U.S. Insurance

"Once-in-a-generation": Motor vehicle insurance CPI up 20%+ in 2023

Price Objective Change

12 January 2024

Equity
United States
Insurance

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Auto insurance prices continue to accelerate into year-end

According to CPI, the cost of insuring a car in the US rose by 1.6% in December 2023, up 20% from a year ago (compared with broad-based CPI up 3.4%) and up 37% over two years, the sharpest two-year increase since 1977. Motor vehicle repair costs declined a touch, up 7% for the year and up 21% over two years. Used cars/parts were flat from November, but are down 1% for the year and down 10% over two years. An argument can be made that auto insurance pricing is catching up to loss trends, though we don't believe carriers are likely to stop raising prices.

Allstate's margins require more rate

Allstate auto's loss ratio peaked in 2H23, but, despite year-over-year improvement, the company cannot operate anywhere near target margins at 3Q23's 80% loss ratio. We expect the company seeks a 70% loss ratio or sub-70% loss ratio to achieve target returns. The company has successfully implemented 33% worth or regulatorily-approved rate filings through November 2023. When the company announces its December rate action impact on January 18, it will include an additional 30% rate in California among other states. We expect the monthly disclosure to show a 6% average improvement across all states, which will show up in profitability by year-end 2024.

Progressive will also likely seek additional rate

While its rate "need" is not as urgent as Allstate's after likely achieving a sub-96% combined ratio for 2023 (when it reports year-end results on January 24), Progressive is currently operating at about a 76-77% loss ratio, approximately 500bps higher than its 2017-2019 loss ratio and in-line with the 2016 result, after which it continued to raise prices. The company does not need 500bps of rate to reach 2017-2019 profitability as much increased economies of scale have improved its expense ratio by 200bps+ over the past half decade unrelated to currently suppressed ad spend that will resume in 2024. It will raise prices, but its increases will be general below those of its competitors.

The speed of margin improvement will likely surprise

We anticipated that the 2yr CAGR for US motor vehicle insurance will likely accelerate above 40% before it begins to recede. Our Progressive 2024 and 2025 EPS high-on-the-Street EPS estimates are 28% and 34% above consensus as the company benefits from an exodus of customers from their incumbents to a better deal. We additionally expect a quick turnaround in Allstate's fortunes from an operating loss in 2023 to a 20%+ ROE in 2024. We are increasing our 2024 and 2025 EPS forecasts to above consensus $13.00 and $16.75 from $12.15 and $15.80, respectively and raising our price target to $168 from $148 (based on parity with the large-cap commercial P/E of 10x 2025 EPS, up from 9.4x previously). We believe the current auto market is experiencing a once-in-a-generation cycle improvement, and investors should Buy Allstate and Progressive to take advantage.

Refer to important disclosures on page 11 to 14. Analyst Certification on page 10. Price Objective Basis/Risk on page 9.
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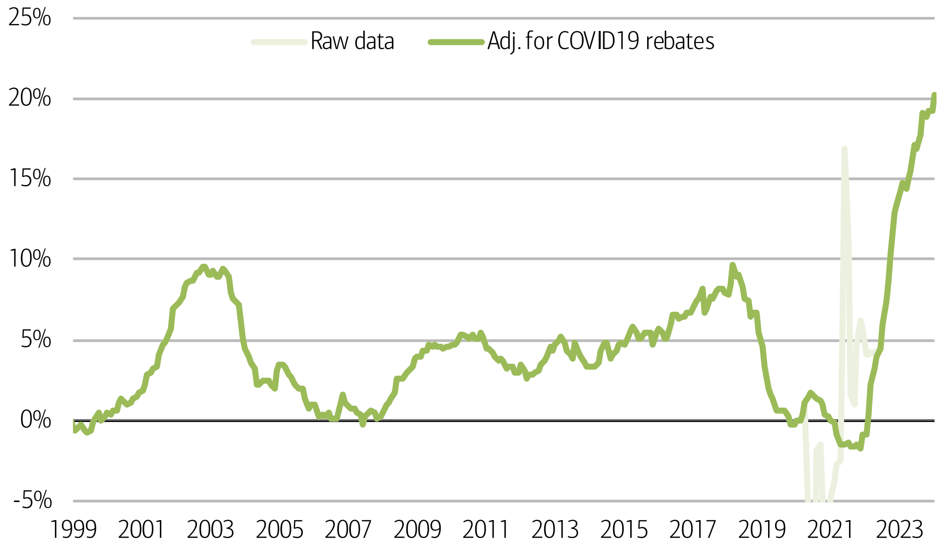
Timestamp: 12 January 2024 05:00AM EST

The price of US auto insurance continued to accelerate in December 2023. According to CPI, the cost of insuring a car in the US rose by 1.6% in December 2023, up 20% from a year ago (compared with broad-based CPI up 3.4%) and up 37% over two years, the sharpest two-year increase since 1977. From July 1975 to July 1977, the price of motor vehicle insurance rose 48%, and it is likely worth mentioning that broad CPI was up 13% over that two-year stretch. There aren't too many investors with a keen grasp on the 1976 auto insurance market around today (paging Mr Buffett), but this is probably the proper antecedent for today's personal auto marketplace with, as-yet a 37% increase in the price of auto insurance compares with broad-based CPI up 10% over the past two years. As a frame of reference for current investors, the most significant two-year increases in US motor vehicle in "contemporary times," were 19% from June 2001 to June 2003 and 18% from February 2016 to February 2018. We mention this historical context to give investors a frame to recognize that what is currently happening in the US auto insurance market is more infrequent that a once-in-a-generation event.

