Trends and Insights:
How Inflation Affects P/C Insurance Premium Rates – and How It Doesn't

Today's historically high interest rates have left none of the daily costs of living in the United States untouched, including the cost of insurance. As a result, Triple-I fields a lot of questions from consumers and the media as to exactly how inflation affects the premiums consumers pay for coverage – particularly for their homes and cars.

In one sense, the impact is straightforward. As material and labor costs rise, the cost to repair and replace damaged homes and vehicles increases. If premium rates didn't reflect these increased costs, insurers would quickly exhaust the funds they set aside – "policyholder surplus" – to ensure that they can afford to keep their promises to pay all claims. If their losses and expenses exceed their revenues by too much for too long, they risk insolvency.

But insurers do more than pay claims: They employ people (labor costs) and conduct business operations (supplies and energy costs); and, if they are to remain in business, they have to earn a reasonable profit.

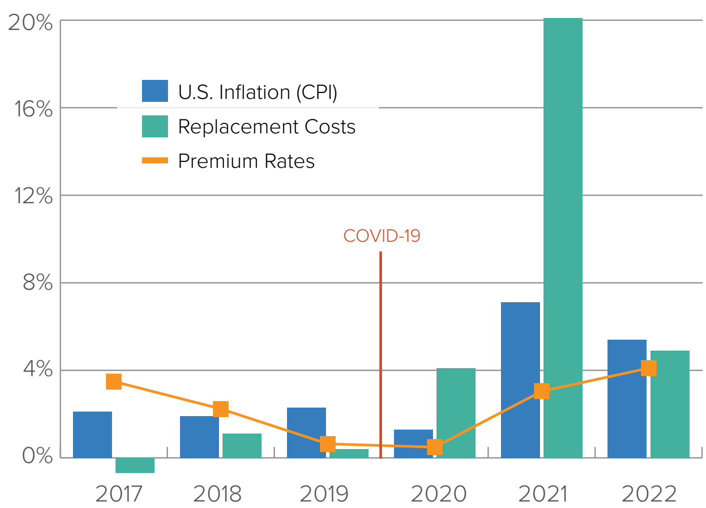
This may seem like a simple formulation, but it's instructive to look at how personal auto and homeowners insurance premium rates have changed across evolving inflationary conditions, compared with general inflation and growth in replacement costs. As shown in the charts below, rates remained relatively flat during 2021's sharply higher inflation and replacement costs that coincided with the height of the COVID-19 pandemic.

In addition to not increasing premium rates proportionately to rising costs, personal auto insurers – expecting reduced losses as fewer drivers were on the road during lockdown – returned about $14 billion to policyholders through cash refunds and account credits. While loss ratios fell briefly and sharply in 2020, they have since climbed steadily to exceed pre-pandemic levels.

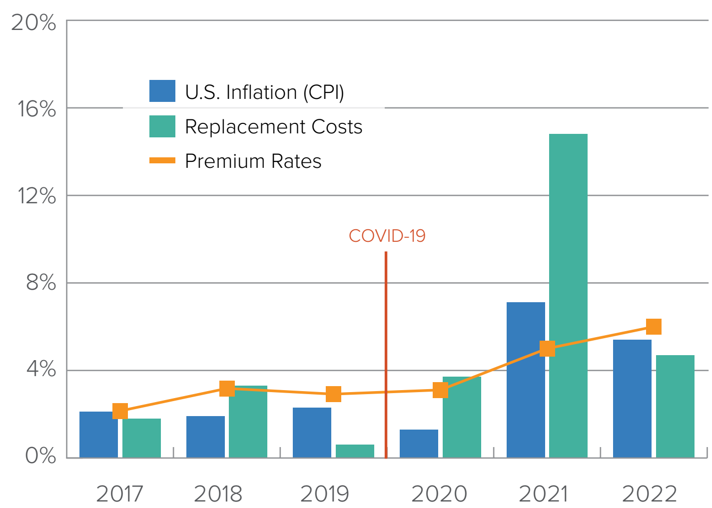
With drivers fully on the road again, this loss trend is expected to continue.

Personal Auto & Homeowners Premium Rates vs. Inflation & Replacements Costs*

Personal Auto



Homeowners



* Inflation numbers, replacement costs, and premium rates are year-over-year numbers.

Source: Inflation data from the U.S. Bureau of Labor Statistics and Federal Reserve; Replacement cost date from Triple-I; Premium rates from Triple-I and Milliman

Inflation alone doesn't drive rates

Auto premium rates aren't just affected by inflation costs – they also are affected by frequency and severity of claims. After decades of decline, traffic deaths have increased in the past several years due to riskier driving behaviors - more speeding, driving under the influence, not wearing seat belts, distracted driving - during the pandemic.

In 2021, U.S. traffic fatalities reached a 16-year high, with nearly 43,000 deaths. In the first quarter of 2022, the National Highway Traffic Safety Administration (NHTSA) estimates, 9,560 people died in motor vehicle crashes, up 7 percent from the same period in 2021, making it the deadliest first quarter since 2002.

Attorney involvement tends to be more prevalent in cases involving bodily injury and fatalities. It also has been found to contribute to protracted litigation and higher claims costs. For these reasons, the NHTSA numbers are important for understanding upward pressure on auto insurance rates.

Similar considerations come into play for homeowners insurance. Global economic losses from tornadoes, hurricanes, severe storms, wildfires, floods, and other natural disasters reached $270 billion in 2021, according to Swiss Re. Of those losses $111 billion were insured, Swiss Re says.

Much of this loss trend is due to people moving into risk-prone areas. More people, homes, businesses, and infrastructure means more costly damage when extreme events occur. More damage to insured properties means more and larger claims. An Aon analysis of U.S. Census Bureau data shows the number of housing units in the United States has increased most dramatically since 1940 in areas that are most vulnerable to weather and climate-related damage (see Triple-I white paper: Beyond Risk Transfer: Why Closing the Flood Protection Gap Will Take Innovation and Collaboration.)

Learn more:

Monetary Policy Drives Economic Prospects; Geopolitics Limits Inflation Improvement

Why Personal Auto Insurance Rates Are Likely to Keep Rising

Acting to Curb Rising Auto Fatalities

Triple-I Brief Explains Rising Homeowners' Insurance Premium Rates

Rising rates are likely

Because of the way insurers are regulated, their options for responding to rising claims, other than by raising rates, are severely limited. Without substantial rate increases, they might have to draw heavily from their policyholder surplus. If surplus approaches defined regulatory thresholds, insurers will be required to raise rates, write less coverage, or, potentially, go out of business.

The trends described above make it likely that homeowners' and auto insurance premium rates will have to rise significantly in years to come. Even if general inflation levels off, labor and replacement-parts costs will continue to rise, albeit more slowly.

Mitigation is crucial

Containing or reducing premium rates requires gaining control over claims.

In the case of auto insurance claims, this means creating incentives for safer driving, improving enforcement of safe-driving laws, and reducing bodily injuries and fatalities that contribute to inflated legal costs.

In the homeowners' space, it means encouraging pre-emptive mitigation measures, from taking steps to reduce weather-related damage to installing smart-home technology that detects vulnerabilities like plumbing leaks before they result in an expensive claim. It also means improving building and land-use codes; considering policy changes to discourage migration into disaster-prone areas; establishing community-based catastrophe insurance and other programs to close insurance gaps; and restoring natural buffers against wind, wildfire, and storm surge.

The property/casualty insurance industry is working with partners across the commercial, government, and community spectrum to cultivate a risk-management ecosystem based on predicting and preventing costly damage. Educating the public about what factors have the greatest impact on claims and losses is an important first step.

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