**JOINT OVERSIGHT HEARING**

**Senate Committee on Insurance &**
**Assembly Committee on Insurance**

September 25, 2012

# Background Paper on Proposition 33 – Automobile Insurance Rating Factors

## INTRODUCTION

Proposition 33 has been qualified to appear on the November, 2012, Statewide Ballot as a proposed initiative statute. Proposition 33 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 33[1]

AUTO INSURANCE COMPANIES. PRICES BASED ON DRIVER'S HISTORY OF INSURANCE COVERAGE. INITIATIVE STATUTE.

- Changes current law to allow insurance companies to set prices based on whether the driver previously carried auto insurance with any company.
- Allows insurance companies to give proportional discounts to drivers with some history of prior insurance coverage.
- Will allow insurance companies to increase cost of insurance to drivers who have not maintained continuous coverage.
- Treats drivers with lapse as continuously covered if lapse is due to military service or loss of employment, or if lapse is less than 90 days.

Summary of Legislative Analyst's Estimate of Net State and Local Government Fiscal Impact:

- Probably no significant fiscal effect on state insurance premium tax revenues.

## 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.[2]

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).[3]

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 "persistency."

The regulations provide that, at policy renewal, a persistency 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 persistency 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 persistency-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."*[4]

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.[5] 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 it's 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 33. 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.[7] 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.

In June 2010, a very similar initiative (Proposition 17) was voted down (48% Yes, 52).

To fully understand the controversy it is unfortunately necessary to delve into some of the details of automobile insurance rating. The Department of Insurance has explained 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 33 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 33 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 33 continuous coverage discount is included as part of the insurer's rate application.

The primary policy question posed by Proposition 33 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.

## DESCRIPTION OF PROPOSITION 33[8]

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 insurance consumers if they have continuously followed the mandatory insurance law. Under this measure, continuous coverage means uninterrupted automobile insurance coverage. Consumers with a lapse in coverage would still be eligible for this discount, however, if the lapse was:

- Not more than 90 days in the past five years for any reason.
- For no more than 18 months in the last five years due to loss of employment resulting from layoff or furlough.
- Due to active military service.

Also, children residing with a parent could qualify for the discount based on their parent’s eligibility.

If an insurance company chose to provide such a discount, it would be provided on a proportional basis. The discount would be based on the number of years in the immediate previous five years (rounded to a whole number) that the customer was insured. For example, if a customer was able to demonstrate that he or she had coverage for three of the five previous years, the customer would receive 60 percent of the total continuous coverage discount."

**ARGUMENTS PRO AND CON**

According to the proponents:[9]

"CALIFORNIA CONSUMERS DESERVE A REWARD FOR FOLLOWING THE LAW AND PURCHASING CAR INSURANCE. PROPOSITION 33 LETS YOU SHOP YOUR DISCOUNT FOR A BETTER DEAL.

California law requires all drivers to buy automobile insurance. Approximately 85% of California drivers follow the law and buy insurance. If you follow the law and maintain continuous automobile insurance coverage, you are currently eligible for a discount, but only if you stay with the same insurance company.

Current law punishes you for seeking better insurance or trying to get a better deal by taking away your discount for being continuously insured.

Proposition 33 corrects this problem and offers this discount to consumers who maintain automobile insurance with any company. Proposition 33 allows you to shop for a better insurance deal.

Leaders from both parties, Democrats and Republicans, the Veterans of Foreign Wars (VFW), the American GI Forum of California, firefighters, small business owners, individual consumers, and Chambers of Commerce join in their support of Proposition 33. VOTE YES ON PROPOSITION 33. It rewards those who follow the law.

The reward you get for being responsible and following the law is yours to keep under Proposition 33, even if you exercise your right to move to a different insurance company. That is why some insurance companies like Proposition 33 and others don't. It creates competition. Your neighborhood insurance agents support Proposition 33 because it will force insurance companies to compete for your business.

We encourage you to read Proposition 33. It is simple. It makes sense.

VOTE YES ON PROPOSITION 33 because you should get the discount that you have earned, regardless of which insurance company you pick.

