

**Testimony of  
American Property Casualty Insurance Association (APCIA)  
Senate Finance Committee**

**SB 805 Motor Vehicle Insurance – Rate Filings – Discrimination, Trade Secrets, and States of Emergency**

**March 3, 2021**

**Letter of Opposition**

The American Property Casualty Insurance Association (APCIA) is a national trade organization representing nearly 60 percent of the U.S. property casualty insurance market. APCIA appreciates the opportunity to provide written comments in opposition to Senate Bill 805. APCIA strongly opposes this bill which would ban the use of territory as a rating tool for personal auto, remove the protection of proprietary rate-related information as confidential commercial information; and provides that during a declared state of emergency by executive order, the Insurance Commissioner may require an insurer to reduce rates for private passenger auto policies.

APCIA and the property casualty insurance industry recognize that today, there is greater scrutiny of racial and social equity, justice, and inclusion issues. The industry is committed to creating a more diverse and inclusive workforce, providing fair treatment to all customers, and helping provide our unique expertise in risk mitigation, risk management and loss prevention to make insurance more affordable in low income, minority and traditionally underserved communities. APCIA is aligned with the National Association of Insurance Commissioners (NAIC) and National Council of Insurance Legislators on the need to have hard conversations together about how to directly tackle concerns related to fairness and preventing unlawful discrimination to determine if there are improvements that could both strengthen competitive markets and address inequities while preserving the risk-based foundation of insurance. Last year the NAIC announced the formation of a special committee focused on Race & Diversity. The committee is charged with the following: 1) Conduct research and analyze the level of diversity and inclusion within the insurance sector; 2) Engage with a broad group of stakeholders on issues related to race, diversity, and inclusion in the insurance sector; 3) Determine whether current practices exist in the insurance sector that potentially disadvantage minorities; 4) Make recommendations to the Executive Committee and membership by year-end regarding steps: (a) both insurance regulators and the insurance industry can take to increase diversity and inclusion; (b) that should be taken to address practices that potentially disadvantage minorities; and (c) to ensure ongoing engagement of the NAIC on these issues through charges to existing committees, task forces and working groups.

**Removing Trade Secret Protection**

Senate Bill 805 would remove the protection provided under Section 11-307 of the Insurance Article for an insurer’s designated “proprietary rate-related information” that is filed with the Insurance Commissioner for private passenger auto and designated as a trade secret under Maryland law. Trade secret protection is afforded to all industries in Maryland and insurance rating models should not be signaled out. Insurers are in a competitive market and wish to protect the investment they have made in developing their pricing models from their competitors. The insurance regulator does have access to this information to ensure that the information

subject to trade secret protection is in compliance with the law. Removing this protection would significantly limit the incentives for insurers to innovate and compete to the detriment of Maryland consumers.

## **Overview of Rating**

For many years, there has been much controversy throughout the United States on the use of territorial rating in private passenger automobile insurance. Interest in this area partially stems from rising insurance losses in both automobile and homeowners insurance, resulting in higher insurance premiums for the policyholder. While some regulators and legislators have attempted to revise traditional rating criteria used by insurers, the property/casualty insurance industry maintains that the use of rating by geographical location, or territory, is an equitable and statistically-supported method of distributing costs among policyholders.

Automobile insurance loss costs are generally the highest in the city, attributable to: (1) the greatest number of claims incurred in the urban area; (2) the highest amount of loss dollars per claim; or (3) a combination of both. Probable factors contributing to higher insurance costs in the city include higher population and/or traffic density and greater exposure to crimes such as theft and vandalism.

If restrictions in geographical location as a rating factor were imposed and different rating territories were no longer used in a state, then a redistribution of premiums among policyholders would be necessary. Those policyholders living in higher-cost areas would have a decrease in their premium, while policyholders in lower-cost areas would have an increase. In other words, the residents of less populated communities would be required unfairly to subsidize their counterparts living in the more heavily populated cities. Generally, it is the majority of policyholders in the state who would be affected negatively by this type of change.

While some critics say it is wrong to differentiate in price on the basis of geographical location, insurers say it is wrong to require anyone to pay more than the amount reflected in his or her expected loss cost. Such an imposition is recognized by both insurers and the insurance-buying public. According to public opinion polls, a large majority of people feels it is unfair to make suburban and rural residents pay more automobile premium to help their urban counterparts. Insurance companies need to base their premiums on projected costs and differentiate among areas with varying loss potential. Restrictions placed on territorial rating would: (1) create forced subsidies for some policyholders at the expense of others and limited insurance products or services; (2) undermine the ability to influence responsible behavior on the part of individuals; and (3) cause a shift in the marketplace by companies, thus reducing competition.