Exhibit 1: CPI for Motor Vehicle Insurance

At up over 20% over the past year and up over 37% over the past two years (and continuing to accelerate), insurance prices are up more over the past couple of years than any time since the mid-1970s. (Not pictured: The next biggest peak was October 1984 to October 1986 where US personal auto pricing was up 27% over two years.)



Source: Department of Labor Bureau of Statistics

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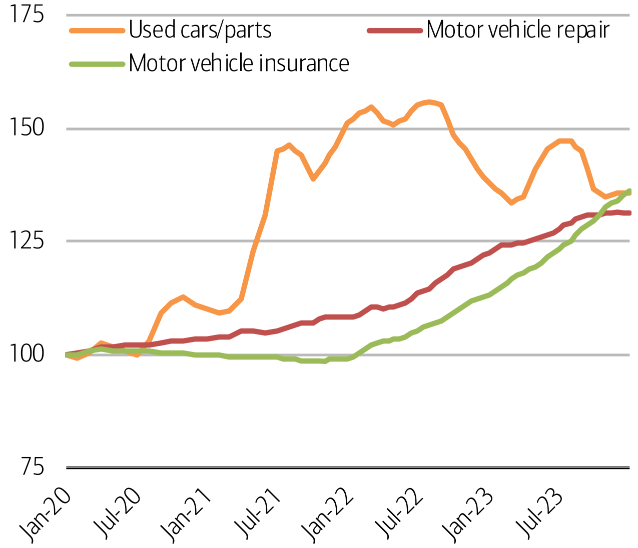
Prices are up because loss costs have risen materially, driving US auto insurers into underwriting losses out of which they intend to escape through materially repricing efforts. Motor vehicle repair costs declined a touch, up 7% for the year and up 21% over two years. Used cars/parts were flat from November, but are down 1% for the year and down 10% over two years. While the prices of used cars and parts are down over the past couple of years, this trend is an "epilogue" to a prior theme where the price used cars rose 50% during the pandemic (2Q20-1Q22). They are falling from significant highs two years earlier.

Exhibit 2: CPI elements compared: insurance costs vs. vehicle costs

If we index CPI inputs back to the pre-pandemic period level, auto insurance costs, used cars/parts costs and motor vehicle repair costs are all up about 30-35%



Source: Department of Labor Bureau of Statistics

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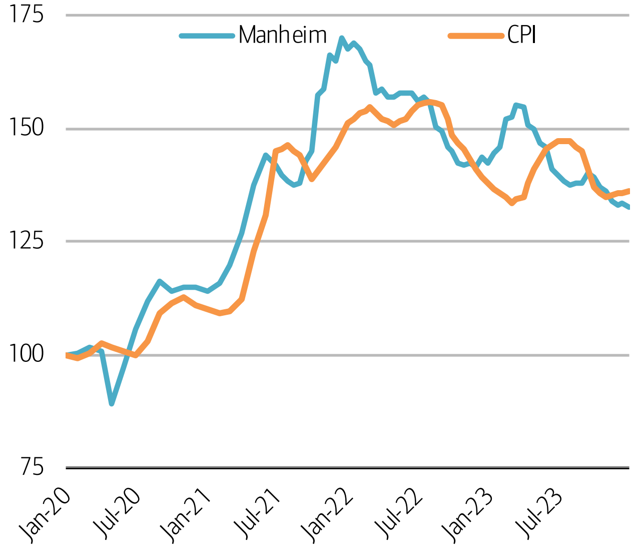
Exhibit 3: Used car price indices compared

Some might make the argument that used car prices have fallen a touch lower than what CPI numbers indicate, as suggested by the Manheim Used Car Index.



Source: Department of Labor Bureau of Statistics and Manheim

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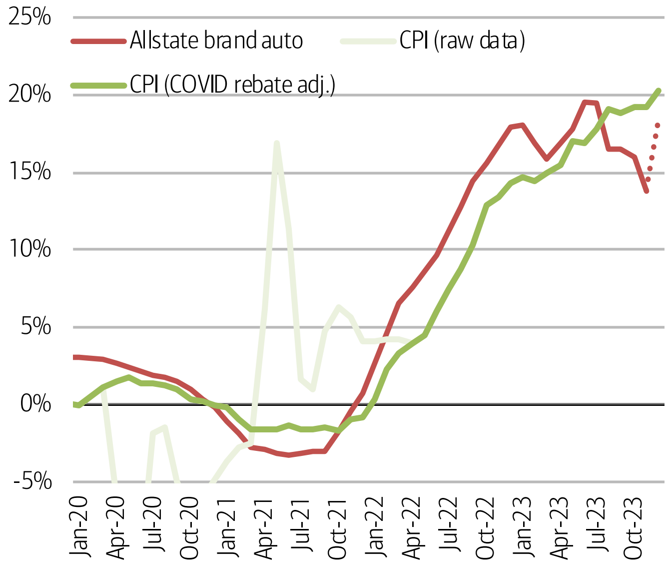
An argument can be made that auto insurance pricing is catching up to loss trends, creating a risk that the market will begin to become more competitive. We have said in the past that the biggest risk to our Buy rating on shares of Progressive is a massive step-function drop in the price of vehicles and their repair. This risk is a bit counterintuitive as it would likely result in a significant increase to Progressive's current profitability; however, it would also result in a significant increase to competitors' current profitability, which would likely trigger price cuts. As the market would become more competitive the opportunity to take market share from customers unhappy with their incumbent carrier would decline. While we believe this risk is still valid, we believe it is more a 2H25 or 2026 risk than anything that will appear in 2024. We don't believe carriers are likely to stop raising prices.

