

# Louisiana's Tort System and Automobile Insurance

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College of Business

**Alabama Center for Insurance  
Information and Research**



25

-

42



3 Clemson Tigers  
(14 - 1)

1 LSU Tigers  
(15 - 0)

Final

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Team	1	2	3	4	T
Clemson Tigers	7	10	8	0	25
LSU Tigers	7	21	7	7	42

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# Risk-based Pricing

## Risk-Based Pricing of Property and Liability Insurance

By Lars Powell, PhD<sup>1</sup>  
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### Abstract

Policymakers currently show renewed interest in restricting the use of certain accurate ratemaking variables in personal lines (automobile and homeowners) insurance. Policymakers are considering laws that would exclude gender, education, occupation, and credit-based insurance scoring (CBIS) as insurance rating variables. I argue that excluding accurate rating variables from the insurance pricing process has negative consequences. The accuracy of insurance prices decreases, creating cross subsidies where lower-risk insureds pay higher premiums and higher-risk insureds pay lower premiums. In addition to being objectively unfair, cross subsidies increase the overall cost of insurance and create incentives for risky behavior. The end result is higher prices, more property damage, more injuries, and more fatalities. I also address arguments put forth by industry critics and demonstrate the high level of competition in insurance markets.

<sup>1</sup> I thank the American Property-Casualty Insurance Association (APCIA) for financial support. However, my agreement with APCIA specifically established my independence in producing this research. Opinions expressed in this report are mine and may not reflect the opinions of the APCIA or the University of Alabama.

# Affordability



## JOURNAL OF INSURANCE REGULATION

Cassandra Cole and Kathleen McCullough  
Co-Editors

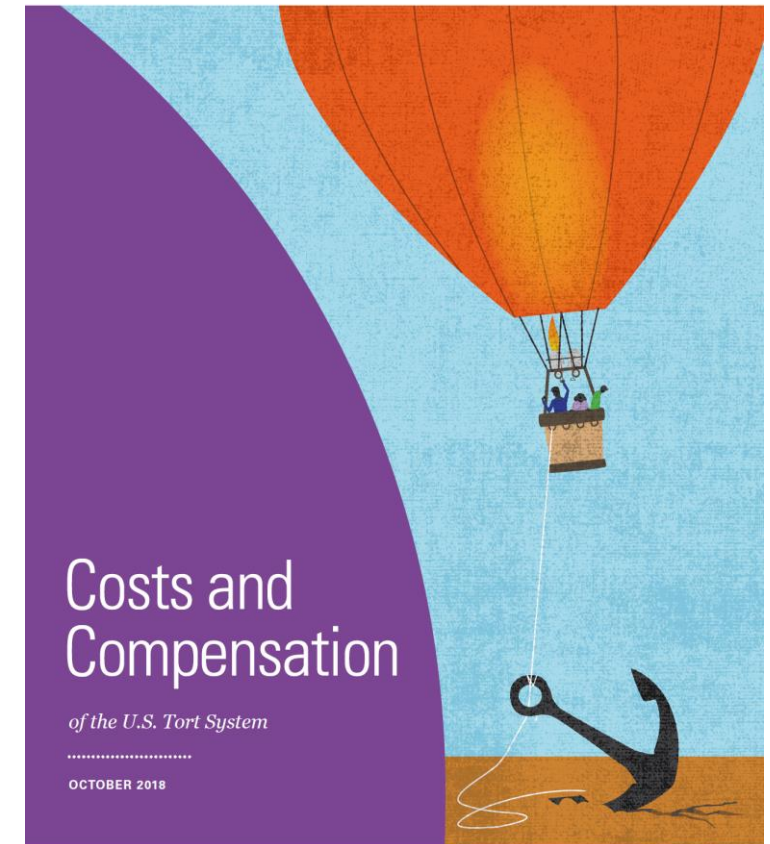
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### Cost Trends and Affordability of Automobile Insurance in the U.S.

*Martin Grace, J.D., Ph.D.*  
*J. Tyler Leverty, Ph.D.*  
*Lawrence Powell, Ph.D.*

JIR-ZA-38-07

# Tort System Costs



# Economic Roles of the Tort Liability System

Optimal Safety



Optimal  
Compensation

# Economic Roles of the Tort Liability System

## Optimal Safety

- At fault party must pay 100% of damages as a deterrent to risky behavior
- Ignores transaction costs



## Optimal Compensation

# Economic Roles of the Tort Liability System

## Optimal Safety

- At fault party must pay 100% of damages as a deterrent to risky behavior
- Ignores transaction costs



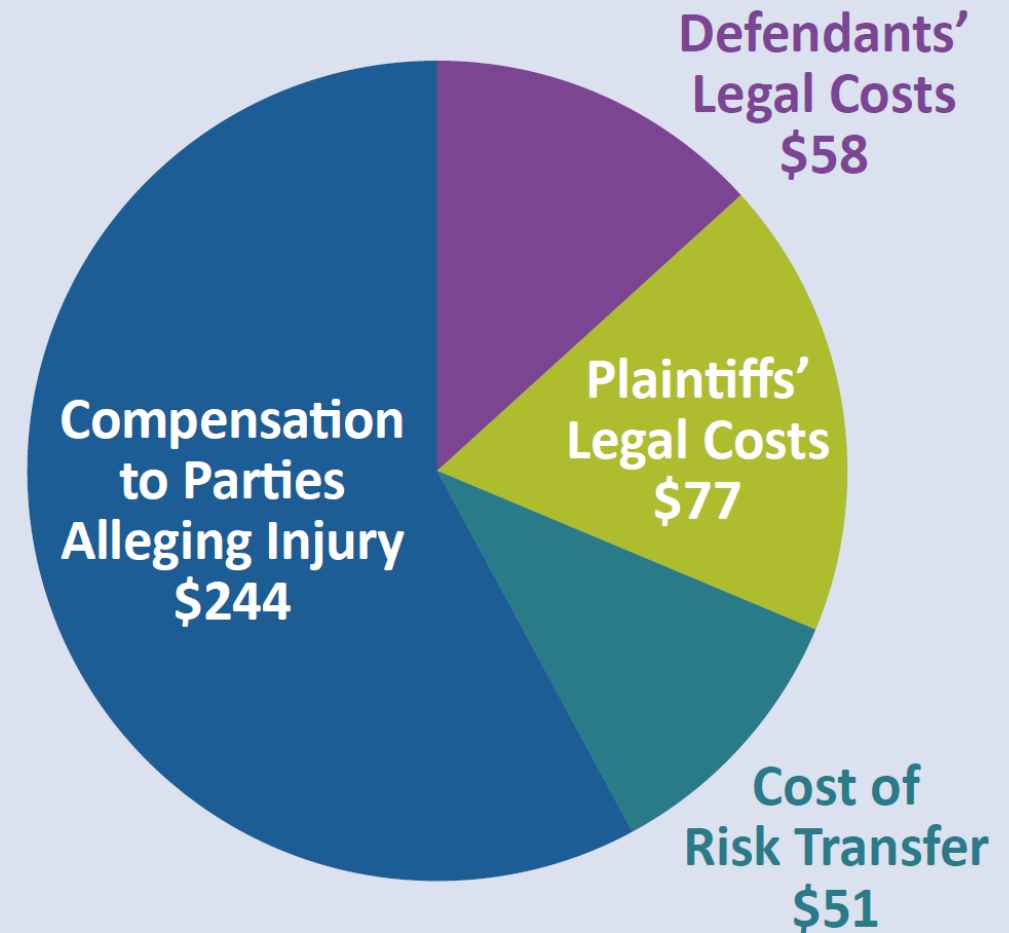
## Optimal Compensation

- Recognizes that consumers pay for liability damages in the cost of goods and services
- Considers the cost of providing protection