## **Concept of Spreading Risk and Geographical Rating**

Insurance is a method of reducing the uncertainty of financial loss through the transfer of risk by many individuals to an insurer. Since individuals generally cannot bear the financial consequence of a large loss, policyholders contribute premium payments to a common fund that covers losses and expenses. The policyholder thus exchanges the possibility of an unknown large loss for a comparatively small certain payment.

Insurers face the challenge of measuring risk; they need to know whether to accept a risk and how much to charge. Ratemaking involves measuring the probability of the occurrence of losses and the financial impact that may be expected to result from the hazards or perils against which insurance is provided. Since rates are determined before all future costs are known, the insurance pricing function is more difficult than that of most other businesses, making it among the most important and intricate company operations. Hence, the insurance industry is unique in American business because it cannot price its product like other businesses with full knowledge of costs and be guaranteed a return on investment. Each state, nevertheless, subjects insurance ratemaking to a specified type of statutory regulatory control; that is, rates may not be "excessive, inadequate, or unfairly discriminatory."

The basic principle underlying the development of insurance rates is the estimate of claims for the varying risks being insured during future months and a determination of whether current rates are adequate or inadequate to pay these losses. Loss experience is measured by two fundamental elements: (1) claim frequency; and (2) average loss or claim severity. Claim frequency is usually expressed as the number of claims occurring per 100 insured vehicles or housing units during one year. For example, if automobile collision coverage claims occurred at the rate of 10 per 100 insured car years (a car year is one car insured for one year), then the frequency is 10 percent. The average loss is the average cost of each claim

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paid or incurred for a particular coverage. The combination of these two factors is the loss cost, or the average amount of loss paid or incurred by the insurer for each vehicle or housing unit covered.

In most cases, the geographical area having the highest automobile insurance loss cost in each state has the highest claim frequency, the highest average loss per claim, or both. The highest loss cost typically reflects residents of the urban area. This indicates that people living in these areas are the riskiest to insure, due to the most number of claims incurred per insured exposure and/or the costliest claims incurred in these areas. Clearly, the cost to provide protection to residents of these locations is greater than elsewhere.

### **Geographical Location in Ratemaking**

Historical loss data establish the fact that automobile accidents, or vandalism and theft losses are more likely to occur in certain locations than in others. The cost of automobile accidents and property damage is more likely to be greater in certain areas as well. Hence, there is a need for insurance companies to distinguish those geographical regions with greater loss potential from those with less.

The territory must contain exposure risks sufficiently large and homogeneous to allow a reasonable accuracy of predicting loss costs by application of the concept of large numbers. For automobile insurance, territorial lines are drawn to commonly group motorists who operate vehicles under similar conditions and face similar hazards. For the sake of simplicity and equity, territorial boundaries generally were developed by using existing political demarcations, geographical features or contiguous zip code areas. The number and size of territories vary from state to state and among insurers; for example, states may comprise anywhere from about 3 to 90 automobile rating territories depending on the particular jurisdiction.

There are many reasons why losses and, hence, insurance rates vary by territory. Some characteristics contributing to loss potential in automobile insurance are population density, traffic density, motor vehicle theft rates, varying types of law enforcement, conditions and maintenance of roadways, health care costs, body shop repair rates, and claiming behavior. For example, population and traffic densities both provide a measure of congestion. The higher the population and the more vehicles there are, the more likely there will be automobile accidents and, hence, insurance claims. Urban areas tend to produce more claims per insured car than rural or suburban areas. Similarly, the cost of paying automobile insurance claims is higher in urban areas because hospital and medical expenses, repair costs, and legal fees tend to be substantially higher in these areas. It has also been found that residents in metropolitan cities typically are more prone to make injury claims than residents living elsewhere. Past studies have also shown that most automobile accidents usually take place within twenty-five miles of home, or the primary garaging location of the vehicle.

If the use of territorial rating were eliminated or restricted, an increase in premiums for some policyholders would take place to offset the decrease in premiums given to others, unfairly overcharging those persons who actually have less loss exposure than other persons having greater exposure. This imposition usually affects the majority of policyholders in each state who live in the non-urban parts. Invariably, persons residing in rural communities would have premium increases, while their city counterparts would have decreases. The positive or negative impact on suburban and medium-sized city dwellers depends upon how their loss costs compare with the statewide average.

