August 21, 2019

Re: Comments on "Insurance Rating Variables: What Are They and Why They Matter" by Insurance Information Institute and Casualty Actuarial Society

Dear Commissioner:

The Insurance Information Institute (III) and the Casualty Actuarial Society (CAS) have recently issued a paper on auto insurance rating factors to respond to "recently generated discussion within the United States" on "the use of some rating factors." The paper, *Insurance Rating Variables: What Are They and Why They Matter*,[1] notes that "some states have even passed legislation controlling the use of certain variables."

This paper is clearly a reaction to a series of studies by Consumer Federation of America (CFA) on the topic.[2] Over the past several years, CFA has been critical of the use of certain socio-economic factors in auto insurance, which are not driving related and which act as proxies for the prohibited class of income. These factors generally have the effect of driving up the cost of state-required auto insurance for low- and moderate-income Americans, even when they have pristine driving records. State-required auto insurance has, in significant part due to these unfair factors, or "rating variables" to use the III/CAS term, become unaffordable for many of these drivers.[3]

Among the unfair and abusive socio-economic factors we have highlighted as proxies for income are:

- Credit history: rates rise significantly for anyone not having an "excellent" rating.
- Education: Those with lower levels of education pay a higher rate than highly educated drivers.
- Occupation: Drivers with blue collar jobs pay more than white collar professionals.
- Widowhood: A widow penalty raises auto rates for widows compared with married drivers. Similar hikes are faced by other unmarried drivers as well.
- Home ownership: Renters pay more for auto insurance than homeowners.

[1] III/CAS, July, 2019. Insurance Rating Variables: What They Are and Why They Matter, retrieved from https://www.iii.org/sites/default/files/docs/pdf/ratingvariables_cas-iii_wp072419.pdf
[2] See https://consumerfed.org/cfa-studies-on-the-plight-of-low-and-moderate-income-good-drivers-in-affording-state-required-auto-insurance./ Included in this list of reports are detailed analyses of the rating factors itemized in the list above.
[3] According to the Federal Insurance Office more than 18.6 million US residents live in ZIP codes in which auto insurance is unaffordable. Federal Insurance Office, 2017. Study on the Affordability of Personal Automobile Insurance, p.11, retrieved from https://www.treasury.gov/initiatives/fio/reports-and-notices/Documents/FINAL%20Auto%20Affordability%20Study_web.pdf

- Prior carrier: Rates rise if a driver was previously insured with a non-standard (higher priced) insurer.
- Prior limits: Rates are higher if a driver previously bought only the state required coverage rather than higher coverage.
- Break in coverage: If a customer dropped insurance while not owning or driving a car, rates rise.
- Gender: On average, women pay more than men, all else being equal.
- ZIP Code: People in lower income ZIP Codes often pay more than those in higher income ZIPs, even when the ZIP Codes share a common border.

The III/CAS paper reads as though these incongruous factors are not in use and that insurance company rating variables send clear and logical signals to customers. According to the paper, "[s]afe behaviors can help drivers reduce their auto premiums by making themselves a better risk. There is an intuitive sense of fairness in rating drivers based on things they can improve." While that is true, it fundamentally ignores the many socio-economic factors that CFA has highlighted.

The factors listed above do not send a message leading to safer driving. Instead the signal they send is that if consumers want to save money, they should pay down their loans, get married, go back to school, get a higher paying job, buy a house, move to a different ZIP code, and don't let your spouse die or, at least, remarry immediately!

Interestingly, although these socio-economic factors are at the center of the national discussion that obviously inspired this paper, the III/CAS paper refers only to gender, and then does so in plain conflict with the facts about the predominant gender-based pricing approach currently found in the U.S. auto insurance market. Notably, the III/CAS paper argues that

> Using other rating variables may also result in **lower-risk policyholders effectively subsidizing higher-risk policyholders**. Male drivers might cost more to insure than female drivers, but if gender as a rating variable is restricted, then female drivers will overpay for insurance and male drivers will underpay, relative to their expected costs. **Restricting rating variables therefore impacts the insurance consumer much more than it does insurance companies.** [p.6, emphasis in original]

Presumably, III/CAS use this example because most Americans *believe*, as CFA has shown through a national survey,[4] that women justifiably pay less than men for insurance.

