

**Maryland Insurance Administration's
Auto Insurance Task Force to Study Rates in Urban Areas**

Minutes of the Meeting of
May 26, 2005

Attendance

Alfred W. Redmer, Jr., Insurance Commissioner, Co-Chair
Senator Lisa Gladden, Co-Chair
Delegate Obie Patterson
Delegate Peter Hammen

Brett Lininger, Maryland Insurance Administration, Staff
Kimberly Robinson, Maryland Insurance Administration, Staff
Kathleen A. Birrane, Esquire, Counsel to the Task Force

MIA staff also present:

P. Randi Johnson, Associate Commissioner of Property and Casualty

I. Introductions

Introductory remarks were made by the co-chairs, Insurance Commissioner Alfred W. Redmer, Jr. and Senator Lisa Gladden.

Kathleen Birrane, Principal Counsel to the Maryland Insurance Administration, indicated that the meetings of the Task Force would be subject to Maryland's Open Meetings Act and that the Attorney General's office was available to answer questions and advise the Task Force on issues that may arise.

II. Historical Overview of Legislation

Brett Lininger offered a review of past legislative action regarding auto insurance.

III. Overview of Issues Discussed in the Abell Foundation Report

Tom Waldron presented information regarding the report that he wrote for the Abell Foundation, "Actuarial Discrimination: City Residents Pay Up To 198% More For Car Insurance Than County Residents." He prefaced his remarks by stating that he was neither an actuary nor an expert on insurance. Mr. Waldron noted that private passenger auto rates are higher in Baltimore City and Prince George's County than in surrounding areas. He also stated that higher rates make auto insurance less affordable for the residents of those areas and may result in increased numbers of uninsured motorists in those areas. While recognizing that there is an actuarial justification for the use of territorial factors in establishing auto insurance rates, Mr.

Waldron questioned the general fairness of territorial factors, since the application of those factors seems to have the greatest impact on those least able to absorb higher costs. Mr. Waldron also questioned the assumptions and methodologies that underlie the geographic boundaries drawn by some insurers for rating purposes, as the rationale for those boundaries was not apparent to him and thus, in his mind, raised concerns about whether improper discriminatory factors (such as race) impact the development and maintenance of territorial boundaries.

Mr. Waldron pointed out that it would be a challenge to enact legislation that would reduce auto insurance rates for residents of urban areas, if that legislation would result in higher costs for the residents of other jurisdictions. Mr. Waldron summarized the approaches that some other states have taken to reduce insurance rates in urban areas:

- California - Created a bare-bones policy that provides limited coverage for a cost of approximately \$400 a year. Has an income restriction, a residency restriction, and requires a minimum driving record. This type of policy is available only in the Los Angeles and San Francisco areas. This program has not been a success, but this may be due to poor marketing of its availability.
- Philadelphia, PA - Offers a limited tort policy where policyholders give up some rights to sue in exchange for lower premiums. Took political pressure to get insurers to bring down rates to reflect the decreased benefit.
- Massachusetts - Placed limits on the differences among geographic areas. Many companies do not like this system. Massachusetts also allows group discounts (unions, churches, etc.).
- New Jersey - Has a bare-bones policy for one dollar per day (\$365 annually). It provides catastrophic coverage only and the coverage is capped at \$250,000.

Mr. Waldron made a number of suggestions for the Task Force's consideration:

- The Maryland Automobile Insurance Fund (MAIF) should be allowed to accept installment payments as a way of easing the burden of payment on its subscribers.
- The use of credit scoring should get another look.
- "Pay-as-you-drive" policies might be a possible option to render cost savings in urban areas.

- Increase funding for auto theft prevention programs. Funding has decreased in recent years, but such programs have been shown to reduce the frequency of auto theft, which reduces insurance rates.
- Tort reform is another approach to bringing down auto insurance rates. Approaches to address collateral source issues and abuses around soft tissue injuries could be explored. Some places have considered using a fee schedule for compensation of soft tissue injuries (similar to the workers' compensation schedules).
- Further study is needed of the relationship between the cost of insurance and the cost of litigation.

IV. Actuarial Overview of Rates in Urban Areas

David Unnewehr of the American Insurance Association (AIA) presented information regarding the use of territorial factors in the development of auto insurance rates. Many reports, including the Abell report, are often based on rate data that is several years old. In order to try and base his conclusions on more up-to-date information, Mr. Unnewehr contacted the Insurance Services Organization (ISO) to obtain more current data. He found that while rates continue to be higher in urban areas, the relationship between the rates in urban areas and the rest of the state is no different than it was 10 years ago. Mr. Unnewehr stated that it is the frequency of claims that is driving up the rates in urban areas. Recent data obtained from ISO shows that claim frequency is twice as much in Baltimore City as it is in other parts of the State.

Members asked questions as to how losses incurred by insurers on behalf of policyholders are attributed from a territorial perspective. It was confirmed that insurers attribute losses based on the jurisdiction where the at-fault driver garages the vehicle, regardless of where the accident occurs. Therefore, if a Howard County driver is at fault in an accident in Anne Arundel County, the losses incurred by the insurer in connection with that accident will be included in the company's loss statistics for Howard County, the place where the at-fault driver garages the auto. This is done because the frequency of the claim and the severity of the claim are attributable to the at-fault driver.

Members discussed with industry what role personal injury protection (PIP) coverage has played in litigation. PIP is a no-fault coverage to provide monies to pay for medical expenses and lost wages. Because American society as a whole has become significantly more litigious over time, it is difficult, if not impossible, to quantify the impact of PIP coverage, as opposed to other factors, on litigation.

Industry also pointed out the impact of the double recovery under PIP in Maryland. This is a cost that gets spread amongst all policyholders and impacts all Marylanders.

Mr. Unnewehr stated that the data establishes that claim costs are higher in urban areas. He pointed out that about 15 years ago a study was done regarding the frequency of claims for bodily injury in urban areas and Baltimore ranked third at that time. He was not able to offer any insight into why bodily injury claims were higher in urban areas. He speculated that various attitudes about litigation, desire to recover, likely jury awards and sociological factors could contribute to the increased frequency of such claims, but could offer no definitive reasons. He also noted that not all urban areas have claim costs that are significantly higher than surrounding areas and cited Jacksonville, FL and Pittsburgh, PA as examples.

