



October 20, 2008

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RE: Proposed Amendments to Title 10, California Code of Regulations (CCR), Chapter 5, Subchapter 4.7, Section 2632.5 [Pay-Drive (Usage Based Auto Insurance)]

Dear Mr. Goodell:

On behalf of the Association of California Insurance Companies (ACIC) and the Personal Insurance Federation of California (PIFC), we thank you for the opportunity to provide these written comments to the California Department of Insurance (CDI) regarding the above-referenced proposed regulations (the "Proposed Regulations"). We greatly appreciate the CDI's interest in improving the auto insurance rating system. The concept of rating upon the exact number of miles *actually* driven, instead of today's heavy reliance upon estimated annual mileage, represents an important positive step in auto rating.

The Proposed Regulations offer concrete, incremental improvement of the current auto rating system. However, additional changes are needed in order to satisfy the Commissioner's stated goal of PAYD producing significant environmental benefits and real rate incentives to consumers.

These written comments have two purposes. First, we will offer technical input on the Proposed Regulations in the event that the CDI ultimately promulgates the

Proposed Regulations without conceptual change. Second, we offer additional substantive amendments that we believe would generate significant market competition surrounding the PAYD concept. We believe that if the CDI were to incorporate such substantive amendments, the PAYD concept would take root in California. We base this opinion, in part, on the attached study by former CDI-actuary Shawna Ackerman, whom we asked to analyze the Proposed Regulations and offer comment. We attach Ms. Ackerman's work hereto and will refer to her comments at various points in our comments.

Background

We are encouraged by the direction of the CDI to promote auto insurance product innovation and competition. Such innovation is sorely needed because the current auto insurance rating system mandates various unfair cross-subsidies of one consumer by another and restricts the market innovation otherwise available and permissible under Proposition 103.

We respectfully submit that a key goal of any PAYD program should be to promote auto rating innovation without requiring a particular approach that would pick market winners and losers. Configured to allow flexibility and market differentiation, CDI regulations could make PAYD market competition irresistible. Configured otherwise, CDI regulations would not effectively foster market interest and thereby represent an unrealistic public promise of PAYD discounts and environmental benefits.

Properly structured, PAYD concepts could make available a wide array of insurance discounts for California drivers. Allowing carriers to provide discounts to consumers willing to satisfy carrier-developed verification standards is a good starting point. Carriers individually develop expertise in particular forms of verification, but generally not in all forms available (e.g., service records, odometer readings, technological devices, etc.). We hope the CDI would resist the impulse to mandate use of specific types of PAYD verification. Such a mandate would likely discourage a carrier from embracing PAYD rather than pursuing verification-based discounts that it fully understands. We believe it is better to encourage PAYD programs suited to individual carrier knowledge rather than requiring cumbersome PAYD programs that few can implement.

Technological improvements have also created the exciting ability to use real-time mileage data (instead of estimated mileage) for rating purposes. The original backers of Proposition 103 have praised the concept of insurance rating based upon controllable factors, such as how much one drives. Yet, when carriers have proposed voluntary opt-in rating programs using technology that would measure annual mileage precisely, these same backers of Proposition 103 have inexplicably cried foul. In the legislative privacy debates of several years ago, voluntary opt-in privacy programs were considered the "gold standard." We submit that voluntary opt-in PAYD programs using technology do represent the

gold standard. We respectfully request that CDI staff ask tough questions of those who raise specious “privacy” concerns about voluntary opt-in PAYD programs that rely upon technology.

Technical Amendments to the Proposed Regulations

In this section, we offer specific suggested amendments to the Proposed Regulations.

