

Automobile Insurance: The Road Ahead

A REPORT OF THE ATTORNEY GENERAL
ON THE STATUS OF INSURANCE DEREGULATION



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DECEMBER 2009

Executive Summary

In July 2007, Commissioner of Insurance Nonnie Burnes decided to deregulate the automobile insurance market by introducing a policy of “managed competition.”¹ Starting April 1, 2008, managed competition has three principal features:

I. The removal of price regulation.

For the past thirty years, the Commissioner of Insurance established a single rate ceiling for all companies in a formal administrative proceeding in which the Attorney General represented consumers, and the insurance industry’s rate proposals were closely scrutinized. Insurers provided the Division of Insurance and Attorney General’s Office with comprehensive data regarding their expenses and claims experience, and each component was carefully reviewed. Based on this review, the Commissioner set an insurance premium that was consistently lower than that proposed by the industry – billions of dollars lower over the last twenty years. The regulated rate also contained limits on variation across territories and classes, and thus capped the charges insurers could levy against urban drivers. The new system ended this price regulation by (1) eliminating the rate ceiling, (2) ending the requirement that companies disclose their data, and (3) beginning to phase out caps on urban rates.

II. The introduction of rating based on non-driving factors.

In the regulated market, rates were based on a limited number of variables, most of which were related to the insured’s vehicle, driving behavior, and garaging location. In managed competition, insurers use numerous additional factors to determine the price charged to individual consumers, most of which are not directly related to a consumer’s driving history. Many of these new factors cause certain consumers, including young drivers, the poor, senior citizens, urban residents and non-homeowners, to pay higher rates, regardless of driving record.

III. The repeal of “take all comers.”

In the regulated market, insurers were required to provide insurance to all drivers. In managed competition, insurers are permitted to reject any new customer they choose; consumers who cannot find an insurer that will offer them a policy are randomly assigned to insurers in the residual market.

At the start of the deregulation initiative, the Commissioner stated that she had several goals in deregulating the marketplace. These included increased product innovation, lower prices for consumers, and more choice among insurance companies. Although she recognized that some drivers could be hurt by the system, she opined that the benefits to Massachusetts consumers would outweigh the costs.

Nonetheless, deregulation was not without its skeptics. Consumer advocacy groups, Massachusetts insurance agents, some Massachusetts insurers, and certain

¹ *Opinion, Findings & Decision on the Operation of Competition in Private Passenger Motor Vehicle Insurance in 2008*, Dkt. No. 2007-03, p. 15 (July 16, 2007).

legislators opposed many of the changes. The Office of the Attorney General raised serious questions about how the Massachusetts market, after thirty years of government rate ceilings and strong consumer protections, would perform when deregulated without adequate preparation or legislative involvement.

With more than a year of experience with deregulation of the auto insurance marketplace, it is now an appropriate time to assess deregulation, and to determine whether changes are needed to properly provide consumer rights, consumer choice, fair prices for consumers, and a healthy marketplace for insurers. This report provides a technical and specific review of the deregulated system and its performance to date, and makes specific recommendations to improve managed competition going forward.

The results over the first year have been, at best, mixed. While prices have dropped overall, consumers are currently paying more than they would have had the market not been deregulated. A variety of new insurance companies have entered the market, but most of the new entrants have not offered lower rates overall. Moreover, the new insurers have not caused incumbent carriers to lower statewide prices (indeed, in 2009, many insurers began increasing statewide prices).

In addition, many developments during the first year of deregulation have been troubling:

Many consumers paid higher prices while companies increased profit targets in the rates.

- Insurance companies began managed competition by raising their base rates by up to 10%, resulting in excessive rates in an environment where insurer losses have, on average, decreased over the past several years. If drivers are not chosen by insurers for preferential discounts, they will pay these increased rates.
- The number of rating factors that rely on characteristics other than driving has increased; insurers now charge consumers based on factors such as prior limits of coverage, payment history, and the purchase of homeowners insurance. Many such discounts or rating factors may be proxies for banned factors, such as income and homeownership.
- Insurance companies have significantly increased their underwriting profit adjustment provisions and shareholder returns loaded in their rates. In 2008, the Commissioner accepted target returns in the insurer rate filings that were over 150% of the 2007 regulated value for some insurers.
- It appears that Hispanics and low income consumers (those earning under \$25,000) have been especially disadvantaged by deregulation; a larger proportion of these groups have received rate increases, and fewer have received decreases. Elderly consumers and urban drivers may also ultimately pay increased prices, regardless of driving record.

- Many consumers whose rates decreased paid more than they should have. Had the regulatory rate-setting process occurred in 2008, rates would have been reduced for essentially all consumers, with average rate reductions much greater than those seen under deregulation.

Company prices and rating behavior have become less transparent.

- Deregulation has produced more secrecy and less transparency. Insurers have omitted data and information from their public filings; as a result, the filed rates are unsupported, and it is impossible to adequately assess their accuracy.
- Many companies have refused to make public key rating information; it is impossible to determine how an individual consumer's rate is calculated or whether individuals' rates are accurate or fair.
- The insurers and their rating organization, the Automobile Insurers Bureau, have refused to make public data on claims, premiums, and expenses necessary to determine whether statewide rates are fair and not excessive.

Consumers do not have easy access to accurate price information.

- There is currently no easy way for consumers to determine what the market prices for insurance are, what each company will charge a particular individual, and what discounts and special coverages are available.
- Some consumers have not been offered all discounts to which they are entitled, have had difficulty obtaining quotes from agents, and have received different quotes from different agents for the same insurers.
- It appears that only a small percentage of consumers switched carriers to take advantage of lower prices (or for any other reason) in 2008.
- The Division of Insurance's website, ostensibly designed to help consumers to "shop around," gives unhelpful and misleading insurance information and steers consumers in many instances to more expensive insurance companies.

Consumer protections have weakened.

- The Commissioner adopted an order to eliminate the Board of Appeal, which provides an impartial forum for consumers to appeal insurers' fault determinations; the Legislature subsequently passed a law keeping the Board permanently in place.
- Because insurers are no longer required to offer insurance to consumers they consider undesirable, many good drivers, particularly in urban areas, may be nonrenewed or denied coverage.

- Consumers refused coverage are randomly assigned to an insurer in the residual market; agents report that many such consumers fail to receive appropriate discounts.
- Insurers have created new policy provisions and rules that eliminate consumer protections. Some insurers increase prices for not-at-fault accidents, charge for excluded drivers or drivers who already have their own insurance policies, and have adopted problematic provisions related to cancellation, down payment, deductibles, installments, and rating factors. Many consumers are unaware of these changes.

Significant barriers to competition still exist.

- Many companies charge “short rate” penalties when consumers switch companies during the policy year, limiting customers’ ability to switch carriers except around the renewal date. Moreover, loyalty discounts may also deter consumers from switching to a better priced carrier every year.
- Many companies offer insurance agents significant bonuses for bringing in specific kinds of customers. Certain agents, as a result, may have an incentive to recommend the policy that offers the most lucrative commissions.
- Most Massachusetts consumers purchase insurance through an independent agent, yet most agents typically cannot or do not provide price quotes for more than a couple of carriers.
- Some insurers have been allowed special deals from Commissioner Burnes, creating an uneven playing field in the marketplace. These special arrangements, such as permitting new entrants to avoid residual market costs for two years, harm other insurers, and harm competition.

The Road Ahead

Implementation of a truly competitive system has the potential to lower prices for all consumers. Unfortunately, the current experiment in deregulation has thus far not achieved this goal. Instead, managed competition has caused many drivers to be overcharged, and has led to fewer consumer protections. For reform to work, true consumer protections need to be developed, and regulators must ensure that rates are transparent and not excessive.

It is possible to design an effective managed competitive system that meets these goals. Such a system would:

- Provide consumers with the necessary tools to “shop around.” To benefit from a competitive market, consumers must obtain price quotations from a wide range of

companies in order to find the best price for their needs. A central web portal would allow consumers to input their information once and obtain comparative quotes from any or all insurers.

- Ensure that underwriting and rating are not unfairly discriminatory. Insurers should not use proxies for prohibited rating factors or refuse to offer insurance to good drivers.
- Strengthen consumer protections. While Commissioner Burnes promulgated regulations and bulletins dealing with managed competition, none of these provisions deal with consumer protection issues such as marketing and unfair practices. Advertising, pricing, and claim practices should be fair and consistent.
- Remove impediments to competition. Currently, numerous barriers to competition exist, including inadequate information, non-standardization of policies, and short rate penalties. These barriers should be removed.
- Provide for rigorous review of proposed rates. Insurers now file rates with little or no supporting information or documentation for important rating elements. Rate support should be carefully scrutinized, and inappropriate costs should not be passed on to consumers. Insurance premiums should not be based on inflated projections that overcharge Massachusetts drivers.

To protect consumers, it is important to address the issues outlined above and discussed in this report. While deregulation may ultimately offer advantages to consumers, reforms are needed to increase price transparency, create easy access to accurate and complete information, ensure fair prices, and provide adequate consumer protections. Without these features, insurers and not consumers will benefit from deregulation, and many Massachusetts drivers will continue to overpay for their automobile insurance.

The Attorney General's Office represents consumers in matters related to insurance. Under managed competition, the Attorney General has reviewed filed rates and called for rate hearings before the Division of Insurance, demanding the rejection of discriminatory and excessive rates; urged the Commissioner to require full and complete filings; provided testimony before the Legislature and Division of Insurance recommending stronger consumer protections; and brought cases against insurance companies that sought to take advantage of Massachusetts consumers. However, while advocacy and enforcement proceedings do help, the market also needs fair and firm rules that create bright-line boundaries for insurer behavior, a level playing field, and strong consumer protections. Therefore, the Attorney General's Office intends to promulgate consumer protection regulations under her G.L. Chapter 93A Consumer Protection regulatory authority. In addition, for issues that are not best suited for regulation, the Attorney General's Office plans to work with the Legislature to explore potential solutions to these problems.

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AGO Report on Auto Insurance Deregulation

Historically, regulation of the automobile insurance market has been based on a number of public policies. Perhaps the most important is the mandatory nature of automobile insurance. Massachusetts law requires all drivers to insure their vehicles;² insurance is necessary to register a vehicle, and driving without insurance is a criminal act, punishable by fine or imprisonment.³ This mandatory nature of insurance has a number of implications for regulation:

--The cost of insurance should be fair and affordable. As a matter of policy, it is unfair and inefficient to *require* consumers to purchase a product at an excessive price.

--Insurers should not be permitted to take advantage of the governmental mandate in order to extract excessive profits from consumers. Because not purchasing auto insurance is not a choice, profits must be fair and reasonable.

--The provision of insurance should not be unfairly discriminatory. Since all consumers must purchase insurance, the conditions under which insurers may refuse to sell to individuals should be limited, and terms and prices should be applied fairly.

A second public policy giving rise to the need for regulation is the complex nature of insurance. The insurance policy is a legal contract drafted by the insurer, and imposed on consumers without negotiation. Drivers often do not see the policy until after they have purchased it, and the policies and wordings are typically full of jargon and terms of art. As a result, the government historically has protected consumers from insurance company abuses and deception in marketing, sales, and the payment of claims.

Given these policy considerations, the principal features of the regulated system were a government-established ceiling on rates, the standardization of policy terms and rules, and a “take all comers” requirement.⁴ The Massachusetts system functioned under these general principles for the past thirty years.

Under this prior system, the Massachusetts automobile insurance market was governed by a combination of statutory provisions, regulations, and adjudicatory decisions. The Commissioner of Insurance established a single rate cap for all companies in an administrative proceeding, which functioned similar to a trial, in which the Attorney General represented consumers, and the insurance industry’s rate proposals were scrutinized. In the regulated system, companies were permitted to *reduce* their rates to compete for business – rates were capped, but companies were allowed to compete by lowering rates.

² Or, in the alternative, a driver may deposit \$10,000 with the state treasurer. G.L. c. 90, § 34D.

³ G.L. c. 90, §§ 1A, 34J. In addition to state mandated insurance, many lease agreements require additional coverages.

⁴ The “take all comers” requirement gives consumers the right to obtain a policy from any company to which they apply. Insurers must, effectively, “take all comers,” with very limited exceptions.

In each of (at least) the last twenty years, past Commissioners determined that the rate proposed by the insurance industry was excessive,⁵ and set rates at a level lower than the industry's proposal. Over these years, rates were kept billions of dollars lower than the industry's desired rate level.

Similarly, consumers received the benefits of having insurer policies and procedures scrutinized to ensure that terms were fair. Customers had a variety of choices, but all insurers were required to use the same coverage language. Thus, no matter which carrier consumers chose, they did not need to worry about being shortchanged by fine print exceptions that differed among carriers. All policies contained the same floor of consumer protection provisions.

Finally, under the regulated system, consumers were allowed to choose any insurer in the marketplace. Insurance companies were required to "take all comers," and consumers were able to stay with their carriers and agents as long as they paid their premiums. This system largely prevented insurers from discriminating against consumers and cherry-picking those drivers they viewed as "good" risks.

That all changed in 2008. At that time, the Commissioner of Insurance, Nonnie Burnes, eliminated each of these features by deregulating the auto insurance market and implementing a program of "managed competition." Insurers had lobbied for deregulation for many years – the multi-billion difference between their desired rates and those set by regulation provided a financial incentive to oppose regulation.⁶ Yet, for each of the thirty years from 1977 through 2006, every Commissioner refused to accede to the wishes of the insurance industry for deregulation and capped the rates that policyholders pay. Former Governor Mitt Romney did seek to dismantle the system by filing a bill that was similar to the current managed competition, but this bill was rejected by the Legislature, which has never approved deregulation.

Under managed competition, a rate cap is no longer established; insurers are now permitted to charge rates above what was previously allowed. They are also permitted to change many of their rules and procedures, which had previously been uniform across the industry. Finally, insurers are no longer required "to take all comers;" they are now permitted to reject those new customers they deem undesirable. These drivers end up in what is known as the residual market, where they are then randomly assigned to a carrier.

⁵ Industry rates were proposed in these proceedings by the industry trade group, Automobile Insurers Bureau (AIB).

⁶ Many legislators were suspicious of deregulation, at least in part because it was so heavily championed by the industry rather than by consumers. The Commissioner, however, took a different view of the insurers' advocacy of deregulation. In her deregulatory decision, she found that the insurers' lobbying was *itself* evidence of the market's ability to "support rates that are not excessive." "A key consideration in assessing the market's ability to operate in a healthy manner and support rates that are not excessive is *the extent to which the industry supports less regulated rates*" (emphasis supplied). *Opinion, Findings and Decision on the Operation of Competition in Private Passenger Motor Vehicle Insurance in 2008*, Docket No. R2007-03 (2007). Of course, the industry's desire for less regulation does not ensure that rates are fair – given the historical excess of the companies' desired rates over the regulated rate cap, the industry's opposition to regulation may more plausibly be viewed as evidence of its desire for increased prices and profit.

These changes were met with concern from consumer advocates, some industry participants and government officials that consumers would be shortchanged by deregulation. Nonetheless, the Commissioner maintained that deregulation would encourage companies to enter the market and compete for business. She assured the public that her changes would produce lower, fairer, and more transparent rates.

This report reviews the first year of deregulation and provides recommendations that will protect consumers and ensure a healthy marketplace. Overall, the results of managed competition in the first year have been disappointing for consumers. This report finds that (A) prices, while down for many consumers, are not as low as they would have been in a regulated market, (B) the deregulated process is significantly less transparent than regulation, (C) significant barriers to competition still exist, (D) a consumer's driving record has become less relevant in determining the price of insurance, (E) it is difficult for drivers to "shop around" for better prices, and (F) consumer protections have been significantly weakened and are in danger of being eroded further. We believe that the recommendations this report offers can help cure these shortcomings in the current deregulated system.

A. Prices after Deregulation

A key test of deregulation is whether insurance prices have really decreased for consumers. Indeed, a study commissioned by the Patrick Administration found "there was near universal agreement [among consumers] that price is the most important consideration in buying insurance."⁷ An analysis of insurance prices shows that while prices have, in many instances, decreased, they have decreased significantly less than they would have under the regulated pricing structure, effectively representing an increase in prices for the driving public.

Prior to deregulation, insurance rates were dropping steadily; it was widely expected that rates would have dropped at least 10% in 2008 had the regulatory structure remained in place. In the first year of managed competition, however, automobile insurance rates only declined, on average, by about 7%.⁸ The rate decrease in the first

⁷ On the Friday before July 4, 2009, Commissioner Burner issued a summary of an "extensive statewide study" the Patrick Administration commissioned (the "Commissioner's Study") to review the first year of managed competition in Massachusetts. Discussion Guide for Driver Focus Groups, Version 1, p. 3 (Nov. 9, 2008) ("Discussion Guide"). The Commissioner's study comprises a number of documents: Producers Interview Summary (Dec. 11, 2008) ("Study 1"); Driver Focus Group Report (Dec. 11, 2008) ("Study 2"); Driver Orientation Research Discussion Document (Dec. 18, 2008) ("Study 3"); and Consumer Satisfaction with Managed Competition for Personal Vehicle Insurance, Report on Background Synthesis and the Insured Driver Study (April 2009) ("Study 4"). As of the writing of this report, the Division has not yet publicly released the full study. Study materials were apparently prepared by marketing firms Denneen & Company and Hattaway Communications, based on a "market sizing" survey of 1,104 consumers and an "in depth satisfaction survey of 4,000 consumers." Focus groups were also held with consumers all over the state. The Study's stated intention was to help the Commissioner "make informed decisions to adjust the [deregulation] policy where needed." Discussion Guide, p. 3.

