More than you might think it turns out. The intense competition for your auto insurance dollars, as witnessed every day on television ads, has over time driven down the price of auto insurance in many areas. But the insurance companies have to make a profit to stay in business and their traditional avenue for profits has been to make up the difference with investment income. The options in that arena these days are leaving them with no choice but to raise rates.

The insurance industry focuses on a term called loss ratio. In its simplest form, this is simply the ratio of losses paid out, divided by the premiums taken in. This is called the pure loss ratio. Of even more importance is the combined loss ratio which is all premiums taken in, divided by the sum of losses paid out plus all other expenses. If the combined loss ratio goes over 100%, then the insurance company has lost money on their underwriting and will need to find their profit in the income that they generate by investing your premiums until they need them to pay for losses.

The intense competition in the insurance marketplace has driven the combined loss ratios of many insurance companies up over the dreaded 100% level. To protect themselves they either need to cut expenses, increase investment income or increase the rates that they charge for the various insurance products that they sell. Traditionally, insurance companies invested primarily in very stable and safe government bonds. But the volatility of the government bond market, along with dreadfully low yields has driven some insurance companies to invest more in corporate bonds. The problem with this is that it exposes the insurance company to debt risk if and when interest rates rise. If we see more corporate defaults, then the insurance companies that have invested in corporate paper will suffer losses and will have to raise their rates even further.

With high quality corporate bond yields at under 2%, corporate debt is no longer a viable option for helping to reduce the combined loss ratio to produce a profit for the insurance company. The remaining options left for the insurance companies are to cut expense or invest in riskier investments to increase their yield. This leaves only one final option, raising rates. When yields ran at 6% for grade A corporate bonds, then the insurance companies that purchased this debt had 4 additional points to play with on their combined loss ratio. At 2% the margin is getting pretty thin. So you can see, while falling interest rates may be helpful to you from a mortgage or car loan standpoint, they do have a counter effect on your car insurance rates and your home insurance rates.

If you would like to ask questions or receive any help at all with your car insurance, your home insurance, your business insurance or even your life insurance, I hope you will call us, toll free, at 877-687-7557.