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Attorney General's Informational Bulletin No. 2 on the State of Managed Competition
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On Monday, insurers made their auto insurance rate filings for the new "managed competition" system. The average statewide change was about -6%. The average -7.7% statewide change reported by the Division of Insurance includes the impact of group discounts, which were add-ons to the former fix and establish system; the new -6% value is an apples to apples comparison of the discounted 2007 rate with the average current filing.

Two aspects of the current filed rates are of concern.

- **Increased profit provisions:** The profit in the current filing is, on average, about 4% higher than the profit permitted by the Commissioner in her prior rate decisions. Companies use costs of capital that are considerably higher than the cost of capital found reasonable by the Commissioner in her decisions, and fail to include sources of revenue that the Commissioner has required the insurers to include in their profit provisions.
- **Contingent commissions:** Many of the insurers include contingent commissions in their rates. This increases rates, on average, by about 2%. In at least six decisions dating back to 1987, the Commissioner found that the inclusion of contingent commissions did not comply with the statutory standard of "adequate, just, reasonable and nondiscriminatory rates." In her decisions, the Commissioner stated that these commissions, which are similar to profit sharing, do not benefit policyholders. In similar contexts in competitive markets, such commissions have been found to create troubling conflicts of interest that may alter agent behavior and harm policyholders by encouraging "steering" of policyholder business to insurers that may not offer the best prices.

If the insurers' profit did not increase from 2007 rates and contingent commissions were not included in rates, the current filings would, on average, result in a decrease of about -11%. In a \$4 billion market, the 6% discrepancy represents a transfer of over \$200 million from policy holders to insurers.

Only two companies, Liberty Mutual (-10.7%) and USAA (-15%), have filed rate reductions of more than ten percent. Four of the larger writers, representing about 60% of the market, have filed average rates that vary by only three tenths of one percent, a surprising coincidence given the differences in the companies' losses and expenses (this comparison

excludes the impact of Commerce's group discount). While a full examination of the losses and expenses in the filing will take several weeks, an initial review shows that many companies selected loss and expense provisions considerably higher than the loss and expense provisions "indicated"--or calculated using the data--in their filings. While the selection of lower than indicated provisions may be justified by companies that wish to compete for additional consumer business, there is no apparent explanation for the adoption of higher provisions than those that result from the insurers' own calculations.

A significant feature of most of the insurers' filings is the adoption of a number of rating factors that will redistribute rates among policyholders. The Attorney General remains concerned that some of these factors will be substituted as "proxies" for factors prohibited by statute and regulation. This is an area that will be closely examined by outside experts.

Under the Commissioner's regulations, insurers are entitled to alter their rate requests for five business days after filing. This period ends on November 27th. We anticipate that at least some insurers will reassess their rate filings and urge all insurers to take advantage of this period to file lower rates. After November 27th, it is likely that additional reductions will require the Commissioner's approval.

Insurers are invited to contact the Attorney General's Office in advance regarding any planned alterations to their rate requests. In any event, insurers should provide a copy of any re-filing and supporting documentation to the Attorney General's Office at the time they file their amendments with the Commissioner of Insurance.