⁸ Economists retained by the Commissioner created several estimates of premium reductions for 2008, 6.4%, 6.5%, 7.6%, and 8.3%. P.B. Levine and H. Weerapana, *The Impact of the 2008 Auto Insurance*

year of managed competition was less substantial than the decreases during the last two years of the regulated period: from January 1, 2006 through April 1, 2007, rates dropped 8.7%, and from April 1, 2007 to April 1, 2008, 11.7%.⁹ Rates had been decreasing prior to managed competition because losses had been decreasing: between 2004 and 2007, losses declined for all coverages, by 18.2% for bodily injury, 22.5% for personal injury protection, 1.1% for property damage liability, 4.1% for collision, and 16.6% for comprehensive. Most agree that these decreases are partly due to a joint insurer and government initiative to fight fraud.¹⁰ Thus, the reduction in rates in the first year of managed competition occurred not because of competition, but because losses had been steadily decreasing.

These decreases occurred under the regulated system, where insurance companies were allowed to set their own prices, subject to a cap set by the Commissioner and DOI approval after a rate setting proceeding. Under deregulation, insurers were no longer subject to a real cap on rates.¹¹ Each insurer brought a proposed rate structure to the Commissioner individually, filed it, and then, after a waiting period, began to charge their new rates.

Had the Commissioner applied the standard methodologies used in prior rate setting years to cap the rates, 2008 rates would have dropped by about 11%, similar to the regulated reduction in 2007 (11.7%). Thus, the purported “decrease” in rates under managed competition was a significant overcharge, costing consumers in the aggregate well over a hundred million dollars.

Moreover, many consumers did not even receive this 7% decrease. In fact, according to industry rate filings, approximately 20% of consumers received rate *increases*. These figures were confirmed with material from the Commissioner’s Study, which noted that between 15% and 20% of consumers saw rate increases.¹²

Certainly, rates did not decrease as much as they should have for many drivers. For example, the chart below demonstrates the rates quoted for one sample Cambridge

Reform on the Massachusetts Economy (Mar. 19, 2009). These values are based on an assumed average household premium in 2007 of \$1,343 for the 2.444 million households in Massachusetts, or on a total premium base of \$3.28 billion; the actual 2007 premium base was over \$4.1 billion, nearly 30% higher. In 2009, average rates for most insurers were changed little; some insurers increased rates by up to 5%. For both 2008 and 2009, these premium changes are, in part, based on insurer estimates of how their new rate structures will impact their client base. It may be that the actual rate reductions are, in fact, less than those proffered by the insurers. The lack of data and transparency in the insurer filings is discussed later in this report.

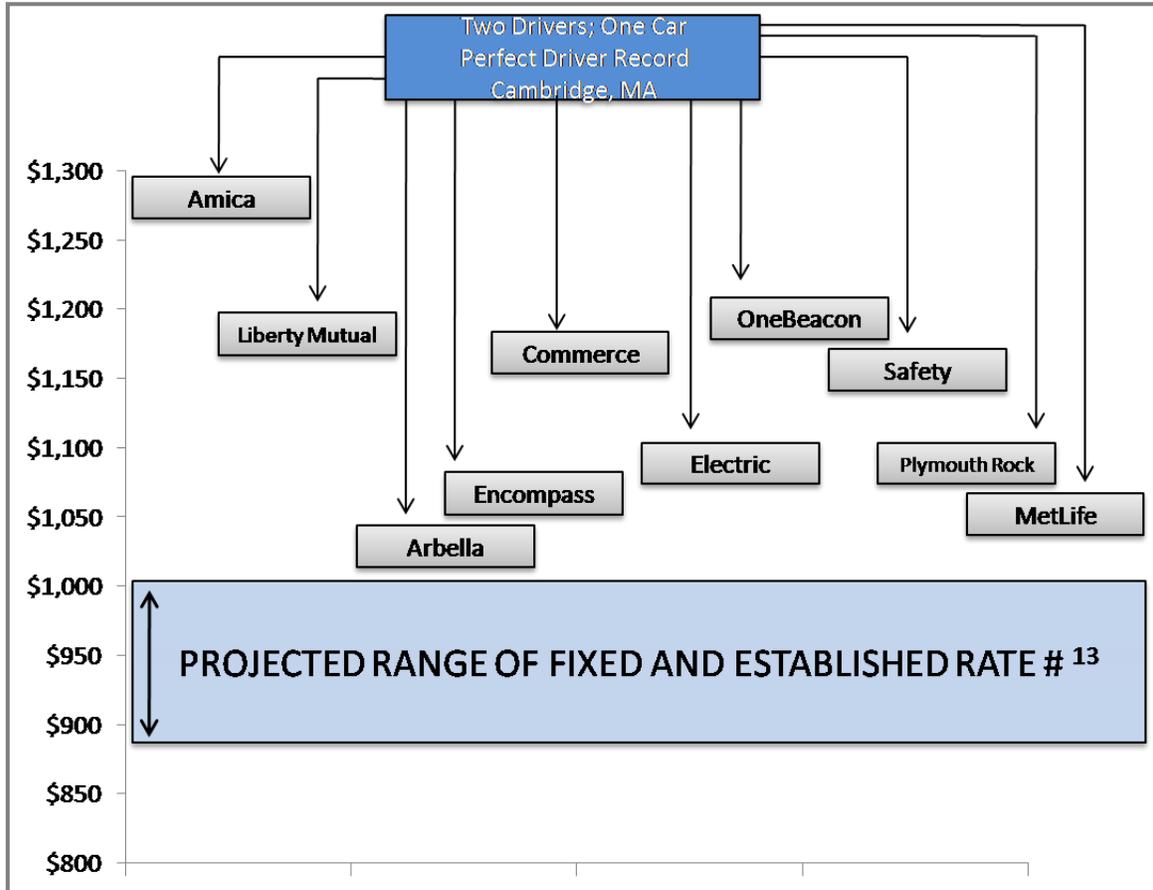
⁹ The Commissioner’s Study includes calendar year premium reductions of 6.4% from 2005-06, 8.2% from 2006-07, and 7.8% from 2007-08. Study 4, p. 9.

¹⁰ The Community Insurance Fraud Initiative was developed in 2003.

¹¹ The Commissioner did provide some rate cap related limitations at the start of deregulation, but these did not effectively control rates. Insurers could not raise an individual consumer’s rate on certain coverages more than 10%, but they were allowed to raise the price of other coverages instead. Similarly, the Commissioner kept in place in 2008 certain restrictions regarding territorial relativities. These may be phased out for future rate cycles.

¹² Study 4, pp. 57, 58.

couple who shopped around at the beginning of managed competition, as compared to the rates the drivers would have received under the old system's approach.¹³ Despite the fact that both drivers have perfect records, any rate they choose would be an increase under the new system.¹⁴

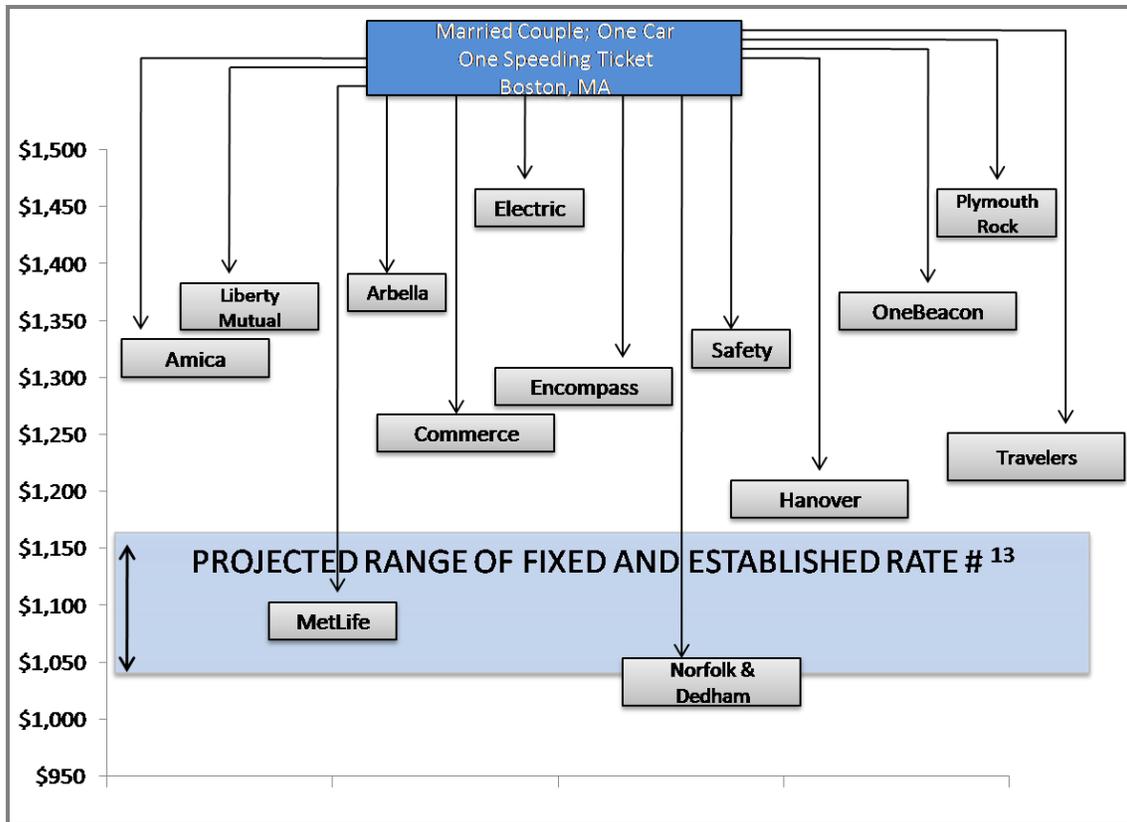


The next chart illustrates the rate search for another sample couple, this time living in Jamaica Plain. After several days, and seven hours on the phone, the couple was able to obtain thirteen quotes.¹⁵ Only two of the quotes were comparable to the expected regulated rate.

¹³ The projected range for the regulated rate is based on the standard methodologies the Commissioner used the years before rates were deregulated.

¹⁴ These rates were obtained over the phone; no insurer provided written quotes, and some agents said the quotes could not be confirmed.

¹⁵ Similar to the drivers' experience in Cambridge, no insurer provided written quotes and some agents said the quotes could not be confirmed.



Without proper regulation and a well-functioning competitive environment, the insurers were able to significantly raise the effective price of their products. As outlined below, they did so in largely the same manner: they inflated their underwriting profit adjustment provisions, and passed along new expenses to customers. Insurers were able to pass costs along because no regulator prevented it, and the market failed to ignite competition between insurance companies.

1. *Lack of Regulatory Oversight*

The essential legal difference between regulation and deregulation is the ability of the companies in the deregulated system to raise rates to levels previously viewed as excessive. It is not the ability to lower rates to compete for business, which was allowed under both systems. Thus, when the Commissioner deregulated the market, many companies immediately sought higher returns. They did so by hiking their filed “profit provisions” in their rates and by passing along additional expenses.

a. Increased Profit Provisions

The “profit provision,” or “underwriting profit adjustment provision,” provides a credit to policyholders for extending premium dollars now, even though losses, in aggregate, will not accrue, or need to be paid until later on. This effectively adjusts for the time value of money. This adjustment to the rate is usually calculated by a complex

set of equations that measure a variety of factors. These factors include shareholder return, timing of cash flows, return on assets, and the premium to surplus ratio. Historically, this adjustment has been negative, reflecting, among other things, the fact that insurers had the ability to make money on premium dollars before losses were paid out.

The underwriting profit adjustment provision adjusts the rate by a certain percentage. From 1988 to 2007, this provision averaged -3.5%,¹⁶ thus decreasing the rates by approximately 3.5% on average during this period. As soon as the market was deregulated, however, the insurance companies increased their filed profit adjustment provisions (and rates of return) well over the 2007 regulated amount. On average, the insurers increased their rate of return by about 25%. **The average filed profit adjustment provision under managed competition in 2008 was substantially higher than the profit adjustment provision in regulated rates in any year for at least the last twenty-five years.**¹⁷

The insurers increased their profit adjustment provision over the 2007 level principally by employing higher target rates of return to shareholders or cost of capital values (a value in the profit adjustment calculation). In 2007, the last year of regulation, prior Commissioner Julie Bowler adopted a target return of 9.64%. This return, which was intended to reproduce the return that would exist in a competitive market,¹⁸ was based on identified data sources and supported by methods adopted after analysis and review.¹⁹ The target was similar to the target return established by the insurance commissioner in California, a competitive market state that reviews profit in order to ensure that consumers do not overpay. In California, the target profit (as of January 2008) was 9.66%.²⁰

The companies' deregulated filings used much higher targets, targets as high as 15%.²¹ This structural change in the calculation of the underwriting profit adjustment provision will add hundreds of millions of dollars of additional premium payments to the

¹⁶ For most of this period, the profit adjustment provision was calculated using the Myers-Cohn model, a mathematical model developed by economists at MIT and the University of Hartford and introduced by the industry.

¹⁷ In fact, from 1988 to 2007, every regulated underwriting profit adjustment provision was negative. (A negative underwriting profit adjustment provision does not indicate negative profits; indeed, even in the regulated system, insurers amassed millions in profit from investing assets and charging policyholders finance fees). The 2007 regulated profit adjustment provision was -1.35%.

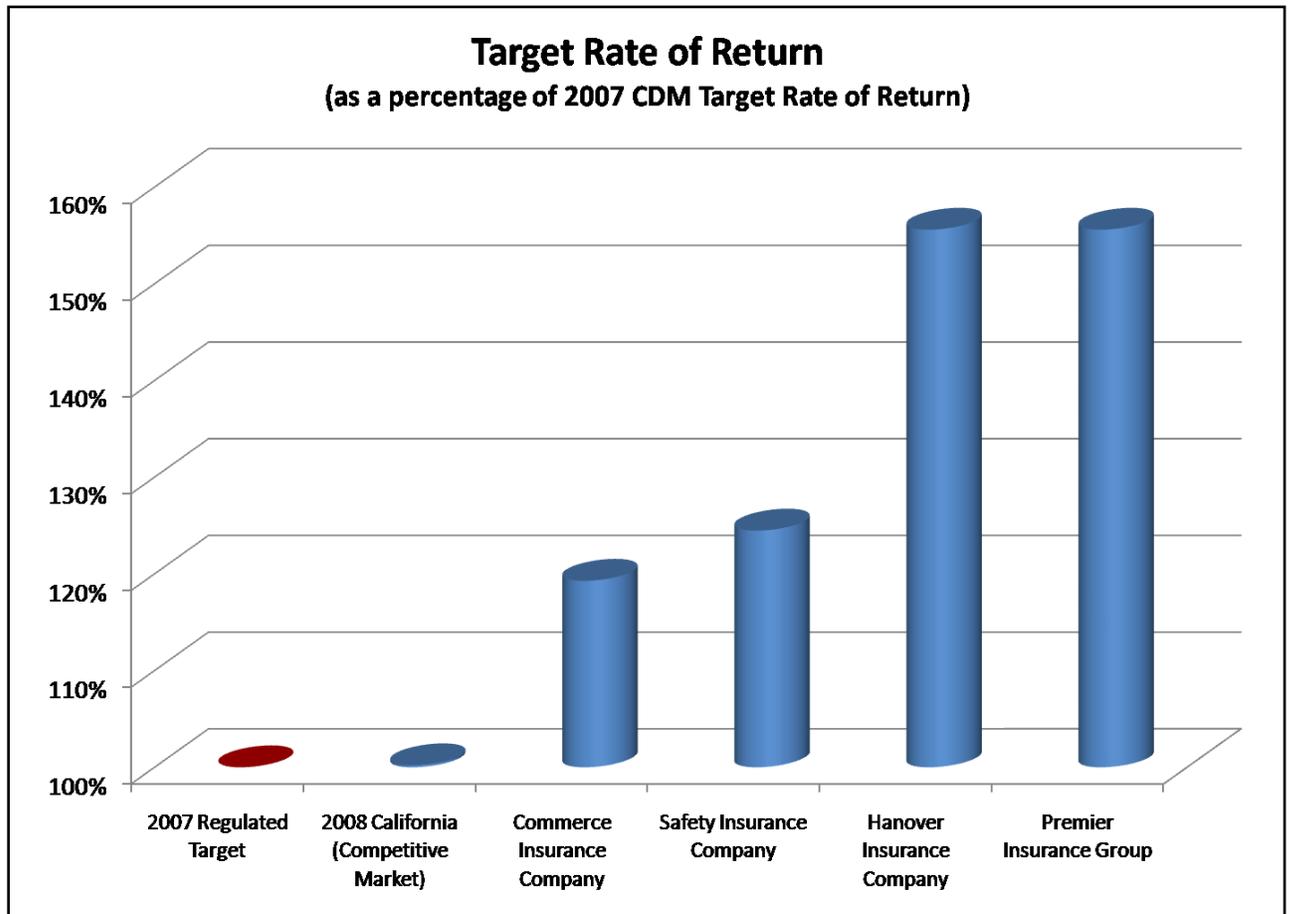
¹⁸ "The rate of return to an investor in the model insurer should equal what he would expect on an investment of comparable riskiness in the competitive market." *Attorney General v. Commissioner of Insurance*, 370 Mass. 791, 817 (1976). See also, e.g., *MARB v. Commissioner of Insurance*, 401 Mass. 282, 286 (1987) ("The goal in setting rates is to reproduce the effects of competitive markets and the rates as ultimately set must leave the industry with at least the opportunity to achieve the average returns earned in competitive markets.").

