Consumer Federation of America

WHY NOT THE BEST?

THE MOST EFFECTIVE AUTO INSURANCE REGULATION IN THE NATION

By J. Robert Hunter,
Director of Insurance

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EXECUTIVE SUMMARY

Responding to the recommendation of the insurance industry, the National Association of Insurance Commissioners (NAIC) has begun considering proposals to deregulate automobile and homeowner insurance across the nation. To support the campaign for deregulation, a spate of reports generated by industry-sponsored academics have sought to discredit regulation generally as anti-consumer and to offer economic arguments for deregulation.

To provide an objective analysis, the Consumer Federation of America researched the results of regulation over the last decade in the 50 states. We focused on auto insurance since it represents 79% of the personal lines premium volume currently and because the other large volume personal line, the homeowners' line of insurance, has been troubled with huge hurricane losses which distorts results over the time period studied.

Regulatory Standards

We sought to find the state that best accomplished what we see as the standards for excellence in regulation:

- Make regulation easily understood by, responsive to, accountable to and inspire confidence from the public and regulated entities.
- Promote beneficial competition towards the end of fair profits for regulated entities and fair treatment of consumers.
- Address the problems with selection competition[2] and make public policy the primary determinant of risk classification schemes.
- Provide for public involvement in the regulatory process, including institutionalized consumer participation in review of forms, manuals and rates.
- Provide the regulator, regulated entities and the public with the tools to identify market problems and harmful competition.

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[1] Mr. Hunter has served as Federal Insurance Administrator under Presidents Ford and Carter and as Texas Insurance Commissioner under Governor Ann Richards.

[2] Commissioner Benjamin R. Schenck of New York said of selection competition, " In insurance there is one form of competition that seldom exists in other products or services. That is selection competition – the ability of an insurer to affect its success, not by the price or quality of its products, but by selecting its customers in a fashion that will give it an advantage over its rivals…Selection competition should have few admirers. It is capable of denying to some people the opportunity to buy insurance at all in a day when many forms of insurance have become legal and practical necessities." Convention of Casualty and Surety Agents, White Sulfur Springs, West Virginia, October 9, 1972.

- Prevent harmful products from coming to market, deter regulated entities from unfair and harmful practices, stop harmful practices from continuing and provide restitution to consumers injured by harmful and unfair practices of regulated entities.
- Promote loss prevention and loss mitigation as the most important way for insurers to manage exposure.
- Promote uniformity among the states at the highest levels of consumer service and protection and utilize the tools of the NAIC to help every state insurance department match the skills and resources of large insurers operating in many states – i.e., a regulatory system that prevents regulatory arbitrage by insurers.

Proposition 103 Bests Meets the Standards

One state stands out as having the "best practices" [3]in the nation: California, under the remarkably effective provisions of Proposition 103, the insurance reform initiative approved by California voters in 1988.

Under Proposition 103's rate rollback requirement, refunds totaling $1.3 billion[4] were paid to consumers. But that pales in significance when considering the lasting impacts on premiums that Proposition 103 achieved. Consider the following table of personal automobile insurance rate changes over the period since the passage of the Proposition in 1988 and implementation in 1989 after the first wave of legal challenges and stays in the implementation of the Proposition were overcome[5]:

AVERAGE AUTO INSURANCE PREMIUMS PER POLICYHOLDER

TABLE 1

Average Expenditure	1989 Premium	1989 Rank	1998 Premium	1998 Rank	89-98 % Change
California	$747.97	3	$717.98	20	-4.0%
Countrywide	$551.95	NA	$704.32	NA	+27.6%
Total Premium					
California	$875.60	3	$823.10	17	-6.0%
Countrywide	$635.58	NA	$797.23	NA	+25.4%
Liability Premium					
California	$519.39	2	$452.23	18	-13.0%
Countrywide	$339.82	NA	$426.21	NA	+25.4%
Collision Premium					

[3] Those factors that produced the best results for consumers and good results for insurers as well.

[4] California Department of Insurance website, visited May 19, 2001.

[5] State Average Expenditures & Premiums for Personal Auto Insurance, NAIC, 1993 and 1998 Editions. Expenditure equals total written premium divided by total written number of cars insured. It measures what consumers actually spent for insurance per insured vehicle. Total premium, on the other hand, is the sum of the premiums for liability, collision and comprehensive and represents what a driver buying all coverages would spend on average.

California	$235.53	9	$249.97	16	+6.1%
Countrywide	$197.33	NA	$245.28	NA	+24.2%

Comprehensive Premium

California	$120.68	9	$120.90	25	+0.2%
Countrywide	$98.44	NA	$125.74	NA	+27.7%

During the decade after Proposition 103 was adopted by the people of California, rates went down in California by 4.0% while nationally, rates were rising by over 25%. California has enjoyed the lowest rate change of any state in the nation since the adoption of Proposition 103.[6]

What is it about Proposition 103 that is so remarkable? It meets all of our standards as shown in this report. Thus unlike the watered down version of deregulation already pushed into place in some states and advocated before the NAIC for national implementation by the insurers, Proposition 103 incorporates fully all of the necessary changes to accomplish real, full competition (imposed antitrust law on the industry, allowed banks to sell insurance well before the nation did, allowed group sales well before other states did, allowed agent competition through rebating, etc.).

Further, unlike half hearted regulatory efforts in most prior approval states, Proposition 103 incorporates full regulatory oversight to assure that competition is effective and sufficient to do the job. California regulations are the state-of-the-art regulations in the nation –far and away the best[7]. They lay out for all to see exactly what is expected. They disallow excessive costs (such as excessive expenses, fines, bad-faith lawsuit costs, excessive executive salary costs, etc.). They test insurer assumptions with state standards. The required data elements assist insurers to obtain information on competitors, which improves their competitive situation.

Very key to the reduced costs resulting from Proposition 103 are the strong incentives for driver safety built into the initiative. "Clean" drivers get a 20% discount. They also have the right to buy insurance from the company of their choice through Proposition 103's "Good Driver Protections."

Proposition 103 was a shot across the bow of the insurance industry. Prior to 103, the industry saw itself as a "pass-through" operation. Indeed, there was a perverse incentive in the ratemaking methods employed by the industry –so long as costs rose within their projections (called "trend"), their profit rose (since the ratemaking method loaded profit as a percent of costs). This "cost-plus-percentage-of-cost" operating style was achievable because full competition was not present. Many insurers used the same trends and tried

[6] See spreadsheet, "Personal Auto Expenditure Ranked by Least to Most Change in the 1989 to 1998 Period," in Appendix 4.

[7] Although the California Commissioner has never adopted the final prior approval regulations, the excellent rollback regulations continue to be used to guide rate approvals or challenges.

to achieve them. Fraud was not fought aggressively. Safety was not a paramount concern of the industry.

Proposition 103 changed all that. Not only did the industry react in California but, fearing a national spread of the Proposition's provisions including a 20% rollback of rates, insurers undertook to stop passing through excessive and unjustified costs across the nation. They ended rate bureau final rate agreements (although they maintained joint trending outside of California). They joined with consumer groups to form the Coalition Against Insurance Fraud and the Advocates for Highway Safety. (To be sure, insurance companies and their trade associations also filed more than eighty lawsuits and used other means to forestall 103's implementation for as long as possible, both to delay the application of the Proposition and to confuse other states into believing that Proposition 103 was not working.)

In addition to premium savings, there are many other real consumer benefits from the passage of Proposition 103, including the fairness requirements, such as regulation of rating factors; greater disclosure and transparency, such as availability of detailed loss data by Zip Code to determine if redlining is present and public scrutiny of filings (including procedures for reimbursing consumer groups that make a "substantial contribution"); and accountability through consumer participation in the process.

Proposition 103 can also be considered a success when measured by the insurance industry's own favorite yardsticks (low residual market, many companies in the market and reasonable profits).

Insurers claim a key test of the effectiveness of Proposition 103 is the size of the personal auto residual market[8]. They claim that regulation keeps prices too low, which forces companies not to write consumers[9]. While we do not agree that a simple look at the residual market size proves much unless coupled with a review of the size of the non-standard and uninsured markets, this test of the insurers is passed by Proposition 103 with flying colors. In 1989, 8.4% of the insureds in California were in the California Automobile Assigned Risk Plan (CAARP). In 1999, the percentage had fallen to 0.3%. The national drop from 1989 to 1998 was 7.1% to 2.1%[10]. This represents an astounding drop in the California Assigned Risk Plan of 96%. The number of uninsured motorist

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[8] A "residual market" is a mechanism for insuring those persons that the normal ("voluntary") market will not cover. The most usual mechanism is the assigned risk plan, where a person not able to get normal insurance applies for coverage and is randomly sent to an insurance company. The share of the normal market is the basis for the number of assignments a company receives. California uses this mechanism, as do most states. Other mechanisms include Joint Underwriting Associations (where all insurance companies share the risk of a pooled policy), State Funds and Reinsurance Facilities. In this latter system, the consumer can go to the company of his/her choice and the insurer must write the account. The company is free to cede (send) the risk to a pool that reinsures the risk but the privity of contract remains with the insurer, just as in the normal market. Strictly speaking, this facility approach is not "residual" since insurers have incentives to cede more than poor risks to the facility.

[9] But insurers also claim that regulation does not lower profit to insurers.

[10] AIPSO Facts 2000/2001, AIPSO. Some of the drop may be due to the sharp increase in CAARP rates during the period, but to the extent that's so, you would expect the uninsured motorist population to rise, which it did not.

claims in California in 1989 was 23.2%. That dropped to 14.2% in 1997, the latest year reported by the Insurance Research Counsel. This represents a drop of 38% in the uninsured population over the time period. The national figures were 16.3% in 1989, 13.2% in 1997, for a drop of 19%[11]. Once again California passes the test. We were unable to find data on the non-standard market shares in California and nationwide.

Insurers also look at market entry/exit as a test of the quality of a state's market. Again, we do not think this is a particularly valid measure. Many entrants into a state may mean that high-cost, so-called "non-standard" insurers are entering the market because regulation of excessive charges is too soft. This is not a pro-consumer event. South Carolina is a recent example where there has been much entry of high cost insurers, running mates of insurers already entered in the state, with adverse consumer results. But, again, Proposition 103 passes this insurer test. There was entry and exit consistent with "a competitive industry" according to academic analyses[12] of post-Proposition 103 California. A few companies left the state but the number of insurer groups competing in the state increased.

Insurer Profit. The excellent results for consumers in the Proposition 103 environment did not come at the expense of insurers. Insurers enjoyed profits in California auto insurance that were considerably higher than they had in the nation, viz.:

CALIFORNIA AND NATIONAL AUTO INSURER PROFITS

TABLE 2

	90/99Return on Net Worth	
	California	Countrywide
Personal Auto Liability	15.40%	8.80%
Personal Auto Physical Damage	18.70%	17.20%
Personal Auto Total	16.00%	10.90%
Homeowners	-0.90%	-3.80%

All this progress occurred despite aggressive litigation by insurers, and despite six years (1994 – 2000) of a disgraced commissioner whose refusal to enforce the Proposition fully and his insurer favoritism ultimately resulted in federal and state law enforcement investigations, and his forced resignation.

Conclusion

As the following report demonstrates, Proposition 103 has been an astounding success from both a consumer and an industry perspective. As the National Association of

[11] Uninsured Motorists, Insurance Research Council, 2000 Edition.
[12] The Regulation of Automobile Insurance in California, Jaffee and Russell, 2001.

Insurance Commissioners (NAIC) considers the future of personal lines regulation, they should look at California's astounding successes under Proposition 103.

The provisions of Proposition 103 offer the best model in the nation for the NAIC to follow in reinventing regulation. The question consumers raise to the nation's commissioners is this: Why not the best? Instead of running headlong toward deregulation under slogans such as "competition is good," we call upon the NAIC to adopt our standards for a quality regulatory system. Based upon these standards, the California system – Proposition 103 – is clearly the model for the nation to emulate. Consumer protection requires thoughtful, efficient and effective regulation. Mindless deregulation of the current flawed systems would represent an abdication of state insurance regulators' responsibility to consumers.

Outline of Report

In the report, we lay out the standards by which we measure the regulatory system. We show why Proposition 103 best meets these standards.

We show the provisions of the Proposition and a history of the industry efforts to undermine its effectiveness. We then review the successes and failures of Proposition 103.

We then respond to the arguments made by the insurance companies and academics regarding what they see as blemishes (they can not bring themselves to seriously challenge the effectiveness of the Proposition, which they reluctantly acknowledge) on the Proposition's stellar reputation.

In Appendix 2 we compare the Provisions of California law to the principles of consumer protection laid out in "Reinventing State Insurance Regulation for the Benefit of Consumers – A Time for Change." This paper was presented to the NAIC in September of 2000 and outlines why consumer protections must be strengthened as we enter the 21st Century.

INTRODUCTION

This report was prompted by the National Association of Insurance Commissioners (NAIC) decision at their spring meeting of 2001 to consider deregulation of personal lines of property/casualty insurance.

In late1999, Congress passed the Gramm-Leach-Bliley Act (GLBA). This allowed banks to sell insurance products. In February 2000, The American Council of Life Insurers (ACLI) voted to look into a federal role in insurance out of fear that the banks could get products similar to those being sold by the life insurers approved at a single point and quickly.

The ACLI vote prompted the NAIC into jettisoning its agenda for the Spring 2000 Meeting and instead beginning work on a Statement of Intent, which was to guide the organization through 2000 as it reinvented insurance regulation.[13]

The Statement of Intent called consumer protection their "primary goal." But that was not the real goal – the real goal was to discouraging insurance companies from favoring a federal approach.

In 2000, NAIC created committees whose names belied the idea that consumer protection was the prime goal. They had a committee for "National Treatment of Companies" but none for "National Treatment of Consumers." They had a "Speed to Market" committee to help companies get products, even anti-consumer products, into the market, but no committee to speed information or other needed assistance to consumers.[14]

Seeing this trend, in September 2000, the consumer community united to present to the NAIC its white paper, Reinventing State Insurance Regulation for the Benefit of Consumers –A Time for Change. In it, eight major principles were set forth, consisting of over 70 sub-principles.

With the exception of the privacy area, the NAIC either ignored rejected or put off consideration of almost all of these principles until after the industry-sought changes are implemented. Thus the NAIC refused to improve data to access market performance, offered no new information to consumers, suggested commercial lines deregulation without applying antitrust law, and so on. This greatly exposes consumers, particularly small commercial consumers, to risk of abusive insurer practices.

At the same time that consumer concerns were stalled or rejected, the NAIC asked states to adopt memos of understanding, or even use administrative ways around their state laws, to implement areas of eased oversight that the insurance companies sought.

The NAIC told consumer groups that we should not worry about the lessening of "front-end" regulation because they intended to strengthen "back-end" market conduct review. But, while the Speed to Market Committees met more often than weekly to finish their work on deregulating commercial lines of insurance, between the September and December meetings of the NAIC, the Market Conduct Committee never met at all.

When it finally met at the December 2000 NAIC meeting, the Market Conduct Committee did not propose strengthened market conduct review but debated self-certification methods where the companies would review themselves. Not only that,

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[13] The NAIC feared the ACLI's movement to favoring a federal role caused the movement for a federal role to have a critical mass since the American Insurance Association (AIA) and the American Bankers Association Insurance Association (ABAIA) already were on record favoring such a move.

[14] In 2001, the NAIC reacted to our continued criticism of this process and created a consumer committee to look at some of our issues. There has been no action by that committee yet.

most of the discussion centered on ways to achieve "privilege" for such self-certifications so that they would never become public, even in discovery in the event of a lawsuit.[15]

Consumer representatives who attended the weekly meetings of the Speed to Market committees between September and December 2000 observed firsthand the bias toward the insurance industry and against the consumer in each substantive proposal and in implementation of the proposals. Whatever the consumers wanted was either rejected without comment in executive session or put off for possible study in 2001/2 whereas the vast majority of what the insurance companies wanted was adopted and to be fully implemented by June 2001.

Emboldened by the remarkable progress in gutting consumer protections they made in 2000, the industry spoke at the spring 2001 NAIC meeting and told the commissioners that their ambitious effort to gut regulation was too little and too late[16]. They demanded faster action and deeper cuts in consumer protections, particularly in personal lines[17]. The commissioners offered no objection to these threats. In fact, they adopted a proposal to start studying personal lines, contrary to their earlier assurances to consumer leaders, which leads to this report.

METHODOLOGY

The proposals to deregulate personal lines of property/casualty insurance prompted CFA to look at the various models to see which state has had experienced the lowest price increase. Although personal lines include auto and home insurance predominantly, we decided to review auto because of the unusual impact of catastrophes over the last decade on homeowners' insurance pricing. Personal auto also represents the vast majority of personal lines premium, representing 79% of the personal lines premium volume in the nation.[18]

We sought to find the state that best accomplished a series of tests we used as standards for excellence in regulation:

- Make regulation easily understood by, responsive to, accountable to and inspire confidence from the public and regulated entities.
- Promote beneficial competition towards the end of fair profits for regulated entities and fair treatment of consumers.

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[15] In 2001, the NAIC Market Conduct Committee has begun what appears to be a more serious look at the process, but no actions have been taken yet.

[16] Industry contacts have confirmed that many of the insurance companies that don't want a federal bill do want to push the NAIC with the threat of a bill – thus the continued silence of much of the industry about federal proposals is understandable.

[17] The industry representatives, speaking at the Industry Liaison Committee meeting in Nashville, told them that they wanted to see not just proposals for state action on commercial deregulation but actual implementation of the proposals; they asked for immediate action on deregulation of personal lines; they accused the NAIC and the states of moving too slowly and losing insurer support daily. They threatened the NAIC with the federal option. NAIC's reaction was to ask for more time and promise to do better.

[18] Aggregates and Averages, A. M. Best, 2000 Edition, Page 286.

- Address the problems with selection competition[19] and make public policy the primary determinant of risk classification schemes.
- Provide for public involvement in the regulatory process, including institutionalized consumer participation in review of forms, manuals and rates.
- Provide the regulator, regulated entities and the public with the tools to identify market problems and harmful competition.
- Prevent harmful products from coming to market, deter regulated entities from unfair and harmful practices, stop harmful practices from continuing and provide restitution to consumers injured by harmful and unfair practices of regulated entities.
- Promote loss prevention and loss mitigation as the most important way for insurers to manage exposure.
- Promote uniformity among the states at the highest levels of consumer service and protection and that utilizes the tools of the NAIC to help every state insurance department match the skills and resources of large insurers operating in many states – i.e., a regulatory system that prevents regulatory arbitrage by insurers.

