



*Formerly The Foundation for Taxpayer & Consumer Rights*

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June 20, 2008

Ms. Sara Urakawa  
California Department of Insurance  
45 Fremont St., 21<sup>st</sup> Floor  
San Francisco, CA 94105

Re: "Pay-As-You-Drive" Automobile Insurance Workshop, REG-2008-00020

Dear Ms. Urakawa:

I write on behalf of Consumer Watchdog in response to the May 23, 2008 Notice of Workshop and invitation to provide comments on issues related to "pay-as-you-drive" ("PAYD") insurance and its implementation in California.

Consumer Watchdog is in strong support of regulations to encourage the insurance industry to more accurately measure and weight the number of miles driven annually as required by Proposition 103. Any such regulations, however, while providing incentives for consumers to lower their annual mileage and thus lower their annual premiums, should not come at the expense of consumer privacy and must continue to ensure that drivers who drive the same number of miles, all else being equal, are charged the same premium (i.e., are not charged unfairly discriminatory premiums) and that all rating factors continue to comply with the weighting requirements of Proposition 103.

Consumer Watchdog also calls upon The Department of Insurance ("Department") to encourage insurers to more aggressively set auto insurance premiums based upon miles driven by highlighting the environmental benefit of reducing mileage and developing a "CDI Environmental Seal of Approval" to award those companies that aggressively set premiums according to mileage. Any such program must, of course, ensure that premiums remain fair and in accordance with the provisions of Proposition 103, including premiums based only on approved rating factors.

Encouraging drivers to help address the crisis of global warming by reducing their mileage is a worthy goal. It can even be a selling point to jump-start a program with insurers and the public. However, the environmental advantage of reducing mileage cannot take a front seat to fair insurance rates.

## Proposition 103 and Automobile Insurance Premiums

A chief goal of the voters when enacting Proposition 103 was to “fundamentally change” the way their automobile insurance premiums were calculated so as to minimize the role certain factors – such as ZIP Code, marital status, and a policyholder’s length of time with an insurer – played in determining the cost of automobile insurance in favor of maximizing factors that were actually related to how well and how often people drive. That’s why Proposition 103 requires miles driven be the second most important factor, after driving safety record, for setting insurance premiums.

Insurance Code section 1861.02(a) requires that automobile insurance premiums be based primarily on three factors **in decreasing order of importance**: 1) driving safety record, 2) annual miles driven and 3) years of driving experience. (Ins. Code § 1861.02(a)(1)-(3).) Any other rating factors used by insurers must be adopted by the Commissioner by regulation and have less weight than any of the three mandatory factors. (Ins. Code § 1861.02(a)(4).)<sup>1</sup>

In 2006, the Commissioner enacted new auto rating factor (ARF) regulations to enforce Insurance Code section 1861.02 and require insurance companies to submit class plans to fully comply with the voters’ mandate by July 14, 2008. (Cal. Code Regs., tit. 10 (“10 CCR”), §§ 2632.8 and 2632.11.) At the same time, the Commissioner promulgated new regulations to make it easier for insurers to verify the actual miles driven by their policyholders. (10 CCR § 2632.5(c)(2).) (“Mileage Verification regulations”) The 2006 Mileage Verification regulations were the culmination of an extensive workshop and public hearing process with the consideration of comments by consumer groups and the industry on three different draft versions of the regulations. The comments by Consumer Watchdog and other consumer groups sought to ensure that the resulting Mileage Verification regulations would allow insurers to obtain accurate mileage estimates without imposing unduly burdensome requirements on consumers or invading their privacy, so that the annual mileage rating factor is properly applied to a consumer’s premium as required by Insurance Code section 1861.02(a) and section 2632.8 of the ARF regulations.

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<sup>1</sup> 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.

## Rating issues

A key priority of the Department should be to encourage the use of more precise mileage categories. Narrower tiers will allow insurance companies to tie premiums more accurately to the number of miles driven by the insured. More categories – each corresponding to a higher or lower premium – will also provide consumers with more incentive to reduce mileage by illustrating how a change in driving habits can directly effect premiums. Importantly, this incentive-based strategy is entirely consistent with Proposition 103 and its underlying goals of tying auto insurance premiums to those factors most within the driver’s control.