¹⁹ E.g., *Decision on 2007 Private Passenger Automobile Insurance Rates* (2006) ("2007 Decision").

²⁰ <http://www.insurance.ca.gov/0250-insurers/0800-rate-filings/index.cfm>

²¹ The target profits were 11.5% (Commerce), 12% (Safety), and 15% (Premier and Hanover). Arbella adopted the AIB Advisory Filing, which averaged the 2007 profit and a higher AIB value calculated using a method rejected in the 2007 Decision.

companies if these practices remain in place over time. The chart below displays the target returns in relation to the 2007 regulated target of several large Massachusetts insurers.



Despite these increased values for the target return inputs (which cause an increase in the profit adjustment provision), the insurers' filings provided no information, data source, data, assumptions, or methods justifying the use of these values.²² This

²² See, e.g., Decisions on 2001 through 2007 rates. The transcripts from the 2008 rate hearings demonstrate the absence of support in the profit targets:

Q. In the filing that Safety made, which has been marked as Exhibit 2, Safety uses a target 12 percent return on equity, correct?

A. Yes.

Q. Is there a place in the filing where the 12 percent value is calculated?

A. No.

Q. Does the filing provide a data source for the 12 percent value?

A. No, the filing does not.

Q. Does the filing show a method by which the 12 percent value is obtained?

A. No.

Transcript, p. 43 (January 11, 2008).

Q. Does the AIB calculation in Exhibit 3 include any Arbella data?

A. I don't think so.

Q. Did you, in connection either with the preparation of filing Exhibit 3 or in connection with your testimony here today, review Arbella's

practice actually flouted the new managed competition regulations, which require filings to contain “information and its data source” for the calculation of the profit adjustment provision (and other elements of the insurers’ proposed rate).²³ Actuarial standards also require a filing to “identify the data, assumptions, and methods used by the actuary....”²⁴ Commissioner Burnes explicitly stated that the filing must be “adequately supported, and if ... it’s not adequately supported, then I do not approve it.... [A]ctually, I affirmatively disapprove it.”²⁵ Nonetheless, the insurers simply selected the high target rate of return inputs because they sought a higher underwriting profit provision adjustment, and the Commissioner permitted them to do so.

loss flow data?

A. No.

Transcript, pp. 17-18 (January 18, 2008).

Q. Can you point to a place in the filing where the 11.50 value is calculated?

A. It is not calculated.

Q. Does the filing provide a data source for the 11.50 return on equity?

A. No; it's a goal.

Q. Does the filing show a method by which the 11.50 percent return on equity value is obtained?

A. No. It's a goal.

Q. Is there any data in the filing that supports this value?

A. No.

Transcript, p. 97 (January 9, 2008).

Q. Is there a place in the filing where the 15 percent value is calculated?

A. No.

Q. Is there a data source for the 15 percent value in the filing?

A. I think you would have to define what a data source is.

Q. Okay. Is there any data in the filing that supports the 15 percent?

A. Not within the filing.

Q. What about a method? Is there any method in the filing that supports that value?

A. No.

Transcript, pp. 43-44 (January 16, 2008).

Q. Is the 2-to-1 premium-to-surplus ratio referred to in the filing?

A. No, it is not.

Q. And what about the 15 percent return on equity?

A. It's not specifically referenced in the filing, I do not believe. I can double-check.

(Reviewing document) No, it is not.

Q. The numbers that we've just been talking about, the 2-to-1 premium-to-surplus ratio, the 15 percent target and so forth, is there any indication in the filing as to how those numbers are calculated?

A. Not in the filing.

Q. Any discussion of the data source for those numbers?

A. Not in the filing.

Q. What about a method?

A. Not in the filing.

Q. Is there any analysis of the cost of capital in the filing?

A. No, there is not.

Q. Did you perform any kind of a profit calculation based on a cost of capital?

A. Personally, I did not.

Q. Did anyone at Premier that you know of?

A. At Premier? No.

Transcript, pp.112-13 (January 14, 2008).

²³ 211 CMR 79.06 (4).

²⁴ Actuarial Standards of Practice (ASOP) No. 41.

²⁵ Transcript, p. 34 (Dec. 19, 2007). *Cf. Travelers Indemnity Co. v. Commissioner of Ins.*, 362 Mass. 301, 304 (1972) (“We hold that [the Commissioner] may disallow rates if, upon request by him under G.L. c. 175A, § 6 (a), an insurer or rating organization fails to produce supporting information which is reasonably adequate to enable him to determine whether the proposed rates are ‘excessive, inadequate or unfairly discriminatory.’”).

In her assessment of the insurers' proposed rate, Commissioner Burnes stated that "[i]n a competitive market, companies are free to incorporate their own target profit provisions into their proposed rates; price competition is expected to exert pressure on rates to provide some control on profit levels."²⁶ The Commissioner provided no standard by which to judge the company's "own target profit provision." She then, despite the objections of the Attorney General's Office and consumer advocates, accepted all profit adjustment provisions filed by the companies, notwithstanding their lack of support.²⁷

Several companies also increased the profit adjustment provision by ignoring other sources of revenue that should have been accounted for in the profit adjustment provision calculations. Historically, investment income on surplus and finance income have been reflected in the profit adjustment calculations. Actuarial standards *require* the inclusion of both,²⁸ as do Massachusetts judicial²⁹ and DOI decisions: prior commissioners found that the purpose of the underwriting profits provision is "to provide a fair return to insurers, recognizing the effect of revenue that insurers receive in addition to premium, *including but not limited to income earned on their invested assets and finance charges.*"³⁰ Even Commissioner Burnes stated that the profit provision must reflect investment income on surplus: "[t]he underwriting profit loading in rates recognizes investment income from both insurance operations and surplus, in keeping

²⁶ *Opinion, Findings and Decision on Request for Hearing on Premier Insurance Company's Private Passenger Motor Vehicle Filing Dated November 27, 2007*, pp. 9-11 (2008) ("Premier Decision"); *Opinion, Findings and Decision on Request for Hearing on Hanover Insurance Company's Private Passenger Motor Vehicle Filing Dated November 27, 2007*, p. 7 (2008) ("Hanover Decision"); *Opinion, Findings and Decision on Request for Hearing on Safety Insurance Company's Private Passenger Motor Vehicle Filing Dated November 27, 2007*, p. 6 (2008) ("Safety Decision"); *Opinion, Findings and Decision on Request for Hearing on Commerce Insurance Company's Private Passenger Motor Vehicle Filing Dated November 27, 2007*, p. 8 (2008) ("Commerce Decision"). In the Commerce Decision, the Commissioner also relied on materials provided by a consultant, Milliman, Inc., that were not contained in the filing. Milliman produced higher profit provision estimates using methods and inputs rejected by the prior Commissioners; why Commissioner Burnes relied on the Milliman estimates rather than the benchmarks established in the 2007 rate decision, which she found to be "irrelevant," is unstated. Commerce Decision, pp. 8-9.

²⁷ Massachusetts law provides that "[e]vidence that a reasonable degree of competition exists in the area with respect to the classification to which such rate is applicable shall be considered as material, not conclusive evidence, that such rate is not excessive." G.L. c. 175E, § 4 (a).

²⁸ There are two elements of investment income that the actuary should consider: investment income from insurance operations *and investment income on capital.*" ASOP No. 30, § 3.5 (emphasis added); *see also* ASOP No. 30, § 2.10.

²⁹ *See Workers Compensation Rating and Inspection Bureau v. Commissioner*, 391 Mass. 238, 254 (1984) ("To determine how much investment income is earned on a coverage line, surplus of the model company must be allocated among different insurance coverage lines").

³⁰ *Decision on 2004 Private Passenger Automobile Insurance Rates*, p. 28 (2003) ("2004 Decision") (emphasis added). "The underwriting profits provision in private passenger automobile rates recognizes that insurers receive income in addition to premium, and that rates charged to policyholders should reflect the presence of that income." *Decision on 2003 Private Passenger Automobile Insurance Rates*, p. 57 (2002) ("2003 Decision").

with industry-wide target returns on capital.”³¹ She also stated that “[t]he company must use generally accepted actuarial standards.”³² Later, she changed her mind on both issues, permitting the exclusion of investment and finance income and stating that requiring the insurers to comply with actuarial standards is “*a path leading to nowhere.*”³³

These changes to the inputs for the profit adjustment provision are important and must be controlled to allow for fair insurance pricing. The insurer’s profit adjustment provision must be supported by real actuarial data, and regulators must give clear guidelines on what is fair and reasonable for consumers. This is especially important in a market where, as discussed later in this report, too many barriers exist for real price competition.

b. Increased Insurer Expenses

Another rate component that regulators must closely monitor is the expense provision. Similar to their inflation of the underwriting profit adjustment provision, insurers took advantage of deregulation to load additional expenses into consumer premiums. Together with the excessive underwriting profit adjustment provision, these extra expenses cost consumers, in 2008, over \$150 million.

While a portion of an insurance rate always pays for certain expenses related to the writing and selling of insurance policies, insurers were previously never permitted to pass on such costs that were unfair to consumers. Most pertinently, contingent commissions – payments that are above the standard commission payment to agents, and are generally given to agents who bring in more or better business – were previously excluded from the rates, because the Commissioners found that they “would not comply with the Commissioner’s statutory duty to ‘set adequate, just, reasonable and nondiscriminatory rates.’”³⁴ Thus, the cost of these bonuses was not passed on to consumers in the regulated market.

The inclusion of contingent commissions in the rate was always prohibited for important policy reasons. Past commissioners found that “it is reasonable to expect that contingent commission expenses, if policyholders are to pay them through the rates, should represent expenses that benefit those consumers.... No evidence in the record would support a conclusion that excess commissions are linked to services provided to policyholders.”³⁵ Indeed, some regulators and consumer advocates believe that contingent commissions affirmatively disadvantage policyholders by creating conflicts of interest and producing anticompetitive effects, such as the steering of business away from

³¹ Transcript, p. 14 (December 19, 2007). See also 2007 Decision, pp. 18-19 (“insurers earn “investment income on both premiums received and surplus funds. Historically, underwriting profits provision modeling has reflected, among other things, items such as investment and other income....”)

³² Transcript, p. 23 (December 19, 2007).

³³ Safety Decision, p. 7; see also Hanover Decision, p. 8, Premier Decision, p. 7.

³⁴ E.g., *Decision and Order on 2005 Private Passenger Insurance Rates*, Docket Nos. R.2004-11, 12, 13, pp. 26-27 (2004). See also 2007 Decision, pp. 104-05.

³⁵ See, e.g., 2003 Decision, p. 32.

more cost-effective carriers. A former commissioner also found that contingent commissions are a form of profit sharing, in which companies share a portion of their profit with agents; “[w]e already include an allowance for company profits in the rate base; thus, to include profit-sharing payments to agents would double-count these amounts.”³⁶ The State Rating Bureau, the Commissioner’s technical arm, previously stated that contingent commissions produce “rates that are per se unreasonable and excessive.”³⁷

In spite of this precedent and the principles of fairness upon which it relied, under deregulation Commissioner Burnes permitted the insurers to pass the costs of contingent commissions on to policyholders.³⁸ In 2008, these additional commissions in the insurers’ rate filings totaled more than \$70 million annually. The chart below lists the filed contingent commissions of some of Massachusetts’ largest insurers in 2008:³⁹

Insurance Company	Contingent Commissions in Filed Rates
Arbella Mutual Insurance Company	\$9 million
Commerce Insurance Company	\$33 million
Hanover Insurance Company	\$8 million
Premier Insurance Company of MA	\$10 million
Safety Insurance Company	\$10 million
Combined	\$70 million

The pass-through of contingent commissions was not the only way that deregulation allowed consumers to be overcharged with new expenses. Several insurers also included other new expenses in their filed rates. For example, Commerce increased its overhead and selling expenses 50-80% over its historical costs, raising Commerce’s filed rate by about \$35 million in 2008.⁴⁰ The filing provided no calculation, data source, data, or method in support of this increase. The company simply justified the increase by stating at the rate hearing that it expected its expenses to rise because a competitive market is more expensive than a regulated market.

³⁶ *Decision on 1987 Private Passenger Automobile Insurance Rates*, p. 195 (1986).

³⁷ 2004 Decision, p. 123.

³⁸ “Contingent commissions” includes commissions that are contingent on future or past profitability and exceed the pre-set commission rate. “Contingent commissions” includes categories of commissions that are sometimes referred to as “override” commissions and “excess” commissions.

³⁹ The listed commissions are included in the insurers’ filed indicated rates.

⁴⁰ This amount also includes a reduction in miscellaneous offsetting income in the expense calculation.

When managed competition was implemented, some argued the market would act as the regulator and prevent insurers from pushing costs onto consumers. In 2008, the market failed to provide these protections, leaving many consumers with overpriced insurance.

2. Lack of Market Competition

In the absence of effective regulation, only strong competition can act as a deterrent to inflated rates. Thus far, however, real competition has failed to materialize in Massachusetts. When insurers were first allowed to submit separate rate filings, there was little variation among the companies' requested average rates. In fact, notwithstanding the companies statements during their advocacy for deregulation that they intended to compete on price, nine of the top ten companies in Massachusetts (by market share), representing about 80% of the market, filed average rates within 1% of each other:

Company	Average Decrease
Commerce	-6.0%
Safety	-6.3%
Arbella	-7.7%
MetLife	-6.0%
Premier	-6.3%
Plymouth Rock	-7.3%
Amica	-7.9%
Hanover	-8.0%
OneBeacon	-7.2%
Expected decrease if rates were regulated	At least -10%

The one exception was Liberty Mutual, which reduced rates by -10.7% in 2008. Liberty subsequently increased its rates by 4% in 2009.

Moreover, the entry of new carriers failed to spark competition and price cutting. Deregulation advocates had relied on the entry of new insurers as a guarantee that prices would come down. The theory was that new companies would force old ones to seek customers and cut costs. Under the current deregulated system, this has not happened.

While a handful of new insurers entered the Massachusetts market in 2008 and early 2009, the presence of new insurers failed to ignite real competition among the incumbent carriers.

Progressive Insurance Company, the nation's 5th largest carrier and a major price cutter for certain categories of drivers, began selling policies in Massachusetts on May 1, 2008. While Progressive's rates appear to be lower, on average, than those of other insurers, Progressive's impact on the market, at least in the short term, was modest; its entry in May 2008 did not propel incumbent insurers to lower statewide prices.

Similarly, the entry of other carriers into the market in 2008 did not cause incumbent insurers to file lower rates. Vermont Mutual and Preferred Mutual priced their policies above or similar to those of existing companies.⁴¹ AIG did not compete broadly – it only began offering policies to customers in its Private Client Group, which seeks to provide insurance options for some of its more affluent consumers. Peerless Insurance Company a wholly owned subsidiary of Liberty Mutual, offered average prices similar to those already in the market.⁴²

Indeed, rather than lowering statewide rates, it appears incumbent carriers may now be doing the opposite. Recently filed rates show that prices of some insurers have started to increase. Liberty Mutual filed for a rate increase of 4%, Premier for a rate increase of 2%. Even Progressive has now raised its prices by 4.9%, abandoning the company's initially aggressive price strategy.

