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How ERA Will Raise Insurance Rates

One of the many unforeseen and undesirable effects of the Equal Rights Amendment is the way it will raise the rates of automobile insurance for most Americans, principally for young women age 16 to 25 (and their parents if they pay the premiums). Young women under age 25 pay much lower automobile accident insurance premiums than young men because young men have a much higher rate of accidents.

Since insurance is an industry regulated by state law, the ERA mandate would govern it. ERA would forbid the industry to charge young men more and young women less as a result of a classification by sex. Under ERA, both sexes would have to pay the same rate, which means that young men would pay 8 percent less but young women would pay 29 percent more.

Some people who don't understand insurance ask the question, why not charge rates based on which individuals have the accidents? But if the insurance companies know who will have the accidents, they will simply refuse to sell insurance to those individuals or charge them what their accidents actually cost. The whole principle of insurance is based on distributing the risk among groups in which the average cost can be statistically and reliably predicted. This is the system that charges everyone a reasonable rate and prevents any one individual from being ruined by a $100,000 accident.

The ERA, if ratified into the U.S. Constitution, will prohibit any difference of treatment "on account of sex." ERA cannot change the statistical fact that young men on the average have many more accidents and therefore cost more to insure. But ERA would require insurance companies to pretend that this difference does not exist and to treat males and females the same.

Some people might be inclined to think that, if a bona fide sex difference could be statistically proved, the U.S. Supreme Court would allow the different rates to continue. This argument was conclusively eliminated by the U.S. Supreme Court in the 1978 case of *Los Angeles v. Manhart*.

In that case, the issue was whether the city of Los Angeles could charge women employees more for payments into a pension plan since it is a proven statistical fact that women live longer after retirement than men, and therefore their pensions cost more.

The Supreme Court answered no. The Court ruled that, even though the pension plan was based on a factual difference in longevity between women and men, it ended up as a difference of treatment on account of sex, and therefore is "sex discrimination" prohibited under Title VII of the Civil Rights Act, which applies to nearly all employers.

The *Manhart* case applies only to pensions governed by Title VII. The ERA, if it ever becomes part of the Constitution, would apply to all areas including automobile accident insurance and life insurance. Life insurance is another area where women receive more favorable treatment. Women now pay lower life insurance rates than men because women live longer.

There is another item to note in reading the insurance study printed later in this Report. Remember, ERA does not use the words "on account of gender" or even the word "women." It says "on account of sex." The women's lib movement usually argues that "sex discrimination" not only includes a difference of treatment based on gender, but also on marital status. "Sex" is a word with many meanings, and it is not defined in ERA. It is therefore possible that ERA would prohibit insurance companies from charging different rates for married persons and unmarried persons. If different rates based on marital status are prohibited by ERA, rates on married males under age 25 would go up 68 percent while the rates on unmarried males under 25 would go down 9 percent.

Thus ERA would substantially raise the automobile accident rates on most Americans. It would require groups with good accident records to subsidize groups with bad accident records. And like nearly everything else about ERA, those who would lose the most would be women and married couples.

Report by National Association of Independent Insurers

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Classifications in Auto Insurance: Are They Really Fair?

Are some people paying more than they should for auto insurance simply because they are young, or single, or male or living in an urban area?

These questions go the heart of the current controversy over the auto insurance rate system in the U.S. Critics of the insurance industry's classification system are contending that the use of age, sex, marital status and geographical location in determining auto insurance rates is "unfairly discriminatory" and should be abolished. Those who are paying the highest insurance rates would like to see the entire system of insurance risk classification scrapped.

Although their feelings are certainly understandable these critics are unwittingly advocating the destruction of a system that distributes costs fairly among policyholders, encourages safety and loss reduction, and enables the insurance industry to serve the needs of all motorists.

Most significantly, *abolition of the risk classification system would increase the cost of insurance for the great majority of motorists in this country.*

Why? Because the abolition of rate classifications would do nothing to change the aggregate number of dollars that insurers must pay out in claims each year -- all it would do is place a disproportionate burden of the cost of insurance on those drivers who have fewer and less costly accidents -- the majority of drivers in the U.S.

A Proven System

The modern insurance system is based on the straightforward proposition that each policyholder should pay a premium proportionate to the risk of loss that he or she represents.

Over many years, insurers have developed certain classifications that -- while not perfect -- do fairly accurately predict the losses that certain groups of policyholders are likely to experience. Because accidents are a fairly rare occurrence even for a "bad" driver, it is not possible to accurately predict the losses of individuals -- but it is possible for insurers to calculate the aggregate expected losses of groups of individuals sharing certain characteristics.

Among these characteristics are age, sex, marital status and geographical location (or territory). In addition, the rates for coverages that protect the vehicle itself (collision and comprehensive coverages) are based primarily on the value and age of the car.

