Consumer Federation of America

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WHAT WORKS? A REVIEW OF AUTO INSURANCE RATE REGULATION IN AMERICA

How Best Practices Saved Californians over $100 Billion

(Washington, D.C.) - In a report released today, the Consumer Federation of America (CFA) studied state auto insurance rate regulation in every state. It found that, over the past quarter century, auto insurance expenditures in America have increased by 43 percent on average, with the median state, Wisconsin, jumping 56 percent. In Nebraska, rates rose by as much as 108 percent. These increases occurred despite substantial gains in automobile safety and the arrival of several new players in the insurance markets. These escalating rates, which are made worse by the use of non-driving rating factors by major insurance companies, limit the ability of low- and moderate income drivers to comply with state insurance requirements.

Only in California, where a 1988 ballot initiative transformed oversight of the industry and curtailed some of its most anti-consumer practices, did insurance prices fall during the period. CFA found that the amount that drivers spend on auto insurance in California declined by 3 tenths of one percent, resulting in billions of dollars of annual savings.

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"It is the 25th Anniversary of Prop 103, passed on November 8, 1988. On this silver anniversary we can report that the Proposition delivered over $102 billion in savings for California's motorists, an average annual savings of $345 per household, or $8,625 per family over the entire period," said J. Robert Hunter, Director of Insurance and former Texas Insurance Commissioner and Federal Insurance Administrator under Presidents Ford and Carter. "This was the result of strong regulatory oversight and a more competitive market fostered by the 1988 insurance reform measure."

In the report CFA looked at each state and evaluated the various types of insurance regulatory regimes found across the country. Using these data CFA identified best practices from a consumer protection perspective.

Some of the highlights of what CFA found:

On insurance costs

1. The average expenditure on auto insurance since 1989 has increased by 43.3 percent nationwide;

2. The states with the highest increases are Nebraska, Louisiana, Montana, Wyoming and Kentucky;

3. The states with the lowest increases are Hawaii, New Hampshire, New Jersey, Massachusetts, and Pennsylvania; and

4. Only California has seen average expenditures decrease since 1989.

On regulatory systems

1. The prior approval system of regulation, in which insurers must apply for rate changes before they can be imposed in the market, is most effective at keeping rates low.

2. Markets that are less or not regulated tend to have the most substantial increases. The prior approval 25 year increase was 48 percent, the File and Use system was 60 percent; the Use and File system was 62 percent, the FLEX system was 67 percent and the deregulated system was 70 percent.

3. While mildly and strongly regulated states tend to have very or somewhat competitive markets for auto insurance, deregulated and flexible rating states have the least competitive markets. Prior approval had an HHI (market concentration score) of 996, File and Use 1030, Use and File 865, FLEX 1311 and Deregulated 1207;

4. Insurance companies are generally able to adapt to any regulatory system and consistently maintain reasonable or high levels of profitability. Prior Approval profit over the 25 years was 8.5 percent ROR on Net Worth, the overall profit was 8.6 percent. The deregulated states had the highest profits.

On California's unique success

Besides achieving the only price drop over the last 25 years, CFA found these other indicia of California's remarkable achievement:

1. Insurers operating in California returned over $1.43 billion in premiums refunds ("rollbacks") to over seven million policyholders under Proposition 103's mandate;

2. Proposition 103's provisions spurred full competition and penalized collusive behavior by insurers. For instance, it imposed the state's antitrust law on the industry.

3. Proposition 103 built strong incentives for safety into the initiative. Drivers with clean records gain a 20 percent rate discount. They also receive the right to buy insurance from the company of their choice through Proposition 103's "Good Driver Protections;"

4. State rules prohibit many of the discriminatory elements that plague low-income and minority consumers in other states, especially prohibitions on use of credit scoring and prior insurance coverage as rating factors;

5. State rules temper the impact on consumers of other non-driving related classifications, such as territory and marital status by requiring that the most weight in the pricing for a consumer must be given to driving record;

6. The intervenor system, allowing systemically-funded public challenges to rate hikes, improves both industry and government accountability;

7. The state has innovated in the marketplace with the implementation of an unsubsidized alternative policy for low-income consumers;

8. Insurers earned above average profits in California during the study period;

9. California is the fifth most competitive state in the nation at an HHI of 753;

Recommendations for state action

“Consumers across the country would be better served with a more robust, prior-approval system of auto insurance regulation than the system currently in place in most states,” Tom Feltner, CFA’s Director of Financial Services said. “When drivers, particularly low- and moderate-income drivers, are required to purchase auto insurance, states have a responsibility to address the high cost of coverage.”

In particular, CFA suggested that state policymakers should adopt reforms that:

1. Set standardized and transparent ratemaking standards, such as reasonable rates of return, restrictions on the amount of overhead costs that can be passed on to consumers, and guidelines for projecting future rate increases;

2. Prevent excessive or unjustified expenses from being passed on to consumers, such as fines, penalties for bad faith behavior, and excessive executive salaries;

3. Require that driving record is the most important factor in setting rates for drivers, followed by miles driven and years of experience;

4. Eliminate unfair and discriminatory rating factors such as occupation, education and prior purchase of insurance coverage in order to increase market access for low- and moderate income drivers;

5. Increase competition by (a) requiring insurers to offer coverage to all good drivers who are compelled by the state to purchase it and to offer the lowest rate from among a company’s group of affiliates to that applicant; and (b) repealing the state anti-trust exemption; and

6. Involve consumers actively in the rate-setting process by funding consumer participation in the regulatory process.

“If every state in the nation were to implement and enforce a regulatory and pro-competitive agenda as demonstrably pro-consumer as that in California, our research indicates that Americans could save over $350 billion over the next decade ($3,361 per household), even as insurance companies realize reasonable profitability and competition remains robust,” said Hunter. “When it comes to regulating an industry as large as the auto insurance industry that impacts so many millions of Americans who are required to purchase insurance, we ask of policymakers and regulators the same question we asked when we first began reviewing auto insurance systems around the country more than a decade ago:

Why not the best?”

Related materials:

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The Consumer Federation of America is an association of more than 250 non-profit consumer groups that, since 1968, has sought to advance the consumer interest through research, education, and advocacy.