In response to questions by Members, Mr. Unnewehr noted that the statistics that he presented did not include claims related to auto theft which would be covered under the comprehensive coverage on an automobile insurance policy.

V. Additional Testimony

Members discussed the role of territories in developing auto insurance rates. Representatives on behalf of various companies, primarily Bryson Popham and Jack Andryzak, discussed how they draw their territories in order to gain a competitive advantage in pricing. The more accurately they identify risk areas, the better the companies are able to formulate their rates. This is one way in which they compete.

Associate Commissioner Johnson noted that auto insurance rates must, by statute, be actuarially justified. That includes the requirement that distinctions that a company makes among insureds through the development of rating factors and classifications (including territorial rating) must be actuarially justified. Auto insurance rates and rating plans, which include the rating classes and factors used by a company, must be filed with the MIA. While auto insurance rates are not subject to prior approval by the MIA, the MIA's staff does review rate filings, which are required to include the actuarial justification for the rates. In those cases where the MIA staff questions the justification, the MIA works with both its internal and independent actuary to make a more detailed review and, where appropriate, to require the company to alter its rates or rating factors.

Some companies alter or review their territories regularly; some, like State Farm, have been said to have used the same territories for many years. Members expressed some concern over the lack of periodic review of territories by some companies. While some companies use territories they draw themselves based on risk experience, some companies use zip codes to determine the territories as these are drawn by the U.S. Post Office. Territories are just a small part of the ultimate rate that an individual pays for insurance. Companies look to the age of the driver,

gender, marital status, type of vehicle driven, mileage and then the individual's driving record.

Representatives of insurers noted that auto theft is the largest problem facing auto insurers in Prince George's County. The frequency of auto theft in that County is the highest in the State and exceeds the total number of thefts in the entire state of Virginia. Theft losses impact all drivers in the County. Industry urged the State to invest in auto theft prevention. Auto theft needs to be prosecuted and punished in order to operate as a deterrent.

Lars Kristiansen from Nationwide Insurance used the following example as a way to describe the impact of disposing of rating territories. Company A has two territories at \$80 and \$120 respectively. Company B has one rate everywhere at \$100. In this example, Company B will lose market share because people who have a choice of rates will naturally choose the lower rate.

Larry Hinton from GEICO discussed the issues of fraud and auto theft. There were 18,000 cars stolen in Prince George's County in 2004. In the entire state of Virginia, there were 17,000 cars stolen during the same period.

GEICO periodically reviews territorial lines every 12 to 18 months. Various factors go into rating. GEICO will get more information on how often they review rating territories in Prince George's County and Baltimore City.

Agency Services, Inc. (ASI), represented by Bryson Popham, is a small insurer formed to compete with MAIF. They have over 50 rating territories. Their relatively small size requires them to be nimble.

Property and Casualty Insurers Association of America (PCI), represented by Bob Enten, urged the Task Force to discuss the rating issue with experts in rate making.

Ed Cooper of Nationwide said that pricing is not predictive, companies must operate off past experience. He also added that territorial rating has statistical credibility; it is based on using similar patterns with similar experience to produce similar rates. It is not arbitrary in pricing. He suggested that auto theft be dealt with regionally. Theft is not usually an at-fault situation.

Mr. Cooper added that accidents are more preventive than fraud, and Task Force members should be careful to stay out of market forces. If the frequency and severity of accidents are reduced, then rates will go down.

VI. Scope of Task Force

The Task Force will dedicate its upcoming meetings to the following topics:

- June - The Role of Claims as Cost Driver in Auto Insurance

- July - Rate Making
- August/September - Looking at What Other States Are Doing to Address the Problem of Auto Rates
- September/October - Recommendations/Wrap-up

The goal of the Task Force is to produce recommendations for introduction in the 2006 legislative session.

VII. Next Meeting

The next meeting will be held mid-June. Members will be informed of the date as soon as the meeting is set.

**Maryland Insurance Administration's
Auto Insurance Task Force to Study Rates in Urban Areas**

Minutes of the Meeting of
June 29, 2005

Attendance

Alfred W. Redmer, Jr., Insurance Commissioner, Co-Chair
Senator Lisa Gladden, Co-Chair
Delegate Carolyn Krysiak
Delegate Obie Patterson
Senator Ulysses Currie

Brett Lininger, Maryland Insurance Administration, Staff
Kimberly Robinson, Maryland Insurance Administration, Staff
Kathleen A. Birrane, Esquire, Counsel to the Task Force

MIA staff also present:

P. Randi Johnson, Associate Commissioner of Property and Casualty
Ron Sallow, Associate Commissioner of the Insurance Fraud Division

I. Opening Remarks

Senator Gladden called the meeting to order.

Senator Gladden welcomed Delegate Carolyn Krysiak, Delegate Obie Patterson and Senator Ulysses Currie to the Task Force.

II. Approval of the Minutes

Commissioner Redmer called for additions or corrections to the minutes of the May 26, 2005 meeting. Hearing none, the minutes were adopted as drafted.

III. Brief Summary of Last Meeting

Commissioner Redmer reviewed information from the previous meeting and went over the handout entitled "Goals, Principles and Cost Drivers of Rate Making".

IV. Overview of the Components of Auto Insurance Coverage

*P. Randi Johnson, Associate Commissioner for Property and Casualty,
Maryland Insurance Administration*

When you purchase auto insurance you purchase an automobile insurance policy you are buying first party coverage (coverage for claims you make against your policy), third party coverage (coverage for claims others make against you) and the costs of defense (your insurance company will investigate claims made against you, settle them or assign an attorney to defend you if suit is filed against you). Your policy covers different types of coverages and may provide several different types of benefits which are described below:

Bodily Injury Liability:

This is a mandatory coverage. It provides coverage for medical bills, loss of wages and pain and suffering to another person for which the insured is liable, or which was caused by the negligence of the insured. Policy provides limits of coverage on a per person and per occurrence/accident basis. Currently, Maryland law requires minimum coverage in the amount of \$20,000 per person/\$40,000 per occurrence for bodily injury liability coverage.

Property Damage Liability:

This is a mandatory coverage. It provides coverage for physical damage to other vehicles or property other than property owned by the insured caused by the negligence of the insured. Currently, Maryland law requires minimum coverage in the amount of \$15,000 for property damage liability coverage.