[4] 48 percent of Americans think auto insurers charge men more for coverage than women, while only 23 percent of Americans think women are charged more, according to a national survey conducted for CFA by ORC International. 17 percent think men and women are charged the same for coverage. The survey asked respondents to exclude "teenagers and other young drivers" when thinking about who pays more to eliminate the possibility that respondents were focused on young male drivers, who generally do pay higher premiums. (The telephone survey of 1,004 Americans was conducted between September 28, 2017 and October 1, 2017 and had a ±3.09% margin of error.) See https://consumerfed.org/press_release/large-auto-insurers-charge-40-60-year-old-women-higher-rates-men-often-100-per-year/

However, as research by CFA[5], the California Department of Insurance[6], Texas Appleseed[7], and insurance premium comparison site TheZebra.com[8] have shown, women actually pay more on average than men for auto insurance these days. Prohibiting the use of gender in auto rating – as California and six other states do – actually lowers rates for female drivers on average. In other words, the III/CAS primary example of how prohibiting non-driving rating variables might be a mistake relies on a widely held assumption that women are lower risks than men and, more importantly, the false premise that women currently pay less than men for auto insurance.

Perhaps most revealing about the III/CAS paper is that, other than the inaccurate portrayal of the use of gender in rating, III and CAS do not name any of the other controversial non-driving rating variables that have "recently generated discussion within the United States." The paper's defense of rating variables is (again with the exception of gender) a defense of *driving-related* factors such as accident history, annual mileage, and vehicle type, around which there is little disagreement.[9] Nowhere in the paper do they mention the significant rating and underwriting reliance on, for example, drivers' credit scores, job titles, or level of education. It is, as III/CAS well know, specifically around those rating variables among a few others that the III/CAS-noted discussions have been taking place. Yet III/CAS apparently saw no reason to explain how those variables interact with rates and what would happen should they be eliminated. That is not oversight; it is strategic and deeply disingenuous.

The paper does make an important admission. It states that "State and federal laws prohibit using rating variables that directly **or indirectly** impact groups based on characteristics such as race, nationality, religion, **or income."** They go on to say "It is important to note that rate regulations still apply to the use of proxies. That means that **proxies cannot directly or indirectly impact groups** based on certain characteristics such as race." (Emphasis added)

It is clear that the paper is saying that proxies for income are prohibited. Nevertheless, at least some proxies for income are in use in every state – except, arguably, Massachusetts – today. It is incumbent on regulators to consider rating factors used in their state and eliminate any that indirectly impact certain drivers based on their income.

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[5] Consumer Federation of America, October 12, 2017. Most Large Auto Insurers Charge 40 and 60-Year-Old Women Higher Rates Than Men, Often More Than $100 Per Year, retrieved from https://consumerfed.org/press_release/large-auto-insurers-charge-40-60-year-old-women-higher-rates-men-often-100-per-year/

[6] California Department of Insurance, October 19, 2018. Initial Statement of Reasons: Gender Non-Discrimination in Automobile Insurance Rating. REG-2018-00020, retrieved from https://legaldocs.insurance.ca.gov/CyberDOCS/Libraries/DOCS_WEB/Common/viewdocdsp.asp?doc=322167&lib=DOCS_WEB&version=326844&mimetype=APPLICATION%2FPDF&file=.pdf&rendition=html&MSOESPq330994WA=x.mht

[7] Texas Appleseed, October 11, 2018. Out of Alignment: Women & Discrimination in the Texas Auto Insurance Market, retrieved from http://stories.texasappleseed.org/out-of-alignment

[8] The Zebra, undated. Male vs. Female Car Insurance Rates, retrieved from https://www.thezebra.com/auto-insurance/male-vs-female-car-insurance-rates/

[9] III/CAS do pose the possibility of increased use of telematics – in which data from an insured vehicle are collected and used for rating purposes – which is controversial because insurers have refused to share precisely what data they are collecting as well as due to privacy concerns.

