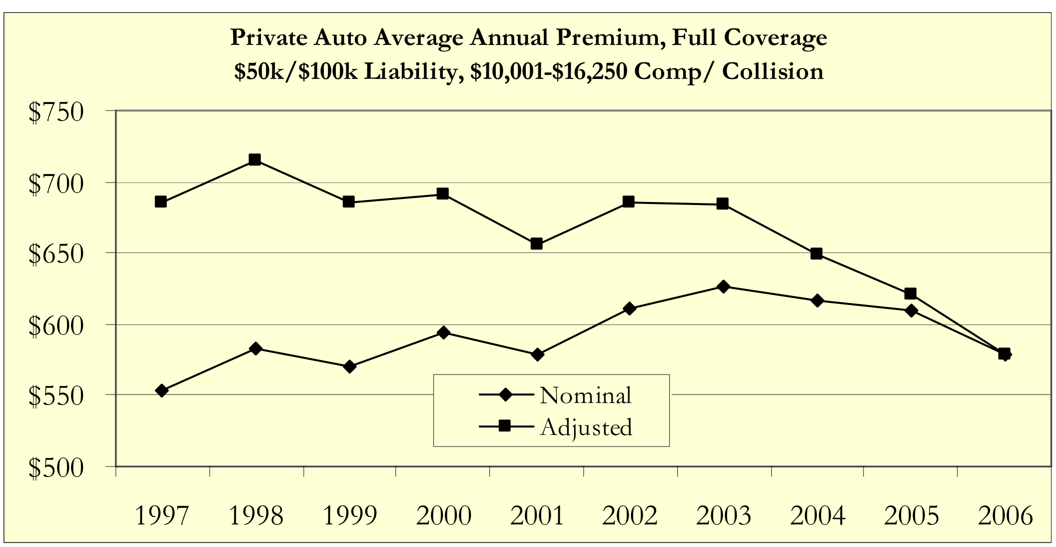
Types of Coverage

Homeowners policies consist of forms HO 1, 2, 3, 5, or comparable policies, or standard homeowners policies that cover a wide variety of perils to structure and contents, as well as liability. Excluded are more basic "dwelling fire" policies, as well as renters coverage.

Private passenger automobile coverages consist of liability, collision, and comprehensive. The liability portion includes only BI/PD, and excludes uninsured and underinsured motorist, med pay, and other ancillary coverages that are sometimes included in liability insurance statistics.

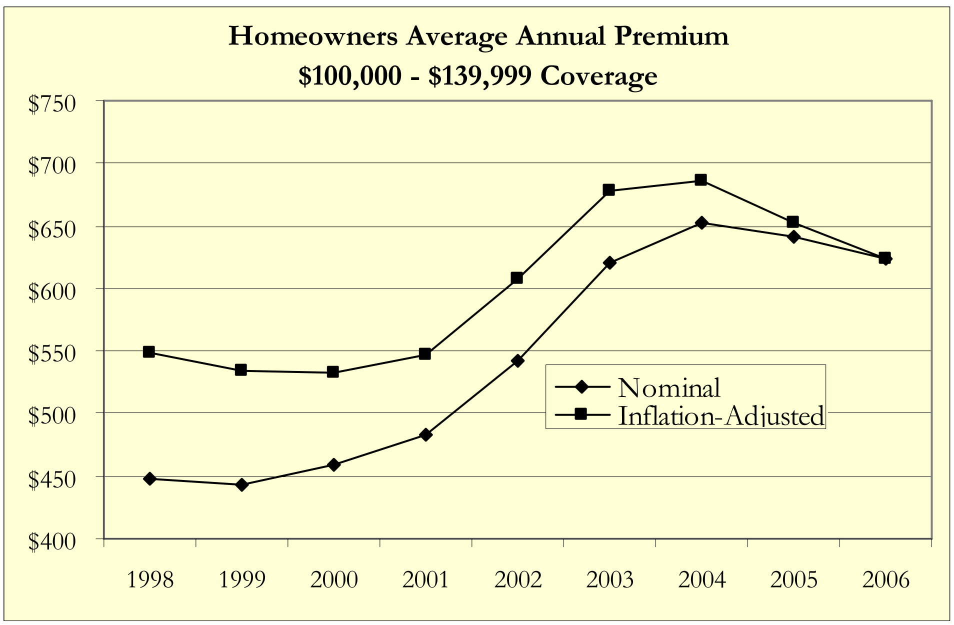
[1] However, the data do not capture changes in covered perils, deductible amounts, or other factors that might impact price. While no assertion is made that the data represent *identical* coverage across years, the coverages should be broadly similar over the period under consideration, so that price comparisons are meaningful.

