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FOR IMMEDIATE RELEASE:
January 30, 2012

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CFA RESEARCH REVEALS THAT AUTO INSURANCE PRACTICES DENY ECONOMIC OPPORTUNITIES TO LOW- AND MODERATE-INCOME HOUSEHOLDS

Study Explains Steps State Insurance Commissioners Could Take to Increase Affordability of Mandated Auto Coverage

Washington, DC – A study released this morning by the Consumer Federation of America (CFA) concludes that the auto insurance marketplace denies important economic opportunities, especially those related to employment, to low- and moderate-income (LMI) households. The study also explains how state insurance regulators could ensure that mandated auto insurance coverage is fairly priced and affordable for these families so that they have greater access to car ownership and jobs. The research, undertaken by CFA Executive Director Stephen Brobeck and Director of Insurance J. Robert Hunter with support from The Ford Foundation, reveals that:

- For the large majority of LMI households, automobile ownership greatly increases economic opportunities, particularly access to jobs.
- These households cannot legally own a car without purchasing auto insurance, whose premiums often exceed $700 and sometimes cost thousands of dollars.
- These premiums reflect not only considerable disparate impacts but also some discriminatory treatment, such as being charged more for less liability coverage when all other factors are held constant.
- In large part because of high costs and disparate impacts, a significant minority -- perhaps one-quarter to one-third -- of LMI drivers do not carry auto insurance and are driving illegally.
- State-based policies and programs -- especially reduced mandatory coverages, programs offering lower premiums to safe drivers, and more vigorous efforts to eliminate disparate treatment and reduce disparate impacts -- have the potential to equitably reduce auto insurance costs for responsible LMI drivers.

"In some areas, many responsible lower-income drivers are required to spend more than $1000 a year for liability coverage that is often unfairly priced and provides no real insurance protection to them," said CFA's Brobeck.

"State insurance commissioners have the ability to take steps that would equitably reduce auto insurance costs for responsible lower-income drivers, thus increasing access to car ownership and employment in a difficult economic environment," said CFA's Hunter, former Texas Insurance Commissioner and Federal Insurance Administrator.

The study, "Lower-Income Households and the Auto Insurance Marketplace: Challenges and Opportunities," is based on research in hundreds of sources, It has been reviewed by several auto insurance experts and will be presented to state insurance commissioners at their meeting next weekend.

Most LMI Families Need Affordable Insurance Coverage

Except in a few urban areas, such as New York City, lower-income families benefit greatly from ready access to a car. Researchers agree that, for most of these families, having this easy access greatly increases economic opportunities related to work and shopping. As one academic study concluded, "the importance of the automobile in providing employment access to lower-skilled, low-waged labor can hardly be overstated." One old government study showed that lower-income households take 75 percent of their trips by car, only 5 percent by public transit, and most of the rest on foot.

However, nearly all households who own a car are required by law, and by lenders if the purchase is financed, to purchase auto insurance. All states except New Hampshire require car owners to purchase liability coverage that, in "fault" states, pay expenses suffered by other parties in accidents for which the insured driver is at fault. In "no-fault" states, insured drivers must pay for their own Personal Injury Protection (PIP) in all accidents in which they are involved. Further, auto lenders require car owners they are financing to pay for adequate collision and comprehensive coverage to protect the lender’s security interest in the car. Apart from these mandatory coverages, many LMI car owners feel the need to purchase liability protection beyond required state minimums, while many owners without car financing still desire collision and comprehensive coverage.

LMI Families Spend a Great Deal on Auto Insurance

In part because auto insurance is required, LMI households spend a great deal on it compared to other financial services -- $30 billion in 2010, according to the BLS Consumer Expenditure survey data, compared to only $4 billion in auto financing and much less than $10 billion in payday consumer loans. These data, together with Federal Reserve Board Survey of Consumer Finance data, suggest that low-income car owning households (incomes below about $19,000) have recently paid over $700 in annual premiums while moderate-income car owning households (incomes between about $19,000 and $37,000) have paid over $1,000 in annual premiums.

These premiums vary considerably, however, from household to household and are especially high in many lower-income urban communities. To cite only one of numerous examples, according to data collected by the California Department of Insurance, a single male from Compton -- who is under 30 years of age, has been licensed 6-8 years, drives 7,600-10,000 miles per year, and has had one traffic ticket and one at-fault accident -- would be charged between $1,628 and $2,353 for basic liability coverage and between $5,670 and $7,500 for standard coverage including collision and comprehensive.

These high costs explain why so many LMI car owners nationwide, probably more than one-fifth and perhaps as many as one-third, drive without any insurance coverage. In California, where this issue has been studied most carefully, more than three-fifths of drivers from many lower-income communities are uninsured.

LMI Auto Insurance Rates Reflect Disparate Treatment and Impacts

Many lower-income families with auto insurance suffer disparate treatment -- discriminatory practices -- and/or disparate impacts -- insurer practices such as higher rates that may be risk-related but impose unfair burdens.