### **Consumer Survey Results**

Even consumers recognize the inequity of forcing suburban and/or rural policyholders to subsidize their counterparts living in the city. In previous public attitude surveys conducted by the Insurance Research Council, the majority of respondents generally favor lower automobile insurance rates for drivers who live in suburban and rural areas because they have fewer accidents than drivers who live in cities. Once again, the majority of consumers feel it is somewhat or very unfair for lower-risk drivers to pay higher automobile insurance rates to compensate for decreases given to higher-risk drivers.

In summary, rating on the basis of territories evolved in order for companies to achieve equity among policyholders and to determine which areas are more likely to result in claims and how serious those claims might be. So that each group of policyholders pays its fair share of losses and expenses, insurers must continue to pursue sound and legitimate business practices and base their premiums on the exposure to risk.

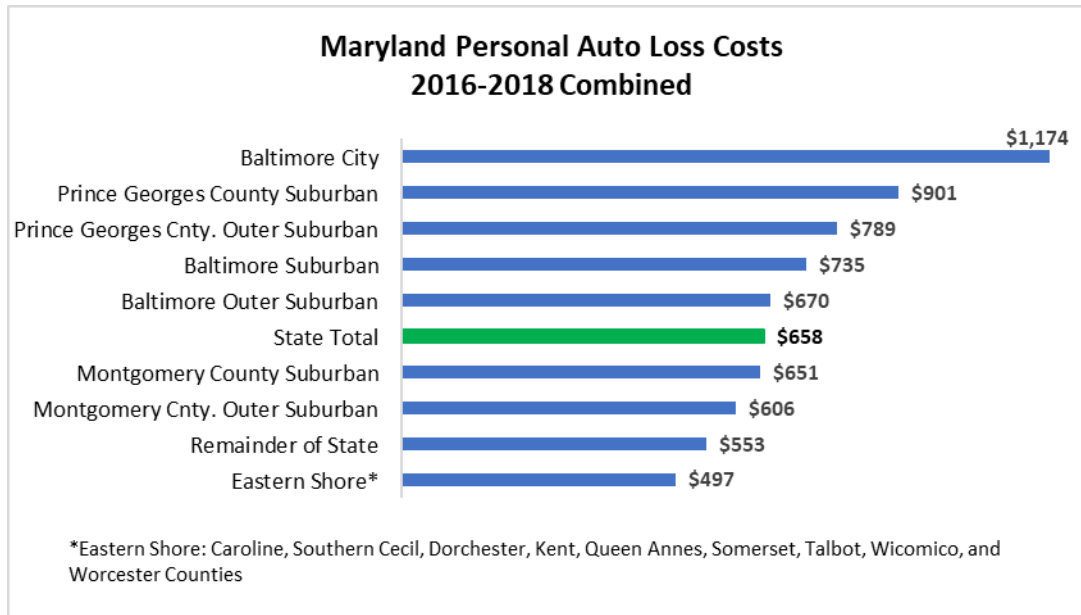
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## Maryland Results<sup>1</sup>

Territory has been used for classification of personal auto risk. Without the use of territory in pricing, rates will not be reflective of the loss variances in the different territories. Furthermore, there would be subsidies created benefiting riskier policyholders at the expense of policyholders in less congested areas with better loss experience.

For this analysis loss experience and average premiums<sup>2</sup> for each territory are compared to that of the statewide total to assess potential impacts of eliminating territorial rates and charging the statewide average premium to all Maryland personal auto policyholders.

Approximately 52 percent of Maryland policyholders have loss experience below the statewide loss cost<sup>3</sup> (indicating less risky drivers, in general) while 48 percent have loss experience above the statewide loss cost (indicating more risky drivers, in general).