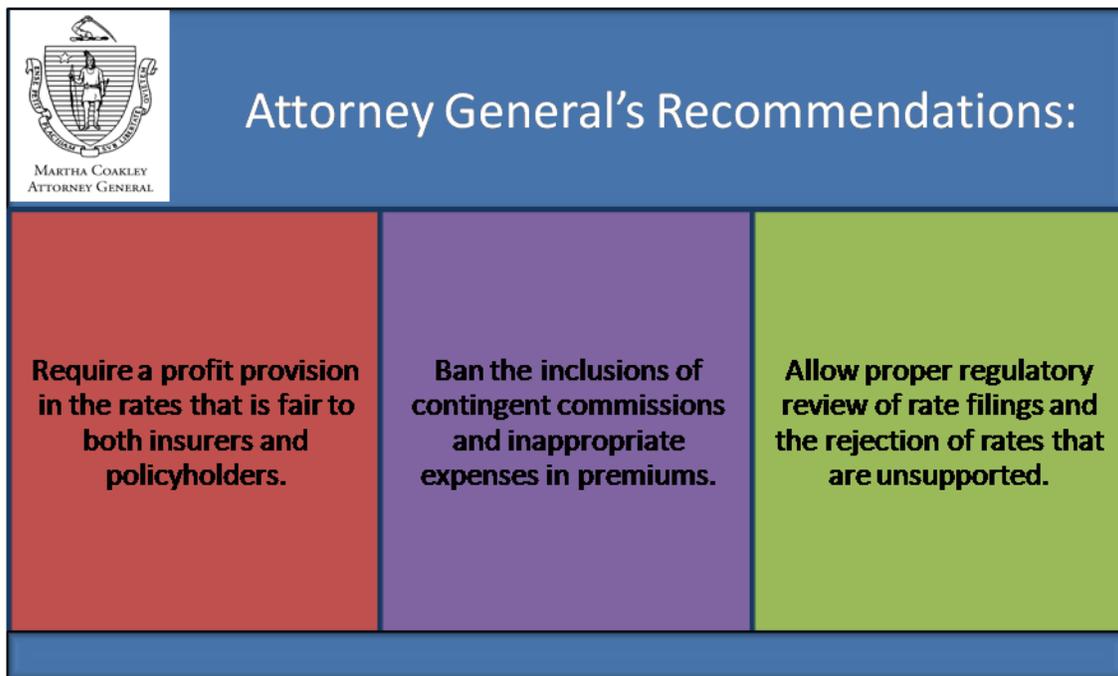
The new carriers have had an effect on incumbent insurer behavior, but not in a way that benefits consumers. Rather than emulating any newcomer price-cutting, the incumbent carriers have instead adopted the newcomer practice of using "secret rating factors," which are discussed later in this report. The incumbents have also adopted the newcomer penchant for massive spending on non-informational advertising, the costs of which are borne by policyholders. These advertisements are primarily "image" ads and often contain claims that are ambiguous or impossible to verify. Such ads typically do not provide consumers with useful information about their complex insurance choices.

Basic economic theory makes clear that competition works best under perfect market conditions, and that a key to any healthy competitive environment is a large number of potential sellers, each with the proper incentives to provide services at low or "marginal" costs. Companies have an economic incentive to overcharge their customers, and they will likely do so unless they believe their customers will go elsewhere. This "switching" of business from an overpriced company to less expensive carriers can only happen when consumers have good information, and moving between companies is relatively easy. As discussed later in this report, neither is currently true in Massachusetts, and as a result, and many consumers are overpaying for their auto insurance purchases.

⁴¹ Preferred Mutual primarily adopted the rules and rates of the AIB advisory filing. Vermont Mutual primarily adopted the rates of Safety Insurance Company.

⁴² In 2009, additional insurers have entered the market, including Occidental and GEICO. To date, incumbent insurers do not appear to have generally lowered their prices to compete with the new entrants.

This need not be the case. Flaws in managed competition relating to pricing can be cured by introducing clear standards and expectations for insurer rate filings. The Attorney General’s Office intends to promulgate consumer protection regulations under her Chapter 93A authority that will address abuses in the filings for inappropriate profit adjustment provisions and expenses in insurance rates. Proposed regulations would also require insurers to have support for their proposed consumer premiums. This will ensure a level playing field and proper protections for Massachusetts drivers. In addition, the Attorney General recommends that the Insurance Commissioner allow an open and thorough review of each filed rate. Each element of a filed rate that is excessive or not actuarially supported should be rejected. Without this sort of oversight, insurers will seek out the highest rates possible and cause many customers to overpay while causing others to go without insurance at all due to lack of affordability.



The graphic features the Attorney General's Office logo on the left, which includes the state seal and the name 'MARTHA COAKLEY ATTORNEY GENERAL'. To the right, the title 'Attorney General's Recommendations:' is displayed in white text on a blue background. Below the title, three colored boxes (red, purple, and green) list the recommendations:

- Require a profit provision in the rates that is fair to both insurers and policyholders.**
- Ban the inclusions of contingent commissions and inappropriate expenses in premiums.**
- Allow proper regulatory review of rate filings and the rejection of rates that are unsupported.**

Not only have insurers been unable to contain prices under deregulation, the market has become significantly less transparent. Now, the rate review that does occur happens behind closed doors, and consumers have no way to calculate how the insurers come up with their proffered rates. Thus, a key consumer protection – open information – has been effectively eliminated. This should be reversed.

B. The Lack of Transparency

Commissioner Burnes stated that one of the goals of deregulation is to increase transparency.⁴³ Consumers agree that transparency is important. The Commissioner’s

⁴³ The Patrick Administration has long touted “greater transparency” as one of three principal “intents” of

Study found that “participants were generally excited about the idea of more openness on rating factors and coverage. Virtually everyone shared a desire for greater access to clear information.”⁴⁴ Nonetheless, despite these stated goals and consumer demand for more openness, deregulation has produced less – not more – transparency in rating. This elimination of transparency is most evident in two ways: 1) the lack of proper review of rate filings, and the evisceration of the public hearing process and 2) the introduction of secret rating factors that cannot be reviewed or tested.

1. *Managed Competition Rate Hearings*

Insurance rate filings are still subject to certain statutory requirements. Massachusetts state law requires insurers to file their proposed rates and supporting materials with the Division of Insurance, and allows the Attorney General to trigger administrative hearings in front of the Commissioner to review whether the rates violate G.L. c. 175E in any way, including whether the rates are “excessive or inadequate . . . [or] unfairly discriminatory.”⁴⁵

At the start of managed competition, the Attorney General, in her statutory role as the Commonwealth’s chief legal officer and representative of consumer interests in rate matters before the Division,⁴⁶ found that the filed premiums on average were too high. Because of this finding, she challenged the inflated rates of five companies, which insured more than half of Massachusetts consumers: Commerce Insurance Company, Safety Insurance Company, Arbella Insurance Company, Premier Insurance Company (Travelers St. Paul Group), and Citizens Insurance Company (Hanover Group).⁴⁷

Rate hearings are governed by Massachusetts law, under which the Attorney General has the statutory right to obtain materials by subpoena, to call and examine witnesses, and to submit evidence.⁴⁸ In the hearings, it is the responsibility of the companies to show that their rates are reasonable and not excessive.⁴⁹ The hearings are intended to be public proceedings, in which policyholders are entitled to determine what their rates are based on, and individual companies are required to justify the rates. As Supreme Court Justice Louis Brandeis said, “Sunlight is the best disinfectant; electric

deregulation. It is listed as one of the three principal goals for deregulation in the outline for the Governor’s survey. See the Survey Discussion Guide, p. 4.

⁴⁴ Study 2, p. 49. In fact, when asked what was important in purchasing auto insurance, 75% of consumers indicated that they wanted to “understand how the price of my policy is determined.” Study 4, p. 114.

⁴⁵ G.L. c. 175E, § 4. The Attorney General’s authority to trigger rate hearings is set forth in G.L. c. 175E, § 7. The Commissioner can, of course, also trigger a rate hearing. G.L. c. 175E, § 8.

⁴⁶ G. L. c. 175E, § 7; G.L. c. 12, § 11F. The Attorney General’s role is an integral part of the G.L. c. 175E competitive system. The statute provides that “[t]he commissioner may in his discretion, and shall on the motion of the attorney general, initiate a hearing on any such filing prior to its effective date....” G.L. c. 175E, § 7. In her “managed competition” regulations, Commissioner Burnes limited the time period to request a hearing to “no later than 20 days after the submission of the Rate Filing.” 211 CMR 79.11 (3).

⁴⁷ Together, these insurers represented about sixty percent of the Massachusetts market, insuring about 2.5 million cars.

⁴⁸ G. L. c. 30A, §§ 11, 12.

⁴⁹ G. L. c. 175E, § 4.

light the best policeman.” A true test of deregulation would be whether rates could withstand thorough public scrutiny and review.

The Commissioner’s 2008 hearings, however, did not afford a meaningful or thorough review of issues. During the hearings, Commissioner Burnes made twenty rulings on the scope and content of the hearings; all limited the public availability of information and analysis. Her decisions:

- prohibited discovery of and access to insurance company information,
- disallowed administrative subpoenas seeking key insurance company documents,
- refused to consider issues of discriminatory rating factors and redistribution of premiums, and
- excluded the testimony of the Attorney General’s expert witnesses on issues of fairness and discrimination.

In what was supposed to be an impartial review of a proposed rate to determine its reasonableness, the Commissioner, in many instances, made a point of stating *prior to the hearing* that she had completed her own internal review of the filings and found that “the rates meet all the statutory, regulatory, and guidance requirements.”⁵⁰ During her tenure, Commissioner Burnes failed to disapprove a single company rate filing.

Regular hearings have been conducted at the Division of Insurance on many lines of insurance: private passenger auto, homeowners, workers compensation, and Medicare supplement insurance rates. In all such hearings, the production of insurance company data is mandatory, discovery is permitted, no issues are off limits, and no expert testimony is excluded. In judicial proceedings, similarly, requests for information are routinely permitted and the production of responsive materials required; when such materials are confidential, the courts may issue protective orders to permit disclosure while maintaining confidentiality. The Commissioner’s regulations give the Commissioner comparable authority to “make rulings regarding the admissibility of evidence or any other matter which may arise during a hearing.”⁵¹ Virtually the only exceptions to disclosure in administrative and judicial proceedings are in the areas of privilege and national security, exceptions that do not apply to the insurers’ rates.⁵² Nonetheless, this transparency was not permitted when applied to auto insurance rates.

⁵⁰ *E.g.*, Transcript, p. 17 (December 19, 2007). Moreover, prior to and during the hearings, the Commissioner’s office staff engaged in secret discussions with and came to private arrangements with the insurers concerning the filed rates.

⁵¹ 211 CMR 79.13 (2).

⁵² Commissioner Burnes relied on the rule that insurers have the burden of proof as a basis for refusing to permit discovery. However, in all administrative hearings on insurer rate filings, the insurer has the burden of proof to demonstrate that its rate is reasonable and not excessive; this has never been considered a reason to refuse to permit discovery. In judicial civil proceedings, one party has the burden of proof; this has never been considered a reason to refuse to permit discovery. Discovery in administrative and judicial

During the first year of deregulation, insurance companies failed to provide the information needed to support their rates. An example is the Liberty Mutual filing from January of 2009. Liberty’s filing produced an “indicated” rate increase of 15.1%. However, this was an unsupported number that even Liberty did not believe was needed, since it ignored the “indication” and proposed an increase of 4%. The effect, and perhaps the purpose, of Liberty’s unsupported values was to permit Liberty to “pick” the rate increase it wanted. The data that Liberty does include in its filing, historical loss and premium data, are actually inconsistent with the value that Liberty chose:

Amount by Which Liberty Understates Projected Premium Revenue Because of Understated Premium Trends				
	Liability	Personal Injury Protection	Comprehensive	Collision
Annual Premium Trend Historical:	0.2%	0.2%	1.6%	5.7%
Annual Premium Trend Projected:	0.0%	-1.5%	1.5%	4.0%
Difference:	-0.2%	-1.7%	-0.1%	-1.7%
Premium Projection Understated by:	-0.4%	-3.8%	-0.2%	-3.6%

	Bodily Injury	Property Damage	Personal Injury Protection	Comprehensive	Collision
Annual Loss Trend Historical:	-9.5%	-1.0%	-9.0%	-8.5%	0.0%
Annual Loss Trend Projected:	3.0%	3.0%	0.0%	0.0%	1.5%
Difference:	12.5%	4.0%	9.0%	8.5%	1.5%
Loss Projection Overstated by:	33.8%	9.3%	23.7%	22.1%	3.4%

Liberty also uses key unsupported inputs to produce an arbitrary underwriting profit adjustment provision of 3.7% for liability and 8.2% for physical damage (the comparable 2007 regulated profit values were -2.15% for liability and 0.41% for physical damage). These unsupported inputs include a cost of capital of 15%, and pre-tax investment yield of 4.8%, and an investment tax rate of 29%.⁵³ In its latest California filing, in August 2008, Liberty used a substantially lower rate of return (10.89%), a

proceedings is provided as a matter of fairness and efficiency.

⁵³ Liberty similarly provided no support for the expense values in the filing. The Attorney General expressed these concerns to the Division of Insurance in a letter dated March 9, 2009. Commissioner Burnes responded on April 17, 2009, stating that she found the filing wholly supported.

higher pre-tax yield (5.49%) and lower investment tax rate (27.79%), all factors that, as compared to the Massachusetts inputs, reduce the underwriting profit. These inputs are not state-specific; use of the California inputs in Massachusetts significantly lowers Liberty's filed underwriting profit. Liberty is not alone. Many companies are now simply choosing numbers in their rate calculations to reach the result they want. But beyond choosing arbitrary numbers to estimate trend, profit and expenses, they are hiding other necessary information as well. Many companies are now including rating factors that use "secret" formulas to determine how each individual is charged.

2. *Invisible Rating*

Until the introduction of managed competition, each individual's rate could be determined and checked from publicly available data. Now, individuals must trust the insurers. For many companies, there is no way to determine how a price is calculated or whether a rate quote or a charged rate is appropriate or accurate. Companies simply state that they are using an undisclosed formula based on a number of criteria to generate an individual's rate. The filed rating plans do not say what any individual, or any consumer with certain characteristics, will be charged. Thus, although the law requires insurers to file their entire rating plan, the Commissioner's office permits insurers to use secret or undisclosed rating factors or formulas, and there is no way to determine whether the premiums of any individual are excessive or unfairly discriminatory.

Progressive, for example, employs a "Category Factor" to develop rates for individual consumers. This factor uses an unknown calculation that considers the following criteria: the length of prior insurance coverage, number of not-at-fault accidents, number of comprehensive claims, length of residency, number of excluded drivers,⁵⁴ number of late payments, how the insurance was purchased (through the internet or on the phone), and whether or not the applicant omitted information (inadvertent or otherwise).⁵⁵ The weight assigned to these criteria and the contribution of each criterion to an individual's price are not disclosed. Without this disclosure, however, no one has the ability to determine if Progressive is rating each driver fairly.⁵⁶ Following Progressive's example, other insurers, including Arbella, Liberty Mutual, Hanover, and OneBeacon, have now adopted similar rating methods without revealing how consumers' prices are determined. Failing to file all relevant information is prohibited in other states, such as Florida and California.

Despite Commissioner Burnes' stated intention that managed competition should increase transparency, it has had the opposite effect. The public has taken note; in the

⁵⁴ Excluded drivers are household members who agree not to drive the insured vehicle. Presumably, because they agree not to drive the vehicle, the listing of the excluded driver should not affect the policy. However, some insurers argue that even association with the excluded driver is an increased risk.

⁵⁵ In its first filing, Progressive omitted even this list; the company apparently wished to withhold from the public what the "Category Factor" was based on, and provided this information only in response to a demand from the Attorney General.

⁵⁶ The Attorney General wrote four letters to the Commissioner of Insurance on this issue, on March 13, 2008, April 7, 2008, April 16, 2008 and May 20, 2008. The Division, however, has never required Progressive or any other company to provide public support for its rating factor.

Commissioner’s Study, while 75% of consumers want to know how the prices of their policies are determined, only 34% reported that deregulation produced the disclosure they wanted.⁵⁷ This should not be allowed to continue, and the Attorney General intends to promulgate regulations that will require all insurance companies to fully disclose all rating elements in all proposed rates in Massachusetts. They will also require insurers to include relevant supportive data in their rate filings. In addition, the Attorney General recommends the Commissioner reestablish full and comprehensive rate proceedings whenever an insurance rate is called into question. The parties should be allowed to conduct discovery, and the Commissioner should not permit an insurer to use the proposed rate until a thorough, unbiased, review of the filing is complete.

Attorney General's Recommendations:

- Require all filings to include complete and actuarially correct supporting data.**
- Require transparency in the implementation of rating factors and in premium calculations, including clear information for consumers about rating factors and the calculation of rates.**
- Make public basic insurance information collected by the Commissioner's statistical agent.**
- Require full and fair rate hearings that include reasonable time frames and the use of discovery.**
- Prevent the use of a rate until the completion of a full and fair hearing.**

C. The Importance of Driving Record

Lack of transparency harms consumers because they, and those who advocate for them, cannot determine if their rates are actually fair. Similarly, the ability of insurers to ignore longstanding Massachusetts rules on rating factors has also undermined consumer rights. After rates were deregulated, insurers introduced a large number of new rating factors; many of these are based on criteria such as income, age or homeownership, that have nothing to do with a consumer’s driving record.

According to the Commissioner’s Study, 85% of Massachusetts consumers feel that it is very important that “good drivers are not charged more in order to help pay for bad drivers.”⁵⁸ Consumers want their driving records to play a central role in how much they are charged for insurance. Deregulation, however, has moved the state away from

⁵⁷ Study 4, p. 114.

⁵⁸ Study 4, p. 114.

this goal. In the regulated market, rates were based on a limited number of variables, most of which were related to the insured's driving behavior. These included at-fault accidents and traffic violations, driving experience (0-3 years, 4-6 years, and over 6 years), territory, and miles driven.