To understand why, it may be useful to look at the financials of Allstate, the #4 carrier of US personal auto insurance with about 12% marketshare. On the third Thursday of each month, Allstate provides investors with a monthly update on the pace at which it is receiving approvals to raise prices in the various states in which it operates. Allstate's rate approvals do not look too dissimilar from the industry's pricing trend as described by CPI numbers.

Exhibit 4: Comparing Allstate brand auto aggregate price increases with motor vehicle insurance CPI

Allstate's pricing increases have looked similar to the experience of US consumers broadly. However, in recent months Allstate' regulatory pricing changes appear to have decelerated, until December 2023 when the company received material price increase approvals in California, New Jersey and New York.



Source: Department of Labor Bureau of Statistics and company filings

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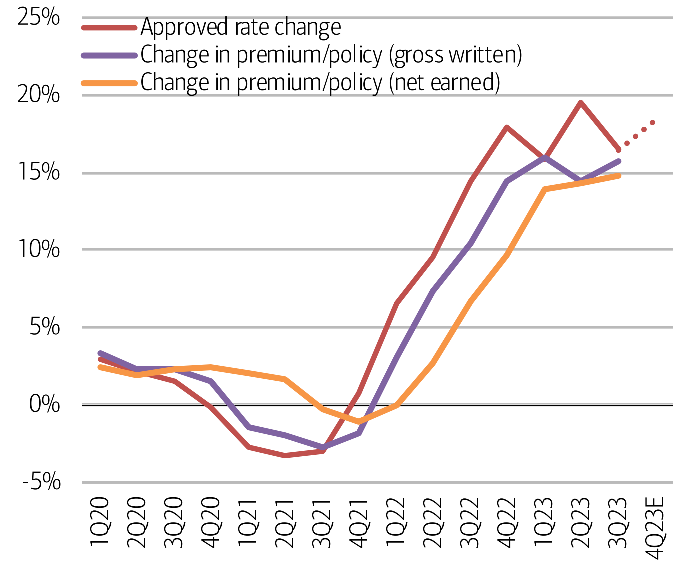
Exhibit 5: How rate approvals work their way into pricing, revenue and profitability at Allstate

It may not be completely apt to compare rate approvals with CPI numbers. CPI records consumer out-of-pocket expenses. Allstate (and others) receive rate approval and then increase the prices of their customers upon renewal, which typically indicates a lag. The change in premium per policy on a gross written basis is likely more comparable to CPI numbers.



Source: Company filings

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Through November 2023, Allstate brand auto has received approval to raise prices by 14% over the past year and 33% over two years. These increases potentially understate the degree to which Allstate has raised prices. In three of its largest states—California (12% of Allstate auto premium), New Jersey (3%) and New York (8%)—the regulatory burden to receive approvals has proven a particular roadblock to charging customers appropriately. Allstate has raised its prices in aggregate by 33% over two years without satisfactory regulatory approval in three of its biggest states representing 23% of its footprint. This suggests even higher pricing in the other 47 states.

However, in December, Allstate did receive long-awaited approval to raise prices in those states: 30% in California, 20% in New Jersey and 15% in New York. When Allstate reports its monthly regulatory pricing approvals on January 18, we expect the company will announce price increases averaging a 6% boost across its entire Allstate brand auto book. The previously single month with the most significant rate change impact was August 2022 with a 3.2% lift to pricing across the whole book. While this news is available in pieces across the public domain, we believe the "sticker shock" of that 6% number may represent another positive catalyst for the stock.

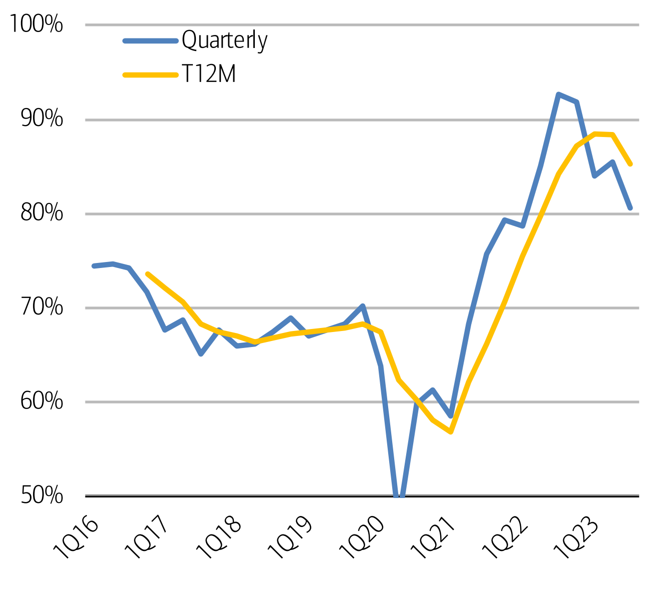
> On January 18, we expect the company will announce price increases averaging a 6% boost across its entire Allstate brand auto book. We believe the "sticker shock" of that 6% number may represent another positive catalyst for the stock.