Once we determined which state had the best laws on the books, we looked at insurance cost and other information to test if these laws served the public interest well, as we anticipated they would. We then searched the literature for recent critiques of the state we determined was best and prepared our analysis of those reports.

KEY FINDINGS

By any measure, for all of the detailed reasons spelled out below, consumers find that Proposition 103 in California represents far and away the best practices for regulation in the nation. We call upon the NAIC to adopt Proposition 103 as the model for regulating personal lines of insurance throughout the nation.

The provisions of Proposition 103 meet each of our above-enunciated standards well. While we discuss these provisions in some detail below, in short we see that:

- It promoted competition through a series of changes that are necessary to accomplish full competition. Proposition 103 eliminated the state antitrust exemption, it allowed banks to sell insurance, it allowed groups to form that were previously prohibited, it enabled agents to rebate part of their commission and compete with other agents in that way, and it vastly improved consumer information.
- While empowering real competitive forces, Proposition 103 stopped competition that would have adverse influences on the public. For example, it

[19] Commissioner Benjamin R. Schenck of New York said of selection competition, " In insurance there is one form of competition that seldom exists in other products or services. That is selection competition – the ability of an insurer to affect its success, not by the price or quality of its products, but by selecting its customers in a fashion that will give it an advantage over its rivals…Selection competition should have few admirers. It is capable of denying to some people the opportunity to buy insurance at all in a day when many forms of insurance have become legal and practical necessities." Convention of Casualty and Surety Agents, White Sulfur Springs, West Virginia, October 9, 1972.

outlawed selection competition through its good driver protections and it imposed fairness standards on the classification system.

- It promoted efficiency not only through enhanced competition, but also through regulatory rejection of excess expenses such as fines, excessive salaries, bad-faith lawsuit costs, etc.
- It promoted safety through its classification plan giving most weight to driving record, the mandatory 20% discount for good drivers and the benefits of good driver protection for good drivers.
- It resulted in the adoption of the best, most complete regulatory system for prior approving rates and forms in the nation.
- It opened the books of the insurance companies to public scrutiny. It made significantly more information available to consumers.
- It allowed for consumer intervention in the regulatory process. It allows as well for funding for such intervention if the consumer makes a "substantial contribution" to the case.
- It made data on markets, such as ZIP Code data, available to the public and regulators for their review of how well insurers serve all of the markets of the state.

These provisions of the law have produced outstanding results such as lower prices, fewer assigned risks, fewer uninsured motorists, safer driving, lower insurer expenses and reasonable (some would say excessive) profits for insurance companies.

BACKGROUND OF PROPOSITION 103

On November 8, 1988, the people of California adopted an insurance reform initiative, Proposition 103 (attached, Appendix 1) by a narrow 51% to 49% margin. This was a remarkable victory by consumers, especially considering that the insurance industry spent $63.8 million opposing reform, while the grassroots campaign for Proposition 103, led by consumer advocates, spent only $2.9 million, less than 5% as much.

I. Proposition 103's Key Elements

Proposition 103 enacted a series of measures designed to reform the insurance marketplace and industry practices and to provide far greater protections to policyholders. The key elements were:

1. Immediate rate relief to offset excessive rate increases in business, auto and other lines of insurance.

2. Reforms to encourage competition in the insurance marketplace.

3. Rate regulation to limit rate instability and unjust premiums, and to focus the industry on efficiency and loss prevention.

4. Provisions to promote fairness and eliminate unjust and discriminatory practices.

5. Provisions to encourage public participation and accountability in insurance matters.

1. Short Term Premium Relief. The Insurance Rate Freeze & Rollback

Proposition 103 reduced all automobile, homeowner, business and most other property-casualty insurance rates and premiums to the levels in effect on November 8, 1987, then required that they be reduced a further 20%. During the period of the freeze/rollback (November 8, 1988 through November 8, 1989), insurers were to be prohibited from raising rates or premiums. However, the initiative was drafted to allow an insurer to obtain increases from the Insurance Commissioner, if the freeze "substantially threatened" the company's solvency.

The rollback and reduction were intended to:

(1) Protect consumers by offsetting possible rate increases during the campaign year prior to the election.

(2) Establish a lower baseline premium from which rate increase requests would be reviewed under the prior approval system. In effect, the rollback reduced rates, which had reached excessive levels because of the absence of either regulation or effective competition.

(3) Ease the transition to the new system established by 103 by providing the Insurance Commissioner with a full year from election day to develop the regulations needed to implement the prior approval system.

The California Supreme Court upheld the rollback against a constitutional challenge by insurers, but ruled that the test for exemptions -- "substantially threatened with insolvency" -- violated the insurers' constitutional rights. The Court provided a different standard (See discussion of 'The CalFarm Case," below).

2. Enhanced Beneficial Competition

Prior to the passage of 103, insurance companies were exempted by state law from California's consumer protection statutes. These exemptions artificially blocked competition in the insurance marketplace, resulting in higher than required insurance rates.

• **Antitrust Exemption.** Proposition 103 repealed the insurance industry's exemption from the state's antitrust laws. In 1945 the insurance industry had won an exemption from California's antitrust laws; similar exemptions remain on the books federally and in almost every other state (Texas and New Jersey reduced their exemptions in the wake of Proposition 103). As a result, insurer-operated "rating bureaus" were permitted to distribute proposed pricing data, including projected losses, expenses, profits and

overhead charges, among carriers. The prices always were based on the least efficient members of the cartel.

In addition to repealing the exemption, Proposition 103 prohibited the operation of "rating" and "advisory" organizations. Proposition 103 does allow insurers to exchange historical claims data. This permits insurers -- particularly new or small carriers -- to obtain information that will enable them to develop their own projections and prices. Such information must also be provided to the Insurance Commissioner and to the public. Additionally, Proposition 103 permits insurers to participate in joint pooling arrangements established by the Insurance Commissioner or by law which assures access to insurance for certain customers, such as day care centers, automobile drivers, etc.

• **Discounting Agents' Commissions.** Proposition 103 repealed the statutory prohibition against competition among insurance agents and brokers known as the "anti-rebate law." Every other state (except Florida) had a similar law. Under the "anti-rebate law," agents and brokers were prohibited from reducing their own commissions in order to offer consumers a discounted premium (in the same way that "Fair Trade" laws had prohibited retail competition on products decades earlier). Those who violated the law were subject to penalties and loss of license. Consumers paid higher prices because of the anti-rebate laws. Moreover, such laws reward the inefficiency of some agents because they are shielded from competition by agents who are willing to cut price in an attempt to gain market share.

• **Bank Sales of Insurance.** Proposition 103 repealed the statutory prohibition on the sale of insurance by financial institutions. The ban on bank sales of insurance limited the number of providers in the market and thus reduced price competition[20].

• **Expanded Group Insurance.** Prior to Proposition 103, state laws deprived consumers of the ability to join together to negotiate discounted insurance plans. Proposition 103 expands the definition of acceptable groups in order to permit consumers to unite to negotiate the policies and coverage they need, using their joint bargaining power in the marketplace just as large businesses do.

• **Enhanced Transparency: Consumer Comparison Shopping Service.** A chief tenet of insurance reform is full disclosure of information. A consumer must be well informed on price, service and solvency if the marketplace is to operate efficiently. While the insurers' statutory exemptions permitted them to exchange information with each other, consumers in the past had had little access to data that would enable them to effectively shop for insurance. Proposition 103 requires the California Commissioner to provide consumers with a current rate comparison survey for all personal lines of insurance. Consumers are to be charged a modest fee to cover the costs of this system.

3. Increased Effective and Efficient Regulation

[20] Congress allowed bank sales nationally under legislation adopted in 1999 (i.e., the Gramm-Leach-Blialy Act).

Prior to Proposition 103, California had no meaningful regulation of insurance rates; there was no requirement that rates be filed with the Commissioner, much less reviewed or justified. Imagine the situation: Through antitrust exemption, insurers could jointly price, but the commissioner could not regulate (or even know about) this joint action. This was a prescription for the pricing abuse and inefficiency that occurred.

As a result, insurers could pass through all costs to consumers. They explained that their rates were "mirrors of society" and they passed through nearly every penny, plus a percentage profit factor. This cost-plus-percentage-of-cost approach gave insurers a perverse incentive; the larger the costs, the bigger the dollars of profit the percentage add-on would produce.

Imagine yourself on the board of directors of a stock insurance company when your actuary appears to present next year's rate analysis:

"We could go along as usual, increasing prices ten percent based on past cost increases and allow the costs to meet that expectation or we could hold the line or even reduce rates if we take on our agents by establishing more reasonable commissions, lay off our excess layers of middle management, fight GM to produce safer cars, lobby for safer roads and fight fraud more extensively. For our trouble, all this excess work will hold our profit flat rather than the 10% profit increase we can enjoy if we do nothing to hold the line."

How would you vote?

Proposition 103 mandates that insurance companies open their books and justify rate increases (or decreases). The Insurance Commissioner must approve proposed rate changes after a process in which the public may participate.

The "Prior approval" regulatory system established by Proposition 103 promotes insurer efficiency and loss prevention by ending the insurers' ability to unilaterally pass-through all expenses and claims costs, accompanied by that percentage of cost markup for profit, overhead and expense costs. Instead, Proposition 103 established a system that gives extra rewards for efficient performance so that Proposition 103, for the first time, provides insurers with an incentive to eliminate waste, cut unneeded expenses, weed out fraud and engage in loss prevention practices.

4. Enhanced Fairness

Excessive premiums were but one of the complaints which motivated the call for reform in California. Many motorists opposed the insurers' risk classification systems, which categorized policyholders by geography or even on such non-risk related criteria as whether they had prior insurance in order to determine the basic premiums each policyholder would pay.

Insurers allocate risk among policyholders by grouping each consumer into a pool composed of individuals with similar characteristics. Insurers traditionally set base premiums by giving first and primary emphasis to territories -- clusters of zip codes -- in a model known as "territorial rating." The unfairness of this approach is obvious: within any particular zip code -- urban or rural -- there are many drivers who have never had an accident at all. Yet their rates constantly increase -- because under the territorial rating system, the vast majority of good drivers are forced to subsidize the rates of a few bad drivers located in the same zip code. The same unfairness relates to use of age, gender and marital status as classifiers. Rather than using the individual's driving record for pricing, the insurers used these non-risk related, non-causal factors to price. As an example, using age did not signal safer driving as a goal but rather aging. This "guilty until proven older" concept is unfair to every excellent young driver.

A 1986 study prepared for the California legislature by the National Insurance Consumers Organization (NICO) demonstrated the defects of territorial rating. Of the 4.9 million cars insured in California between 1982 and 1984, 95.4% had no claims. In central Los Angeles, 93.5% of the cars avoided claims. The difference in the number of claims is to be expected given population density and reliance on automobiles in Los Angeles. However, the difference in claims between L.A. and the rest of California does not explain why accident-free L.A drivers pay on the average 66% more for property damage insurance than did the average accident free driver outside L.A. ("Insurance in California: A 1986 Status Report for the Assembly," National Insurance Consumer Organization, October, 1986, Sec. IV, p. 14-16).

On a related point, insurers effectively evaded any sales in particular locations simply by refusing to write or by more subtle methods such as failing to establish offices or agencies in those regions. This practice, known as "redlining," is a particular problem in congested urban areas.

Finally, many policyholders complained of other arbitrary practices, such as abrupt cancellation of policies or non-renewals.

Proposition 103 terminated these abusive and unjustified practices.

• **Emphasis on Driving Safety Record.** Proposition 103 minimizes the use of discriminatory territorial rating, under which insurance companies determine automobile insurance premium by looking primarily at a customer's zip code. Proposition 103 requires that auto insurance premiums be based primarily upon a motorist's driving record, the number of miles he or she drives each year, and the consumer's years of driving experience, weighting those factors in that order. Only after primary weight is given to these factors can the Commissioner allow other factors to have any effect. By substituting the driver's own record as the primary determinant of his or her auto premiums, Proposition 103 gives drivers a strong incentive to keep their rates low by driving safely, thus restoring logic and "fairness" to the system.

The commissioner may approve additional factors -- but only after full public hearings, and only upon proof that the factors are substantially related to risk of loss, i.e., that they are shown by statistical analysis to hold predictive power once the first three "mandatory" factors are applied to determine the majority of the premium. Such additional factors approved by the commissioner will have relatively little impact on rates, as the initiative specifies that they must be accorded lower weight compared to the three chief factors.

The Unruh Civil Rights Act as well as other provisions of the California law made applicable by Proposition 103, were applied to effectively prohibit rate classifications that include race, language, color, religion, national origin, ancestry, age, gender, marital status, occupation, and student status (see below).

• **20% Good Driver Discount.** Proposition 103 further required that insurers provide a 20% Good Driver Discount to all qualifying consumers -- individuals with a virtually clean driving record (one moving violation is permitted) for the preceding three years. This adds a further incentive for drivers to maintain a clear auto safety record.

• **Elimination of Harmful Competition, such as Selection Competition (Redlining).** Proposition 103 specifies that any good driver has the right to purchase a Good Driver auto insurance policy from the insurer of his or her choice. The absence of prior insurance coverage cannot disqualify an otherwise good driver. By providing all "good drivers" with this statutory right to a policy priced for "Good Drivers," the measure effectively eliminates redlining and allows for classifications that are fairer in that insurers cannot opt, if they don't like a class, not to write such persons.

• **Arbitrary Cancellations.** A common experience of California policyholders prior to Proposition 103 was the abrupt cancellation or non-renewal of an automobile insurance policy immediately after the first claim is filed. Proposition 103 prohibits cancellation or non-renewal except under one of the following conditions: (1) non-payment of premium; (2) fraud or material misrepresentation affecting the policy or insured; (3) a substantial increase in the hazard insured against.

• **Application of Other State Laws As** noted above, prior to the passage of Proposition 103, insurance companies were exempt from the application of many state laws, including the state's civil rights and consumer protection statutes. Proposition 103 made these laws applicable to the insurance industry. By making California's consumer protection, civil rights and other laws applicable to the insurance industry, Proposition 103 makes available to the consumers a panoply of remedies for improper action that were previously specifically inapplicable to the insurance industry.

5. Public Participation and Accountability

It is essential that consumers' interests be represented in the often-complex regulatory system, and that government regulators be accountable to the public.

"Capture" of the regulators by the regulated -- the fox guarding the chicken coop -- is common, and, even if only perceived to be the case, is highly corrupting of public trust. The opportunity for individual citizens to enforce reforms and challenge insurer actions, and the democratic accountability of those administering insurance reform, are critical to its success.

Proposition 103 established a series of measures designed to foster participation and accountability; by specifying such measures, the voters could be assured that the specific purposes and goals of Proposition 103 would be implemented in the most pro-consumer fashion.

• **Elected Insurance Commissioner.** In all but 12 states, the Insurance Commissioner is an appointee (usually by the governor). Often, the individual is a former insurance industry executive (as was true in California), and the appointment is a form of political patronage. All too often in America's insurance regulatory history, the only people lobbying the governor when the appointment of an insurance commissioner was being considered was the insurance industry. As a result, state insurance agencies have frequently been criticized for a pro-industry bias that harmed consumers. In California, independent studies had repeatedly criticized the Department of Insurance for its inaction in the insurance crisis, failure to respond to consumer complaints and incompetent enforcement of the Insurance Code.

Proposition 103 required that the Insurance Commissioner be elected, beginning in November 1990. Entrusting the responsibility to implement Proposition 103 to an elected official had several virtues. An elected commissioner is subject to public, rather than political, supervision: only the voters may pass judgment on the commissioner's performance, providing the commissioner with the independence and incentive necessary to establish good public policy. A commissioner who fails to protect the public will not be re-elected to office. This will protect against efforts by insurance companies to install their own candidate for the job. This is not to say that there cannot be bad elected commissioners. The scandal surrounding California Insurance Commissioner Chuck Quackenbush, who was forced out of office in 2000, is a stark lesson in what happens when the news media, law makers and voters fail to pay close attention to the conduct of state regulators (the Quackenbush scandal is discussed in detail below). Appointment does make the commissioner beholden to the Governor more than to the people. Since it therefore takes two persons (the governor and the commissioner) to be politically willing to stand up to the powerful insurance lobby, the election process offers a somewhat better opportunity for consumer interests to be fairly represented. Obviously, election of an insurance commissioner should be coupled with campaign finance reform.

• **Funded Consumer Intervention.** It is a basic tenet of due process that each party to a proceeding has the right to be fully represented. Such participation is critical in the context of insurance regulation, since insurance premiums represent more than 10% of the average American family's annual disposable income and is a necessity for consumers and businesses.

As presented to the voters, Proposition 103 set forth three avenues for consumer participation in establishing a fair insurance system. First, it provided individual consumers with the right to seek redress from the Department of Insurance or the courts should insurance companies fail to comply with their responsibilities to the policyholder. If the Department of Insurance fails to respond effectively to a consumer's complaint, consumers will not be 'locked out" of the courts with no remedy.

Second, recognizing the cost and complexity of regulatory participation, Proposition 103 encouraged non-profit consumer advocacy groups to intervene in the expanded regulatory process to protect the interests of the public. Citizen groups which make a "substantial contribution" to a rate hearing or other matter before the Department of Insurance, or to an insurance matter which goes before a court, are entitled to receive reasonable advocacy fees and reimbursement of expenses for such costs as expert witnesses. Assessments collected from insurers are used to fund this program. The reimbursement system enables citizen groups to monitor the Department of Insurance on a stable -- and professional -- basis. Numerous citizen groups have utilized this system to monitor implementation of Proposition 103.

Finally, Proposition 103 contained an additional mechanism to guarantee effective consumer representation. Insurance consumers were to be given the opportunity to establish and join a democratically created and controlled advocacy organization. A staff of advocates, funded by voluntary contributions and grants, would represent consumers on insurance matters before the Insurance Commissioner, the courts, and the state legislature. In order to enable the advocacy organization to obtain the support of consumers, Proposition 103 required insurers to enclose special notices with their premium bills, informing their customers of the opportunity to participate in the program. (Insurers would be reimbursed by for any additional expenses caused by insertion of the notice). However, the California Supreme Court excised this provision of Proposition 103, as discussed in the next section.

