Consumer Watchdog

Formerly The Foundation for Taxpayer & Consumer Rights
1750 Ocean Park Boulevard, #200, Santa Monica, CA 90405-4938 • Tel: 310-392-0522 • Fax: 310-392-8874 • www.consumerwatchdog.org

October 20, 2008

Mr. Daniel Goodell
California Department of Insurance
45 Fremont St., 21st Floor
San Francisco, CA 94105

Re: "Pay-Drive (Usage Based Auto Insurance)" Public Hearing, REG-2008-00020

Dear Mr. Goodell:

I write on behalf of Consumer Watchdog to provide comments on the "Pay-Drive (Usage Based Auto Insurance)" regulation proposed on September 5, 2008. Consumer Watchdog's comments of June 20, June 30 and July 14 in regards to the June 20, 2008 workshop on these regulations are incorporated by reference.

With fluctuating gas prices and a tanking economy, drivers across the country are already reducing their mileage. The total number of miles driven nationally has fallen for the first time in decades, according to the industry trade publication Auto Insurance Report. Drivers in New York just saved $515 million when their Department of Insurance called on insurers to re-examine rate hike requests as drivers spent less time on the road.

It is the ideal time to press for more aggressive implementation of Proposition 103's mandate requiring miles driven to be the second most important factor in determining drivers' auto insurance premiums. Consumer Watchdog supports amendments to the mileage verification regulations to require the insurance industry to more accurately measure and weight the second mandatory factor, number of miles driven annually. Ensuring a closer connection between annual miles driven and premiums will provide a financial incentive for drivers to reduce their mileage. Reducing mileage will benefit consumers by saving them money, benefit insurers by reducing their risk and benefit the environment by lowering greenhouse gas emissions. Any regulations to achieve these goals, however, cannot come at the expense of consumer privacy, must continue to ensure that drivers who drive the same number of miles, all else being equal, are charged the same premium, and must make certain that all rating factors remain in compliance with the weighting requirements of Proposition 103.

The notice of proposed action and public hearing for this proceeding states that the regulations "will improve the correlation between automobile premiums and the actual number of miles an insured drives pursuant to the second mandatory rating factor." As drafted, however, the regulation would allow insurance companies to charge unfairly discriminatory rates by charging drivers with the same mileage differently, raises concerns about driver privacy because it does not ensure consumer options for verifying

mileage, and may not lower premiums for people who drive less because it fails to require insurance companies to more closely tie premiums to mileage.

Mileage rating factor

Insurance Code section 1861.02(a) mandates that the second most important factor in determining auto insurance premiums be the number of annual miles driven.[1] California is the only state in the nation that already requires that mileage have significant impact on insurance premiums. We do not need to create a 'pay-as-you-drive' program from scratch. We simply need better implementation and enforcement of Proposition 103's mandate on miles driven.

At the June 23, 2008 workshop, Consumer Watchdog sought to ensure that new regulations would properly apply the annual mileage rating factor to a consumer's premium, as required by Insurance Code section 1861.02(a) and California Code of Regulations, title 10 ("10 CCR"), section 2632.8 of the auto rating factor regulations, through the use of more precise mileage categories.

Each insurance company currently applies the second mandatory factor using mileage rating categories of varying ranges. The broad mileage categories in use by some companies mean that drivers with vastly different annual mileage end up paying the same premiums. A 10,500 and 15,000 mile driver, all else being equal, would pay the same premium under one company's current mileage tiers; an 8,000 mile and a 20,000 mile driver would pay the same premium with another. Narrower categories tie premiums more closely to annual miles driven, and are the only fair way to create an incentive for drivers to reduce their mileage in exchange for premium reductions in a manner that complies with Proposition 103.

Consumer Watchdog recommends that the Commissioner set standards for compliance with the mileage rating factor by mandating a maximum width for mileage categories.

---

[1] Insurance Code section 1861.02(a) provides in full:

> (a) Rates and premiums for an automobile insurance policy, as described in subdivision (a) of Section 660, shall 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.

We propose two standards. The first would apply a maximum width for mileage categories to all insurance companies operating in California. Companies could, of course, use any width lower than the maximum. The Commissioner should determine exact standards, but Consumer Watchdog recommends a range of 2,500 miles to ensure a driver's premiums are more closely connected to miles driven.

The second standard would be adopted by all insurance companies seeking to meet the "green" performance criterion necessary to earn the Department of Insurance "Environmental Seal of Approval." The standard would again be set by the Commissioner, but Consumer Watchdog recommends a 500 mile range. Bands this narrow could illustrate to every driver how attainable mileage reductions can lower their premiums. Categories broader than 500 miles are less likely to provide such incentives.

