Consumer Federation of America

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CFA RESPONDS TO INSURER CRITICISM OF LATEST REPORT ON AUTO INSURANCE RATES -- FINDS RATES CHARGED MANY LOW- AND -MODERATE INCOME DRIVERS OFTEN TO BE UNSCIENTIFIC, ARBITRARY, AND UNFAIR

Washington, D.C. -- Both individual auto insurers and insurer trade groups have criticized the latest Consumer Federation of America (CFA) report showing that most insurers use non-driving factors, such as education and occupation, in pricing insurance policies and that most consumers think insurer use of these factors is unfair. The insurer response can be summarized as follows:

- Insurers base prices on insurance risks and related costs, and the non-driving factors are highly correlated with these risks.
- Insurer pricing based on both non-driving and driving-related factors has helped ensure a competitive auto insurance marketplace with prices that are actually lower today than in the past.

CFA finds these insurer arguments, which they use to justify unfair practices, to be false or irrelevant.

Profitability, Not Risk, Is The Most Important Factor in Insurer Rate-Making

Insurers base prices on more than risks and related costs. In fact, for many low- and moderate-income drivers, insurer assessment of these risks and costs is apparently not that important. That's why the last two CFA auto insurer reports found huge price differences quoted by different insurers -- often exceeding $1000 annually -- to consumers with identical driving and non-driving characteristics. The fact is that the most important criterion of insurer pricing is expected profitability, and this profitability is influenced not just by insurance risks but also by the level of expected premiums. Drivers purchasing just minimum liability coverage for one vehicle -- typical low-income purchases -- generate much less premium income than drivers purchasing standard liability, collision, and comprehensive coverages on two or more vehicles and often home insurance as well -- typical higher-income purchases.

When Making Rates, Insurers Rely on Correlations, Which Can Be Spurious, Not On Causal Relationships

When insurers assess risk, they often only try to establish correlations, not causal relationships. A correlation is not considered meaningful until it is shown to be based on a causal relationship, however. If a large number of independent variables are correlated with a dependent variable, many spurious correlations will be found. Correlations are used by researchers only as leads, never as meaningful in themselves until a causal relationship is established. In fact, most researchers will not even look for correlations until they have framed a hypothesis that links an independent variable to a dependent variable based on a plausible rationale.

According to the industry's actuarial standards: "If a cause and effect relationship can be established, this tends to boost confidence that such information is useful in predicting the future...[and] the classification characteristics may be more acceptable to the public." But when causation cannot be scientifically established, according to the standards, there should be a "plausible relationship between the characteristics of a class and the hazard insured against."

Even "Plausible" Relationships May Not Be An Appropriate Basis for Rate-Making

Even if insurers can establish a plausible relationship between a non-driving factor and risk, they are not necessarily justified in using this factor in their pricing. At present, they apparently do not use factors such as income and race in their pricing either because they are not permitted to do so by law or they believe the use of these factors is not acceptable in today's society. CFA's survey of consumer opinion about insurer use of non-driving factors, such as education and occupation, suggests that large majorities believe that their use by insurers is unfair. Since the industry's actuarial standards recognize that "any risk classification system must recognize the values of the society in which it is to operate," public rejection of classification characteristics would suggest that, even in terms of the industry's standards, these characteristics are not appropriate for insurers to use in rate-making.

For Lower-Income Drivers, Insurance Marketplace Not Competitive

For most lower-income drivers, the insurance marketplace is not competitive. Even those who, for many years, have never been involved in an accident or had a moving violation are often quoted relatively high prices, typically more than $1,000 and sometimes more than $2,000, for minimum liability coverage. These high prices reflect the desire of insurers not to serve them and contribute significantly to the high percentage of lower-income consumers who drive without insurance.

For the record, the principal reasons insurance prices have risen little over the past decade have little or nothing to do with market competition. During this period, there is no compelling evidence that this marketplace has become more competitive. But during the period, insurers losses have tended to decline because cars are older (by 2 years) and are being driven fewer miles (about 5% less), and because drivers have benefited from improvements in traffic safety that, to their credit, some auto insurers have strongly supported.

"State insurance commissioners need to more carefully examine the use of non-driving factors in the pricing of auto insurance policies," said J. Robert Hunter, CFA's Director of Insurance and a past Texas Insurance Commissioner. "It appears insurer use of these factors discriminates against Americans who are already at a disadvantage and forces many of them to drive without insurance," he added.

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