

## PROPOSITION 103'S IMPACT ON AUTO INSURANCE PREMIUMS IN CALIFORNIA 1998 ANNUAL REPORT

Proposition 103 was approved by California voters in November 1988 to address massive increases in the price of business, homeowner and auto liability insurance between 1985 and 1987 -- the so-called "insurance crisis," which rocked the state as well as the nation in the mid-1980s. Efforts in the state legislature to enact reforms in 1987 were blocked by the insurance lobby; insurers spent \$60 million in an unsuccessful effort to defeat the grassroots-based voter initiative.

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, including its 20% rollback.<sup>1</sup>

The following tables summarize insurance industry data drawn from the California Department of Insurance and from annual reports published by the National Association of Insurance Commissioners, *State Average Expenditures & Premiums for Personal Automobile Insurance in 1996* (January 1998). This is the most recent data available.

For national comparisons, the report utilizes NAIC data for the "average liability insurance premiums." This data is most relevant since the so-called 'insurance crisis' of the 1980's involved skyrocketing increases in the liability portion of premiums for homeowner, business as well as auto insurance. Furthermore, liability data exclude the data on collision and comprehensive coverage, which reflect changes in automobile ownership.

**Average auto liability premiums dropped 1.4% in California between 1989 and 1996.** Prior to Proposition 103, auto insurance premiums in California rose dramatically each year. (Premium volume rose 20% in 1985; 22% in 1986; 13% in 1987 and 13% in 1988, according to NAIC data). Pre-election rate increases by insurance companies in anticipation of Proposition 103's passage, and post-election rate increases taken while Proposition 103 was stayed pending California Supreme Court review, pushed the average liability premium in California to \$519.39 by 1989.

According to the new NAIC data, California's average auto liability insurance premium for 1996 was \$512.27 -- 1.4% less than the 1989 figure. Note that these figures are not adjusted for inflation. Adjustment for inflation would show an even greater real decline in California's average premium.

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<sup>1</sup> 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.

**Table 1. Comparison of Average Liability Premiums, 1989-1996**

	1989	1990	1991	1992	1993	1994	1995	1996
California	\$519.39	\$501.34	\$522.95	\$510.71	\$512.44	\$502.39	\$508.62	\$512.27

**Auto premiums fell in California while premiums throughout the rest of the nation increased 35.8%.** Another measure of the impact of Proposition 103 is a comparison with average liability premiums in other states. While liability premiums for the rest of the country grew 35.8% since 1989, California's dropped 1.4%. Tables 2 and 3 below compare California's average premium to national averages.

**Table 2. Comparison of Average Liability Premiums, 1989-1996**

Calculation is liability premiums/liability written car-years (total private passenger auto liability premiums written divided by the total number of policy-years)

	1989	1990	1991	1992	1993	1994	1995	1996
California	\$519.39	\$501.34	\$522.95	\$510.71	\$512.44	\$502.39	\$508.62	\$512.27
Rest of Nation	\$317.32	\$338.55	\$358.82	\$381.69	\$402.01	\$410.99	\$416.75	\$430.94

**Table 3. Comparison of Growth in Average Liability Premiums, 1989-1996**

Calculation is change in premiums/liability written car-years

	% Change 1989-90	% Change 1990-91	% Change 1991-92	% Change 1992-93	% Change 1993-94	% Change 1994-95	% Change 1995-96	% Change 1989-96
California	-3.5%	4.3%	-2.3%	0.3%	-2.0%	1.2%	0.7%	-1.4%
Rest of Nation	6.7%	6.0%	6.4%	5.3%	2.2%	1.4%	3.4%	35.8%

**California's average liability premium, though still high, dropped significantly after the passage and implementation of Proposition 103.** With its urban populations and extraordinary reliance on the automobile, California's average liability premium is still high, compared to the rest of the nation. However, since the passage of Proposition 103, California's rank relative to the nation has dropped. In 1989, California had the 2nd highest average auto liability premium in the nation. By 1992, the state had dropped to 8th highest. In 1996, California ranked 12th.

**\$1.18 billion in Proposition 103 refunds has been paid.** Insurance companies operating in California have issued more than \$1.18 billion in rate rollbacks to more than seven million Californian policyholders. Among those companies which have voluntarily complied with the rollback are ten major auto insurance companies. The state's largest insurer, State Farm, continues to challenge its rollback obligation.