II. The *CalFarm* Case

The morning after Proposition 103 was approved by the voters, thirteen separate lawsuits were filed in state and federal courts by numerous insurance companies challenging the constitutionality of the new law and its compliance with state statutes governing the subject matter of initiatives. These cases were consolidated into one before the California Supreme Court. On Thursday, November 10, 1988, in the face of a shutdown of operations by nearly all carriers in the state, and threatened withdrawals by many insurance companies, the Supreme Court granted a stay of the entire initiative.

One month later, in December of 1988, the Court lifted the stay on all provisions of the measure with the exception of the rate rollback and the formation of the consumer advocacy group.

On May, 4, 1989, the California Supreme Court unanimously upheld the initiative, including the rate rollback, but ruled that the "substantially threatened with insolvency"

standard might be interpreted so severely by the Commissioner that it would force insurers to obtain an "inadequate return" on their investment. The Court said, "[t]he risk that the rate set by the statute is confiscatory as to some insurers from its inception is high enough to require an adequate method for obtaining individualized relief." CalFarm Insurance Company v. Deukmejian (1989) 48 Cal.3rd 805 ("Calfarm"). The Court therefore substituted a "fair rate of return" standard, leaving it to the Commissioner through the exemption process established by Proposition 103 to determine whether the rate rollback would deprive each insurer of a fair rate of return. The Court further ruled that insurers would be allowed to maintain their existing rate levels pending completion of the exemption process, noting that when rollbacks were ordered they would be retroactive and accompanied by interest.

The Court also excised the provision of Proposition 103 that required the Insurance Commissioner to establish a citizen funded insurance consumer advocacy group with access to insurer envelopes. The Court ruled that this provision violated a provision of the California Constitution, which states that no initiative may "name" or "identify" a "private corporation."

The constitutional "fair return" requirement is familiar to regulators throughout the nation. It has become the focal point of most of the subsequent litigation brought by insurers against the implementation of Proposition 103.

449 insurance companies licensed to operate in California filed 4,089 specific line of insurance requests for exemptions from the rollback, claiming they would be deprived of a fair rate of return if forced to comply. The remaining 230 insurers either issued rebates, totaling about $125 million, or else had maintained rates that complied with the rollback levels.

III. History of the Post-Calfarm Implementation of Proposition 103

Appendix 3 contains a brief history of the actions of the four insurance commissioners (Gillespie, Garamendi, Quackenbush and Low) in implementing Proposition 103. To say that there have been ups and downs in regulation over this time period would be a great understatement. This history is presented to show that the forces unleashed by Proposition 103 have been effective in holding down insurance prices with pro-consumer and pro-industry commissioners at the helm.

FINDINGS

Proposition 103's components did, as the above review of the law's provisions demonstrates, meet the standards for regulatory excellence we set forth earlier in this paper. The question is, how did Proposition 103 perform in the years since its passage? As the following list shows, Proposition 103 has produced results that are unmatched throughout the nation.

Under Proposition 103, these remarkable results occurred (in the 1989 to 1998 period unless specified otherwise):

A. Auto insurance rates went down in California by 4.0% while nationally, rates were rising by over 25%.
B. California has enjoyed the lowest rate change of any state in the nation since the adoption of Proposition 103.
C. Rate rollbacks totaling $1.3 billion were paid to consumers.
D. Loss costs were controlled by the strong incentives for driver safety built into the initiative. "Clean" drivers received a 20% discount. They also gained the right to buy insurance from the company of their choice.
E. Insurer expenses were reduced by the system of disallowing excess expenses and fines, coupled with increased competitive pressure.
F. In 1989 8.4% of the insureds in California were in the Assigned Risk Plan. In 1999, the percentage had fallen to 0.3%. This represents an astounding drop in the Assigned Risk Plan of 96%.
G. From 1989 to 1997, the uninsured motorist population declined 38%.
H. There was entry and exit consistent with a competitive industry. The number of insurer groups competing in the state increased.
I. Proposition 103 produced excellent profits for insurers, the highest in the nation.
J. Proposition 103 encouraged a national movement by insurers to fight fraud, push for safety and cut costs partly in order to head off Proposition 103 clones in other states.

One key test is the Proposition's ability to hold down costs and premium charges while maintaining reasonable profits for insurance companies. As to holding down cost, the following table of expenditure change ranked from lowest to highest shows that since 1989 California has had the lowest percentage change in auto insurance prices, viz.:

STATE	1989 Aver. Expenditure Per Car Insured	1998 Aver. Expenditure Per Car Insured	Percent Change 89 to 98
California	747.97	717.98	-4.0
New Hampshire	609.13	621.50	2.0
Pennsylvania	646.03	721.91	11.7
Massachusetts	728.39	815.62	12.0
Maine	434.84	492.05	13.2
New Jersey	982.93	1138.28	15.8
Rhode Island	725.82	851.79	17.4
Hawaii	673.36	797.49	18.4
Maryland	646.18	769.34	19.1
Connecticut	740.02	900.60	21.7
Vermont	423.43	534.37	26.2
Florida	610.21	770.55	26.3
Georgia	531.01	672.38	26.6
Virginia	437.87	563.74	28.7
District of Col.	796.72	1032.52	29.6
Ohio	447.73	581.47	29.9

Illinois	505.32	667.66	32.1
South Carolina	494.25	655.33	32.6
Wisconsin	392.46	522.07	33.0
Michigan	550.84	736.71	33.7
Oregon	466.29	630.41	35.2
Indiana	426.29	583.21	36.8
Alaska	560.27	771.32	37.7
Tennessee	423.26	586.65	38.6
Arizona	581.42	817.65	40.6
Idaho	348.31	494.02	41.8
Missouri	430.05	611.48	42.2
Nevada	586.60	842.67	43.7
Oklahoma	399.19	575.40	44.1
New York	665.07	959.77	44.3
Washington	490.5	710.00	44.8
Louisiana	571.96	830.30	45.2
North Carolina	388.00	564.35	45.5
Iowa	315.02	458.98	45.7
Texas	497.35	730.66	46.9
Delaware	574.04	845.32	47.3
Minnesota	460.41	679.62	47.6
Colorado	515.31	763.75	48.2
Mississippi	440.80	653.41	48.2
Alabama	426.30	632.24	48.3
Montana	336.04	509.58	51.6
New Mexico	443.76	675.94	52.3
Wyoming	318.28	492.45	54.7
Kansas	340.76	532.15	56.2
North Dakota	283.11	452.03	59.7
Utah	385.44	618.88	60.6
Arkansas	364.68	589.05	61.5
Kentucky	375.71	617.32	64.3
West Virginia	437.09	724.58	65.8
South Dakota	273.51	479.24	75.2
Nebraska	284.86	517.52	81.7
Countrywide	551.95	704.32	38.9[21]

Source: State Average Expenditures and Premiums for Personal Automobile Insurance, National Association of Insurance Commissioners, 1995 and 2000 Editions

From the consumer perspective, this finding makes California a very favorable state. In order to determine how favorable, we looked at other information such as insurer profitability, viz.:

90/99 Insurer Return on Net Worth

[21] Note: The figure here, +38.9%, is the simple average change over the 50 states plus D.C. The weighted average change (using premium as weights) is +27.6%. For the purpose of comparing systems, we use simple averages in order to give each data point (i.e., state result) equal weight.

	California	Countrywide
Personal Auto Liability	15.40%	8.80%
Personal Auto Physical Damage	18.70%	17.20%
Personal Auto Total	16.00%	10.90%
Homeowners	-0.90%	-3.80%

The profits are so good that some cite them as a failure of Proposition 103. We cover this claim below.

A. FINDINGS RELATIVE TO IMPACT ON PREMIUMS IN CALIFORNIA

BENEFITS

- Between 1989 and 1997, insurance companies operating in California issued over $1.3 billion in premium refunds to more than seven million policyholders under Proposition 103's rollback mandate.

- California consumers have saved over $23 billion since 1988 under Proposition 103[22].

- California's annual auto insurance premium fell by 0.4% from 1989 to 1998. California was the only state in the nation to experience a reduction during this period.

- California has dropped from the state with the third fastest growing auto premiums in 1989 to the lowest premium growth state in the nation by 1998.

- Insurance companies that fulfilled their rollback obligation were permitted rate increases when justified based on informal application of the regulatory formula developed by the Insurance Department for use in determining the rollbacks. This enabled insurance companies to be profitable and to react to changing conditions.

PROBLEMS

- Insurers were determined to exhaust all legal avenues in order to delay payment of the rate rollbacks. Although unsuccessful in their attempts to have the rate rollback requirement invalidated, this was also part of the insurer strategy to discredit 103 in order to discourage similar reforms in other states.

- Insurers lobbied state lawmakers to repeal or amend certain provisions of Proposition 103, despite state law banning hostile amendments to voter approved measures.[23] In

[22] The Regulation of Automobile Insurance in California, Jaffee and Russell, 2001.

[23] Proposition 103 section 8(b) forbade legislative amendments to the initiative that did not further the purposes of Prop 103: "The provisions of this act shall not be amended by the Legislature except to further

each case, the amendments were successfully challenged and invalidated. In one instance, lawmakers exempted three lines of insurance from Proposition 103's rollback requirement. Consumer advocates sued and the California Supreme Court invalidated the legislation.[24] In another instance, the Insurance Services Office (ISO) won enactment of legislation that purported to permit insurance advisory organizations to resume distribution among insurers of data on projected losses for price-setting purposes.[25] A legal challenge invalidated this legislative assault.

- By refusing to enforce Proposition 103's prohibition on "excessive" rates, Insurance Commissioner Quackenbush permitted insurers' profits to exceed reasonable levels[26].

- Had Proposition 103's "prior approval" regulatory requirements been properly enforced, Californians would have saved an estimated additional $4 billion over the time Proposition 103 has been in effect[27].

- Without first seeking action by the California Department of Insurance, a group of lawyers filed a lawsuit in 1998 against major insurers and Insurance Commissioner Quackenbush, charging that the Commissioner had approved excessive rates and requested damages. The case was dismissed by the San Francisco Superior Court on the well-recognized principle of law that such complaints should first be brought to the administrative agency with expertise in the issue – in this case, the Department of Insurance – for its review. The plaintiffs appealed. The appellate court in San Francisco went beyond the lower court ruling, and held that once the insurance department has approved or failed to disapprove a proposed insurance rate, those rates may not be subsequently challenged in a lawsuit. (Walker v. Allstate Indemnity Co. 2000; 92Cal.Rptr.2d132). The decision effectively negated sections 1861.05, 1861.09 and 1861.10 of Proposition 103, which specifically allows consumers to challenge, and seek judicial review of, any rate in effect in violation of Proposition 103's requirements. In litigation challenging any misconduct, insurers routinely assert a Walker defense, arguing that so long as the rate, rule or practice was part of a filing not disapproved by the Commissioner, it cannot be subsequently challenged.

II. FINDINGS RELATIVE TO THE IMPACT ON INSURER OPERATIONS

BENEFITS

- Proposition 103 impelled insurers to engage in major cost cutting programs. The termination of the pre-103 "pass-through" mentality of the insurance companies was one of the most important achievements of the Proposition. The freeze on rates,

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its purposes by a statute passed in each house by roll call vote entered in the journal, two-thirds of the membership concurring, or by a statute that becomes effective only when approved by the electorate."

[24] *See* Amwest Surety Ins. Co. v. Wilson, 906 P.2d 1112 (Cal. 1995)

[25] § 1855.5.

[26] See Appendix 3.

[27] Arguably, profits over the time period were of the order of 4 to 6% too high on a net worth basis; which is 2 to 4% too high on a premium basis. Using 2.5% of the premium as an estimate of the overcharge produces a rough estimate of $4 billion in overcharges.

imposed to encourage compliance with the 103 rollback requirement, forced insurers to tighten their belts significantly in order to maintain profit levels. Insurers are now fighting fraud, pushing for safety, cutting expenses and otherwise working to hold down costs rather than continuing the "pass-through" system of pre-103 "open competition" days.

- Regulatory controls have impelled insurers to actively pursue anti-fraud programs. Two years after Proposition 103 passed, the Los Angeles District Attorney noted that, "until coming under pressure to lower rates under Proposition 103, [insurance] carriers simply settled claims and passed the cost to consumers in the form of higher premiums. 'That has begun to change,' he said. 'Insurance companies are getting serious about fraud.'"[28] A trade publication observed that "low expense ratios [are] a common factor among many of [the] auto insurers that posted underwriting profits. They have avoided expense-hungry products, out-sourced functions or eliminated the middle man from their operations."[29]

- Proposition 103 also has renewed insurers' attention to loss prevention practices. 103 directly prompted the insurance industry to work with consumer groups in 1989 and 1990 to establish the Advocates for Auto and Highway Safety and the Coalition Against Insurance Fraud. The holding down of loss costs in the nation and, particularly in California, is a legacy of Proposition 103.

- Insurers have been able to maintain profits while premiums have been frozen. Insurers claimed that Proposition 103 would destroy their ability to earn a fair profit in California. This threat has failed to materialize. Now, deregulation advocates' chief criticism of 103 is that it "caused" excess profits for insurance companies. It is true that profits were too high for personal auto insurance in California over the period since passage of 103. We discuss this in some depth below.

PROBLEMS

- None that are significant. Minor changes have been made to accommodate specific concerns by insurers. For example, the industry successfully sought state legislation to tighten the timelines for departmental review of rate change applications.[30]

III. FINDINGS RELATIVE TO THE IMPACT ON COMPETITION AND THE MARKETPLACE

BENEFITS

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[28] Lois Timnick, *51 to Face Charges in Auto Insurance Fraud Roundup*, L.A. TIMES, Oct. 18, 1990, at B4.
[29] Richard Yingling, *Rebuilding Crumbling Loyalties*, BEST'S REV., Sept. 1, 1990, at 57, 59.
[30] Insurance Code §1861.05 was amended in 1992 and 1993. §1861.055 was added by statute in 1990

- Under the Proposition, California's antitrust laws are fully applied to insurance to prevent monopolistic pricing. Indeed, the application of the antitrust laws protected Californians against industry misconduct in the aftermath of Proposition 103's approval by the electorate. Immediately after the passage of Proposition 103, most insurers in the state ceased selling new policies to exert pressure upon the California Supreme Court to rule favorably on the industry's request to invalidate the ballot measure. The state Attorney General subsequently found the boycott to be a violation of the antitrust laws made applicable by the measure, although he declined to prosecute.[31] The California Attorney General issued specific antitrust guidelines applicable to the industry in 1990. The threat of antitrust prosecution has made insurers more competitive and discouraged industry collusion in rate setting.

- Within four years of 103's passage, 133 banks obtained approval to sell insurance, increasing competition in the marketplace. Proposition 103 led the way to national change when, in 1999, Congress adopted the Gramm-Leach-Bliley Act allowing banks to sell insurance across the nation, although consumer groups expressed concern over the absence of regulatory oversight under the 1999 legislation..

- Competition has strengthened in California, contrary to industry predictions. Despite repeated threats that many insurers would leave the state if Proposition 103 became law, no major auto insurance company closed its California operations after the passage of the Initiative.[32] One early analysis concluded that more insurance companies had applied to do business in California since the passage of Proposition 103 (85) than withdrew (3), or had requested permission to withdraw, as of July, 1990 (25). While the number of individual insurance companies writing auto insurance in California has dropped from 265 to 241 since 1989, this is not the relevant yardstick by which to measure competition, since the industry has consolidated in recent years. The proper yardstick is the number of insurance corporate groups writing auto insurance in the state, which has risen from 94 to 110.[33]

PROBLEMS

- Proposition 103 permitted insurance agents and brokers to cut their commissions in order to discount the price of a policy. Such discounting is common in negotiations over commercial insurance policies, but was prohibited by law in consumer sales prior to 103. Unfortunately, insurance companies, under pressure from trade associations representing agents, have sought to discourage such competition among their sales force by terminating individual agents who engage in "rebating."[34] Consequently, few

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[31] *See* E. Scott Reckard, *Insurers' Pullout Blamed on Conspiracy*, THE ORANGE COUNTY REG., Jan. 3, 1991, at A3. .

[32] Jay Angoff, Editorial, *Quit California? Don't Bet on It*, L.A. TIMES, Dec. 1, 1988, at § II, at 7.

[33] The Regulation of Automobile Insurance in California, Jaffee and Russell, 2001.

[34] In 1994, an administrative law judge ruled that it did not violate the antitrust laws for an insurance company to terminate an insurance broker who engaged in such competition, so long as the company's action was not the product of pressure from other brokers. *See In re* Prudential Ins. Co., OAH Nos. L-60175, L-60174, L-60173, L-60172, L- 60171, Case Nos. UPA 0053-AP, UPA 0054-AP, UPA 0055-AP, UPA 0056-AP, UPA 0057-AP (Cal. Dep't of Ins. 1993). UPDATE?

consumers are aware of their ability to request a discount, and few agents are willing to risk termination to offer one.

- California was one of the first states to require a computerized buyers' guide to insurance policies, again leading the nation thanks to Proposition 103. However, the Proposition mandated a service operated by the Department of Insurance that would provide each consumer with a complete list of the prices charged by each carrier applicable to that consumers' profile. The state has not yet implemented the requirement; instead it provides examples of prices for different policyholder profiles, on the Department of Insurance website. In the 1990s, several private firms have entered the California marketplace to provide a service similar to that envisioned by 103, though with limited scope and at a significant cost. When Progressive Insurance announced the first-in-the-nation auto premium quote service in 1995, they said that they had gotten the message of consumer empowerment that Proposition 103 signaled. Internet technologies have also responded to the public need for such information: numerous quote services have been created.

- Proposition 103 empowered consumers to more easily negotiate group insurance purchases. Few group policies have been negotiated under the expanded definition. However, in California and throughout the nation in the wake of 103, significant research at NAIC and elsewhere into group policies has shown real savings for consumers through the efficient delivery of auto insurance by this method. Many states have moved to allow group policies, following 103's lead in this area.

- There is a critical need for public education and awareness of group insurance options to assure that their choices maximize the effect of competition. The issue of improved consumer education has moved to the national stage in recent years. There has been a lot done in California and elsewhere since 1992. For example, the NAIC seem about to, at long last, release the national complaint database, which will allow much better service information to be created and delivered to consumers. More needs to be done to help consumers deal with the complexities of buying insurance. Too much "junk" insurance is still sold in California and around the country: people still buy from high-price, low-service insurance companies.

