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ATTORNEY GENERAL

# THE COMMONWEALTH OF MASSACHUSETTS OFFICE OF THE ATTORNEY GENERAL

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May 23, 2011

Commissioner Joseph Murphy  
Division of Insurance  
1000 Washington Street, Suite 810  
Boston, MA 02118-6200

Re: Massachusetts Commercial Automobile Insurance Experience

Dear Commissioner Murphy:

We are writing to urge you to use your authority under G.L. c. 175E to reduce commercial automobile insurance rates for Massachusetts businesses. By letter dated February 10, 2011, we requested that you reject Progressive's unjustified 23% rate increase for commercial auto in Massachusetts. (You declined to take this action.) As set forth below, however, the problem of excessive rates goes beyond any single company writing commercial automobile insurance in Massachusetts. Based on National Association of Insurance Commissioners (NAIC) and industry reported data, rates are, and have for a number of years been, excessive throughout the Massachusetts market.

- NAIC and Automobile Insurers Bureau (AIB) data show that Massachusetts businesses have been overcharged for commercial auto insurance by about \$1 billion during the period 2004 to 2010. This translates into an overcharge of about \$150 million per year for this period.
- During each of the last seven years, from 2004 through 2010, the Massachusetts loss ratio has been consistently and significantly lower than the countrywide loss ratio.<sup>1</sup>
- Massachusetts commercial automobile insurance companies have done much better than insurance companies nationwide based on various measures of profit, including underwriting profit, profit on the insurance transaction, and return on net worth.

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<sup>1</sup> The loss ratio measures the extent to which the premium paid by policyholders to insurance companies is returned to policyholders in the form of insurance coverage payments. A lower loss ratio indicates a smaller return to policyholders and a more favorable result for insurance companies.



- Based on metrics previously used by your Division, reducing rates to a fair level would have resulted in about an additional \$450 million in overall annual economic activity in Massachusetts and would have created about 3,000 additional jobs in each year in Massachusetts.<sup>2</sup>
- The problem in Massachusetts is not attributable to just one or two insurance companies, but is spread across almost all insurance companies. As a result, “shopping around” is not a solution to this problem.

Massachusetts law explicitly provides that motor vehicle rates shall not be “excessive” or “unreasonably high for the insurance provided.” M. G. L. c. 175E, section 4. This is a mandatory and independent standard adopted by the legislature to ensure that motor vehicle rates are fair, regardless of the level of competition in the market. Excessive commercial auto rates are not just an abstract problem. These inflated commercial auto premiums impact virtually every industry in Massachusetts – from manufacturing, trucking, and construction to sales and services. The added costs limit the ability of businesses to invest in Massachusetts and cost Massachusetts residents thousands of jobs. The problem is especially acute for small businesses, whose ability to create jobs is impaired by excessive rates. A full review of commercial automobile insurance rates, followed by appropriate regulatory action by the DOI to reduce rates in Massachusetts to a reasonable level and to prevent insurance companies from charging excessive rates, can save employers hundreds of millions of dollars, and help to create thousands of new jobs in Massachusetts.

#### I. NAIC and AIB Data Show that Massachusetts Businesses Have Been Substantially Overcharged

Using actual insurance company incurred claims<sup>3</sup> and expenses reported to the NAIC by the insurers, and based on the AIB’s 2011 filed profit of 3.8% (profit provisions filed by the AIB during the 2004-2010 period were lower<sup>4</sup>), companies substantially overcharged Massachusetts businesses for commercial automobile insurance during the 2004 through 2010 period. Based on the expenses of Massachusetts companies as determined by the NAIC and on the profit used by the Massachusetts’ companies’ consortium rating organization (AIB) in its 2011 Massachusetts rate filing, Massachusetts

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<sup>2</sup> These values reflect the analysis in the report entitled “The Impact of the 2008 Auto Insurance Reform on the Massachusetts Economy” issued on behalf of the Massachusetts Division of Insurance.

<sup>3</sup> Incurred claims include both claims payments and claims reserves established by the insurers.

