

Battling Rising Prices

Increases in costs of key components in claims drive price indexes for the property/casualty industry's major business lines.

by Jeremy P. Pecora and Jacob D. Roe

Physician services, hospital services, legal costs and auto-body repair expenses continued to outpace the general rate of inflation, keeping the price indexes for most of the property/casualty industry's major business lines above the consumer price index for the period

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1999-2001, although many dropped below the CPI for 2001.

This article presents an update of the Masterson Indexes, detailing the annual average cost indexes for property/casualty coverage from 1990 through 2001, plus a forecast for 2002. The annual changes in the indexes are shown in "U.S. Claim Cost Indexes, Annual Percentage Increases."

A property/casualty insurer's claims settlements are affected directly by economic factors as they relate

to price, salary and wages. In economic terms, claim costs for loss and

Decennial Increases

Base index, 1982-1984 = 100

Cost for:	1991	2001	Increase
CPI*, All Items	136.2	177.1	30.03
CPI*, Physician Services	170.5	253.6	48.74
CPI*, Hospital Services	191.9	327.4	70.62
Legal Costs	160.0	236.2	47.69
CPI*, Auto Body Work	140.3	194.9	38.92

* Consumer Price Index
Source: Tillinghast-Towers Perrin.

U.S. Claim Cost Indexes, Annual Percentage Increases

Cost indexes for most of the major property/casualty lines dropped below the consumer price index in 2001.

Base index, 1982-1984 = 100

Coverage	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002*
Auto Bodily Injury	6.91	6.58	6.35	5.97	4.88	4.84	3.89	3.96	3.90	4.48	5.42	4.95	4.40
Auto Property Damage	4.60	5.28	3.90	4.36	4.24	3.70	3.80	3.38	3.38	3.43	4.02	3.31	3.71
Auto Physical Damage	3.26	4.13	2.95	3.40	3.94	3.02	3.75	3.02	3.19	2.47	3.38	1.84	3.38
Subtotal Auto	5.22	6.19	5.19	7.36	4.48	3.47	1.78	3.61	3.63	1.63	4.62	1.05	3.94
Workers' Compensation	7.31	5.60	5.42	4.86	2.56	1.65	3.71	3.83	4.23	3.82	4.95	5.28	5.78
Other Bodily Injury	6.46	5.76	6.78	6.13	4.81	3.85	3.85	4.03	4.00	4.85	4.72	5.92	4.15
Other Property Damage	1.79	5.34	4.16	3.93	4.17	2.77	3.29	4.00	3.18	3.62	3.89	1.51	2.40
Burglary & Theft	1.52	1.49	5.25	4.72	4.45	1.22	4.51	3.80	3.32	5.20	4.22	1.91	2.36
Boiler & Machinery	2.81	3.43	4.30	3.98	3.06	0.27	1.82	4.89	2.27	2.96	1.36	0.43	3.63
Fire	0.76	3.00	2.18	4.11	3.57	1.76	3.10	4.27	2.28	2.62	4.74	0.23	2.65
Allied Lines	0.83	2.56	2.82	3.52	3.63	1.90	2.87	4.25	2.27	2.68	3.80	2.10	2.77
Homeowners	4.16	3.89	3.57	3.51	3.14	4.22	2.92	3.24	3.03	3.75	4.26	2.47	4.23
Commercial Multiperil	1.82	3.73	3.37	4.50	4.09	2.13	3.52	4.41	2.96	3.17	2.93	1.71	3.01
Inland Marine	1.97	4.54	4.13	3.21	3.51	3.45	3.83	3.28	2.83	4.94	3.99	2.58	2.39
Composite	4.91	4.21	5.47	4.20	3.85	3.20	2.38	3.73	3.54	2.72	4.68	2.15	3.97
CPI**, All Items	5.40	4.21	3.01	2.99	2.56	2.83	2.95	2.29	1.68	2.08	3.36	2.85	1.55

* Estimated

** Consumer Price Index

Source: Tillinghast-Towers Perrin.

Property/Casualty

loss-adjustment expenses are an insurer's cost of production. Insurers' major 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, such as lawyers' fees and other legal and court costs.

During the 10 years since 1991, the individual indexes for physician services, hospital services, legal costs and auto-body work have exceeded the consumer price index for all items, as shown in "Decennial Increases." Since these are key components in claim costs for the casualty insurance lines, it follows that those lines experienced increases in claim costs that are considerably above the general inflation level.

