

Automobile Insurance: The Road Ahead

**AN EXECUTIVE SUMMARY OF THE ATTORNEY GENERAL
ON THE STATUS OF INSURANCE DEREGULATION**



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Executive Summary

In July 2007, Commissioner of Insurance Nonnie Burnes decided to deregulate the automobile insurance market by introducing a policy of “managed competition.”¹ Starting April 1, 2008, managed competition has three principal features:

I. The removal of price regulation.

For the past thirty years, the Commissioner of Insurance established a single rate ceiling for all companies in a formal administrative proceeding in which the Attorney General represented consumers, and the insurance industry’s rate proposals were closely scrutinized. Insurers provided the Division of Insurance and Attorney General’s Office with comprehensive data regarding their expenses and claims experience, and each component was carefully reviewed. Based on this review, the Commissioner set an insurance premium that was consistently lower than that proposed by the industry – billions of dollars lower over the last twenty years. The regulated rate also contained limits on variation across territories and classes, and thus capped the charges insurers could levy against urban drivers. The new system ended this price regulation by (1) eliminating the rate ceiling, (2) ending the requirement that companies disclose their data, and (3) beginning to phase out caps on urban rates.

II. The introduction of rating based on non-driving factors.

In the regulated market, rates were based on a limited number of variables, most of which were related to the insured’s vehicle, driving behavior, and garaging location. In managed competition, insurers use numerous additional factors to determine the price charged to individual consumers, most of which are not directly related to a consumer’s driving history. Many of these new factors cause certain consumers, including young drivers, the poor, senior citizens, urban residents and non-homeowners, to pay higher rates, regardless of driving record.

III. The repeal of “take all comers.”

In the regulated market, insurers were required to provide insurance to all drivers. In managed competition, insurers are permitted to reject any new customer they choose; consumers who cannot find an insurer that will offer them a policy are randomly assigned to insurers in the residual market.

At the start of the deregulation initiative, the Commissioner stated that she had several goals in deregulating the marketplace. These included increased product innovation, lower prices for consumers, and more choice among insurance companies. Although she recognized that some drivers could be hurt by the system, she opined that the benefits to Massachusetts consumers would outweigh the costs.

Nonetheless, deregulation was not without its skeptics. Consumer advocacy groups, Massachusetts insurance agents, some Massachusetts insurers, and certain

¹ *Opinion, Findings & Decision on the Operation of Competition in Private Passenger Motor Vehicle Insurance in 2008*, Dkt. No. 2007-03, p. 15 (July 16, 2007).

legislators opposed many of the changes. The Office of the Attorney General raised serious questions about how the Massachusetts market, after thirty years of government rate ceilings and strong consumer protections, would perform when deregulated without adequate preparation or legislative involvement.

With more than a year of experience with deregulation of the auto insurance marketplace, it is now an appropriate time to assess deregulation, and to determine whether changes are needed to properly provide consumer rights, consumer choice, fair prices for consumers, and a healthy marketplace for insurers. This report provides a technical and specific review of the deregulated system and its performance to date, and makes specific recommendations to improve managed competition going forward.

The results over the first year have been, at best, mixed. While prices have dropped overall, consumers are currently paying more than they would have had the market not been deregulated. A variety of new insurance companies have entered the market, but most of the new entrants have not offered lower rates overall. Moreover, the new insurers have not caused incumbent carriers to lower statewide prices (indeed, in 2009, many insurers began increasing statewide prices).

In addition, many developments during the first year of deregulation have been troubling:

Many consumers paid higher prices while companies increased profit targets in the rates.

- Insurance companies began managed competition by raising their base rates by up to 10%, resulting in excessive rates in an environment where insurer losses have, on average, decreased over the past several years. If drivers are not chosen by insurers for preferential discounts, they will pay these increased rates.
- The number of rating factors that rely on characteristics other than driving has increased; insurers now charge consumers based on factors such as prior limits of coverage, payment history, and the purchase of homeowners insurance. Many such discounts or rating factors may be proxies for banned factors, such as income and homeownership.
- Insurance companies have significantly increased their underwriting profit adjustment provisions and shareholder returns loaded in their rates. In 2008, the Commissioner accepted target returns in the insurer rate filings that were over 150% of the 2007 regulated value for some insurers.
- It appears that Hispanics and low income consumers (those earning under \$25,000) have been especially disadvantaged by deregulation; a larger proportion of these groups have received rate increases, and fewer have received decreases. Elderly consumers and urban drivers may also ultimately pay increased prices, regardless of driving record.

- Many consumers whose rates decreased paid more than they should have. Had the regulatory rate-setting process occurred in 2008, rates would have been reduced for essentially all consumers, with average rate reductions much greater than those seen under deregulation.

Company prices and rating behavior have become less transparent.

- Deregulation has produced more secrecy and less transparency. Insurers have omitted data and information from their public filings; as a result, the filed rates are unsupported, and it is impossible to adequately assess their accuracy.
- Many companies have refused to make public key rating information; it is impossible to determine how an individual consumer's rate is calculated or whether individuals' rates are accurate or fair.
- The insurers and their rating organization, the Automobile Insurers Bureau, have refused to make public data on claims, premiums, and expenses necessary to determine whether statewide rates are fair and not excessive.