33% over the past two years and another 6% in December 2023 may seem like enough price increases to stabilize margins in theory, but, in practice, it would seem that Allstate may need more rate than this. It is first essential to understand that, there is a lag impact among rate approval, renewal policy premium and earned premium/profitability. (See Exhibit 5.) 33% rate approval (rate changes on paper only) spanning 4Q21-3Q23 has so far translated in to a 28% increase in gross written premium per policy (cash flow statement) and a 23% increase in net earned premium (income statement/profitability). Additionally, it is unlikely that gross premium written per policy will quite match the rate approval number, and it is also unlikely that net premium earned per policy with equally match the rate approval number. Regarding gross premium written, when presented with a material price increase, some customers will leave their incumbent carriers and others will opt to buy down to a coverage with lower limits to save money. Regarding net premium earned, the cost of reinsurance is rising, and that creates a gap between gross and net results.

More central to the argument, however, is to note that Allstate auto is currently running at around an 80% loss ratio (in 3Q23 results, which probably means a slightly higher loss ratio overall as wintertime tends to be seasonally less profitable than summertime due to darkness, slippery roads and year-end revelry gone awry). Using the 2017-2018 period as a benchmark, one should probably expect Allstate would aim to operate at a 70% or sub-70% loss ratio to achieve a combined ratio in the low 90% range. Allstate would require at least 1,000bps of additional rate IN EXCESS OF rising loss costs to reach said target profitability. Even though the translation from rate approval to gross premium written to net premium earned occurs on a lag, we would not expect Allstate to end its pursuit of healthy price increases until it has a confident line of sight on target profitability. A cyclical business, US auto insurance underwriting (as well as insurance underwriting more broadly) will tend to suffer worse-than-anticipated margins at the bottom of the cycle and overshoot profitability goals at the top.

Exhibit 6: Catastrophe-normalized Allstate auto loss ratio

Allstate auto incurred losses peaked in 3Q22, but the 80% loss ratio in 3Q22 is still materially in excess of target margins. We would expect Allstate to continue to raise prices, even if it ultimately means overshooting profitability goals for a temporary period.



Source: Company filings

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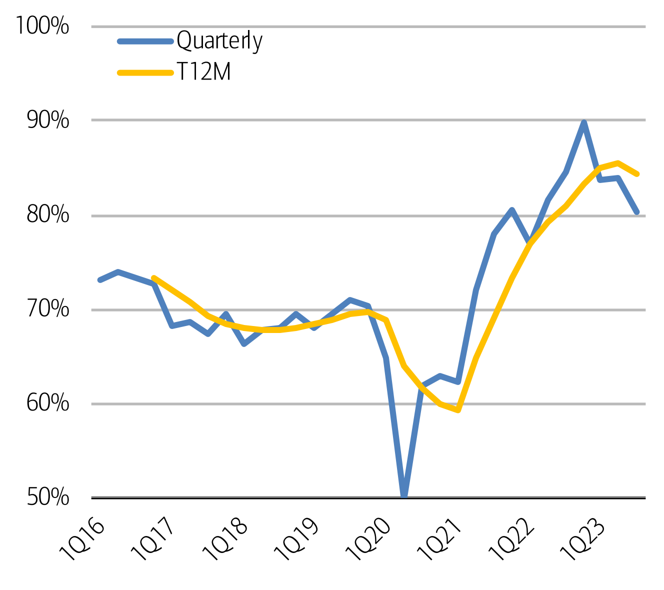
Exhibit 7: Current ultimate accident-year catastrophe-normalized Allstate auto loss ratio

The risk of adverse prior-year development, a material obstacle for Allstate in 2H21-2022, likely requires a margin of safety. In retrospect the 2020-2021 accident-years were less profitable than initially expected and reserved for.



Source: Company filings

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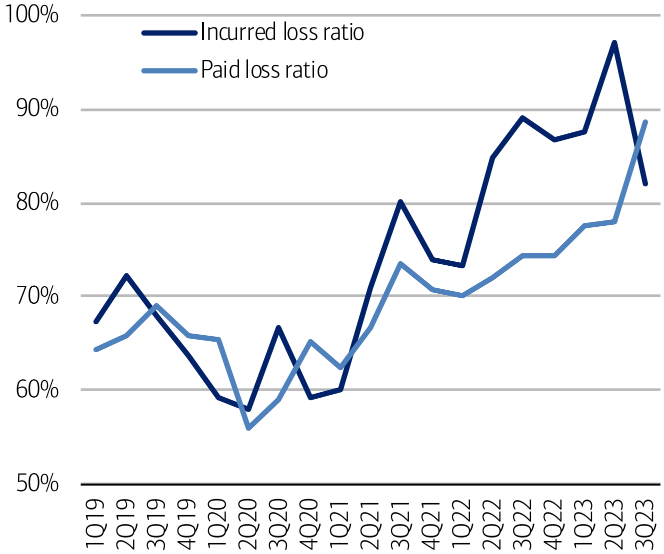
One might also note that in 2023 (and most particularly 3Q23), the company turned the corner on underwriting profitability with year-over-year improvement, even if still far from adequate levels of profitability. This is on an “incurred” (income statement) basis. However, on a “paid” (cash flow statement) basis, 3Q23 continued the trend of higher losses than in the year ago people. We cannot disentangle Allstate’s auto and homeowners’ results when looking at quarterly paid losses, but Allstate manages its business holistically. The paid loss ratio hasn’t quite turned the corner, and we would expect that the company desires a paid loss ratio closer to 70% than 80%+ as well. There is not a great argument to be made that Allstate has hidden earnings on its balance sheet from over-reserving. To increase profits, Allstate needs to increase prices in excess of loss costs.