<sup>4</sup> The profit provisions come from the AIB’s under 1% filing. Prior to 2011, the profit provisions were about 2% in 2008 and about 1% in 2005. A lower profit provision implies a higher overcharge during this period.

rates were excessive during the 2004 to 2010 period by at least 21.6%.<sup>5</sup> (Appendix 1) During this period, commercial automobile insurers in Massachusetts collected about \$5.32 billion in commercial automobile premium; the excess portion of the premium totaled about \$1.15 billion, or about \$164 million annually.<sup>6</sup>

Even the insurance industry's own calculations show that commercial automobile insurance rates are excessive. In early March of this year, the AIB made an advisory commercial automobile insurance rate filing in Massachusetts<sup>7</sup> for companies with less than 1% of the Massachusetts market. The AIB's own data and calculations indicated that an overall rate decrease of -14.3% was needed. However, the AIB declined to reduce rates to the level indicated by its own data and analysis, instead filing for only a 3% downward adjustment to existing rates. (Appendix 3) In our view, the loss trends and profit provisions adopted by the AIB in the industry filing are excessive and already reflect an increase over the levels supported by the data; reasonable inputs for these values would indicate a substantially larger decrease in rates than the AIB's indicated -14.3%, and, correspondingly, point to a substantially greater overcharge of Massachusetts businesses.

## II. Other Indicators Show that Massachusetts Commercial Automobile Insurance Premiums Are Excessive

- a. Loss ratios have been consistently and significantly lower in Massachusetts than countrywide

During each of the seven years from 2004 through 2010, the commercial automobile insurance loss ratio, a measure of the portion of the insurance premium returned to policyholders through the payment of claims, has been significantly lower in Massachusetts than on a countrywide basis. (Appendix 4) Commercial automobile insurers in Massachusetts have kept more of policyholders' premium—and provided substantially less in benefits to Massachusetts businesses—than insurers in other states.

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<sup>5</sup> The 21.6% value is a lower bound on company overcharges. It is based on an AIB filed profit provision for 2011; profit provisions during the 2004-2010 period were lower. In addition, as found by the Commissioner on numerous occasions in past hearings on private passenger automobile insurance, the AIB has historically included excessive profit provisions in its filings. In our view, a 3.8% value is unreasonably high.

<sup>6</sup> A similar result comes from comparing Massachusetts experience to that of businesses across the country. NAIC data show that controlling for the difference in incurred claims across states, Massachusetts businesses paid about \$834 million more than comparable businesses nationwide during the 2004 through 2010 period. (Appendix 2)

<sup>7</sup> The filing was sent with a March 3, 2011 letter from William A. Scully of the AIB to The Honorable Joseph Murphy.

In every year from 2004 through 2010, moreover, Massachusetts loss ratios have been less than 50%. This means that more than half the premiums paid by Massachusetts' businesses have been kept by the insurance companies as underwriting profit<sup>8</sup> and expenses. In 2010, the (preliminary) Massachusetts loss ratio dropped below 40%; this extraordinarily low loss ratio means that for every dollar of expected claims payments, insurance companies kept more than \$1.50 for underwriting profit and expenses.

b. Massachusetts insurers' profits are substantially higher than countrywide profits

The low loss ratios for Massachusetts commercial automobile insurance have resulted in high profits for Massachusetts insurers. Insurance industry profits for Massachusetts commercial automobile insurance are consistently significantly higher than countrywide values whether the basis of measurement is underwriting profit,<sup>9</sup> profit on the insurance transaction,<sup>10</sup> or return on net worth.<sup>11</sup> Underwriting profit during the 2004 through 2010 period averaged 18.2% in Massachusetts, nearly three times the countrywide average of 6.8%. (Appendix 5) Massachusetts profit on the insurance transaction and return on net worth were nearly twice as high as countrywide values, 15.8% and 17.3% in Massachusetts compared to 8.6% and 10.8% countrywide. (Appendices 6 and 7)

Preliminary estimates suggest, moreover, that in 2010 Massachusetts insurers recorded their highest level of underwriting profit of the last decade, 22.6%, more than five times the national level. (Appendix 5) By countrywide standards, Massachusetts profits are excessive.