Private Passenger Automobile Insurance Average Annual Premiums in Missouri											
Coverage	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**Average Annual Change (Geometric Mean)**
All Coverage Levels Combined Nominal (not adjusted for inflation)											
Liability	$276	$286	$276	$277	$282	$300	$314	$317	$312	$311	1.3%
Collision	$219	$239	$246	$252	$264	$278	$287	$284	$269	$257	1.8%
Comprehensive	$110	$117	$117	$118	$123	$131	$138	$142	$138	$132	2.0%
Combined	$605	$642	$638	$647	$668	$709	$740	$742	$719	$700	1.6%
All Coverage Levels Combined Inflation-Adjusted (2006 Dollars)											
Liability	$342	$351	$332	$322	$319	$336	$344	$333	$318	$311	-1.1%
Collision	$271	$293	$296	$293	$299	$312	$314	$298	$274	$257	-0.6%
Comprehensive	$137	$144	$140	$137	$139	$147	$151	$149	$141	$132	-0.4%
Combined	$750	$788	$768	$752	$756	$795	$809	$780	$732	$700	-0.8%
$50k/$100k Liability Coverage, Comp and Collision $10,001 - $16,250 Nominal (not inflation adjusted)											
Liability	$252	$264	$255	$256	$263	$284	$300	$301	$298	$299	1.9%
Collision	$203	$217	$217	$232	$217	$223	$220	$211	$207	$183	-1.1%
Comprehensive	$98	$101	$99	$107	$99	$104	$106	$106	$104	$96	-0.1%
Combined	$553	$583	$571	$595	$579	$611	$626	$617	$610	$578	0.5%
$50k/$100k Liability Coverage, Comp and Collision $10,001 - $16,250 Inflation-Adjusted (2006 Dollars)											
Liability	$313	$324	$306	$297	$298	$319	$327	$316	$303	$299	-0.5%
Collision	$251	$266	$261	$269	$246	$250	$240	$221	$211	$183	-3.4%
Comprehensive	$121	$124	$119	$125	$112	$116	$116	$111	$106	$96	-2.5%
Combined	$685	$715	$686	$691	$656	$685	$684	$649	$620	$578	-1.9%



Average Premium Homeowners Insurance, Policy Forms HO 1, 2, 3, 5 or Comparable Policies										
	1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**Average Annual Change (Geometric Mean)**
All Homeowners Policies										
Nominal	$451	$455	$481	$515	$591	$694	$755	$755	$746	6.5%
Inflation-Adjusted*	$553	$547	$559	$584	$663	$759	$793	$768	$746	3.8%
Homeowners Policies With $100,000 - $139,999 Coverage										
Nominal	$448	$444	$459	$483	$542	$621	$653	$642	$624	4.2%
Inflation-Adjusted	$549	$534	$533	$547	$607	$678	$686	$653	$624	1.6%

***2006 dollars**



Indicators of Market Structure and Performance

This section presents indicators of market structure and performance for personal lines insurance. These indicators do not constitute an exhaustive analysis of competition in a line of insurance, but are best viewed as pointing toward potential market irregularities that may merit further investigation and analysis.

Missouri statutes are generally predicated on the belief that market competition is an effective and efficient regulator of insurance rates. In a competitive market, rates should approach a theoretical equilibrium point that matches consumer demand for risk mitigation to the willingness of insurers to supply coverage.

Competitively determined prices serve an important signaling function or feedback mechanism to market participants. Prices alert consumers and producers to adjust demand and supply of products and services. In insurance, premium rates are particularly salient signals of risk levels: market rates (subject to actuarial uncertainty) ought to most accurately reflect risk levels associated with a given activity. Consumers respond to price incentives in part by reducing excessively risky activity, or by actively attempting to mitigate such risks. For example, many economists argue that subsidized flood insurance encourages consumers to move to flood prone areas, an action that would otherwise be discouraged by the proper risk-based price signals.

Definitions

Data is aggregated at the insurance group rather than company level. That is, companies within the same group are not viewed as effective competitors.

Measures of Market Concentration

Three measure of market concentration are presented

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Concentration Ratio, Five Largest Groups – The combined market share of the four largest writers in a line of business.

Concentration Ratio, Ten Largest Groups – The combined market share of the eight largest writers in a line of business.