Currently, the insurance industry uses a wide variety of mileage categories. Some carriers have categories that adjust premiums at increments of 1,000 miles, while other companies set premiums in much broader categories. State Farm, for example, has just two mileage categories: motorists who drive more than 7,500 miles annually and motorists who drive less than 7,500 miles. Just two rating categories – one for higher mileage and one for lower mileage drivers – means that drivers with widely different mileage may pay the same premium. When an 8,000 mile-per-year driver pays as much as a 25,000 mile-per-year driver, premiums are clearly not closely related to miles driven. Such wide categories also give drivers little incentive to change how frequently they drive. A motorist who drives 12,000 miles a year will find it almost impossible to drive 4,500 miles less to move into the only other rating tier (below 7,500 miles), so she has no insurance-related incentive to drive less at all.

However, with rating categories narrow enough to adjust premium for every 1000, 500 or even 250 miles driven, premiums would be more closely tied to miles driven and the consumer could see that small changes in driving habits make a noticeable difference in her auto insurance premiums.

Some may even suggest categories that adjust premium on a mile-per-mile basis. So long as the mileage factor does not gain so much weight as to have more of an impact on premiums than driving safety record, we encourage the creation of narrower categories, and discuss this in our proposal for a “CDI Environmental Seal of Approval” below. (It is worth considering, however, the possibility that consumers who must think about every mile they drive may have less motivation than consumers who have round number goals to meet.)

### *Good drivers*

Any regulations developed in this process must also hew to the requirement of Insurance Code section 1861.16(b), which requires an insurer to sell a good driver policy at the lowest rates offered by the company or any affiliated company within the same common ownership, management or control group. In addition to Proposition 103’s ban on unfairly discriminatory rates discussed above, this provision prohibits an insurer from charging a different premium for auto insurance to any good driver.

“Pay-as-you-drive” will not conflict with the requirement that good drivers receive an insurance company’s lowest rate as long as insurers do not have separate PAYD programs and drivers are not charged differently according to how they determine their mileage.

### Mileage Verification

Auto insurance is, by definition, prospective. Drivers purchase an insurance policy for the coming year. “Annual miles driven” is necessarily an estimate because it is a projection of miles a motorist will drive in the future.

Some have interpreted the current regulation’s description of the mileage rating factor as “the estimated annual mileage” to mean that insurance companies cannot verify actual miles driven. This is one of the reasons given to argue that insurers cannot determine mileage accurately, and therefore cannot more closely tie premiums to miles driven.

However, simply because miles driven is necessarily an estimate as a projection for the coming year, this does not mean that actual miles driven cannot be verified under the current Mileage Verification regulations, and the estimate and premium adjusted accordingly, as long as the policyholder is notified before purchasing the policy. (10 CCR § 2632.5(c)(2).)

It may be argued that, for those drivers whose mileage estimates are not confirmed, the insurance company can never be certain whether they drove the miles they claimed. In order to encourage insurance companies to more closely align premiums with miles driven, we believe the Department should clarify that insurers have the right to require all policyholders to verify mileage.

In practice, this may mean that some insurance companies will want to require verification from all policyholders. We think this is fair, as long as the verification methods used are not overly burdensome and allow consumers a verification alternative to the use of technological devices. Our chief dispute with some proposals we have seen is that customers not be required to pay higher premiums because they choose not to use, or cannot use, an insurer’s preferred verification method, such as a technological device. Technology should always be optional, even if verification is not, and mere use of a technological device cannot be used as a basis for lower rates.

Insurance companies may be allowed to choose whether to use verified mileage, estimated mileage, or both. It is our view, however, that any company that allows consumers to choose whether to estimate or verify must charge the same premium for the same number of miles driven.

### *Verified vs. estimated*

One “pay-as-you-drive” proposal that has been suggested would allow separate programs for drivers who “estimate” their mileage versus those who “verify.” Charging different premiums for estimated and verified 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 risk of loss based on miles driven (the second mandatory rating factor) is exactly the same between the three, regardless of the different methods of determining mileage.

