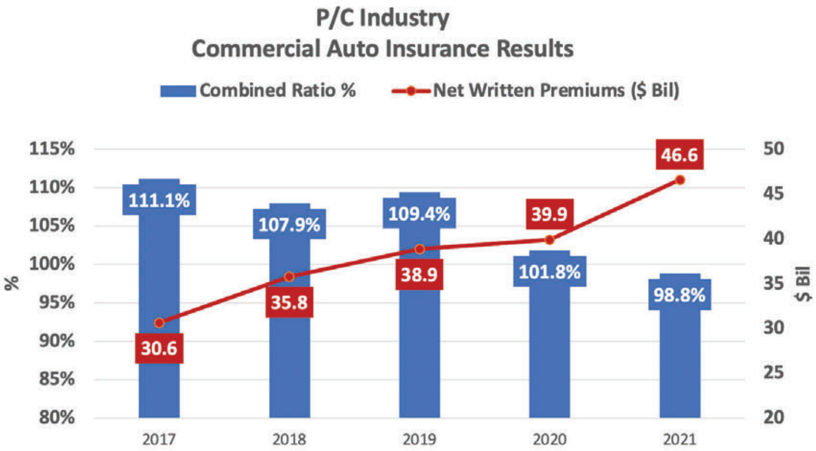
# Commercial Auto Recovery Uncertain Beyond 2022

*By James B. Auden*

Property/casualty insurers have proven resilient in the last two years amid the considerable challenges derived of the coronavirus pandemic. One unanticipated outcome in this period is sharp improvement in underwriting results of the commercial automobile insurance line.

Following 10 consecutive years of underwriting losses, this chronic underperforming business moved to a 99 statutory combined ratio in 2021, tied to substantial pricing and reunderwriting actions and a material shift in claims experience amid the pandemic.




**Source:** S&P Global Market Intelligence
Statutory Accounting - Commercial Auto Liability and Physical Damage Combined

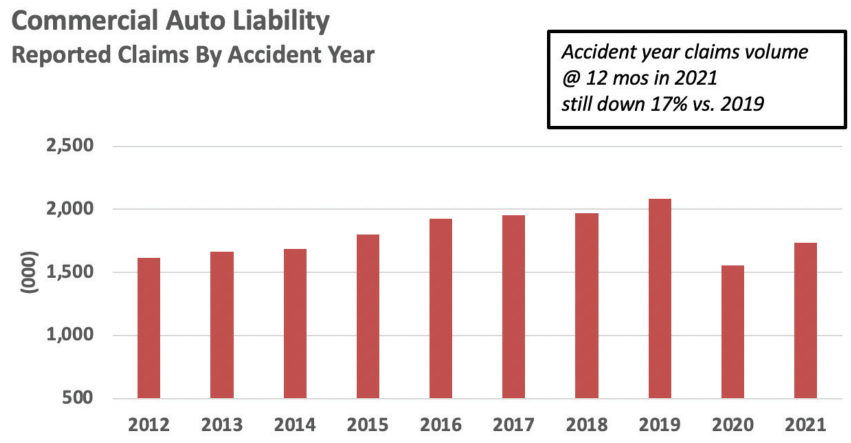
A segment 99-100 combined ratio is attainable in 2022 from earned premium growth and recognition of better claims and reserve experience in most recent underwriting periods. But longer term, a flattening trend of premium rate increases suggests pricing is less likely to keep pace with loss cost trends amid higher general inflation and ongoing litigation uncertainty.

Commercial auto insurance is now the third largest U.S. commercial lines market segment following 65 percent net written premium growth in the last five years. Commercial auto written premiums total only 18 percent of the much larger U.S. personal auto segment.

Segment statutory combined ratios averaged 108 from 2011-2019, a consequence of prior competitive pricing conditions, less disciplined underwriting standards, and persistent rising claims severity tied to heightened litigation activity and higher repair costs as vehicles are stocked with more sophisticated technology. Systemic issues that affect claims incidence, including shortages of trained drivers and proliferation of distracted driving from dependence on digital devices also contributed to performance weakness.

Despite multiple rounds of price increases, higher deductible requirements and more discerning risk selection processes, efforts to turnaround performance proved unsuccessful until 2020.

Economic lockdowns enacted to combat the coronavirus pandemic led to sharp reductions in driving activity and automobile accidents in 2020. Statutory reported claims data indicates that industry commercial auto liability claims declined by 25 percent for the year. While activity returned closer to prior norms in accident year 2021, reported claims remained 17 percent lower than 2019 figures.




