PROPOSITION 103'S IMPACT ON AUTO INSURANCE PREMIUMS IN CALIFORNIA

15 YEARS OF INSURANCE REFORM: 1989 - 2004

In a voter revolt against massive increases in the price of auto, homeowner and business insurance, Californians approved Proposition 103 on November 8, 1988. The insurance crisis in the mid-80's sent rates skyrocketing in California and across the nation, but efforts to address the price hikes in the state legislature were blocked by the insurance lobby. When citizens placed insurance reform on the 1988 ballot, insurance companies spent a then-record $80 million in their unsuccessful effort to defeat the grassroots voter initiative.

Proposition 103 applies to most lines of property-casualty insurance including auto, homeowners and medical malpractice, but not workers compensation, health or life insurance. Under Proposition 103, insurance companies must open their books and justify any rate changes to the insurance commissioner, prior to imposing higher rates. The law also sets standards for company profits, allows consumers to review insurer data and challenge proposed rate increases, and applies anti-trust laws to insurance companies, the only industry exempt from such laws in most of the country. Proposition 103 mandates that insurance companies provide a discount to all consumers with good driving records, and it required a 20% rate rollback of excessive premiums during the 1980s that resulted in insurer refunds of over $1.2 billion directly to consumers.

Proposition 103's rollback and prior approval rate regulation requirements took effect in May 1989, when the California Supreme Court lifted an injunction and upheld all provisions of the initiative.[1]

This study examines 15 years of data following the implementation of Proposition 103, 1989 – 2004, the entire period for which data is now available on the impact of regulation on auto insurance rates in California.

The data is clear: Proposition 103 has impacted California auto insurance premiums dramatically, causing a massive money-saving shift that reduced California premiums over a 15-year period even as premiums rose in the rest of the nation. Unregulated insurance lines in California – like health insurance and workers compensation – have not experienced the same rate stability or premium reductions.

The following discussion summarizes insurance industry data drawn from annual reports published by the National Association of Insurance Commissioners (NAIC).[2]

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[1] The Court altered the legal standard by which an insurance company could obtain an exemption from the rollback. Proposition 103, as written, permitted exemptions only for those insurers who could show that full compliance would pose a "substantial threat of insolvency"; the Supreme Court ruled that such a standard might deprive insurers of their constitutional rights to a fair return, and substituted a "fair profit" test.

[2] *State Average Expenditures & Premiums for Personal Automobile Insurance* 1993-2004, National Association of Insurance Commissioners

I. The average auto liability premium dropped 7% in California between 1989 and 2004.

Prior to Proposition 103, auto insurance premiums in California rose dramatically each year. By the time the California Supreme Court lifted the injunction on Proposition 103 in 1989 the average liability premium[3] in California had risen to $519.39.

According to the latest NAIC data, California's average auto liability insurance premium for 2004 was $483.44 -- 7% less than the figure from 15 years previous. The average premium decrease in California becomes even more striking when adjusted for inflation. The average premium in 1989, in 2004 dollars[4], was $791.23. In comparison, the average premium in 2004 was 39% lower.

Table 1. California Average Liability Premiums, 1989-2004[5]

Year	California	California (2004 dollars)
1989	$519.39	$791.23
1990	$501.34	$724.58
1991	$522.95	$725.30
1992	$510.71	$687.62
1993	$512.52	$670.00
1994	$502.76	$640.83
1995	$514.53	$637.76
1996	$508.71	$612.46
1997	$492.31	$579.42
1998	$446.90	$517.91
1999	$404.33	$458.45
2000	$403.44	$442.57
2001	$422.33	$450.47
2002	$453.69	$476.39
2003	$486.06	$499.00
2004	$483.44	$483.44

II. Auto premiums in California fell 7% while premiums in the rest of the nation rose 47% over the same 15-year period.

Another measure of the impact of Proposition 103 is a comparison with average liability premiums in other states. California premiums were 52% higher than the national average in 1989; they were 3% lower than the nation's in 2004.

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[3] Liability insurance covers the bodily injury and property damage caused by the insured driver. Liability insurance is the statutorily mandated coverage required to drive a car in California and most states.

[4] Adjusted to value of the dollar in 2004 using the Consumer Price Index, Bureau of Labor Statistics Inflation Calculator accessed at http://data.bls.gov/cgi-bin/cpicalc.pl.

[5] Table 1 calculation is liability premiums/liability written car-years

While liability premiums for the rest of the country increased $159.18, or 47% since 1989, California premiums dropped by $35.95, or 7%. Tables 2 and 3 below compare California's average premium to the national average.

