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PROPOSITION 103'S IMPACT ON AUTO INSURANCE PREMIUMS IN CALIFORNIA

15TH ANNIVERSARY REPORT

Fifteen years ago, on November 8, 1988, California voters approved Proposition 103 to address massive increases in the price of auto, home and business insurance between 1985 and 1987 – the so-called "insurance crisis," which rocked the state as well as the nation in the mid-1980s. Efforts in the state legislature to enact reforms in 1987 were blocked by the insurance lobby and insurers spent $80 million in an unsuccessful effort to defeat the grassroots voter initiative.

Under Proposition 103, insurance companies must justify to the insurance commissioner any rate changes prior to imposing higher rates. The law, which applies to most lines of property-casualty insurance – including auto, homeowners, medical malpractice and commercial liability but not workers compensation, health or life insurance – also sets standards for company profits, allows consumers to review insurer data and challenge proposed rate increases and applies anti-trust laws to insurance companies, which are exempt from such laws in most of the country. The law mandates that insurance companies provide a discount to all consumers with good driving records. Proposition 103 also required insurers to refund over $1.2 billion directly to consumers to compensate for excessive premiums during the 1980s.

Proposition 103's rollback and prior approval rate regulation requirements took effect in May 1989, when the California Supreme Court lifted an injunction and upheld the provisions of the initiative, including its 20% rate rollback.[1]

The following tables summarize insurance industry data drawn from company annual reports and published by the National Association of Insurance Commissioners (NAIC).[2] This study analyzes data for the years 1989-2001, encompassing the entire period following the implementation of Proposition 103 for which data is available.

As the data show, insurance regulation has proved to be a powerful restraint against the national trend toward higher insurance rates over the past 15 years.

[1] The Court altered the legal standard by which an insurance company could obtain an exemption from the rollback. Proposition 103, as written, permitted exemptions only for those insurers who could show that full compliance would pose a "substantial threat of insolvency"; the Supreme Court ruled that such a standard might deprive insurers of their constitutional rights to a fair return, and substituted a "fair profit" test.

[2] *State Average Expenditures & Premiums for Personal Automobile Insurance* 1993-2001, National Association of Insurance Commissioners

I. The average auto liability premium dropped 22% in California between 1989 and 2001.

Prior to Proposition 103, auto insurance premiums in California rose dramatically each year. Pre-election rate increases by insurance companies in anticipation of Proposition 103's passage, and post-election rate increases taken while Proposition 103 was stayed pending California Supreme Court review, pushed the average annual liability premium in California to $519.39 by 1989.

According to the latest NAIC data, California's average annual auto liability insurance premium for 2001 was $404.48 -- 22% less than the 1989 figure. The average premium decrease in California becomes even more striking when adjusted for inflation (using the Bureau of Labor Statistics Inflation Calculator). The average premium in 1989, in 2001 dollars, was $741.81. In comparison, the average premium in 2001 was 45% lower.

Table 1. Comparison of Average Annual Auto Liability Premiums, 1989-2000

Year	California Premium	California Premium (2001 dollars)
1989	$519.39	$741.81
1990	$501.34	$679.32
1991	$522.95	$679.99
1992	$510.71	$644.67
1993	$512.52	$628.15
1994	$502.76	$600.80
1995	$514.53	$597.92
1996	$508.71	$574.20
1997	$492.31	$543.23
1998	$447.51	$486.22
1999	$405.85	$431.43
2000	$391.24	$402.37
2001	$404.48	$404.48

II. Auto premiums in California fell *22%* while premiums throughout the rest of the nation rose 30.2%.

Another measure of the impact of Proposition 103 is a comparison with average liability premiums in other states. While liability premiums for the rest of the country increased by $95.81, or 30.2% on average since 1989, California's dropped by $114.91, or 22%. Tables 2 and 3 below compare California's average premium to the rest of the nation's average.