Personal Injury Protection:

This is a mandatory coverage. It provides limited coverage per person for payment of medical bills and reimbursement for a portion of lost wages incurred as a result of an occurrence, regardless of fault, up to a minimum of \$2,500. If the insured elects to provide this coverage for all insured drivers and residents of the household above 16 years of age, this is known as "Full PIP." However, the insured may elect to waive a portion of this coverage. Coverage may be waived for any listed driver and family members of the household over 16 years of age; this is known as "Limited PIP."

Comprehensive Coverage:

This coverage is optional; however, if the vehicle was purchased through the use of a loan, most lienholders will require the insured to purchase this type of coverage. It provides coverage over and above any applicable deductible for property damage to the insured vehicle resulting from occurrences other than collision, and is sometimes referred to as coverage for "acts of God."

Comprehensive coverage includes coverage for theft, vandalism, glass breakage not resulting from an accident, and accidents in which the operator strikes an animal

Collision Coverage:

This coverage is optional; however, if the vehicle was purchased through the use of a loan, most lienholders will require the insured to purchase this type of coverage. It provides coverage over and above any applicable deductible for

property damage to the insured vehicle in the event of a collision or overturn of the vehicle.

Uninsured Motorist Bodily Injury Liability:

This is a mandatory coverage. It provides coverage for medical bills, lost wages and pain and suffering of the occupants of the insured vehicle when this vehicle is struck by a vehicle that does not have insurance or is struck by a phantom vehicle (i.e. a vehicle which cannot be identified) provided certain coverage conditions are met (usually a requirement to notify the police and report the accident within 24 hours). Coverage applies on a per person and per occurrence/accident basis. Coverage may be provided up to the limits of the bodily injury liability coverage you have on your policy or coverage may be waived for any amount above the statutory limits (\$20,000 per person/\$40,000 per occurrence).

Uninsured Motorist Property Damage Liability:

This coverage is mandatory. It provides coverage for property damage to the insured vehicle and owned property arising out of an accident caused by a vehicle which does not have insurance or a phantom vehicle. Coverage may be provided up to the limit of property damage liability coverage you have on your policy or coverage may be waived for any amount above the statutory limit (\$15,000).

Underinsured Motorist Bodily Injury Liability:

This coverage is mandatory up to the statutory limits (\$20,000 per person /\$40,000 per occurrence). It provides coverage for medical bills, lost wages and pain and suffering of the occupants of the insured vehicle when this vehicle is struck by a vehicle which maintains limits of liability insurance lower than the damages incurred by the injured parties and the limits on the UIM policy exceed the tortfeasor's limits of liability. Coverage applies on a per person and per occurrence/accident basis and is reduced by the amount paid by the tortfeasor's liability insurer.

Underinsured Property Damage Liability:

This coverage is optional. It provides coverage for property damage to owned property when this property is struck by a vehicle which maintains lower limits of liability insurance. Coverage is reduced by the amount paid by the tortfeasor's liability insurance.

Medical Payments Coverage:

This coverage is optional and may be purchased to provide additional monies for medical bills arising out of an auto accident regardless of fault.

Towing and Labor

This coverage is optional and provides coverage to reimburse the insured for towing and labor expenses arising out of a breakdown of the insured vehicle.

Rental Reimbursement:

This coverage is optional and provides coverage for the cost of renting a vehicle that is needed as a result of accident caused by the insured's negligence. Coverage is usually provided on a fixed rate basis per day with a maximum amount of days (usually not to exceed 30 days).

V. Claims Adjustment and Payments

A panel of attorneys, both plaintiffs counsel and defense counsel, addressed the Task Force.

Plaintiffs' Counsel - Paul D. Beckman and Robert J. Zarbin

Defense Counsel - Michael J. Budow

Paul Beckman has 30+ years practicing primarily in Baltimore City in the areas of serious personal injury and medical malpractice for plaintiffs.

Bob Zarkin has been practicing for 19 years, representing plaintiffs in cases involving negligence, auto accidents, and workers' compensation claims.

Mike Budow has 30 + years practicing primarily in Montgomery and Prince George's Counties as defense counsel and represents numerous insurance companies with respect to claims made involving automobile accidents, bodily injury claims, property damage claims, fire, theft, fraud and arson claims.

The Task Force members and the panelists discussed the panelists' views on auto insurance rates and rating. The following represent highlights of the exchange:

Why are rates higher in Baltimore City? Urban areas, like Baltimore City are more densely populated resulting in more people and more cars. The increase in volume would translate to an increase in the number of accidents.

If a county driver has an accident in Baltimore City, is the accident charged to the city or the county?

The key issue is where the involved vehicle is "garaged" and which driver was at fault. If the county driver is at fault and the car is garaged in the county, then the accident is charged to the county. However, any resulting lawsuit can be brought in the city since that is where the accident occurred and this puts cases before city juries which are perceived to render higher judgments than jurors in other jurisdictions.

Given the nature of city driving – more stop and go at lower speeds than highway driving – there appears to be a disproportionately high number of bodily injury claims in the urban areas as opposed to more rural areas. It is hard to identify a reason for the high number of bodily injury claims. It maybe that there are more inexperienced drivers on the roads in urban

areas facing more vehicles while inexperienced drivers in more rural areas would have less vehicular traffic to contend with

What determines the cost of the claim? Are formulas used? A formula would be using 2 or 3 times the amount of the medical bills and adding in the amount of the lost wages for determining the value of a case. Insurers have moved away from the use of formulas to value a case. Formulas can be misleading and are not necessarily reflective of the value of a case. The injury itself may not involve significant medical expenses, such as a scar to the face, but a disfiguring injury is traumatic and its value would be hard to quantify using a formula.

What drives the cost of the claims?

The cost of replacing and repairing motor vehicles has gone up over time. As a result, property damage costs are higher today. Additionally, bodily injury claims have increased in cost. Lost wages have become higher cost driver as wages have risen over time and there has been a significant increase in the cost of medical care.

The Task Force members and the panelists discussed a 1994 study that suggested that claimants recovered more monies when they were represented by counsel. Plaintiffs' counsel believe that insurance companies will sometimes try to take advantage of claimants by quickly offering them low settlement amounts that may not be sufficient to cover future medical expenses.