Proposition 33 also encourages those who don't have insurance to obtain it, because Proposition 33 makes it easier to earn the continuous coverage discount. You get a share of the discount for every full year you are insured. The longer you are insured, the greater the discount. This encourages uninsured drivers to become insured and make our roads safer.

Proposition 33 provides other protections as well:

If you are active military, Proposition 33 says you will not lose the discount. That's why our military families, led by the American GI Forum and Veterans of Foreign Wars, say Yes on Proposition 33.

If you are laid off or furloughed, Proposition 33 allows you to keep your status as a continuously covered driver for up to 18 months.

Under Proposition 33, driving age children get the discount whether they are living with their parents or are away at school.

Proposition 33 allows you to miss payments for 90 days for any reason and remain eligible for this discount.

Proposition 33 will result in more competition between insurance companies and better insurance rates because you will be able to shop around for insurance without losing your discount.

In California, you must have automobile insurance. You deserve a reward for following the law. VOTE YES ON PROPOSITION 33.

According to the opponents:[10]

Consumer advocates agree: NO ON PROPOSITION 33 —It's another deceptive insurance company trick to raise auto insurance rates for millions of responsible drivers in California.

Mercury Insurance spent $16 million on a similar initiative in 2010. Californians rejected it.

Now they're at it again. Mercury Insurance's billionaire chairman George Joseph has already spent $8 million to fund Proposition 33. When was the last time an insurance company billionaire spent a fortune to save you money?

Proposition 33 unfairly punishes anyone who stopped driving for a good reason but now needs insurance to get back behind the wheel. Proposition 33 "will allow insurance companies to increase cost of insurance," according to the Attorney General's Official

Summary—even on motorists with perfect driving records.

Proposition 33 is a cleverly worded initiative that says one thing and does another. Beware: the California Department of Insurance has said the so-called "continuous coverage discount" scheme "will result in a surcharge" for many California drivers. That's why Consumers Union, the policy and advocacy division of Consumer Reports, opposes Prop. 33.

Proposition 33 raises insurance rates for students completing college who now need to drive to a new job.

Proposition 33 raises insurance rates for people who dropped their coverage while recuperating from a serious illness or injury that kept them off the road.

Prop. 33 deregulates the insurance industry, making big insurance companies less accountable—which is why this measure is 99% funded by an insurance billionaire whose company, Mercury Insurance, has a record of overcharging consumers. The California Department of Insurance says Mercury has "a deserved reputation for abusing its customers and intentionally violating the law with arrogance and indifference." No on 33: It penalizes responsible drivers who did not need auto insurance in the past.
Prop. 33 allows insurance companies to charge dramatically higher rates to customers with perfect driving records, just because they had not purchased auto insurance at

some point during the past five years. Drivers must pay this unfair penalty even if they did not own a car or need insurance at the time. No on 33: It hurts California's middle-class families.

In states where the Proposition 33 surcharge is legal, the result is HIGHER PREMIUMS:
• Texans can pay 61% more.
• Nevadans, 79% more.
• Floridians, 103% more.

No on 33: It leads to more uninsured motorists, costing us all more.

According to the California Department of Insurance, the financial penalty insurance companies want to impose "discourages [people] from buying insurance, which may add to the number of uninsured motorists and ultimately drives up the cost of the uninsured motorist coverage for every insured."

MORE UNINSURED DRIVERS hurts taxpayers and the state. No on Prop. 33: Californians already rejected a nearly identical proposal in 2010. Let's make it clear to these powerful special interests that No means No.

Don't give insurance companies more power to raise our rates. VOTE NO on PROP. 33. It's too good to be true.

---

[1] As printed in the official Voter Information Guide.
[2] The New York Times, November 18, 1988, Editorial, "The Only Real Fix for Auto Insurance"
[3] "What We Know About Uninsured Motorists and How Well We Know What We Know", J. Daniel Khazzoom, December 1997 Discussion Paper, Revised April 2000, published by Resources for the Future, p. 21, footnote 23.
[4] See California Insurance Code Section 1861.02, subdivision (c).
[5] 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.
[6] 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."
[7] A copy of the report is attached.
[8] A copy of the Proposition is attached.
[9] As printed in the official Voter Information Guide.
[10] As printed in the official Voter Information Guide.