### III. Fair Rates Would Result in the Creation of Massachusetts Jobs

Excessive commercial automobile insurance premiums resulted in the transfer of hundreds of millions of dollars from Massachusetts business to insurance companies,

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<sup>8</sup> Insurance companies have earned profits from investment income in addition to the high underwriting profits.

<sup>9</sup> The underwriting profit is calculated as premiums less losses less expenses. The percentage is in relation to premiums. It is a before-tax value.

<sup>10</sup> The profit on insurance transactions adds investment income on reserves to the underwriting profit. The percentage is in relation to premiums. It is an after-tax value.

<sup>11</sup> The return on net worth adds investment income on net worth to the profit on insurance transactions. The percentage is in relation to net worth. It is an after-tax value.

effectively reducing the businesses' ability to invest in Massachusetts and costing thousands of Massachusetts jobs annually. Using your Division's analysis of the impact of private passenger automobile insurance rates on the Massachusetts economy, the commercial automobile insurance premium overcharges have decreased Massachusetts economic activity by about \$450 million a year and reduced jobs by about 3,000 a year. (Appendix 1)

Requiring insurers to charge fair rates would free funds for investment in the Massachusetts economy and, based on your Division's analysis, would produce thousands of new Massachusetts jobs every year.

#### IV. Shopping Around Is Not a Solution to Excessive Rates

The low loss ratios, and correspondingly high profits, for Massachusetts commercial automobile insurance are not an aberration caused by the experience of one or two insurance companies. Instead, almost the entire commercial automobile insurance market in Massachusetts has low loss ratios and high profits.

From 2004 through 2010, each of the top five insurers, which together wrote more than half of all the commercial automobile insurance in Massachusetts, had loss ratios lower than 50%. During this time period, sixteen out of the top twenty insurers had loss ratios lower than 50%. These sixteen insurers wrote more than three quarters of the overall market for commercial automobile insurance in Massachusetts.

While the availability of fair rates from some companies is not in any case an excuse to permit other companies to charge excessive rates in violation of G L. c. 175E, section 4, businesses in Massachusetts seeking to lower their commercial automobile insurance rates to fair levels have few realistic alternatives. Shopping around is not a solution to excessive rates.

#### Conclusion

Based on the NAIC and AIB data and filings, (1) Massachusetts commercial automobile profits have been substantially higher than countrywide profits over an extended period of time, and (2) commercial automobile insurance rates in Massachusetts have been and are currently excessive throughout the market. These high profits and excessive rates affect both large and small businesses in Massachusetts, have had a deleterious impact on the Massachusetts economy, and have eliminated thousands of Massachusetts jobs in a time of national and state economic crisis.

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We urge you to review the rates of Massachusetts commercial automobile insurers and take steps—including formal regulatory action or rate disapprovals pursuant to G. L. c. 175E, section 8, if necessary—to reduce excessive commercial automobile insurance premiums. Commercial automobile insurers should be required to file fair and reasonable insurance rates for businesses in Massachusetts.

Thank you for your attention to this matter.

Sincerely,

A handwritten signature in dark ink, appearing to be 'G. Kaplan', written over a horizontal line.

Glenn Kaplan  
Chief, Insurance and Financial Services Division

## Appendices

### Appendix 1

#### Massachusetts Commercial Automobile Insurance

##### Derivation of Indicated Excess Rate Level from 2004 to 2010

	<u>Rate Component</u>	<u>Value</u>
(1)	Losses	44.9%
(2)	Loss Adjustment Expenses	8.0%
(3)	General Expenses	6.1%
(4)	Selling Expenses	19.9%
(5)	Premium Taxes, Licenses and Fees	2.7%
(6)	Underwriting Profit Provision	3.8%
(7)	Indicated Excess Rates During Time Period	21.6%
(8)	Average Dollar Overcharge : (7) X \$760 (Average Annual Premium)	\$164
(9)	Multiplier for Economic Impact *	2.93
(10)	Annual Economic Impact : (8) X (9)	\$481
(11)	Factor for Employment Per Million Economic Activity *	6.625
(12)	Annual Jobs Impact : (10) X (11)	3,200

\* Values derived from report entitled "The Impact of the 2008 Auto Insurance Reform On the Massachusetts Economy" prepared for the Massachusetts Division of Insurance.