Table 2. Comparison of Average Liability Premiums, 1989-2004[6]

Year	California	Nation
1989	$519.39	$339.82
1990	$501.34	$354.61
1991	$522.95	$375.35
1992	$510.71	$394.34
1993	$512.52	$411.66
1994	$502.76	$420.23
1995	$514.53	$428.51
1996	$508.71	$439.05
1997	$492.31	$440.21
1998	$446.90	$425.60
1999	$404.33	$405.43
2000	$403.44	$401.90
2001	$422.33	$419.86
2002	$453.69	$456.06
2003	$486.06	$487.10
2004	$483.44	$499.00

As Table 3 below shows, California auto insurance rates consistently decline faster, or rise more slowly, than they do nationally since the implementation of Proposition 103. The notable exceptions occurred in the first year of former insurance commissioner Chuck Quackenbush's tenure, and during the fallout of his 2000 resignation in disgrace after evidence of inappropriate financial dealings with insurance companies.

Even during the industry-friendly Quackenbush administration, Proposition 103's public intervention provisions allowed consumer groups to intervene in the regulatory process and force insurance companies seeking insufficient rate decreases to cut rates more substantially. Thus, when insurers were reducing rates throughout the country between 1997 and 2000, California consumers earned far steeper premium decreases thanks to Proposition 103.

[6] Table 2 calculation is liability premiums/liability written car-years

Table 3. Comparison of Growth in Average Liability Premiums, 1989-2004

Period	California % Change	Nation % Change
1989-1990	-3.48%	4.35%
1990-1991	4.31%	5.85%
1991-1992	-2.34%	5.06%
1992-1993	0.35%	4.39%
1993-1994	-1.90%	2.08%
1994-1995	2.34%	1.97%
1995-1996	-1.13%	2.46%
1996-1997	-3.22%	0.26%
1997-1998	-9.22%	-3.32%
1998-1999	-9.53%	-4.74%
1999-2000	-0.22%	-0.87%
2000-2001	4.68%	4.47%
2001-2002	7.43%	8.62%
2002-2003	7.13%	6.81%
2003-2004	-0.54%	2.44%
1989-2004	**-6.92%**	**46.84%**

III. California's average liability premium has plummeted relative to the rest of the nation since the passage and implementation of Proposition 103.

At the time of Proposition 103's implementation California's automobile premiums were extraordinarily high when compared to other states and to the nation as a whole. However, since Proposition 103 has been in effect, California's average premium has fallen while that of the rest of the nation has climbed. In 1999, those trajectories crossed, and California's average liability premium in 2004 -- $483.44 -- remains lower than the average in the rest of the nation -- $499.00.

The sharp drop in California's average premium relative to that of other states brought California's rank down from the 2nd most expensive state for auto insurance in 1989 to 21st in 2004. Just three other states moved out of the top twenty most expensive states in those fifteen years from 1989 to 2004: Georgia, New Hampshire and Colorado, all of which ranked at the bottom of the list at 17, 18 and 19. No state enjoyed a fall as precipitous as California's.

Table 4. Most Expensive States, Average Liability Premiums, 1989 & 2004

Rank	1989	2004
1	New Jersey	New York
2nd	**CALIFORNIA**	New Jersey
3	Connecticut	Florida
4	Hawaii	Delaware
5	District of Columbia	Massachusetts
6	Pennsylvania	Rhode Island
7	Maryland	Louisiana
8	Massachusetts	District of Columbia
9	Florida	Connecticut
10	Rhode Island	Nevada
11	Nevada	Alaska
12	Arizona	Maryland
13	New York	West Virginia
14	Delaware	Hawaii
15	Louisiana	Washington
16	Alaska	Arizona
17	Georgia	Pennsylvania
18	New Hampshire	Oregon
19	Colorado	Michigan
20	Washington	Kentucky
21st	South Carolina	**CALIFORNIA**

In addition to the overall rate decreases associated with Proposition 103, California insurance consumers received over $1.2 billion in insurance rebate checks due to the initiative that were above and beyond the premium savings reflected in this study.

IV. California's overall post-Proposition 103 premium decline defies national trend toward higher rates.

In addition to lowering auto *liability* premiums, Proposition 103 has slowed premium growth for other types of automobile coverage at the same time that the rest of the nation saw its premiums increase drastically. California's comprehensive premiums[7] fell 4% while comprehensive premiums in the rest of the nation shot up by 49%. Collision premiums[8] in California went up 52%, in contrast to the rest of the country's 59% increase.

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[7] Comprehensive insurance covers the vehicle for losses resulting from incidents other than collision, for example, damage if a vehicle is stolen, or damaged by flood, fire, or animals.

[8] Collision insurance covers the vehicle for damage in an accident involving a vehicle or other object.