Table 2. Comparison of Average Liability Premiums, 1989-2000

Year	California	Rest of Nation[3]
1989	$519.39	$317.32
1990	$501.34	$338.55

[3] In this table and in subsequent tables, "Rest of Nation" data do not include California data.

1991	$522.95	$358.82
1992	$510.71	$381.69
1993	$512.52	$400.80
1994	$502.76	$411.40
1995	$514.53	$419.45
1996	$508.71	$431.45
1997	$492.31	$434.17
1998	$447.51	$423.39
1999	$405.85	$402.60
2000	$391.24	$398.44
2001	$404.48	$413.13

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

As Table 3 below shows, California auto insurance rates have consistently declined faster or rose more slowly than the national average since the implementation of Proposition 103. Only during 1995 – the first year of former insurance commissioner Chuck Quackenbush's tenure – did California auto premiums increase faster than the nation. Quackenbush eventually resigned in disgrace after evidence of inappropriate financial dealings with insurance companies surfaced. Later into his tenure, insurance companies seeking small rate decreases were forced to cut rates more substantially in order to comply with Proposition 103 after consumer groups intervened in the regulatory process. Thus, between 1997 and 2000, when insurers were reducing rates throughout the country, California consumers earned far steeper premium decreases because of Proposition 103.

Table 3. Comparison of Growth in Average Liability Premiums, 1989-2000

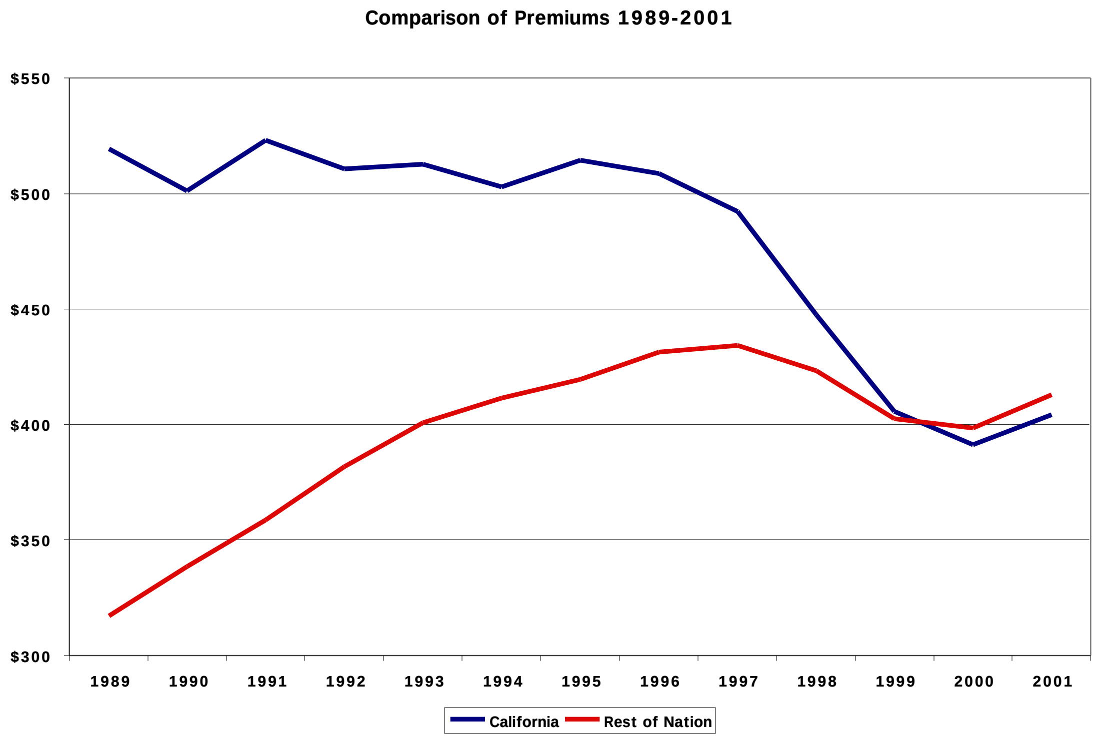
Calculation is change in premiums/liability written car-years