Because few critics have questioned the need for rate classifications based on the age and value of the car, this paper will deal only with the questions of the driver's age, sex, marital status and geographical location in auto insurance rating.

Age As A Criterion

Many critics of the classification system contend that a person's age has nothing to do with his "loss potential;" they say that driving experience is the thing that really matters. However, this view fails to consider the fact that both the risk of being involved in an accident and the cost of that accident are affected not only by driving experience, but also by a driver's attitudes toward safety, emotional maturity, and the amount and type of driving that he or she does.

Taken individually, these factors would be virtually impossible for any insurer to measure. However, companies have found that a person's age provides a fairly accurate measurement of all these factors. Losses incurred by drivers under age 25 are 106 per cent more than losses incurred by older drivers.

If age were abolished as a classification criterion, 83 per cent of the nation's motorists would have to pay 18 per cent more for their auto insurance in order to subsidize the losses of younger, higher risk drivers. The remaining 17 per cent would have their premiums lowered by an average of 42 per cent.

Sex and Marital Status

Sex and marital status are secondary classifiers and are generally applied only to younger drivers. However, among younger drivers, sex and marital status are important measures of loss potential.

As shown in charts 1 and 2, losses incurred by young male drivers are 41 per cent more than losses of young female drivers. In addition, young single male drivers incur losses which are 84 per cent more than losses of young married male drivers.

If sex and marital status were eliminated as classification criteria, rates for young female drivers would have to increase 29 per cent in order to subsidize the losses of young males. Similarly, rates for young married males would have to increase 68 per cent in order to subsidize the losses of young single males.

Geographical Location

Although many metropolitan area motorists are complaining that their insurance rates are unfairly high, the fact is that these motorists experience much higher losses than motorists who live in less congested areas.

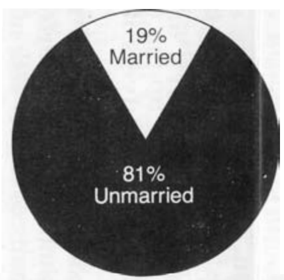
There are many reasons for this: traffic congestion, road conditions, terrain, and police effectiveness are the obvious ones. In addition, residents of metropolitan areas are often more prone to file lawsuits once an accident occurs than small town residents. Auto theft and vandalism are also much more common in large metropolitan areas.

Courts in large cities tend to award larger sums for damages in auto accidents than small-town courts. Auto repair and hospital costs are generally higher in urban areas.

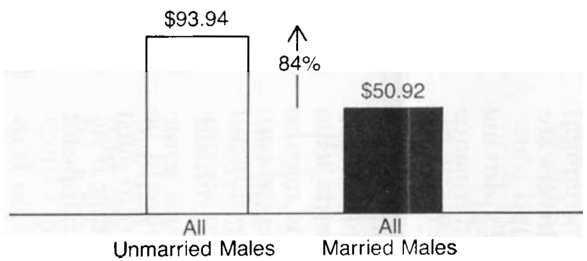
Insurers use rating territories as a method of adjust-

(Continued on page 4)

MALES UNDER 25 YEARS OLD PROPORTION BY MARITAL STATUS



LOSS COST PER INSURED CAR BY MARITAL STATUS



EFFECT OF ELIMINATING MARITAL STATUS AS RATING CRITERION

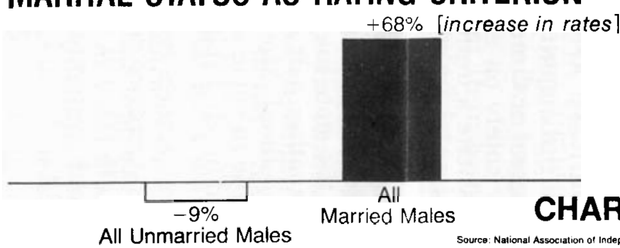
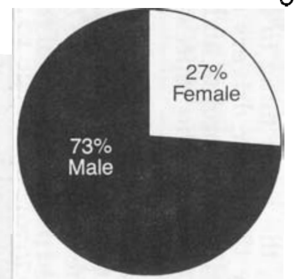


CHART 2

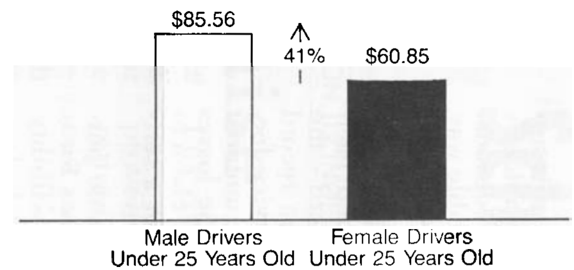
Source: National Association of Independent Insurer

PROPORTION OF INSURED MOTORISTS BY SEX

Under 25 Years Old



LOSS COST PER INSURED CAR BY SEX



EFFECT OF ELIMINATING SEX AS RATING CRITERION

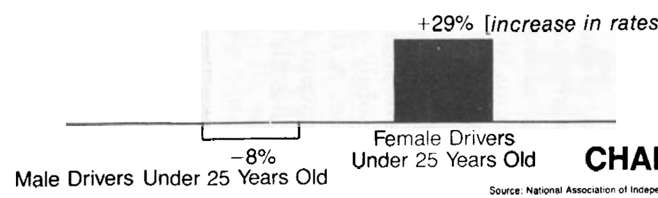


CHART 1

Source: National Association of Independent Insurers

(Continued from page 2)
ing premiums to reflect these differences in the driving environment. The rates developed for each territory are based on the loss experience of that territory relative to the state as a whole. . . .