Under deregulation, these restrictions have been abolished, allowing insurers to take into account, or not take into account, good driving records as they see fit. To start, insurers are no longer required to use the tightly regulated Safe Driver Insurance Program (SDIP) to determine how well a consumer drives. Under the SDIP, each consumer's moving violations and at-fault accidents are counted in the same way in computing a driving score. Only moving violations that are part of a consumer's official driving record at the Registry of Motor Vehicles and accidents listed under a consumer's record at the state's Merit Rating Board are used in the SDIP. An important benefit of this system was that it ensured that only official data could be used to penalize a consumer, and that consumers were treated equally based on their driving behavior.

Under deregulation, insurance companies have migrated away from the SDIP system, and now use their own calculations instead. Some insurers value certain accidents more than others, and some count accidents regardless of whether the driver was at-fault. Some insurers even allow the driver to pay money for special coverage packages which ignore various at-fault accidents. In addition, certain insurers rely on outside sources such as CLUE (Comprehensive Loss Underwriting Exchange) and A-Plus (Automated Property Loss Underwriting System). Consumer advocates argue that these industry databases contain unverified information from insurance companies as well as official records; CLUE, for instance, may contain information about calls drivers made to their agents regarding potential issues, even if there is no MRB record and no actual claim, and information assigning fault to a driver even though the Board of Appeal has ruled the driver was not at fault.⁵⁹

More importantly, since the market was deregulated, the insurance companies have watered down the significance of driving record by rating consumers based on new, non-driving factors such as whether or not a consumer purchased homeowners insurance, how a driver pays, and how long a driver has been in the same residence.

Because of these extra factors, many with good driving records may end up paying a lot more than those with bad ones. Since deregulation, companies have increased their base rate, and then applied a number of these rating factors or "discounts" based on these rating factors to the rates for each individual. Those consumers who receive no "discount," pay the inflated base premium. For many drivers, falling on the wrong side of a new factor actually raises the rate rather than lowering it. For instance, Premier Insurance alters a driver's premium based on the number of years he or she has

⁵⁹ Many states have passed laws to address consumer concerns about insurer use of CLUE reports. *See, e.g.*, N.C.G.S.A. § 56-36-115; 36 Okl.St. Ann. § 940; C.R.S.A. § 10-4-116, Ga. Code Ann. § 33-24-91; 215 ILCS 157/20. These include the prohibition of premium increases, policy cancellation, and the refusal to issue or renew a policy based on a report or inquiry that does not result in a claim. Massachusetts should have in place rigorous provisions to ensure proper protection.

lived at the same address. If the driver has lived at his or her current address less than ten years, Premier often raises the driver's rate rather than lowering it.

In addition, rating factors not directly related to driving dilute incentives to improve driving. While an individual may drive more carefully because a traffic violation would increase her insurance rates, this perceived incentive becomes weaker when driving record is no longer as large a component of the auto insurance premium. Finally, the use of all of these non-driving related factors raises some concerns about whether they are proxies for illegal rating criteria in Massachusetts.

As a matter of policy, Massachusetts law and regulations prohibit rating based on sex, marital status, race, creed, national origin, religion, age (except for purposes of the senior discount), occupation, income, education and homeownership. The use of rating based on credit information is also prohibited.⁶⁰ Policymakers ban these factors because they believe that insurance rates should be based on driving behavior, not on socioeconomic factors. Under deregulation, however, insurers have circumvented restrictions on a variety of rating factors – some examples include the prohibition on factors for homeownership, age, income, and credit information.

1. *The Emphasis on Homeownership*

Massachusetts regulations bar rating based on homeownership status. However, instead of raising rates because a driver does not own a home, under deregulation insurers have been allowed to charge more because that driver does not own *home insurance*. For many companies, this practice is extended not only to those purchasing homeowners insurance from the same company (where cost savings by “bundling” may be offered as a justification for the price differential) but to those purchasing homeowners insurance from *any company*. While companies also offer discounts to those consumers who purchase renters insurance, that insurance is generally attractive only to wealthier renters, and significantly fewer renters than homeowners actually purchase property insurance. Moreover, many insurers offer a lower discount for the purchase of renters insurance.

⁶⁰ 211 CMR 79.05 (13). Rating based on credit scoring has been shown to harm poorer and minority drivers.

The following companies offer an automobile insurance discount to drivers with homeowners insurance:

	Discount for Property Insurance	Discount for Property Insurance with Another Company	Different Discounts for Owners v. Renters
AIG	✓	✓	
Ameriprise	✓	✓	✓
Amica	✓		✓
Arbella	✓	✓	
Commerce	✓	✓	
Electric	✓		✓
Encompass	✓		✓
Fireman's Fund	✓		
Geico	✓		
Hanover	✓	✓	
Liberty	✓		✓
MetLife	✓		
Norfolk and Dedham	✓		✓
Occidental	✓		
OneBeacon	✓		✓
Peerless	✓	✓	
Plymouth Rock	✓		
Progressive	✓		
Quincy Mutual	✓	✓	✓
Safety	✓		
Premier / Travelers	✓	✓	✓
USAA			
Vermont Mutual			

2. *The Emphasis on Age*

The Massachusetts Legislature has forbidden insurance companies from discriminating against drivers based on their age. A primary goal here is to protect senior citizens. Indeed, Massachusetts law goes further, and includes a requirement that insurers offer a 25% discount for senior drivers “who otherwise qualify for the lowest rate classification applicable to drivers generally.”⁶¹ Nonetheless, under deregulation,

⁶¹ G.L. c. 175E, § 4.

some insurers have begun to employ a “years driving” surcharge⁶² which raises rates for many senior citizens.⁶³ This use of age as a variable dilutes the mandated 25% discount for these drivers.

3. *The Emphasis on Income*

Insurance companies use a number of rating factors that may distinguish among policyholders based on income or affluence. These include the prior purchase of higher limits or more expensive coverage, and the number of payments a driver has previously missed. Insurers may also be underwriting based on proxies for income, seeking out wealthier customers who can buy extra insurance coverage, pay their bills in advance, or pay a minor claim out of pocket rather than file a claim, while shunning those who purchase lower limits of coverage or request a monthly payment schedule.

Some seemingly innocuous discounts may be proxies for income. For example, many companies offer discounts for insuring hybrid vehicles. Ostensibly this discount rewards green behavior, yet is only available to those drivers who can afford to drive these more expensive vehicles. In addition, the “good student” discount is often only available to those families whose children can afford to attend college. The chart below lists the non-driving relating factors used by some of the companies:

⁶² The regulated system distinguished between relatively new drivers (under six years of driving experience) and the rest of the driving population. Under deregulation, instead of the factors “driving less than six years” and “driving more than six years” that were used under the regulated system, many companies charge different rates for every five or ten years of experience. Some start surcharging drivers once their years of driving experience show the drivers are seniors. Thus, elderly drivers who received a license when young are penalized. Oddly, those elderly drivers who got their license later in life don’t pay this surcharge.

Company	Rating Factors that May Correlate to Income
Commerce Insurance Company	Driver to Vehicle ratio, number of cancellations or late payments, type of optional coverage purchased (if any), having no lapse of coverage for three years, whether or not the driver purchased substitute transportation, Good Student, Student Away
Safety Insurance Company	The maintenance of continuous coverage, Good Student, Student Away, Hybrid Vehicle, Account Discount
Arbella Insurance Company	Student Away, Hybrid or Electric Vehicles, how much collision coverage is purchased, driver to vehicle ratio, whether or not optional bodily injury coverage is purchased
Liberty Mutual	Good Student, age of vehicle, coverage combination, vehicle base cost, advance quote days, prior carrier lapse, current and prior bodily injury limits, time at current residence, time since vehicle purchased, number of premium bills sent to collection, number of excluded, deferred, or non-rated operators, number of late premium payment, number of nonpayment cancellations, payment method, presence of companion policies, presence of a previous automobile insurance cancellation, presence of a previous automobile insurance policy, years at present employer
Premier	Paying premium in full, the amount of physical damage purchased, Hybrid Vehicle, purchasing a roadside assistance program, years at residence
Plymouth Rock	Good Student, Student Away, prior optional bodily injury limits
Hanover	Driver to vehicle ratio, account credit, household structure factor, which includes whether there are any excluded operators, children, and/or inexperienced operators
OneBeacon	Having a lapse in coverage in previous six months, Driver to Vehicle ratio, value of vehicle
Progressive	Length of prior insurance, number of not at fault accidents, number of comprehensive claims, length of residency, how the policy was purchased (by the internet or over the phone), number of late payments
Geico	Amount of insurance purchased, payment method, number of owners of the vehicle, Good Student, companion policies, household composite

4. *The Use of Credit Reports*

The use of credit information in insurance rating and underwriting is widely believed by consumer advocates and enforcement agencies to be directly tied to socioeconomic factors. Under the regulated system, insurers were not allowed to rely on credit information, or consumer credit scores, to set driver premiums. At the start of deregulation, Commissioner Burnes banned the use of credit score for only one year. Public pressure, including from the Attorney General and consumer groups, called for a complete and permanent ban on the use of credit scores. The Commissioner subsequently removed the one year time limit.⁶⁴ Whether, and when, a commissioner may fully deregulate credit scoring is unclear. With no statutory bar in place, the issue may be revisited at any time.⁶⁵

⁶⁴ 211 CMR 79.05 (13).

⁶⁵ Moreover, some insurers are currently using credit scores relating to their auto insurance business in Massachusetts. These insurers opine that the current bar on credit scoring does not extend to *marketing* efforts: they obtain lists of consumers with good scores from credit rating agencies and send material to only these consumers. While a consumer with a poor score might be able to get the same deal if they knew to ask for it from the insurer, they most likely would never find out. Such selective marketing, based on credit information, is another troubling development in the Massachusetts marketplace. Similarly, insurers continue to collect credit information about consumers from a variety of sources. Why they are gathering this information about consumers (including those they do not intend to contact for marketing purposes) is

There is a demonstrated correlation between credit score and income. Thus, regardless of any potential actuarial connection between score and risk of claims or loss, rating based on credit score significantly harms poorer drivers. Race is implicated as well; a 2007 study by the Federal Trade Commission found that black and Hispanic drivers pay more for auto insurance when credit scores are used. There are also criticisms that the use of credit scores benefits wealthy and high income drivers, and unfairly harms those suffering unexpected financial losses, such as a financially debilitating family illness or the death of a loved one.

The use of factors tied to homeownership, age, income, credit, and other socioeconomic indicators is troubling. As a result of such potential proxies, lower-income individuals have been disadvantaged by deregulation. The Commissioner's Study found that "Hispanics and those describing their race as 'Other' are more likely to have seen no change and less likely to have lower premiums. Households earning less than \$25,000 are more likely to report an increase."⁶⁶ Only 21% of Hispanics reported receiving any rate decrease at all, half as many as the population at large; 78% of Hispanics paid prices that were unchanged or higher, 1.6 times as high as in the population as a whole.⁶⁷ Twenty-four percent of households earning less than \$25,000 reported paying higher premiums, about 60% more than in the population as a whole.⁶⁸

This analysis of the use of these various factors supports the findings made last year by MassPIRG and the Center for Insurance Research. It appears that deregulation has caused insurers to price drivers based much more on who they are, rather than how they drive. Without proper restraints, insurers may use proxies to favor wealthier customers who can provide them with additional business, while harming poor and minority drivers, who will pay higher prices, or drive uninsured. Thus, any rating factor unrelated to driving record must be given careful scrutiny.

Commissioner Burnes declined to address these problems. At rate hearings held during the first year of deregulation, she refused to hear testimony on discriminatory proxies by renowned expert Birny Birnbaum.⁶⁹ She also refused to hear testimony on alleged discrimination in the rate hearing on Occidental's proposed premium in 2009.⁷⁰ (Occidental subsequently entered into a settlement with the Office of the Attorney General to alter certain rating practices.) Therefore, the Attorney General's Office intends to promulgate consumer protection regulations requiring that insurers justify their use of various rating factors that are unrelated to driving, and that insurers be barred from using proxies for banned rating factors.

unclear.

⁶⁶ Study 4, p. 23.

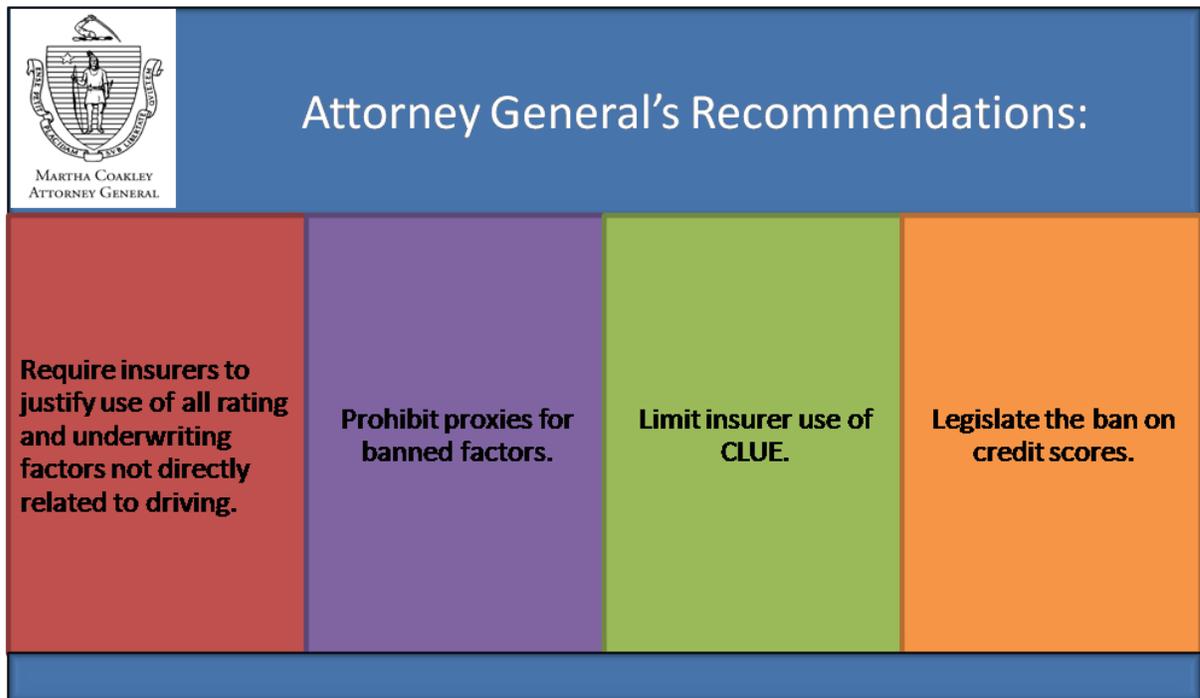
⁶⁷ *Id.*, p. 59.

⁶⁸ *Id.*, p. 60.

⁶⁹ Birny Birnbaum is the Executive Director for the Center for Economic Justice and a nationally acclaimed expert on auto insurance availability.

⁷⁰ Letter to the Office of the Attorney General from the Commissioner of Insurance (March 19, 2009).

The Attorney General also recommends that the Legislature put in place a statutory ban on the use of credit scoring in insurance rating or underwriting, and that the Legislature prohibit inappropriate use of information from sources outside the RMV.



D. Barriers to Competition and Meaningful Consumer Choice

Another key promise of managed competition was that it would unleash competitive market forces and permit consumers, by comparing insurance company prices and products, to force change in the marketplace. As with the other deregulatory promises at issue here, this one remains unfulfilled. Deregulation has yet to eliminate the barriers that prevent competition.

For competition to work, consumers must have ready access to information and to insurance choices. Without an easy way for consumers to obtain price information and to switch companies (that is, unless there are low “switching costs”), insurers will not face a wholesale loss of customers when they keep prices too high, rely on unfair rating criteria, or are too secretive in their dealings with the public. For competition to work, even in theory, consumers must be able to readily shop around.

Consumers are more than willing to play the role they need to play in a competitive marketplace. Consumers do want to shop for insurance; the Commissioner’s Study found that 69% of consumers desired a system in which “[i]t’s easy for me to shop around for the best rates.”⁷¹ Nonetheless, only 38% reported that managed competition is

⁷¹ Study 4, p. 118.

such a system.⁷² This section of the report analyzes the barriers that still exist in the system, starting with an overview of what consumers face in the Massachusetts auto insurance market and then focusing on a variety of specific impediments to competition.

1. *What Consumers Face: High Switching Costs and a Bad Shopping Experience*

There is no supermarket for insurance. In order to obtain comparative price information for the market, consumers must obtain separate quotes from numerous insurers, agents, and internet sites, repeatedly providing for each such entity detailed information concerning their driving experience and personal characteristics and receiving a separate price from each entity. This is an inefficient process, requiring the investment of a substantial amount of time and resources.

Over the last year, the Attorney General's office reviewed the experience of volunteer Massachusetts consumers who "shopped around" for automobile insurance. The consumers represented various geographical areas and homeownership status; some had one car, some had more. The purpose of the review was to follow the consumers while they obtained market-wide information in order to find their best automobile insurance choices and prices. These consumers found:

- ✓ The shopping process is difficult, time-consuming, and complex;
- ✓ Quotes obtained are inconsistent, even quotes from the same carrier;
- ✓ Discounts are unevenly applied, or not applied at all;
- ✓ The knowledge of agents, whether independent or affiliated with a company, varies, and some agents provided inaccurate quotes;
- ✓ Relatively few agents are interested in offering more than one quote;
- ✓ Many websites generating online quotes are inaccurate and/or ultimately direct consumers to live agents;
- ✓ Certain carriers appear to be engaging in improper practices; and
- ✓ The internet was unhelpful in obtaining real price information.

