The Uncertain Future of Auto and Home Group Insurance:

Oversight of Department of Insurance Proposed Regulations

March 11, 2020

Background

Introduction

"Any insurer may issue any insurance coverage on a group plan, ***without restriction as to the purpose of the group, occupation or type of group***. Group insurance rates shall not be considered to be unfairly discriminatory, if they are averaged broadly among persons insured under the group plan." (Insurance Code Section 1861.12, adopted by the voters via Proposition 103 in 1988, emphasis added) The two key provisions of this statute are separately highlighted because the meaning of each underlies the controversial draft regulation developed by the Department of Insurance (DOI) that is the subject of this hearing.

The first provision, ***"without restriction as to the purpose of the group, occupation or type of group"*** plainly states that the DOI may not discriminate against groups based on three criteria:

- The group's purpose
- The occupation of group members
- The type of group.

The second provision, "shall not be considered to be unfairly discriminatory, if they are averaged broadly among persons insured under the group plan" states in unequivocal terms that rates charged to group members are by definition NOT ***unfairly discriminatory*** as long as the rate is averaged broadly among members of the group. The phrase "unfairly discriminatory" is a somewhat arcane, and often misunderstood, insurance term of art. At its heart it does not address invidious discrimination in the sense of racial or religious discrimination, although race or religion or other protected classes do constitute unfair discrimination if used to classify insurance risks. Instead, the phrase more specifically refers to the process of risk classification, whereby insurance companies figure out who to charge more to, and who to charge less based on actuarial evidence. Among the purposes of the law requiring prior approval of insurance rates is to regulate this process to ensure fairness.

Group insurance rates proposed under this rating rule are subject to the normal "prior approval" procedure implemented by the DOI under the authority established by Proposition 103. For 30 years, the DOI has approved rates for numerous group plans on this basis. Typical plans include the AARP discount program for AARP members written by The Hartford, and the group discount program available to teachers written by California Casualty.[1] Insurers have

[1] California Casualty has a broad range of group plans that provide discounts to a variety of groups, including firefighters and EMS workers, Higher education employees (colleges), educator (K-12), peace officers, and nurses, among others. The company's business model is predicated on writing group business, and it considers its group arrangements/contracts highly proprietary.

used the plain language of the initiative statute for decades to offer discounted insurance policies (typically auto insurance and homeowners' insurance) to over 6 million Californians[2].

Notwithstanding the language in the initiative statute, the regulations that DOI is in the process of developing would likely curtail the number of group discounts currently offered by excluding insurer created groups entirely and imposing requirements on other groups that will likely reduce both the willingness to offer group policies and the size of the discounts that could be offered. These regulations could have a substantial negative impact on the ability of current group policyholders to keep the discounts that they currently enjoy. The March 11 hearing of the Assembly Insurance Committee is intended to review the basis for, and impact of, those proposed regulations.

History and rationale

In 2015, former Insurance Commissioner Dave Jones, in response to a petition filed by Consumer Watchdog, initiated a rulemaking proceeding similar to the current DOI proposal. However, in response to consumer and Legislative concerns about policyholders losing valuable discounts (see attached letter from the Assembly Insurance Committee to Commissioner Jones in appendix I), that effort was withdrawn.

Undaunted, Consumer Watchdog again filed a Petition for Rulemaking[3] shortly after Commissioner Lara took office (see attached petition in appendix 2). That petition characterized Proposition 103-authorized and Insurance Commissioner-approved group insurance plans as implementing illegal automobile insurance rating factors such as occupation and education. The implication of the petition was that group auto insurance rates as approved by the Insurance Commissioner were legally "unfairly discriminatory" (and hence illegal) by virtue of the alleged improper use of occupation or education. This argument appears to assume that the specific rating factors detailed in Section 1861.02 apply to group insurance, and that the language in the statute that states that rates "shall not be considered to be unfairly discriminatory, if they are averaged broadly among persons insured under the group plan" does not apply.

In accordance with the Administrative Procedures Act, Commissioner Lara declined the petition, and instead initiated a fact-finding process that included a voluntary insurer data call to gather information about group insurance plans.

Based on the information gathered, the DOI appears to have drawn several conclusions using the geographic data of policyholders who participate in group plans and those who do not.[4] In broad terms, the DOI appears to interpret that data as indicating that policyholders who reside in lower income or minority population zip codes tend to have lower participation in group plans than policyholders in higher income or higher educational correlation zip codes.

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[2] Precise numbers are difficult to obtain, but reasonable interpretations of the data gathered by the DOI suggest that 6 million is a conservative number.