IV. FINDINGS RELATIVE TO THE IMPACT ON ACCOUNTABILITY AND PUBLIC PARTICIPATION

BENEFITS

- Proposition 103 encourages non-profit consumer advocacy groups to intervene in the regulatory process to represent and protect the interests of the public. Insurance Commissioner John Garamendi established "state of the art" regulations to encourage consumer representation in insurance matters. Subsequently, Insurance Commissioner Quackenbush sought to discourage such representation by delaying or denying payment of attorneys' fees to consumer representatives. In several instances,

Quackenbush was sued by consumer organizations for failing to comply with the statutory requirement. California remains the best state for consumer intervention rules in the nation.[35]

- The elected insurance commissioner position has provided crucial public accountability, although the two individuals elected to the position since 1990 conducted themselves in starkly different ways. As noted above, Insurance Commissioner Garamendi largely championed consumers' interests in Proposition 103 and other insurance matters, whereas Insurance Commissioner Quackenbush abused his authority in office and left it in disgrace. There are two lessons to be learned from the track record of the elected commissioner in California so far. First is, "If a commissioner is elected with insurer dollars – watch out!" If ever there was proof of the need for campaign finance reform applicable to insurance regulators, California is it. Second, Commissioner Quackenbush was ultimately held accountable because he was elected to the position. An appointed regulator operates under the cloak of the governor, and corruption involving industry campaign donations to the appointing official is far more difficult to uncover. The Quackenbush scandal confirms that the best way to make insurance regulation accountable to the public is to make the regulator accountable to the public.

PROBLEMS

- In upholding the constitutionality of Proposition 103 in May, 1989, the California Supreme Court eliminated from the initiative an important mechanism to guarantee effective consumer representation. Under § 1861.10(c), insurance consumers were to be given the opportunity to establish and join a democratically created and controlled advocacy organization that would represent consumers on insurance matters before the Insurance Commissioner, the courts, and the state legislature. The California Supreme Court excised this provision of Proposition 103, ruling that section 1861.10(c) violated Article II, Section 12 of the California Constitution, which prohibits an initiative from "naming or identifying" a private corporation. *Calfarm Ins. Co. v. Deukmejian*, 48 Cal. 3d 805, 832 (1989). A later effort in the California Legislature to create such an advocacy group was blocked by insurance industry lobbyists. Meanwhile, Texas, following the lead of 103, enacted the Office of Public Insurance Council, a well-funded consumer group but subject to gubernatorial selection/pressure. The nation still needs a model of independent consumer advocacy with sufficient funding to be relevant. The National Association of Insurance Commissioners (NAIC) will not take up the issue.[36]

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[35] A handful of citizen organizations routinely intervene in California's insurance regulatory proceedings; as of 1997, the latest information made available by the California Department of Insurance, a total of $4.3 million has been spent reimbursing citizen groups for their fees and expenses incurred in connection with their interventions.

[36] Although, in the wake of Proposition 103, the NAIC finally agreed to fund the travel expenses of about a dozen consumer advocates to attend their meetings. No money is available for the time of these advocates, however.

- In *Farmers Ins. Exch. v. Superior Court*, 2 Cal. 4th 377 (1992), the California Supreme Court limited immediate recourse to the courts as provided by Proposition 103. In a lawsuit brought by the state's Attorney General against an insurer under California's Unfair Competition Act, CAL. BUS. & PROF. CODE § 17200 (West 1996) for violating the anti-redlining provision of Proposition 103 CAL. INS. CODE § 1861.02(b) (West 1988), the court ruled that in matters involving regulation of rates, the courts should first defer to the administrative expertise of the regulatory agency. The court's opinion imported a primary jurisdiction requirement that did not previously reside within state law. Concern that the courts are ill equipped to handle the complexities of insurance rate matters plainly motivated the decision. The proposition's explicit purpose of permitting recourse to the courts in the event that a recalcitrant Insurance Commissioner fails to enforce the law is not barred by the *Farmers'* decision in cases when recourse to the administrative agency is futile.

V. FINDINGS RELATIVE TO THE IMPACT ON FAIRNESS

BENEFITS

To ensure that qualified drivers can obtain insurance regardless of where they live, the measure specifies that any good driver, as defined by law, has the right to purchase an auto insurance policy from the insurer of his or her choice. This anti-redlining provision is in effect. Moreover, under Proposition 103, the absence of prior insurance coverage cannot be used by the insurer to disqualify or penalize motorists applying for insurance. These provisions, intended to reduce the uninsured motorist pool, are in effect and successful. In 1989, 8.4% of the insureds in California were in the California Automobile Assigned Risk Plan (CAARP). In 1999, the percentage had fallen to 0.3%. The national drop from 1989 to 1998 was 7.1% to 2.1%[37]. This represents an astounding drop in the California Assigned Risk Plan of 96%. The number of uninsured motorist claims in California in 1989 was 23.2%. That dropped to 14.2% in 1997, the latest year reported by the Insurance Research Counsel. This represents a drop of 38% in the uninsured population over the time period. The national figures were 16.3% in 1989, 13.2% in 1997, for a drop of 19%[38]. Once again California passes the test.

- However, a number of insurers routinely violate these provisions,[39] and the Department of Insurance has issued a proposal to prevent insurers from employing subterfuges to evade the "no prior" rule. Consumer advocates have recently petitioned the Department of Insurance for further regulations on this subject.

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[37] AIPSO Facts 2000/2001, AIPSO

[38] Uninsured Motorists, Insurance Research Council, 2000 Edition.

[39] *See* Vlae Kershner, *Agents Say Insurers Forcing Them to Skirt Prop. 103*, S.F. CHRON., Feb. 5, 1990, at A1; Scott Ard, *Farmers Sued for Denying Coverage*, THE DAILY REV. (Alameda County, Cal.), Mar. 3, 1990, at 1; Vlae Kershner & David A. Sylvester, *Survey Shows Biggest Insurers Sidestep 103*, S.F. CHRON., Feb. 8, 1990, at A1.

- Proposition 103's prohibition on arbitrary cancellations and non-renewals is in effect. In 1990, the California Supreme Court has ruled that this provision of Proposition 103 does not prevent an insurance company from terminating its policyholders as part of a plan to cease doing business in the state.[40] Indeed, Proposition 103 contained a specific provision intended to protect California policyholders against a boycott or market withdrawal by insurance companies. Under section 1861.11 of the California Insurance Code, the Insurance Commissioner is empowered to establish a "joint underwriting authority" in which all insurance companies selling any form of insurance in California must participate to provide coverage in the event of a shortage in any specific line of insurance. The California Department of Insurance has not utilized this provision. An exception in the statutory prohibition against non-renewals – for a "substantial increase in the hazard insured against" – has created an opportunity for insurers to evade the law. Regulations defining this exception were promulgated in 1994 and amended in 1998.[41]

PROBLEMS

- Proposition 103 minimized "territorial rating" by requiring that premiums be based primarily on driving record and other characteristics within the control of the motorist. Implementation of this requirement has been repeatedly delayed by insurer litigation and still must be implemented by the Commissioner.

  In 1994, Insurance Commissioner Garamendi published a detailed statistical analysis that found that, contrary to the industry's predictions, eliminating territory as the primary determinant of premiums would not result in substantial premium increases for good drivers. The study rebutted the industry's contention that territorial rating was consistent with the provisions of Proposition 103.[42] However, Garamendi left office before completing work on regulations needed to implement the change in law. In 1996, Insurance Commissioner Quackenbush issued new regulations.[43] An independent review of the rating plans filed by three major insurance companies determined that the regulations allowed insurers to continue to use territorial rating.[44] Two lawsuits were subsequently filed to compel the Insurance Commissioner to

[40] Travelers Indem. Co. v. Gillespie, 50 Cal. 3d 82 (1990)

[41] CCR Title §10,2632-19.

[42] *See* OFFICE OF POLICY RESEARCH, CALIFORNIA DEP'T OF INS., IMPACT ANALYSIS OF WEIGHTING AUTO RATING FACTORS TO COMPLY WITH PROPOSITION 103 (1994). *See id*. at 4.

[43] *See* CAL. CODE REGS. tit. 10, § 2632.1 (1997).

[44] Virtually all insurance companies in the state were found to be misinterpreting the regulations in order to continue to base premiums on territory, in violation of Proposition 103. *See* Kenneth Reich, *Loophole Seen Gutting New Car Insurance Plan*, L.A. TIMES, Oct. 4, 1997, at A1. An industry trade journal noted that Insurance Commissioner Quackenbush had improperly approved the rating plans: "[T]he commissioner has been misleading the public and the media by proclaiming that under his new rules territory is no longer the dominant factor in setting auto insurance rates." *California Class Plan Ruling Should Be in Quackenbush's Hands; What Will He Do?* AUTO INS. REP., Nov. 17, 1997, at 1, 3.

properly enforce the statute.[45] Citizen groups successfully challenged the regulations in the Alameda Superior Court, which struck down the defective portion of the regulations. The insurers and Quackenbush appealed. The 1st District Court of Appeal, in a decision issued December 29, 2000, ruled in favor of the Department of Insurance and the insurers, upholding the Quackenbush regulations on the grounds that they preserve a substantial relationship between rating factors like territory and the risk of loss. The Court acknowledged that the regulations do not ensure that rates would be determined primarily by driving safety record and miles driven as Proposition 103 requires. However, the court left the ultimate determination of the statute's requirements to the insurance commissioner.[46] The state Supreme Court subsequently refused to hear an appeal by a coalition of citizen groups and local officials. Insurance Commissioner Harry Low, appointed to fill the vacancy created by Quackenbush's resignation, has announced he will review the issue, presumably through a new rule-making proceeding.

VI. FINDINGS RELATIVE TO THE NATIONAL IMPACT OF PROPOSITION 103

BENEFITS

- Proposition 103 has spurred insurance reform activity in over 40 states. Over 1,000 Proposition 103-style reforms have been introduced in state legislatures. Numerous states have enacted rollbacks or other significant Proposition 103-type reforms, including Texas, South Carolina, Pennsylvania and New Jersey. Antitrust exemptions were partially removed in New Jersey and Texas. Auto rates were frozen in South Carolina, Florida and Georgia. Proposition 103 positively impacted the nation in many other areas including information systems, bank entry into insurance, safety efforts, eroding but not ending the 'pass-through' mentality in the industry[47], fraud fighting and the like.

- Shortly after Proposition 103 passed, the Insurance Services Office, an industry-controlled organization that distributes proposed rates to insurance companies, agreed to cease this most anti-competitive of its practices. It announced that it would end the filing of final rates, instead filing only prospective loss costs (i.e., not adding expense or profit provisions into the rates). The National Council on Workers Compensation Insurance did likewise, later. This is less anti-competitive than the pre-103 full rates, but it still results in collusive prospective ratemaking, particularly as respects joint trending. The joint use among insurers of trend data is particularly objectionable since insurers thereby use the same predictions of future costs to develop the loss portion, the majority of their rates. This encourages the perverse "pass-through"

[45] *See* Proposition 103 Enforcement Project v. Quackenbush and Spanish Speaking Citizens' Found., Inc. v. Quackenbush, consolidated case No. 796071-6 (Alameda Super. Ct. filed Mar. 25, 1998).
[46] Spanish Speaking Citizens' Foundation Inc. vs. Low, (2000) 103 Cal, Rptr, 2d 75.

[47] One key problem in other states is the continued exemption from state anti-trust law and the joint insurer use of trend factors made by rating organizations.

mentality of insurers. In California, happily, ISO and the other rate bureaus can't function this way. So there are no prospective loss costs filed in California by ISO. This is a great advance and one of the key reasons prices have moderated in the state.

- Post-103, insurers worked nationally for more efficient overhead costs. They trimmed commissions and opted to use more efficient, direct marketing methods. However, as the pressure for reform has eased in recent years, insurers have let up some on this effort. In 1999, industry personal auto underwriting expenses were 24.4% of earned premiums, according to A. M. Best and Co. In 1992 the similar percentage was 23.0%. Some of this loss in efficiency may be due to the national drop in premiums late in the 1990s, but it is clear that the industry is getting lazy as the pressure for regulatory reform is lessening and the pressure for gutting consumer protections has increased.

- Major insurers have joined with consumer groups to create the "Advocates for Auto and Highway Safety" and the "Coalition Against Insurance Fraud." Both the Coalition and the Advocates remain very active in public policy matters, the Coalition to oppose insurer and consumer fraud and the Advocates to push hard for safer cars and roads.

- In Congress, Proposition 103 inspired a serious effort to repeal or amend the industry's federal antitrust exemption. However, with an enormous lobbying effort, the industry managed to hold off reform, but not before elements of the industry broke ranks and now supports repeal or amendment of the McCarren-Ferguson Act's antitrust exemption.

PROBLEMS

- Generally, Proposition 103 forced the once-invincible insurance lobby to compromise in many states. But the insurers worked intensively to mislead lawmakers and regulators in other states concerning the status and impact of Proposition 103. Like the magician who diverts your attention in order to perform sleight-of-hand, the insurance industry was very successful in "selling" the idea that if 103's rollbacks were not paid immediately, Proposition 103 was a failure. Then, in a clever maneuver, the same insurers that established that as the test of Proposition 103's success proceeded to file lawsuits and did everything in their power to delay the rollbacks in California. In many instances, industry lobbyists in other states simply asserted that 103 had been ruled unconstitutional by California courts. This ploy was quite successful and held off reforms elsewhere, to the great detriment of consumers around the nation. The industry's propaganda effort was supplemented with a more sophisticated and fierce lobbying and public relations strategy, which included temporarily holding down costs, and forming coalitions with consumer groups. As a result of the industry's heroic efforts, it managed to hold back most of the reforms proposed across the nation. Most states, if they did anything, only managed to pass watered-down, pale imitations of some of the aspects of Proposition 103.

· To be sure, fears of another popular uprising have tempered the insurance industry's ability to raise rates nationally. As a result, insurance has, at least until now, been a "back burner" issue for the public, and this too has enabled the industry to thwart reforms by lobbying legislatures and defeating initiatives. This is why no other state has shown the remarkable successes of California in 2001. California remains, for consumers, the best state for insurance regulation in the country, the model for insurance regulation for the nation.

- For nearly thirteen years, fear of another Proposition 103-style revolt discouraged insurers from substantially raising rates in the cyclical fashion that characterized the insurance industry until 103. However, with a weakening economy, insurers are now faced with reductions in their investment income and may be preparing industry-wide rate increases. In anticipation of the consumer uproar that will result, a major effort by the emboldened insurers to gut state regulations across the nation occurred. The insurers are pressurizing the NAIC and pushing for deregulation on a state-by-state basis. The effort is powered by the industry's threat to seek federal action to create a federal optional charter that would allow no rate or form regulation. Using the threat of federal regulation, the insurers have stampeded the NAIC into a near panic of deregulatory effort.

  The current game to threaten state regulators with the possibility that the federal government will preempt state regulation of insurance has led state regulators, anxious to protect their turf, to accede to the industry's wish list for deregulation. When the American Council of Life Insurers (ACLI) published its federal charter bill, one of the leaders of the NAIC deregulation effort (Commissioner Fitzgerald of Michigan, the co-chair of the one-stop rubber stamp approval process he is pushing at NAIC) said, "It's important to recognize that everything the ACLI has asked for is being worked on and developed by state regulators…We have been specifically responsive to concerns raised by the industry."[48]

Other Tests of the Effectiveness of the Proposition

Insurers maintain another test of the effectiveness of Proposition 103 is the size of the personal auto residual market (in California the Assigned Risk Plan). While we do not agree that a simple look at the residual market size proves much, this test of the insurers is passed by Proposition 103 with flying colors. In 1989, 8.4% of the insureds in California were in the Assigned Risk Plan. In 1999, the percentage had fallen to 0.3%. This represents an astounding drop in the Assigned Risk Plan of 96%! And, the motorist population is only about 14%. (The number of uninsured motorist claims in California in 1989 was 23.2%. That dropped to 14.2% in 1997, the latest year reported by the Insurance Research Counsel. This represents a drop of 38% in the uninsured population over the time period. The national figures were 16.3% in 1989, 13.2% in 1997, for a drop of 19%.[49]).

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[48] ACLI Proposal Could Undermine Efforts of State Regulators, Michigan Commissioner Says, Bestwire, A. M. Best, April 20, 2001.

[49] Uninsured Motorists, Insurance Research Council, 2000 Edition.

Consumers do not accept the proposition put forth by insurers that a small residual market is a great thing. For example, in a state like New Hampshire or Massachusetts, the insured has the right to get insurance from a company he/she chooses. The insurance company has a right to send the applicant to a Reinsurance Facility if the company has any questions regarding the applicant. There is no penalty for the company for sending (ceding) the risk to this reinsurance entity. Since about half of all applicants in any class are worse than average, you would expect that up to 50% of the people would end up in the reinsurance plan. The existence of up to half of the market in a plan in this circumstance is not a problem.

A better test is to sum the residual market, the non-standard market[50] and the uninsured motorist market. The number of uninsured motorist claims in California in 1989 was 23.2%. That dropped to 14.2% in 1997, the latest year reported by the Insurance Research Counsel. This represents a drop of 38% in the uninsured population over the time period. The national figures were 16.3% in 1989, 13.2% in 1997, for a drop of 19%[51]. California was more successful than the nation in reducing these costs. We were unable to find data on the non-standard market shares in California and nationwide.

Insurers also look at market entry/exit as a test of a state's market. Again, we do not think this is a particularly good test. Exits might mean that active merger activity is taking place in a competitive market. Many entrants into a state may mean that high-cost, so-called "non-standard" insurers are entering the market because regulatory ease allows this. South Carolina is an example where there has been a lot of entry with adverse consumer results. When the consumer had the right to go to the company of his/her choice, these scavenger insurance companies could not survive at their remarkably high prices and profits.

In California, the number of individual companies writing auto insurance has dropped from 265 to 241 since 1989 but the number of groups of companies (e.g., State Farm Group contains many companies, such as State Farm Mutual Insurance Company and State Farm Fire Insurance Company) writing auto insurance in the state has risen from 94 to 110.[52] This is a good record and is real entry as opposed to just counting companies (since members of a group do not compete with each other in any real way).

