NATURAL RESOURCES DEFENSE COUNCIL

October 20, 2008

Daniel Goodell
California Department of Insurance
45 Fremont Street, 21st Floor
San Francisco, CA 94105
PubComments.2008-020@insurance.ca.gov

Re: Support with Proposed Amendments (Usage Based Auto Insurance)

Dear Mr. Goodell:

On behalf of NRDC (Natural Resources Defense Council), which has 1.2 million members and activists, 214,000 of whom are Californians, we are writing to express our support and appreciation for the efforts of Insurance Commissioner Poizner and the California Department of Insurance to implement usage-based auto insurance, popularly known as Pay As You Drive (PAYD). We would like to recommend strengthening the proposed regulations by making PAYD a required offering in California.

As co-sponsor of AB 32—California's Global Warming Solutions Act—NRDC is committed to identifying strategies that allow California to reach our global warming pollution reduction targets. California has strong policies in place to reduce emissions from vehicles and to reduce the carbon content of fuels, but the California Energy Commission projects that increases in vehicle miles traveled (VMT) could neutralize these gains if business as usual growth trends continue.

NRDC was also co-sponsor of the recently-signed SB 375 (Steinberg), a groundbreaking reform that for the first time in American history ties land use and transportation decision making to climate change and the reduction of VMT. In signing the legislation, Governor Schwarzenegger called SB 375 the "sequel" to AB32, highlighting the importance of cutting the third of California emissions that come from the transportation sector:

> *We can reduce the time that people spend in their cars... while we are cutting down on traffic, on gridlock and on sprawl. That's good for the people, that's good for their wallet, that's good for the environment, that is good for the fight against global warming.*

The effects of global warming are already being felt, as California experiences record-breaking heat waves, changing precipitation patterns, earlier snow melt and species migration. California has taken an internationally-recognized leadership role in combating climate change. From foresters to auto makers, from cement manufacturers to housing developers, from farmers to appliance makers—everyone is being asked to do their part to fight climate change. Many businesses in California must change their core practices to reach our environmental goals. The California economy will benefit from the opportunities, savings, job growth and investment that cleaner and more efficient technologies promise. PAYD offers the insurance industry the opportunity to make its own contribution to California's historic fight against global warming.

For years, NRDC has supported land use reforms, investments in public transportation and other proven strategies to shorten car trips and give people viable alternatives to car travel. We also support market-based strategies that give clear pricing signals to consumers to make choices that benefit the environment and their pocketbooks.

As gas prices influence whether or not drivers choose to fill up or take trips, the price of insurance can have a similar effect. Estimates vary, but all PAYD scenarios point to reductions in VMT and global warming pollution. UC Berkeley's Aaron Edlin sees a potential national VMT reduction somewhere between 9% and 10%, the Victoria Transport Policy Institute's Todd Litman projects VMT reductions up to 10%, depending on how PAYD is implemented, and the Brookings Institution forecasts up to an 8% VMT reduction here in California.

NRDC's own analysis, based on a range of VMT reductions from 4%-8% and a modest 50% participation rate among California's lowest mileage drivers, projects a reduction range of 1.3 – 2.6 MMT in 2020. For scale, the Governor's Million Solar Roofs Initiative promises 2.1 MMT. Even greater reductions are possible with more widespread utilization of PAYD.

PAYD Insurance will give California yet another chance to reduce global warming pollution while providing California households a simple way to save money and rewarding those who choose to drive less; all while making our streets safer and cutting down on congestion. Importantly,

NRDC recommends two approaches to PAYD in California: requiring companies to offer a PAYD product to their customers, or requiring companies to verify all of their customers' miles and set usage-based rates using minimum mileage bands and performance standards set by the Department of Insurance

Alternative #1: NRDC asks the California Department of Insurance to require companies selling auto insurance in the State of California to offer a Pay As You Drive product to their customers. To meet this requirement, the PAYD product would set rates for drivers with similar risk factors based solely on mileage, as confirmed through odometer readings, and would meet basic performance standards.

Alternative #2: NRDC asks the California Department of Insurance to require companies selling auto insurance in the State of California to verify their customers' mileage and to set usage-based rates using minimum mileage bands and performance standards. The Department of Insurance should also publically recognize exemplary performance by insurance companies that deliver insurance that meets PAYD goals.

Require Auto Insurance Companies to Offer a PAYD Product to Their Customers

The proposed amendments to Section 2632.5 are a significant improvement over current practice. By permitting verification of odometer readings and the setting of rates upon those readings, the proposed regulation provides a necessary precondition for the provision of PAYD. However, by merely permitting PAYD, the regulation leaves open the question of how, or even whether, PAYD will be offered to enough California drivers to realize its environmental potential. Accordingly, to ensure PAYD policies get into the glove compartments of California drivers, we would ask that companies be required to offer a PAYD product to their customers.