In addition, the panel discussed whether or not the ability to advertise, whether it is on TV, radio or other media, has an impact on the rate of claims made and paid in urban areas. Generally, the panel seemed to believe that certain segments of the population were targeted by these ads and that the end result is to promote litigation. Advertising speaks to individuals knowing they have the ability to obtain representation; it does not speak to the professionalism of the advertiser.

The Task Force then touched on the issue of venue (where a case is filed). Cases arising out of auto accidents are often filed in urban jurisdictions (i.e. Baltimore City or Prince George's County) areas because juries are perceived to award larger verdicts in these areas. While every case cannot be filed in one of these jurisdictions, as long as there is a legal basis for the jurisdiction to handle the case (the accident occurred in the jurisdiction or the defendant lives or does business in the jurisdiction), the case can be brought there. If the insurance company is a party to the suit, it is subject to being sued in any jurisdiction in the State as it does business all over the State. However, that allows the plaintiff to decide which jurisdiction in which the suit will be filed and that usually translates to Baltimore City or Prince George's County.

Plaintiffs' Counsel Zarbin - The best jury verdicts come as a result of the insurance company's being hard on consumers and unwilling to make appropriate settlements. When the jury believes the company acted out of order or tried to take advantage of the consumer, the verdict is likely to reflect disapproval of that behavior.

Defense Counsel Budow - Soft tissue injuries are prone to a lot of fraud and abuse. They are difficult to test for or quantify. Medical practitioners are sometimes complicit in the fraud, continuing to see patients that do not need treatment and running up medical bills.

Plaintiffs' Counsel Beckman - There has been a move toward the use of alternative dispute resolution in auto cases. It is being used more and more. It helps keep cases from having to go to trial.

Senator Currie inquired about the practice of attorneys referring clients to medical providers. While on the one hand, it can be helpful as injured claimants do not know physicians and sometimes the attorney knows the specialist and can help obtain a hard-to-get appointment more quickly. On the other hand, unprofessional attorneys sometimes have inappropriate relationships with providers who are willing to provide excessive treatment which results in increased costs and exaggerated claims.

Gabrielle Lynch, Claims Counsel for Nationwide Insurance Company

Nationwide evaluates claims on a daily basis and it does not use formulas to establish the value of a case. Cases are evaluated on an individual basis. The company seeks to pay actual cost of the medical bills, lost wages and then to add monies for pain and suffering. The great unknown is always pain and suffering. And that is where the subjective judgment of the evaluator comes into play.

When evaluating a case, the insurance company will always consider the jurisdiction where the claim is pending as a factor. The company will look at past jury verdicts and Judges' rulings in evaluating the claim.

In urban areas there tend to be more accidents, there are often more than one claimant per vehicle, and there are more uninsured motorist claims. All of these factors combine to increase the cost of automobile insurance rates in urban areas.

Comprehensive claims also impact rates. The rising number of automobile thefts have resulted in the creation of Special Investigation Units within insurance companies to determine if the vehicle was in fact stolen and whether the value of the vehicle has been inflated.

VI. Cost of Fraud

*Ron Sallow, Associate Commissioner of the Insurance Fraud Division
Maryland Insurance Administration*

Insurance fraud takes many forms, but ultimately they all impact consumers negatively. Common fraudulent practices include lying about the circumstances of an accident to make it a covered claim, claiming that you were a passenger in a car involved in an accident when you were not, falsifying documents related to an accident, exaggerating injuries and falsifying injuries. Most fraudulent acts are crimes of opportunities. Currently, sophisticated and elaborate fraud rings are becoming more prevalent in the State. These rings often include physicians, physical therapists, attorneys, mechanics, and claims adjusters. Frequently they target high-end vehicles and yield high financial payouts.

In urban areas, unscrupulous people will attempt to exploit the socioeconomic status of the population. Bodily injury claims are higher in these areas. Often, this phenomenon is enhanced by the use of “runners” – individuals paid to approach people involved in an accident and convince them to pursue claims through certain attorneys or law firms. “Runners” will use police scanners, tow truck contacts, even police officers to identify accident victims. In Maryland, we call them “runners” but other jurisdictions call them “cappers.”

Joe Jackson – GEICO, Special Investigations Unit

Investigates fraud rings of various kinds. Lately, a great deal of the reported fraud has been in connection with street racing clubs. These clubs have evolved into criminal operations. They commit criminal acts on the roads often resulting in injury, death, and significant property damage. They treat it as a game, awarding points for hitting each other. They then file fraudulent insurance claims, lying about how the damage was sustained to the vehicle. These often result in high claims and payouts. One team of 80 people was found to have filed over 200 fraudulent claims. In addition, many of these groups used a great number of stolen cars. They often go into the State’s urban area where the cars are more densely populated to steal the cars they use.

V. Next Meeting, Time and Location

The next meeting is planned to be held in late July or early August at the University of Maryland Law School. The fourth meeting will be held in Prince George’s County.

The meeting was adjourned.

Maryland Insurance Administration's
Auto Insurance Task Force to Study Rates in Urban Areas

Minutes of the Meeting of
August 31, 2005

Attendance

Alfred W. Redmer, Jr., Insurance Commissioner, Co-Chair
Senator Lisa A. Gladden, Co-Chair
Delegate Peter A. Hammen
Delegate Obie Patterson
Delegate Marshall T. Goodwin

Brett S. Lininger, Maryland Insurance Administration, Staff
Kathleen A. Birrane, Counsel to the Task Force

MIA staff also present:

P. Randi Johnson, Associate Commissioner of Property and Casualty

I. Opening Remarks

Senator Gladden called the meeting to order.

Senator Gladden introduced Dean Gilbert Holmes of the University of Baltimore School of Law.

Dean Holmes made some opening remarks welcoming the Members of the Task Force and attendees to the University of Baltimore School of Law.

II. Approval of the Minutes

Senator Gladden called for any additions or corrections to the minutes of the June 29, 2005 meeting; hearing none, the minutes were adopted as drafted.

III. A Primer on Property and Casualty Insurance Ratemaking

Robert Hartwig, Ph.D., CPCU, Senior Vice President and Chief Economist for the Insurance Information Institute

Ratemaking

Ratemaking is the use of historical information that has been gathered over the years to establish a current price for coverage of future losses. It is the need for good underlying data that assists in what is known as "underwriting." Historical

information is used to identify trends in data and to establish a base rate. The data is then adjusted for geographic experience (territorial rating), industry specific factors or other factors that are statistically correlated with risk of future losses. Rates are determined by using territorial rating, by looking at individuals and their specific risk characteristics, such as the type of vehicle they drive, and experience rating, using a policyholder's loss history. Each company uses each of these components in varying degrees. The statistical information reflects the number of claims made, not the actual number of accidents. This is because many accidents may result in damage in amounts below deductible limits or are otherwise not reported to the insurer.

