Consumer Federation of America

January 25, 2006

The Honorable Linda Hall
Director
Alaska Division of Insurance
550 West 7th Avenue, Suite 1560
Anchorage, Alaska 99501-3567

RE: GAS PRICE SPIKE – IMPACT ON AUTO INSURANCE PRICING

Dear Director Hall:

We write to urge you to take immediate steps to determine if auto insurance rates in your state are excessive because current ratemaking methods have not adequately considered the impact that higher gasoline prices have had in reducing the number of miles driven and claims filed.

It is well known that as gas prices rise for a sustained period, consumers react by driving less. This is simple economics. Consumers respond to economic incentives and disincentives. It is also true that as people drive less, auto insurance claim frequencies drop. Consequently, higher gas prices lead to lower auto insurance claim costs.

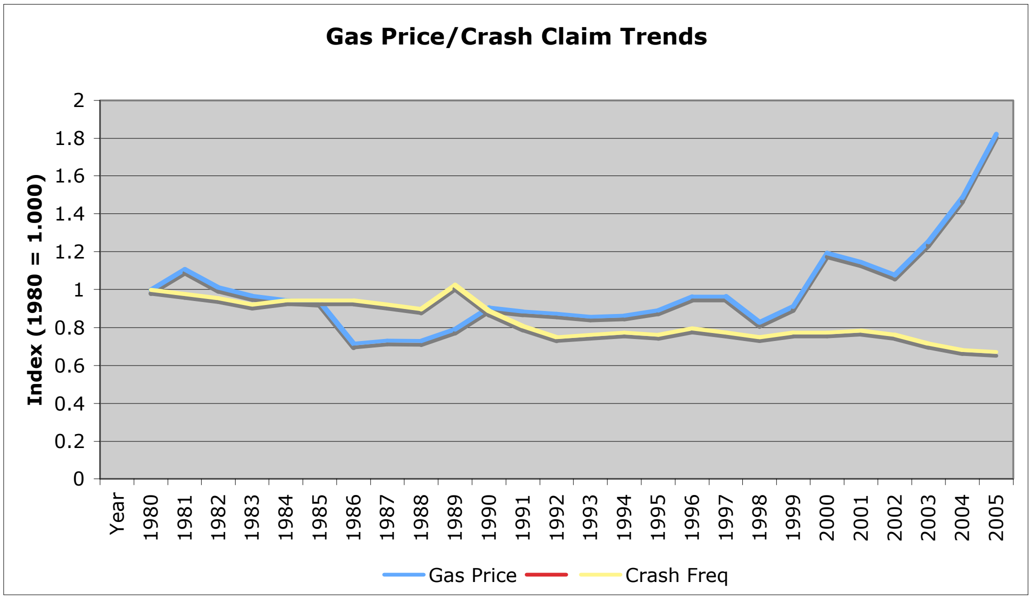
This matter has been extensively studied. In 1981, Robert Hunter wrote a paper, *Gas Prices and Auto Rates: Insurance Implications of the Dynamic Changes in America's Driving Habits,* that documented the impacts of sharp gas price spikes during the early 1980s. The insurance industry does not dispute these findings. In fact, a recent study, *Will Post-Katrina Gas Shortages Impact Auto Claim Frequencies?*[1] by LeRoy Boison of Pinnacle Actuarial Resources, Inc. examines the long-term history of the relationship between gas price and auto claims frequency.

Boison, an actuary formerly with the ratemaking organization Insurance Services Office (ISO), concludes, "the gas crisis of the early 1980s…contributed to a long-term reduction in claims frequency." Importantly, he also reports that even after gas prices later declined, "claims frequency failed to return to pre-crisis levels" because, among other things, "drivers found other ways to get around and stuck with them." "During the 1970's and 1980's 'energy crises,' the average number of miles driven decreased significantly and stayed below pre-energy crisis levels for fourteen and five years respectively," he explains.

Over the long range, auto claim frequencies have fallen, as the following graph reveals:

---

1 The report is available at www.pinnacleactuaries.com.



The recent spike in gas prices has also contributed to a drop in collision claims frequency.