# Efficiency of the Tort System

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**FIGURE 4: SOURCE OF TORT COSTS  
(\$ BILLIONS)**





# Dividing the Tort Dollar

Plaintiff  
Compensation  
\$0.57

Plaintiff Legal Cost  
\$0.18



Defendant Legal  
Cost  
\$0.13

Risk Transfer  
Cost  
\$0.12



# Dividing the Tort Dollar

Plaintiff  
Compensation  
\$0.57

Plaintiff Legal Cost  
\$0.18



Defendant Legal  
Cost  
\$0.13

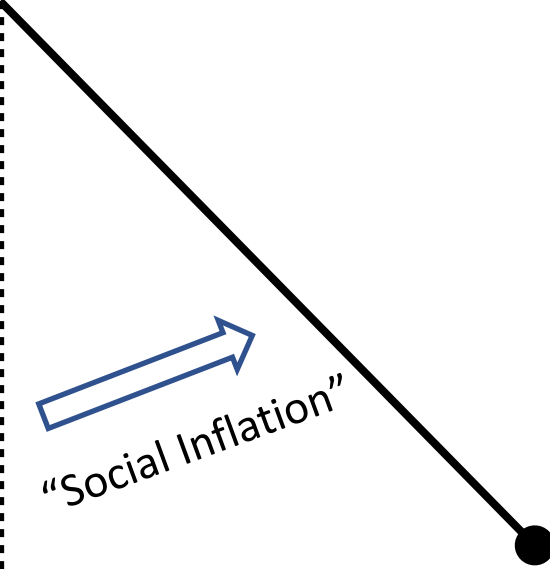
Risk Transfer  
Cost  
\$0.12



Stingy



Generous

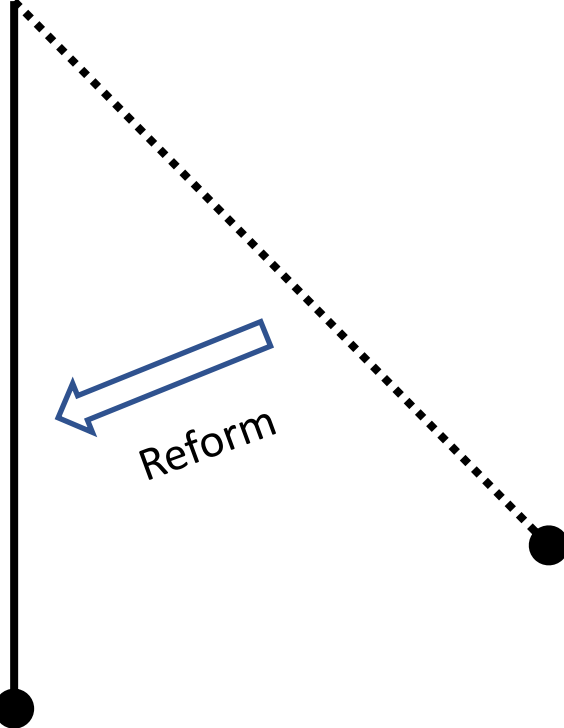


“Social Inflation”