A company's base rate is the pure premium number that each individual insurer develops to enable them to calculate the premium charged to consumers. The premium charged to consumers is made up of the base rate, plus an amount for expenses and an amount for the company to earn a reasonable profit. Although there is no actuarial guideline for what constitutes a "reasonable profit", companies are required to file their rates with the Maryland Insurance Administration ("MIA") to ensure the rates are actuarially justified and that the rates are not excessive, inadequate or unfairly discriminatory.

The current method for filing rates has led to a healthy competitive insurance market. Each company uses the rating factors in varying ways and are competitive with respect to their expenses and profits. Some companies specialize in insuring high risk drivers while other companies specialize in insuring low risk drivers and still other companies insure the gamut of drivers from high risk to low risk by adjusting their premiums appropriately. Thus, one consumer may be quoted different prices from different insurers for automobile insurance coverage as each company may assess the risk presented by the consumer in a different manner. This translates into more choices for consumers as companies compete for the business and seek to distinguish themselves based on premiums and customer service.

Underwriting

Underwriting is the process by which a company decides whether it should issue a policy and on what terms. There are some basic rating factors that insurers use and weigh in their underwriting. These rating factors include the vehicle type, the use of vehicle, location of vehicle (territory), driving history of the insured, prior insurance and other factors personal to the insured. Much like rate making, each carrier gives different weight to each of these rating factors.

The rating factors are broader than may first appear when looking at the category. For example, "vehicle type" includes the number of vehicles insured on a policy and the number of operators in a household as well as the make, model and age of the vehicle, its safety features and any anti-theft devices. Theft prevention plays a varying role in rate making depending on where the car is garaged.

Geographic areas with higher incidents of automobile theft factors into the premium. The territory rating factor also reflects the statistics that urban drivers are more likely to be involved in claims as opposed to rural drivers and the costs of claims are higher than in rural areas. For example, bodily injury liability costs in Baltimore are more than double the overall state average, property damage liability costs are 47 percent higher in Baltimore City, and personal injury protection costs are triple the costs as opposed to the rest of the state overall. There has been roughly the same disparity since 1998.

Vehicle usage is an important consideration for insurers. The distance driven annually, the commuting distance, and the years of driving experience are all important factors for carriers to evaluate and assess whether it is a risk they are willing to insure and at what price level.

An individual's driving history helps an insurer determine the risk and whether they wish to accept that risk. History of accidents, moving violations, driving related convictions, and frequency of claims filed all contribute to what type of risk an individual represents to an insurer.

Credit scoring has also been found to be an accurate predictor of risk and the future claims activity of individuals. The logic behind this process is that credit history reflects the same personal responsibility traits that go into risk taking when driving. Maryland law sets forth limitations on how insurers may use credit history for automobile insurance rates.

Statistics have shown that gender plays an important role in assessing risk. For example, males are involved in 50 percent more accidents on average than females. Males are 61 percent more likely to be killed in an automobile accident.

Innovative Ways to Assess Risk

The automobile insurance industry has been testing new ways in which to analyze and assess risk. Progressive Insurance Company, for example, has been testing a "black box" program known as "Trip Sense" in Minnesota. This program is designed to match the premium charged for coverage to a vehicle's actual use. The black box is installed in the vehicle to monitor speed, distance driven, and time of day usage. Every few months the consumer downloads data to the insurer. Program participants are eligible for discounts of 5 percent to 25 percent. Another black box program called "Pay As You Drive" has been tested by Norwich Union in the United Kingdom. It uses global positioning technology to report speed, distance driven, and type of driving (i.e. highway, urban, rural). It can also be used to locate stolen vehicles, generate accident reports automatically and provide trip mapping for a driver. There are concerns about costs associated with the installment, maintenance and use of the black boxes and with issues of privacy surrounding their use and the information generated.

Another underwriting innovation is the use of electronic data recorders (“EDR”). Not only does an EDR record information on speed, it also captures brake use, seat belt use, headlight use, and airbag deployment. In addition to insurers, this information is helpful to highway safety agencies, automakers and litigators.

The final point with respect to rating factors is that premiums are largely determined by the frequency (number of claims) and the severity of claims (costs of the claims). Losses are the experience that insurers look to in determining rates. While different insurance companies use different rating factors in different ways, they are all trying to take information and analyze it so they can better assess the risk presented by the insured and price it accordingly.

IV. ISO Rate Making and How ISO Establishes Territories

Patrick Woods, Assistant Vice President and Actuary for the Insurance Services Office, Inc.

The Insurance Services Office (“ISO”) is a leading source of information about risk. It supplies data and analytical services for the insurance industry. Mr. Woods discussed risk classification in general, drivers of automobile insurance costs, and ISO’s methodology for determining territories.

In setting rates, consideration must be given to the legal requirement that rates not be excessive, inadequate or unfairly discriminatory and to the actuarial principle that rates be a sound estimate of all future costs associated with the risk transfer. Risk classification is a main component of rate making. It promotes fairness among insureds by having those with different characteristics and different loss experiences obtaining different prices, encourages availability of insurance coverage, and protects the financial viability of the insurers to pay future claims.

A risk classification system is considered to be sound when it reflects cost differences based on relevant risk characteristics and is applied objectively and consistently. It also must be practical in the sense that it is affordable and adaptable. Not only must the consumer be able to afford the insurance, the insurer must be able to provide proper incentives by providing discounts to customers. For example, if the characteristics of the insured change, the company can respond appropriately such as when an insured takes a defensive driving course, the insurer then provides the insured with a discount. Thus, a company starts with a base rate and then can apply discounts for those with good driving records or apply surcharges for those with accidents or violations because, actuarially, those with past losses are more likely to have future losses.

Automobile insurance costs are driven by the location of the risk and the likelihood of expected costs. Higher cost areas are characterized by higher claim frequency. More claims result in higher costs. The higher number of bodily

injury claims and the higher population density translate to higher costs as there is increased claim frequency.