The paper also makes the important point that "[r]egulators and consumers want insurance to be **affordable**. This is especially true when insurance is required by law ('proof of financial responsibility' for vehicle owners)…" (Emphasis in original) Affordability is certainly something consumers want. However, as long-time observers and monitors of state-based regulation, we believe that many regulators need to do far more to achieve the goal of affordability. Indeed, many regulators are not acting to even determine if auto insurance rates are affordable in their jurisdictions, much less doing something about it.

Similarly, the paper states: "Regulators and consumers also often want to see a rating variable exhibit **clear relationships**, that is, they want rating variables to have an obvious impact on expected losses." (Emphasis in original) With respect to consumers, again, this is entirely true, and average Americans understand the problem with the use of these non-driving rating factors. In a survey CFA commissioned in 2016, ORC International found that over 80% of Americans felt that it was fair or very fair that prices should vary with accidents and moving tickets but less than 40% agreed that education, occupation, marital status, no previous insurance due to the lack of a car, home ownership, or use of credit history were fair. Only around 10% of respondents thought these socio-economic factors were very fair, compared to about 55% saying accidents and tickets were very fair. But, among regulators, too many Insurance Departments do not require an establishment of that clear relationship for the non-driving variables (namely those listed above) that cause the most frustration and confusion for consumers.

The III/CAS is right, it should be noted, to highlight this issue of public acceptability as relevant, but its decision to ignore the use of these controversial non-driving factors demonstrates the political nature of this paper. If this were an honest and independent effort to, in its own words, "help legislators, policymakers, the media and the public to understand" the use, regulation, and importance of rating variables, III/CAS would have also acknowledged the actuarial standards regarding public acceptability of rating factors.

According to the American Academy of Actuaries "Risk Classification Statement of Principles":

> The [rating] system should be acceptable to the public. Any risk classification system must recognize the values of the society in which it is to operate...they should not differentiate unfairly among risks; they should be based on clearly relevant data...they should be structured so that the risks tend to identify naturally with their classification.[10]

Another "clear relationship" that III/CAS paper ignores from the actuarial standards is that risk classes (as constructed through rating variables) should be "neither obscure nor irrelevant." The Causality standard states,

> If a cause and effect relationship can be established, this tends to boost confidence...Thus classification characteristics may be more acceptable to the public if there is a demonstrable cause and effect relationship between the risk characteristic and expected costs. However, in insurance it is often impossible to prove statistically any postulated

[10] American Academy of Actuaries Committee on Risk Classification, Risk Classification Statement of Principles, IV (G)

> cause and effect relationship. Causality cannot, therefore, be made a requirement for risk classification systems. Often causality is not used in the rigorous sense of cause and effect but in a general sense, implying the existence of a plausible relationship...Risk classification characteristics should be neither obscure nor irrelevant to the insurance provided, but they need not always exhibit a cause and effect relationship.[11]

The inattention to these standards has led, in many states, to rating practices that are incompatible with actuarial principles and that run counter to some of the most compelling statements in the III/CAS paper. For example, the paper alleges"…a driver with a poor record will usually pay a higher auto insurance premium," but CAS and III should know, and should have reported, that in most states a driver with a perfect driving record but a poor credit score will pay a higher premium (and sometimes significantly more) than a driver convicted of drunk driving who has an excellent credit score.[12] Similarly, drivers with unblemished records often will pay more than drivers with points on their record, solely because of the safe driver's ZIP code.