[3] The Administrative Procedures Act provides for a mechanism for the public to petition any state agency to adopt regulations within that agency's scope of authority. See the petition attached in appendix II.

[4] Documents that summarize the data gathered and relied upon by DOI can be found at http://www.insurance.ca.gov/0400-news/0200-studies-reports/.

According to the DOI, it attempted to survey 95 insurers comprising 95% of the private passenger automobile insurance market, but succeeded in obtaining data from only 33 insurers comprising 62% of the market. Nonetheless, the data collected is probably statistically adequate to draw generalized conclusions.

Insurers have raised concerns with some of the conclusions reached by DOI based on the data call, but their primary objection is that the regulation, even assuming the validity of DOI's conclusions, does nothing to address expanding access to group programs for the drivers who DOI has identified as being underrepresented in group plans.

The proposed DOI regulation

The regulation being proposed by DOI (see appendix 3) has several components.[5] The key proposal of the regulation is a definition of "group" for purposes of approving group insurance rating plans. The proposed regulation *restricts* what groups are acceptable. Specifically, to qualify as a group *under the proposed regulation* the group would have to charge dues or require its members to periodically renew their membership, and exist before any interaction with an insurer or broker/agent licensed by the DOI. Thus a group created or proposed by an insurer, or any individuals who approach an insurer to ascertain if the creation of a group might be beneficial, would appear to be prohibited by the proposed regulation. Many group plans currently approved by the Insurance Commissioner and providing benefits to Californians are of this "insurer created" type and would become unlawful if the regulation is ultimately adopted.

The proposed regulation includes a number of provisions that mandate that certain documents must be public records. The proposed regulation prohibits unwritten agreements between groups and insurers, and then provides that all of these documents must be public records.

With respect to private passenger automobile insurance[6], Proposition 103 establishes 3 mandatory rating factors (driving safety record, miles driven, and driving experience) and authorizes the DOI to adopt additional rating factors that are determined to have actuarial relevance. The proposed regulation adds group membership as one of these optional rating factors. This raises the potential that the value of group discounts may be reduced even for groups that qualify under the proposed regulation, and poses a potential legal issue.

The proposed regulation also restates without additional clarification the statutory rule that the Unruh Civil Rights Act applies to group insurance.

Finally, the regulation imposes substantial data reporting and related requirements. While the DOI has authority to require data to be provided by its licensees – particularly if it adopts a valid regulation based on express or implied statutory authority – concerns have been raised by some group policyholders that the proposed regulation's requirements are so burdensome and impractical to comply with that insurers will determine that the additional costs exceed the benefits, and conclude that maintaining the group discount program no longer makes sense.

[5] The full text of the proposed regulation is attached to this Background paper.

[6] According to a DOI press release, the proposed regulations apply to automobile insurance. In fact, there is no "auto insurance-only" limitation, and many group programs also include homeowners' insurance.

Policy considerations

1. *Does the proposed regulation address the problem identified by DOI?*

   The problem identified by the DOI appears to be the concern that low-income and minority drivers are underrepresented in group plans. To the extent that the data supports this conclusion, the proposed regulation does nothing to address the issue. Instead of identifying ways to achieve greater participation by those drivers not already in group plans, the proposed regulation operates to overtly deprive a broad range of drivers of their existing group discount plans (so-called insurer-created groups), and creates burdens and obstacles that may indirectly deprive others of their discount. The ban on insurer-created groups would have the effect of depriving millions of drivers of their discount plans.

   But groups that would satisfy the proposed regulation's definition have also objected that it threatens their members' access to the group discount. They raise several points:

   First, many group policyholders object to the proposed requirement that their agreement with the insurer be made public. This is a separate objection from the insurers' concerns that these agreements are proprietary and would place them at a competitive disadvantage if their competitors could copy their business strategies. The groups believe that their arrangements on behalf of their members are not a public concern. And in light of the insurers' proprietary concerns, they fear a withdrawal by insurers from group discount business as a result of this public disclosure mandate.

   Second, groups fear that cost/benefit factors will also cause insurers to withdraw from the group discount business. There are a couple of reasons. The data collection, record keeping and related administrative costs will cause insurers to re-evaluate their willingness to stay in the group market. In addition, groups are concerned that the provision that makes group status one of the numerous optional rating factors (discussed in more detail, below) will diminish the value of the discount so much that insurers would conclude the group market is not worth it.

   In a broad sense, insurers and groups wonder why a DOI concern that not enough people get group discounts is being addressed by a proposal that reduces the number and size of group discounts.