The time devoted to obtaining comparative prices was extensive. For each quote, the initial conversations took from fifteen minutes to more than an hour. When agents were involved, they generally required at least one day (and sometimes up to a week or more) to get back to the consumers with actual quotes. In some instances, insurance quotes were wrong, either because the wrong coverages were entered or because discounts were not applied, or both. In some cases, consumers could not get quotes over the phone, in one instance because the company representative "didn't believe" that the driver intended to switch carriers. The whole process of obtaining price information from all insurers typically took consumers over twenty hours spread over one to two weeks.⁷³

⁷² *Id.*

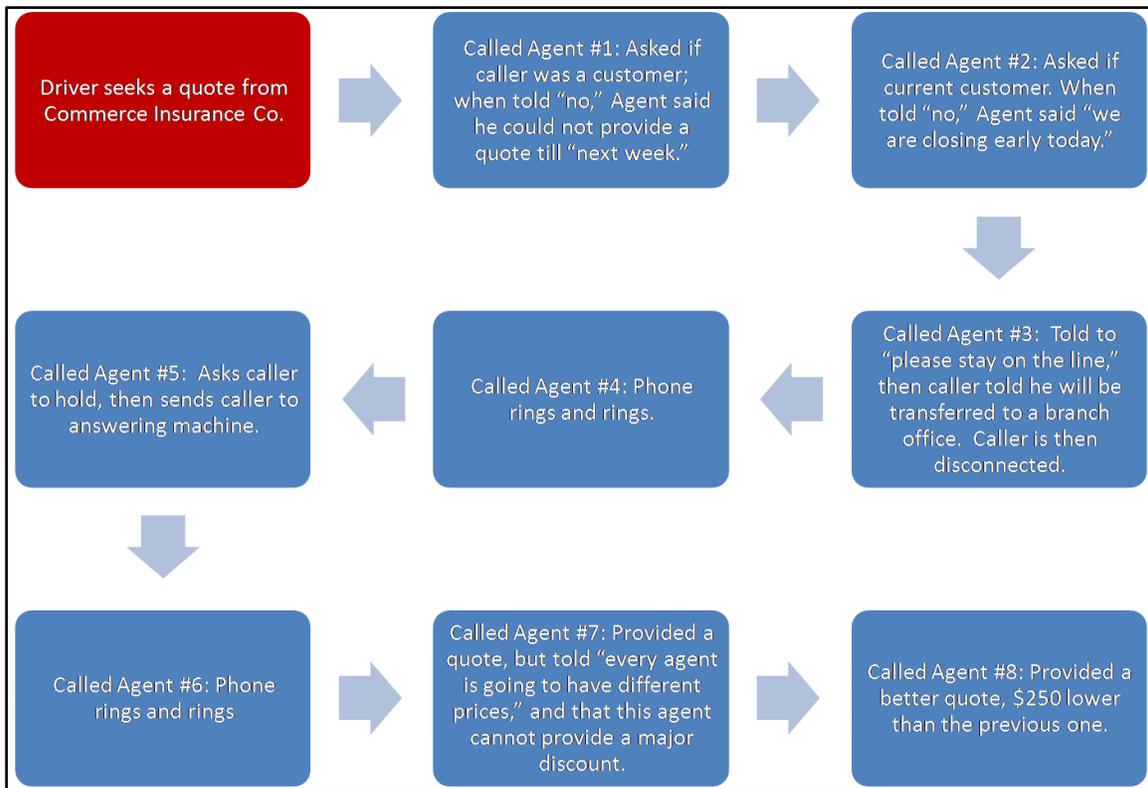
⁷³ This includes time spent on the phone or providing information (see following chart), as well as time spent waiting for quotes. These delays and time investments represent a significant transaction cost, which is a problem for consumers who are really trying to get competition to work. Moreover, some insurers give discounts to consumers who sign up for their policies a certain number of days in advance of their renewal

The chart below highlights the amount of time certain drivers took to obtain information at the beginning of managed competition.

Driver	Number of agents or companies called	Time on the phone or providing information	Number of quotes obtained
Married Couple, Two Vehicles, Brookline	35	9 hours	14
Married Couple, Two Vehicles, Marlboro	7	4 hours	9
Married Couple, Two Vehicles, New Bedford	17	7.5 hours	11
Married Couple, One Vehicle, Boston	17	7 hours	13

In fact, one driver had to call eight separate agents to get a quote from Massachusetts' largest insurer:

dates, making it hard to obtain the best price unless the consumer shops well in advance of his policy expiration.



Inaccuracy of information was also a problem. Some of the consumers were offered different prices by different agents for *the exact same coverages for the same company*. In one case, three quotes from the same carrier differed by more than \$400. This lack of consistency occurred with several different companies. Such discrepancies are hugely problematic if consumers’ “shopping around” is intended to ensure that rates are accurate and not excessive, and if market-wide information is intended to drive down rates. This experience suggests that even approaching each insurer for a rate quote may not be enough. Consumers must obtain information from several sources to assure that the prices they receive are correct.⁷⁴ The reason for these variations is unclear, and it is impossible to adequately test the rate quotes because, as described earlier, the insurers are no longer required to publicly file complete information needed to determine individuals’ rates.⁷⁵ The chart below demonstrates the rate quoted for three separate shoppers by different agents. Each one was looking for identical coverage from each agent:

⁷⁴ This also raises another issue of concern. If an agent is improperly recording a consumer’s information, an insurer may later, at the time of an insurance claim, opine that the consumer’s “false application” voids the insurer’s obligation to pay.

⁷⁵ See *supra* at Section B(2).

Driver A Married Couple and Teenage Son Perfect Driving Records Newton	Travelers Quotes Agent A: \$3,995 Agent B: \$4,359	OneBeacon Quotes Agent A: \$4,323 Agent B: \$4,014
Driver B Married Couple One Speeding Ticket New Bedford	Travelers Quotes Agent A: \$1,706 Agent B: \$1,857	Safety Quotes Agent A: \$1,724 Agent B: \$1,694
Driver C Single One Speeding Ticket Cambridge	Quincy Mutual Quotes Agent A: \$1,291 Agent B: \$1,123	OneBeacon Quotes Agent A: \$1,161 Agent B: \$1,304

Thus, there is simply no easy way to shop for insurance. A consumer must contact numerous agents and companies to gather information. Each direct writer only provided information for its own company and independent agents typically offered only one or two quotes. The quality of information received varied. Some agents suggested a variety of discounts that might be available, while others did not refer to discounts at all. The discounts were unevenly (and, in some cases, erroneously) applied. Consumers generally do not have sufficient information to determine whether the rate quotes and discounts they have received are accurate.

Some carriers even refused to provide specific coverage sought by the consumers. One direct carrier insisted that a driver carry a \$100 glass deductible and refused to offer a twelve-month policy; another insisted on higher-than-required coverage, an amount higher than the driver requested. The existence of a twelve month policy, standard policy limits, and no glass deductible coverage are guaranteed by statute.⁷⁶

In general, “shopping around” was an arduous process, with uneven results. It is not clear that the consumers obtained the best prices available, despite the large amount of time each dedicated to the task. Instead, the prices appeared to depend on the level of the agent’s knowledge, the agent’s or company’s willingness to offer discounts, the accuracy or inaccuracy of the quotes, and the carriers’ willingness to offer coverages requested by the consumer. The system fails to offer consumers a quick, easy or accurate way to comparison shop.

The Commissioner’s Study found similar “impediments to gathering information and comparing options.”⁷⁷ Most consumers believed the process was too time-

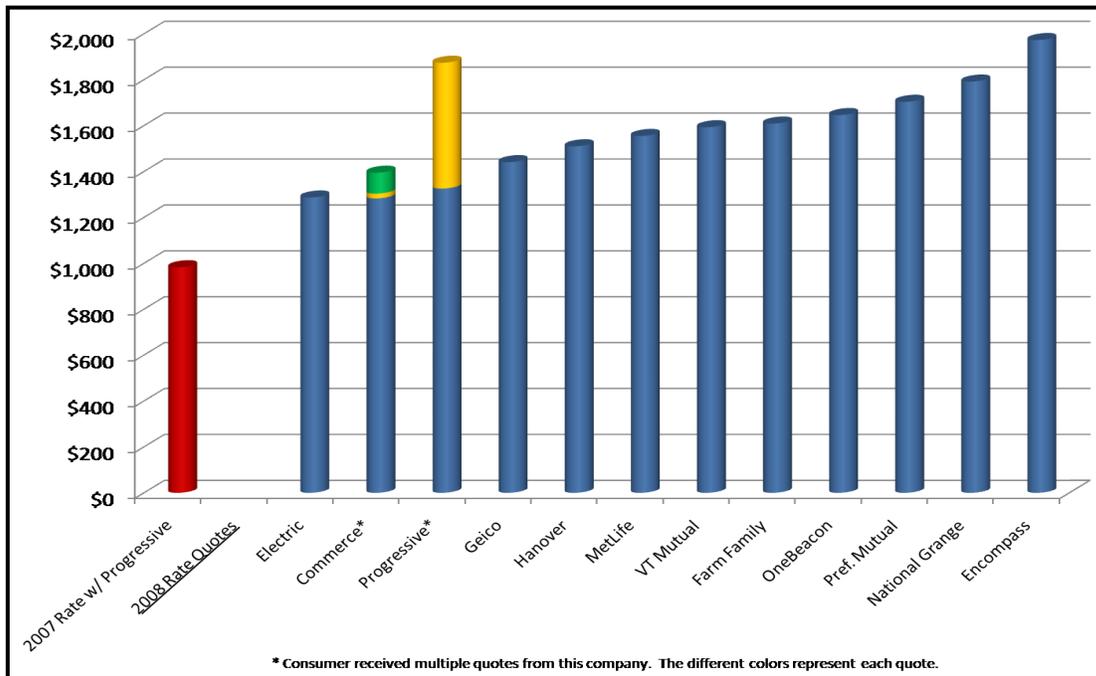
⁷⁶ E.g., G.L. c. 175, §§ 113A, 113O.

⁷⁷ Study 4, p. 23.

consuming and were skeptical that it would save them money.⁷⁸ Just over a third of consumers did any shopping, and most compared only a few companies or agents.⁷⁹ Only 18% of consumers sought information from as many as four companies, only 2% from as many as six.⁸⁰ No consumers who were part of the Commissioner’s Study reported obtaining information from more than seven companies.

As a result, few insureds switched carriers to take advantage of lower prices. According to the Commissioner’s Study, only 8% of consumers changed carriers (it is not clear that such changes were responsive to price or occurred as a result of deregulation).⁸¹ According to the Study’s focus groups, “consumers have historically been on auto-pilot – and most still are.”⁸²

Given the difficulties of obtaining information and changing carriers, competition has not driven down rates. In fact, as the first year of deregulation ended, rates started to increase, even for consumers who are willing to switch carriers. The example in the chart, below, shows the rates for one consumer who had initially switched to Progressive at the start of deregulation. Upon renewal this Spring, the consumer shopped around and found that prices were higher for all companies (including Progressive), than the year before, even though he had no accidents or traffic violations:



Theoretically, it should be possible to greatly expedite the shopping process by using available technology. The recent development of internet websites and web portals for insurance offers the potential for quicker and easier access to insurance information and

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.*, p. 106.

⁸¹ Study 3, p. 12.

⁸² Study 2, p. 9.

products. Thus far, however, the internet has not provided a useful solution during deregulation. While a web portal that allows consumers to enter their information once and obtain pricing information on similar insurance policies for all (or any subset of) insurers would eliminate time and resource problems, no such system exists.

Commissioner Burnes' Office declined to create such a "supermarket" website. Instead, she created a website that takes very limited consumer information and returns a list of companies along with an estimated price for each one. While Commissioner Burnes claimed that the website facilitates shopping, it actually misleads consumers and skews shopping decisions by providing inaccurate prices, omitting discounts and other criteria, and failing to accurately rank companies in terms of value.⁸³ The website itself includes the disclaimer that "this is not a rate quote," an admission that the sample material is unhelpful for actual shopping. There are a variety of drawbacks to the Commissioner's website, including:

- **The Commissioner's reported "sample premiums" are inaccurate.** The website was designed to take into account only a few rating factors or discounts in computing premiums, even though insurers consider many other factors in determining the price.⁸⁴ As a result, the Commissioner's website does not report the correct prices.
- **The Commissioner's website does not accurately rank the companies in terms of value.** When consumers obtain sample premiums from the Commissioner's website, they are shown a list of "best to worst" insurance quotes and implicitly directed to the insurer providing the best price. But the best prices identified on the Commissioner's website are not the best prices in the real world. Because the Commissioner's website generates quotes that are off by up to several hundred dollars, the ranking is often incorrect, and consumers are directed to high-priced rather than low-priced insurers. Based on a sample performed by the Attorney General's Office, the top five best picks of insurers on the website were wrong more than 60% of the time; in some instances, the insurer lists were completely incorrect, and in others only one or two of the top five were correct. The Commissioner's website often steers consumers to the wrong companies.
- **The Commissioner's website ignores families.** The Commissioner's website is designed only for single drivers with one car. Many Massachusetts policies list two drivers (husband and wife) or more (teenage children), and prices may vary depending on the number of drivers in a family, the number of cars, and which drivers are assigned by the company to which vehicles.

⁸³ The listed factors are taken from The Attorney General's April 1, 2008 Letter to the Commissioner regarding concerns about the website.

⁸⁴ The website algorithm only considered the consumer's zip code, years licensed, car make and model, miles driven and driving record. Even these criteria are further limited on the website by allowing consumers only four options to choose from - for years licensed, drivers must choose between 1, 4, 25 or 50 years, and for car make or model, they must choose between only four 2005 vehicles.

The Commissioner's Study found that while consumers accessing the Commissioner's website saw value "in comparing rates across carriers," many consumers "complained that the information used to generate sample rates was incomplete, which meant the rates were perceived as less useful than they would like."⁸⁵ Agents also complained that the rates were inaccurate.⁸⁶ The Commissioner did warn consumers that "[c]osts may also fluctuate when consumers provide more detailed information at the time they apply for insurance."⁸⁷

Individual insurers also have their own websites, yet few offer real information. Although some sites purport to offer a range of insurance pricing, they, instead, direct drivers to a local insurance agent.⁸⁸ Some individual insurers, such as Progressive and Liberty, offer on-line quoting, yet the systems often do not provide a full range of insurance choices. Some websites fail to offer all available levels of deductibles, or all the available optional coverage combinations. Some discounts are not offered or mentioned. Most company websites do not offer sufficient information to assist drivers in understanding all the features of their policies.

⁸⁵ Study 2, p. 12.

⁸⁶ Study 1, p. 12. After the Attorney General raised concerns regarding inaccuracies on the Commissioner's website, Commissioner Burnes publicly promised to fix the website, but this never occurred. The website still steers consumers to more expensive carriers. The Commissioner's office continues to promote the website as a useful shopping tool.

⁸⁷ Discussion Guide, p. 2.

⁸⁸ There is concern regarding these sites and use of consumer information. The AGO has previously investigated certain sites for steering and deceptive practices. *See Attorney General v. InsWeb*, Assurance of Discontinuance, Docket No. 02-1914H, May 1, 2002.

	Amica	Arbella	Hanover	Commerce	Geico	Liberty	OneBeacon	MetLife	Progressive	Quincy Mutual	Safety
Online Quote Offered?	YES (limited)	NO	NO	NO	YES	YES	NO	NO	YES	NO	NO
Can user choose from all available coverages for the online quote?	NO	N/A	N/A	N/A	NO	YES	N/A	N/A	NO	N/A	N/A
All coverages explained?	Brief Description	YES	Brief Description	NO							
All discounts offered or explained?	NO	NO	NO	YES	NO	NO	NO	NO	NO	NO	NO
Company explains how to qualify for policy?	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO	NO
Short rate fee mentioned?	NO	NO	NO	NO	N/A (no fee)	NO	NO	NO	N/A (no fee)	NO	NO
One year policy available online?	YES	N/A	N/A	N/A	NO	YES	N/A	N/A	NO	N/A	N/A

The company websites do not significantly reduce the time needed to obtain market-wide insurance prices. Each website provides, at most, one quote; consumers must enter their individual data again and again on each individual company’s website. One insurer, Progressive, did attempt to solve this problem by providing quotes from three of its competitors on its website. However, in thousands of instances, the rates provided on the website for other carriers were incorrect.⁸⁹ Progressive has since removed the comparative quotes and, in response to an enforcement action, paid a penalty under the Consumer Protection Act to the Office of the Attorney General.

Thus, consumers shopping in the Massachusetts market face significant delays and informational gaps, all of which add to the time and effort needed to shop around. Developing a one-stop shop auto insurance website would eliminate much time and confusion and encourage consumers to shop around. Even such a website, however, will not entirely solve the lack of fluidity of consumer purchasing. There are other specific problems in the deregulated market that further limit competition in our marketplace.