From the fourth quarter of 2002 through the third quarter of 2005, claim frequency has dropped by almost 6 percent for liability coverage and about 12 percent for physical damage coverage, according to national Fast Track data published by ISO. For the period from the second quarter of 2001 to the first quarter 2004, the drop was less: under 5 percent for liability and about 8 percent for physical damage, so the drop is accelerating as gas prices rise.

In 2000, vehicle miles driven per car totaled 12,667. By 2003, it was 12,492, a drop of 1.4 percent. This occurred before the recent sharp jump in gas prices. Recent gas prices are below:

PRICE PER GALLON

Year	Nominal	Inflation Adjusted
1995	110.9¢	142.0¢
1996	120.0	149.2
1997	120.0	145.9
1998	103.0	123.3
1999	113.5	133.0
2000	148.6	168.4
2001	142.6	157.2
2002	134.1	145.5
2003	155.9	165.4
2004	184.9	191.1
2005	226.8	226.8
2006	241.4	235.6

NOTE: 2005 = 1.000; CPIU adjustment.
SOURCE: Federal Energy Administration

The 2000 to 2003 change in gas prices was 5 percent, but the change since 2003 to date was 55 percent.

On the rate filings we have reviewed, claim frequency projections have not reflected the recent sharp drop in claim frequency, much less the projected drop now that prices have continued to rise.

It is incumbent upon you to test the current pricing structures in auto insurance to determine if the changes in driving behavior have led to windfall profits for any insurers in your state. Specifically, we call upon you to hold hearings on the current rates of leading private passenger car writers to determine if these rates are excessive or not. It is critical that you focus on the trend factors used in the latest rate filings to see if trends reflect the recent dramatic jump in gas prices. It would be an error to simply rely on long-term trend factors with no adjustment for the dynamic gas price increases. Consideration should be given to moderating historic trends by several percentage points, (i.e. requiring that rates be lowered by more than history alone would indicate). Using experience with gas price increases in the recent past as a measure, claims frequency should drop by about one-third of the percentage increase in gas prices in your state.

We also ask that you make available to us an electronic copy of the latest private passenger auto insurance rate filing for the top five writers of the coverage in your state so that we can provide you with our analysis of the situation as part of your overall review. Please send these filings to birny@sbcglobal.net.

As you review the implications of gas price increases, you should also look into the possibility of increasing the importance of miles driven in the rating structure. By making miles driven a more important rating factor, where importance is defined as having a more significant effect on premium paid by consumers, greater economic incentives are provided to consumers to reduce their loss exposure, reduce claim costs and lower their premium cost.

The ability of auto risk classification systems to provide economic incentives to consumers for saving money and promoting loss prevention has weakened considerably in the past few years as insurers have given increasing weight to rating factors like credit history and prior liability limits. We urge you to promote auto rating systems that strengthen the role of rating factors that provide economic incentives for consumers to reduce their loss exposure and that give consumers greater ability to affect their insurance premiums through driving choices.

Miles driven is a key factor that has widespread consumer acceptance. Indeed, the voters of California, in passing Proposition 103 in 1988, established it as the second most important factor after driving record. Studies over the decades have shown that miles driven is an excellent predictor of claim potential. Evaluating two identical drivers with all the same characteristics except miles driven demonstrates this point. The one who drives further presents the higher risk.

We think the obstacles to greater consideration of miles driven have been overstated by an insurance industry that prefers to rely on third-party databases for underwriting and rating information. There are a variety of options and tools available for greater inclusion of miles driven as a rating factor, if there is a will to use them. Some have suggested paying for insurance at the pump. Others have suggested annual drive-in odometer checks. Still others have suggested buying insurance in 10,000-mile blocks.

Another point about rating classifications is critical here: low-income people are more likely to adjust their driving habits as gas prices rise. This is another example of how credit scoring does not work well if used as a rating factor, particularly during a dynamic time such as a period of gas price hikes.

We would welcome the opportunity of working with you as you undertake a review of the auto rates in your state to determine if the recent jump in gas prices has caused auto insurance prices to become excessive.

Yours truly,

Birny Birnbaum
Executive Director
Center for Economic Justice

J. Robert Hunter
Director of Insurance
Consumer Federation of America