Section 2632.5(c)(2)(E)(1)

This section of the Proposed Regulations would permit use of verified actual mileage in auto insurance rating in one of three ways: either (i) odometer readings, (ii) service records; or (iii) a technological device. This is a positive step to improve classification of drivers. The specific language creates a few questions:

- In this section, could the discount be based on other forms of verification not explicitly listed? For example, could a discount be based upon smog check odometer readings mentioned in subsection (F)?
- Could a discount be based upon a blend of verification methods, if a carrier could justify such an approach to CDI staff?
- Could a discount be based upon odometer data or service records obtained from a third party vendor? The proposed regulations indicate verification could be accomplished by an “agent of the insurer” and we would greatly appreciate clarification of how far this extends. Greater flexibility on who can verify the data would improve the likelihood of market adoption.

Based upon these questions, we would greatly appreciate consideration of the following amendments:

1. Actual mileage pursuant to this subdivision must be verified by one or more of the following means either:
 - (i) by odometer readings of the insured vehicle or vehicles, made or provided by an employee, vendor or agent of the insurer or by any other reliable means or source; 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 to subdivision (D)(2); or

(iv) through other means filed with the commissioner.

Section 2632.5(c)(2)(F)

This section permits insurers to obtain smog check odometer readings from the California Bureau of Automotive Repair. It is our hope that insurers could also obtain such information from the Department of Motor Vehicles when possible. A proposed change could be:

(F) An insurer may obtain and use smog check odometer readings from the California Bureau of Automotive Repair **or the Department of Motor Vehicles** to estimate annual miles driven.

Additional Changes Are Necessary to Encourage Market Innovation With the PAYD Concept

While making the above changes would improve the Proposed Regulations, we do not believe adopting such regulations, even with the above changes, would lead to demonstrable PAYD market innovation. 10 CCR 2632.5 remains a powerful impediment to market innovation and would remain so even after adopting the Proposed Regulations. We state this belief based not only upon member company feedback, but also upon the attached analysis by Ms. Shawna Ackerman, detailed below.

We respectfully request the Commissioner to consider additional amendments to the Proposed Regulations that would promote market innovation and that are fully consistent with Proposition 103.

Section 2632.5(e)

Section 2632.5(e) places unnecessary limitations on auto insurance rating that are not required by Proposition 103 and which, we respectively submit, run counter to Proposition 103's express purpose of stimulating market competition. The regulation provides:

2632.5 (e) The three mandatory factors may not be combined with any other factor, except Percent Use, Academic Standing, Gender, Marital Status, and Driver Training may be combined with number of years of driving experience. *If an insurer elects to combine number of years of driving experience with any other optional factor as provided in this Section, the insurer shall demonstrate in its class plan that the rating factors used in combination, when considered individually, comply with the weight ordering requirements of Section 2632.8. (Emphasis added.)*

There are two significant problems with this current rule. First, it prevents rating factor interactions that could produce significant rating discounts in a PAYD system. Second, it distorts the relationship between the second mandatory rating factor (Annual Mileage) and the third mandatory rating factor (Years of Driving Experience), creating subsidies that inhibit market innovation.

Increased Rating Factor Interaction Will Produce Market Innovation Consistent With Proposition 103.

Allowing more auto rating factors to “interact” would produce new, powerful rating tools. As Ms. Ackerman notes in her review of the Proposed Regulations, Proposition 103 already embraces rating factor interaction even though the current CDI regulations restrict it. For instance, at footnote 6 on page 10 of her comments, Ms. Ackerman notes that Proposition 103’s “Good Driver Discount” is nothing more than measuring two rating variables at once (Driver Safety Record and Years of Driving Experience), in addition to measuring them separately. When these two rating factors are combined (i.e., when they “interact”), they can produce a powerful consumer discount for those who drive accident free for a significant period of time.

There is no reason to prevent the availability of additional interactions that carriers can petition for CDI approval. There is every reason to promote additional rating discounts utilizing the combination of two or more rating factors. If a carrier’s research leads to the conclusion that, hypothetically, combining the first, second and third mandatory factors would lead to a more powerful predictor of the risk of loss, then why shouldn’t a carrier be allowed to use this new tool after obtaining CDI approval? Or, why can’t a carrier use a combination of mandatory and optional factors if they produce greater predictive power than those rating factors do when used separately? There is no reason, either based on policy, politics or the law, that CDI regulations should restrict rating factor interactions to only the third mandatory factor and several distinct optional rating factors.

