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Consumer Federation of America

PUBLIC HEARING ON THE PRICING OF AUTO INSURANCE
AUTO INSURANCE (C/D) STUDY GROUP OF THE
NATIONAL ASSOCAIATION OF INSURANCE COMMISSIONERS
November 19, 2015
Comments of J. Robert Hunter, FCAS, MAAA

Good afternoon. I'm Bob Hunter, Director of Insurance at CFA. I formerly served as Texas Insurance Commissioner and as Federal Insurance Administrator under Presidents Ford and Carter.

Thank you for allowing us to testify today. I request that my written testimony be made a part of the record of this hearing.

This is an important hearing, marking the beginning of a much-needed NAIC review of auto insurance ratemaking. The focus of your questions, on the rating factors currently being used, is an important one, one that we at CFA have carefully studied over the last three years. We attach (at Attachment A) links to all of these studies, with thumbnail descriptions of our findings. We have shown conclusively that the use of socio-economic rating factors adversely impacts low- and moderate-income (the "LMI") Americans and people of color, while broadly diminishing the loss mitigation role that insurance pricing ought to serve.

LMI individuals and families need a car to prosper in modern America. Researchers agree that, for most of these families, having access to a vehicle 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."[1] But to own a car, these

[1] B.D. Taylor and P.M. Ong, "Spatial Mismatch or Automobile Mismatch? An Examination of Race, Residence and Commuting in U.S. Metropolitan Areas," Urban Studies, v. 32 (1995), p. 1471. See also

individuals must purchase the liability coverage required by all states except New Hampshire and, if the car is financed, must also purchase physical damage coverage required by lenders.

If mandated insurance is unaffordable, the LMI are faced with an awful choice: either give up the car and suffer the economic consequences that entails or drive uninsured and face the legal consequences.

LMI drivers spend a huge amount on auto insurance -- $46 billion in 2013[2] using numbers from the insurance industry and the Labor Department.

Since January of 2012, CFA has published eleven studies demonstrating the serious problems the LMI face in affording state required auto insurance. As I indicated, you have a handout with summaries of each report as well as links to all of the reports. I encourage you to have your staff review these important studies when you get back to your offices. Let me touch on only a few of the most disturbing findings.

Using leading insurance company web sites to get quotes, we documented the frightening extent of the high prices paid by accident- and ticket-free, good driving LMI for the minimum liability insurance required by the states. In 15 major cities we found that over half of these drivers had to pay more than $1,000 for such coverage. One-third had to pay more than $1,500. If the car is financed and the LMI good driver also has to buy physical damage coverage (on the 10-year old Honda Civic we used for testing purposes), over half of the quotes exceed $1,500, about a third exceed $2,000 and 11% exceed $3,000.

In order to expand our research, we purchased national data from Quadrant, an insurance price quote source. This gave us insurance prices for any hypothetical driver we wanted to study for all of the ZIP Codes in the nation. Focusing on the state-required minimum limits only and looking at all of the lower-income ZIP Codes in 50 urban regions for the top five insurers, we saw that 9 cities had no lower-

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Donald S. Houston, "Methods to Test the Spatial Hypothesis," Economic Geography, v. 81, n. 4 (Oct. 2005), pp. 422-423.

[2] $175 billion spending on private passenger auto insurance according to Insurance Information Institute and 26.3% of this by LMI households according to Consumer Expenditure Survey.

income ZIP Code with even one rate below $500 and almost half of the cities had at least one ZIP code where the premium charged always exceeded $500. In public opinion surveys we undertook, 76% of the public believes that minimum liability insurance required by the state should cost no more than $500 and if physical damage insurance is also required, the same percentage of the public believes that coverage should not cost more than $750.

In another study we found that LMI drivers with no accidents and tickets pay more for auto insurance than wealthier drivers with an accident. In fact, in 60% of our tests, the LMI good driver paid at least 25% more than the higher-income driver who caused an accident.