2. Other Impediments to Competition

In addition to the difficulties consumers face in shopping for auto insurance, our review found other factors which help to hobble potential competition in our

⁸⁹ The Attorney General recently compelled Progressive to pay \$120,000 to the State as a result, in part, of the misrepresentations on its website.

marketplace. These include (a) the nonstandardization of policies, (b) agents' difficulty in obtaining insurance contracts from carriers, (c) the presence of short rate penalties, (d) consumer privacy concerns, (e) an unlevel playing field for competitors, and (f) the emerging importance of "loyalty" discounts. Each is discussed briefly below.

a. Nonstandardization and Complexity

Insurance policies are complex commercial contracts, replete with exclusions, coverage adjustments, and terms dependent on a complicated set of definitions. The very nature of these contracts, and the disadvantage at which consumers operate when purchasing them, are major reasons for insurance regulation. Traditionally insurance companies are not permitted to offer policies to the public without first submitting them for review to an administrative agency.

Even in a regulated market, the complexity of these contracts often creates consumer protection issues. The policies are typically over thirty pages in length, not including the riders and endorsements that can alter or add to the terms of the contract. Many consumers do not read their insurance contracts. Even those who do read them have difficulty understanding the terms. In the deregulated market, companies now offer different policies, which may lead to even greater confusion among consumers. No longer can drivers compare "apples to apples."

For example, many insurers have created nonstandard options and use such options as marketing tools to differentiate their products; consumers generally do not have sufficient information to evaluate the cost-effectiveness of these new coverages. Even a difference in the length of a policy has confused drivers; prior to managed competition, one year policies were standard, but now some companies routinely quote six-month policies. Consumers may be lured in by a six-month price, without realizing the insurer is only offering half the length of coverage. "Unit pricing" that facilitates shopping in a supermarket is unavailable for insurance.

The Commissioner's Study confirmed that consumers do not have enough information about insurance products; it found that "uncertainty about coverage is a strong barrier to switching,"⁹⁰ and that consumers "felt unsure about whether coverage would be comparable."⁹¹ Some consumers mentioned different deductibles and the confusion over six-month policies as examples of comparability problems, and complained that "[o]ne thing about shopping around is that I'm never sure I'm comparing apples to apples."⁹²

b. Agency Penetration

Consumers purchase insurance through agents in Massachusetts much more frequently than drivers in other states. According to the Commissioner's Study, about

⁹⁰ Study 2, p. 17.

⁹¹ *Id.*

⁹² *Id.*

69% of Massachusetts drivers purchase insurance through independent agents.⁹³ In most other states, agency usage is significantly less. Many insurance companies in Massachusetts only operate through agents; a consumer may not obtain a quote or purchase a policy through a company directly. Of the roughly thirty companies currently doing automobile insurance business in Massachusetts, about two-thirds are “agency companies.”⁹⁴

Insurance agents are only able to quote prices and sell policies for those companies with which they have contracts. Most represent four or fewer insurers; many agencies only represent one or two.⁹⁵ Thus, if consumers in Massachusetts continue to rely solely on a single agent for information, as many currently do, they will be unable to shop for market-wide prices. Currently, 45% of those who use agents note that they are “very loyal to [their] auto insurance agent.”⁹⁶ Thirty-six percent said that they did not compare insurance options because they “rely on [an] auto insurance agent to do this.”⁹⁷

Some consumer advocates, moreover, caution against relying on the advice of agents receiving contingent and bonus commissions for selling their products. Such payments are often contingent on the volume of business an agent brings to the company, or the quality of the business, and may provide an incentive to promote the company that offers the largest bonus. While agents can provide real value and guidance to their customers, deregulation makes it difficult to maintain this relationship while still ensuring the consumer has a full range of options. In the Commissioner’s Study, marketing consultants opine that reliance on agencies discouraged shopping; “complacency and reliance on insurance agents are the reasons most drivers don’t shop around.”⁹⁸

c. Short Rate Penalties

Most companies charge consumers a penalty, known as a *short rate*, if they switch companies while their policies are in effect (there is generally a grace period at the beginning of the policy when no penalty is charged). Paying that penalty and switching carriers may still benefit the consumer if the competing carrier offers much lower rates. However, the penalty deters consumers from shopping and, thus, provides an additional barrier to competitive access.

The Commissioner’s Study confirmed that short rates inhibited switching. In the survey, some consumers stated: “the only time you can switch is during your renewal

⁹³ Study 4, p. 23. The Massachusetts Association of Insurance Agents estimates that 80% of consumers use agents.

⁹⁴ Agency companies also comprise the largest market share: Commerce, Safety, Arbella, Hanover and Plymouth Rock all rely on independent agents. Amica, Met, Electric and Liberty Mutual are some of the few companies that do not use agents, known as “direct writers.” After deregulation, more direct writers entered the market, such as Progressive and Geico.

⁹⁵ In September 2008, 564 agents had only one contract, 640 had 2-3, 285 had 4-6, and just 41 had six or more. Study 4, p. 14.

⁹⁶ Study 4, p. 112.

⁹⁷ Study 4, p. 91.

⁹⁸ Study 4, p. 90.

time, otherwise there's a penalty. If that went away, more people would be more open to more comparative pricing and switching."⁹⁹ Nonetheless, companies are still allowed to charge these penalties, preventing deregulation from achieving its goal of encouraging real price competition.

d. Privacy Concerns

Despite the fact that certain prohibited factors may not be used in rating or underwriting, insurers still collect information on sex, credit score, marital status, education level, occupation, and homeownership. Many agents and insurers directly ask consumers for this information; some agents even ask for social security numbers. These practices may raise privacy concerns, or lead to rating or underwriting based on banned factors. When asked for an explanation of its collection of education information, one company stated that it provided discounts to almost all college graduates. Such a practice certainly contradicts the non-discrimination principle behind the ban on rating based on education level.

The Commissioner's Study found that consumers have "privacy concerns about sharing personal information."¹⁰⁰ These are valid concerns, and steps should be taken to protect consumers from invasions of their privacy.

e. Playing Favorites

All companies should be able to compete on an even playing field. This is an important way to encourage both new entry and carrier retention in the marketplace. It also helps to focus companies on competition for customers rather than putting their efforts into avoiding what they view as unfair rules that disadvantage them.

However, several new rules advantage certain carriers and disadvantage others. For instance, new carriers are not required to write policies for the residual market (the MAIP) for two years.¹⁰¹ As MAIP business is not as profitable as voluntary market business, this places an uneven burden on those carriers who are required to write these policies. Arbella Insurance Company, one of the incumbents, has sued the Commissioner to reverse this policy; the case is before the Supreme Judicial Court.¹⁰²

Similarly, Commissioner Burnes allowed some carriers, but not others, to enter into Limited Assignment Distribution Company (LADC) agreements. These agreements essentially transfer the administration of residual market consumer claims from the real carrier to the LADC. While there may be efficiencies to such transfers, there is also

⁹⁹ Study 2, p. 18.

¹⁰⁰ Study 4, p. 23.

¹⁰¹ Originally, Commissioner Burnes sought to give new carriers a three year reprieve from undesirable business, but after much protest, limited it to two years. *See* Decision and Order on Amendments to Rules 21 through 24 and 26 through 38 of the Massachusetts Automobile Insurance Plan, Docket C2008-01.

¹⁰² As the Commissioner has broad authority on this issue, the Attorney General is defending the Commissioner's right to impose this two year rule in this court case.

another reason insurers are interested in entering the LADC contracts. Under Massachusetts law, insurers may not charge customers obtained through the MAIP more than they charge the customers they sought out voluntarily. In determining the “voluntary market” rate for a given consumer, Commissioner Burnes ruled an insurer could use the LADC’s rate, rather than its own. So, if an insurer has an LADC contract, it may be able to charge the consumer more than it could have absent the LADC agreement.

Finally, a change in the interpretation of certain rules appears to benefit some companies over others. For example, Commissioner Burnes originally issued a bulletin that stated that “[a]ll insurers within an insurance company group will be required to offer the same rates and classification plans for Massachusetts private passenger motor vehicle insurance policies.”¹⁰³ This policy was also later reinforced by a Decision that stated that if a carrier is part of an insurance Group, “it must use the same rate that its other group members use in the voluntary market.”¹⁰⁴ But when Peerless Insurance Company, a wholly owned subsidiary of Liberty Mutual, sought to enter the market and charge a rate that differed from Liberty, the Commissioner’s office permitted Peerless to do so.

Peerless benefited again when Commissioner Burnes amended CAR Rule 22. Under the previous rule, Peerless was considered as part of Liberty and therefore, had to take its share of MAIP assignments as an incumbent carrier. Under Commissioner Burnes’ revision, however (issued on an emergency basis), new companies created by an incumbent carrier can choose to be considered a new company and thus forgo MAIP assignments for two years. Therefore, Peerless, and any other new company formed by an incumbent carrier, will receive the benefit of avoiding their fair share of residual market costs for two years.

f. Loyalty and Bundling Discounts

Competition will only benefit consumers if they shop and move to the lower-cost carriers. However, certain discounts may also keep consumers from shopping. As part of deregulation, certain insurers have started to offer loyalty discounts, and to give discounts tied to the purchase of additional (non-automobile) insurance products from the company. These discounts may inhibit consumers from purchasing better or cheaper insurance elsewhere.

To address the barriers to competition discussed in this section, the Attorney General intends to promulgate, in her draft regulations:

- A requirement that agents provide available quotes to each consumer who requests it,
- The elimination of unapproved short rate penalties,
- The elimination of unapproved contingent commissions, and

¹⁰³ Division of Insurance Bulletin 2007-12.

¹⁰⁴ *Decision and Order on Amendments to Rules 21 through 24 and 26 through 38 of the Massachusetts Automobile Insurance Plan, Docket C2008-01, p. 12.*

- The prohibition of collection of unnecessary data by insurance companies.

The Attorney General also recommends that the Division of Insurance, or the Legislature:

- Enable the development of a comprehensive website that allows drivers to obtain real quotes from all insurers,
- Provide a thorough review of all alterations of insurer rules or policy forms to ensure that the changes will not mislead consumers,
- Regulate the use of loyalty discounts, and
- Ensure that no company is given a special deal that allows for an uneven playing field.

These steps will greatly improve the chances for a fair and healthy marketplace for insurance.



E. The Erosion of Consumer Protections

Managed competition was adopted without legislation and with little advance preparation. Neither legislators nor consumer groups had a role in deregulation. As a result, the two major changes that arose from the deregulation effort – the ability of insurers to set their own prices, and the ability of insurers to use non-driving related factors to evaluate potential customers – resulted in the loss of major consumer protections for consumers. The deregulatory “hands off” approach to rating also encouraged insurers to make other changes in their rate filings, which further undercut consumer protections for drivers in Massachusetts.

During the first year of deregulation, insurers have filed over fifty rating plans and manuals; in not a single instance did Commissioner Burnes formally reject an insurer filing. Similarly, she did not call for a single hearing (except in instances where the Attorney General had also triggered the statutory hearing process) to ensure that rates were not excessive or unfairly discriminatory, despite the lack of rate support provided by insurers. Even in instances where insurers have eliminated longstanding pro-consumer provisions in their policies, Commissioner Burnes failed to act.

Occidental Insurance Company, a North Carolina insurer that entered the Massachusetts market in early 2009. In its rate filing, the company specifically noted that it intended to do business in those areas where other companies were not extending agent contracts. Although this may appear a positive solution to the ERP situation (as described below), Occidental's proposed rates, rating practices, and operating practices were harmful to consumers. The company adopted a number of problematic or illegal practices related to cancellation, claims payment, reinstatement, deductibles, installments, and surcharges. Commissioner Burnes did not object to or prevent these provisions, and when requested by the Attorney General to hold a hearing on these consumer practices, she refused.¹⁰⁵

Ultimately, the Attorney General had no other recourse but to go to court to resolve the matter with Occidental using the State Consumer Protection Act. On March 31 of this year the Attorney General and Occidental filed an Assurance of Discontinuance under which Occidental was required to offer and/or sell insurance in Massachusetts in accordance with the following terms and conditions:

- Occidental cannot charge a consumer a higher premium if an oral or written misrepresentation was not made with actual intent to deceive or the matter misrepresented increased the risk of loss.
- Occidental cannot require company approval if a consumer desires to cancel a policy.
- If a policy is cancelled, Occidental will pay a return premium calculated on a pro rata basis.
- Occidental cannot require a consumer to pay more than what is deficient if that consumer receives a notice of cancellation.
- Occidental cannot require a "No Loss Statement" on reinstatements after cancellation for nonpayment of premium when the deficient premium is paid on or before the effective date of cancellation.

¹⁰⁵ Commissioner Burnes stated that she did not have the jurisdiction to address these illegal practices. She did schedule a hearing on certain rate issues, but, based on an agreement with the Attorney General's Office, Occidental lowered its rates and removed certain surcharges prior to the hearing.

- Occidental cannot charge installment fees after a consumer paid a premium in full.
- Occidental cannot charge a consumer both a collision and a glass deductible on glass claims.
- Occidental cannot charge a 25% surcharge on high risk vehicles.
- Occidental cannot charge an interest rate above Massachusetts' usury limits.
- Occidental cannot sell insurance in Massachusetts for the next year that includes in the premium a \$25 policy fee or rates Massachusetts drivers based on length of residency.

While adopting a general policy of noninterference relating to insurer ratemaking, Commissioner Burnes rolled back regulations and standing procedures that protected consumers. These include the Commissioner's (1) attempted elimination of the Board of Appeal, (2) elimination of the requirement that insurers "take all comers," (3) failure to maintain safeguards in the new residual market system, (4) removal of special restrictions on urban pricing, and (5) actions that undercut the availability of local agents in inner city areas.

1. *The Commissioner's Attempted Elimination of the Board of Appeal*

The Board of Appeal is a unique Massachusetts consumer protection institution. It provides consumers with a neutral and impartial forum in which to appeal an insurance company's determination of fault in accidents. The appeal of at-fault determinations is important for consumers; if successful, the consumer can reverse an erroneous insurer decision and eliminate what might otherwise be thousands of dollars in surcharges, a black mark on the consumer's driving record, and a loss of the consumer's right to stay with the insurance company of his or her choice (when an insurer finds a customer with a clean driving record "at-fault," the insurer is no longer required to renew that driver's policy). Fault determinations affect the price of an individual's insurance, the decision to renew a policy and ultimately the placement of a policy in the residual market, and in some cases the ability to continue driving.

A substantial number of the insurers' fault determinations have been found to be incorrect or unwarranted. The Board of Appeal typically overturns about half of insurers' at-fault determinations, saving consumers millions of dollars in subsequent insurance premiums.

When Commissioner Burnes deregulated the market, insurers quickly asked her to strip the Board of its ability to hear fault appeals. The elimination of such appeals would reverse consumer savings and add millions of dollars to insurer profits by increasing premiums for incorrect fault determination. Hanover Insurance Company took the lead,

providing the Commissioner with an “analysis” demonstrating that the Board should not hear appeals in a deregulated market.¹⁰⁶ While the Attorney General urged the Commissioner to maintain the neutral third party review process,¹⁰⁷ the Commissioner stated that the Hanover Insurance Company’s position was also her position.

In January 2009, the Commissioner issued a “bulletin” eliminating the Board’s right to fix erroneous insurer surcharges and “at-fault” determinations. In place of the Board, Commissioner Burnes proposed to allow insurers to simply review their own decisions. The Commissioner stated that the Board’s consumer protection role was “longstanding, but no longer applicable” because she had deregulated the auto insurance market.¹⁰⁸ This move not only harmed consumers, but the state as well, as the Board brought in millions of fees.¹⁰⁹

The Attorney General and consumer groups urged the Commissioner to reverse her decision. The Legislature also disagreed with her actions, and in April of this year, it codified in Massachusetts law the consumer right to a hearing at the Board of Appeal on insurer at-fault determinations. The law passed unanimously in both the House and the Senate.

Commissioner Burnes repeatedly stated that the Board of Appeal was unnecessary because consumers who disagree with a company’s determination of fault have the option of switching insurers.¹¹⁰ But the ability to switch does not solve the problem of incorrect fault determination. Most consumers do not switch companies (92% in 2008 stayed with the same company, according to the Commissioner’s Study¹¹¹), and erroneous at-fault determinations are reported to private industry data collectors and to the Merit Rating Board; if the consumer switches companies, the new company will rate the driver based on the previous carrier’s *incorrect* determination, producing an inaccurate and unfair rate.¹¹² Fortunately, the Legislature ensured that consumer rights were protected in this case.

¹⁰⁶ Hanover’s recommendations stated that the Board’s authority was only granted through the fix and establish system. The authority for the Merit Rating Board, which captures and maintains fault determinations, however, is established by identical language, yet no one sought the removal of the MRB, or advocated for change in the statutory language to ensure that the MRB maintains its role. G.L. c. 6, § 183.

¹⁰⁷ In a letter dated October 24, 2008, the AG strongly recommended the Commissioner maintain a third party appeal process.

¹⁰⁸ The Commissioner abolished the Board of Appeal in the end of 2008, while simultaneously releasing a “Consumer Bill of Rights.” The Bill of Rights gave consumers the right to appeal any at-fault determination to their insurance company. Consumers already had this right.

¹⁰⁹ The Board’s operating budget was only \$500,000 a year.