Herfindahl-Hirschman Index (HHI) The HHI affords a more complete measure of market concentration by using the market shares of all groups active in a line of business. The HHI is calculated as the sum of the squared market shares of all groups. This index approaches 0 in a very highly completive and fragmented market. A market consisting of a single firm will produce an HHI of 10,000. The anti-Trust Division of the Department of Justice provides one commonly used guideline for interpreting the HHI:

A. Below 1,000: Unconcentrated or competitive
B. 1,000 to 1,800: Moderately concentrated
C. Over 1,800: Highly concentrated

Other Measures

Entries and exits – Excessive barriers to entry into, and exit from, a given market stifles competition. Firms operating in a concentrated market may still behave as if competition existed due to the potential for other firms to enter the market. For example, setting premiums excessively high could signal firms in other lines of insurance to the presence of unexploited profit opportunities and entice them to enter new lines of insurance. Excessive exit costs will deter other firms from entering a new market.

Residual market share—Many states have established residual markets to provide insurance coverage to individuals that cannot obtain insurance from the private market. In Missouri, the FAIR Plan provides coverage to homeowners, and the Joint Underwriting Association (JUA) provides automobile insurance. In periods of diminished capacity or restricted availability of affordable coverage, residual markets can significantly expand. Thus, the size of residual markets is a good indicator of the overall health of the private market.

Private Passenger Automobile Insurance Herfindahl-Hirschman Index (HHI), Derived by Market Share of Insurer Groups*								
1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
1,072	1,055	1,001	1,050	1,081	1,099	1,082	1,068	1,062

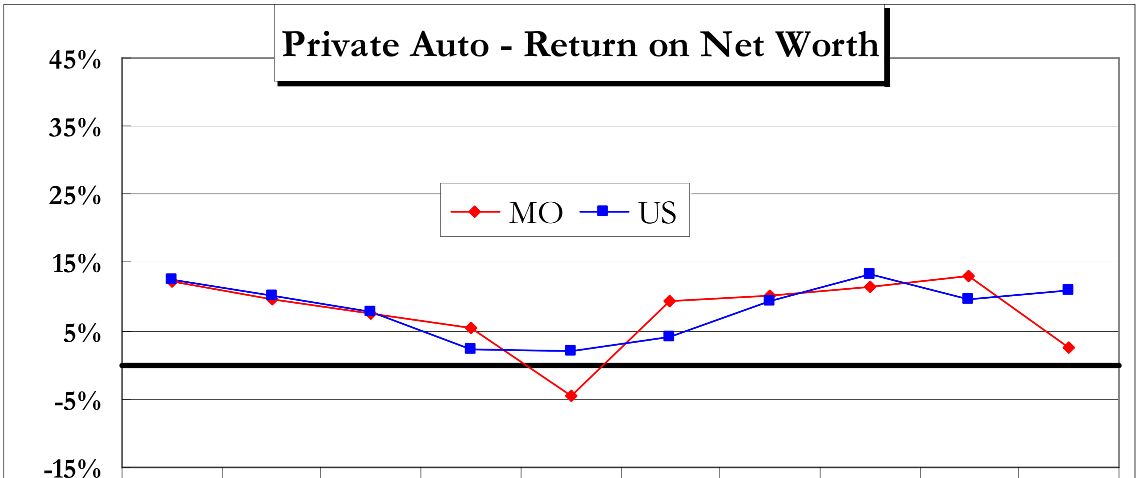
*DOJ Guidelines:

Below 1,000: Unconcentrated or competitive
1,000 to 1,800: Moderately concentrated
Over 1,800: Highly concentrated

Private Passenger Automobile Insurance Market Concentration								
1998	1999	2000	2001	2002	2003	2004	2005	2006
Market Share, Five Largest Insurer Groups								
62.6%	61.9%	60.0%	60.5%	60.4%	61.1%	60.6%	60.0%	59.1%
Market Share, Ten Largest Insurer Groups								
77.2%	77.4%	76.5%	77.0%	77.6%	78.5%	79.0%	79.0%	78.1%

Entries and Exists into Missouri Private Passenger Automobile Insurance Market $10,000 Threshold for Entry and Exit										
	1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**Total**
Entries	5	9	11	8	7	5	9	4	5	63
Exits	11	11	15	8	14	7	6	10	8	90
Total Groups	**102**	**100**	**96**	**96**	**89**	**88**	**90**	**84**	**81**	

Market Share Joint Underwriting Association (JUA)								
1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
0.10%	0.04%	0.02%	0.01%	0.01%	0.01%	0.01%	0.01%	0.00%



	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
MO	12.3%	9.7%	7.6%	5.4%	-4.5%	9.4%	10.2%	11.5%	13.1%	2.6%
US	12.4%	10.1%	7.7%	2.2%	2.0%	4.1%	9.4%	13.2%	9.7%	11.1%

Average Annual Rate of Return (% of Net Worth)