Period	California % Change	Rest of Nation % Change
1989-90	-3.5%	6.7%
1990-91	4.3%	6.0%
1991-92	-2.3%	6.4%
1992-93	0.4%	5.0%
1993-94	-1.9%	2.6%
1994-95	2.3%	2.0%
1995-96	-1.1%	2.9%
1996-97	-3.2%	0.6%
1997-98	-9.1%	-2.5%
1998-99	-9.3%	-4.9%
1999-2000	-3.6%	-1.0%
2000-2001	3.3%	3.7%
1989-2001	-22.1%	30.2%

III. California's average liability premium has plummeted relative to the rest of the nation since the passage and implementation of Proposition 103.

At the time of Prop 103's implementation California's automobile premiums were extraordinarily high when compared to other states and to the nation as a whole. However, since Proposition 103 has been in effect, California's average premium has fallen, while that of the rest of the nation has climbed. In 2000, those trajectories crossed, and California's average liability premium -- $391.24 – was lower than that of the rest of the nation – $398.44. The sharp drop in California's average premium relative to that of other states brought California's rank down from 2nd highest premiums in 1989 to 22nd in 2001. In addition to the overall rate decreases associated with Proposition 103, California insurance consumers received over $1.2 billion in insurance rebate checks due to Proposition 103, which the data in this study do not reflect.

Table 4. Comparison of Growth in Average Liability Premiums, 1989-2001



IV. California's overall post-Prop 103 premium decline defies national trend toward higher rates.

In addition to lowering auto liability premiums, Prop 103 has slowed premium growth for other types of automobile coverage at the same time that the rest of the nation saw its premiums increase drastically. California's comprehensive premiums have fallen 9% while comprehensive premiums for the rest of the nation have shot up by 40%. Collision premiums in California have gone up only 12%, in contrast to the rest of the country's 32%. The average California driver's overall premium (Average Expenditure) has fallen 12% since 1989, from $747.97 to $658.32.[4]

Table 5. Comparison of Average Collision and Comprehensive Premiums, 1989-2001

	Collision		Comprehensive	
Year	California	Rest of Nation	California	Rest of Nation
1989	$235.53	$193.13	$120.68	$95.95
1990	$245.19	$197.98	$125.80	$99.39
1991	$246.35	$202.29	$122.58	$101.31
1992	$250.32	$203.39	$125.15	$107.35
1993	$257.50	$202.45	$131.76	$109.24
1994	$254.99	$202.41	$135.93	$111.70
1995	$240.93	$210.12	$131.30	$118.75
1996	$238.91	$220.74	$128.91	$122.87
1997	$246.33	$234.35	$121.04	$127.17

[4] Average Expenditure reflects the variation in combined coverage types among consumers.