We understand that there is special sensitivity regarding the so-called “territorial” rating factors. We would not propose to include the two territorial rating factors in the above discussion. While combining the territorial rating factors with other rating factors would, undoubtedly, produce more accurate rating (e.g., combining annual mileage with territory), such a proposal would cause unneeded consternation and would distract from the overall goal of additional changes to make the PAYD concept viable in California.

To improve the PAYD proposal, we respectfully request replacing the current language of Section 2632.5(e) with the following:

2632.5 (e) The three mandatory factors may be combined with any other factor, except Claims Frequency and Claims Severity.

As noted above, we would propose to avoid the controversy associated with the territorial rating factors, while proposing additional market innovation wholly consistent with Proposition 103. **At all times, the CDI would retain the power of approval or disapproval.**

The Current ARF Regulations Unnecessarily Cause Unfair Subsidies and Prevent Market Innovation

As noted by Ms. Ackerman, at page 8, the italicized sentence above in Section 2632.5(e) is not necessary for compliance with Proposition 103 and causes unfair cross-subsidies of some drivers by others. The italicized sentence did not exist until the final public rulemaking draft when the auto rating factor (ARF) regulations were revised in July, 2006. The previous version of the ARF regulations did not contain the italicized sentence above and yet was upheld in court without this requirement in *Spanish Speaking Citizens' Foundation, Inc. v. Low*, 85 Cal.App.4th 1179 (2000).

As Ms. Ackerman notes, at page 10, the italicized sentence is “creating a tension between years licensed and annual mileage, two mandatory factors.” If the goal of the italicized sentence is to ensure that the individual weight of each optional rating factor is less than the individual weight of a mandatory rating factor, as previously stated by the CDI in 2006, there are ways to accomplish this without creating unfair subsidies¹.

We respectfully request the CDI to replace the above-italicized sentence with a straightforward prohibition regarding rating factor weights. We propose: “No optional factor may yield a weight that is higher than the third mandatory factor.”

When combined with the above requested amendment, we respectfully request the CDI to amend Section 2632.5(e), in its entirety, to read as follows:

“2632.5 (e) The three mandatory factors may be combined with any other factor, except Claims Frequency and Claims Severity. No optional factor may yield a weight that is higher than the third mandatory factor.”

Such a revised rule, which the Commissioner undoubtedly has the power to adopt under Proposition 103, would promote needed market innovation within the PAYD concept.

¹ Please note that the *Spanish Speaking Citizens* case explicitly found that the Commissioner has the power to adopt an auto rating system where the individual weight of an optional rating factor can exceed the individual weight of a mandatory rating factor as long as the average weight of the optional rating factors does not. We are not presently advocating re-adoption of such a system.

New Optional Rating Factors That Allow Drivers to Control Insurance Outcomes Would Improve the Likelihood of PAYD Market Innovation

We urge the CDI to consider additional changes to the ARF regulations to make the PAYD concept viable in California. The Proposed Regulations' verified mileage changes are an improvement over the current rules, but would not likely lead the market to embrace PAYD in California. The Proposed Regulations would be enhanced if the CDI would permit additional optional rating factors that give drivers a greater ability to control their auto insurance outcomes.

We take this cue from a bulletin the CDI issued earlier in 2008. In its bulletin, the CDI requested academic studies on whether *how* and *when* someone drives could become useful rating factors that are consistent with Proposition 103. We believe this type of an approach could lead to a greater array of insurance discounts that would be much more within the control of a driver than the current rating factors. Such an approach should hold great consumer appeal, particularly if done within an opt-in PAYD approach.

We understand that many groups submitted data to the CDI in response to its bulletin. We look forward to the results of the CDI's examination of this issue.

