

Insights

Willis Towers Watson Claim Cost Index Claim cost severity greater than general inflation rate

By Jeremy P. Pecora and Emily M. Thompson

This article updates a family of price indices for major lines of business written by property & casualty (P&C) insurers.

Analysis of the annual changes in the Willis Towers Watson Claim Cost Index, as illustrated in *Figure 1*, shows that the composite insurance inflation rate has outpaced the general inflation rate since 2013. The 2017 cost increases are preliminary, as many of the cost indices contributing to the Willis Towers Watson Claim Cost Index are not finalized.

A P&C insurer's claim settlements are directly affected by economic factors such as trends in the cost to replace damaged property, the cost of repair parts, the cost of medical services and drugs, and salaries and wages. In economic terms, claim costs for loss and loss adjustment expenses are the cost of production for the insurer. An insurer's major claim costs include physician services and other medical expenses; hospital care and rehabilitation; lost time and wages; automobiles, including repairs and parts; building materials and construction labor; and personal effects. The components for loss adjustment expenses are those incurred by insurance companies in settling claims (e.g., legal fees, and other legal and court costs).

The Willis Towers Watson Claim Cost Index is calculated from a variety of sources (e.g., the Consumer Price Index [CPI] and the Producer Price Index [PPI]) that reflect insurance costs. The Index can be used as an indicator of the rate of change in claim severity. For example, insurance companies purchase auto mechanic services for auto physical damage coverage. As the hourly wage of auto mechanics increases, the cost for auto physical damage insurance coverage increases.

We have made one change to the methodology this year. Specifically, we have altered the weights associated with the medical portion of the workers compensation index. Through publicly available data, derived by National Council on Compensation Insurance we were able to improve the split among hospital beds, physician services and medicinal drugs. We incorporated this weighting going forward and made no change retroactively.

The tradition continues

Willis Towers Watson publishes trusted Index

As part of Willis Towers Watson's continuing commitment to the P&C insurance industry, we are publishing the Masterson Index under the rebranded name, Willis Towers Watson Claim Cost Index.

The Index has a long history of excellence. Norton E. "Doc" Masterson created the claim cost index in his seminal work, "Economic Factors in Liability and Property Insurance Claims Costs 1935 – 1967."

Originally developed in the 1960s by Masterson, a consulting actuary, the index was first published by A.M. Best and Co. in 1968.

Masterson's index work was taken over by William Van Ark in 1996. Jeremy Pecora has been updating it since 2005.

Figure 1. U.S. claim cost indices
(1982 – 1984 = 100)