There are many ways to classify risks. Territorial classifications must be done in a manner that is data driven and methodical. A zip code is used as an area with data that can be analyzed. The zip code and its experience is compared with an adjacent zip code to determine if they have similar experience. By using insurance data and external data, an insurer starts out small and builds the territory. Some of the data includes losses, claims, and vehicle density for each zip code. By looking at the frequency index over time for each territory and if it is consistent, it will be a good predictor of future frequency within that territory. ISO feels that by combining similar contiguous territories into a larger territory, the resulting territories are more easily explained. This approach is based on objective data with no goal in mind, just creating parameters.

Many insurers derive territories from ISO data. ISO is committed to analyzing rate bands every five to seven years or more frequently if the state experiences population shifts. It last reviewed the Maryland territories in 2000. While Maryland law does not require insurers to reevaluate their territories using any set time line, they are forced by the competitive marketplace to review and respond to data. Failure to do so would put a company at a competitive disadvantage.

An important part of understanding rate making is the cost drivers. Claim frequency determines higher loss costs in a given geographic area. The severity of claims is a lesser factor. Claim frequency is calculated at the zip code level. The data in each zip code is then evaluated for credibility. This is done by supplementing one zip code's claim frequency with other contiguous zip codes and an external density model. The end result is a credibly weighted frequency index covering a given territory.

In summary, risk classifications are intrinsic to the insurance industry. The costs for automobile insurance are primarily driven by claim frequency. Population density directly correlates with the frequency of claims. Territorial rating is based on cost drivers in a given geographic area.

V. Factors Used in Maryland and Examples of Territories Used by Carriers

P. Randi Johnson, Associate Commissioner for Property and Casualty, Maryland Insurance Administration

At present, Maryland's automobile insurance market is competitive. It is important to note that premiums are not developed solely by the use of territories. Rather, the geographic location of an individual insured is just part of what is factored into the overall premium charged to each. Multiple rating factors are used to determine the price of auto insurance for each individual insured. A handout reflected the rating territories used by nine companies in Baltimore City

and Prince George's County for setting rates in these parts of Maryland. The variations among these companies clearly establish that territorial rating is common, but that there is no one set territory used by all companies. Premium quotes will vary from company to company depending upon a number of factors discussed above in earlier presentations. Thus, one consumer may be quoted different prices from different insurers for automobile insurance coverage as each company may assess the risk presented by the consumer in a different manner. Therefore, consumers are encouraged to shop around to get the best price for the coverages they want.

The Maryland Insurance Administration publishes a "Comparison Guide to Maryland Auto Insurance Rates" to enable consumers to get an idea of what different companies will charge for insurance in different areas of the state. The rate guide is issued twice a year with the most recent guide showing sample premiums as of August 2005. The Maryland Insurance Administration has also prepared a "Consumer Guide to Auto Insurance" that explains the different types of coverages available under an automobile insurance policy. Currently, consumers can obtain the guides by either calling the Maryland Insurance Administration or by visiting the MIA website at www.mdinsurance.state.md.us. In July 2004, Commissioner Redmer also established the Consumer Education and Advocacy Unit ("CEAU") to develop public outreach programs to educate consumers about insurance matters, including automobile insurance. The CEAU provides consumer information at fairs and other public events throughout the state all year long. The Maryland Insurance Administration is always looking for ways to expand and facilitate outreach efforts.

VI. Next Meeting, Time and Location

The next meeting is planned to be held in mid-to-late October in Prince George's County.

The meeting was adjourned.

Maryland Insurance Administration's
Auto Insurance Task Force to Study Rates in Urban Areas

Minutes of the Meeting of
October 18, 2005

Attendees

P. Randi Johnson, Associate Commissioner, Property and Casualty Insurance, Maryland
Insurance Administration, Co-Chair

Senator Lisa A. Gladden, Co-Chair

Delegate Obie Patterson

Brett S. Lininger, Maryland Insurance Administration, Staff

Kimberly Y. Robinson, Maryland Insurance Administration, Staff

Kathleen A. Birrane, Counsel to the Task Force

I. Welcome

Senator Gladden called the meeting to order. She expressed her sadness at Alfred W. Redmer, Jr.'s departure from the Maryland Insurance Administration and welcomed Randi Johnson to the Task Force in his place.

II. Review and Approval of Minutes from Last Meeting

The members adopted the minutes of the August 31, 2005 meeting without correction.

III. What Other States are Doing

- Donald Cleasby
Vice President, Regional Manager and Counsel
Property Casualty Insurance Association of America
- David Snyder
Vice President and Assistant General Counsel
American Insurance Association

Mr. Cleasby and Mr. Snyder did a joint presentation to the Task Force regarding actions that have been taken by other states to address the issue of the high cost of auto insurance. They began their presentation by noting that Maryland has a higher than average claims frequency for bodily injury (BI), personal injury protection (PIP) and property damage (PD) claims compared to the national average. This is the first challenge facing those looking to improve the cost of automobile insurance coverage in Maryland. Generally, it appears that states with more options for consumers to choose with regard to the coverages they wish to have results in fewer claims. Because Maryland has a number of mandatory coverages, that may translate to more claim frequency. For example:

Pennsylvania- In 1990 made many auto insurance coverages optional (lowered minimum limits, mandatory discounts and deductibles) which has resulted in a decrease in the average cost per claim (pre-1990, the average cost per claim was \$3,000 and since the change in law the average cost per claim has dropped to \$2,400 in 2000) and, consequently, a decrease in auto insurance rates in Pennsylvania. Rates are still higher in the city of Philadelphia than in the rest of the State, but are lower than they would have been absent the reforms. Under the PA reforms, consumers limit under what circumstances they can sue in exchange for lower premiums. This does have the result of benefiting tortfeasors but also benefits the consumer voluntarily limiting their right to sue with reduced rates. In addition, PA instituted a Medicare based fee schedule for doctor's fees and employs a system of peer review for claims.

California and New Jersey- Both of these states offer a type of "mini-policy" for auto insurance. This approach is seen as allowing consumers to move closer to a minimum policy concept where the consumer chooses they type of coverages they wish to have. It appears that these very basic policies have not been successful in some states, but it is hard to judge as many other states have income tests in order to obtain these policies and consumers seem to be reluctant to provide the required information. It appears that this "menu" option is a way of giving more choice and encouraging people not to forgo coverage and drive uninsured. The question is whether these options are going to give Maryland's highest cost jurisdictions the relief they are looking for.