As stated above, under Proposition 103, premiums must be based only on the three mandatory factors, and those optional rating factors which have been adopted by regulation and have a substantial relationship to risk of loss. (Ins. Code § 1861.02(a).)

Drivers who estimate or verify mileage and, in the end, still have the same mileage driven must be rated the same with respect to the mileage rating factor. Premiums cannot vary between the two and still comply with Proposition 103.

A discount for drivers who verify by agreeing to install a technological device in their car (as opposed to verifying with odometer readings or otherwise) would amount to the same thing. The setting of insurance premiums is a zero-sum game. Therefore, 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.<sup>2</sup>

In fact, under a program that provides discounts to drivers based solely upon whether they accept a technological device, it is likely that a device-user could drive more miles annually and still pay less than a motorist who cuts back and drives less miles but doesn't have a device.

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 . . ." Separate rating plans for estimated and verified mileage would be unfairly discriminatory, again because similarly situated drivers would pay different rates.

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<sup>2</sup> 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].

Were the Department to make a distinction between estimated and verified mileage, it could also offer insurers a new way to redline. What if the “verified” mileage program is marketed to avoid lower income communities? Or what if the verification is done through technology older cars cannot support (a known limitation of currently available mileage tracking devices)? Those drivers not in the right demographic, or driving the wrong car, would never have the opportunity to verify but would still pay different (almost certainly higher) rates.

This is not to say that incentives to lower mileage are necessarily unfairly discriminatory; they are not. It is the creation of two classes of insurance customers who are equal in all ways, except for a factor that is not an approved rating factor, that is the problem.

When companies begin implementing verification programs, drivers are likely to end up with a choice between companies with more or less aggressive mileage verification regimes. However, all policyholders with the same company must have the same verification requirements and options, and device-based tracking should always be optional, even if verification is not.

Finally, to the extent discounts or differential rating is contemplated, it is imperative that any such discounts are tied to actual mileage reduction, not simply to whether a consumer participates in a verification plan, or if the consumer accepts an insurer’s technological device in order to track her mileage.

### Verification Methods

The next question becomes which verification methods an insurance company may request from a motorist, versus those they may require.

We believe that insurance companies should be free to elect those verification methods they prefer. However, consumers must be offered a verification alternative to installing a technological tracking device in their cars.

Insurers should be able to require consumers to provide their odometer readings. These readings could be obtained by insurers in a variety of ways, for example:

- Insured self-reporting: To ensure accuracy, the Department could require insurance companies who verify through self-reporting to conduct a yearly audit of a specified percentage of a company’s policyholders. (Such a system could also help determine how accurate consumers are when they estimate.)
- Insurer verification: Policyholders could be required to check in with their agent for verification, or insurance companies could send a verifier to policyholders, such as a claims representative, underwriter, or independent contractor.
- Independent third-party verification. A system of third-party verification would allow consumers to drive to a mileage-check station and have their odometer

checked and their insurance company electronically notified of their mileage. These verification stations could be located at existing smog-check stations, the DMV, or some other location widely accessible statewide.

It is reasonable for an insurer to require policyholders to verify mileage in any of these ways. Of course, this workshop was initiated in part because some insurance companies wish to require drivers to verify mileage through technology or other methods. We have no problem with allowing insurers to offer the use of technology for consumers. However, as we also discuss above, requiring consumers to use technology raises serious concerns about fairness.

Some cars, typically the older models most likely to be driven by low-income motorists, are not compatible with the technology available. For example, the device currently used by Progressive in some states cannot be installed in cars built before 1996, and even in some later models. Technological devices also raise privacy concerns that we expand on below. Similarly, a requirement that motorists provide service records also raises fairness concerns: Some consumers may service their cars themselves and should not be required to produce records they will not otherwise obtain.

We believe that many consumers are likely to accept a technological device to verify mileage rather than send in their service records, drive to their agent's office or choose some other verification method. However, if a driver does not want to or cannot participate in the insurer's preferred verification method, he must be given a less-intrusive option.

Of course, methods of verification must be made clear to the insured before purchase of the policy.