2. *Is the proposed definition of "group" lawful?*

   The Administrative Procedures Act allows state agencies to adopt regulations that clarify or implement statutes. However, a regulation cannot conflict with a statute, because statutory law adopted either by the Legislature or the voters is superior to a regulation. The issue presented by the proposed regulation is whether the DOI's definition of "group" conflicts with the initiative statute.

   The primary argument that the definition violates the statute involves insurer-created groups. It is difficult to understand how a ban on these groups can be reconciled with the statute that provides "without restriction as to the purpose . . . or type of group." Insurer-created groups can be viewed as a "type" of group. They can be viewed as a group created

for the "purpose" of obtaining a discount. On its face, the proposed definition expressly restricts what type or purpose groups can be by detailing which groups may obtain benefits and which may not. While there may be policy arguments about what the statute *should* include, in fact it is drafted extremely broadly as to preclude the very limitations the DOI is proposing. In addition, the definition would also prevent groups that are not insurer-created, such as lifetime membership groups or other associational arrangements that do not meet the criteria of the proposed regulation's definition. Again, these banned groups would argue that the definition violates the "without restriction" language of the statute.

Insurers have argued that the prohibited insurer-created groups in fact serve to include many of the drivers the DOI is concerned about. As an example, one insurer provides a group discount program based on the occupation of "secretary." This program is not a secretary union plan, as any person who qualifies in the occupation, and meets the other underwriting criteria, is eligible. This insurer and its policyholders argue strenuously that their "type of group" is lawful under the "without restriction" language in the statute, and that secretaries generally are lower income employees who are not organized in unions or associations and may not have any other access to a discount group program. Secretaries are but one example of lower wage service workers who are not likely to be in unions or associations. By eliminating insurer-created occupational groups, the proposed regulation may be harming the very population it is theoretically intended to assist.

There is also a concern about application of the group definition in the context of homeowners' insurance. It is difficult to understand why it is a sound policy to curb group discounts in a homeowners' insurance market that is already challenging for many homeowners. It does not appear that either the industry or the DOI has examined the implications in the homeowners' insurance market, and perhaps a more careful review of this issue should be undertaken before taking actions with uncertain consequences.

3. *Does reducing group status to a mere optional rating factor comport with the language of the initiative statute?*

As noted above, private passenger automobile insurance policies generally must be rated based on 3 specific statutory factors, plus additional "optional" factors that the Insurance Commissioner is empowered to establish (Section 1861.02). The proposed regulation changes the way current group rates are calculated by making group status one of the optional rating factors. Group rates as currently approved by the Commissioner apply the 1861.02 factors within the group to determine which group members pay how much (i.e., the riskier group members pay more than the less risky). By changing the current approach and making group status merely one of the optional rating factors, it is highly probable that the amount of discount available to group members will be reduced.

A short note on private passenger automobile insurance rating factors is in order. Under Proposition 103, all property/casualty insurance rates are subject to a "prior approval" requirement. That is, an insurance company cannot sell property/casualty insurance unless and until its "rates" have been formally approved by the Insurance Commissioner ("rate" is commonly understood to be "premium" although technically rate and premium are different things – think of "rate" as the average cost, with "premium" being the particular

price for a given policy determined by plusses and minuses by applying rating factors). However, with respect to personal automobile insurance, there are a number of rules, both in statute and DOI regulations, that apply in addition to the basic "prior approval" rule.

Proposition 103 includes 3 "mandatory" rating factors for personal automobile insurance. These are the primary means by which insurers determine who pays how much. The mandatory factors are found in Insurance Code Section 1861.02, and they are 1) the insured's driving safety record, 2) the number of miles he or she drives annually, and 3) the number of years of driving experience the insured driver has had.

Proposition 103 also authorizes the Insurance Commissioner to adopt other so-called "optional" rating factors that have proven relevance to the risk of loss. Currently there are 15 optional factors. With respect to these optional factors, the initiative statute requires the Commissioner to determine the "weight" to be assigned to these factors.

The weight of a rating factor is essentially a measure of how much influence a particular factor can have on the overall premium paid by a particular driver. Based on regulations adopted several years ago, the sum total of all of the optional rating factors cannot have more "weight" than the third mandatory rating factor. This makes any individual optional factor a relatively minor contributor to the overall premium that any driver pays.

As relevant here, the proposed regulation would change the way group rates are calculated. Ignoring the specific "broadly averaged" rating rule in the Insurance Code Section that specifically addresses group insurance, the proposed regulation would make group membership merely one of these optional rating factors. While it would take a sophisticated actuarial analysis to pinpoint the precise extent of this change, this proposed regulation would make group discounts smaller.