Why do lower-income Americans pay more? Primarily because insurers do not want their business and find ways to raise their prices to discourage the poor from insuring with them. You see, insurers want richer clients because they can sell them higher limits of auto insurance, insure more of their cars, insure their homes, insure their lives, sell them banking products, insure their businesses and even insure some of their yachts and planes. Companies love to, as they call it, "multiline" the client. To capture this segment of business, insurers shift rate onto customers they deem less attractive. The poor, offering no multi-lining opportunities are priced up in order that the target market, the more affluent, can pay less without the insurer losing the total income they want to generate. In other words, the auto insurance pricing systems in place in most states today is built on subsidies for high wealth drivers paid for by low wealth drivers with clean records.

One of the key ways the insurers raise the price on the poor is through the use of non-driving-related factors. Our research, in which we've tested thousands of online price quotes, proves that these are some of the characteristics insurers have developed to implement this practice:

- Less education means higher price
- Lower paying jobs means higher price.
- Renting rather than owning a home means higher price.
- Being single, divorced, separated, or widowed means higher price.
- A short lapse in coverage means higher price.
- Having less than perfect credit score means higher price.

- Not paying in full means higher price.

And there are other such factors used to raise the price of auto insurance for the LMI such as purchasing lower limits from the previous insurer. I will demonstrate how these factors work to raise the premium for the LMI in a few minutes.

Consider just credit score as one example. Research shows that the average policy in Maryland costs $1,000 more if drivers have two at-fault accidents. Most people understand and support higher prices for accidents. But the average auto insurance policy in Maryland costs $3,000 more if your credit score is poor as opposed to excellent!

The public does not like factors such as credit score. Our surveys show that, by two to one, the public rejects the use of credit score, lapse of coverage, education and occupation. On the other hand, large majorities of the public support the use of accidents and tickets for pricing auto coverage. The public gets the unfairness of non-driving related factors, something that, unfortunately, is ignored by most of the nation's policymakers and regulators.

In recent years insurers have started a new pricing scheme that raises the rates even more on the LMI, although all drivers are at risk of this factor. This new "innovation" is called price optimization. You are well aware of this "innovation" and have asked CASTF to finalize a White Paper on the subject, which should be before you very shortly.

On September 30, 2015, I emailed a letter to this Study Group pointing out that the White Paper only deals with pricing aspects of price optimization. It has become more and more clear to us that price optimization is often applied at the underwriting level and not directly in pricing. In this letter I stated:

> It does not diminish the amount of work done by the CASTF team to note that there is critical work still to be done in order to be sure that NAIC can offer a comprehensive assessment of price optimization and useable guidance to regulators. To stop with the rating side of this investigation would be to end the effort before it is complete. And to provide regulators with guidance on the use of price optimization in rating alone, even if the recommendation is a strict ban, as we believe it

> ought to be, is insufficient. In fact, we believe that at least partly in response to the NAIC's work on price optimization in rating, insurers are refocusing their use of unfairly discriminatory practices toward the underwriting and tiering aspects of pricing to elude the thrust of CASTF's findings and individual regulators' efforts.
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> Therefore, we urge you to take up the draft suggestion from CASTF and initiate new research into the use of price optimization by insurers in manners outside of the rate filing setting. This should begin immediately.

But most disturbing of all, our research shows that African-American drivers from all income groups are being charged the highest prices.

The startling impact of questionable rating factors (and, particularly, the cumulative effect of several socio-economic rating factors) on lower-income people can be demonstrated by the PowerPoint presentation attached to this testimony (Attachment B). With the hotel we are in right now, the Gaylord National Resort and Convention Center, as a backdrop for the presentation, we review the impact of these factors on a woman in her 30s, living in Baltimore, driving a financed 2003 Ford Focus, commuting 16 miles with a perfect driving record who needs to purchase a basic limits, liability only policy to comply with state law.

Throughout this presentation, these facts do not change. The slides take you through changes in price, step by step, from a married executive with an MBA, living in the upper-income, predominantly white Homeland neighborhood, who is currently insured and pays in full (annual premium: $586) to an unmarried janitor with a high school degree living in the lower-income, predominantly African American Lower Park Heights neighborhood who did not have a car or insurance for a few months and must pay in installments (premium: $2,513 or more than quadruple the starting premium).