**Source:** S&P Global Market Intelligence - P/C Industry Aggregate

## Shift in Loss Reserve Deficiency

The extended period of large underwriting losses corresponds with reporting of significant reserve deficiencies as actuaries struggled to fully estimate ultimate incurred losses, which contributed to long-term underpricing of the product. Prior period loss reserves in commercial auto developed unfavorably for the last 10 consecutive years, averaging approximately 7 percent of calendar year earned premiums from 2012-2020.

Adverse development declined to only 2 percent of earned premiums in 2021 due largely to a shift in 2020 accident year performance. Industry accident year loss ratios in commercial auto liability from 2012-2019 were originally reported in the 72-79 range, but as loss experience matured, loss ratios developed upward over time by an average of approximately 8 percentage points to the mid-80s range in many instances.

The 2020 accident year loss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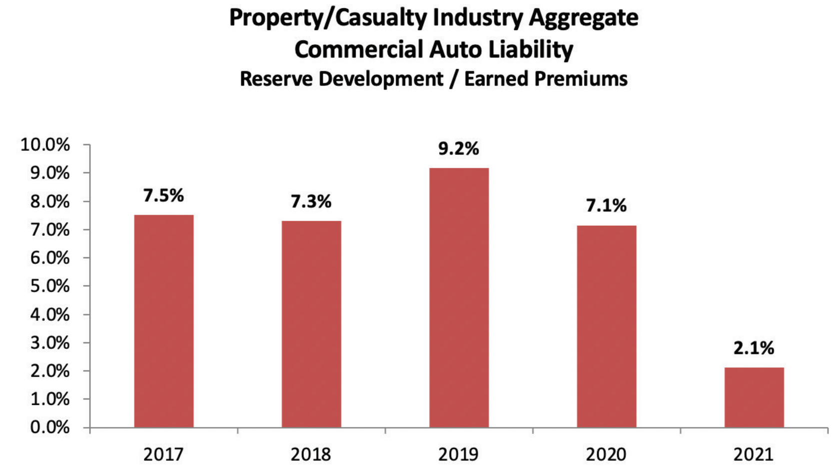
ratio showed vast improvement, and in contrast to past periods, developed favorably to date relative to the original estimate—an indication that carriers exercised some caution in reflecting improvements in original loss estimates from frequency changes.

While accident years 2012-2019 are likely to continue to show ongoing deficiencies, several statistics suggest that 2020 and 2021 incurred losses were reported more conservatively from the past and have potential for redundancies. Particularly, reserves held per outstanding claim at the same period of development are higher with the 2021 underwriting year 26 percent above 2019. Also, incurred but not reported (IBNR) losses, which are the more actuarially estimated portion of losses, represent a materially higher percentage of all incurred losses for 2020-2021 versus prior periods (15 percent higher in 2021 vs. the 2012-2019 average).

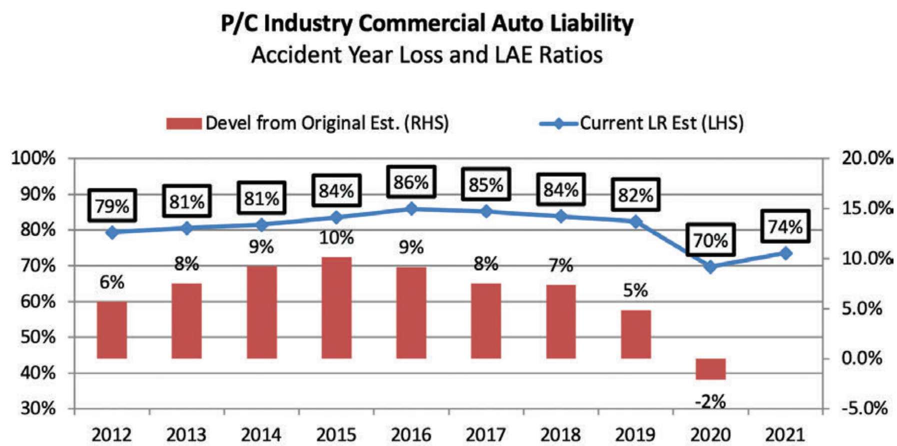
## Longer Term Challenges Remain

The commercial auto line is positioned for a breakeven or better underwriting result in 2022. However, segment performance may retreat as soon as 2023 as the magnitude of pricing increases subsides after many years of substantial jumps while loss costs inexorably move higher. A return to higher general inflation in the U.S. adds to uncertainty as the effect on key loss cost drivers—vehicle repair costs, medical inflation and litigation costs—is unclear.