Exhibit 8: Allstate paid loss ratio vs. incurred loss ratio

While Allstate has seemed to turn the corner on peak losses on an incurred basis, this is not necessarily apparent on a paid loss basis. In 3Q23 paid losses were higher than incurred losses (largely due to payments for homeowners' repairs associated with unprecedented springtime convective storm activity.)



Source: Company filings

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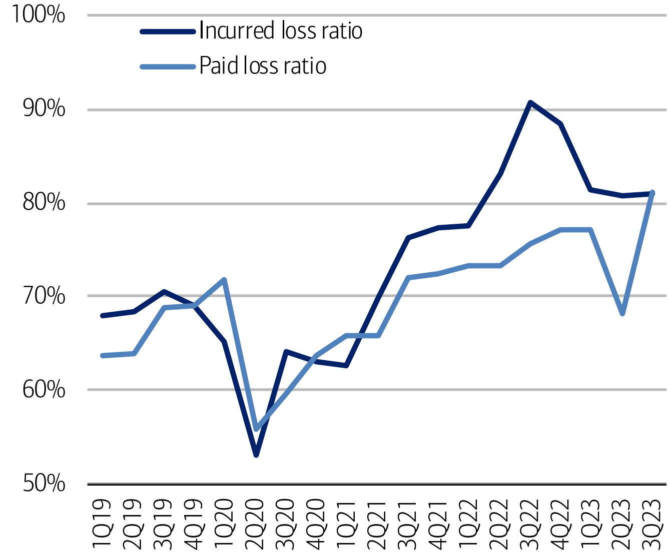
Exhibit 9: Allstate paid loss ratio vs. incurred loss ratio ex-catastrophes

Even excluding the impact of delayed catastrophe loss payments, 3Q23 represented peak paid losses (after a 2Q23 dip). With catastrophes having an average headwind of 6-10% on Allstate's loss ratio, it seems reasonable to consider paid loss ratio at Allstate needs to decline from the 85-90% range.



Source: Company filings

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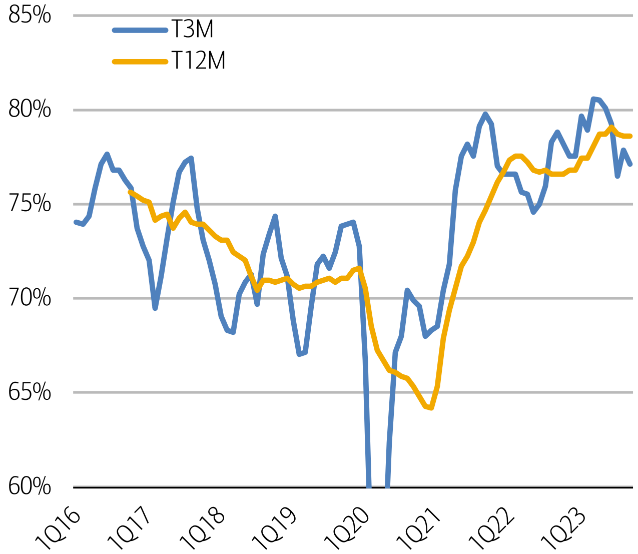
We would argue that even Progressive, which is likely to report a 2023 combined ratio a touch below its 96% lodestar when it reports year-end results on January 24. The company appears to be running its auto business with a 76-77% loss ratio as it closes out 2023. As a frame of reference, the company was operating at a loss ratio of 76-77% in 2016 AT THE BEGINNING of the 2016-2018 rate cycle. As it increased priced across 2015-2018, it found a "terminal" loss ratio of around 71-72%.

Exhibit 10: Catastrophe-normalized Progressive auto loss ratio

While Progressive has achieved its "ceiling" target of a 96% combined ratio for 2023, the loss ratio remains at multi-year highs after hitting a peak not seen since 2001. Progressive likely intends to continue to work to improve its loss ratio, which would likely require raising pricing in excess of the loss cost trend.



Source: Company filings

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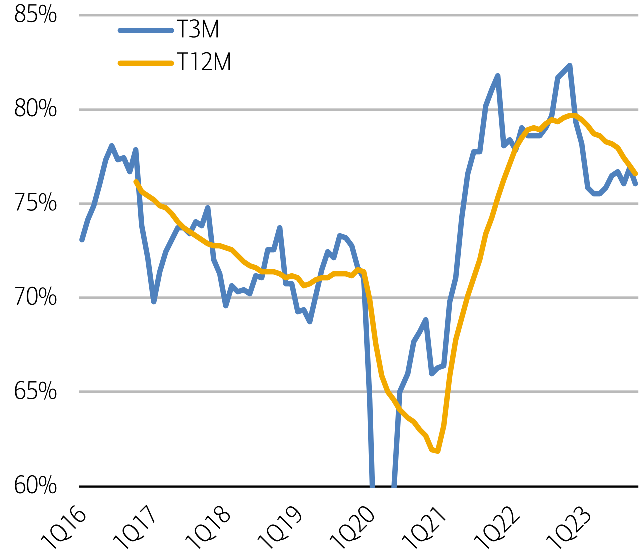
Exhibit 11: Current ultimate accident-year catastrophe-normalized Progressive auto loss ratio

It is difficult to see pricing "bending the curve" toward greater profitability on a calendar-year basis, given notable 2023 issues with adverse prior year development, but this trend to improvement arguably peaked at YE2022 and has been improving since.