**Rates are still excessive in California.** Despite a lengthy freeze on rate increases and over \$1 billion in refunds, the average profit of California insurers (for private passenger automobile insurance) was 19.3% return on net worth in 1996, 60% higher than the national

average.<sup>2</sup> What explains the higher profitability despite the rate stabilization and refunds mandated by 103? As predicted, Proposition 103 ended the "pass-through" mentality under which insurance companies used to operate. Confronted with 103's stringent rate regulation and rollback requirements, insurers have tightened their belts: cutting commissions, reducing expenses, fighting fraud, promoting loss prevention. The excessive profits insurance companies are earning in California prove that further reductions in existing rates are justified.

An analysis undertaken for the Project by consulting economist Birny Birnbaum reveals that if Proposition 103 were properly implemented by Insurance Commissioner Quackenbush, California motorists would see significant reductions in their auto liability insurance premiums. [From 1993 to 1996 Mr. Birnbaum was the Chief Economist and Associate Commissioner for Policy and Research at the Texas Department of Insurance]. The analysis further indicates that because the Commissioner has failed refusal to enforce guidelines to regulate excessive profits, California motorists have paid \$5.2 billion in excessive premiums for auto liability coverage alone during Quackenbush's first three years in office.

Table 4 below shows the percentage reduction in average yearly liability premium drivers would have seen if Proposition 103 were enforced to reduce insurance company profits to reasonable levels. Table 4a shows the amount of excessive premiums paid annually by California motorists due to the lack of enforcement of proper regulation governing excessive industry profits since Proposition 103 took effect in 1989.

**Table 4. Reductions in Average Liability Premiums if Proposition 103 Was Properly Implemented Yet Still Achieving a Reasonable Profit for Insurers, 1989-1996**

Calculation is based on allowing insurers a fair return of return consistent with Proposition 103 regulations

	% Change 1989	% Change 1990	% Change 1991	% Change 1992	% Change 1993	% Change 1994	% Change 1995	% Change 1996
California	0.0%	0.0%	-5.7%	-10.6%	-9.8%	-10.7%	-17.6%	-20.4%

**Table 4a. Amount of Excessive Premiums for Automobile Liability Insurance in California (rounded off, in \$thousands), 1989-1998**

1989	1990	1991	1992	1993	1994	1995	1996	1997	TOTAL
\$0	\$0	\$406,513	\$732,811	\$685,706	\$739,454	\$1,254,828	\$1,506,223	\$2,391,655	\$7,717,191

*Motorists have paid over \$5.2 billion in excessive premiums under Quackenbush.*

<sup>2</sup> Report on Profitability by Line by State in 1996, National Association of Insurance Commissioners, November 1997. Figure used is "return on net worth as a percentage of direct premiums earned." California's was 19.3%, the U.S. figure was 12.1%

The justified reductions show that California motorists have paid more than \$7.7 billion in excessive auto liability premiums alone since 1989 (\$5.2 billion under Quackenbush).

Table 5 below shows the actual average liability premium in California and what the average premium would have been in California had these reductions been mandated through regulation of excessive profits.

**Table 5. Average Liability Premium Compared to Premium if Excessive Profits Were Reduced As Required By Proposition 103, 1989-1996**

Calculation is premiums/liability written car-years

	1989	1990	1991	1992	1993	1994	1995	1996
Actual	\$519.39	\$501.34	\$522.95	\$510.71	\$512.44	\$502.39	\$508.62	\$512.27
Should Have Been	\$519.39	\$501.34	\$493.14	\$456.57	\$462.22	\$448.63	\$419.10	\$407.77

Finally, Table 6 below shows what California motorists are paying for liability insurance compared to the rest of the nation and what they would be paying if Commissioner Quackenbush properly implemented Proposition 103. The data shows that Commissioner Quackenbush's failure to enforce Proposition 103 is costing individual motorists over \$100 per year in automobile liability coverage, a total of \$5.2 billion during his first 3 years in office.

**Table 6. California's Average Liability Premium Compared to the Rest of the Nation and if Excessive Profits Were Reduced As Required By Proposition 103, 1989-1996**

Calculation is premiums/liability written car-years

	1989	1990	1991	1992	1993	1994	1995	1996
Rest of the Nation	\$317.32	\$338.55	\$358.82	\$381.69	\$402.01	\$410.99	\$416.75	\$430.94
<b>California Actual</b>	<b>\$519.39</b>	<b>\$501.34</b>	<b>\$522.95</b>	<b>\$510.71</b>	<b>\$512.44</b>	<b>\$502.39</b>	<b>\$508.62</b>	<b>\$512.27</b>
CA Should Be	\$519.39	\$501.34	\$493.14	\$456.57	\$462.22	\$448.63	\$419.10	\$407.77

Table 7 below shows the yearly growth in average automobile liability premiums for California, compared to the rest of the nation. Table 7a shows the savings motorists would have obtained if Commissioner Quackenbush properly enforced Proposition 103. Table 7b shows a comparative cumulative growth rate of average auto liability premiums between California and the rest of the nation.

