Louisiana’s Tort System and Automobile Insurance

Dr. Lars Powell
University of Alabama
Lars.Powell@ua.edu
# NCAA football - 1/13

## Final

<table>
<thead>
<tr>
<th>Team</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>T</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clemson Tigers</td>
<td>7</td>
<td>10</td>
<td>8</td>
<td>0</td>
<td>25</td>
</tr>
<tr>
<td>LSU Tigers</td>
<td>7</td>
<td>21</td>
<td>7</td>
<td>7</td>
<td>42</td>
</tr>
</tbody>
</table>
Risk-based Pricing

Risk-Based Pricing of Property and Liability Insurance
By Len Powell, Ph.D.
Alabama Center for Insurance Information and Research
University of Alabama
Len.Powell@ua.edu
December 10, 2019

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 (OBIS) as insurance rating variables. I argue that excluding inaccurate rating variables from the insurance pricing process has negative consequences. The accuracy of insurance premiums 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. It also addresses arguments put forth by industry critics and demonstrate the high level of competition in insurance markets.

Affordability

Journal of Insurance Regulation
Cassandra Cole and Kathleen McCullough
Co-Editors
Vol. 38, No. 7

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.

Tort System Costs

U.S. Chamber
Institute for Legal Reform

Costs and Compensation
of the U.S. Tort System
OCTOBER 2018
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

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

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

- Compensation to Parties Alleging Injury: $244
- Plaintiffs’ Legal Costs: $77
- Defendants’ Legal Costs: $58
- Cost of Risk Transfer: $51
Dividing the Tort Dollar

Plaintiff Compensation $0.57

Defendant Legal Cost $0.13

Plaintiff Legal Cost $0.18

Risk Transfer Cost $0.12
Dividing the Tort Dollar

Plaintiff Compensation: $0.57

Defendant Legal Cost: $0.13

Plaintiff Legal Cost: $0.18

Risk Transfer Cost: $0.12
“Social Inflation”
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

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: 20%
- No crash: 80%
Average drivers

- Crash: 3.5%
- No crash: 96.5%
Credit-Based Insurance Scores

- Property Damage Liability Coverage
- Bodily Injury Liability Coverage
- Collision Coverage
- Comprehensive Coverage

Red line: Without controlling for other risk variables
Blue line: After controlling for other risk variables
Gender and Marital Status
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!

Lars Powell, PhD
Lars.Powell@ua.edu