One can only read the III/CAS paper as a piece of advocacy by the insurance industry in an effort to pressure lawmakers and regulators to resist the instinct to demand fairness in the market. The III/CAS advocacy argument is summed up when it argues:

> **Restricting rating variables therefore impacts the insurance consumer much more than it does insurance companies.** The companies will still set overall premium levels that meet corporate objectives, regardless of rating variable restrictions. To meet these levels, low-risk policyholders will need to subsidize high-risk policyholders to compensate for the inaccurate premium. The premium will be paid to the insurance company regardless – but who pays how much will change. (Emphasis in original)

The first two sentences are fundamentally accurate (except that the in addition to meeting corporate objectives, overall premiums must also comply with state laws and regulations). Insurance rates can be divided in myriad ways among a pool of policyholders in order to bring in the gross premium required to manage the pool's total risk of loss. But there is no reason that prohibiting the use of unfair variables should require low-risk drivers to subsidize high-risk drivers. California has long prohibited most socio-economic factors, including credit history, and there is no such subsidy. In a fair insurance market, good drivers pay their actuarially determined share and worse drivers pay their higher share of the overall premium. In fact, addressing these factors would end unfair subsidization in the market, because allowing insurers to use non-driving variables such as job title, educational status, and credit score, leaves low-risk (but socio-economically disfavored) drivers subsidizing higher-risk (but socio-economically favored) drivers.

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[11] Ibid., IV (F)

[12] Consumer Reports, July 30, 2015. The Secret Score Behind Your Rates, retrieved from https://www.consumerreports.org/cro/car-insurance/credit-scores-affect-auto-insurance-rates/index.htm

What Should Be Done

With respect to the use of auto insurance rating factors, the III/CAS paper is correct to highlight the importance of using rating variables that divide the auto insurance pool into groups of higher and lower risk drivers, so that drivers pay their fair share and receive the important signal that safe driving will lead to lower rates. The proper response to that reasonable premise, however, cannot be to maintain the systems of unfair discrimination that are found in most states. Instead, regulators and, where needed, lawmakers should step in and protect consumers from the use of non-driving related socio-economic rating variables.

We believe that the prohibition against "unfair discrimination" in most states' statutes is a sufficient basis on which to prohibit these socio-economic rating variables. We understand, however, that in some states lawmakers may prefer to address the issue directly, and we are confident that the language to ban the use of these problematic variables is easily drafted.

With respect to the overarching concern for auto insurance affordability that III/CAS notes, we encourage regulators to take the first step in that direction by establishing a process for assessing affordability in their respective states. The Federal Insurance Office, in 2017, published a study of auto insurance affordability, which found that more than 18 million Americans live in ZIP codes in which auto insurance is unaffordable.[13] State-based assessments of affordability could be more expansive and nuanced and could point more clearly toward appropriate strategies for addressing affordability. Where, for example, the average premium would be reasonably affordable to good drivers if policies were made available at that rate, addressing socio-economic rating factors may be a sufficient policy response. Where the underlying cost of insurance is unaffordable for a significant percentage of drivers, adopting low-limits auto policies for low-income drivers, such as that offered under California's Low-Cost Auto Insurance program,[14] might be the right approach. Wherever a state ends up, beginning to investigate the scope and scale of unaffordability in each state is a crucial first step.

Conclusion

When III and CAS issued their paper, we assume, they intended to address an important debate and discussion about the use of non-driving socio-economic rating factors in auto insurance pricing. While we disagree with many of their claims and remain perplexed by their unwillingness to address the key points of contention in these discussions, we agree that policymakers and regulators must take these concerns seriously. Auto insurance, as the rare product that government requires people to purchase, must be priced in a manner that is fair and affordable. We encourage you and your department to look into ways to improve both fairness and affordability, and we would be pleased to help in whatever way you need.

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[13] Federal Insurance Office, 2017. Study on the Affordability of Personal Automobile Insurance.
[14] See MyLowCostAuto.com for information about the California program.

Sincerely,

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