There is a movement among academia to examine the sufficiency of a verification-only PAYD concept. For instance, the Brookings Institution examined whether a mileage verification-only PAYD program could be improved by adding additional optional rating factors, in this case, rating factors within a driver's control:

“While adding mileage to the rating mix will increase efficiency and equity in the auto insurance market, even more can be done to price auto insurance more accurately and efficiently. Optimal premiums would incorporate other factors that contribute to accident risk, such as speed, time of day, and aggressiveness.”²

The Minnesota Department of Transportation's study of a PAYD program in the Twin Cities found that the program resulted in a reduction in miles driven. Importantly, it should be noted that the PAYD program monitored not just annual mileage, but also mileage by time-of-day and day-of-week.³

In addition, a verified mileage-only PAYD approach would not create sufficient incentives to improved driver safety. A case study of PAYD in the Netherlands found that:

² Jason E. Bordoff and Pascal J. Joel (2008) Pay-As-You-Drive Auto Insurance: A Simple Way to Reduce Driving-Related Harms and Increase Equity, p. 46.

³ Maya Abov-Zied (2007) Minnesota Pay-As-You-Drive Pricing Experiment.

“An optional flat kilometer-based PAYD premium has the smallest effect on traffic safety (about 1%). When the objective would be to improve traffic safety, the best strategy would be to differentiate to both road category and time of day for all drivers.”⁴

While many studies show that miles are related to accidents to a limited extent, the relationship is generally not linear. Not all miles are the same in terms of crash risk, let alone insurance risk. Among others, *when* and *how* a car is driven are at least as important indicators of potential insured loss as the number of miles driven.

One analysis observed that PAYD programs benefit from the introduction of consideration of driving behaviors beyond just miles driven. The analysis noted:

Drivers traveling the same distance may face significantly different crash risks depending on time of day and facility types that they travel and based upon how they operate their vehicles. In addition, the travel mileage cannot describe whether they drove at high speeds or they frequently changed their driving speeds, which are also highly related to the probability of crash involvement. New classification method can use driving behavior activity metrics that would describe major travel conditions: where drivers drive, when they drive, how they drive, and under what environmental conditions they drive.”⁵

The Commissioner’s PAYD proposal would greatly benefit from the addition of optional rating factors that are substantially related to the risk of loss – particularly those within a driver’s control that allow a driver to better control his or her insurance outcome. We have presented academic literature exploring how a PAYD concept that only relies upon annual mileage could be insufficient. We invite your critical review of this literature and await your conclusions after reviewing the information submitted in response to your bulletin.

⁴ J. Zantema (2008) Pay-As-You-Drive (PAYD): A Case Study Into the Safety and Accessibility Effects of PAYD Strategies, pp.8 and 11.

⁵ Jungwook Jun (2006), Potential Crash Exposure Measures Based on GPS-Observed Driving Behavior Activity Metrics, a dissertation presented to the faculty of Georgia Institute of Technology.

Conclusion

ACIC and PIFC greatly appreciate the CDI's willingness to explore the new frontier of auto insurance rating. We look forward to engaging in a lively debate about how to unveil a PAYD program that would be embraced by insurers and consumers alike.

The proposals we jointly set forth in these comments represent market-oriented improvements to the Proposed Regulations while observing the constraints placed upon the CDI by Proposition 103. While Proposition 103 contains some constraints, it also vests the CDI with enormous powers to encourage market competition, as the *Spanish Speaking Citizens* case notes forcefully. In the case of PAYD reforms, we view Proposition 103 as presenting opportunity for reform, not a straightjacket.

In order to create a viable opt-in PAYD program in California, the Proposed Regulations: 1) would benefit from the technical improvements detailed above, 2) should eliminate the current unnecessary restrictions on combining rating factors that impede development of additional discounts and 3) should allow additional optional rating factors that encourage market innovation, particularly those rating factors that allow drivers improved control over their auto insurance outcomes. We look forward to working with you and interested parties to create a robust and meaningful PAYD program for California.

Sincerely,



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President
Personal Insurance Federation of CA



Samuel Sorich
President
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