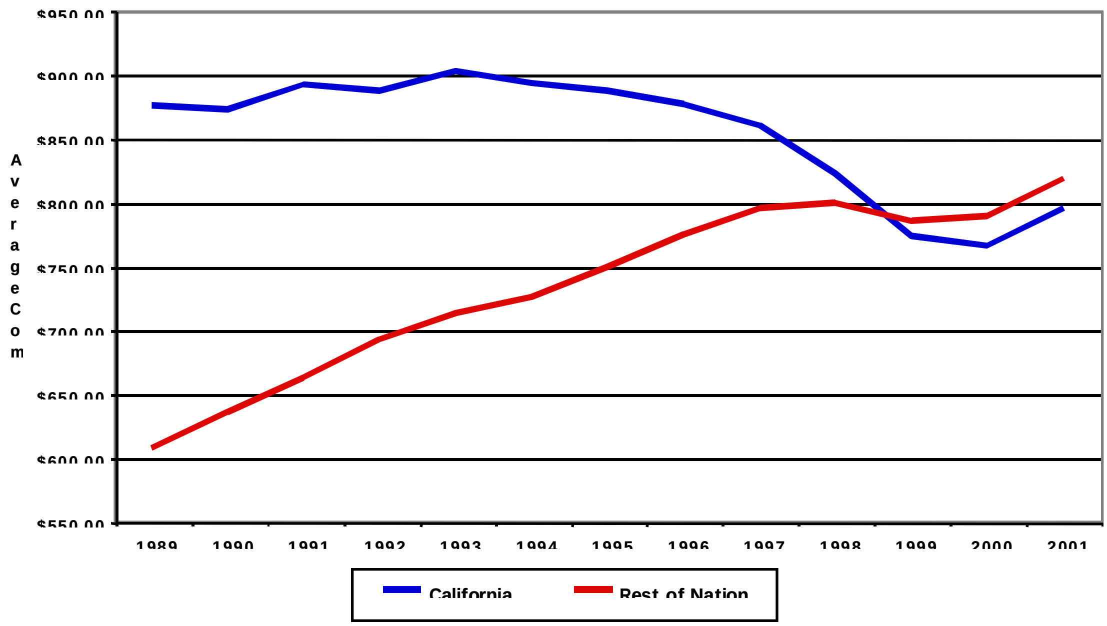
1998	$253.52	$244.54	$121.06	$131.05
1999	$253.45	$249.40	$113.67	$132.72
2000	$263.64	$255.66	$110.32	$134.32
2001	$282.42	$270.75	$108.46	$133.99

Calculation is premiums/written car-years (total premiums written divided by the total number of policy-years for private passenger collision and comprehensive coverage)

V. Combined liability, collision and comprehensive premiums are down 9.2% for Californians, up 35% nationally since Proposition 103

In 1989 Californians paid $875.60 for liability, collision and comprehensive combined coverage on average. Nationwide consumers paid $606.40 for the combined coverage. However, with Proposition 103 in effect, California drivers' fortunes have changed, as combined average premium in California in 2001 was $795.36, a 9.2% decline while nationally, motorists paid $817.87, a 34.9% increase.

Table 6. Comparison of Average Combined Premiums, 1989-2001



VI. Insurance rates in recent years and the "Garamendi Effect"

Throughout the country, including California, auto insurance premiums and virtually all insurance premiums have increased since 2000. The data synchronize with national economic factors that historically push rates upward. Namely, a rapid decline in investment opportunities – the result of the bursting of the stock market bubble, the degradation of corporate bonds in the wake of scandals such as Worldcom and Enron and the historically low interest rates – have led insurers to increase rates in order to maintain profits earned from investment income during the mid 1990s.

Though Californians, under Proposition 103, have seen premiums increase somewhat less rapidly, the Quackenbush scandal certainly impacted the ability of regulators with the California Department of Insurance to effectively resist insurers increases. After the resignation of Quackenbush in June of 2000, a Department shakeup during the following year and the focus on internal organizational issues left the rate regulation function of the Department dramatically weakened during 2001 and 2002.

The flow of insurance rate increases has apparently been stanched under the new administration led by John Garamendi, who was elected commissioner in November 2002. Only two among the twenty largest insurers have even requested auto insurance rate increases in 2003 and to date no increases have been approved. Under Proposition 103, no rate increases can take effect unless the insurer can justify the need for the increases and the insurance commissioner has approved it.

VII. California: a profitable market for insurers under Prop 103

Despite the insurance industry's automatic negative reaction to insurance regulation, California, under the stringent rules of Proposition 103, has been a more profitable environment for insurers than the nation as a whole. According to the most recent data available from the National Association of Insurance Commissioners, in the majority of lines of insurance returns are better in California than countrywide.[5]

Whether one compares return on net worth or profit on insurance transactions (both are measures of profitability used by NAIC), the findings consistently show that California is generally more profitable for insurers than the national average.

