To: NAIC Stat Data Working Group

From: Brian Sullivan, President, Risk Information Inc.

Re: Suggestions on the NAIC Profitability Report, the Auto Insurance and Property Insurance Reports, from your longest-tenured user.

Date: June 19, 2024

Thanks to all who have asked for my input on these reports, and how they can be improved. I am thrilled that so many of you are committed to this project because I believe these reports are the bedrock of understanding the personal insurance markets in the United States. There are plenty of organizations who estimate insurance costs or profits, but nothing comes close to the rigor of this trio of NAIC reports. I have been using them for three decades and find them an invaluable tool.

All regulators should all be familiar with our newsletters, *Auto Insurance Report* and *Property Insurance Report*, because the NAIC has a license for unlimited distribution within NAIC members. If you do not see the newsletters, please let me know and I’ll make sure you get on the distribution. And we always stand ready to help any regulator researching the markets and looking for an independent source of information.

Some suggestions:

1. Make the data available in a digital format. Right now, I must take the reports and manually input all the data into a database of my own construction in order to conduct the most rudimentary analysis. Just export the tables as an Excel spreadsheet or CSV file and you will open the door to far more people being able to add value to your work. I appreciate that this is being discussed and hope you will implement soon.
2. Consider adding back in “profit margin,” as once calculated by the NAIC. In 1995 the statistical working group chose to drop that number, which was calculated as return on net worth as a percentage of earned premium to net worth. Jim Bugenhagen, who I believe was the head of the NAIC research department and passed away at a relatively young age in 2002, told me that the “total profit” calculation was designed to normalize for the high level of net worth held by many insurers, distorting the industry’s profit margin. In other words, too much “E” results in a low ROE. He said the decision to drop the number was to avoid the political fallout some regulators faced from reported profits that were too high or too low. Return on net worth was less obvious to the media. He gave me the formula and encouraged me to continue. I have done so for nearly three decades without challenge from anyone except Birny Birnbaum, who I respect enormously as an analyst but was unable at the time to talk me out of continuing the calculation. Many people, including legislators and regulators, have cited our profit number, especially our calculation of average profits over time (more on that below). Are we wrong? Should we stop? Should the NAIC revert to the prior calculation? I would love to talk with anyone about this.
3. I would also love to talk to anyone about what we can learn from the Earned Premium to Net Worth data in the report. The number varies wildly from line to line, sometimes from state to state, and sometimes from year to year. I have tried without success to discern what these differences mean for how different product lines function and how they differ across state lines.
4. Include coverage limits in the auto insurance database. It is not accurate to compare an average premium in a state where people are buying high liability limits and insuring expensive cars (say Connecticut) to one where more people are buying low limits and insuring less valuable cars (say Alabama). Adding coverage amounts is the same concept as already embraced in the homeowners report with insured home value. The Auto Database Report admonishes readers not to compare states because of this and other complexities, but in reality it is possible – and important – to compare apples to apples across different states. What is the real cost of the litigious nature of one state’s system? What is the true impact of high hail losses? This can be known. Yes, the insurance industry will dislike the cost of programming their systems to send you more information, but this is mostly a one-time challenge, and will yield valuable results.
5. Increase the granularity of the insured home values gathered in the property insurance report. I have reported for years that a primary cause of rising homeowners costs is as much increased coverage amounts as rate increases. But it becomes increasingly difficult to get this right when we’re working with decades-old home value data segments. This is already under discussion, and I hope is implemented. Don’t make the mistake of creating new segments to reflect today. Rather, gather data with as much granularity as possible – perhaps in $25,000 increments – so the analysis can adapt to changing times in the future. Yes, the insurance industry will dislike the cost of programming their systems to send you more information, but this is mostly a one-time challenge, and will yield valuable results.
6. Ad a measurement of profitability over time to a 10-year total, in addition to a 10-year average. This weighted average gives a more accurate measure of performance, as it gives more consideration to the years in which premiums and losses are higher. I do this for loss ratios: I add up all incurred losses for a 10-year period and divide them into all earned premium for the same period to create a 10-year loss ratio. Since premiums tend to rise over time for auto, home and other property, this gives more weight to the more recent years. For an insurance executive, this is a more valuable measure for deciding whether to expand or retract their presence in a market. This is most important in property insurance, where a long-term perspective (minimum 5 years, and more productively 10 years) is essential to any profit analysis.
7. Fix the data problems with the Michigan personal auto liability profit report. The premium and data flows through the Michigan Catastrophic Claims Association results are not accurately reflected in the statutory annual reports, and this throws off analysis of both statutory data and the NAIC profit report. When we write about Michigan in our *Auto Insurance Report* newsletter, we ignore short-term incurred losses, which as distorted by MCCA data anomalies, and look instead to paid losses, which are apparently unaffected. It’s not perfect, but it is more useful. Many years ago the NAIC published a supplemental page adjusting the Michigan number to correct for the MCCA problems, but that was dropped. There was a similar corrective exercise for South Carolina due to an involuntary market issue, but that was eventually ironed out.