Table 5. Comparison of Average Comprehensive and Collision Premiums, 1989-2004[9]

	Comprehensive		Collision	
Year	California	Nation	California	Nation
1989	$120.68	$98.44	$235.53	$197.33
1990	$125.80	$101.88	$245.19	$202.34
1991	$122.58	$103.38	$246.35	$206.83
1992	$125.15	$109.11	$250.32	$208.29
1993	$131.76	$111.42	$257.50	$208.11
1994	$135.93	$114.00	$254.99	$207.75
1995	$131.30	$120.01	$240.93	$213.32
1996	$128.91	$123.48	$238.91	$222.65
1997	$121.04	$126.41	$246.33	$235.40
1998	$121.06	$129.83	$253.52	$245.20
1999	$113.67	$130.53	$253.45	$249.53
2000	$110.11	$131.51	$259.10	$255.79
2001	$104.66	$133.06	$278.60	$270.54
2002	$108.41	$138.12	$318.03	$292.82
2003	$115.29	$145.07	$346.58	$307.98
2004	$115.89	$146.80	$358.39	$313.95

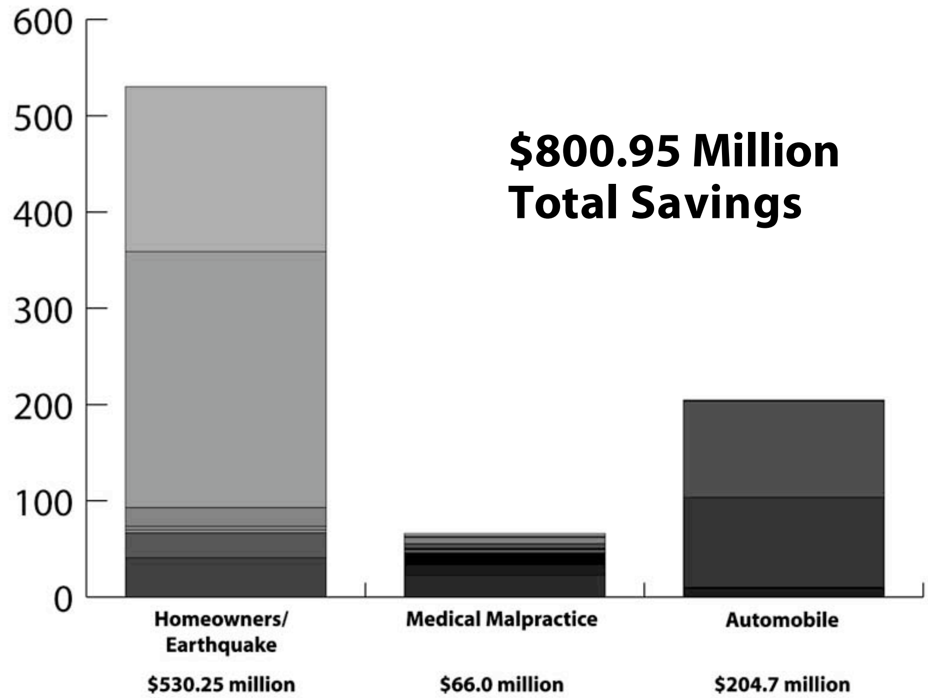
Combined together, California's liability, collision and comprehensive premiums have increased at a fraction of the national pace. In 1989, Californians paid $875.60 for liability, collision and comprehensive combined coverage, on average. Nationwide, consumers paid an average $635.59 for the combined coverage. California drivers' fortunes have changed with Proposition 103, as 2004 combined average premium in California was $957.72, an increase of just 9.4%, while nationally motorists paid $959.75, a 51.0% increase.

V. Consumer rate challenges save policyholders $800 million, 2003-2007.

Perhaps the most powerful tool in Proposition 103's arsenal is the provision allowing consumers to intervene in rate proceedings to challenge unfair or excessive rates. As Table 7 shows, that process has allowed the Foundation for Taxpayer and Consumer Rights (FTCR) to challenge unjustified rate increases and save drivers an additional $204 million between 2003 and 2007. Homeowners and doctors saved an additional $596 million on homeowners and medical malpractice insurance rates, for a total $800 million in policyholder savings after FTCR rate challenges under Proposition 103.

[9] Table 5 calculations are premiums/written car-years

Table 7. Proposition 103 Saves $800 Million in Insurance Premiums, 2003-2007



VI. Proposition 103 as an "insurance cycle" buffer.

Auto, and virtually all other insurance premiums, started increasing in 2000 in California and throughout the country. The data synchronize with national economic factors that historically push rates upward – known as the "insurance cycle." The cycle means lower premiums for consumers when the financial markets (including stock, bond and real estate) are booming and insurance companies want to attract as much business as possible in order to invest the premiums. But consumers pay the price when the cycle turns. A rapid decline in investment opportunities leads insurers to increase rates rapidly in order to maintain profits earned from outsized investment income.