Another problem with the number of companies argument insurers make is this – what's better, 200 companies where the top 2 write 95 % or 15 companies where each write 6 to 7 percent? A much better test is the HHI, which shows a competitive situation in California with auto at 1027 and Homeowners' at 1197.[53]

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[50] These are high priced companies who move into non-competitive areas of the state, such as cities. It is particularly offensive to count a reinsurance facility as bad for high populations when much of that is due to the elimination form the market of these high-priced, scavenger companies.

[51] Uninsured Motorists, Insurance Research Council, 2000 Edition.

[52] The Regulation of Automobile Insurance in California, Jaffee and Russell, 2001.

[53] Ibid.

There are many other real consumer benefits from the passage of Proposition 103, including the regulation of rating factors, availability of detailed loss data by Zip Code, and consumer participation in the process. Proposition 103 appears to have discouraged insurers from normal cyclical behavior.[54]

Why did Proposition 103 Achieve so Much Compared to Other Regulatory Systems?

What is it about Proposition 103 that makes its capacity for rate control so remarkable? It is this: unlike the watered down version of deregulation pushed into place in many states and advocated today for national implementation by the insurers, Proposition 103 incorporates fully all of the necessary changes to accomplish full competition. For instance, it imposes antitrust law on the industry, allows banks to sell insurance, allows group sales, and allows agent competition through rebating.

But it does not just rely on competition. Proposition 103 incorporates full regulatory oversight to assure that competition is effective and sufficient to do the job. California regulations are the state-of-the-art regulations in the nation –far and away the best. The regulations lay out for all to see exactly what is expected. They disallow excessive costs such as excessive expenses, fines, bad-faith lawsuit costs, excessive executive salary costs, etc.).

Proposition 103 had strong incentives for safety built into the initiative. "Clean" drivers gained a 20% discount. They also received the right to buy insurance from the company of their choice through Proposition 103's "Good Driver Protections." Thus, safety is emphasized with the nearest thing to the Bonus-Malus Plan of Europe, which has been shown to produce positive results on driving behavior.[55]

Further, Proposition 103 was a shot across the bow of the insurance industry. Prior to 103, the industry saw itself as a "pass-through" operation. Indeed, there was a perverse incentive in the ratemaking methods employed by the industry –so long as costs rose within their projections (called "trend"), their profit rose (since the ratemaking method

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[54] "The last soft market was driven purely by the need for cash to invest. . .We all know we can't do the dumb things we did last time. . . . We will not see a repeat of 1985-86" Mark A. Hofmann & Christine Woolsey, Marketplace Not What It Used To Be: Insurers, BUS. INS., July 13, 1992, at 5. Another executive has observed: "I don't think you1ll see a 1985-1986 repeat. There are too many regulatory restraints put in place to preclude it. A lot of regulations addressed our own stupidity. We made the bed and now we have to lie in it." Mark A. Hofmann & Christine Woolsey, Insurers Say Expectation of Price Turn Pushed Back, BUS. INS., Jan. 10, 1994, at 1, 14. And a senior official with the Insurance Services Office, an industry trade group, warned: "As an industry, nothing will disrupt our relations with customers faster, not to mention regulators and public-policy makers‹than an abrupt recovery from our current underwriting down cycle. . . . Remember the fallout from the last recovery: California1s Proposition 103 and other price-suppression laws, threats to the industry on the antitrust front, and virulent consumer hostility." Not Like 1985's: ISO Official Predicts Next Upturn in Cycle to be Gradual, INS. WK., Oct. 19, 1992, at 15, 15.

[55] See Lameire.

loaded profit as a percent of costs). There was little incentive not to have costs rise by the trend, particularly when the trend was agreed to at the cartel-like rating bureaus that existed in California under its pre-Proposition 103 so-called "competitive" regime. This "cost-plus-percentage-of-cost" operating style was achievable because full competition was not present. Many insurers used the same trends and tried to achieve them. Fraud was not seriously fought. Safety was not a paramount concern of the industry.

Proposition 103 changed all that. Not only did the industry react in California but, fearing a national spread of the Proposition's provisions including a 20% rollback of rates, insurers undertook to stop passing through costs across the nation. They joined with consumer groups to form the Coalition Against Insurance Fraud and the Advocates for Highway Safety. (They also used many lawsuits and other means to hold off 103's effects for as long as possible to confuse other states into thinking that Proposition 103 was not working.)

All this progress despite non-stop litigation by insurers and six years of a disgraced commissioner!

Comparing Proposition 103 to Other California Regulatory Changes

Providing backup for the NAIC's push for insurance deregulation are think tanks, academics, economists and other "scholars" sponsored by insurance companies and other corporations. The mantras of "deregulation" and "privatization," and their corollary principle, that everything government does is bad (except when it provides corporate tax benefits and subsidies to fund their own vital research) reflect the success of a multi-million dollar propaganda machine.

What they do not reflect is reality. At the same time that Proposition 103's stringent regulation has protected California for thirteen years, the state's residents are presently experiencing the devastating impact of deregulation of the electricity system in 1996. Under deregulation, a handful of energy companies have seized control of California's electricity supply and are manipulating it to maximize their profits. Electricity prices have risen 1000% since 2000, while energy company profits have soared up to 600%. One of the state's private utilities is in bankruptcy, the other close behind, while over $7 billion in taxpayer money – the entire surplus of the state -- has been spent since January of this year on purchasing electricity. Utility bills have been increased by 49% so far, with estimates of further increases of 200% or more considered reasonable. Total cost of California's electricity deregulation fiasco: $60 to $80 billion so far. So badly has deregulation harmed the state that there is a broad movement to supplant the private sector with a publicly owned energy company.

Lost in California's energy crisis is another looming deregulation disaster: workers' compensation. In 1993, California legislators repealed state regulation of workers' compensation insurance rates. As occurred in the property-casualty arena in the early 1980s, unscrutinized competition for premium dollars in California's then-golden economy led to reckless underwriting practices that have in turn led to major

insolvencies. According to a recent analysis in the Los Angeles Times, "of the top 12 companies that specialized in workers' compensation coverage in 1994--the last year before deregulation--eight have become insolvent, been forced to operate under the supervision of the state, or are not doing any new business in California."[56] Policyholders will end up paying surcharges to cover at least some portion of the claims these insolvent companies failed to pay.

Meanwhile, as if in blissful ignorance of the real world, the drumbeat from the deregulation propaganda machine continues. Will the NAIC fall into the deregulation trap? Because California's insurance regulatory system was enacted by the voters, it cannot be limited or repealed absent another vote of the people – of which there is little chance. Other states are not so fortunate. Industry lobbyists will move to win state legislatures' approval of a model deregulation law once approved by the NAIC if that body continues to be pushed into compliance by industry threats of federal regulation.

Review of Industry Objections to Proposition 103

The insurance industry and its partisans offer criticisms of Proposition 103 despite its acknowledged impact on California's auto insurance premiums.

Excessive Profits. Insurers argue that Proposition 103 allowed them to reap excessive profits. The theory they put forth is this: had insurers been free to increase rates without regulatory approval, they would have lowered their prices even more than they did, knowing that they could later increase rates freely if conditions changed. In other words, the insurance industry and its partisans argue that 103 didn't work because insurers failed to reduce their rates as much as they should have, given their profits.

This theory is a classic example of chutzpa! It was the refusal of Insurance Commissioner Quackenbush to enforce Proposition 103's regulatory requirements that enabled the insurers to obtain the high profit levels.

One of the best practices components of Proposition 103 is the consumer participation provisions. Consumer can ask for hearings on rates and have their costs (including expert and lawyer fees) reimbursed if they make a "substantial contribution" to the process.

Recognizing that profits were high, consumer groups (including the Proposition 103 Enforcement Project and Consumers Union) asked for hearings to require further rate reductions under the terms of the Proposition. The then-Commissioner, Chuck Quackenbush, refused to investigate, much less limit, the insurers' profits. Indeed, it later became clear that some of the same companies who benefited from the Commissioner's refusal to use his regulatory powers under 103 were companies that provided money to various slush funds he was amassing outside of government in exchange for favors.

[56] Los Angeles Times, April 16, 2001, Part A; Page 1.

It is the height of hypocrisy for insurance companies to make attack Proposition 103 for high profits that they enjoyed while resisting enforcement of the provisions of the Proposition. The only fault that might be found with the terms of the Proposition when it comes to excess profits is that the Proposition should have outlawed insurer funding of Commissioner elections. That's a real flaw, as Commissioner Quackenbush so adroitly demonstrated.

It is true that Proposition 103's provisions forced insurers to reduce rates after the measure passed, and by prohibiting excessive and unjustified expenses, forbade increases. This, in turn, compelled insurers to trim waste and inefficiency dramatically in order to obtain higher profits[57]. There is little doubt that absent 103's regulatory protections; insurers would have *raised, rather than lowered,* rates in California, as they did throughout the rest of the nation.

But nothing in Proposition 103 itself prevented insurers from lowering rates to levels that would produce reasonable profits as expenses and loss costs fell due to Proposition 103's provisions. Indeed, the claim that insurers were fearful of being able to raise rates is belied by the significant rate reductions that ultimately occurred in California in 1999 and 2000. Thus, when insurers wanted to compete, they could and they did. However, for many years the insurers chose not to, and instead were allowed by the state regulator to reap windfall profits. The delay in lowering prices also fit neatly into the insurer strategy to make Proposition 103 appear to fail, so other states would hold off on adopting its provisions.

Role of change in California bad-faith claims handling law. The industry and its partisans assert that the lower costs in California, which in part helped to fuel lower premiums, are not the result of, or at best only partly the result of, the Proposition. They argue that a 1988 California Supreme Court ruling, which prohibited some lawsuits against insurance companies for refusing to pay claims properly, is responsible for the dramatic post-Proposition 103 premium savings identified above.

This argument is contradicted by data on prices for "physical damage" auto insurance coverages (Collision and Comprehensive). Physical damage covers claims for property damage. Lawsuits for bad faith are less likely in physical damage coverages.

Table I above (expenditure and premium changes) reveals: Collision premiums in California rose by 18.1% less than they rose nationally (1.242-1.061). The increase in comprehensive premiums was 27.5% less (1.277-1.002). Liability premiums changed by 38.4% less (1.254-0. 870).

These data imply that well over half of the liability rate savings and most of the physical damage savings are due to the Proposition. Using 1999 data as weights and assuming that only half of the liability savings are from Proposition 103's provisions, a calculation of the overall savings can be made:

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[57] See The Regulation of Automobile Insurance in California, Jaffee and Russell, 2001.

Liability	-19.2% (half of 32.9%)
Collision	-18.1%
Comprehensive	-27.5%
Overall	-19.5%

By this calculation, Proposition 103 represented 62% of the overall savings of 31.5% (-19.5%/-31.5%).

Research comparing California and other states also contradicts the industry's argument that the limited change in California bad faith law was responsible for the dramatic post-103 premium savings. In states with Moradi-style laws, rates rose *faster* over the 1989-1998 period than in states without such a law in place[58]. Meanwhile, as noted, California's rates actually declined.

Seat belt usage in California. It has been argued that greater use of seat belts in California relative to the nation is responsible for California's remarkable rate savings after the passage of Proposition 103. It is true that seatbelt use is higher in California than nationally. But the issue is change in use over the 1989 to 1998 period. Data show that for the period 1989 to 1998, seatbelt use in California rose by 34% while in the nation seatbelt use rose by 54%. If anything, changes in seatbelt use in the 1989-1998 period would have caused California rates to *rise* relative to the nation.

Others have reviewed the results of Proposition 103. What follows are the key conclusions of reviewers as well as our comments upon their findings.

THE REGULATION OF AUTOMOBILE INSURANCE IN CALIFORNIA, By Jaffee and Russell, April 2001.

The Jaffee/Russell findings are as follows:

> "1) We find no evidence of the 'traditional' adverse consequences (of regulation) from the Proposition, such as firm exit, an expanding assigned risk pool, or declining industry profit rates.
>
> "2) We find the Proposition may have had a positive effect by (a) encouraging safer driving (through incentives created by the safe driver discount for insurance premiums) or by (b) causing firms to control fraud and dissipative expenses…by limiting their ability to pass such costs on to their consumers.
>
> "3) We find the Proposition may have had a detrimental effect on auto insurance premiums by increasing (insurer) profit margins.

[58] See spreadsheet, "Personal Auto Insurance Expenditure Change in the 1989 to 1998 Period by Moradi Law Status," in Appendix 4.

> "Taken together, these findings suggest that drivers in California have little to regret from the passage of Proposition 103 and the regulatory regime it introduced."

The report noted a sharp drop "in absolute and relative terms" in California auto insurance premiums, but indicated that, based on "back of the envelope calculations" half of the savings came from the "relative decline in collisions with injuries and fatalities to greater seat belt use" and 14.5% (some envelope) due to the Moradi case (Moradi held that the Unfair Claims Practices Act did not allow direct actions against an insurer).

This report's findings on Proposition 103's effect on California consumers is very positive. The only "problems" it "uncovered" were high profits for insurers and the possibility that back of envelope calculations imply that "only" 35.5% of the drop in premiums in California can be attributed to Proposition 103.

The first problem is easily dispensed with. As discussed above, Proposition 103 would have avoided these excess profits had the Insurance Commissioner followed the provisions of the Proposition and had held hearings on the profits as requested time and time again by consumer groups. The fact that the Commissioner refused to follow the clear directions and authorities of 103 at a time when he was taking money from insurers for waiving or diminishing other regulatory requirements can hardly be blamed on the Proposition.

The second problem is also discussed above. The Jaffee report ignores the physical damage costs. The Moradi and seatbelt arguments do not explain the huge savings relative to the nation that California has enjoyed in the personal auto physical damage sub-lines.

As to the liability sub-line itself, data comparing state laws with price changes suggests that the safety impact of seat belts is only 5.8%[59] whereas the savings over the last decade in California relative to the nation (assuming that California rates moved with the nation although prior to 103 rates went up faster than nationally) are about 31.6% (27.6% + 4.0%)[60]. So seatbelts account for only about 18% of the savings if we analyze only seatbelt law status.

However, we have data that allows a sharper analysis than that. The question is: How did California's seatbelt use change over the 1989 to 1998 period since Proposition 103 became effective? We have these data on percentage of vehicle occupants using seatbelts in private passenger cars:

	1989	1998	% Change

[59] See Spreadsheet "1989 to 1998 Premium Changes by Seatbelt Law Status," in Appendix 4.

[60] See the attached spreadsheet, "Personal Auto Insurance Expenditure Ranked by Least to Most Change in the 1989 to 1998 Period," in Appendix 4.

California[61]	67%	90%	+34%
Country[62]	46%	71%	+54%

Thus, the impact on rates of the change in seatbelt use should make California rates rise more than nationally. The reason is the effect of seatbelt use is in the rates so that the 1989 rates include a trended estimate of the 1989 seatbelt use in the state. So, hypothetically, if one state had 100% seatbelt use over a period and another went from 25% use to 50% use in the same period, the auto insurance prices of the latter state would fall relative to the former, everything else held equal.

Seatbelt use does not contribute to the remarkable rate effects in California over the 1989 to 1998 period.

States with Moradi-type laws had rate increases over the last decade of 41.5% on average while states overall had increases averaging 38.9%[63]. So Moradi did not contribute to the savings in California by this measure.

It is also clear that the simple imposition of prior approval would not have had as significant an impact in California as Proposition 103 did. The spreadsheet attached[64] shows that prior approval states have had rate changes of about the same increase as File and Use states and both had changes less than Use and File States. It is clear that prior approval resulted in slightly lower profits to insurance companies over the last decade, however. But this is a minor impact.

The problem with comparing prior approval with so-called "competitive" states is that both systems are deeply flawed. Prior approval in this country is weakly enforced in many jurisdictions. Regulators are understaffed, under funded and too cozy with the industry.[65] Competition is not real in most states – it is merely rivalry. Antitrust exemptions, anti-group laws, anti-trust laws, common use of trend factors, and so forth undercut the claim of competition. No wonder the results of these two flawed systems are alike!

California is unique and produces unique results because it relies on both real competition (with full antitrust enforcement, improved consumer information, rebating

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[61] California Highway Patrol as reported in "Mired in Mediocrity: A Nationwide Report Card on Driver and Passenger Safety," National Safety Council, 2001

[62] "Buckle-up America – Report to Congress," U. S. Department of Transportation; National Occupant Protection Use Survey; National Highway Safety Administration; 2001.

[63] See the attached spreadsheet, "Personal Auto Expenditure Change in the 1989 to 1998 Period by 'Moradi' Law Status" in Appendix 4.

[64] See attached spreadsheet, "Personal Auto Expenditure Change in 1989 to 1998 by Regulatory Status," in Appendix 4.

[65] Half of the nation's commissioners come from the industry and half return to the industry per Issues and Needed Improvements in State Regulation of the Insurance Business, GAO, 1978, updated by NICO in 1988 and by CFA in 1995. Resource inadequacy documented in State insurance Department Resources – 1988, 1993, 1998, CFA, August 2000.

by agents, group sales allowed, etc.) and real regulation (with state of the art regulatory requirements such as disallowance of wasteful expenses, consumer funded intervention, etc.). This powerful combination of effects, coupled with the Proposition's strong safety incentives has worked wonders for the citizens of California by anyone's measure.

MODERNIZING INSURANCE REGULATION – TACKING TO THE WINDS OF CHANGE, By O'Connor and Esposito, April 2001.

State Farm and Allstate funded this study. So, if there appears to be any straining to get to a pro-insurer result, it might be understandable.

O'Connor, after criticizing other prior approval states for running up the residual market populations, driving companies out of the state, etc., can find no such effects in California. His reported data shows how well Proposition 103 performed, viz.:

- He reports a sharp drop in insurance costs and premiums.
- He reports a sharp drop in residual market size (he reports that it fell to 0.8% in 1998 – after he completed the report, it further fell by more than half to 0.3% in 1999).
- He reports a high percentage of all the companies in the nation in California. (23% of auto insurance companies and 18% of homeowners' insurance companies).
- He reports high auto insurance profits (14,8% in California in the decade ended 1998 vs. 7.3% nationally).

Unable to make his usual criticisms of a prior approval state (high residual market, exit of firms, etc.), O'Connor determines that the "single most startling point, after more than a decade of Prop 103 rate regulation is that average auto liability profit levels for insurers in California appear to have been considerably higher than the average in the other 49 states…" He pointed out that the profits were about 50% above fair profits.

Like Jaffee, O'Connor never mentions the fact that consumer groups begged that Commissioner Quackenbush act under the clear provisions of 103 to remedy this problem (discussed in detail above).