The graph, "Yearly Increase in Costs by Line," shows the annual change in the price level for property, liability and multiperil lines from 1991 through 2001. Price increases for property and multiperil have stayed between 3.9% and 1.7% over the period, although the preliminary estimate for 2002 shows a larger increase. Liability price increases gradually declined to 3.8% in 1995, from 5.5% in 1992. But after staying flat for the next three years, they

**Average Increase—
U.S. Claim Cost Indexes**

Coverage	5-Year Increase		2-Year Increase
	1991-1996	1996-2001	1999-2001
CPI*, All Items	2.87	2.45	3.10
Auto Bodily Injury	5.18	4.54	5.18
Auto Property Damage	4.00	3.50	3.67
Auto Physical Damage	3.41	2.78	2.61
Workers' Compensation	3.63	4.42	5.11
Other Bodily Injury	5.08	4.70	5.32
Other Property Damage	3.66	3.24	2.69
Homeowners	3.47	3.35	3.36
Commercial Multiperil	3.52	3.03	2.32

* Consumer Price Index
Source: Tillinghast-Towers Perrin.

turned up in 2000, 2001 and 2002 as currently estimated.

From 1992 to 2001, the increases in costs for physician services dropped to 2.1% from 6.3% before increasing to 3.7% in 2000 and 3.6% in 2001. The increases in hospital-room costs fell to 3.2% in 1997 and 1998 before increasing to 4.1% in 1999, 6% in 2000 and 6.6% in 2001. Hospital costs show larger increases in the preliminary figures for 2002. The decreases reflect the strong efforts in recent years to control the costs of medical treatment, but the effect of these decreases on the cost of liability and workers' compensation insurance might be reversing, as the effects of cost containment run into natural limitations.

While increases in legal costs were less than 3% from 1992 through 1995, these costs also have shown larger

increases, to a high of 7.4% for 2000 and an estimated increase of 7.5% for 2002.

The average annual increases in costs for several major lines for the five-year periods from 1991 to 1996 and from 1996 to 2001, as well as the two-year period from 1999 to 2001, are shown in "Average Increase—U.S. Claim Cost Indexes." The general patterns of lower increases in costs for the liability lines and flat increases for the property lines are repeated in the figures for the individual lines.

However, the latest two years aren't consistently below the latest five years, again indicating that inflation in costs might have flattened or even begun to grow.

These indexes don't measure "social" inflation, which encompasses changes in attitudes toward litigation; changes in jury attitudes; new theories of liability; and the push toward larger settlements given by large punitive-damage awards. They also are affected by the events of Sept. 11, 2001, only to the extent that the underlying indexes are affected.

BR

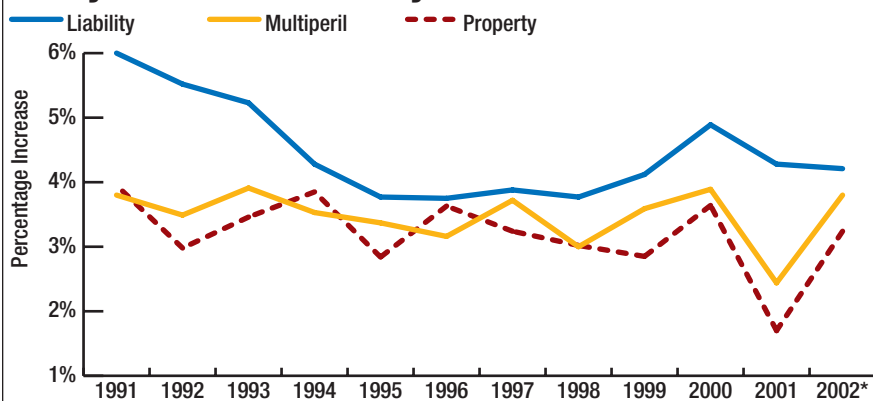
Editor's Note

This article presents an update of a family of price indexes for major lines of business written by property/casualty insurers. Originally developed in the 1960s by consulting actuary Norton E. "Doc" Masterson, the "Masterson Indexes" were first published by A.M. Best Co. in 1968.

The authors would like to acknowledge the Insurance Services Office Inc. for providing an improved percentage breakout between auto bodily injury and property damage. This breakout improved the quality of the indexes.

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Yearly Increase in Costs by Line



* Estimated
Source: Tillinghast-Towers Perrin.