Also in CA, another approach to address the uninsured motorist problem, which drives the rates of auto insurance, is to provide a "no pay, no play" disincentive. In CA, certain benefits are not available to an uninsured driver who is involved in a motor vehicle accident.

Colorado- In 1991, Colorado instituted a managed care system that has yielded a decrease in bodily injury claims as well as a 20% savings in rates.

New York - NY is a good fraud success story. The state's efforts at cracking down on fraud have led to a significant decrease in the cost of auto insurance in NY. Senator Gladden inquired whether, in the presenters' view, MD needs better laws or resources to combat fraud. The presenters believe MD would benefit from a little of both. More resources to the Insurance Fraud Bureau means there is more effective use of the premium tax to fund the anti-fraud efforts which will, in turn, decrease the cost of auto insurance.

The presenters than discussed some of the recommendations from the 1995 Task Force on Auto Insurance noting that some of those recommendations would still be applicable today. For instance, doing away with duplicate payments (PIP and the liability claim paying the same bills) which was done in PA.

The presenters referred to the Insurance Institute for Highway Safety and its publication *Ways to Reduce Urban Crashes* which makes clear that there is a public safety role that affects auto insurance premiums as well. Crashes in urban

areas can be decreased if not avoided all together through improved public safety measures such as better timing of lights, use of left turn lights, use of four-way rather than two-way stop signs and encourage use of rear seatbelts. By preventing accidents, you prevent insurance claims. If jurisdictions implement highway and roadway changes they will eventually see a decrease in rates but not immediately as the rate of accidents must have time to decline. Once the accident rate declines, there will be a decline in the premium rates. Senator Gladden advised that a community meeting she attended in her district, it was suggested that mandatory safety inspections (for brakes, lights and signals) as a means of keeping unsafe vehicles off the roadways could help reduce accidents. In addition, some insurers provide a discount if you obtain a comprehensive inspection. The presenters felt like this could have some minimal impact, however, the leading cause of accidents remains driver error rather than equipment malfunction.

The presenters cited the regulatory burdens of doing business in the State as a reason for higher insurance rates- Title 27, subtitle 6 of the Insurance Article is a mishmash of various laws which are confusing, costly and difficult to follow which increases the cost of doing business in the State. Insurers find it harder to get of off a risk even for reason(s) that would be allowed in other states. The result is that insurers are more cautious about what risks to write because they know once they take on the risk it will be hard to get off of the risk in the future. NJ had a positive response in its insurance marketplace when it reduced this kind of regulatory burden. The presenters referenced a bill that had been introduced during the 2005 legislative session (Senate Bill 659) by Senator Astle which sought to reduce the regulatory burden in Maryland without increasing consumers' exposure and indicated that this would encourage companies that are not currently doing business to enter the marketplace and write in Maryland. Although Maryland has a good number of insurers represented in the market, there are a number of niche players who do not do business in MD at this time, but if the regulatory burdens were eased, without decreasing the consumer protections, that could result in additional choices of auto insurance coverage for Maryland consumers. While regulatory reforms do not result in lower rates, it makes the market more attractive to insurance companies which creates the competition that does result in lower rates.

There was some discussion about the role of probation before judgment (PBJ) in MD. If a consumer receives probation before judgment the offense will carry no points and not be reflected on their MVA record. Senator Gladden argued, however, that it hard to say an offense for which there is no conviction should be held against the consumer.

IV. An Overview of New York's Success

- Greg Serio (former Superintendent of the New York Insurance Department)
Managing Director
Park Strategies, LLC

(Please see handout)

Because of reforms instituted in NY, the NY risk pool has been reduced to 250,000 from 1.5 million. NY has become a more competitive market with carriers battling for market share and as a result, the auto insurance rates in NY have decreased.

NY started with the basic philosophy that costs equals rates. Thus, the NY Insurance Department's focus was on bringing costs down as a means to bring rates down. To achieve this result, NY enacted the following reforms:

- Changed timeframes for submission of medical bills from 180 to 45 days.
- Changed timeframes for time to submit claims from 90 to 30 days.
- Required insurers to pay bills within 30 days unless fraud involved and if the insurance carrier was relying on fraud to deny the payment, the carrier had to refer the matter to the Insurance Fraud Bureau.
- Each insurer was required to have a special investigation unit to investigate suspect fraudulent claims.
- Regulated cost of durable medical equipment by applying Medicare reimbursement rates for those items.
- Reforms focused heavily on fraud. Used a multi-jurisdictional approach. The strategy was to work at the most local level possible but to support the team with state resources. Made sure that setting up the local task forces was revenue neutral.

It should be noted that while the reforms in NY were highly effective, they do not translate as easily to Maryland as NY is a "No Fault" state, which MD's insurance program is not; with the exception of the PIP coverage. Thus, to reach the same level of impact as the NY reforms, MD would have to alter its insurance scheme from a tort based approach to a no fault approach.

V. Overview of the Maryland Insurance Administration's Consumer Education and Advocacy Unit

- Joy Hatchette
Associate Commissioner, Consumer Education and Advocacy Unit
Maryland Insurance Administration

Ms. Hatchette highlighted the work of the Consumer Education and Advocacy Unit and discussed the various consumer education efforts of the Maryland Insurance Administration.

VI. Next meeting

Time and date to be determined.

The meeting was adjourned.

Maryland Insurance Administration's
Auto Insurance Task Force to Study Rates in Urban Areas

Minutes of the Meeting of
December 12, 2005

Attendees

P. Randi Johnson, Associate Commissioner, Property and Casualty Insurance, Maryland
Insurance Administration, Co-Chair

Delegate Obie Patterson

Delegate Marshall T. Goodwin

Brett S. Lininger, Maryland Insurance Administration, Staff

Kimberly Y. Robinson, Maryland Insurance Administration, Staff

I. Review and Approval of the Minutes

Randi Johnson called the meeting to order. The minutes of the October 18, 2005 minutes were adopted with one correction.

II. General Overview of Task Force Meetings

Brett Lininger provided an overview of the Task Force's work to date. (*See* attached handout)

III. Comments and Ideas for Task Force Recommendations for a report

The Task Force held an open session to allow interested parties to suggest recommendations for the Task Force's final report.