O'Connor, unable to find any real faults with 103, also falls back on the "Moradi" defense as did Jaffee. O'Connor concludes that, "It is most likely that this (Moradi) decision reining in the tort system along with other developments…contributed to significantly lower costs since passage of Prop 103."

The Moradi argument is not convincing, as we showed above.

He also credits increased seat belt use in California. As we showed above, the change in seatbelt use would produce a *higher* change in prices in California than the nation, not *lower* as O'Connor wrongly suggests.

O'Connor's also discusses other regulatory changes in California. He thus ventures into the California deregulation thicket (he is not so bold as to mention electricity, of course) to applaud the deregulation of Workers' Compensation in the state. But, according to an article in the Los Angeles Times, "a wave of insolvencies has led officials to warn of a looming crisis."[66]

[66] "Deregulation is Taking Toll on Workers' Compensation," Ellis, Los Angeles Times, April 16, 2001.

APPENDIX 1

Text of Proposition 103[67]

On November 8, 1988, Californians passed the Insurance Rate Reduction and Reform Act, better known as Proposition 103. What follows below is the complete, original text of the ballot initiative.

NOTE: Changes made by the state Legislature and the Courts are noted in different text (shaded for additions **BOLD CAPS** *for deletions). For the complete text noting the repeal of then-existing laws (Section 7), please consult the 1988 California General Election Voter Information Pamphlet or the Insurance Code at your local law library.*

Insurance Rate Reduction and Reform Act

Section 1. Findings and Declaration.
The People of California find and declare as follows:

Enormous increases in the cost of insurance have made it both unaffordable and unavailable to millions of Californians.

The existing laws inadequately protect consumers and allow insurance companies to charge excessive, unjustified and arbitrary rates.

Therefore, the People of California declare that insurance reform is necessary. First, property-casualty insurance rates shall be immediately rolled back to what they were on November 8, 1987, and reduced no less than an additional 20%. Second, automobile insurance rates shall be determined primarily by a driver's safety record and mileage driven. Third, insurance rates shall be maintained at fair levels by requiring insurers to justify all future increases. Finally, the state Insurance Commissioner shall be elected. Insurance companies shall pay a fee to cover the costs of administering these new laws so that this reform will cost taxpayers nothing.

Section 2: Purpose.
The purpose of this chapter is to protect consumers from arbitrary insurance rates and practices, to encourage a competitive insurance marketplace, to provide for an accountable Insurance Commissioner, and to ensure that insurance is fair, available, and affordable for all Californians.

Section 3: Reduction and Control of Insurance Rates.

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[67] Downloaded from the web page of the Foundation for Taxpayer and Consumer Rights at www.consumerwatchdog.org on May 25, 2001. A change was made to alter colored text to shaded or bold test so that black and white printing would be feasible.

Article 10, commencing with Section 1861.01 is added to Chapter 9 of Part 2 of Division 1 of the Insurance Code to read:

Insurance Rate Rollback
1861.01.(a) For any coverage for a policy for automobile and any other form of insurance subject to this chapter issued or renewed on or after November 8, 1988, every insurer shall reduce its charges to levels which are at least 20% less than the charges for the same coverage which were in effect on November 8, 1987.

(b) Between November 8, 1988, and November 8, 1989, rates and premiums reduced pursuant to subdivision (a) may be only increased if the commissioner finds, after a hearing, that an insurer is substantially threatened with insolvency.

(c) Commencing November 8, 1989, insurance rates subject to this chapter must be approved by the commissioner prior to their use.

(d) For those who apply for an automobile insurance policy for the first time on or after November 8, 1988, the rate shall be 20% less than the rate which was in effect on November 8, 1987, for similarly situated risks.

(e) Any separate affiliate of an insurer, established on or after November 8, 1987, shall be subject to the provisions of this section and shall reduce its charges to levels which are at least 20% less than the insurer's charges in effect on that date.

Automobile Rates & Good Driver Discount Plan
1861.02. (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) Such other factors as the commissioner may adopt by regulation that have a substantial relationship to the risk of loss. The regulations shall set forth the respective weight to be given each factor in determining automobile rates and premiums. Notwithstanding any other provision of law, the use of any criterion without such approval shall constitute unfair discrimination.
[Insurance Code Section 1861.02(b) was amended by the state Legislature. Amendments are noted in shaded text, deletions in BOLD CAPS.]

(b) (1) **EVERY PERSON WHO (A) HAS BEEN LICENSED TO DRIVE A MOTOR VEHICLE FOR THE PREVIOUS THREE YEARS AND (B) HAS HAD, DURING THAT PERIOD, NOT MORE THAN ONE CONVICTION FOR A MOVING VIOLATION WHICH HAS NOT EVENTUALLY BEEN DISMISSED** Every person who meets the criteria of Section 1861.025 shall be qualified to purchase a Good Driver Discount policy from the insurer of his or her choice.

An insurer shall not refuse to offer and sell a Good Driver Discount policy to any person who meets the standards of this subdivision.

(2) The rate charged for a Good Driver Discount policy shall comply with subdivision (a) and shall be at least 20% below the rate the insured would otherwise have been charged for the same coverage. Rates for Good Driver Discount policies shall be approved pursuant to this article.

(3) (A) This subdivision shall not prevent a reciprocal insurer, organized prior to November 8, 1988, by a motor club holding a certificate of authority under Chapter 2 (commencing with Section 12160) of Part 5 of Division 2, and which requires membership in the motor club as a condition precedent to applying for insurance from requiring membership in the motor club as a condition precedent to obtaining insurance described in this subdivision.

(B) This subdivision shall not prevent an insurer which requires membership in a specified voluntary, nonprofit organization, which was in existence prior to November 8, 1988, as a condition precedent to applying for insurance issued to or through those membership groups, including franchise groups, from requiring such membership as a condition to applying for the coverage offered to members of the group, provided that it or an affiliate also offers and sells coverage to those who are not members of those membership groups.

(C) However, all of the following conditions shall be applicable to the insurance authorized by subparagraphs (A) and (B):

(i) Membership, if conditioned, is conditioned only on timely payment of membership dues and other bona fide criteria not based upon driving record or insurance, provided that membership in a motor club may not be based on residence in any area within the state.
(ii) Membership dues are paid solely for and in consideration of the membership and membership benefits and bear a reasonable relationship to the benefits provided. The amount of the dues shall not depend on whether the member purchases insurance offered by the membership organization. None of those membership dues or any portion thereof shall be transferred by the membership organization to the insurer, or any affiliate of the insurer, attorney-in-fact, subsidiary, or holding company thereof, provided that this provision shall not prevent any bona fide transaction between the membership organization and those entities.
(iii) Membership provides bona fide services or benefits in addition to the right to apply for insurance. Those services shall be reasonably available to all members within each class of membership.
Any insurer that violates clause (i), (ii), or (iii) shall be subject to the penalties set forth in Section 1861.14.

(c) The absence of prior automobile insurance coverage, in and of itself, shall not be a criterion for determining eligibility for a Good Driver Discount policy, or generally for automobile rates, premiums, or insurability.

[Insurance Code Section 1861.02(d), noted in shaded text below, was added to the Insurance Code by the state Legislature. It was NOT part of the original text of Proposition 103.]

(d) An insurer may refuse to sell a Good Driver Discount policy insuring a motorcycle unless all named insureds have been licensed to drive a motorcycle for the previous three years.

(D)(e) This section shall become operative on November 8, 1989. The commissioner shall adopt regulations implementing this section and insurers may submit applications pursuant to this article which comply with **SUCH** those regulations prior to that date, provided that no such application shall be approved prior to that date.

[Insurance Code Section 1861.025, noted in shaded text below, was added to the Insurance Code by the state Legislature. It was NOT part of the original text of Proposition 103.]

1861.025. A person is qualified to purchase a Good Driver Discount policy if he or she meets all of the following criteria:

(a) He or she has been licensed to drive a motor vehicle for the previous three years.

(b) During the previous three years, he or she has not done any of the following:
(1) Had more than one violation point count determined as provided by subdivision (a), (b), (c), (d), (e), (g), or (h) of Section 12810 of the Vehicle Code, but subject to the following modifications:
For the purposes of this section, the driver of a motor vehicle involved in an accident for which he or she was principally at fault which resulted only in damage to property shall receive one violation point count, in addition to any other violation points which may be imposed for this accident.

If under Section 488 or 488.5 an insurer is prohibited from increasing the premium on a policy on account of a violation, that violation shall not be included in determining the point count of the person.

If a violation is required to be reported under Section 1816 of the Vehicle Code, or under Section 784 of the Welfare and Institutions Code, or any other provision requiring the reporting of a violation by a minor, the violation shall be included for the purposes of this section in determining the point count in the same manner as is applicable to adult violations.

(2) Had more than one dismissal pursuant to Section 1803.5 of the Vehicle Code which was not made confidential pursuant to Section 1808.7 of the Vehicle Code, in the 36-month period for violations that would have resulted in the imposition of more than one violation point count under paragraph (1) if the complaint had not been dismissed.

(3) Was the driver of a motor vehicle involved in an accident which resulted in bodily injury or in the death of any person and was principally at fault. The commissioner shall adopt regulations setting guidelines to be used by insurers for the their determination of fault for the purposes of this paragraph and paragraph (1) of subdivision (b).

(c) During the previous seven years he or she has not been convicted of a violation of Section 23140, 23152, or 23153, of the Vehicle Code, a felony violation of Section 23175 or 23190 of the Vehicle Code, or a violation of Section 191.5 or paragraph (3) of subdivision (c) of Section 192 of the Penal Code.

(d) Any person who claims that he or she meets the criteria of subdivisions (a), (b), and (c) based entirely or partially on a driver's license and driving experience acquired anywhere other than in the United States or Canada is rebuttably presumed to be qualified to purchase a good driver discount policy if he or she has been licensed to drive in the United States or Canada for at least the previous 18 months and meets the criteria of subdivisions (a), (b), and (c) for that period.

Prohibition on Unfair Insurance Practices

1861.03 (a) The business of insurance shall be subject to the laws of California applicable to any other business, including, but not limited to, the Unruh Civil Rights Act (Civil Code Sections 51 through 53), and the antitrust and unfair business practices laws (Parts 2 and 3, commencing with section 16600 of Division 7, of the Business and Professions Code).

[Insurance Code Section 1861.03(b) was amended by the state Legislature. Additions are noted in shaded text, deletions in BOLD CAPS.]

(b) Nothing in this section shall be construed to prohibit (1) any agreement to collect, compile and disseminate historical data on paid claims or reserves for reported claims, provided such data is contemporaneously transmitted to the commissioner, **OR** (2) participation in any joint arrangement established by statute or the commissioner to assure availability of insurance.
, (3) any agent or broker, representing one or more insurers, from obtaining from any insurer it represents information relative to the premium for any policy or risk to be underwritten by that insurer, (4) any agent or broker from disclosing to an insurer it represents any quoted rate or charge offered by another insurer represented by that agent or broker for the purpose of negotiating a lower rate, charge, or term from the insurer to whom the disclosure is made, or (5) any agents, brokers, or insurers from utilizing or participating with multiple insurers or reinsurers for underwriting a single risk or group of risks.

(c) Notwithstanding any other provision of law, a notice of cancellation or non-renewal of a policy for automobile insurance shall be effective only if it is based on one or more of the following reasons:

(1) non-payment of premium;
(2) fraud or material misrepresentation affecting the policy or insured;
(3) a substantial increase in the hazard insured against.
[Insurance Code Section 1861.03(c)(2), noted in shaded text below, was added to the Insurance Code by the state Legislature. It was NOT part of the original text of Proposition 103.]

(2) This subdivision shall not prevent a reciprocal insurer, organized prior to November 8, 1988, by a motor club holding a certificate of authority under Chapter 2 (commencing with Section 12160) of Part 5 of Division 2, and which requires membership in the motor club as a condition precedent to applying for insurance, from issuing an effective notice of nonrenewal based solely on the failure of the insured to maintain membership in the motor club. This subdivision shall also not prevent an insurer which issues private passenger automobile coverage to members of groups that were in existence prior to November 8, 1988, whether membership, franchise, or otherwise, and to those who are not members of groups from issuing an effective notice of nonrenewal for coverage provided to the insured as a member of the group based solely on the failure of the insured to maintain that membership if (i) the insurer offers to renew the coverage to the insured on a nongroup basis, or (ii) to transfer the coverage to an affiliated insurer. The rates charged by the insurer or affiliated insurer shall have been adopted pursuant to this article. However, all of the following conditions shall be applicable to that insurance:

(A) Membership, if conditioned, is conditioned only on timely payment of membership dues and other bona fide criteria not based upon driving record or insurance, provided that membership in a motor club may not be based on residence in any area within the state.

(B) Membership dues are paid solely for and in consideration of the membership and membership benefits and bear a reasonable relationship to the benefits provided. The amount of the dues shall not depend on whether the member purchases insurance offered by the membership organization. None of those membership dues or any portion thereof shall be transferred by the membership organization to the insurer, or any affiliate of the insurer, attorney-in-fact, subsidiary, or holding company thereof, provided that this provision shall not prevent any bona fide transaction between the membership organization and those entities.

(C) Membership provides bona fide services or benefits in addition to the right to apply for insurance. Those services shall be reasonably available to all members within each class of membership.

Any insurer that violates subparagraphs (A), (B), or (C) shall be subject to the penalties set forth in Section 1861.14.

Full Disclosure of Insurance Information
1861.04. (a) Upon request, and for a reasonable fee to cover costs, the commissioner shall provide consumers with a comparison of the rate in effect for each personal line of insurance for every insurer.

[Insurance Code Section 1861.03(b) was amended by the state Legislature. Additions are noted in shaded text.]

Approval of Insurance Rates
1861.05. (a) No rate shall be approved or remain in effect which is excessive, inadequate, unfairly discriminatory or otherwise in violation of this chapter. In considering whether a rate is excessive, inadequate or unfairly discriminatory, no consideration shall be given to the degree of competition and the commissioner shall consider whether the rate mathematically reflects the insurance company's investment income.

(b) Every insurer which desires to change any rate shall file a complete rate application with the commissioner. A complete rate application shall include all data referred to in Sections 1857.7, 1857.9, 1857.15, and 1864 and such other information as the commissioner may require. The applicant shall have the burden of proving that the requested rate change is justified and meets the requirements of this article.

(c) The commissioner shall notify the public of any application by an insurer for a rate change. The application shall be deemed approved sixty days after public notice unless (1) a consumer or his or her representative requests a hearing within forty-five days of public notice and the commissioner grants the hearing, or determines not to grant the hearing and issues written findings in support of that decision, or (2) the commissioner on his or her own motion determines to hold a hearing, or (3) the proposed rate adjustment exceeds 7% of the then applicable rate for personal lines or 15% for commercial lines, in which case the commissioner must hold a hearing upon a timely request.
In any event, a rate change application shall be deemed approved 180 days after the rate application is received by the commissioner (A) unless that application has been disapproved by a final order of the commissioner subsequent to a hearing, or (B) extraordinary circumstances exist. For purposes of this section, "received" means the date delivered to the department.

(d) For purposes of this section, extraordinary circumstances include the following:

(1) Rate change application hearings commenced during the 180-day period provided by subdivision (c). If a hearing is commenced during the 180-day period, the rate change application shall be deemed approved upon expiration of the 180-day period or 60 days after the close of the record of the hearing, whichever is later, unless disapproved prior to that date.

(2) Rate change applications that are not approved or disapproved within the 180-day period provided by subdivision (c) as a result of a judicial proceeding directly involving

the application and initiated by the applicant or an intervenor. During the pendency of the judicial proceedings, the 180-day period is tolled, except that in no event shall the commissioner have less than 30 days after conclusion of the judicial proceedings to approve or disapprove the application. Notwithstanding any other provision of law, nothing shall preclude the commissioner from disapproving an application without a hearing if a stay is in effect barring the commissioner from holding a hearing within the 180-day period.

(3) The hearing has been continued pursuant to Section 11524 of the Government Code. The 180-day period provided by subdivision (c) shall be tolled during any period in which a hearing is continued pursuant to Section 11524 of the Government Code. A continuance pursuant to Section 11524 of the Government Code shall be decided on a case by case basis. If the hearing is commenced or continued during the 180-day period, the rate change application shall be deemed approved upon the expiration of the 180-day period or 100 days after the case is submitted, whichever is later, unless disapproved prior to that date.

[Insurance Code Section 1861.055, noted in shaded text below, was added to the Insurance Code by the state Legislature. It was NOT part of the original text of Proposition 103.]

1861.055. (a) The commissioner shall adopt regulations governing hearings required by subdivision (c) of Section 1861.05 on or before 120 days after the enactment of this section. Those regulations shall, at the minimum, include timelines for scheduling and commencing hearings, and procedures to prevent delays in commencing or continuing hearings without good cause.

(b) The sole remedy for failure by the commissioner to adopt the regulations required by subdivision (a) within the prescribed period or to abide by those regulations once adopted shall be a writ of mandate by any aggrieved party in a court of competent jurisdiction to compel the commissioner to adopt those regulations, or commence or resume hearings.

(c) Nothing in this section shall preclude the commissioner from commencing hearings required by subdivision (c) of Section 1861.05 prior to adopting the regulations required by this section.

(d) The administrative law judge shall render a decision within 30 days of the closing of the record in the proceeding.

1861.06. Public notice required by this article shall be made through distribution to the news media and to any member of the public who requests placement on a mailing list for that purpose.

1861.07. All information provided to the commissioner pursuant to this article shall be available for public inspection, and the provisions of Section 6254(d) of the Government Code and Section 1857.9 of the Insurance Code shall not apply thereto.

[Insurance Code Section 1861.08 was amended by the state Legislature. Additions are noted in shaded text, deletions in BOLD CAPS.]

1861.08. Hearings shall be conducted pursuant to Sections 11500 through 11528 of the Government Code, except that:

(a) hearings shall be conducted by administrative law judges for purposes of Sections 11512 and 11517, chosen under Section 11502 or appointed by the commissioner;

(b) hearings are commenced by a filing of a Notice in lieu of Sections 11503 and 11504;

(c) the commissioner shall adopt, amend or reject a decision only under Section **11517 (C) AND (E)**11518.5 and subdivisions (b), (c), and (e) of Section 11517 and solely on the basis of the record; as provided in Section 11425.50 of the Government Code.

