

JOINT OVERSIGHT HEARING

Senate Committee on Business, Finance, and Insurance Assembly Committee on Insurance

March 24, 2010

Background Paper on Proposition 17 – Automobile Insurance Rating Factors

INTRODUCTION

Proposition 17 has been qualified to appear on the June, 2010, Statewide Ballot as a proposed initiative statute. Proposition 17 allows auto insurance companies to base their premiums, in part, on a driver's history of insurance coverage.

OFFICIAL BALLOT TITLE AND SUMMARY OF PROPOSITION 17

According to the Attorney General, as recently approved by the courts, Proposition 17:

ALLOWS AUTO INSURANCE COMPANIES TO BASE THEIR PRICES IN PART ON A DRIVER'S HISTORY OF INSURANCE COVERAGE. INITIATIVE STATUTE.

- Changes current law to permit insurance companies to offer a discount to drivers who have continuously maintained their auto insurance coverage, even if they change their insurance company, and notwithstanding the ban on using the absence of prior insurance for purposes of pricing.
- Will allow insurance companies to increase cost of insurance to drivers who do not have a history of continuous insurance coverage.
- Establishes that lapses in coverage due to nonpayment of premium may prevent a driver from qualifying for the discount.

BACKGROUND

Proposition 103 of 1988

In 1988, California voters approved Proposition 103 following a decade of steadily increasing costs for auto insurance in California. Proposition 103 was the only one of four insurance reform initiatives to pass. In a November 18, 1988 editorial commenting on the passage of Proposition 103 ten days earlier, the New York Times noted that for Californians, "the typical auto insurance premium" had doubled since 1982.¹

This doubling of the cost for auto insurance during the decade of the 1980's did not operate in a vacuum. By 1988, California's level of uninsured drivers was

very high, estimated variously as either 28.4% (California DMV) or 25.6% (California DOI).²

In this historical context, Proposition 103 was qualified and placed on the November 1988 statewide General Election ballot with a stated goal of improving the affordability of auto insurance. It included various Findings and Declarations, among them a statement that “Enormous increases in the cost of insurance have made it both unaffordable and unavailable to millions of Californians.”

Proposition 103 imposed new rules for how auto insurance rates were to be calculated as well as a system of prior approval of rates, to be administered by an elected Insurance Commissioner. As to rate-setting, Proposition 103 provides that automobile insurance rates are to be determined “*by application of the following factors in decreasing order of importance:*

- (1) *The insured’s driving safety record.*
- (2) *The number of miles he or she drives annually.*
- (3) *The number of years of driving experience the insured has had.*
- (4) *Those other factors that the commissioner may adopt by regulation and that have a substantial relationship to the risk of loss.*

Pursuant to this 4th statutory category, the Insurance Commissioner has adopted regulations that include 16 optional rating factors that insurers may lawfully use when setting auto insurance rates and premiums. Among these optional factors is “persistence.”

The regulations provide that, at policy renewal, a persistence discount can be applied by an insurer for the current named insured if “*the individual is currently insured by that company or an affiliate*”. The regulations prohibit giving a persistence discount for a policy, at any time, if it is based in whole or in part on auto insurance coverage provided by a non-affiliated insurer.

The prohibition in the Insurance Commissioner’s “optional rating factors” regulation against an insurance company offering a persistence-type discount to a new customer based on being insured by an unaffiliated insurance company is due to an express prohibition in Proposition 103. Specifically, Proposition 103 provides that “*The absence of prior automobile insurance coverage, in and of itself, shall not be a criterion for determining eligibility for a Good Driver Discount policy, or generally for automobile rates, premiums, or insurability.*”³

Even before enactment of Proposition 103, the issue of surcharges on drivers who lacked prior insurance was controversial. In 1985 the Department of Insurance issued Bulletin No. 85-11 specifically addressing the practice of insurers surcharging, or even refusing to cover drivers who were not currently insured.⁴ The Bulletin provided, in part:

"The intent of this bulletin is to inform recipients that [surcharging drivers who have not previously carried insurance] could result in a charge of

unfair discrimination. It has been the position of this Department that lack of evidence of prior insurance in itself is not a proper rating standard. There are many reasons why an applicant may not have had prior insurance, many of which have no bearing on the applicant's future loss potential."

In the context of November 1988, when Proposition 103 was passed, with insurance rates soaring and an estimated 1 of every 4 drivers uninsured, this rule can be understood as an attempt to help persons who were then uninsured, for whatever reason, to be able to get auto insurance coverage at the best rate possible, subject to the new mandatory and optional rating factors, without being penalized by their prior lack of insurance.

Proposition 103 also includes a provision that its new rules governing the business of insurance in California *"shall not be amended by the Legislature except to further its own purposes by means of a statute passed by a 2/3rds roll call vote or by a statute approved by the electorate."*⁶

Related Legislation – SB 689 of 2002 and SB 841 of 2003

In 2002, the Legislature passed SB 689 (Perata), which contained substantially the same proposal as Proposition 17. However, the Governor vetoed the bill, asking the Insurance Commissioner to prepare a report evaluating driver discounts that are consistent with the will of the electorate in passing Proposition 103.⁶ The ensuing report by the Insurance Commissioner indicated that SB 689 conflicted with the provision of Proposition 103 that bars consideration of prior insured status. It further noted that, while the overall impact across all drivers is neutral, it would cause an increase in premiums for some drivers. (This principle is discussed in more detail, below.)