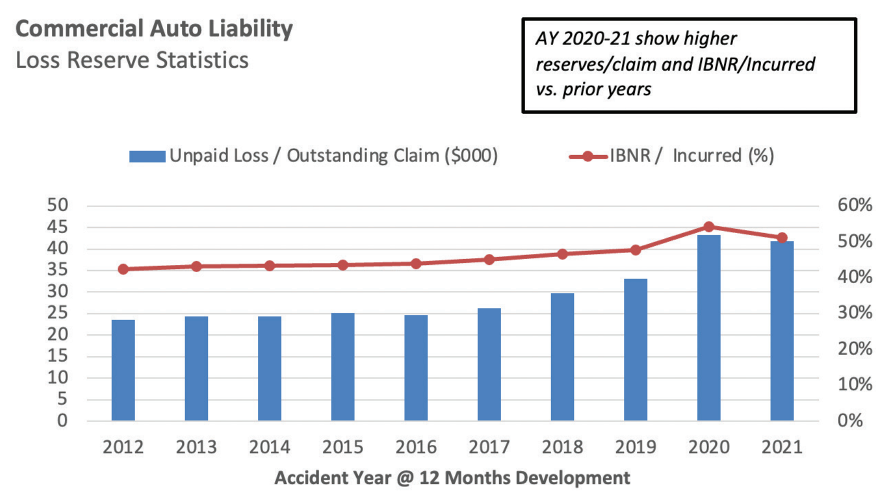
The broader U.S. commercial lines sector has experienced a hardening pricing phase for the last three years, but improvement in results and customer




**Source**: S&P Global Market Intelligence



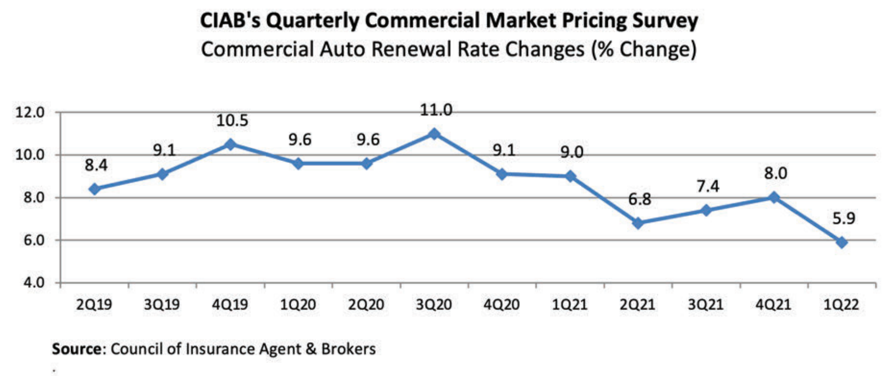

**Source:** S&P Global Market Intelligence, Fitch




**Source:** S&P Global Market Intelligence fatigue from repeated premium increases are reducing momentum. In commercial auto, premium rates have increased for the last 43 consecutive quarters according to the Council of Insurance Agent & Brokers Quarterly Commercial Market Pricing Survey. However, the rate of increase fell to 5.9 percent in first-quarter 2022, compared to 9.0 percent in the previous year quarter with an expectation that pricing will flatten further as the year progresses.

The average closed claim payment in commercial auto liability has risen by 35 percent from 2016-2021 with expansion of litigated claims and larger settlements seen as a key driver. Growth in the number of jury verdicts for transportation claims in excess of both $1 million and $10 million are a primary source of commercial auto loss volatility. More frequent attorney involvement in claims and the evolution of the litigation finance industry further expands insurers' exposure to high severity losses.

There are signs that driving behavior is riskier coming out of the pandemic which leads to more severe crashes at higher speed. The National Highway Traffic Safety Administration reports that [motor vehicle traffic fatalities rose by 10.5 percent in 2021].




## Implementing Technology Can Reduce Volatility

The coronavirus pandemic spurred insurers to boost virtual interaction capabilities, foster operating efficiency, and promote faster decision-making through information technology investments. In commercial auto, better information and analytics can boost underwriters' performance in areas, including risk selection, pricing and claims management that can translate into lower combined ratios and narrower cyclical swings in results.

Insurers can now utilize electronically accessible third-party data (e.g., Department of Motor Vehicle data) and unstructured data that reduces the volume of information required of policy applicants while improving quality and accuracy.

Telematics are more widely utilized in personal auto, but can provide widespread value when applied to commercial auto. Requirements for electronic logging devices in commercial trucking implemented by the Federal Motor Carrier Safety Administration provide similar abundant information on driver behavior.

Besides capturing information useful for segmenting and pricing commercial auto risk, telematics information can be utilized in claims assessment, driver training and risk management purposes. For policyholders, this information can provide value in tracking vehicle maintenance needs, improving routing efficiency and lowering fuel costs.

Advances in data analytics and predictive modeling provide commercial auto insurers tremendous opportunities to optimize claims values and accelerate payments. Scoring models provide a tool to quickly identify incidents that correspond with large losses or have a strong propensity for litigation. More sophisticated analytics are also available to aid in identification and prevention of fraudulent claims. CM