AN ALERT FROM THE BDO INSURANCE INDUSTRY PRACTICE

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THE ROAD TO PROFITABILITY FOR COMMERCIAL AUTO INSURANCE

By Peter Popo and James Evans

In 2011, the combined ratio of the commercial auto industry broke into unprofitable territory—scoring a 103.5% combined ratio—as favorable loss reserve takedowns in the years prior left commercial auto insurers ill-prepared for a downturn.

Despite the fact that insurers have continued to take rate increases quarterly since 2011, the industry's combined ratio sustained upward momentum until the first quarter of 2019, which also yielded the lowest direct incurred loss ratio in the last three years.

Commercial auto is not out of the woods just yet, however, as over half of the profitability shortfall in the last decade can be attributed to adverse development on prior year loss reserves. This continued underestimation of reserves remains a headwind to any recovery in the commercial auto insurance space—and even with the planned improvements in underwriting, prognosticators are still calling for future rate increases throughout 2019 and AM Best maintains its negative outlook on commercial auto.

In an attempt to right the ship, every silo in the industry has begun to take action—but there's still work to do. Underwriters are looking to the data to cull the riskier insureds, but are limited by a lack of detailed driver information. Pricing actuaries are raising rates,

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BDO's Insurance practice understands the complexities of the industry and the implications for your business. Whether you're looking to tap our extensive SEC experience in order to enter the public market, discuss the latest insurance accounting and reporting requirements from the NAIC, or comply with state regulatory agencies, BDO's Insurance practice provides proactive guidance to our clients. We know that no two insurers are alike, and we tailor our services accordingly. We're proud of our industry focus and experience, and our commitment to delivering the right team with relevant industry experience, both as we begin our relationship and for the long term.

but class-based rating plans are not providing enough detail to capture the best risks. Claims teams are integrating triage models to improve the efficiency of their processing and provide early warnings of problematic claims, but are continuing to muddy the data further downstream. Reserving actuaries are trying not to be reactive, but nine years creates a trendline and adverse developments keep on coming.

Many within commercial auto share a view that issues in net combined ratio are broader in scope than ever before, and will require new tools and technology to return to profitability. **Climate change**, for example, is expected to play a larger role in underwriting as extreme weather events intensify and insureds face greater risks of auto physical damage.

The deployment of more **advanced technology** in vehicles will also influence the industry over time as both the focus on consumer safety and the cost of repair or replacement for physical damage claims grow. Carriers, for example, are trying to mitigate their exposure to high priced claims by using technology to track and visually monitor the driving behaviors of insureds and their surroundings. This can allow insurers to select the safest drivers to cover and provide footage of an accident in real time.

Further, the strong growth in the U.S. economy is expected to continue to spur a rise in the number of trucks on the road—as well as inexperienced drivers. According to **research by the American Trucking Associations**, the trucking industry is currently understaffed by more than 50,000 drivers, and that figure is at risk of growing by more than threefold within the next eight years if the current trends continue.

Although commercial auto continues to struggle as a whole, some players within the industry are having success—with as much as a 30-percentage point gap between 1st and 4th quarter loss ratios in 2018.

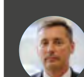
WHAT'S NEXT FOR COMMERCIAL AUTO INSURANCE?

For the commercial auto outlook to improve, insurers must start from scratch and bring a cross-functional, data-driven approach to the table. A comprehensive data strategy can allow insurers to use new and existing data to augment models, expand rating plan granularity and strengthen their ability to react to shifts within the industry appropriately. Driving model risk management and change management processes through each silo will give insurers the opportunity to identify what is and is not working and implement changes accordingly.

The insurers that have rapidly expanded their businesses and report favorable combined ratios in the current environment are also making significant efforts to better understand their exposures. Going beyond sourcing their in-house data, these insurers are beginning to look to organizations like the National Transportation Safety Board and other third-party sources for further insights on insureds' driving habits, road density, the number of miles driven and the cost of repair within certain markets. However, to best leverage these new data sets, training, development and change-management programs for key employees within underwriting, pricing, claims management and reserving need to be implemented.

Though the effects of the above strategies will take some time to have a material impact—and rate increases will likely remain a key part of profitability—insurers must equip themselves with the skills and tools necessary to adapt to current trends and thrive in the future, data-enabled state of commercial auto insurance.

To learn more about how your business can adapt to emerging commercial auto trends, contact Peter Popo, Assurance Partner at BDO, at ppopo@bdo.com, or



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