- Less Access to Insurance Offices: Research suggests that those in LMI urban communities have much less access to auto insurance offices than do those in higher-income areas. For example, in the District of Columbia, of 80 insurance offices identified, only three were located in the two wards with the lowest incomes, while 45 were located in the two wards with the highest incomes.
- Inability to Purchase Insurance from Some Major Insurers: Some major insurers will not even sell auto insurance to certain types of car owners or they charge rates that are so much higher than those of most other insurers that they clearly are not serious about selling these policies.
- Being Charged Higher Premiums for Less Coverage: Astonishingly, in at least several states including Arizona, Texas, and Arkansas, and probably in more, some major insurers charge individual consumers lower premiums for standard liability coverage than for minimum liability coverage. It appears that these insurers are discriminating against purchasers of the minimum coverage, who are disproportionately LMI car owners.
- Being Charged Higher Premiums Because of Rating Factors Beyond Their Control: In general, LMI car owners are disadvantaged by rate classification systems used by insurers. They pay higher premiums because insurers use rating factors, such as location of residence, occupation, education, and credit rating, which they claim are correlated with risk. But insurers often have not adequately demonstrated to regulators that these correlations exist or that they adequately reflect risk. Some of these factors, individually and in aggregate, may be surrogates for income, a factor forbidden from use in all states.
- Being Charged Higher Premiums Because Key Rating Factors Are Largely Ignored: One important factor not taken adequately into account by rating systems, to the detriment of LMI families, is miles driven annually. LMI car owners drive far fewer miles annually than do higher-income owners -- about half the miles of those in the top income quintile -- but the lower risks associated with fewer miles driven are not adequately recognized by rating systems.
- Being Charged Very High Premiums for Force Placed Coverage: Collision and comprehensive coverage purchased by auto lenders for borrowers without this coverage is expensive because, as they do for most types of credit insurance, lenders charge insurers large commissions that effectively represent "kickbacks." These commissions are the main reason that, according to one study, loss ratios on force placed coverage -- the percentage of premiums dollars paid out in claims -- averaged 25 percent, well below the industry average of more than 60 percent.
- Being Treated Unfairly in the Claims Process: To quote one plaintiff's attorney who used to work for insurers, it's easier to deny claims to the "the sick, the weak, and the poor than to someone who is big and tough."

From this evidence of disparate treatment, it is difficult to avoid the conclusion that major insurers are far more interested in selling auto insurance to higher-income families. These insurers are well aware that upper-income families are much more likely to own two or three expensive cars, with comprehensive coverages, than are LMI households, who often purchase just minimum liability coverage on an old car.

"Even if insurers earn higher profit rates on lower-income policies, they earn far more dollars per policy on upper-income policies, in part because they can cross-sell other types of insurance," noted CFA's Brobeck.

CFA Urges State Insurance Commissioners to Reduce Discrimination and Increase Economic Opportunity

There is much that insurance commissioners can do to meet LMI household auto insurance needs, increase LMI access to fairly-priced insurance, and reduce related disparities. The CFA study discusses several public policy approaches that could make a difference.

- Work to Lower Minimum Liability Coverage Requirements: These state liability requirements do not directly benefit the many LMI drivers who are effectively judgment-proof because they have few or no financial assets. Liability coverage protects only other drivers -- many of whom carry uninsured motorist coverage required by many states -- who suffer damages caused by the LMI drivers. Lowering these limits to those in Florida and California, for example, would lower premiums and allow more LMI households to purchase insurance and obey the law. Efforts to raise these limits, as have occurred in several states recently, should be questioned.
- Work to Eliminate Disparate Treatment and Reduce Disparate Impacts: State insurance commissioners should evaluate the fairness of rates charged to lower-income families starting with those for liability coverage. For a start, they should research disparate treatment and impacts and how to eliminate or reduce them. They should give special attention to insurers who charge individual consumers higher premiums for minimum than for standard liability coverage.
- Create Low-Income Purchase Programs: The only serious program of this kind exists in California, which offers low-cost liability coverage to LMI drivers. The premiums are relatively low because the program offers very low liability coverage only to "good drivers." This program is not subsidized by taxpayers or other ratepayers. However, a strong case could be made, on the basis of simple fairness, for some subsidization of state-required insurance.

"If there is one priority that insurance commissioners should address, it is lower rates for the liability coverage required by state law," said CFA's Hunter. "By driving inexpensive cars, lower-income households can often avoid having to purchase collision and comprehensive coverage. But to comply with state law they must purchase liability coverage."

For a full copy of CFA's study "Lower-Income Households and the Auto Insurance Marketplace: Challenges and Opportunities", go to: www.consumerfed.org/news/450.

The Consumer Federation of America is an association of nearly 300 nonprofit consumer organizations that was established in 1968 to advance the consumer interest through research, advocacy, and education.