**Table 7. Comparison of Growth in Average Liability Premiums, 1989-1996**

Calculation is change in premiums/liability written car-years

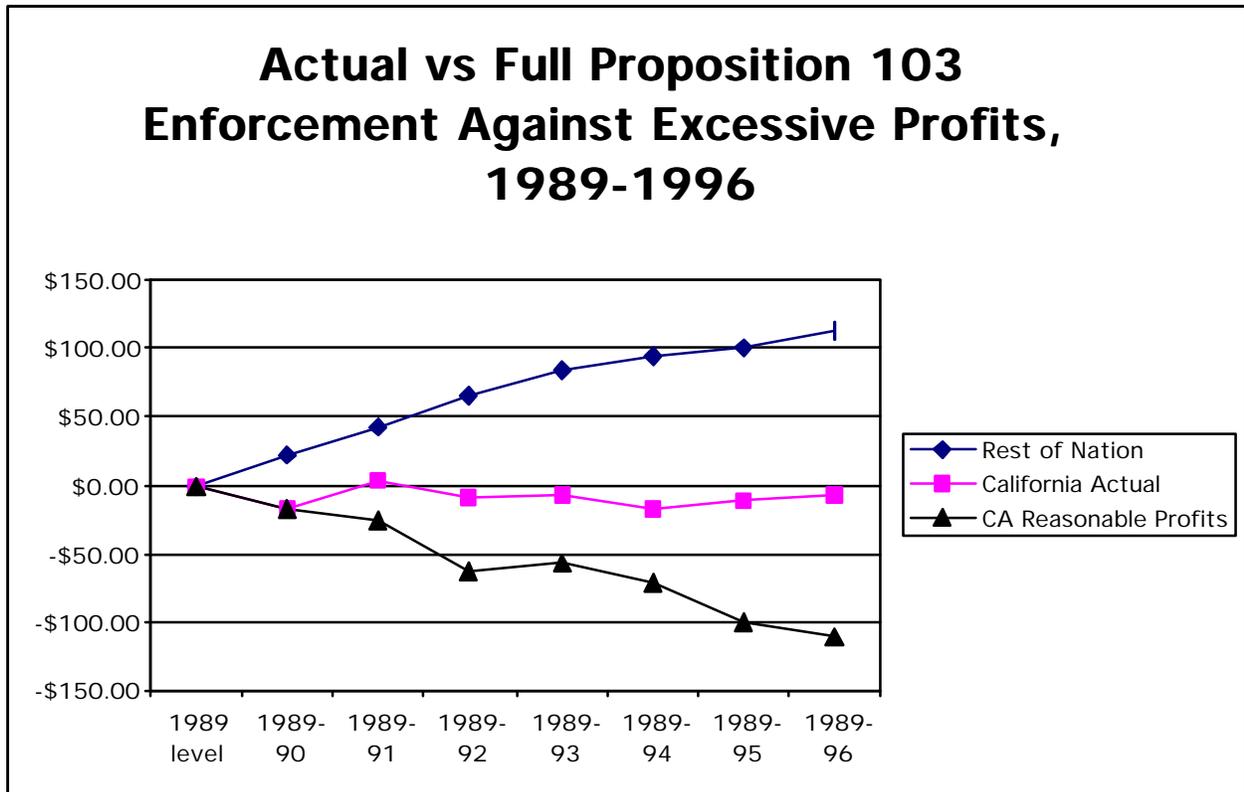
	% Change 1989-90	% Change 1990-91	% Change 1991-92	% Change 1992-93	% Change 1993-94	% Change 1994-95	% Change 1995-96	% Change 1989-96
Rest of Nation	6.7%	6.0%	6.4%	5.3%	2.2%	1.4%	3.4%	35.8%
<b>California Actual</b>	<b>-3.5%</b>	<b>4.3%</b>	<b>-2.3%</b>	<b>0.3%</b>	<b>-2.0%</b>	<b>1.2%</b>	<b>0.7%</b>	<b>-1.4%</b>

**Table 7a. Comparison of Cumulative Growth in Average Liability Premiums, 1989-1996**

Calculation is change in premiums/liability written car-years

	% Change 1989-96
Rest of Nation	35.8%
<b>California Actual</b>	<b>-1.4%</b>
CA Reasonable Profits	-21.5%

**Table 7b. Comparative Cumulative Growth in Average Liability Premium Between California Compared to the Rest of the Nation and if Excessive Profits Were Reduced As Required By Proposition 103, 1989-1996**



In 1996, for the first time since the passage of Proposition 103, the average auto insurance liability premium in California rose for the second consecutive year.