Here are the additional costs making up this huge jump in price:

High School grad rather than MBA	+$ 79
Janitor rather than executive	+$ 59
Widowed rather than married	+$ 215
Moves 3 miles from 21212 to 21215	+$ 650

Pays in installments rather than in full	+$ 60
Stopped driving and had no insurance for three months	+$ 864

Recall that, in every case, this driver had a perfect driving record and was only seeking a quote for basic, liability-only coverage. Disturbingly, when we went back and sought a quote for the original, preferred driver with the MBA, executive job and living husband but apprised the insurer that she received a speeding ticket and caused an accident within the last 12 months, she was quoted a premium that was 58% less - a $1,457 price cut from our good driver who was not so attractive to the company.

I must point out that we did not use credit scoring in this example. Had we done so, and changed the credit score from excellent to poor, the difference in rate would have been significantly more.

The ultra-high prices being charged to the LMI is one of the important reasons that between one-third and one-half of LMI motorists drive without insurance in violation of the laws of all states but New Hampshire. Driving illegally without insurance is understandable for many of these drivers since the families in the lowest earning income quintiles in America earn less than $40,000 and, in the lowest quintile that's an average of about $12,000. Imagine the impact of a $1,500 bill on a family earning $12,000! In 14 of the states, a decision to drive uninsured could result in jail time for the first offense. 32 states could lift the license of the convicted driver. 33 states could fine the driver $500 or more for a first offense. Nine states could do all three. States should work on affordability of the auto insurance they require before imposing draconian penalties on those good drivers who cannot afford to meet the purchase mandate.

Affordability of state- and lender-required auto insurance is an important issue. The data you will review today make this a powerful issue. And the lack of study until CFA got into this in 2012 makes this a long-neglected issue.

There are real opportunities for reform. The atmosphere for change in this space is better that any I have experienced in my over 50 years working on such matters. Auto insurers are on the defensive because of adverse press coverage and our communications with federal and state policymakers, including this important Study Group. The Dodd-Frank Wall Street Reform and Consumer Protection Act provided the Federal Insurance Office with a number of authorities including "monitoring the extent to which traditionally underserved communities and consumers, minorities, and low- and moderate-income persons have access to affordable insurance products regarding all lines of insurance, except health insurance." In July 2015, FIO issued a request for comments on its proposal to create an affordability index that deemed auto insurance affordable if it cost less than two percent of the household income of low- and moderate-income drivers and other underserved Americans. In August, 50 organizations from 23 states and DC jointly submitted comments to FIO calling on FIO to establish a strong affordability standard for low- and moderate-income Americans and move forward with its proposal to collect data directly from insurance companies and review the cost of basic liability auto insurance for tens of millions of financially strained drivers.

Summary of Recommendations

In conjunction with our research, CFA has developed a series of recommendations for policymakers and regulators to address the issue of access and affordability for LMI drivers. The various recommendations can be grouped into three main categories: Data Collection, Reforms to End Discrimination, and Efforts to Increase Access.

<u>Data Collection</u>

- The National Association of Insurance Commissioners should develop a model data call that will assist state regulators in tracking insurance costs of LMI drivers.
- The Federal Insurance Office should collect data sufficient to conduct a comprehensive review of auto insurance access and affordability of auto insurance.

<u>Reforms to End Discrimination</u>

- Prohibit the use of rating factors – such as occupation, education, and credit score – that are surrogates for income and do not have a causal relationship to insurance risk.

Efforts to Increase Access

- States should create programs in which good low- and moderate-income drivers can purchase basic liability coverage for affordable rates. California has such a program with rates that are lower than $350 a year and that cover the program's costs with no subsidy from other drivers or taxpayers.
- States should lower required minimum liability coverage in order to bring down the costs of mandatory auto insurance for LMI drivers
- States should require insurers to offer drivers with clean driving records the lowest premium for which they qualify from among the company's affiliates doing business in the state.

The opportunities are great and movement toward reform is gaining momentum. We now can prove that auto insurance required by the states is unaffordable for many. We can prove that the pricing is unfair and results in disparate treatment and even discrimination against the LMI and minorities. But there will be no significant reform without broad-based efforts at the state level, starting with this important committee. We hope that what you learn today will help persuade you to take steps now to make state-mandated auto insurance affordable for all Americans.

I'd be happy to answer any questions.