As outlined in recent studies, there are a number of obstacles facing the insurance industry in offering PAYD: the administrative cost of designing new actuarial analyses, billings, marketing and consumer education; the cost of installation and maintenance of telemetric devices; and the cost of collecting mileage data from PAYD customers. While the overall savings from PAYD are substantial, only a portion of those savings actually accrue to insurance companies themselves.[1] As a result, there is currently little economic incentive for an individual insurance company to voluntarily invest in PAYD. Indeed, PAYD is not a widespread insurance offering in any state in the country.

There are also significant savings to society as a whole through the reduction of driving-related externalities (global warming pollution, poor air quality, accidents, congestion, etc). A requirement to offer PAYD would address these various

[1] Jason E. Bordoff and Pascal J. Noel, *Pay-As-You-Drive Auto Insurance: A Simple Way to Reduce Driving-Related Harms and Increase Equity*, Brookings Institution, 2008. Todd Litman, *Distance-Based Insurance Feasibility, Costs and Benefits.* , Victoria Transport Policy Institute, 2007.

market failures.[2] The California Department of Insurance could assist insurance companies by creating regulations to facilitate, and reduce the cost of, collecting odometer data.

Incentives vs Requirement
There have been some efforts in other states to offer incentives to companies to offer PAYD voluntarily. However, there is not an incentive program in the United States of which NRDC is aware that has resulted in market penetration, and thereby environmental benefit, anywhere close to what could be achieved with a requirement.

The two most commonly suggested incentives are offering tax credits for each PAYD policy and providing funding for pilot programs to kick-start PAYD.

- The Legislature of the State of Oregon has offered a $100/policy tax credit, up to a maximum of $1 million, since 2004. Whether the total tax credit is too small to move the market, or whether the criteria to meet the requirement are too limiting, to date there has not been a single credit taken. NRDC knows of no other tax credit program that has been offered and/or been effective.

- The program pilot most often referred to is the King County/Unigard program in Seattle. This pilot, funded by both King County and the Federal Highways Administration, is just now getting off the ground after years of negotiation. It is thereby impossible to say whether this pilot will result in PAYD policies. States that have run other pilots, such as Texas, do not necessarily have widespread PAYD utilization as a result (Texas' AB45, which permitted insurers to offer cents-per-mile insurance, sunset without a company offering such a program).

While neither of these incentive approaches has proven effective, they are additionally burdened by requiring action from entities outside the authority of the California Department of Insurance, thereby leaving unresolved the question of whether policies will actually be written. It is not clear, under current state budget realties, whether the Legislature would offer a sufficient tax credit package to make PAYD attractive for a company to offer.[3] Additionally, the Federal funds available for the King County credit are subject to Congressional authorization and oversight.

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[2] For a detailed discussion of externalities specifically related to auto insurance in California, see Aaron S Edlin, *Externalities and Pay As You Drive Insurance,"* California Department of Insurance Workshop, June 2008. http://works.bepress.com/aaron_edlin/62

[3] For example, to offer $150/policy to cover 2% of California's vehicle fleet with PAYD would require an $85.65 million tax credit package (*2010 total on-road vehicle estimate from California Energy Commission's 2007 IEPR)*.

Importantly, particularly with respect to California's Proposition 103, these incentives authorize entities other than the Department of Insurance to define and approve policies as PAYD. NRDC believes that the regulation of insurance in California resides with the Department of Insurance. A requirement to offer PAYD would preserve that arrangement while avoiding granting other agencies the authority to, in effect, become insurance regulators due to their control of financial incentives.

Set Rates For Drivers With Similar Risk Factors Based Solely On Mileage

Proposition 103 clearly sets forth as the second mandatory rating factor the number of miles driven annually. There is a clear and uncontested relationship between the number of miles an individual drives and that driver's crash risk. For the purposes of pricing, the mile is an easily understood unit—drivers clearly grasp the benefits and tradeoffs of driving an additional mile for a certain price. Vehicle Miles Traveled (VMT) is also the standard unit of measure with respect to transportation and land use planning and policy as it relates to climate change. Mileage is easily obtainable with minimal interference on driver privacy. For all of these reasons, NRDC believes that PAYD should be a mileage-only product.