#### Incentives to participate

The opportunity to save money by reducing mileage is the most obvious incentive for consumers to choose a PAYD insurance plan. This means that the number of mileage categories must be significant. A \$50 savings for reducing miles driven from 15,000 to 7,500 won't give consumers a good reason to participate. Knowing that you could shave off some premium by carpooling to work once a week would create a powerful incentive to cut back on driving.

Insurance companies also have a financial incentive to offer PAYD plans: premiums that are more closely tied to actual miles driven will allow insurance companies to more accurately price policies.

The environmental benefit of reducing mileage also provides an incentive for both consumers and insurance companies. "Green" branding has increasingly become a successful marketing tool. Business has responded to consumer desire to reduce their impact on the earth by offering products and services that are better for the environment, with a level of success that would have been unthinkable just ten years ago. Offering a

“green” insurance policy would give insurance companies a means to satisfy the public’s desire to buy a more earth-friendly product and save money at the same time.

To promote the environmental benefit of mileage-based premiums, the Department could create a “CDI Environmental Seal of Approval.” The Seal would be awarded to insurance companies whose policies meet the Department’s environmental standard. The Seal could come with the right to use a Department logo which insurance companies could display on the web and in advertising, and the Department could highlight the Green policies on its own web site.

The Seal would be awarded to those companies who aggressively apply the mileage factor, based on a model class plan created by the Department. The model should include maximum mileage rating categories: an insurance company must set mileage tiers at or below a specified width (perhaps 500 miles) in order to be eligible for the Green Seal. It should also include standards for the distribution of weight among the categories (within Proposition 103’s requirement that mileage is the second-most important factor) to ensure that rates change significantly as mileage is reduced.

The marketing opportunities in a “CDI Environmental Seal of Approval” should provide insurance companies great incentive to more closely tie rates to miles driven.

### Privacy

Some in the insurance industry have expressed interest in using technology to collect information other than mileage, including, speed, acceleration, braking rate and time of day that the car is used. At least one insurance company is already collecting similar data and using it to set premiums in other states.

Progressive Insurance Company has a program called “MyRate” in a few test-market states that offers a discount to drivers who install a device to collect information on their driving habits. Data collected includes “how aggressively you drive” (a phrase that is not defined) as well as time and mileage. At the end of the policy period, a driver receives an additional discount of up to 25% based on the information collected. In the Terms and Conditions of the program, Progressive assures participants that the information will not be used to make claims decisions without the driver’s permission, or to cancel a policy. However, the Terms and Conditions may be changed at any time at Progressive’s discretion.

The privacy ramifications of insurer access to data including acceleration and braking rates, average speed, time of day one is driving and the location of the car at all times must be considered. Will insurers look to avoid providing coverage to janitors who work the late shift, if the company decides (as Progressive has with “MyRate”) that their nighttime driving is riskier? Will an insurer invoke the black box recorder to deny a claim based on the fact that the driver had come to a screeching halt two other times in the past month?



A 2005 insurance industry study found that:

Drivers living within a mile of a church are the safest -- they're 10 percent less likely to crash than their fellow drivers . . . . Alternately, drivers residing within a mile of a restaurant are 30 percent more likely to be in an accident. [*Associated Press* 12/07/05]

Will insurers seek to alter auto premiums for customers based on where they are driving, after this bill places data collection devices in cars?


Even worse for privacy, a driver's location information might be subpoenaed from insurers in a criminal action or a civil trial, such as a rancorous divorce.

Of course, because such data is not currently included in the list of optional rating factors approved by the Department of Insurance under Proposition 103, a regulatory proceeding to consider new optional rating factors would have to be initiated if the insurance industry or the Department were interested in using such information to set rates in California.

If it is suggested that a California PAYD program allow the collection of information other than mileage, many additional privacy concerns must be addressed, including full disclosure of all information collected, requirements that the information not be shared with other entities, and limits on the length of time the information is kept.

California is in a unique position to successfully promote reduced driving, while protecting basic rights of privacy and preserving standards of fairness, because Proposition 103's voter mandate requires that miles driven is the number two factor for insurance rates.

Sincerely,

  
Carmen Balber