According to Consumer Watchdog, which initially raised this issue in its petition for rulemaking, group insurance plans as currently approved by the Commissioner in effect use education and occupation as illegal (optional) rating factors. This argument contains an underlying assumption that the law requires these factors to be the sole basis of group rating.

It is not clear that the initiative statute requires use of these rating factors in the group context, despite the fact that DOI has in the past required that they be used within a group. However, by placing a "group" factor within these optional factors, the proposed regulation may improperly suppress the intended value to consumers attempting to obtain group discounts.

A short note on statutory construction is in order. There are rules that are commonly applied by courts for interpreting the choice of words used in statutes, whether they are legislative statutes or initiative statutes. One of these rules is that where different words are used with respect to a particular issue, a different meaning is intended. Of primary concern here is that the proposed regulation attempts to mandate one set of rating rules (the Section 1861.02 factors) when the initiative statute expressly provides for a different standard for group insurance (the Section 1861.12 "averaged broadly" standard). Specifically, if the initiative drafters had wanted the 1861.02 factors to apply to group

insurance, it would have been a simple matter when drafting Section 1861.12 to cross reference Section 1861.02. But that is not how the initiative was drafted. An entirely different rating method was prescribed for group insurance, requiring that "rates shall not be considered to be unfairly discriminatory, if they are averaged broadly among persons insured under the group plan." Whatever this phrase precisely means, it is difficult to argue that it must mean "the 1861.02 factors" because that could have been easily drafted. If the effect of the proposed regulation's requirement that "group" is a mere Section 1861.02 factor is to diminish the amount of group discounts, it can be argued that the regulation violates the "broadly averaged" standard that the statute establishes. Insurers and policyholders have expressed concerns that this part of the regulation will limit the scope of discounts, even for those drivers who continue to qualify under the proposed regulation.

4. *Can rates be "unfairly discriminatory" when they are expressly defined as not unfairly discriminatory?*

   As noted above, the phrase "unfairly discriminatory" is a somewhat arcane, and often misunderstood, insurance term of art that does not address invidious discrimination in the sense of racial or religious discrimination, although race or religion or other protected classes do constitute unfair discrimination if used to classify insurance risks. The phrase more specifically refers to the process of risk classification, whereby insurance companies figure out who to charge more to, and who to charge less to. The law regulates this process to ensure fairness. While the phrase can be generally applied to all insurance rates, it has a special application to personal automobile insurance. In that narrow application, the mandatory and optional rating factors of Section 1861.02 define "unfair discrimination." The problem in the group insurance context is that the same initiative that applied the Section 1861.02 factors to personal auto insurance adopted a *different* rule for the group context. Thus, so long as the rates are broadly averaged within the group, they cannot be deemed unfairly discriminatory, and therefore illegal. Both the Consumer Watchdog petition and the proposed regulations fail to address this statutory distinction, and appear to presume that it does not exist.

5. *What is the effect of the proposed regulation's references to the Unruh Civil Rights Act?*

   The proposed regulation appears to attempt to overcome these apparent conflicts with the existing initiative statute by referencing the Unruh Civil Rights Act. A separate provision of Proposition 103 expressly applies the Unruh Act to the business of insurance (Section 1861.03). In a preamble to the proposed regulation titled "Overview" – a provision that looks similar to an uncodified set of legislative findings or declarations – the proposed regulation restates the statutory language discussed above, and then states the obvious fact that the Unruh Act applies to group insurance. What is not obvious is how that statement is intended to apply in the group context. For example, there are numerous black fraternities and sororities with both active and alumni membership that participate in group plans. There are numerous ethnic chambers of commerce and other ethnic business and professional associations that participate in group plans. Would the Unruh Act language mean that providing a group plan to these groups would be a violation of the law? Would the non-discrimination language impact the associational rights of these groups? Would

these groups be required to become part of a larger educational or business group? Does it mean that the "rates shall not be considered unfairly discriminatory if broadly averaged" statutory language adopted by the same initiative doesn't actually mean what it says? The language of the proposed regulation is entirely unclear on this issue.

It is also unclear how the Unruh Act is implicated, based on the DOI data. Read in a manner most favorable to the DOI's conclusions, there is a disparate impact on certain communities with respect to participation is group insurance plans. There has been no evidence presented that there is any discriminatory intent to exclude any group from participation in group plans. But the Unruh Act is not a disparate impact law; rather, it prohibits use of the suspect classifications to discriminate.