Source: Company filings

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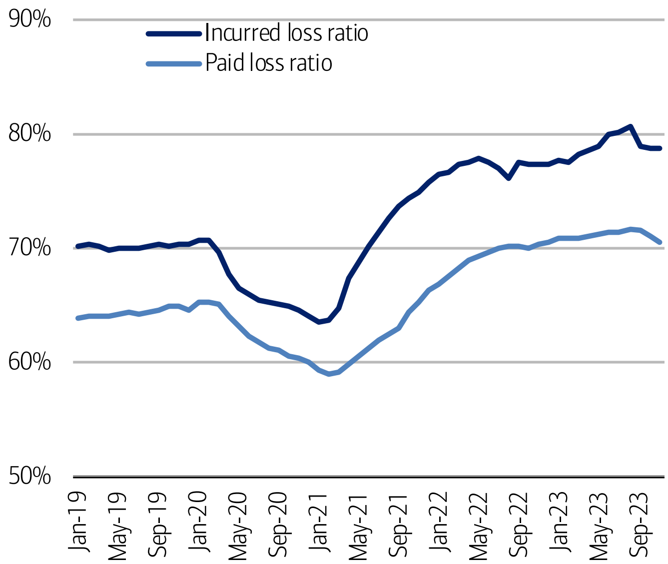
That said, we would argue that Progressive has more flexibility than Allstate. Whereas Allstate's paid losses appear to be at a peak, suggesting the urgency to push more rate through is high, Progressive remains in a position where incurred losses are running well ahead of paid losses, with the benefit redounding to an increased reserve for losses. Some of this clearly relates to Progressive's higher growth rate. A growing company will need to put away more into its loss reserves as the size/amount of losses grows with the premium footprint. Still, the paid loss trend has been essentially flat in 2023. This could be interpreted as suggesting that material reserve additions Progressive took pursuant to lawsuits filed immediately before the passage of Florida's HB837 bill have yet to result in a notable increase in paid losses, whether by jury decision or settlement.

Exhibit 12: Progressive paid loss ratio vs. incurred loss ratio

Unlike Allstate, where paid losses seem to keep pace with incurred losses from 2019-2021, perhaps leading to it being under-reserved in 2022, Progressive's paid losses have run well-below incurred losses. Some of this can be explained by Progressive's higher growth rate.



Source: Company filings

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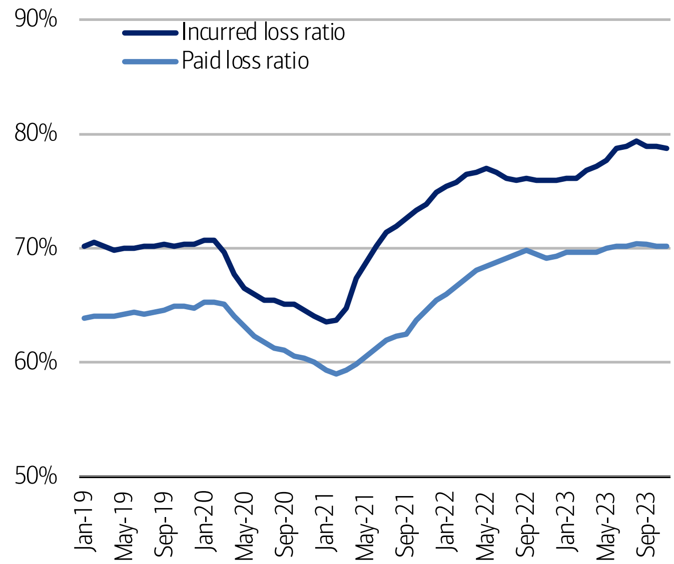
Exhibit 13: Progressive paid loss ratio vs. incurred loss ratio (Hurricanes Ida and Ian excluded)

Arguably, Progressive's incurred losses have accelerated relative to its paid losses, suggesting a wider and perhaps more conservative gap regarding its loss reserve position.