Is Driving Record the Answer?

Another complaint frequently heard is that insurers could, and should, rely mainly on a policyholder's driving record when making classification decisions. On the surface, this seems to be the most equitable way of culling out the "bad" drivers from the "good" drivers.

There are several pitfalls to this solution, however. First, when carried to its logical extreme -- where each policyholder is rated solely on his driving record -- the result is self-insurance. A driver with a clean record would pay nothing, except for a nominal service fee. Once he has had an accident, however, the motorist would have to pay for all of his losses. These losses could range from less than $50 for a small theft claim to perhaps several hundred thousands dollars for a serious personal injury claim.

This makes no sense and defeats the whole purpose of insurance, which is to spread the loss for a group of similar risks, thus minimizing the possibility of financial ruin for any individual.

A more moderate approach is widely used in several European countries. Under that system, insurers rate risks on the basis of the number of claims filed over a fairly extensive period of time. Switzerland, for example, uses a plan that requires 21 years for a motorist to work down from the highest-rated group to the lowest. Experience periods of that duration would probably not be acceptable in this country. Several states (e.g., Maryland, New Hampshire) already have regulations or statutes prohibiting the use of more than three years' experience for rating purposes.

The difficulty with shorter experience periods is that they do not effectively differentiate between "good" and "bad" drivers. Accidents are infrequent enough so that even the majority of "bad" drivers are accident-free over a two or three year period.

Finally, to rely solely on an individual's driving record would necessitate a uniformity of performance on the part of each state's courts, law enforcement officials, and motor vehicle record bureaus. The fact is, courts and police in various localities enforce traffic laws to varying degrees. Thus, a person who runs a stop sign in one part of the state may be let go with just a warning, while in another part of the state he may be issued a citation and fined. Motor vehicle records are notoriously unreliable in some states, and are difficult for insurers to obtain in other states, due to privacy protection statutes.

With all the above considerations, it should be clear that a driver's accident and violation record must be supplemented with class and territory rating if insurers are to fairly and equitably determine significant difference among risks.

Effect On Availability

Any move to abolish or restrict classifications will have one other effect on the insurance marketplace that has not been mentioned so far -- it will inevitably restrict insurance availability for higher risk policyholders.

To illustrate, let's assume that insurers are prevented from using a person's age as a classification criteria. Insurers know from past experience that young drivers are involved in more accidents than older drivers, and that young drivers are much more costly to insure.

If insurers were forced to charge the same rate to high risk young drivers and low risk older drivers, the older drivers will be paying more than their fair share and the young driver's premiums will be insufficient to pay for the losses they generate.

For insurers operating in a competitive environment then, the smart thing to do would be to underwrite only the older drivers (who present a much higher likelihood of profit), and to find ways to ignore the young drivers, who represent highly unprofitable business.

An analogy would be a car dealer who was forced to sell a $10,000 Lincoln Continental and a $4,000 Ford Pinto for the same price -- say $7,000. The dealer would be foolish to push the sales of the Continental because he'd lose $3000 on every car he sells. The Pinto, on the other hand, would be a gold mine for the dealer -- in fact, it would be the only car he'd sell!

The same result would occur in the insurance business: the young driver, who was supposed to be helped by doing away with the age classification, is really hurt by this action. He will be unable to buy insurance in the regular market.

Independent Study and Conclusion

Because of the recent growth of public criticism of the industry's classification systems, insurers commissioned an independent study of the social and economic issues surrounding the classification process. The study was performed by the prestigious Stanford Research Institute. Among the major conclusions of SRI's report were these:

"Government attempts to control the way insurance companies measure risk are both ineffective and harmful to consumer," the report said. "Restrictions on the risk assessment process lead to market restrictions, subsidies among consumers and availability problems for some groups of consumers. We therefore conclude that risk assessment should not be restricted and that insurers should be free to make full use of classification information."

Abolishing or restricting the insurance industry's classification system will raise insurance costs for most motorists and will dry up the availability of insurance for those classes of drivers now viewed as "higher risks."

Legislative or regulatory "tinkering" with this system will simply force lower risk motorists to subsidize the premiums of higher risk motorists.

The only effective way to lower auto insurance costs is to find ways of preventing accidents from occurring or to reduce the losses generated when they do occur.

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