#### Notes:

- (1) to (5) : From NAIC  
(6) : Based upon AIB under 1% filing dated March 3, 2011  
(7) :  $(1 - [(1) + (2)] / [(1 - (3) - (4) - (5) - (6))] ) \times 100\%$

Appendix 2

Commercial Automobile Insurance Experience

Comparison of Countrywide and Massachusetts Loss Ratios

(Amounts in Millions)

(1)	(2)	(3)	(4)	(5) = (3) / (4) Massachusetts Compared to Countrywide	(6) = (2) X [ 1 - (5) ] Massachusetts Overcharge
<u>Year</u>	<u>Massachusetts Premium</u>	<u>Massachusetts Loss Ratio</u>	<u>Countrywide Loss Ratio</u>		
2004	\$826	45.0%	53.7%	0.838	\$134
2005	\$819	46.7%	53.1%	0.879	\$99
2006	\$817	46.4%	51.9%	0.894	\$87
2007	\$787	42.0%	53.1%	0.791	\$165
2008	\$751	46.2%	54.9%	0.842	\$119
2009	\$677	47.8%	53.3%	0.897	\$70
2010 (Prel.)	\$643	39.6%	52.8%	0.750	\$161
Combined	\$5,320	44.9%	53.3%	0.843	\$834
(7) Average					\$119