¹¹⁰ Once it was clear that a bill to reinstate the Board would pass, Commissioner Burnes opined that she would reverse her view and keep the Board in place administratively. The Attorney General testified before the Legislature, urging it to pass the law anyway in order to ensure that the Commissioner would not revoke the Board’s protections at a later date.

¹¹¹ Study 3, p. 12.

¹¹² In addition, the Board of Appeal is important for other reasons: it eliminates a potential increase in judicial appeals, which can be expensive and inefficient; it ensures at-fault determinations are made uniformly; and it provides companies with an incentive to make accurate fault determinations.

2. *Eliminating “Take All Comers”*

Another important longstanding consumer protection in Massachusetts has been the right of good drivers to place their business with any insurer they choose. Previously, as long as the consumer was willing to pay the approved rate, the insurance company was required to provide that consumer with a policy. Massachusetts implemented this policy to reduce potential concerns about redlining and discrimination, and to ensure that consumers could choose a high quality insurance carrier.¹¹³ Under deregulation, however, the Commissioner’s office is currently phasing in a system that permits the insurance companies to refuse to insure any consumer whose business the insurers view as undesirable. This includes many drivers with perfect driving records.

Companies are now permitted to deny insurance to consumers for any reason, provided the reason is not a prohibited criterion.¹¹⁴ While insurers must state a reason for refusing insurance,¹¹⁵ the stated reasons are typically so vague that they provide little information to consumers on the factor (or factors) motivating the refusal. Such reasons include “driver experience,” “insurance history,” “years licensed,” “limits,” and “substitute transportation,” reasons that could justify the refusal to insure virtually any consumer. Insureds have little information on how to amend their behavior to obtain a desired policy.¹¹⁶

Consumer advocates believe that the vague and generic reasons provided by companies may be used to mask improper insurer refusals, and that because the reasons are so broad, they may be applied in such a way as to unfairly discriminate against individuals or groups. As the Commissioner’s office does not require insurers to file underwriting criteria, it is currently impossible for regulators to determine why companies are truly refusing business.

The complete elimination of the “take all comers” requirement is being phased in over the next two years. Right now, insurers can refuse to quote or provide insurance to any new customer, even if he or she has a perfect driving record. Until March 31, 2011, companies are barred from refusing to renew policies for what are known as Clean-in-Three drivers. Clean-in-Three drivers are those who have had no accidents or traffic violations in the past three years (five years for some major violations) and have not had a lapse of coverage for more than sixty days. However, even these drivers are not fully protected – they only have the right to remain with their current carrier. If they attempt to shop around, they can be rejected by a new carrier. Moreover, if a driver is new to the

¹¹³ The law did provide for limited exceptions: insurers were not (and are not) required to provide insurance for those who did not have a license or those who have not paid their previous premium in full. G.L. c. 175, § 113H.

¹¹⁴ 211 CMR 79.05 (12). The prohibited criteria for underwriting are sex, marital status, race, creed, national origin, religion, age, occupation, income, principal place of garaging, education, and homeownership.

¹¹⁵ 211 CMR 97.04 (01)(f), (06)(f).

¹¹⁶ Moreover, some insurers are simply refusing to issue insurance because the applicant seeks only basic coverage.

state, or has even one minor ticket, insurers may currently refuse to renew coverage.¹¹⁷ Insurance agents, especially those in the inner cities, have reported thousands of such refusals and non-renewals. Once the Clean-in-Three provision expires in 2011, those with completely clean driving records will be exposed to rejection by their current carriers, and many additional good drivers may be placed in the residual market. More must be done to ensure that these good drivers have better choices.

3. Consumer Problems with the Residual Market

Massachusetts law requires the Commissioner to create a residual market system for consumers who cannot find an insurance company willing to take them as customers. In the current residual market, such consumers are randomly assigned to insurers via a system called the MAIP. To ensure that these consumers are not overcharged, Massachusetts law bars an insurer from charging a customer in the MAIP any more than it would charge the customer in the voluntary market (a protection known as the ‘Lane-Bolling amendment’). While the Lane-Bolling amendment does help to protect consumers, the implementation of the MAIP, in general, under managed competition, has had a shaky start. First, according to insurance agents who complained to Commissioner Burnes, many consumers were unable to afford the down payment. Although insurers cannot charge a higher premium to residual market customers, they are allowed to require a deposit based on the typically more expensive MAIP premium, which can put a significant financial strain on MAIP customers, many of whom are poor urban residents. Earlier this year, the DOI did alter MAIP practices by requiring only a 20% down payment of MAIP premium. However, there is no statutory provision to ensure this policy won’t be reversed. Other problems agents have listed include additional paperwork and requirements that voluntary customers do not face. Some agents have argued that many consumers are now driving uninsured because they have been unable to meet the MAIP requirements.

Moreover, a number of insurers may attempt to avoid the Massachusetts law on MAIP pricing, by using “placement in the residual market” or “eligibility for the residual market” as a rating factor. When a consumer is assigned to the insurer through the MAIP, the insurer charges the consumer a higher rate than the typical customer because it has defined the residual market assignment itself as the basis for the voluntary rate (voluntary market customers, who are neither placed in nor eligible for the residual market, never receive this rate). Other insurers refuse to offer advertised discounts to residual market insureds.

4. Eliminating Urban Rate Caps

Another concern that has arisen from deregulation is the elimination of urban rate caps. In addition to the rate ceiling established each year under the prior system, the rate setting process also included additional pricing protections for Massachusetts drivers. One of the most important aspects of this system was the limit it placed on price variation

¹¹⁷ If an insurance agent transfers a book of business to another carrier, the new carrier may reject Clean-in-Three drivers. *See* CAR Rule 21.

across territories and classes, thus ensuring that rates in urban areas are not excessive. At least in part, the compression of rates acknowledged that urban losses are attributable to traffic density that benefits consumers from other areas.

When Commissioner Burnes eliminated the rate ceiling, she also decided to phase out the urban caps. As a first step, insurers were allowed to increase non-compulsory coverage with no limits. During 2009, insurers were allowed to increase rates in individual territories by as much as 10%. This 10% cap will expire in 2011, and as of the writing of this report, it appears that insurers will have no restrictions on increasing rates in “undesirable” territories.

Without caps, and assuming that rates rise to the “cost-based” level, urban territories will see substantial average increases in prices, and many urban drivers will pay substantially higher prices for insurance. Once caps are fully phased out, increases may be as high as 40% in some territories. Territories likely to see substantial increases include Roxbury, Dorchester, and other areas in Boston, Lawrence, Lowell, and Springfield. Drivers in these areas must be protected to ensure rates are fair and reasonable. If not, the number of uninsured drivers may significantly increase and all Massachusetts drivers will be harmed.

5. Undercutting the Availability of Agents in Inner City Areas

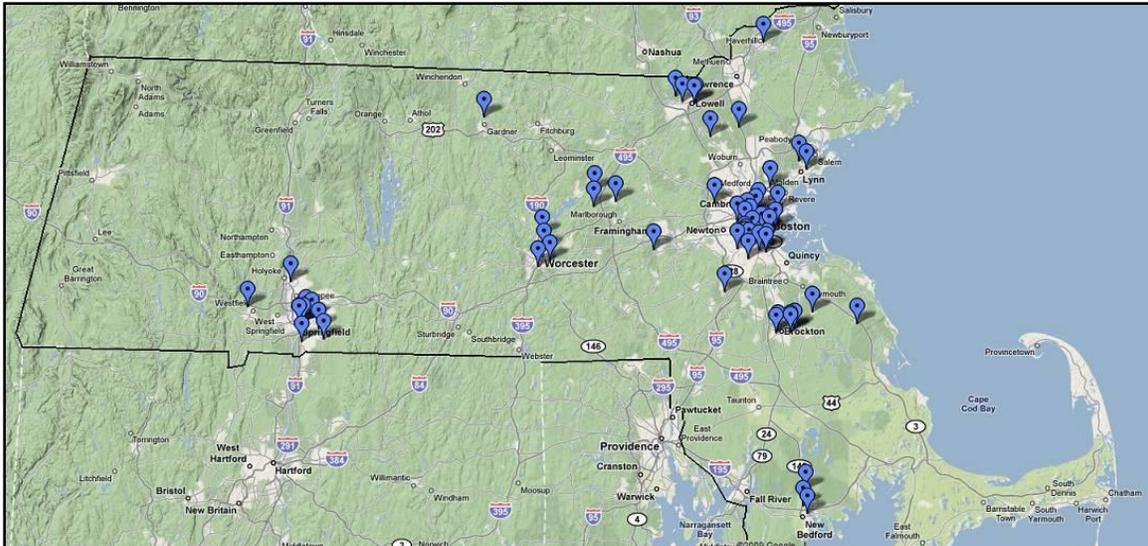
The “take all comers” plan in the regulated market created an infrastructure to ensure that all drivers had access to local insurance agents. Those insurance agents, often located in areas where insurers preferred not to operate and did not voluntarily offer contracts to agencies,¹¹⁸ were designated Exclusive Representative Producers (“ERPs”). Each ERP was assigned to a particular carrier, and the number of ERPs assigned to each carrier was determined by its market share.¹¹⁹ Many ERPs have been in the neighborhood for decades, or service certain immigrant communities and are able to assist non-English speakers to obtain insurance.

With deregulation, former ERPs are no longer assigned to individual insurers. They must obtain contracts voluntarily, and if they are unable to, they are only permitted to place business in the residual market. This means that customers of ERPs who cannot obtain voluntary contracts will no longer have access through their agents to their current insurers. These customers must leave their agents and seek insurance from new agents or directly from insurers.

¹¹⁸ Notwithstanding the good driving records of many consumers who live in urban areas, many such areas are considered to be high risk or undesirable due to the higher incidence of fraud, vandalism, or other claims. In less affluent areas, insurers also feel there is a greater risk of nonpayment.

¹¹⁹ One of the most significant problems with this system was the fact that some of these agents had a much better book of business than others, and thus some companies were advantaged or disadvantaged by their assignments of agents. The ERPs were reassigned prior to deregulation so that companies could compete on a more even playing field; however, Commissioner Burnes completely reformed the system before determining the results of the distribution.

The map below identifies the locations of the eighty-four insurance agencies that were unable to obtain voluntary insurance contracts as of June 11, 2009. Insurers report that they don't want their business, as their clients are "higher risk." Most are located in urban areas.



In part due to the organized effort of these insurance agents, the Legislature required the Commissioner to provide agents with "technical assistance and encourage voluntary contracts between agents and insurers." After this legislation was passed, Commissioner Burnes held one meeting with ERPs on May 13th of this year.¹²⁰ At the meeting, several ERPs raised concerns, including the fear that many of their customers will be uninsured. They also stated that as a condition of obtaining voluntary contracts, many insurers required them to turn away people with foreign licenses, youthful drivers, or those seeking basic insurance coverage. Many of the ERPs report that the Commissioner conducted no follow-up to this meeting. Commissioner Burnes subsequently released a report to the Legislature stating that seventy-six of the agents are still in need of contracts.

To address the removal of specific consumer protections, the Attorney General in her regulations intends to promulgate,

- detailed explanation from insurer upon cancellation or rejection,
- insurers be prevented from implementing increased burdens on residual market assignments
- the fair use of rating factors in order to place a higher emphasis on driving record in underwriting

¹²⁰ Individual meetings with each of the seventeen agents that requested it was apparently too burdensome for the Commissioner.

In addition, the Attorney General recommends that the Insurance Commissioner require the filing of underwriting guidelines, expand the Clean-in-Three protections, increase consumer education in higher risk territories and reinstate urban rate protections. These changes will greatly reduce the risk of an increase in the number of uninsured drivers in the Commonwealth.

The graphic features the seal of the Commonwealth of Massachusetts and the name 'MARTHA COAKLEY ATTORNEY GENERAL' on the left. The main title is 'Attorney General's Recommendations:'. Below the title are five colored boxes, each containing a recommendation:

- Require insurance companies to file underwriting guidelines.** (Red box)
- Require more detailed explanation from companies when a consumer is cancelled or non-renewed.** (Green box)
- Maintain and expand Clean-in-Three.** (Purple box)
- Limit rate increases and provide additional consumer education in urban territories.** (Blue box)
- Expand consumer protections in both the voluntary and residual markets.** (Orange box)

Conclusion and Final Recommendations

While consumers are generally positive about “competition,” which is viewed as quintessentially American,¹²¹ there are sizeable gaps between what consumers want and what they get when purchasing automobile insurance in the deregulated market.¹²² According to the Commissioner’s Study,

--88% of consumers want the amount they pay for insurance to be fair and reasonable, but only 34% find that it is.¹²³

--81% want the government to protect consumers from unfair insurance practices, but only 35% find that it does.¹²⁴

--75% want to understand how the prices of insurance policies are determined, but only 34% do.¹²⁵

¹²¹ Study 2, p. 11.

¹²² Study 4, p. 118.

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ *Id.*

--69% want to shop around for the best prices on auto insurance, but only 38% find it easy to do so.¹²⁶

These “performance” gaps, which range from 31% to 54% of the population, indicate that deregulation is not delivering what consumers want. According to the Commissioner’s Study, consumers are not satisfied. Nor should they be.

At the time Commissioner Burnes announced deregulation, there was already a wide consensus that rates were set to continue their significant decline. Instead of this regulated drop in prices, however, the new deregulated system delivered only a portion of the expected savings. While diverting millions of dollars from consumers to insurance companies would normally have caused consumer protest, the timing of the reform avoided such an action. Insurers could drop rates by less than they would have in a rate setting process, and deregulation advocates could point to the reductions and claim managed competition was a success.

In reality, drivers in the aggregate failed to receive the savings they should have received under the regulated system. They also lost a litany of protections: the right to be rated based on real data and transparent factors; the right to have premiums set based on driving record, rather than potential proxies for socioeconomic factors; the right for good drivers to chose their insurance company; and the right to solid insurance coverage terms. And, unfortunately, rates are now increasing for many. Moreover, as rates rise and consumers are rejected for insurance, the risk of having many drive uninsured increases.

The Commissioner’s Study found that consumers are concerned about insurer behavior and desire government protection from unfair insurer practices. According to the study, 81% of consumers believe that the state should have “mechanisms in place to protect consumers from unfair insurance practices.”¹²⁷ Only 35% of consumers stated that the government currently provides the protections they need.¹²⁸ The Attorney General agrees with the public. There are steps we must take now to reverse the anti-consumer effects of deregulation. Throughout this report, the Attorney General has made the following recommendations to improve the current state of managed competition. For convenience, these proposed steps are again listed below:

¹²⁶ *Id.*

¹²⁷ Study 4, p. 118.

¹²⁸ *Id.*

Provide for real review for insurance rate filings

- **Require all insurer rate proposals, filed with the Division of Insurance, to include supporting data for each of its rate components, discounts and rating factors.**
- **Require transparency in the implementation of rating factors and in premium calculations, including clear information for consumers about rating factors and the calculation of rates.**
- **Make public all basic insurance information collected by the Commissioner's statistical agent.**
- **Require a profit provision in the rates that is fair to both insurers and policyholders.**
- **Ban the inclusions of unapproved contingent commissions and inappropriate expenses in premiums.**
- **Require full and fair rate hearings that include reasonable time frames and the use of discovery.**
- **Prevent the use of a rate until the completion of a full and fair hearing.**

Ensure that rates are not related to socio-economic factors

- **Require insurers to justify use of all rating and underwriting factors not directly related to driving.**
- **Prohibit proxies for banned rating factors or discounts.**
- **Limit insurer use of CLUE.**
- **Legislate a ban on the use of credit scores relating to auto insurance.**

Develop ways to ensure consumers can "shop around"

- **Create a website that provides real side by side insurance quotes for all insurers, quickly and efficiently to consumers.**
- **Require all agents to provide quotes from all insurers with which they have contracts.**
- **Eliminate short rate penalties.**
- **Eliminate contingent commissions.**
- **Prohibit the collection of personal information not needed for rating.**

Increase access to insurance

- **Require insurance companies to file underwriting guidelines.**
- **Require more detailed explanation from companies when a consumer is cancelled or non-renewed.**
- **Maintain and expand Clean-in-Three.**
- **Limit rate increases and provide additional consumer education in urban territories.**
- **Expand consumer protections in both the voluntary and residual market.**

We believe that these changes are necessary to add fairness and consistency back into our auto insurance system, and to nurture a healthy competitive environment. We look forward to working with the Legislature on matters that should best be handled by statutory change, and will move forward on consumer protection regulations for other changes in the interim. To the extent that the market remains uncompetitive and anti-consumer tactics continue, it may be necessary for the Legislature to look to additional structural changes in auto insurance beyond those envisioned in our current recommendations: California for instance has adopted automatic rate review proceedings

for auto insurance rate increases that exceed a certain threshold, a bar on most uses of geography and other non-driving factors in rating, and the semblance of a public option for certain auto insurance purchasers. We intend to continue to monitor the market as we move forward, and will report to the public and the Legislature regarding the state of the auto insurance marketplace. Auto insurance is a government-mandated expense for all Massachusetts drivers. The Commonwealth needs to ensure that our auto insurance system works fairly, efficiently, and effectively to serve the drivers of Massachusetts.