Source: Company filings

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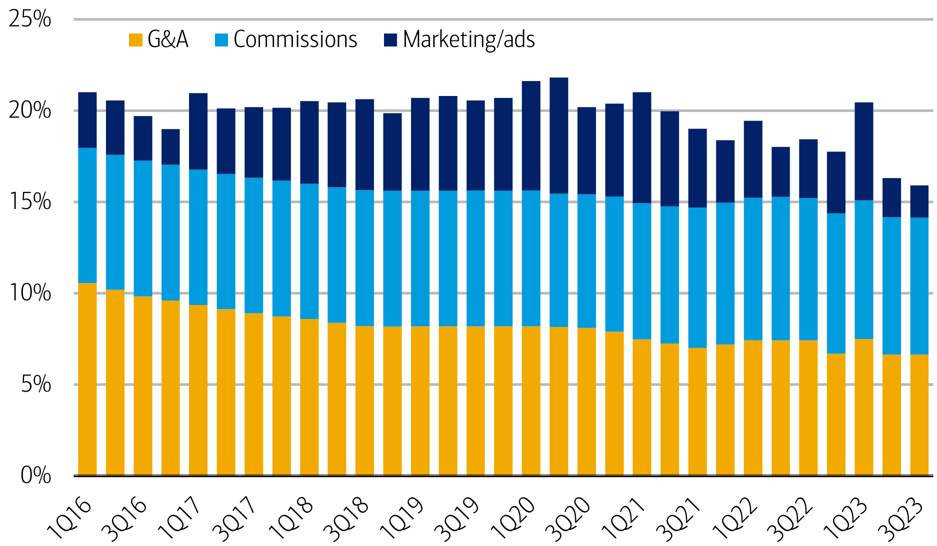
We would note, however, that Progressive does not need to move its currently 76-77% loss ratio to 71-23% in order to achieve the same profitability it enjoyed in 2017-2019. The expense ratio at Progressive is necessarily lower than it was five year ago. It is true that the company has materially reduced its ad spending in L9M23, which has lower the loss ratio and that this reduced ad spend is a temporary benefit. That said the company is much large than it was in 2018. $2 billion in ad spending in 2019 creates a 5.5% drag to underwriting margins, while $2 billion in 2023 is just a 3.5% drag. We would expect a 3.5% drag from ad spending in 2024 ($2.5 billion of spending on a base of $69 billion in premiums), up from a 2.7% drag in 2023 ($1.6 billion of spending on a base of $58 billion in premiums).

Exhibit 14: Components of Progressive's expense ratio

Progressive's expense ratio has notably declined over the short term because of suppressed ad spending that will likely resume in 2024. However, longer-term the company has notably reduced G&A spend as proportion of premium volume as it has grown. This improvement is likely to be permanent and improving, allowing Progressive to operating at lower combined ratios while at higher loss ratios compared with peers.



Source: Company filings and BofA Global Research estimates

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However, the efficiencies of amortizing ad spend across a larger premium footprint are not the most significant benefit that might allow Progressive to operating at higher than a 71-72% loss ratio while achieving combined ratios in the 89-93% range. Scale has come with the ability to amortize general and administrative expenses across a larger footprint as well. This has resulted in about 125bps of margin improvement over the past half-decade that won't return (and will likely continue to creep downward over time.

Exhibit 15: Stocks mentioned

Prices and ratings for stocks mentioned in this report

BofA Ticker	Bloomberg ticker	Company name	Price	Rating
ALL	ALL US	Allstate Corp.	US$ 150.37	B-1-7
PGR	PGR US	Progressive Corp	US$ 168.02	B-1-7

Source: BofA Global Research

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Price objective basis & risk

Allstate Corp. (ALL)

Our $168 PO is based on parity with the peer group 2025E P/E multiple of 10x. The life insurance divestiture from two years prior and upcoming announced health divestiture should drive a higher relative valuation compared to the past, and, given our view that personal lines is a better business, there could be upside potential should the market shift to valuing personal lines at a premium. We believe this valuation is supported by our forecast for a 20%+ ROE (on tangible and stated).

Downside risk is presented by the pressure from lower interest rates causing a decline in earnings power and potentially leading the company to miss our EPS expectations. The race to reprice business following the new wave of auto accident frequency and severity could take longer that we forecast. The volatility associated with catastrophes also creates the risk of missing or exceeding our EPS outlook. Another risk: revenue and earnings uncertainty looms in the distance with the eventual adoption of autonomous vehicles.

Progressive (PGR)
Our $225 price objective is based on the current S&P 500 P/E multiple for 2025 of 17.6x on our 2025E EPS forecast. Due to quickly accelerating EPS ahead of the market growth rate, as seen in 2016-2019, we believe Progressive shares should trade at a premium to market as its earnings accelerate. However, given a multiple valuation two years out, we only assume parity due to the necessarily decreased certainty in an out-year forecast.

Downside risks to our PO are 1) presented by the pressure from lower interest rates, causing a decline in earnings power and potentially leading the company to miss our EPS expectations, 2) the volatility associated with catastrophes, which also creates the risk of missing and exceeding our EPS outlook, 3) the impact of material pricing changes by major competitors, 4) the long-term impact of emergent technologies, such as ride-sharing applications and autonomously driven automobiles.