Stingy



Generous



Reform

Stingy

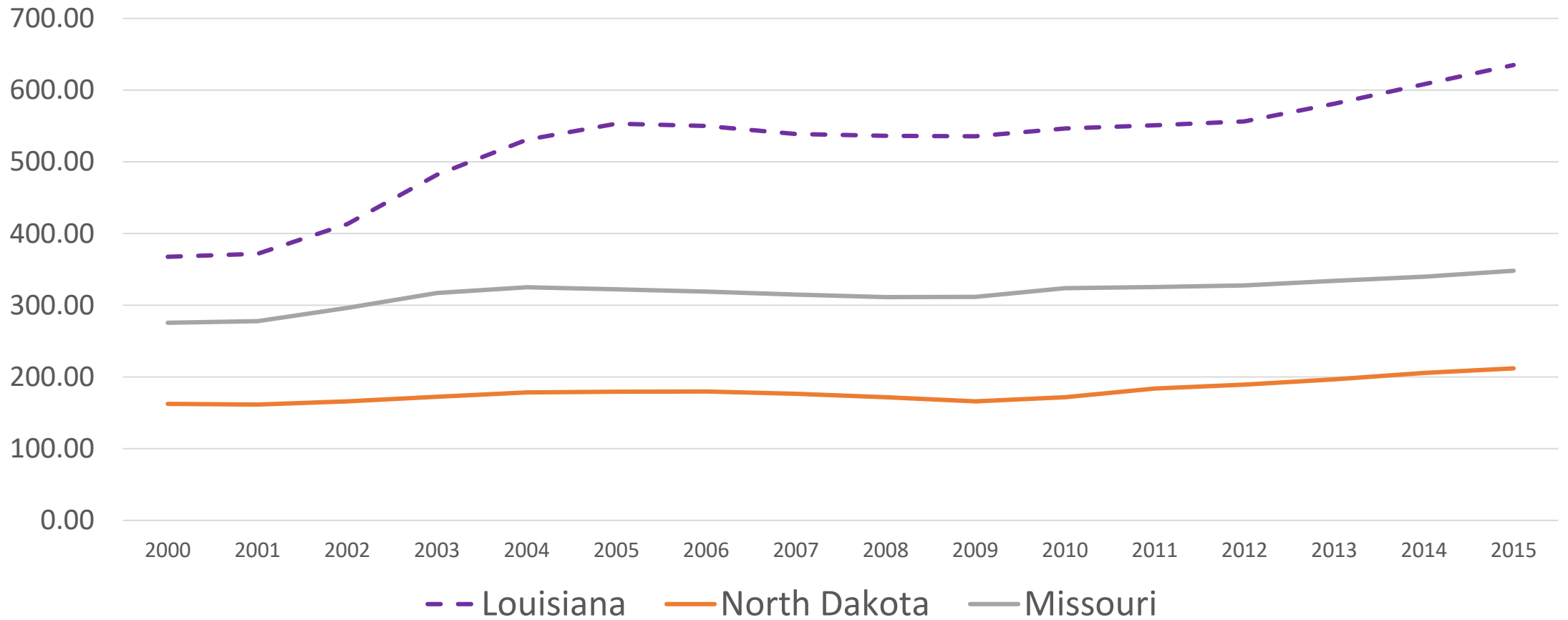


Generous



# Automobile Insurance in Louisiana

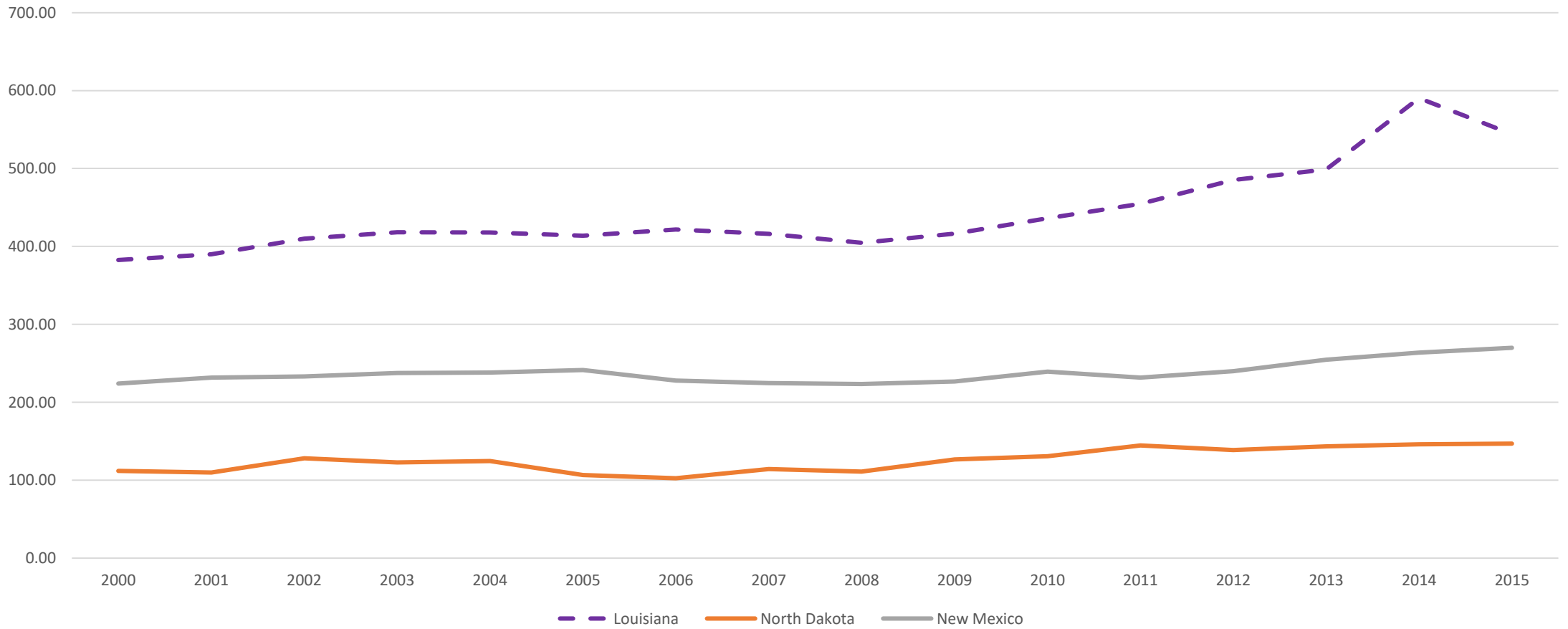
# Insurance Premium per Car



Source: NAIC Auto Insurance Database Reports, 2004-2018



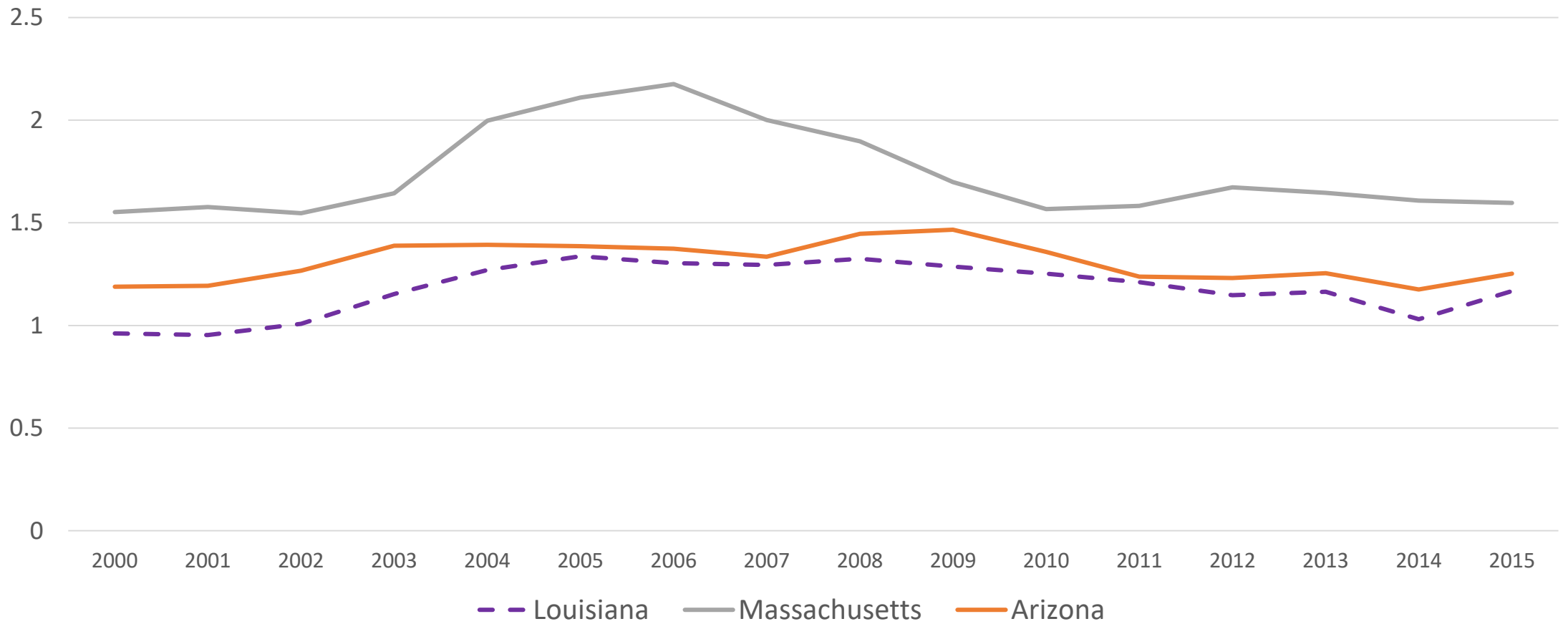