- Every year between 1990 and 1994, California has had one of the six slowest rates of auto liability insurance premium growth in the nation. By 1994, the last year of Commissioner Garamendi's term, California ranked 47th. In 1996, however, California zoomed back up to the 34th highest annual rate of growth in the nation.
- California's average liability premium in 1996 rose 0.7% from 1995 to \$512.27. Furthermore, compared to the 1994 average, California motorists spent nearly \$230 million more in premiums in 1995 and 1996 for auto liability alone.
- In 1996, California had the 12th highest average auto liability premium in the nation.

Pro-industry actions taken by Commissioner Quackenbush in his first three years in office have set California on the path toward higher premiums and stirred enormous controversy over Quackenbush's independence from the insurance industry. The industry has given the Commissioner over \$6.1 million in campaign contributions since 1994, constituting roughly 70% of his campaign contributions for the office and 92% of donations for his Prop. 213, the November 1996 ballot initiative which denies uninsured motorists, who are victims of reckless drivers, full compensation for their injuries. Many of Quackenbush's actions have led to lawsuits by consumer organizations seeking to order him to obey state laws.

- **Reduced 103 rollbacks.** Commissioner Quackenbush has negotiated controversial discounts in the refunds insurers are obligated to pay, with interest, now that the state and U.S. Supreme Courts have rejected all legal challenges. The Proposition 103 Enforcement Project tracked 80 Quackenbush administration settlements with insurance companies for which former Commissioner Garamendi had calculated estimated rollbacks as of May 9, 1993. The refund amount for these insurers under Commissioner Garamendi's original calculations totaled \$830,675,283 (not including interest). Quackenbush's more insurer-friendly calculations came out to a mere \$227,015,044 (not including interest), a markdown of 73.24%.<sup>3</sup>
- **One rate increase per day.** Commissioner Quackenbush lifted his predecessor's freeze on insurance rate increases and approved more than 1,099 rate increases in all lines of insurance between his inauguration and September 9, 1998, nearly one rate increase per day. Quackenbush has granted a total of 264 separate auto

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<sup>3</sup> *Summary of Rollback - Unsettled and Settled Companies*, California Department of Insurance, RSU, March 22, 1993; California Department of Insurance news release, November 22, 1994; Various stipulation and consent orders, California Department of Insurance; *Prop 103 Settlement Status Report*, California Department of Insurance Rate Specialist Bureau, June 13, 1996. The comparison is made *without* the interest calculations, which otherwise would skew the results

insurance rate increases during that period, 157 for private passenger auto and 107 for commercial lines (103 and 81, respectively, for auto liability alone).<sup>4</sup>

These increases have been approved in the absence of regulations that the insurance commissioner is required to institute to govern the prior approval process. Commissioner Quackenbush is presently considering insurance industry proposals to institute a regulatory formula which would in effect allow insurers free rein to charge excessive and discriminatory rates.

- **Unchecked profiteering.** Despite a lengthy freeze on rate increases and over \$1 billion in refunds, the average profit of California insurers for private passenger auto insurance is at least 60% higher than the national average. Proposition 103's pressure to eliminate waste, inefficiency and fraud has worked. However, the excessive profits insurance companies are earning in California prove that further reductions in existing rates are justified. Yet, Commissioner Quackenbush has refused to use his authority under Proposition 103 to order rate decreases.

In August 1996, Commissioner Quackenbush denied a petition and analysis filed by Consumers Union asking that he order insurers to reduce their rates due to excessive profits. The consumer group found that California motorists would see an average price cut of 7% if Quackenbush enforced profit-margin ceilings set under Proposition 103. Drivers would have saved \$800 million in 1995.

In February 1998, Commissioner Quackenbush quashed a study on excessive auto insurance rates and profits by a task force subcommittee he himself appointed. His decision to disband the study panel followed three years of wrangling over rate regulations. Nearing the end of his term, Quackenbush has yet to set standards for auto insurance rates and profits. The Commissioner appointed the Prior Approval Methodology Task Force with its Generic Factors Subcommittee in response to a Consumers Union request in 1996 that he complete rate regulations.

That subcommittee, in which the Project participated, was comprised mostly of insurance industry representatives and completed its hearings and preliminary work in July 1997. Its purpose was to evaluate the feasibility of using existing rate regulations promulgated under Proposition 103 to fulfill the Commissioner's legal duty to protect consumers from excessive rates. The subcommittee then directed Department of Insurance staff to complete a study by running those numbers through Proposition 103's regulatory formula to determine whether current profits were excessive. It is this study that Quackenbush has suppressed.