The insurance cycle-driven premium hikes that began in 2000-2001 were the result of the stock market bubble burst, the degradation of corporate bonds in the wake of scandals such as WorldCom and Enron, and the onset of historically low interest rates. The cycle turned the corner by the end of 2004, just as the available premium data ends.

Under Proposition 103, California premiums increased less rapidly as the cycle began. However, the Quackenbush scandal impacted the ability of regulators with the California Department of Insurance to effectively resist insurers' increases. The resignation of Quackenbush in June of 2000, a Department shakeup during the following year and a focus on internal organizational issues under an interim, appointed commissioner, left the rate regulation functions of the Department dramatically weakened during 2001 and 2002.

The flow of insurance rate increases was stanched under Commissioner John Garamendi, elected in November 2002. In 2005 and 2006, several major insurers in California requested lower rates, which will be reflected in premium data available in years to come.

VII. California: A profitable market for insurers under Proposition 103.

Despite the insurance industry's automatic negative reaction to insurance regulation, California has actually been a more profitable environment for insurers than the nation as a whole.

The most recent data available from the NAIC show that California is more profitable for insurers, measured by return on net worth, than the national average for virtually all lines of insurance regulated by Proposition 103.[10]

Table 8. Insurer Profitability in California vs. Countrywide Average

Return on Net Worth	10 Year Average 1995-2004	
Line of insurance	California	Countrywide
Private Passenger Auto (Total)	11.1%	8.5%
Homeowners Multiple Peril	11%	3.4%
Commercial Auto	8.6%	5.9%
Farmowners Multiple Peril	8.7%	2.4%
Commercial Multiple Peril	6.2%	5.5%
Medical Malpractice	11%	5.4%

California's profitable marketplace is thanks to Proposition 103's regulatory regime. Proposition 103 guards against inadequate, as well as excessive and unfairly discriminatory rates. As a result, regulated lines of insurance maintain stable, reasonable rates for customers while providing the insurance industry an adequate rate of return. Regulation serves to restrain the companies from damaging themselves as well as hurting consumers.

The stable profitability associated with regulatory controls creates an environment in which insurers want to sell in the state. That is why there are so many insurers serving California customers. Over 200 companies sell auto insurance in California, 100 sell homeowners policies and almost 40 sell medical malpractice insurance.

[10] Results are the same if profit on insurance transactions, another measure of profitability by the NAIC, is used.

VIII. Insurers haven't stopped fighting regulation.

Proposition 103 was upheld by the California Supreme Court and its main provisions – the rate rollback and prior approval rate regulation – took effect immediately in May 1989. Despite Proposition 103's indisputable success, and the initiative's victories against repeated legal challenges, insurers continue to seek ways to undermine the regulatory regime created by the 1988 initiative in the legislature, on the ballot and in the courts.

New regulations enacted in 2006 will enforce Proposition 103's requirement that driving record, not ZIP code, marital status or other factors, play the greatest role in setting insurance rates. Years of challenges to this good driver provision were overturned with the new rules by former Insurance Commissioner Garamendi and insurers must fully comply with the regulations by August, 2008.

Former Commissioner Garamendi also enacted regulations to enhance rate oversight by adding detail and specificity to the rules defining an "excessive" rate. The insurance industry has predictably begun to lobby the new Commissioner, Steve Poizner, to weaken the regulations, but he has pledged to uphold both sets of regulations enacted by his predecessor.

IX. Conclusion: Regulation lowers the price of insurance.

New data reflecting 15 years of insurance regulation under Proposition 103 illustrate clearly that insurance regulation saves consumers money. The price of auto insurance dropped 7% in California between the 1989 implementation of Proposition 103 and 2004. Motorists around the country saw their rates jump by 47% in the same 15-year period. California plummeted from the 2nd most expensive state for auto insurance in 1989, to the 21st spot in 2004. Drivers nationally pay more on average for auto insurance than California motorists. Consumer advocates saved drivers $204 million (and another $596 million to other consumers) using Proposition 103's rate challenge provisions over just the last four years.

When voters approved Proposition 103 on November 8, 1988, they spoke out against the greed and power of an unfettered insurance industry that was raising rates at will to keep up with the vagaries of the stock market. A product as integral to economic life and financial security as insurance should be overseen by a vigorous regulatory system to protect consumers and ensure fair and reasonable insurance rates.

Consumers adrift in the unregulated health care market are now experiencing the same unjustified price hikes that California drivers revolted against when they passed Proposition 103. Proposition 103's prior approval requirement that insurance companies open the books and justify premiums before raising prices would protect health insurance consumers from unreasonable, unaffordable premiums, just as they lowered auto insurance premiums in California over the last 15 years.

Policyholders in the unregulated portions of California's insurance market would benefit from the cost savings and transparency of a strong regulatory regime.