The Green Seal should also include standards for the distribution of weight among the categories to ensure that premiums actually change as a driver moves down the mileage tiers, and should require participating insurers to create a tool for drivers to calculate premium savings based on reducing miles. The Seal would come with the right to use a "Green Seal" logo in advertising and the Department would highlight those companies on its own web site.

Insurance companies looking to stand out from the pack should have powerful incentives to participate in the Green Seal program. The California auto insurance market is ranked the 4th most competitive in the nation and almost 100 groups sell private passenger auto insurance in the state.[2] A Green Seal would spur competition in California's already competitive market and, with a little help, could become a competitive necessity for insurers that do not want to be the last California insurance company to go green.

When setting new standards for mileage categories, the Commissioner should also consider setting an overall maximum mileage amount (e.g., 25,000 miles) above which mileage categories would not be subject to the smaller 500-2500 mile ranges in order to allow the differences in relativities (i.e., changes in premiums) across lower mileage categories to be greater; ensuring that each mileage category is assigned a different relativity (multiple tiers with the same relativity can be found in some current class plans); and, that all rating factors continue to comply with the weighting requirements of Proposition 103.

Mileage verification

---

[2] Based on a calculation of the Herfindahl-Hirschman Index (HHI) for the insurance industry (http://www.consumerfed.org/pdfs/state_auto_insurance_report.pdf, see pages 6, 20). The HHI is a measure used by the United States Department of Justice to calculate market concentration.

Section 2632.5(c)(2)(E) of the draft regulation authorizes the use of verified mileage, (E)(4) makes mileage verification programs voluntary, and (E)(3) authorizes discounts for drivers who participate.

This vision of 'pay-as-you-drive' or 'usage-based' insurance is imported from out-of-state and cannot work in California. Charging drivers differently based on whether they estimate or verify mileage is a violation of Proposition 103.

Consider three motorists. One has a technological device in his car that updates his mileage daily with his insurance company. One visits his agent twice a year for an on-site odometer reading. One correctly estimates his driving habits based on past years' experience. Each has driven 10,000 miles at the end of one year. The number of miles driven annually (the second mandatory rating factor) is exactly the same between the three, regardless of the different methods of determining mileage. Under Proposition 103, premiums must be based only on the three mandatory factors, and those optional rating factors which have been adopted by the Commissioner by regulation and have a substantial relationship to risk of loss. (Ins. Code § 1861.02(a).) The mandatory mileage factor is "the ***number*** of miles [a person] drives annually," not whether or how someone verifies that number. The manner in which the number of miles driven is determined is likewise not an approved optional rating factor.

Similary, allowing insurers to provide a discount to drivers who verify mileage by agreeing to install a technological device in their car (as opposed to verifying with odometer readings or otherwise) would also be impermissible for the same reason. A discount for customers who agree to use technology to verify mileage necessarily means a surcharge on all those who do not, which would be illegal under Proposition 103 since the use of the technological device is not itself an approved rating factor.[3]

Proposition 103 also prohibits unfairly discriminatory rates. Insurance Code section 1861.05 provides that: "No rate shall be approved or remain in effect which is excessive, inadequate, unfairly discriminatory . . . ." Section 1861.02(a)(4) provides that "the use of any criterion without approval [i.e., an unapproved rating factor] shall constitute unfair discrimination. Accordingly, separate rating plans (either through

---

[3] See, e.g., *The Foundation for Taxpayer and Consumer Rights v. Garamendi* (2005) 132 Cal.App.4th 1354, 1367-1369 [discussing concept of "revenue-neutrality" in setting premiums and quoting the declaration of CDI actuary Eric Johnson: "[w]hen a particular policyholder represents a greater or lesser risk for purposes of insurance, this greater or lesser risk may be captured mathematically through the application of the rating factors to the particular policyholder. [¶] . . . The premiums for policyholders who, because of their characteristics, do not qualify for a particular discount must be *surcharged* in an amount *equal to the total of the discounts* given to the policyholders that qualified for the discount"]; see also Cal. Code Regs., tit. 10, § 2632.7(c) [requiring that relativities for each rating factor be balanced to a weighted average of 1.0 for multiplicative factors or balanced to a weighted average of 0.0 for additive factors].

separate "program" rate filings for different overall base rates or separate class plans for different premiums) for estimated and verified mileage would be unfairly discriminatory, again because similarly situated drivers would pay different rates or premiums.

To be compliant with Proposition 103, insurance companies cannot offer "voluntary" mileage verification programs and charge drivers who choose to participate any differently than those drivers who still estimate mileage. Mandatory mileage verification for every driver is one way to get around this difficulty. If the Commissioner mandates that companies use mileage verification, rather than estimated mileage, to determine the number of miles driven annually (while requiring insurers to provide reasonable verification alternatives and not just technological devices as discussed below), this will accomplish the dual goal of making individuals' premiums more accurate and ensuring equal premiums for drivers with the same mileage.