Analyst Certification

I, Joshua Shanker, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

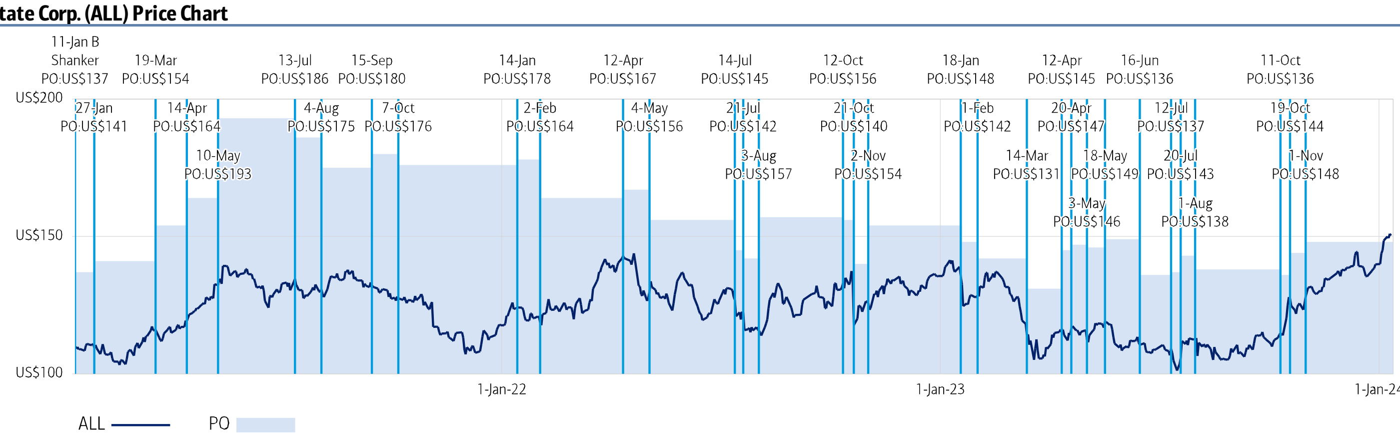
US - Insurance Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Aflac	AFL	AFL US	Joshua Shanker
	Allstate Corp.	ALL	ALL US	Joshua Shanker
	American International Group	AIG	AIG US	Joshua Shanker
	Arch Capital	ACGL	ACGL US	Joshua Shanker
	Assurant	AIZ	AIZ US	Grace Carter, CFA
	Axis Capital	AXS	AXS US	Joshua Shanker
	BRP Group, Inc.	BRP	BRP US	Joshua Shanker
	Cincinnati Financial Corporation	CINF	CINF US	Grace Carter, CFA
	Corebridge Financial	CRBG	CRBG US	Joshua Shanker
	Everest Group LTD	EG	EG US	Joshua Shanker
	Intact Financial	YIFC	IFC CN	Grace Carter, CFA
	Intact Financial	IFCZF	IFCZF US	Grace Carter, CFA
	MetLife	MET	MET US	Joshua Shanker
	Progressive	PGR	PGR US	Joshua Shanker
	RenaissanceRe	RNR	RNR US	Joshua Shanker
	The Hartford	HIG	HIG US	Joshua Shanker
	Voya	VOYA	VOYA US	Joshua Shanker
	W.R. Berkley	WRB	WRB US	Joshua Shanker
NEUTRAL				
	Aon	AON	AON US	Joshua Shanker
	Brown & Brown	BRO	BRO US	Grace Carter, CFA
	CNA Financial	CNA	CNA US	Joshua Shanker
	Lincoln National	LNC	LNC US	Joshua Shanker
	Marsh McLennan	MMC	MMC US	Joshua Shanker
	Principal Financial Group	PFG	PFG US	Joshua Shanker
	Prudential Financial	PRU	PRU US	Joshua Shanker
	The Hanover	THG	THG US	Grace Carter, CFA
	Trupanion	TRUP	TRUP US	Joshua Shanker
	Unum	UNM	UNM US	Joshua Shanker
UNDERPERFORM				
	Arthur J. Gallagher & Co.	AJG	AJG US	Joshua Shanker
	Chubb Ltd	CB	CB US	Joshua Shanker
	Goosehead Insurance Inc.	GSHD	GSHD US	Joshua Shanker
	Selective	SIGI	SIGI US	Grace Carter, CFA
	Travelers Cos	TRV	TRV US	Joshua Shanker
	Willis Towers Watson	WTW	WTW US	Joshua Shanker

Disclosures

Important Disclosures

Allstate Corp. (ALL) Price Chart

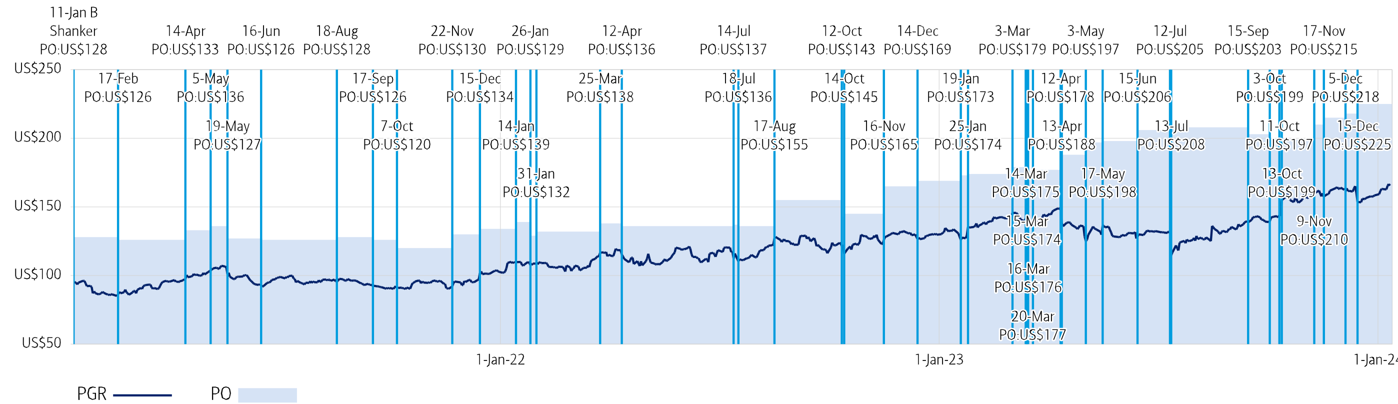


B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Allstate Corp. (ALL) Price Chart

Progressive Corp (PGR) Price Chart



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Equity Investment Rating Distribution: Financial Services Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	156	53.79%	Buy	94	60.26%
Hold	72	24.83%	Hold	48	66.67%
Sell	62	21.38%	Sell	35	56.45%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships [R1]	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

[R1] Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster[R2]
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Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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