# Insurance Losses per Car



Source: NAIC Auto Insurance Database Reports, 2004-2018

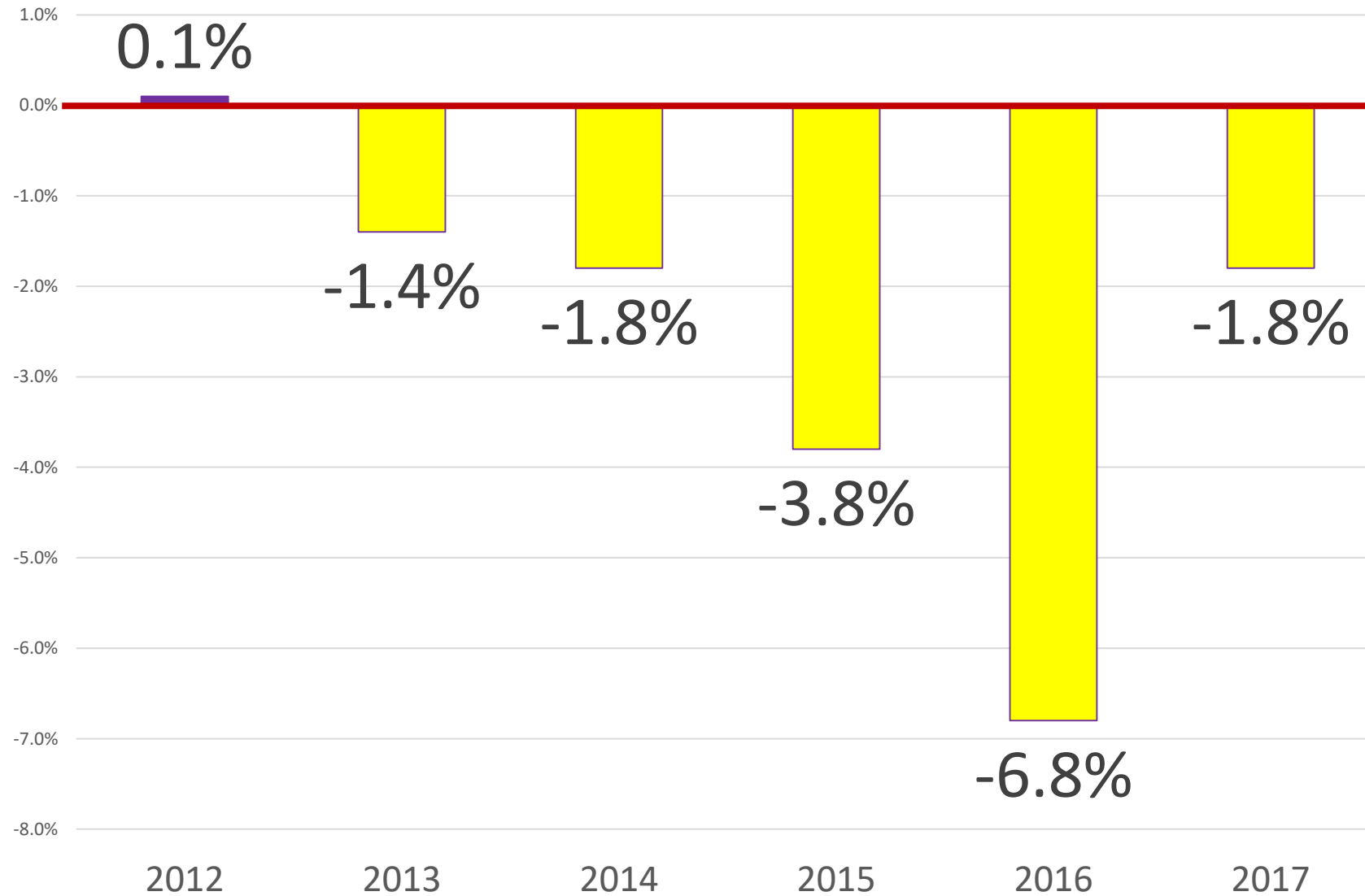
# Insurance Price: Premium÷Losses

#49



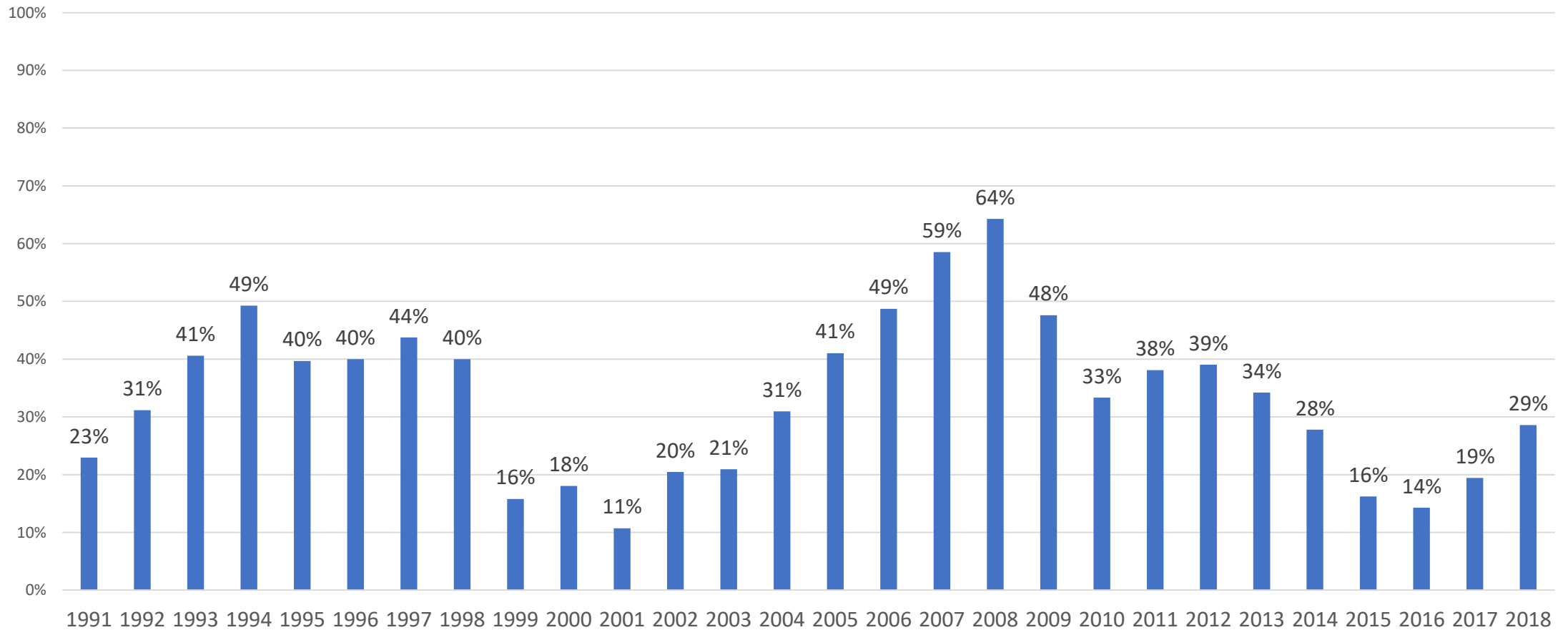
Source: NAIC Auto Insurance Database Reports, 2004-2018