(d) **SECTION 11513.5 SHALL APPLY TO THE COMMISSIONER;**
Notwithstanding Section 11501, Section 11430.30 and subdivision (b) of Section 11430.70 shall not apply in these hearings.
(e) **D**Discovery shall be liberally construed and disputes determined by the administrative law judge. as provided in Section 11507.7 of the Government Code.

1861.09. Judicial review shall be in accordance with Section 1858.6. For purposes of judicial review, a decision to hold a hearing is not a final order or decision; however, a decision not to hold a hearing is final.

Consumer Participation
1861.10. (a) Any person may initiate or intervene in any proceeding permitted or established pursuant to this chapter, challenge any action of the commissioner under this article, and enforce any provision of this article.

(b) The commissioner or a court shall award reasonable advocacy and witness fees and expenses to any person who demonstrates that (1) the person represents the interests of consumers, and, (2) that he or she has made a substantial contribution to the adoption of any order, regulation or decision by the commissioner or a court. Where such advocacy occurs in response to a rate application, the award shall be paid by the applicant.

[The California Supreme Court invalidated Section 1861.10(c) of Proposition 103 in May 1989. The section is in BOLD CAPS below.]

(C) (1) THE COMMISSIONER SHALL REQUIRE EVERY INSURER TO ENCLOSE NOTICES IN EVERY POLICY OR RENEWAL PREMIUM BILL INFORMING POLICYHOLDERS OF THE OPPORTUNITY TO JOIN AN INDEPENDENT, NON-PROFIT CORPORATION WHICH SHALL ADVOCATE THE INTERESTS OF INSURANCE CONSUMERS IN ANY FORUM. THIS ORGANIZATION SHALL BE

ESTABLISHED BY AN INTERIM BOARD OF PUBLIC MEMBERS DESIGNATED BY THE COMMISSIONER AND OPERATED BY INDIVIDUALS WHO ARE DEMOCRATICALLY ELECTED FROM ITS MEMBERSHIP. THE CORPORATION SHALL PROPORTIONATELY REIMBURSE INSURERS FOR ANY ADDITIONAL COSTS INCURRED BY INSERTION OF THE ENCLOSURE, EXCEPT NO POSTAGE SHALL BE CHARGED FOR ANY ENCLOSURE WEIGHING LESS THAN 1/3 OF AN OUNCE. (2) THE COMMISSIONER SHALL BY REGULATION DETERMINE THE CONTENT OF THE ENCLOSURES AND OTHER PROCEDURES NECESSARY FOR IMPLEMENTATION OF THIS PROVISION. THE LEGISLATURE SHALL MAKE NO APPROPRIATION FOR THIS SUBDIVISION.

Emergency Authority
1861.11. In the event that the commissioner finds that (a) insurers have substantially withdrawn from any insurance market covered by this article, including insurance described by Section 660, and (b) a market assistance plan would not be sufficient to make insurance available, the commissioner shall establish a joint underwriting authority in the manner set forth by Section 11891, without the prior creation of a market assistance plan.

Group Insurance Plans
1861.12. Any insurer may issue any insurance coverage on a group plan, without restriction as to the purpose of the group, occupation or type of group. Group insurance rates shall not be considered to be unfairly discriminatory, if they are averaged broadly among persons insured under the group plan.

Application
1861.13. This article shall apply to all insurance on risks or on operations in this state, except those listed in Section 1851.

[Insurance Code Section 1861.135, noted in shaded text below, was added to the Insurance Code by the state Legislature (AB 3798 in 1990 by then-Assembly Member Patrick Johnston, D-Stockton). It was NOT part of the original text of Proposition 103. The Proposition 103 Enforcement Project challenged this Section as an unconstitutional amendment to Proposition 103. In December 1993, the California Court of Appeal struck down the law as an illegal amendment to Proposition 103. In December 1995, the California Supreme Court unanimously upheld the Court of Appeal's decision.]

1861.135. (a) Notwithstanding Section 1861.13, surety insurance shall not be subject to Sections 1861.01 and 1861.05; however, any rate, rating plan or rating system for surety insurance shall be filed with the commissioner before it may be used in this state, and that rate, rating plan, or rating system may be used immediately upon filing with the commissioner.

(b) The rates for surety insurance shall not be excessive, inadequate, unfairly discriminatory, or otherwise in violation of this chapter, except Sections 1861.01 and 1861.05.

Enforcement & Penalties
1861.14. Violations of this article shall be subject to the penalties set forth in Section 1859.1. In addition to the other penalties provided in this chapter, the commissioner may suspend or revoke, in whole or in part, the certificate of authority of any insurer which fails to comply with the provisions of this article.

Section 4. Elected Commissioner
Section 12900 is added to the Insurance Code to read:

(a) The commissioner shall be elected by the People in the same time, place and manner and for the same term as the Governor.

Section 5. Insurance Company Filing Fees
Section 12979 is added to the Insurance Code to read:

Notwithstanding the provisions of Section 12978, the commissioner shall establish a schedule of filing fees to be paid by insurers to cover any administrative or operational costs arising from the provisions of Article 10 (commencing with Section 1861.01) of Chapter 9 of Part 2 of Division 1.

Section 6. Transitional Adjustment of Gross Premiums Tax
Section 12202.1 is added to the Revenue & Taxation Code to read:

Notwithstanding the rate specified by Section 12202, the gross premiums tax rate paid by insurers for any premiums collected between November 8, 1988 and January 1, 1991 shall be adjusted by the Board of Equalization in January of each year so that the gross premium tax revenues collected for each prior calendar year shall be sufficient to compensate for changes in such revenues, if any, including changes in anticipated revenues, arising from this act. In calculating the necessary adjustment, the Board of Equalization shall consider the growth in premiums in the most recent three year period, and the impact of general economic factors including, but not limited to, the inflation and interest rates.

Section 7. Repeal of Existing Law
Sections 1643, 1850, 1850.1, 1850.2, 1850.3, 1852, 1853, 1853.6, 1853.7, 1857.5, 12900, Article 3 (commencing with Section 1854) of Chapter 9 of Part 2 of Division 1, and Article 5 (commencing with Section 750) of Chapter 1 of Part 2 of Division 1, of the Insurance Code are repealed.

Section 8. Technical Matters
(a) This act shall be liberally construed and applied in order to fully promote its underlying purposes.

(b) The provisions of this act shall not be amended by the Legislature except to further its purposes by a statute passed in each house by roll call vote entered in the journal, two-thirds of the membership concurring, or by a statute that becomes effective only when approved by the electorate.

(c) If any provision of this act or the application thereof to any person or circumstances is held invalid, that invalidity shall not affect other provisions or applications of the act which can be given effect without the invalid provision or application, and to this end the provisions of this act are severable.

APPENDIX 2

Consumer Principles and Standards for Insurance Regulation – How Proposition 103 Meets Consumer White Paper Proposals Presented to the NAIC in 2000

All references are to the California Insurance Code unless otherwise noted.

B. Consumers should have access to timely and meaningful information of the costs, terms, risks and benefits of insurance policies.

- Meaningful disclosure prior to sale tailored for particular policies and written at the education level of average consumer sufficient to educate and enable consumers to assess particular policy and its value should be required for all insurance; should be standardized by line to facilitate comparison shopping; should include comparative prices, terms, conditions, limitations, exclusions, loss ratio expected, commissions/fees and information on seller (service and solvency); should address non-English speaking or ESL populations.

  Proposition 103 mandates that the Department of Insurance provide consumers with the ability to "comparison shop" for the best automobile or homeowner insurance policy. The Department must provide, upon request and for a reasonable fee, a statement comparing the rates in effect for each insurer. §1861.04.

- Insurance departments should identify, based on inquiries and market conduct exams, populations that may need directed education efforts, e.g., seniors, low-income, low education.
- Disclosure should be made appropriate for medium in which product is sold, e.g., in person, by telephone, on-line.
- Loss ratios should be disclosed in such a way that consumers can compare them for similar policies in the market, e.g., a scale based on insurer filings developed by insurance regulators or independent third party.
- Non-term life insurance policies, e.g., those that build cash values, should include rate of return disclosure. This would provide consumers with a tool, analogous to the APR required in loan contracts, with which they could compare competing cash value policies. It would also help them in deciding whether to buy cash value policies.
- Free look period with meaningful state guidelines to assess appropriateness of policy and value based on standards the state creates from data for similar policies.
- Comparative data on insurers' complaint records, length of time to settle claims by size of claim, solvency information, and coverage ratings (e.g., policies should be ranked based on actuarial value so a consumer knows if comparing apples to apples) should be available to the public.
- Significant changes at renewal must be clearly presented as warnings to consumers, e.g., changes in deductibles for wind loss.

- Information on claims policy and filing process should be readily available to all consumers and included in policy information.
- Sellers should determine and consumers should be informed of whether insurance coverage replaces or supplements already existing coverage to protect against over-insuring, e.g., life and credit.
- Consumer Bill of Rights, tailored for each line, should accompany every policy.
- Consumer feedback to the insurance department should be sought after every transaction (e.g., after policy sale, renewal, termination, claim denial). Insurer should give consumer notice of feedback procedure at end of transaction, e.g., form on-line or toll-free telephone number.

Proposition 103 provides consumers or their representatives with the right to challenge insurance industry rates and practices. Consumer representatives must be reimbursed for their substantial contribution to agency or judicial proceedings. §1861.10

Proposition 103 requires all information submitted to the Department of Insurance for regulatory purposes be made available to the public. §1861.07

C. **Insurance policies should be designed to promote competition, facilitate comparison- shopping and provide meaningful and needed protection against loss.**

- *Disclosure requirements above apply here as well and should be included in design of policy and in the policy form approval process.*
- *Policies must be transparent and standardized so that true price competition can prevail. Components of the insurance policy must be clear to the consumer, e.g., the actual current and future cost, including commissions and penalties.*
- *Suitability or appropriateness rules should be in place and strictly enforced, particularly for investment/cash value policies. Companies must have clear standards for determining suitability and compliance mechanism. For example, sellers of variable life insurers are required to find that the sales that their representatives make are suitable for the buyers. Such a requirement should apply to all life insurance policies, particularly when replacement of a policy is at issue.*
- *"Junk" policies, including those that do not meet a minimum loss ratio, should be identified and prohibited. Low-value policies should be clearly identified and subject to a set of strictly enforced standards that ensure minimum value for consumers.*
- *Where policies are subject to reverse competition, special protections are needed against tie-ins, overpricing, e.g., action to limit credit insurance rates.*

D. All consumers should have access to adequate coverage and not be subject to unfair discrimination.

- Where coverage is mandated by the state or required as part of another transaction/purchase by the private market, e.g., mortgage, regulatory intervention is appropriate to assure reasonable affordability and guarantee availability.

Auto insurance is mandatory in California. Proposition 103 requires all auto insurance rates be priced fairly based on proper expense and profit levels.

Proposition 103 requires that insurers offer qualified drivers a 20% Good Driver Discount. §1861.02(b).

Proposition 103 forbids insurers from denying or penalizing applicants who have not been previously insured. §1861.02(c)

- Market reforms in the area of health insurance should include guaranteed issue and community rating and where needed, subsidies to assure health care is affordable for all.
- Information sufficient to allow public determination of unfair discrimination must be available. Zip code data, rating classifications and underwriting guidelines, for example, should be reported to regulatory authority for review and made public.

Proposition 103 requires all information submitted to the Department of Insurance for regulatory purposes be made available to the public. §1861.07

- Regulatory entities should conduct ongoing, aggressive market conduct reviews to assess whether unfair discrimination is present and to punish and remedy it if found, e.g., redlining reviews (analysis of market shares by census tracts or zip codes, analysis of questionable rating criteria such as credit rating), reviews of pricing methods, reviews of all forms of underwriting instructions, including oral instructions to producers.

Proposition 103 requires insurers to base auto insurance premiums primarily upon driving safety record, annual miles driven and years of driving experience, rather than upon factors outside of the motorist's control, such as zip code. §1861.02

- Insurance companies should be required to invest in communities and market and sell policies to prevent or remedy availability problems in communities.
- Clear anti-discrimination standards must be enforced so that underwriting and pricing are not unfairly discriminatory. Prohibited criteria should include race, national origin, gender, marital status, sexual preference, income, language, religion, credit history, domestic violence, and, as feasible, age and disabilities. Underwriting and rating classes should be demonstrably related to risk and backed by a public, credible statistical analysis that proves the risk-related result.

Proposition 103 requires insurers to base auto insurance premiums primarily upon driving safety record, annual miles driven and years of driving experience, rather than upon factors outside of the motorist's control, such as zip code. Other rating factors can be used only if demonstrated to have a "substantial relationship to the risk of loss" §1861.02(a).

Proposition 103 also makes the state's civil rights and consumer protection laws applicable to the insurance industry. §1861.03

E. **All consumers should reap the benefits of technological changes in the marketplace that decrease prices and promote efficiency and convenience**.

- Rules should be in place to protect against redlining and other forms of unfair discrimination via certain technologies, e.g., if companies only offer better rates, etc. online.
- Regulators should take steps to certify that online sellers of insurance are genuine, licensed entities and tailor consumer protection, UTPA, etc. to the technology to ensure consumers are protected to the same degree regardless of how and where they purchase policies.
- Regulators should develop rules/principles for e-commerce (or use those developed for other financial firms if appropriate and applicable)
- In order to keep pace with changes and determine whether any specific regulatory action is needed, regulators should assess whether and to what extent technological changes are decreasing costs and what, if any, harm or benefits accrue to consumers.
- A regulatory entity, on its own or through delegation to independent third party, should become the portal through which consumers go to find acceptable sites on the web. The standards for linking to acceptable insurer sites via the entity and the records of the insurers should be public; the sites should be verified/reviewed frequently and the data from the reviews also made public.

F. Consumers should have control over whether their personal information is shared with affiliates or third parties.

- Personal financial information should not be disclosed for other than the purpose for which it is given unless the consumer provides prior written or other form of verifiable consent.
- Consumers should have access to the information held by the insurance company to make sure it is timely, accurate and complete. They should be periodically notified how they can obtain such information and how to correct errors.
- Consumers should not be denied policies or services because they refuse to share information (unless information needed to complete transaction).
- Consumers should have meaningful and timely notice of the company's privacy policy and their rights and how the company plans to use, collect and or disclose information about the consumer.
- Insurance companies should have clear set of standards for maintaining security of information and have methods to ensure compliance.
- Health information is particularly sensitive and, in addition to a strong opt-in, requires particularly tight control and use only by persons who need to see the information for the purpose for which the consumer has agreed to sharing of the data.
- Protections should not be denied to beneficiaries and claimants because a policy is purchased by a commercial entity rather than by an individual (e.g., a worker should get privacy protection under workers' compensation).

G. Consumers should have access to a meaningful redress mechanism when they suffer losses from fraud, deceptive practices or other violations; wrongdoers should be held accountable directly to consumers.

- Aggrieved consumers must have the ability to hold insurers directly accountable for losses suffered due to their actions. UTPAs should provide private cause of action.

Proposition 103 makes state consumer protection laws applicable to the insurance industry. §1861.03.

Consumers may challenge improper actions by insurers in the courts. §1861.09. Proposition 103 provides consumers or their

representatives with the right to challenge insurance industry rates and practices. §1 861 .05.

Consumer representatives must be reimbursed for their substantial contribution to agency or judicial proceedings. §1 861 .1 0.

- Alternative Dispute Resolution clauses should be permitted and enforceable in consumer insurance contracts only if the ADR process is: 1) contractually mandated with non-binding results, 2) at the option of the insured/beneficiary with binding results, or 3) at the option of the insured/beneficiary with non-binding results.
- Bad faith causes of action must be available to consumers.
- When regulators engage in settlements on behalf of consumers, there should be an external, consumer advisory committee or other mechanism to assess fairness of settlement and any redress mechanism developed should be independent, fair and neutral decision-maker.
- Private attorney general provisions should be included in insurance laws.
- There should be an independent agency that has as its mission to investigate and enforce deceptive and fraudulent practices by insurers, e.g., the reauthorization of FTC.

7. Consumers should enjoy a regulatory structure that is accountable to the public, promotes competition, remedies market failures and abusive practices, preserves the financial soundness of the industry and protects policyholders' funds, and is responsive to the needs of consumers.

- Insurance regulators must have clear mission statement that includes as a primary goal the protection of consumers:

  Proposition 103 specifies that the mission of the Insurance Commissioner and the Insurance Department is the protection of consumers. (Preamble, Purposes Clauses).
- The mission statement must declare basic fundamentals by line of insurance (such as whether the state relies on rate regulation or competition for pricing). Whichever approach is used, the statement must explain how it is accomplished. For instance, if competition is used, the state must post the review of competition (e.g., market shares, concentration by zone, etc.) to show that the market for the line is workably competitive, apply anti-trust laws, allow groups to form for the sole purpose of buying insurance, allow rebates so agents will compete, assure that price information is available from an independent source, etc. If regulation is used, the process must be described, including access to proposed rates and other proposals for the public, intervention opportunities, etc.

  Proposition 1 03 applies the antitrust laws, allows group insurance, rebating and requires full disclosure of information. §§1 861 .03, 1 861 .1 2, Sec. 5 (repealers).
- Consumer bills of rights should be crafted for each line of insurance and consumers should have easily accessible information about their rights.
- Insurance departments should support strong patient bill of rights.
- Focus on online monitoring and certification to protect against fraudulent companies.
- A department or division within regulatory body should be established for education and outreach to consumers, including providing:
- Interactive websites to collect from and disseminate information to consumers, including information about complaints, complaint ratios and consumer rights with regard to policies and claims.

- Access to information sources should be user friendly.
- Counseling services to assist consumers, e.g., with health insurance purchases, claims, etc. where needed should be established.
- Consumers should have access to a national, publicly available database on complaints against companies/sellers, i.e., the NAIC database.
- To promote efficiency, centralized electronic filing and use of centralized filing data for information on rates for organizations making rate information available to consumers, e.g., help develop the information brokering business.
- Regulatory system should be subject to sunshine laws that require all regulatory actions to take place in public unless clearly warranted and specified criteria apply. Any insurer claim of trade secret status of data supplied to regulatory entity must be subject to judicial review with burden of proof on insurer.

Proposition 103 requires all information submitted to the Department of Insurance for regulatory purposes be made available to the public. §1861.07. Judicial review is provided. §1861.09.