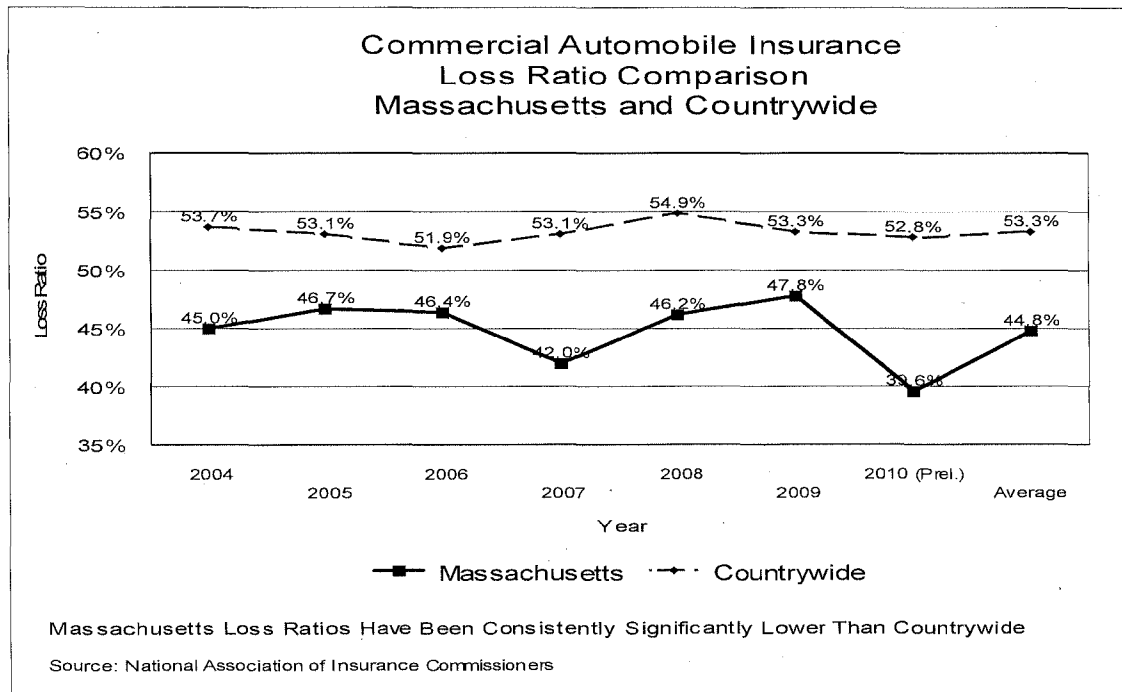
Appendix 3

Massachusetts Commercial Automobile Insurance

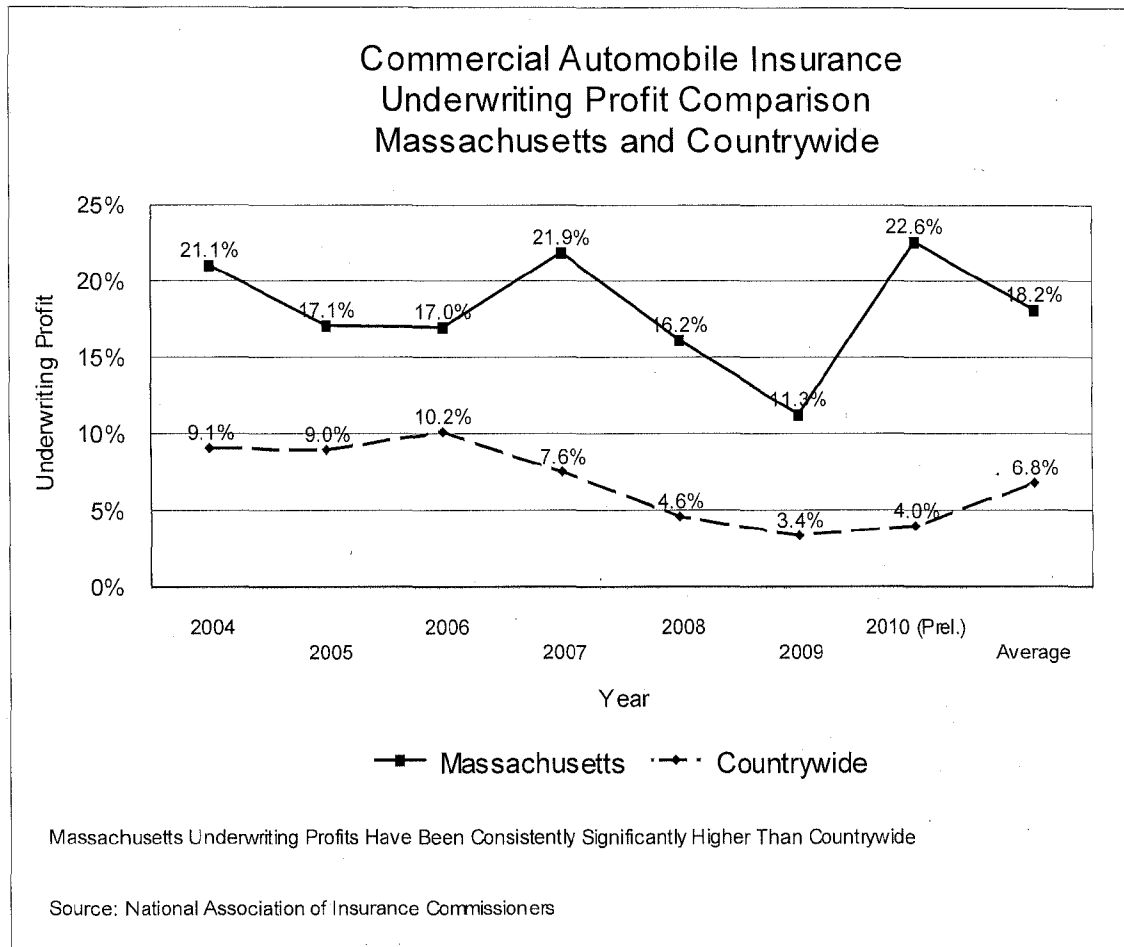
Comparison of AIB Under 1% Indicated and Selected Rate Change