# Return on Net Worth for Auto Liability Insurance



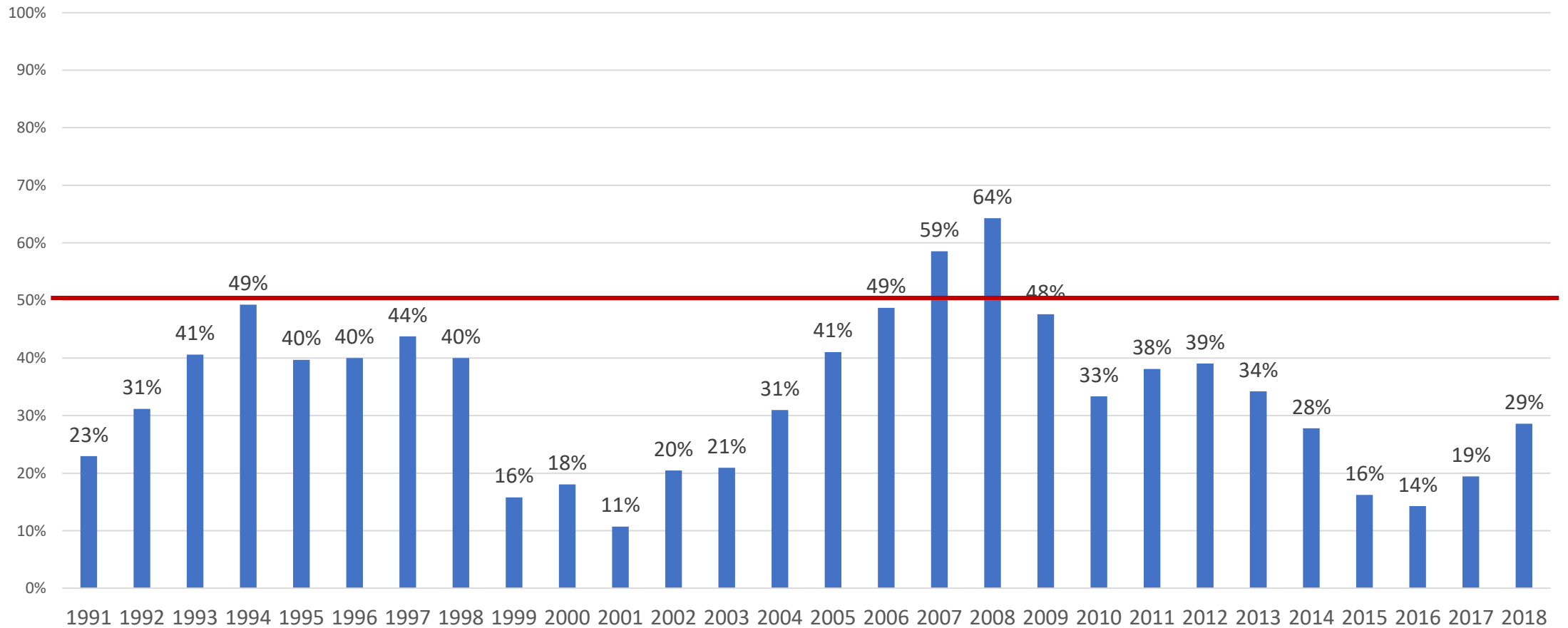
Source: NAIC Report on Profitability by Line by State, 2013-2018

# Percentage of Auto Insurers w/ Loss Ratio < 70



Source: NAIC InfoPro Database

# Percentage of Auto Insurers w/ Loss Ratio < 70



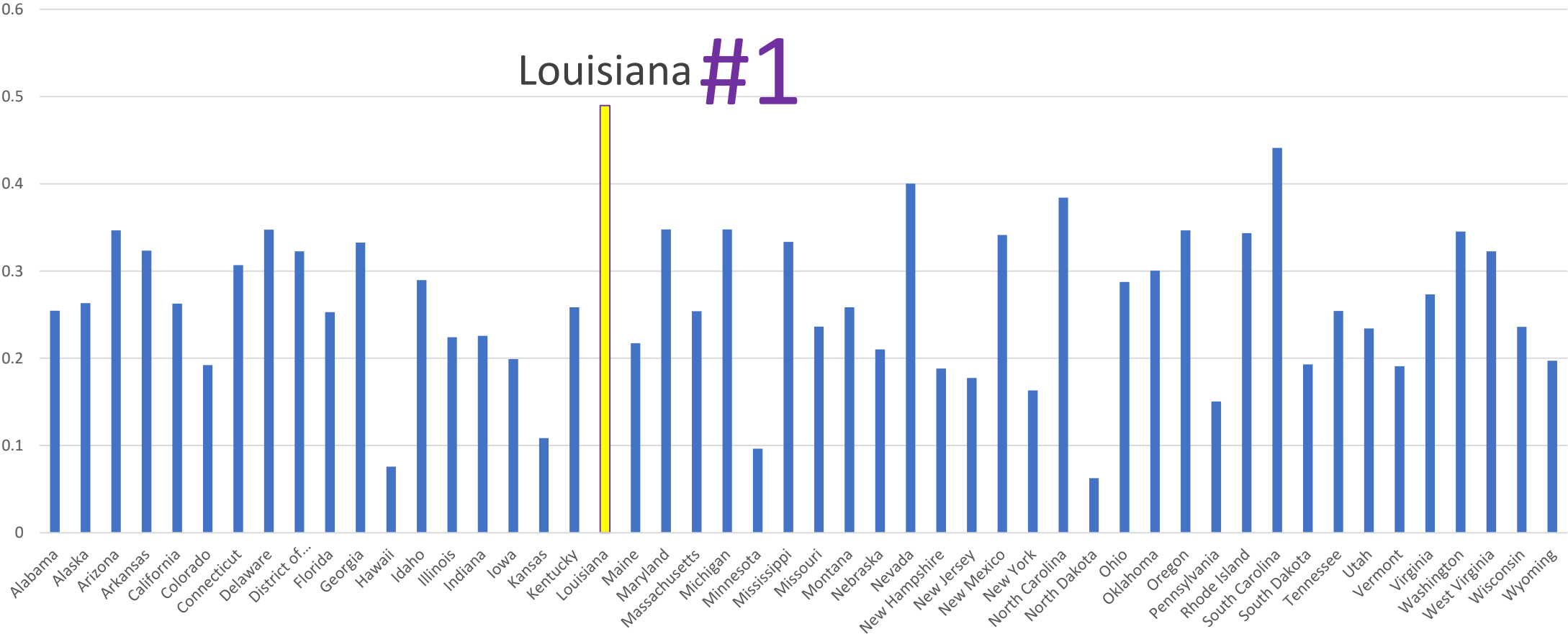
Source: NAIC InfoPro Database



Why does auto  
insurance cost  
more in  
Louisiana?