- Strong conflict of interest, code of ethics and anti-revolving door statutes are essential to protect the public.
- Election of insurance commissioners must be accompanied by a prohibition against industry financial support in such elections.
- Adequate and enforceable standards for training and education of sellers should be in place.
- The regulatory role should in no way, directly or indirectly, be delegated to the industry or its organizations.
- The guaranty fund system should be prefunded, national fund that protects policyholders against loss due to insolvency. It is recognized that a phase-in program is essential to implement this recommendation.
- Solvency regulation/investment rules should promote a safe and sound insurance system and protect policyholder funds, e.g., rapid response to insolvency to protect against loss of assets/value.
- Laws and regulations should be up to date with and applicable to e-commerce.
- Antitrust laws should apply to the industry.

Proposition 103 applies the antitrust laws. §1861.03

- A priority for insurance regulators should be to coordinate with other financial regulators to ensure consumer protection laws are in place and adequately enforced regardless of corporate structure or ownership of insurance entity. Insurance regulators should err on side of providing consumer protection even if regulatory jurisdiction is at issue. This should be stated mission/goal of recent changes brought about by GLB law.
- Obtain information/complaints about insurance sellers from other agencies and include in databases.
- A national system of "Consumer Alerts" should be established by the regulators, e.g., companies directed to inform consumers of significant trends of abuse such as race-based rates or life insurance churning.
- Market conduct exams should have standards that ensure compliance with consumer protection laws and be responsive to consumer complaints; exam standards should include agent licensing, training and sales/replacement activity; companies should be held responsible for training agents and monitoring agents with ultimate review/authority with regulator. Market conduct standards should be part of an accreditation process.
- The regulatory structure must ensure accountability to the public it serves. For example, if consumers in state X have been harmed by an entity that is regulated by state Y, consumers

would not be able to hold their regulators/legislators accountable to their needs and interests. To help ensure accountability, a national consumer advocate office with the ability to represent consumers before each insurance department is needed when national approaches to insurance regulation or "one-stop" approval processes are implemented.

Proposition 103 has a fully accountable regulatory process with full opportunity for consumer participation. The insurance commissioner is elected by vote of the people. §§ 1861.05, 1861.09, 1861.10, Govt. Code §12900.

- Insurance regulator should have standards in place to ensure mergers and acquisitions by insurance companies of other insurers or financial firms, or changes in status of insurance companies (e.g., demutualization, non-profit to for-profit), meet the needs of consumers and communities.
- Penalties for violations must be updated to ensure they serve as incentives against violating consumer protections and should be indexed to inflation.

8. Consumers should be adequately represented in the regulatory process.

- Consumers should have representation before regulatory entities that is independent, external to regulatory structure and should be empowered to represent consumers before any administrative or legislative bodies. To the extent that there is national treatment of companies or "one-stop" (OS) approval, there must be a national consumer advocate's office created to represent the consumers of all states before the national treatment state, the OS state or any other approving entity.

Proposition 103 provides full opportunity for consumer intervention and participation. Consumers may challenge improper actions by insurers in the courts. §1861.09. Proposition 103 provides consumers or their representatives with the right to challenge insurance industry rates and practices. §1861.05. Consumer representatives must be reimbursed for their substantial contribution to agency or judicial proceedings. §1861.10.

- Insurance departments should support public counsel or other external, independent consumer representation mechanisms before legislative, regulatory and NAIC bodies.
- Regulatory entities should have well-established structure for ongoing dialogue with and meaningful input from consumers in the state, e.g., consumer advisory committee. This is particularly true to ensure needs of certain populations in state and needs of changing technology are met.

APPENDIX 3

HISTORY OF PROPOSITION 103 IMPLEMENTATION UNDER FOUR VERY DIFFERENT COMMISSIONERS

1988 – 1990 (Insurance Commissioner Gillespie)

California's final appointed insurance commissioner was Roxani Gillespie, who was in office when Proposition 103 was approved by voters; Gillespie had opposed the measure and, apparently under the belief that the Supreme Court would invalidate the measure, refused to implement its requirements until the Calfarm decision was issued. Commissioner Gillespie subsequently began a series of informal informational hearings and public announcements; however, no progress was made toward the two time-sensitive reforms: (1) the issuance of rollback orders, which was to be completed before November 8, 1989 so that insurers would be able to seek rate increases under the measure's prior approval system thereafter; and (2) the development of a new rating system to replace territorial rating.

In October 1989, Commissioner Gillespie froze insurance rates pending completion of the rollback process. She lifted this freeze prior to the end of her term. On December 13, 1990, shortly before she left office, 60 insurers were granted price increases.

The combination of Commissioner Gillespie's inability -- or, as some consumer advocates argued, her unwillingness -- to implement the Proposition, and the decision by insurers to pursue challenge in the courts against all efforts to implement the measure, effectively precluded implementation of the rollback and classification portions of Proposition 103's reforms during the balance of Gillespie's tenure, although many of the Proposition's reforms -- such as removal of antitrust exemption, anti-rebate and anti-group laws did become effective even absent Commissioner action.

1990-1994 (Insurance Commissioner Garamendi)

The state's first elected insurance commissioner won the post on November 6, 1990. John Garamendi, formerly a state Senator, took office on January 7, 1991.

In his first act in office, Commissioner Garamendi immediately placed a freeze all property-casualty insurance rates, which he announced would not be lifted for any insurer until that insurer had complied with a rollback order from the Commissioner and all related litigation had been concluded. Commissioner Garamendi subsequently withdrew most of the rollback and other regulations proposed by Commissioner Gillespie and issued stringent new regulations that established normative standards for insurer

profitability and efficiency. The regulations specified a formula that determined the amount, if any, each insurer would pay under the rollback requirement.[68] The regulations:

• Capped the rate of return.

• Established ceilings for executive salaries, and set an overall limit on expenses equal to the industry average, rewarding insurers that operate more efficiently with a higher rate of return. Expenses in excess of that amount were to be excluded from the rate base.

• Prohibited insurers from engaging in bookkeeping practices that inflate their claims losses, and limited the amounts insurers could set aside as surplus and reserves.

• Forbade insurers from passing through to consumers the costs of the industry's lobbying, political contributions, institutional advertising, the unsuccessful defense of discrimination cases, bad faith damage awards and fines or penalties.

With revisions to reflect a greater rate of return than would govern the rollback requirement, the regulations were intended to be used to govern the process of approval for rate increase requests once an insurer satisfied its rollback obligation.

Insurers challenged the rollback formula as confiscatory. However, in August 1994, the California Supreme Court unanimously upheld the regulations as constitutional.[69]

Commissioner Garamendi's tenure reflected a massive change in the mission and role of the Commissioner and the Department of Insurance. Forced to begin from scratch, his implementation of Proposition 103 proceeded carefully but efficiently. However, litigation by insurers, as well as hostile actions against reform by state lawmakers and then-Governor Pete Wilson contributed to delays in full enforcement by Garamendi of Proposition 103.

1994-2000 (Insurance Commissioner Quackenbush)

For state legislator Chuck Quackenbush's tenure as commissioner was plagued with criticism from its inception. As a candidate, Quackenbush said, "You can't take company money from [the insurance industry]. You regulate them. The conflict there is difficult to explain to the voters." He went on to accept over $2.5 million from the industry for his 1994 campaign and took over $6 million from the industry before being forced from office in 2000 amidst a major scandal.

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[68] Findings and Determinations of the Insurance Commissioner, State of California, *In the Matter of Determination of Exposure Basis, Reserve-Strengthening, Executive Compensation and Efficiency Standards for 1989 Rate Calculations*, File No. RCD-1 (August 14, 1991); Findings and Determinations of the Insurance Commissioner, State of California, *In the Matter of Determination of Rate of Return, Leverage Factors and Projected Yield for 1989 Rate Calculations*, File No. RCD-2 (August 14, 1991).

[69] *Twentieth Century Insurance Co. v. Garamendi*, 8 Cal.4th 216 (1994). The U.S. Supreme Court refused the insurance industry's final appeal. *Century-National Ins. Co. v. Quackenbush*, 513 U.S. 1153 (February 21, 1995) (*cert. denied*); *State Farm Mutual Automobile Insurance Co. v. Quackenbush*, 513 U.S. 1153 (February 21, 1995) (*cert. denied*).

Quackenbush's 1994 campaign.

After four years of a pro-consumer insurance commissioner, the insurance industry was determined to install an industry-friendly commissioner. Insurance industry interests provided 73% of Quackenbush's campaign war chest in 1994.

* Quackenbush never mentioned the office of insurance commissioner in his campaign television ads or mailings; he refused to participate in most debates and press interviews; and he relied almost entirely on the insurance industry for support. It was even revealed that employees of Allstate, calling voters to urge support for Quackenbush, identified themselves as representatives of police organizations.

* An audit by the Franchise Tax Board subsequently found that Quackenbush failed to report at least $100,000 in insurance industry contributions, did not properly detail $748,000 in expenses and omitted required background information of almost 40% of his individual contributors. The audit found that Quackenbush did not comply with disclosure and record-keeping provisions of the Political Reform Act. Quackenbush was ultimately fined $50,000 by the state's Fair Political Practices Commission.

Quackenbush and Proposition 103 Refunds

* Even after the courts ruled against industry challenges, Quackenbush negotiated numerous deals with insurers — many of whom had contributed to his campaign – to substantially reduce the Proposition 103 refunds ordered by his predecessor Commissioner John Garamendi.

* In one instance, 20th Century Insurance Company's Proposition 103 rollback obligation was cut from $120 million to $46 million due to purported fiscal problems arising from the company's Northridge Earthquake losses. However, 20th Century was able to afford a $5,000 campaign contribution to Quackenbush's election campaign, a month after he had won office. In 1996, Quackenbush granted 20th Century the opportunity to re-enter the homeowner and earthquake insurance market. The insurer also contributed $100,000 to Quackenbush's Proposition 213 initiative that year.

Quackenbush and Earthquake Insurance Under 103 Rules

* Quackenbush came under fire for failing to address widespread complaints concerning insurers' mishandling of Northridge earthquake claims. In 1996, legislation sponsored by Quackenbush at the behest of the insurance industry established a new state agency, the California Earthquake Authority, which assumed responsibility for providing earthquake insurance coverage, effectively providing the insurance industry with a potential $39 billion dollar bailout in the event of a catastrophic earthquake. Homeowners purchasing CEA policies were forced to pay about twice as much for only about half the coverage available prior to the CEA. In February 1998, after a hotly contested hearing

held pursuant to Proposition 103, an administrative law judge found that the rates charged by the CEA were illegal and ordered the Authority to recalculate the rates.

Quackenbush and Insurance Rate Increases Under 103 Rules

* While California was the only state in the nation to experience consistent rate reductions in the post-103 period, data assembled by independent experts confirmed that insurers were reaping excessive profits and that rates should be reduced even further. In 1996, California consumer organizations petitioned Quackenbush to conduct hearings on industry profits and to order rate reductions. Quackenbush refused to investigate, much less limit, the insurers' profits. In February 1998, Quackenbush quashed a study on excessive auto insurance rates and profits by a task force subcommittee he himself had previously appointed.

* Quackenbush failed to complete and issue Garamendi-era regulations governing rate change requests under 103's prior approval process, choosing to allow companies to set rates without standards.

* Quackenbush approved an average of nearly one rate increase request for every day he was in office — 1,002 rate increases through March 18, 1998 (1,172 days in office). This included 122 increase approvals for personal earthquake insurance (32 of them for 100% or more!). One of these was a 100% increase for Allstate, which contributed $266,502 to his campaign committees since 1994.

There are many other anti-consumer activities by Commissioner Quackenbush that could be listed here. Since most are not directly related to the Proposition, we will resist the temptation to cite them all. However, we will cover the large scandal, which led to the resignation in disgrace of the Commissioner. We do so because the insurers involved include some of the largest auto insurers, which may give insight into why there was inaction by the Commissioner on excess profits for these insurers during his term.

The Quackenbush/Northridge Earthquake Scandal

In March 2000, the Los Angeles Times exposed what would become the largest political scandal in recent California history. Based on information provided by a Department of Insurance whistleblower, the Los Angeles Times reported that Insurance Commissioner Chuck Quackenbush had shielded the state's largest insurance company, State Farm, and two other companies from $3.37 billion of dollars in fines – the largest ever assessed against insurance companies in the United States – in exchange for $10.75 million in contributions to non-profit organizations and to his own political committees.

Responding to homeowner complaints concerning the claims handling practices of insurance companies in the aftermath of the Northridge earthquake, Department of Insurance staff had conducted a series of secret investigations into the conduct of insurers. They recommended that State Farm, 20th Century (now 21st Century) and Allstate pay $3.7 billion in fines and restitution. Initially, Quackenbush claimed that the

recommended payment was merely a negotiating tactic. Quackenbush told legislators that the $12 million in tax-deductible donations, made by five insurance companies to non-profit entities set up and controlled by Quackenbush in lieu of the penalties, was an appropriate "settlement" of his agency's investigation of the insurers' conduct. For their part, the insurers repeatedly insisted they did nothing wrong after Northridge, but agreed to the relatively modest donations out of charity. They pointed to the settlement agreements Quackenbush signed with the insurers in exchange for the payments to the non-profit entities. The agreements largely exonerated the insurers of misconduct, concluding that the companies, faced with "an extraordinary circumstance" (a big earthquake), handled their policyholders' claims "in good faith."

Company	**Disposition Recommended by DOI Staff**	**Disposition by Quackenbush**	**Actual Expenditure by Company**
State Farm	$2.38 Billion in fines; $114.7 Million to a policyholder fund	Final Order finds State Farm acted in good faith in Northridge claims	$2,000,000 to foundation. $5,000 "costs" to DOI.
Allstate	$172 Million in fines; $73.7 Million to a policyholder fund	Northridge created "extraordinary circumstances" for Allstate	$2,000,000 to foundation
20th Century	$819 Million in fines; $44.2 Million to a policyholder fund	Allowed to resume selling homeowners insurance; MCE found "alleged deficiencies in claims files reviewed"	$6,550,000 to foundation. $200,000 for "public education" $100,000 fine
Farmer's	Unknown	Unknown	$1,000,000 to foundation $2,500 "costs" to DOI
Fireman's Fund	Unknown	Unknown	$550,000 to foundation

But public disclosure of the secret internal reports – known as "Market Conduct Examinations (MCEs)" – belied Quackenbush's assertion that his settlements were fair. Executive Summaries[70] of the MCEs indicated that the Department, in fact, conducted full-scale investigations between November 26, 1997 and November 18, 1998 into the companies' behavior. According to the reports, the insurance companies routinely low-balled their policyholders, delayed or denied payment of reasonable claims and frequently misled their policyholders concerning whether their claims were even covered. For example:

- State Farm did not properly explain policyholder's benefits, misled policyholders or misrepresented settlement in 37% of the 825 files reviewed**.** State investigators found

70

an average of 3.5 violations of state law in 47% of the State Farm claims files they reviewed. So pervasive was State Farm's claims infractions that investigators recommended the company be ordered to review every claim – auto, homeowner or business — it had handled in the preceding five years, and make any necessary repayments.

- 75% of 20th Century's files included citations, and 20th Century offered unacceptably low settlements in 32% of the 431 reviewed and**;**
- Allstate reduced settlements based on unnecessary or excessive depreciation of property value in 16% of the 808 files reviewed.

Subsequent investigations revealed that the foundations established by Quackenbush were used as "slush funds" to benefit Quackenbush's political efforts, members of his family and friends:

• $3 million were spent on "educational" television ads featuring Quackenbush.
• $500,000 donation made to Sacramento Urban League shortly after Quackenbush joined the Board of Directors of the organization.
• $263,000 donation to a football camp attended by Quackenbush's children.

An extensive legislative inquiry was undertaken, while state and federal law enforcement agencies began their own investigations. When it appeared certain that Quackenbush would be impeached for misconduct in office, he resigned office on June 28, 2000 and moved to Hawaii. Meanwhile, law enforcement investigations are continuing, and have expanded to include Quackenbush's role in derailing litigation brought by another state agency against Lloyds of London for defrauding investors. Several individuals involved in running the Quackenbush foundations have been indicted.

In the aftermath of the scandal, California consumer groups concluded that current state claims handling laws were insufficient to protect the public against abuse by insurance companies, which earn huge profits by investing our premiums and therefore have a powerful incentive to delay or deny claims. They called on California lawmakers to enact new laws that protect consumers by requiring insurance companies to pay all legitimate claims fully and fairly. Additionally, the groups called for a ban on insurance industry campaign contributions to the elected commissioner.

VI. 2000- present (Insurance Commissioner Harry Low)

On July 31, 2000, California Governor Gray Davis appointed retired appellate justice Harry Low to fill the vacancy created by Quackenbush's resignation. Low was considered an individual of high integrity, but consumer groups raised questions concerning his role as a private arbitrator and whether Low had the ability and temperament to be a zealous advocate for consumers.

In the ensuing year, Low has taken a low profile and described his principal goal as restoring the credibility and integrity of the Department of Insurance. However, in critical litigation to enforce Proposition 103's prohibition on unfair rating practices (discussed

below), Low sided with the insurance industry in support of a court decision which upheld Quackenbush regulations that approved of the continued use of territorial rating in violation of the express provisions of Proposition 103. Low subsequently stated he would revisit Quackenbush's regulations.

APPENDIX 4

SPREADSHEETS SHOWING POST-PROPOSITION 103 (1989[71] TO 1998) DATA (See Attachment)

EXPENDITURE CHANGES FOR 1989 TO 1998:

- Charts of Premium Changes Since Proposition 103 (first chart is total expenditure and total premium in California and the nation; second chart breaks premium out by coverage; underlying data displayed on third page).
- Ranked by Least to Most Change in the 1989 to 1998 Period.
- By Seatbelt Law Status.
- By Moradi Law Status.
- By Regulatory Status.

PROFITABILITY DATA

- By Regulatory Status – 1989 to1998.
- 1992 to 1999 California – All Proposition 103 Lines.
- 1002 to 1999 Countrywide – All Proposition 103 Lines.

LISTING OF STATES THAT MEET KEY CONSUMER STANDARDS FOR REGULATORY EXCELLENCE

[71] Proposition 103 was enacted in November 1998 but did not take full effect until lawsuits were completed. The major lawsuit, Calfarm, was decided in May, 1989 and the first rate action, the freeze, was in October of 1989. Thus, 1989 is the proper base year for measuring Proposition 103's achievements.