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<sup>4</sup> *Rate Filing Approvals*, California Department of Insurance, published bimonthly, through February 18, 1998.

Analysis of industry profits reveals that California motorists have paid \$5.2 billion in excessive auto liability premiums during Commissioner Quackenbush's first three years in office.

- **Good Driver/ZIP-code rating reforms evaded.** Commissioner Quackenbush has permitted the continuation of ZIP-code based rating, in violation of Proposition 103, with his approval of new auto insurance class plans that went into effect on October 1, 1997. Insurers were mandated to file the plans, in order to implement a long-awaited provision of Proposition 103 that requires insurance companies to base auto insurance rates primarily upon an insured's driving safety record rather than where he or she lives. However, Quackenbush has allowed insurance companies to evade his regulations through statistical manipulation.

The Project challenged the class plans in Department of Insurance hearings in the Fall of 1997. In a highly irregular and questionable action, Quackenbush hand-picked one of his own deputy commissioners to preside as the Administrative Law Judge (ALJ) on the case. This contrasts with the Department's customary practice of deferring the assignment of an ALJ to the Administrative Law Bureau. On January 30, 1998, the Commissioner accepted the ruling of the ALJ which rejected consumer groups' challenges to the plans. The Project, joined by several other consumer and civil rights organizations and the cities of Los Angeles, Oakland and San Francisco, filed suit against Quackenbush. In June 1998, a Superior Court judge found that the Commissioner's regulations were illegal and ordered him to issue new regulations that comply with Proposition 103. Instead, Quackenbush is joining insurers in appealing the decision.

- **Unlawful surcharges against good drivers authorized.** Prior to a February 18, 1997 deadline for the filing of the new auto rating class plans, and in violation of a specific provision of Proposition 103, Quackenbush approved rating plans allowing insurers to impose surcharges on drivers previously uninsured. Commissioner Quackenbush took this action in spite of requests by consumer groups who challenged the validity of such approvals. In December 1996, a San Francisco Superior Court judge issued an oral ruling that the use of such factors was illegal in the absence of approval by regulation. In February 1997, the judge ordered Quackenbush to notify insurers to end the use of such illegal factors, but the Commissioner has told insurers only to eliminate such surcharges from the new rating plans; he has refused to direct insurers to remove the surcharge in existing policies. Furthermore, Quackenbush pledged last year that he would not approve any new auto insurance class plan that contained the surcharges.<sup>5</sup> In violation of his own pledge, he has allowed such class plans to take effect. For example, Allstate's class plan slaps a nearly 100% surcharge on motorists, even if they are good-drivers, simply because they did not or could not afford insurance in the past.

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<sup>5</sup> Department of Insurance news release, February 12, 1997. The release stated: "As Commissioner, I do not want uninsured motorists who could not afford auto insurance in the past to be surcharged." The release also said that Quackenbush "would not approve any rate plans that added a surcharge to previously uninsured motorists."

**Note on the NAIC data:** Last year, the Proposition 103 Enforcement Project discovered that some California premium data for 1995 was missing from the NAIC report. The NAIC was not aware of the problem until it was contacted by the Project. NAIC officials confirmed this discovery and told us that Commissioner Quackenbush's Department of Insurance had failed to provide the NAIC with complete data. When we presented the data to the press and news media, we informed reporters of this. Quackenbush decided he would attempt to impugn the Project's credibility by claiming the Project was putting out false and misleading numbers, claiming insurance rates were falling and faxed around a letter addressed to him from the NAIC. The letter was dated the very day the Project sent out a news advisory announcing a telephone conference call for reporters and was intended to provide Quackenbush an excuse for numbers he claimed were false. In the letter, the NAIC repudiated its own report, saying the numbers were incorrect. This year's report by the Project updates those numbers supposedly "corrected" by the NAIC, numbers which still show an increase, although smaller, in the average premiums during Quackenbush's first year in office (1995). The revisions this year by NAIC also changed California's 1993 average liability premium to \$512.44. This change would indicate that premiums rose slightly (.3%) in 1993 under former Commissioner Garamendi, whose record Quackenbush likes to malign. Ironically, this year's NAIC report has a caveat at the end: "The 1996 California auto insurance premium data found within this report is preliminary. The California Department of Insurance performs a rigorous set of tests on the data each year to ensure the data's accuracy. At the publication date of this report, the California Department of Insurance had not yet completed the comprehensive data review."

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