Verification methods

Whether mileage verification is mandatory or not, the Department must protect consumers from untenable and unduly burdensome verification requirements. No move to verify the number of miles Californians drive is likely to succeed at the expense of driver privacy or if the consumers are unable to avail themselves of particular verification options (e.g., if they have an older car or live too far from an odometer reading site).

Section 2632.5(c)(2)(E)(1) of the proposed regulation would give insurance companies a choice of verification methods but does not ensure that consumers have the ability to choose any one of these same options. The regulation should be amended to require insurance companies to offer every driver a minimally-invasive option (see Consumer Watchdog's proposed amendment below). It should also specify that insurance companies may only collect ***mileage*** data, and that consumers cannot be required to install technology to track mileage, or pay more if they refuse. As stated above, a discount for drivers who agree to use technology (or any other specific verification method) would run afoul of Proposition 103 since the use of a device is not an approved rating factor.

We suggest that every insurance company be allowed to require mileage verification in the manner the policyholder obtained the insurance coverage. For example, Company X requires consumers to apply for insurance in person at an agent's office. Company X would be allowed to require drivers to return to that agent for an odometer inspection. Company Y collects information about a driver and issues insurance policies entirely over the internet, so Company Y would accept odometer readings submitted online by the insured as proof of mileage. This gives insurance companies a way to verify mileage in a manner it has determined is sufficient to obtain other policy information, such as the zip code where you garage your car, number of drivers, or vehicle use. Consumers' verification burden would be no greater than they were willing

to bear in order to obtain the insurance policy. The insurer could, of course, choose to offer additional approved verification methods.

The list of approved verification methods set forth in proposed section 2632.5(c)(2)(E) should also be amended to include independent third-party verification and self-reporting by the insured. We propose the following language:

> (1) An insurer may require a policyholder to verify actual mileage in the same manner in which the policyholder applied for coverage.
> (2) An insurer may request, but not require, a policyholder to verify actual mileage either:
> (i) by odometer readings of the insured vehicle or vehicles, made by an employee or agent of the insurer; or
> (ii) through service records from an automotive repair dealer, as defined by section 9880.1 of the Business and Professions Code, provided to the insurer by the policyholder pursuant to subdivision (D)(1); or
> (iii) through the use of technological devices provided by the insurer or otherwise made available to the insured that collect only vehicle mileage information; or
> (iv) through a report by the insured of the odometer reading of the insured vehicle or vehicles; or
> (v) through an independent third party as approved by the Commissioner.
> (3) An insurer may verify mileage once at the end of the policy term, and may request, but not require, the applicant or policyholder to verify mileage more frequently.

Additional rating factors

For an insurance company to use information about a driver such as braking patterns, speed, time of day or type of road driven, these factors would have to be approved as new optional rating factors. They cannot logically be considered part of the second mandatory factor, number of miles driven. It requires an enormous linguistic leap to mutate "***number*** of miles he or she drives annually" (emphasis added) to ***when*** a person drives and other factors such as acceleration or traffic density.

We have previously expressed our opposition to the collection and use of any such information, but will postpone consideration of specific factors until they are proposed. As a general observation, it would appear that the first mandatory rating factor, driving safety record, would already capture what these additional factors would purport to measure. Moreover, any additional optional rating factors would have to comply with 10 CCR § 2632.8(d) such that the individual weight of each optional rating factor must be less than the individual weight of each of the mandatory rating factors. (See also 10 CCR § 2632.5(e).) It is also worth noting that any driving behavior information would have to be collected through the use of technology, raising the same privacy and fairness concerns as requiring technological devices to track mileage.

Technology to collect annual miles driven should not collect additional information. Only if, and when, other data is approved as an optional rating factor should insurance companies be allowed to obtain it.

How would "pay-as-you-drive" really operate?

Even within the framework above, big questions remain about how such a plan would impact consumers.

For example, what will the costs of mileage verification be, and will they be passed on to drivers through insurers' overall rates? How will consumers actually see savings from reducing their mileage? Will rebate checks, or surcharge bills, be issued? If discounts are prospective, how will drivers who change insurers receive them? How will the Department ensure that insurers' mileage verification practices do not lead to unfairly discriminatory rates or premiums for drivers who drive the same number of miles annually, particularly for those drivers for whom certain verification methods are not feasible or overly burdensome?

The real-world impact of "pay-as-you-drive" must be addressed as this proceeding moves forward, and Consumer Watchdog recommends enlisting the technical expertise of Department staff who can properly assess these issues and ensure that the regulations are properly drafted to ensure compliance with the existing auto rating factor weighting methodology regulations and Insurance Code section 1861.02. Consumer Watchdog is willing to participate in further discussions with Department staff, industry representatives, and other interested groups to ensure that any final regulations meet these goals.

Sincerely,

Carmen Balber