Consumers do not have easy access to accurate price information.

- There is currently no easy way for consumers to determine what the market prices for insurance are, what each company will charge a particular individual, and what discounts and special coverages are available.
- Some consumers have not been offered all discounts to which they are entitled, have had difficulty obtaining quotes from agents, and have received different quotes from different agents for the same insurers.
- It appears that only a small percentage of consumers switched carriers to take advantage of lower prices (or for any other reason) in 2008.
- The Division of Insurance's website, ostensibly designed to help consumers to "shop around," gives unhelpful and misleading insurance information and steers consumers in many instances to more expensive insurance companies.

Consumer protections have weakened.

- The Commissioner adopted an order to eliminate the Board of Appeal, which provides an impartial forum for consumers to appeal insurers' fault determinations; the Legislature subsequently passed a law keeping the Board permanently in place.
- Because insurers are no longer required to offer insurance to consumers they consider undesirable, many good drivers, particularly in urban areas, may be nonrenewed or denied coverage.

- Consumers refused coverage are randomly assigned to an insurer in the residual market; agents report that many such consumers fail to receive appropriate discounts.
- Insurers have created new policy provisions and rules that eliminate consumer protections. Some insurers increase prices for not-at-fault accidents, charge for excluded drivers or drivers who already have their own insurance policies, and have adopted problematic provisions related to cancellation, down payment, deductibles, installments, and rating factors. Many consumers are unaware of these changes.

Significant barriers to competition still exist.

- Many companies charge “short rate” penalties when consumers switch companies during the policy year, limiting customers’ ability to switch carriers except around the renewal date. Moreover, loyalty discounts may also deter consumers from switching to a better priced carrier every year.
- Many companies offer insurance agents significant bonuses for bringing in specific kinds of customers. Certain agents, as a result, may have an incentive to recommend the policy that offers the most lucrative commissions.
- Most Massachusetts consumers purchase insurance through an independent agent, yet most agents typically cannot or do not provide price quotes for more than a couple of carriers.
- Some insurers have been allowed special deals from Commissioner Burnes, creating an uneven playing field in the marketplace. These special arrangements, such as permitting new entrants to avoid residual market costs for two years, harm other insurers, and harm competition.

The Road Ahead

Implementation of a truly competitive system has the potential to lower prices for all consumers. Unfortunately, the current experiment in deregulation has thus far not achieved this goal. Instead, managed competition has caused many drivers to be overcharged, and has led to fewer consumer protections. For reform to work, true consumer protections need to be developed, and regulators must ensure that rates are transparent and not excessive.

It is possible to design an effective managed competitive system that meets these goals. Such a system would:

- Provide consumers with the necessary tools to “shop around.” To benefit from a competitive market, consumers must obtain price quotations from a wide range of companies in order to find the best price for their needs. A central web portal would allow consumers to input their information once and obtain comparative quotes from any or all insurers.
- Ensure that underwriting and rating are not unfairly discriminatory. Insurers should not use proxies for prohibited rating factors or refuse to offer insurance to good drivers.
- Strengthen consumer protections. While Commissioner Burnes promulgated regulations and bulletins dealing with managed competition, none of these provisions deal with consumer protection issues such as marketing and unfair practices. Advertising, pricing, and claim practices should be fair and consistent.
- Remove impediments to competition. Currently, numerous barriers to competition exist, including inadequate information, non-standardization of policies, and short rate penalties. These barriers should be removed.
- Provide for rigorous review of proposed rates. Insurers now file rates with little or no supporting information or documentation for important rating elements. Rate support should be carefully scrutinized, and inappropriate costs should not be passed on to consumers. Insurance premiums should not be based on inflated projections that overcharge Massachusetts drivers.

To protect consumers, it is important to address the issues outlined above and discussed in this report. While deregulation may ultimately offer advantages to consumers, reforms are needed to increase price transparency, create easy access to accurate and complete information, ensure fair prices, and provide adequate consumer protections. Without these features, insurers and not consumers will benefit from deregulation, and many Massachusetts drivers will continue to overpay for their automobile insurance.

The Attorney General’s Office represents consumers in matters related to insurance. Under managed competition, the Attorney General has reviewed filed rates and called for rate hearings before the Division of Insurance, demanding the rejection of discriminatory and excessive rates; urged the Commissioner to require full and complete filings; provided testimony before the Legislature and Division of Insurance recommending stronger consumer protections; and brought cases against insurance companies that sought to take advantage of Massachusetts consumers. However, while advocacy and enforcement proceedings do help, the market also needs fair and firm rules that create bright-line boundaries for insurer behavior, a level playing field, and strong consumer protections. Therefore, the Attorney General’s Office intends to promulgate consumer protection regulations under her G.L. Chapter 93A Consumer Protection regulatory authority. In addition, for issues that are not best suited for regulation, the

Attorney General's Office plans to work with the Legislature to explore potential solutions to these problems.