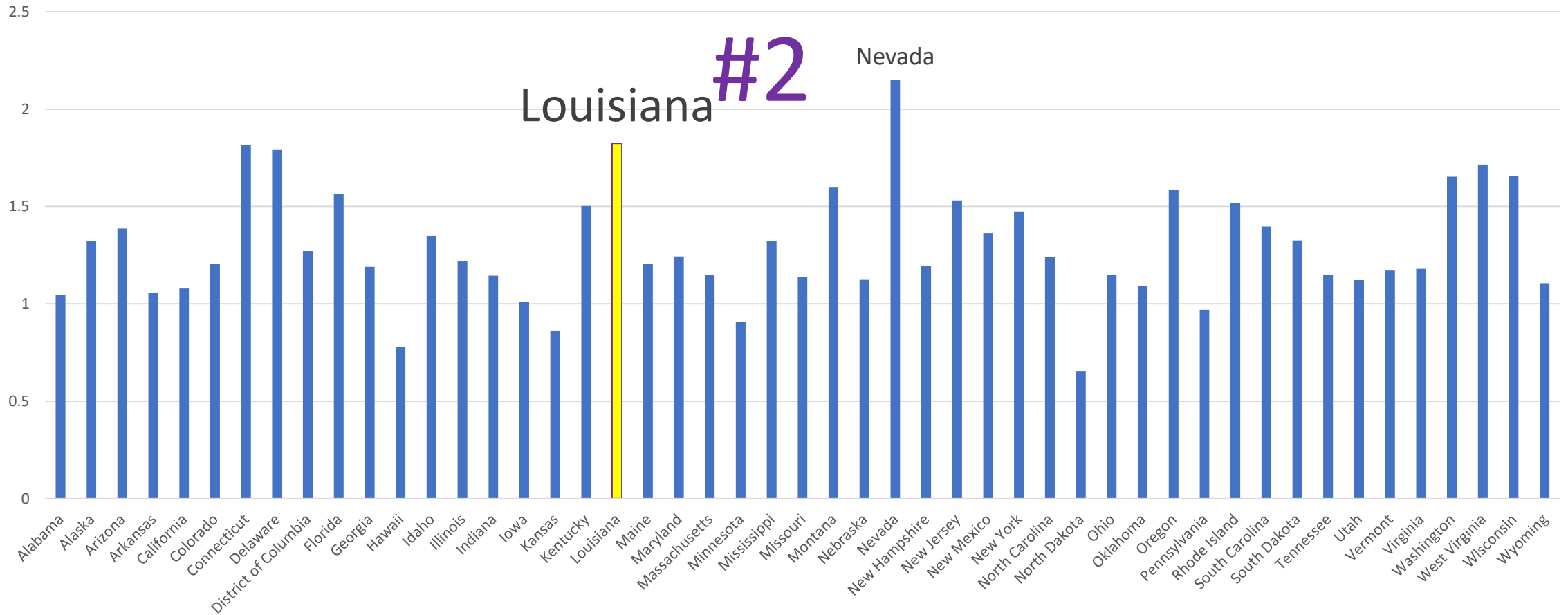


# Bodily Injury Claims ÷ Property Damage Claims



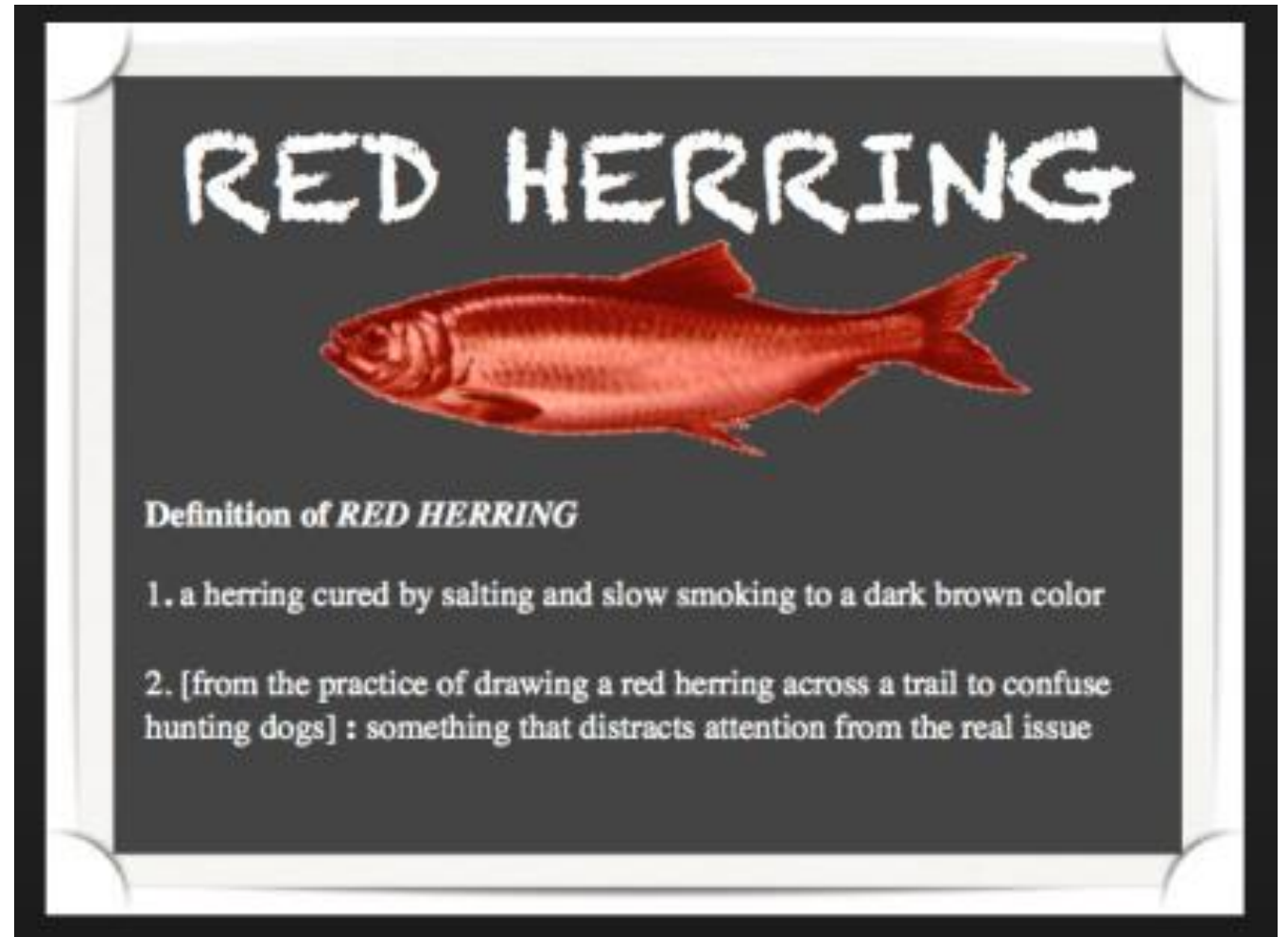
Source: NAIC Auto Insurance Database Reports, 2004-2018

