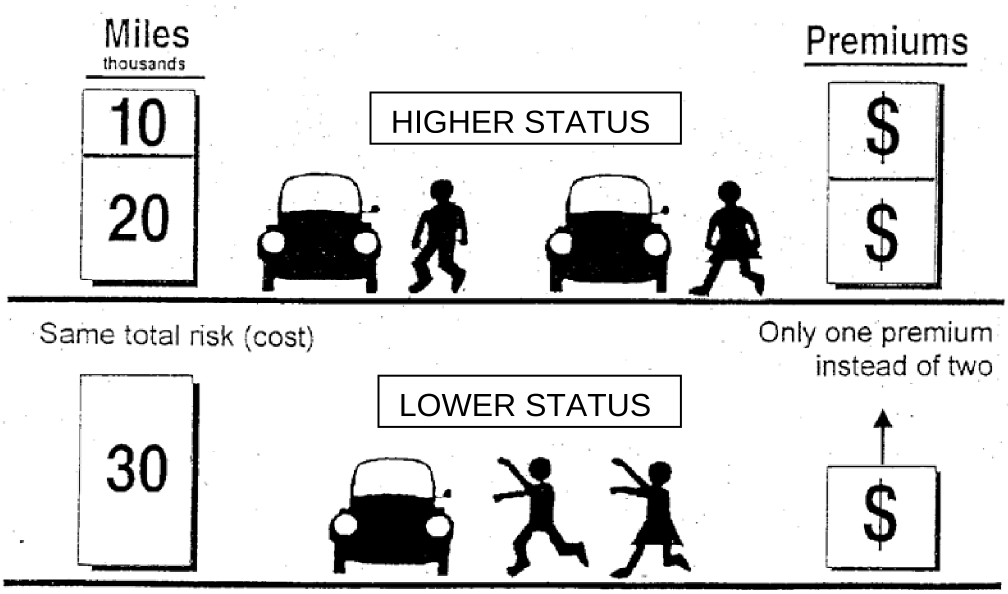
Mandatory Automobile Insurance

- **How it's being sabotaged by status rating**
- **Why higher rates for lower education and occupation status drivers can't be regulated away**

- Mandatory insurance works badly because pay-per-car premiums offer drivers only one way to economize—use fewer cars more miles each.
- Inconvenience keeps drivers from doing this until forced to by high premiums. When groups have to share cars, average miles rise.
- Result: insurers correlate more claims (per 100 car years) with lower education and occupation status and raise per-car premiums.



- To get all cars insured, insurers must offer a way to save that doesn't make drivers give up cars—and then have to pay ever-higher premiums on the remaining cars they are sharing.
- Texas lawmakers did the right thing when they passed HB 45 in 2001, a law validating the cents-per-odometer-mile premium option, which is the only workable remedy in a free market.
- Now insurers are just starting to cooperate with this way to make mandatory insurance work better. (See over for note to NCOIL.)

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Cents-per-mile choice—How it works

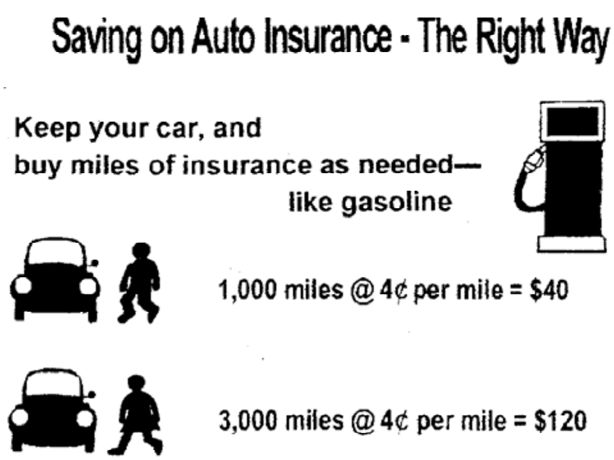
The choice of *exposure unit** between the car-year unit and the odometer-mile unit is straightforward for companies to set up. (They've long offered the odometer-mile as an alternative exposure unit for some commercial fleets.)

After first assigning a car as usual to a **risk class** (by territory, car and driver type, and car use), the company offers the customer a choice between staying with, for example, a fixed premium of $600 a year for driving coverages (liability and collision) or paying a matching 5.0¢ a mile for the **same risk class** and coverage to buy miles of insurance in advance.

The miles are added to the odometer reading and recorded on the insurance ID card. The owner buys more miles when needed. The company has the odometer read annually and when the owner changes cars or companies. Owners pay only for insurance used, and if the odometer limit is exceeded, the car is uninsured. It's that simple.**

Pay-per-mile also **eliminates a major enforcement problem**. Today's ID card shows the policy term but not whether insurance has lapsed through non-payment of installments. Under the pay-per-mile alternative, checking the odometer reading against the ID card's odometer limit shows immediately whether insurance is actually in force.***

Driving a car, not owning it, is what produces cost for the insurance company, mile by mile, and that's the actuarially sound way to pay for it.



* At the Casualty Actuarial Society's 1988 Ratemaking Seminar, CAS Fellow Richard Woll distinguished between car-miles as an odometer *exposure-unit* measure and the estimated future mileage discount classes as one of many possible classification variables (including education and occupation levels as inverse proxies for group-average miles per car year).

> "[I]t makes an awful lot of sense to think of it [mileage] as an *exposure* variable. However, when you are trying to explain classification effects, you have got to recognize that mileage is a *classification* variable today, not an exposure variable. What is explained by mileage on a prospective basis is quite different than looking backward and explaining effects through past actual mileage."

** In October 2008, a new insurance company in Texas began offering (only) cents-per-odometer mile premiums using this method, but without an annual odometer reading. For a description visit www.MileMeter.com .

***** Note to NCOIL**: Regarding ability-to-pay for mandatory insurance, it is essential that, when the odometer limit is exceeded, liability coverage must be considered cancelled for non pre-payment of premium—now the case when an installment is not paid when due. Otherwise drivers who do keep pre-paid miles on their odometers will be paying higher cents-per-mile liability insurance prices than they should. See the report to Texas legislators that prompted enactment of HB 45 in 2001—"Why the Standard Automobile Insurance Market Breaks Down in Low-Income Zip Codes" at www.centspermilenow.org. (The report is on the lower right.)