(1)	(2)	(3)	(4)	(5)
Type of Commercial Automobile	Under 1% Exposures	Current Average Rate	AIB Indicated Rate Change	AIB Selected Rate Change
Trucks, Tractors Trailers	54,019	\$931.63	-17.6%	-3.5%
PPT Fleet	9,374	\$909.32	-6.1%	-0.8%
PPT Non-Fleet	7,544	\$1,108.00	-12.3%	-3.9%
Garages	1,801	\$1,036.23	-30.9%	-5.0%
Taxis	1,539	\$5,924.49	6.3%	2.7%
Limousines	667	\$1,966.16	-40.5%	-5.3%
Car Service Vehicles	94	\$4,128.11	-8.3%	-4.4%
Churches and School Buses	2,889	\$1,814.69	-18.6%	-4.5%
Other Buses	1,843	\$3,389.50	-17.2%	-7.3%
Van Pools	28	\$3,891.84	-50.1%	-5.8%
Total	79,798	\$1,146.53	-14.3%	-3.0%

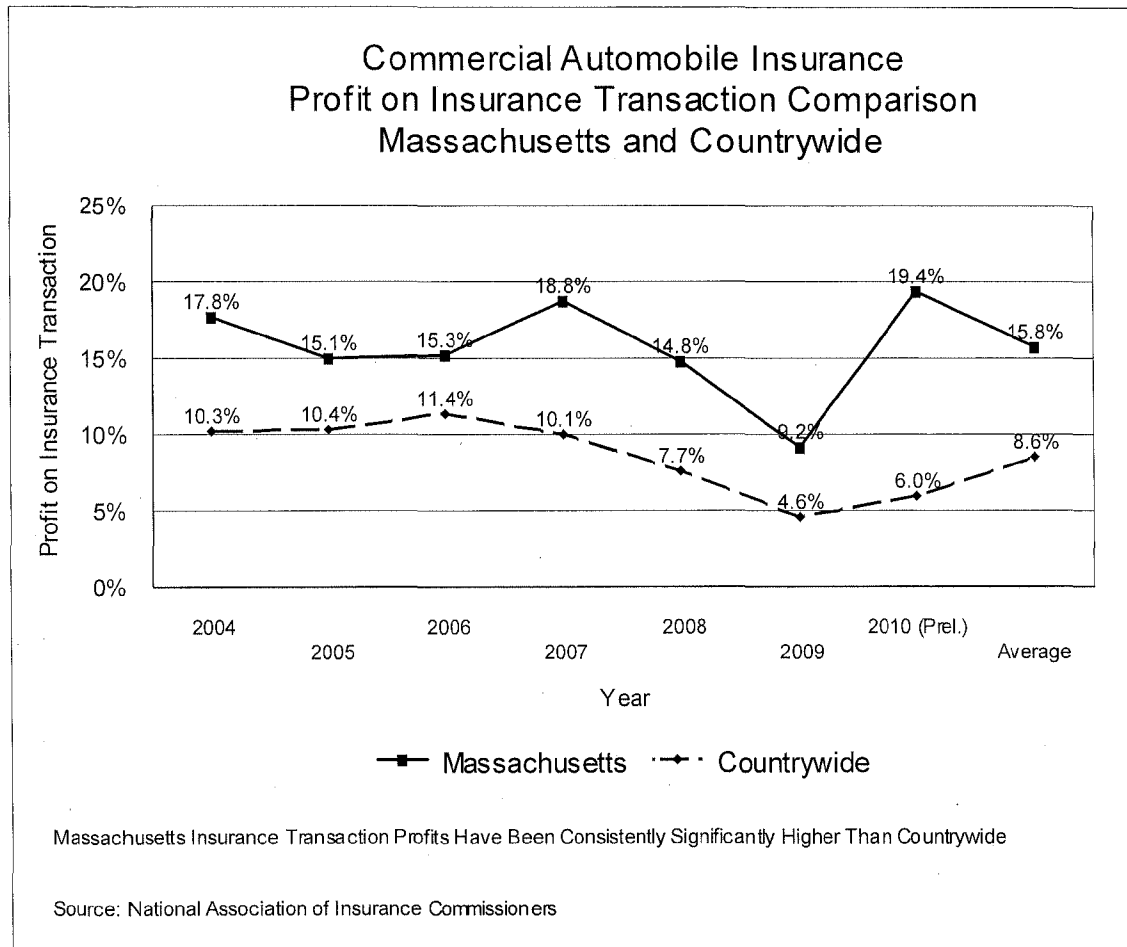
Appendix 4



Appendix 5



Appendix 6



Appendix 7