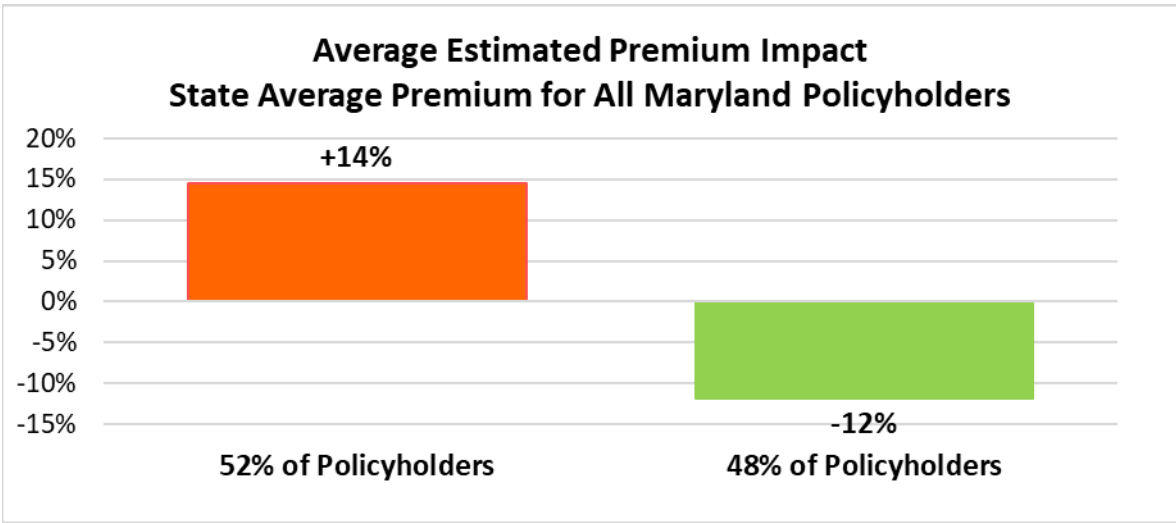
If territorial rating were prohibited, the estimated 52 percent of Maryland policyholders with better loss experience (and thus on average pay less than the statewide average), could potentially see a rate increase of about 14 percent (on average). The resulting higher premiums paid by this group of generally less risky drivers then would subsidize the potential 12 percent (on average) rate decreases for the other 48 percent of generally more risky Marylanders.

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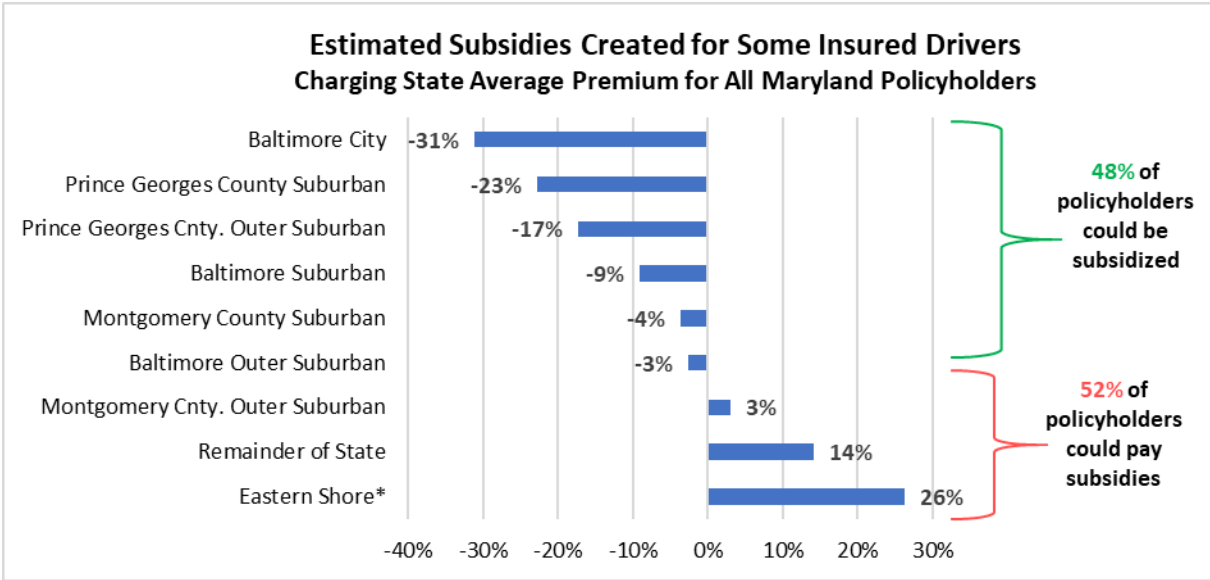
<sup>1</sup> APCIA prepared the estimates in this report using personal auto accident-year data as of March 31, 2019, from the Independent Statistical Service (ISS) reflecting 2016-2018 combined. Personal auto data analyzed include liability coverages (bodily injury and property damage liability, and uninsured/underinsured motorists) and physical damage coverages (\$100 deductible comprehensive and \$250 deductible collision)

<sup>2</sup> Earned premium divided by earned exposure

<sup>3</sup> Average loss per insured vehicle (car-year)



Below is the estimated potential average premium change by territory, should territorial rating be eliminated, and all Maryland personal auto policyholders were charged the statewide average.