# Bodily Injury Severity ÷ Property Damage Severity



Source: NAIC Auto Insurance Database Reports, 2004-2018

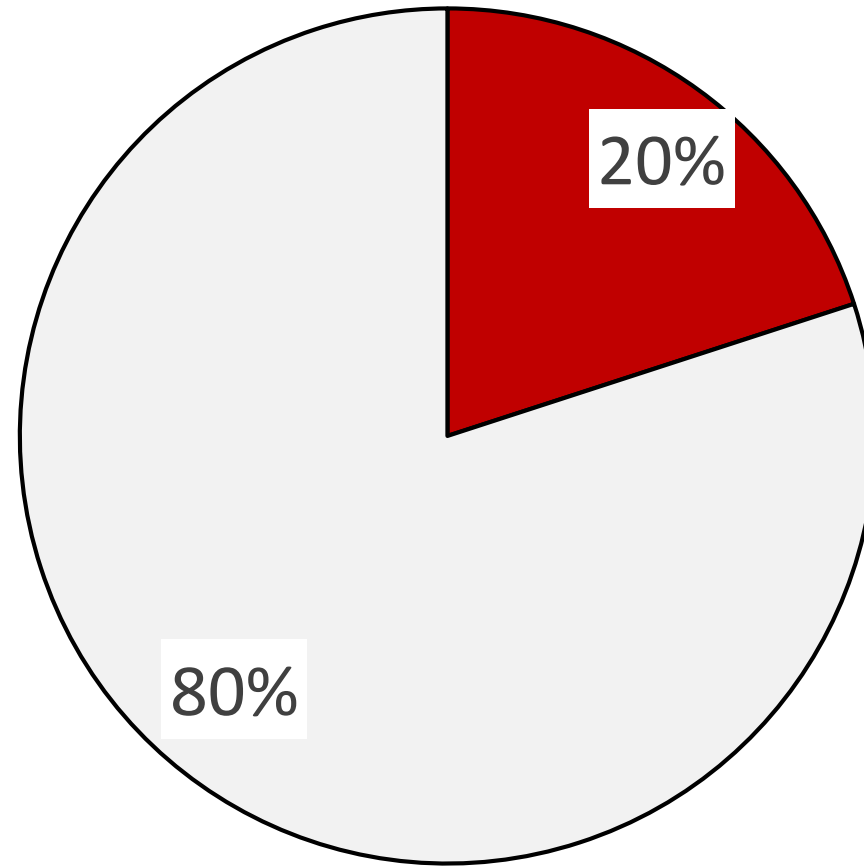
Insurance  
would cost  
less if  
insurers used  
different  
rating  
variables?