Table 7. Insurer Profitability in California vs. Countrywide Average

Return on Net Worth	10 Year Average 1992-2001	
Line of insurance	California	Countrywide
Private Passenger Auto (Total)	13.7%	9.8%
Homeowners Multiple Peril	5.7%	(3.4%)
Commercial Auto (Total)	10.0%	7.2%
Farmowners Multiple Peril	7.3%	0.9%
Medical Malpractice	12.5%	9.6%

Notably, workers compensation has not been as profitable in California as that line has been nationally. Workers compensation insurance, however, was deregulated in California in 1993 and is in crisis currently.

California has been a profitable marketplace for insurers specifically because of the regulatory regime. Regulation serves to restrain the companies from damaging themselves as well as hurting consumers. Insurance regulation is not meant to produce the lowest premiums, it is meant to produce the most appropriate premiums for the risk insured; insurance regulation guards against both excessive and inadequate, as well as unfairly discriminatory rates. As a result, regulated lines of insurance result in more stable rates for customers, even if they are not the absolute lowest premiums at certain points in time.

The stable profitability associated with regulatory controls creates an environment in which insurers want to sell in the state. That is why there are so many insurers serving California customers. There are over 200 companies selling auto insurance in California, 150 selling homeowners and almost 50 selling medical malpractice insurance.

VIII. Insurers are still fighting Prop 103 fifteen years later

[5] *Profitability by Line by State In 2001,* National Association of Insurance Commissioners, December 2002

Although Proposition 103 stood up to each and every legal challenge and despite its indisputable success, insurers continue to seek ways to undermine the regulatory regime created by the 1988 initiative. Over the past two years Mercury Insurance has contributed nearly a million dollars to politicians as it waged a legislative battle to strip from Proposition 103 an important consumer protection against insurance discrimination. The proposal, which was signed by Governor Davis this year, would allow insurers to surcharge motorists who have never been insured in the past or have had a lapse in insurance coverage. Proposition 103 bans any discrimination against drivers based on their prior insurance status. FTCR has recently sued with other consumer and civil rights groups to invalidate the law.

Over the years there have been other efforts to dismantle Proposition 103, including challenges to the initiative's rollbacks and the rewriting of regulations to allow insurance companies to base auto premiums primarily on a driver's zip code rather than their driving record. California Insurance Commissioner John Garamendi has agreed to review current rules, which consumer groups argue allow zip code to play too great a role in setting insurance rates, in violation of Proposition 103.

IX. Conclusion: Proposition 103 lowered auto insurance rates for California drivers

California motorists paid less for insurance in 2001 than they did prior to the implementation of Proposition 103, while motorists around the country were paying substantially more in 2001 than they did in 1989. Additionally, drivers around the country pay more on average for auto insurance than California motorists pay. In short, Proposition 103 has provided the Department of Insurance and consumers themselves with the regulatory tools to ensure low and stable premiums.

During 2001 and 2002, insurers took advantage of the weakened Department of Insurance in the wake of the Quackenbush scandal, and edged rates upward in California just as the industry did freely throughout the nation where regulatory oversight is inevitably weaker and often nonexistent. In order to maintain the strong track record of Prop 103, however, the California Department of Insurance must maintain a vigilant watch over company rate proposals. Additionally, lawmakers and the courts must be wary of and resistant to constant attempts by insurance companies and the industry as a whole to both chip away at the protections of Prop 103 and gut the voters' initiative entirely.

When voters approved Proposition 103 on November 8, 1988, they spoke out against the greed and power of the unfettered insurance industry. Californians argued that a product as integral to economic life and financial security as insurance should overseen with a meticulous and vigorous regulatory system in order to rein in insurance rates and protect consumers from the practices that had for years driven insurance premiums higher and higher. Fifteen years of experience have proven the voters right.