\*Eastern Shore: Caroline, Southern Cecil, Dorchester, Kent, Queen Anne’s, Somerset, Talbot, Wicomico, and Worcester Counties

The debate on territorial rating has resulted, no doubt, in part from increases in the cost of insurance, especially to those living in metropolitan areas. Certain special interest groups feel that restrictions on the insurance ratemaking process will result in lower premiums for the policyholder. This is not the case, however, as affordability concerns cannot be mitigated over the long term by establishing artificial barriers on the risk assessment process and prohibiting the use of territorial rating. Rather, premium decreases should only take place when the true problem of high underlying claim costs is recognized and dealt with directly and successfully.

Ignoring differences in loss costs through rate subsidies has another negative result. It hides the true drivers of losses and thereby further delays the actions should be taken, for example, to improve highway safety, provide better transportation alternatives and fight crime that preys on the most vulnerable.

**Rate Reductions during COVID-19**

Senate Bill 805 would grant the Insurance Commissioner the power to force private passenger auto companies to lower auto premiums during a state of emergency. The Insurance Commissioner already has the power to issue bulletins and

provide mandatory guidance regarding activities during a state of emergency. Everyone agrees that the current state of emergency and the financial and human toll on the United States is unprecedented. Insurers understood the urgency of helping businesses and individuals recover from this unprecedented crisis and mitigate a larger shut down of the economy. Last year, home, auto, and business insurers voluntarily provided customers with more than \$14 billion in policyholder relief. Furthermore, the industry has deployed more than \$220 million in philanthropic contributions during COVID-19 to support local communities.

In Maryland, the Insurance Commissioner issued several bulletins encouraging insurers to assist their policyholders, either working on payment plans, waiving any fees, removing exclusions for food delivery drivers under personal autos, and adjusting rates to reflect changes in exposures as more and more people were working from home<sup>4</sup>. The Maryland Insurance Administration issued several follow up bulletins encouraging companies to review their losses and make future rate adjustments. Auto insurers responded by refunding \$440,000,000 in premiums through the end of the 3<sup>rd</sup> Quarter of 2020 alone according to the Maryland Insurance Administration. It is also important to understand that rates are continuously adjusted by insurers at each renewal using multiple years' data, which means they adjust gradually, in both an upward and downward direction. If there is a sustained decline in number and cost of insurance claims, rates will be adjusted. No one expected the state of emergency to last this long but auto insurers are continually adjusting their future loss expectations to reflect the changes on exposure. Mandatory reduction of rates is not the answer, especially when the facts change rapidly. In many places, there was a short dramatic decline in miles driven and highway losses, but in many places the fatality rate actually quickly increased as a result of less congestion and higher speeds and distraction.

## **Conclusion**

Trade Secret protection is provided to all businesses in Maryland and the insurance industry is no exception. Removing this protection only reduces the incentive to innovate and compete and does not benefit the public at large. Insurers should continue to have equal footing with other Maryland businesses, especially in the context of expert regulators who can and do review virtually everything for compliance with applicable legal standards. With regard to the present territorial rating system, most objections point toward the social philosophy that underlies the criterion of geographical location, and not on the validity of accepted statistical principles of risk assessment. The risk assessment process should be free of restrictions that would prohibit competition and bring about forced subsidies for some consumers at the expense of others. Should different criteria for territorial definitions and boundaries become justified, companies will take the initiative to incorporate them into their systems to benefit the insurance-buying public. In addition, giving the Commissioner the power to mandate premium reductions during states of emergencies seems imprudent as already shown that such a mandate is unnecessary.

For all these reasons, the APCIA urges the Committee to provide an unfavorable report on Senate Bill 805.

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<sup>4</sup> Maryland Insurance Administration issued several bulletins throughout the pandemic. [Bulletin](#) 20-12 encouraging a review of PPA rates. [Bulletin](#) 20-20 encouraging forbearance on cancellation of policies and payment plans.