Observed  
“driving”  
behaviors

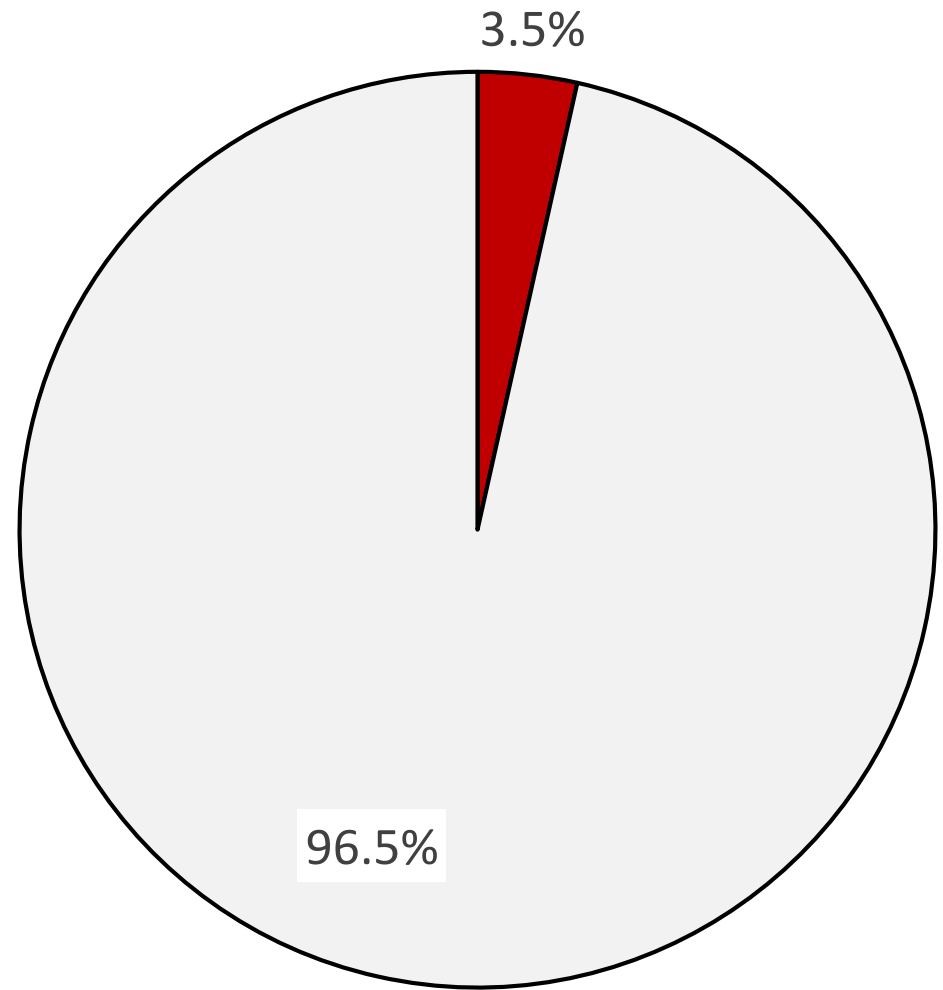


The worst  
class of  
drivers



■ Crash   □ No crash

Average  
drivers

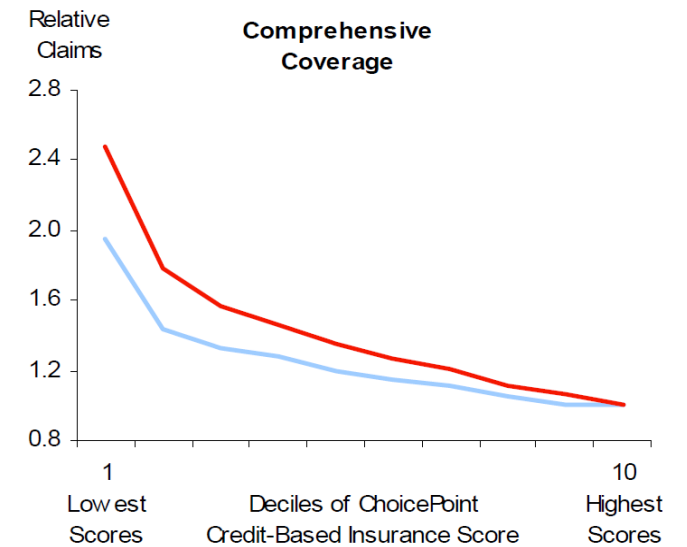
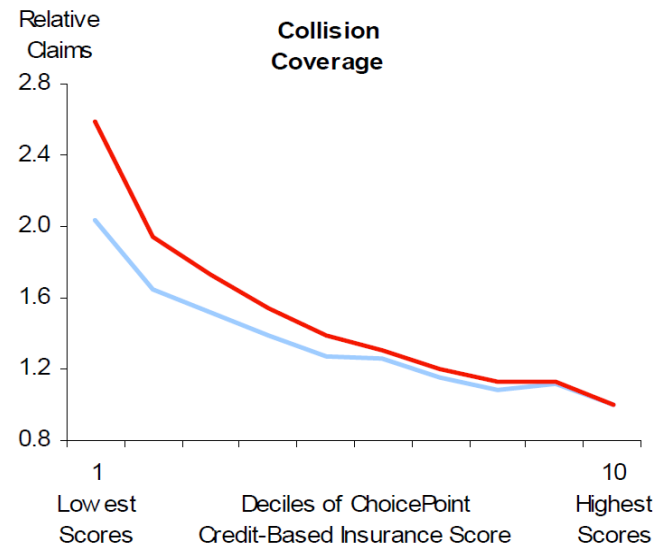
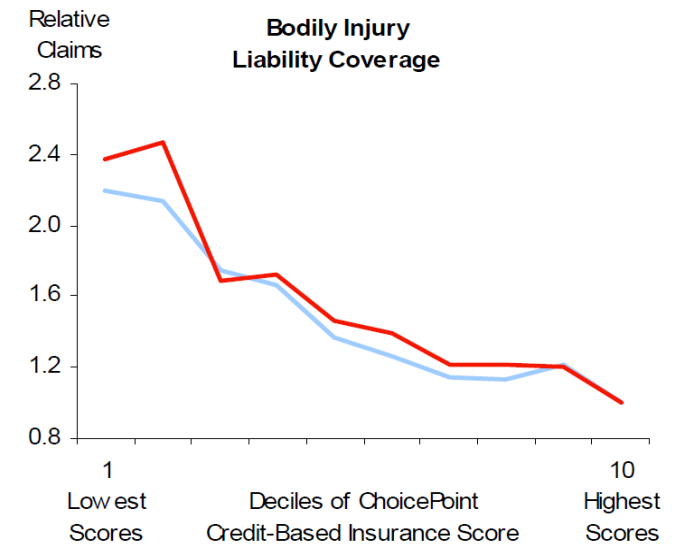
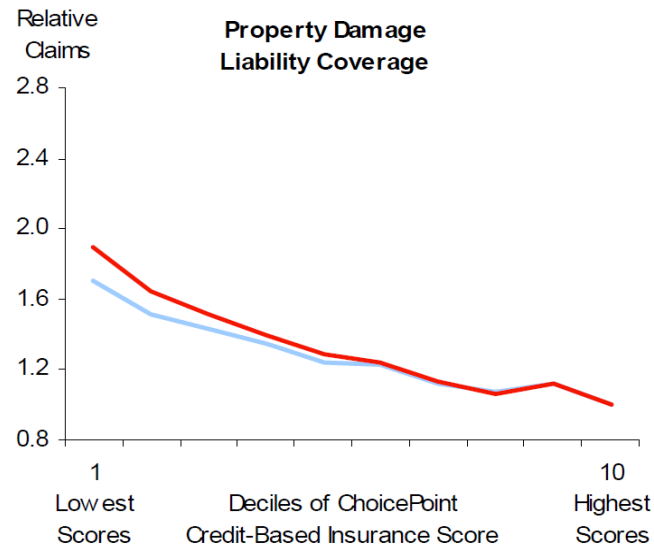


■ Crash    □ No crash

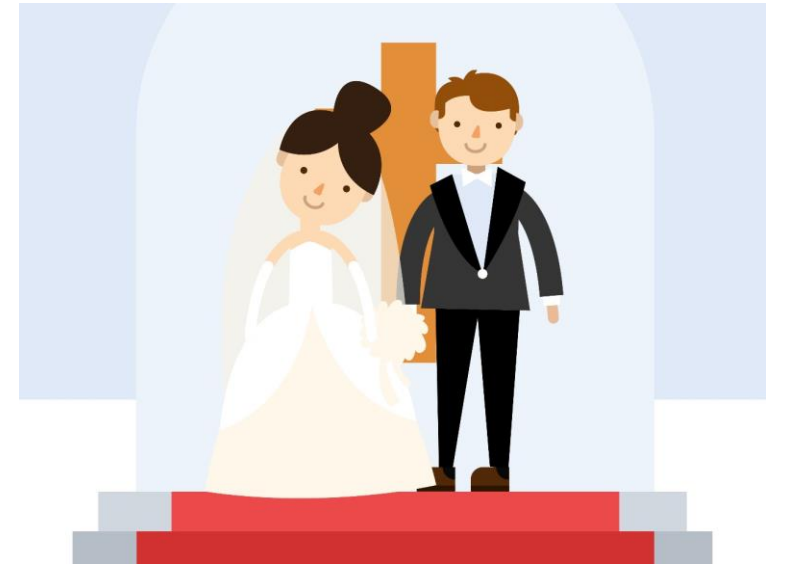
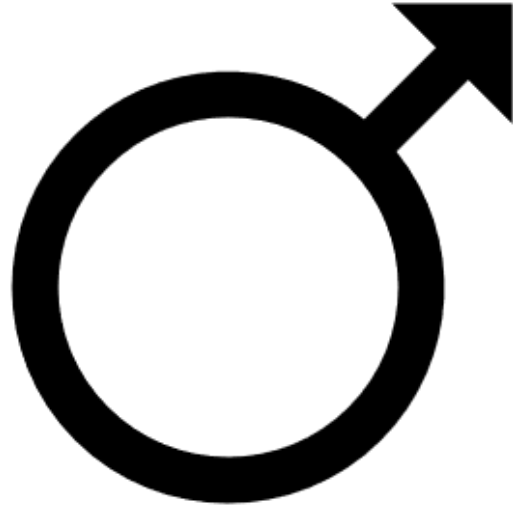
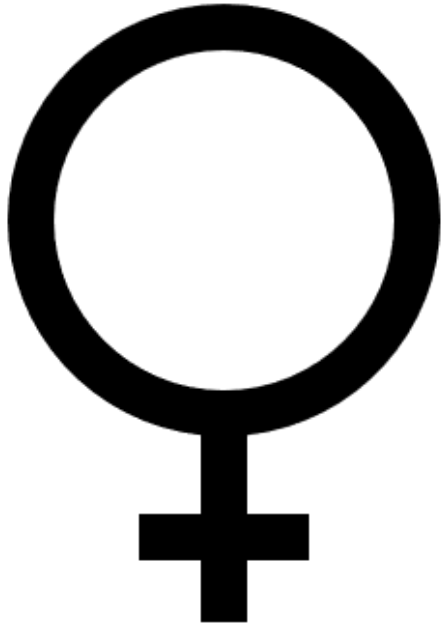


# Credit-Based Insurance Scores

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— Without Controlling for Other Risk Variables  
— After Controlling for Other Risk Variables



# Gender and Marital Status

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Prices become less accurate



# Why do accurate rates matter?



Accurate insurance prices require insureds to internalize the risk they pose to themselves and to others.



When premiums are less accurate, more property is damaged, more people are injured, and more people die.

# Thank You!

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