- Donald Cleasby
Vice President, Regional Manager and Counsel
Property Casualty Insurance Association of America
- David Snyder
Vice President and Assistant General Counsel
American Insurance Association

Mr. Cleasby and Mr. Snyder noted that cost drives the rates for automobile insurance in urban areas. They stated that the Task Force had heard that they only way to reduce premiums in urban areas without increasing premiums in other areas of the State is to look at the cost drivers and find solutions. They identified various "problems" or cost drivers and proposed "solutions" or approaches to deal with each of these (*See* attached handout):

- Mandated Coverages and the minimum required amounts of coverage:
liability coverages in the amount of \$20,000/\$40,000/\$15,000

PIP coverage of \$2,500; Uninsured Motorist Coverage of \$20,000/\$40,000/\$15,000.

Suggestion: Allow Maryland citizens more choices with regard to the coverages they are required to purchase and lower the limits they are required to carry. If PIP and UM coverage were no longer mandatory coverages and if the statutory minimums for liability coverage were reduced to \$15,000/\$35,000, Maryland citizens would immediately see a decrease in the cost of their automobile insurance. For those consumers who desire higher limits or additional types of coverages, they would be able to purchase the higher limits and/or additional coverages if they elected to do so, but they would not be required to do so. They suggested that if the number of mandatory coverages was reduced and the statutory minimums for the mandatory coverages were reduced, it would make automobile insurance more affordable and would encourage more people to purchase automobile insurance.

- Accident levels: Baltimore City and Prince George's County have higher accident levels when compared to the rest of the State.
Suggestion: Increase highway safety. They noted that former New York Superintendent of Insurance, Greg Serio, had stated that "costs equal rates" and that in order to decrease rates, it was necessary to decrease costs. One way to do that is to decrease the number of accidents and thereby decrease the costs and, ultimately, it will result in a decrease in rates. The Task Force was referred to the Insurance Institute for Highway Safety's publication on Ways to Reduce Urban Crashes. They suggested that specific steps be taken to reduce the number of accidents through improved traffic safety measures such as redesigning intersections, traffic patterns, etc. While these actions may take time to translate into reduced rates for automobile insurance, they are none the less important steps. As the issue in Maryland involves more of a frequency issue as opposed to a severity issue, addressing public safety will reduce the frequency and, ultimately, the cost.
- Medical Costs: The cost of medical care and treatment, including hospital care is higher in Baltimore City than in other parts of the State.
Suggestion: Institute a fee schedule for medical costs. Pennsylvania, as part of its 1990 Reform Act, instituted a fee schedule and utilization review of medical claims from auto accidents. New Jersey has created protocols for certain injuries. They noted that only an automobile insurance carrier is the payer of whatever fee the healthcare provider charges. They suggested treatment should be subject to peer review and a fee schedule to assess the cost per visit and the number of visits per injury for reasonableness. The presenters believe this would reduce costs and thereby rates.
- Theft and Fraud: There are more thefts in Baltimore City and Prince George's County than in the rest of the State. The fraud is a well known driver of costs, although it is harder to quantify. Insurance Research Council found that "padding" or increasing the cost of a claim to cover the deductible was a common practice. The presenters noted that Theft and Fraud are not victimless crimes; every insured pays the cost of these crimes. Therefore,

Theft and Fraud have to be combated aggressively. The presenters noted that Delegate Davis had initiatives to deter this type of criminal activity and that increased resources should be provided to investigators, police and prosecutors as a deterrent to the crimes and so that they will be discovered and prosecuted. Delegate Patterson observed that many auto thefts in Prince George's County are committed by youthful offenders (ages 12-15). Delegate Patterson inquired what, if anything could be done to address this situation. Mr. Snyder stated that there should be programs designed to engage youths in other activities, that more complicated ignition systems could be designed so that starting the vehicle is more difficult, instituting real penalties for repeat offenders, and additional resources for the community, including the police and social workers, would all go a long way to combating this problem.

- Uninsured Motorists: Need to reduce the number of uninsured motorists as there tends to be more uninsured motorists in Baltimore City and Prince George's County as compared to the rest of the State.
Suggestion: Provide inducements for people to purchase insurance by instituting a "No Pay, No Play" system. Such a system would prohibit an uninsured driver from recovering anything beyond his or her economic losses; that is to bar any recovery for non-economic damages when the driver is uninsured.
- Relax the regulatory burden of doing business in the State: Increased regulatory controls simply increases the cost of insurance. The presenters cited the Task Force to South Carolina and New Jersey as examples of states that found decreased regulation resulted in decreased cost of insurance. Those states also experienced increased competition in the marketplace when regulation was decreased which resulted in consumers having more choices for the insurance products they wished to purchase.

- Sandra L. Dodson
Maryland Automobile Insurance Fund ("MAIF")

Ms. Dodson discussed the fact that MAIF insureds are there after they have been turned down by 2 private automobile insurance carriers or after they have had their automobile insurance canceled. Thus, MAIF insureds are with the company because the private market will not insure them. MAIF insureds present greater risks and pay higher premiums. Under the current law, MAIF is prohibited from accepting installment payments. Thus, a MAIF insured must either pay the full premium up front or premium finance their insurance. Ms. Dodson made the following recommendation to the Task Force:

- Permit the Maryland Automobile Insurance Fund (MAIF) to accept premium payments on an installment basis. A MAIF policy is a year's length in duration as opposed to the 6 month policy that is offered in the private market. Existing law prohibits MAIF from accepting installment payments so that a MAIF insured must either pay the annual premium in full at the time the policy is taken out or must turn to a premium finance company to borrow the

money in order to pay the premium. Currently, 96% of MAIF's policies are premium financed in order for the insured to spread their payments over a period of time. Premium finance companies typically charge anywhere from 25% to 29% interest and they collect all the interest up front. In addition, Premium finance companies have multiple fees and charges that are added to a premium finance contract; including an initial service fee of \$20, a delinquency fee of \$8, a reinstatement fee of \$5, etc. By allowing MAIF to accept premium payments on an installment basis, a MAIF insured will save an average of \$200-\$400 a year. The predicted savings has been determined by both MAIF actuaries and an independent actuarial firm. Ms. Dodson noted that 28% of MAIF's book of business is Prince George's County residents.

After these presentations and having no further presentations, the general session of the Task Force meeting concluded and the members adjourned to Executive Session.