In 2003, the Legislature passed SB 841 (Perata), which contained substantially the same provisions as SB 689. This time, the Governor signed the bill. The courts, however, subsequently ruled that the bill failed to satisfy the "further its own purposes" requirement for Legislative amendments to Proposition 103.

DESCRIPTION OF PROPOSITION 17⁷

According to the Legislative Analyst, "This measure amends Proposition 103 to allow an insurance company to offer a "continuous coverage" discount on automobile insurance policies to new customers who switch their coverage from another insurer. If an insurance company chooses to provide such a discount, it must be based on the length of time the customer continuously had bodily injury liability coverage. Customers would generally be eligible for this discount so long as their coverage had not lapsed for more than 90 days in the past five years, except if any lapse was the result of a failure to pay the premium. Also, customers would be eligible for this kind of discount under the measure if a lapse in coverage was due to military service in another country. Children residing with a parent could qualify for the discount based on their parent's eligibility.

ARGUMENTS PRO AND CON

Proposition 17 is a proposed Initiative statute that asks California's voters to rewrite the rule of Proposition 103 prohibiting an auto insurer from offering new customers a persistency-type discount based upon their record of being insured by an unaffiliated insurance company. If approved by the electorate, it will allow any California auto insurer to offer new customers a discount if the customer has been continuously insured by another insurer. It is being put forward by its sponsors for voter consideration because the courts have ruled that this is the only means by which the statute can be amended. In the view of proponents, the non-portability of the "continuous coverage" discount is an inconsistency in the law, and they argue that it will enhance competition by allowing other insurers to more effectively price compete for the customers of other insurers.

Not surprisingly, opponents dispute these assertions. To fully understand the reasons for the opponents' position, it is unfortunately necessary to delve into some of the details of automobile insurance rating. The Department of Insurance explains it this way:

"California automobile rating is unique in many ways. However, the nature of applying discounts and surcharges is not unique and reflects a basic principle of insurance ratemaking. This basic principle is "zero-sum" in the following sense: Every automobile insurer must have an approved "rate plan" that establishes its average premium. Within that rate plan, every "discount" requires a corresponding "surcharge" so that every factor will balance evenly over an insurer's book of business."

The Department's explanation continues:

"That is, if an insurer offers a continuous coverage discount for some drivers it will result in a surcharge for other drivers."

Essentially, the "rate" is the average premium, and the price that any particular person pays is determined by what the Department refers to as the "class plan" – the matrix of discounts and surcharges that take into account all of the 19 considerations, or rating factors, that are used to determine what a driver will be billed for his or her auto insurance.

It is impossible to predict the specific impact on a specific customer of a specific insurance company until that company submits its proposed rating plan and supporting data to the Department of Insurance. If an insurer were to propose an overall rate reduction, coupled with adoption of the Proposition 17 continuous coverage discount, it is theoretically possible that customers who did, and those who did not, have prior insurance could experience a lower premium than under that insurer's previous rating structure. Similarly, if an insurer were to propose an

overall rate increase, coupled with adoption of the Proposition 17 continuous coverage discount, it is theoretically possible that customers who did, and those who did not, have prior insurance could experience a higher premium than under that insurer's previous rating structure. What is clear, however, is that the customer without prior insurance will pay relatively more if a Proposition 17 continuous coverage discount is included as part of the insurer's rate application.

Proponents of Proposition 17 make a number of policy arguments,⁸ primarily focusing on the increased competition for other insurers' customers, and the positive effects that this competition would potentially create for those customers. Proponents maintain that the proposal does not require premiums to go up for those who do not qualify for the discount, and that the discount is beneficial for senior citizens, among others.

Opponents, on the other hand, focus on the customers who will be surcharged under a new Proposition 17 rating plan, and argue that many of these customers will be unfairly charged higher premiums, forcing some into uninsured status. To borrow the terms of the 1985 Department of Insurance Bulletin, "There are many reasons why an applicant may not have had prior insurance, many of which have no bearing on the applicant's future loss potential." Some examples that opponents have suggested include:

- Military personnel deployed within the United States;
- Students who are away at school without a car;
- People who previously did not own a car, but have a good driving record;
- People who previously commuted to work by public transportation; and
- People who were previously unemployed and did not need to drive, but must now commute to work.

While proponents and opponents do not entirely agree on each others' "facts," it appears that the primary policy question posed by Proposition 17 is whether the potential benefits from increased competition for current customers of other insurers is outweighed by the burdens placed on certain other drivers, and the impact on the public generally should the initiative lead to an increase in uninsured drivers.

¹The New York Times, November 18, 1988, Editorial, "The Only Real Fix for Auto Insurance"

² "What We Know About Uninsured Motorists and How Well We Know What We Know", J. Daniel Khazoom, December 1997 Discussion Paper, Revised April 2000, published by Resources for the Future, p. 21, footnote 23.

³ See California Insurance Code Section 1861.02, subdivision (c).

⁴ Prior to Proposition 103, there was not requirement that auto insurers issue policies to drivers with clean driving safety records, and there was minimal regulation of the factors that could be used to rate drivers.

⁵ See uncodified Section 8 of Proposition 103 as approved by voters November 8, 1988. The state constitution provides that initiatives placed on the ballot by the voters are not amendable at all by the Legislature, except to the extent that the initiative itself confers that authority. The courts have ruled that

the authority can be conditioned, such as a "further the purposes" clause, and that it is the courts' role, not the Legislature's role, to ascertain whether a particular amendment in fact "furthers the purposes."

⁶ A copy of the report is attached.

⁷ A copy of the Proposition is attached.

⁸ A copy of the Yes on 17 Fact Sheet is attached.