Coverage	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017*
Auto, bodily injury	4.86%	5.48%	4.57%	4.22%	-4.65%	4.52%	3.93%	2.73%	3.48%	3.32%	5.30%	3.81%
Auto, property damage	3.56%	3.54%	3.25%	7.94%	-1.21%	3.00%	2.01%	1.90%	2.62%	2.37%	3.33%	2.43%
Auto, physical damage	2.40%	2.68%	2.59%	9.51%	1.74%	1.94%	0.37%	1.18%	1.93%	1.63%	1.88%	1.27%
Auto, subtotal	3.29%	3.99%	3.68%	6.09%	-1.45%	3.55%	1.85%	2.14%	3.08%	2.38%	4.07%	2.44%
Workers compensation	5.63%	3.88%	4.21%	5.32%	-2.88%	3.29%	3.21%	2.33%	3.60%	3.01%	4.69%	2.68%
Other, bodily injury	4.10%	5.33%	4.65%	3.05%	-3.60%	4.25%	2.73%	2.81%	2.22%	5.59%	3.98%	3.60%
Other, property damage	4.60%	3.64%	2.94%	2.44%	-1.38%	3.10%	3.64%	2.22%	3.38%	-0.05%	3.14%	1.50%
Burglary and theft	4.91%	3.88%	2.37%	3.63%	1.15%	-1.98%	2.76%	3.68%	4.33%	-0.39%	0.01%	1.06%
Boiler and machinery	6.92%	3.08%	2.53%	-0.93%	6.79%	3.83%	-0.74%	5.14%	1.75%	-0.39%	-9.16%	3.53%
Fire	7.68%	3.65%	3.74%	2.07%	6.15%	0.68%	-0.73%	2.44%	2.45%	3.36%	3.15%	1.67%
Allied lines	1.66%	3.48%	3.90%	4.10%	9.15%	-1.20%	-0.91%	1.30%	6.21%	-1.14%	6.13%	0.22%
Homeowners	4.60%	4.27%	3.98%	-11.73%	-0.55%	-0.18%	1.67%	4.84%	4.73%	4.22%	3.85%	3.28%
Commercial multiple peril	2.20%	4.02%	4.15%	3.55%	2.60%	2.27%	0.65%	2.56%	3.20%	2.25%	3.41%	1.59%
Inland marine	1.64%	3.45%	2.42%	1.59%	1.42%	2.47%	1.50%	0.87%	2.79%	3.62%	1.60%	1.34%
Composite	2.87%	5.29%	3.84%	1.36%	-0.05%	2.50%	1.20%	3.19%	4.05%	2.49%	4.11%	2.38%
CPI, all items	3.23%	2.85%	3.84%	-0.36%	1.64%	3.16%	2.07%	1.46%	1.62%	0.12%	1.26%	2.07%

* 2017 figures are preliminary

For the 10-year period ending in 2016, the individual indices for physician services, hospital services, legal costs and auto body work have exceeded the CPI for all items, as shown in *Figure 2*. Since these are key components in claim costs for casualty insurance lines, it follows that these lines have experienced increases in claim costs that are generally in excess of the general inflation level.

The average annual trends for several major coverages (from the five-year periods of 2006 to 2011 and 2011 to 2016, as well as the three-year period of 2013 to 2016) are shown in *Figure 3*. As the figure illustrates, most periods show insurance coverage increases above the CPI. From 2006 to 2011, six

of eight coverages are above the CPI, with eight of eight larger than the CPI for the 2011 to 2016 period, and eight of eight above the CPI for the 2013 to 2016 period. In the latest three-year period, the largest increase was for homeowners, averaging 4.27%, while the lowest growth rate was for auto physical damage, at 1.81%.

The Willis Towers Watson Claim Cost Index *does not* measure changes in the frequency of claims or “social” inflation, which reflects changes in attitudes toward litigation, changes in jury attitudes, new theories of liability or the push toward larger settlements driven by large punitive damage awards.



Figure 2: **Decennial increases**
(1982 – 1984 = 100)

Cost for:	2006	2015	2016	Change 2016 / 2015	Change 2016 / 2006
CPI, all items	201.6	237.0	240.0	1.26%	19.05%
CPI, physicians services	291.9	366.1	378.1	3.28%	29.52%
CPI, hospital services	455.9	768.6	803.3	4.52%	76.21%
CPI, medicinal drugs	NA	115.9	120.0	3.57%	NA
Legal costs	293.7	351.7	359.2	2.14%	22.33%
CPI, auto body work	224.8	280.8	287.6	2.42%	27.93%

Figure 3: **Average increase, U.S. claims cost indexes**

Coverage	Five-year increase 2006 – 2011	Five-year increase 2011 – 2016	Three-year increase 2013 – 2016
CPI, all items	2.22%	1.31%	1.00%
Auto, bodily injury	2.76%	3.75%	4.03%
Auto, property damage	3.27%	2.44%	2.77%
Auto, physical damage	3.65%	1.40%	1.81%
Workers compensation	2.72%	3.36%	3.76%
Other bodily injury	2.68%	3.46%	3.92%
Other property damage	2.13%	2.46%	2.15%
Homeowners	-1.02%	3.85%	4.27%
Commercial, multiperil	3.31%	2.41%	2.95%

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WTW-US-17-RES-1013

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