Missouri: 7.7%
US: 8.2%

Market Competition - Homeowners

Homeowners Insurance Herfindahl-Hirschman Index (HHI), Derived by Market Share of Insurer Groups*								
1998	1999	2000	2001	2002	2003	2004	2005	2006
1,223	1,227	1,193	1,217	1,214	1,269	1,272	1,248	1,254

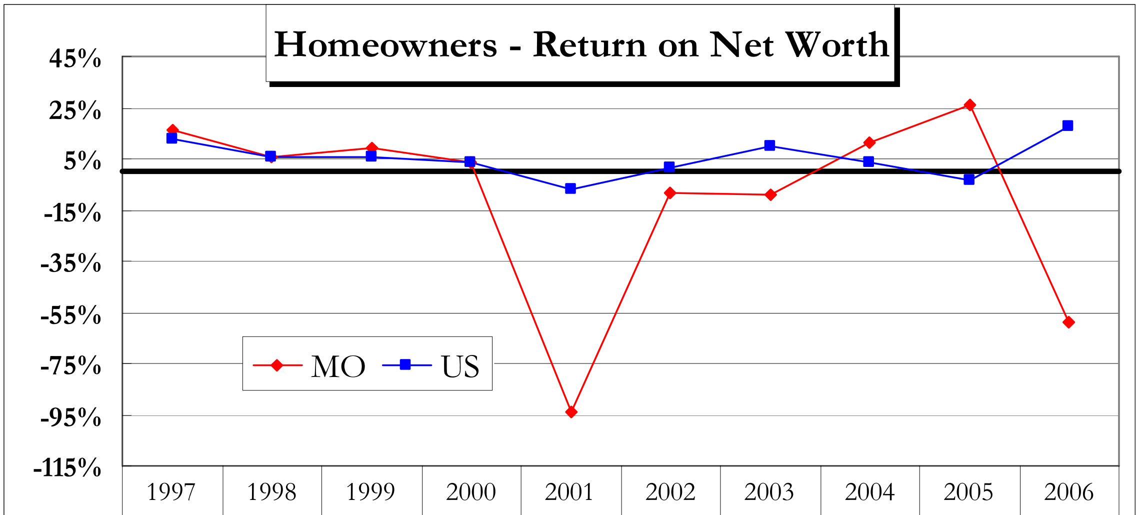
*DOJ Guidelines:

Below 1,000: Unconcentrated or competitive
1,000 to 1,800: Moderately concentrated
Over 1,800: Highly concentrated

Homeowners Insurance Market Concentration								
1998	1999	2000	2001	2002	2003	2004	2005	2006
Market Share, Five Largest Insurer Groups								
65.7%	65.7%	65.5%	66.1%	66.4%	66.3%	66.2%	66.1%	65.7%
Market Share, Ten Largest Insurer Groups								
77.3%	77.4%	77.6%	78.4%	78.8%	79.2%	79.5%	79.5%	79.6%

Entries and Exists into Missouri Homeowners Insurance Market $10,000 Threshold for Entry and Exit										
	1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**Total**
Entries	2	6	4	1	4	4	4	0	2	27
Exits	5	8	8	6	6	2	5	3	4	47
Total Groups	74	72	68	63	61	63	62	59	57	

Market Share-Missouri FAIR Plan								
1998	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**
0.51%	0.43%	0.35%	0.30%	0.28%	0.27%	0.26%	0.26%	0.23%



	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
MO	16.5%	5.4%	9.2%	3.5%	-93.8%	-8.4%	-9.3%	11.4%	25.7%	-58.6%
US	12.4%	5.4%	5.4%	3.8%	-7.2%	1.4%	9.7%	3.6%	-3.5%	17.8%

Average Annual Rate of Return (% of Net Worth)

Missouri: -9.8%
US: 4.9%

Conclusion - Workable Competition

The summary indicators presented in this report afford a glimpse of the structure of personal markets, but will not capture all the ways in which a market can exhibit non-competitive features. For example, the classic textbook ideal-type of a competitive market assumes low information costs and a lack of significant informational asymmetries between buyers and sellers. Information costs for insurance are typically higher than for other commodities and services. Insurance contract language is complex and often highly technical and specialized. In addition to information costs, insurance is relatively unique in that its value can be realized only in the event of some unknown future contingency.

However, most economists believe that personal lines markets are "workably competitive" in the absence of structural impediments such as excessive market concentration. Certain innovations such as standardized or comparable policy forms reduce information costs and facilitate meaningful comparison shopping. Information sources such as consumer complaint indices can provide meaningful cues to individuals regarding the likely future behavior of firms, thereby reducing informational asymmetries. This report found no indication of structural deficits in Missouri's personal lines markets, and every indication of a strong, competitive and robust market.