NRDC does not contest that there are other aspects of driving behavior that have environmental impact. Travel speed, acceleration and deceleration behavior, maintenance, the weight of loads, tire inflation and other factors can improve the environmental performance of an automobile.[4] To the extent that these factors relate to crash risk, NRDC is not opposed to their consideration in a future proceeding. Our concern, however, is that the introduction of new and potentially controversial optional rating factors could prolong the rulemaking process for years, delaying the introduction of PAYD, a program demonstrated to decrease VMT and global warming pollution. NRDC is not opposed to future consideration of factors other than mileage, but would like to begin those discussions from a foundation of mileage-based PAYD. Then, if these other factors are rejected or become controversial, California is still left with mileage-based PAYD, which is, as all agree, a significant improvement over current business practice.

Require Basic Performance Standards for PAYD Policies

As a consequence of requiring companies to offer PAYD policies, the Department of Insurance would need to create criteria and performance standards by which to judge whether a given product meets the requirement. It is vital to give insurance companies as much flexibility as possible in designing and offering their PAYD product while also ensuring that PAYD policies will be accurate enough pricing signals to reward and incentivize less driving.

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[4] See http://www.fueleconomy.gov/feg/driveHabits.shtml

NRDC recommends that the Department of Insurance first provide guidelines for insurers to quantify and more accurately weight mileage to comply with Proposition 103 and any new PAYD requirement. The lack of an agreed-upon standard may be one reason that a PAYD product has not been offered to date in California. As guidance for insurers, and as a way to ensure that mileage is defined and weighted properly within PAYD, the development of these guidelines is a necessary action for the Department to take.

NRDC recommends that any PAYD product offered by California insurers include the following criteria to meet any PAYD requirement[5]:

- *Mileage Bands*: Mileage bands must be narrow enough to give drivers a clear signal of what they are paying for when they drive. Ideally, a driver would know the marginal cost of each mile they drive. However, NRDC would recommend mileage bands in the area of 100 miles and not larger than 500 miles.

- *Verification:* Regulations, like those proposed, must be in place to require the collection of odometer readings and to use those readings to set the price of insurance. At a minimum, PAYD products need to collect odometer readings at the beginning and end of policy terms to adjust premiums accordingly. However, more frequent communication of total mileage and expected premiums would likely result in greater savings for drivers and fewer vehicle miles traveled. Accordingly, companies should be permitted to offer more regular collection, verification and feedback for customers who are interested. Such communication could be facilitated if the Department of Insurance permitted third parties to verify and communicate mileage information.

- *Minimum Savings Per Mile Reduced:* For PAYD to truly function as a market-based mechanism, the price or savings from each mile must be clearly understood by the driver and be valuable enough to change behavior. A price per mile that is too low would not incentivize less driving and a cost per mile that is too high would make a PAYD product unattractive. Therefore, the Department of Insurance should determine a minimum savings per mile and require PAYD policies to be within 80% of that value to qualify as PAYD. In any case, the goal of the savings guideline would be to set a price to reduce vehicle miles traveled

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[5] For more detailed information on these performance standards, see Todd Litman, “Pay-As-You-Drive Insurance: Recommendations for Implementation,” Victoria Transport Policy Institute, 2008 (http://www.vtpi.org/payd_rec.pdf)

Alternative: Require Verification of All Mileage

As an alternative to a mandatory offer of PAYD policies, NRDC would recommend requiring insurance companies to verify the miles of all of their customers. This would be accompanied by efforts by the Department of Insurance to improve the clarity and relative weight of mileage as the second mandatory rating factor, with the goal of migrating all auto insurance in California towards a PAYD approach. Such a requirement is justified to address the same market failures outlined above for the mandatory offer recommendation.

In this alternative, PAYD would still be defined as in the mandatory offer recommendation, above: a policy that has mileage as the unit of exposure, requires verification of mileage only, has the narrowest feasible mileage bands, and has a minimum percentage of the premium tied to miles driven.

Recognize Exemplary Performance

The Department of Insurance can also incentivize insurance companies to adopt programs that put greater emphasis on variations in mileage. As has been suggested by others, the Department of Insurance could create a “Green Seal” for insurance policies that meet or exceed PAYD performance standards.

While Alternative #1 guarantees the issuance and availability of PAYD policies, Alternative #2 has the potential to affect all auto insurance policies in California, moving the overall practice of auto insurance towards a PAYD, or usage-based, approach. If Alternative #2 were adopted, NRDC would encourage the Insurance Commissioner to once again make explicit his goal of using PAYD to decrease driving and combat global warming pollution.

NRDC very much appreciates the work the Department of Insurance has done thus far to promote PAYD insurance. If you have any questions or would like any additional information, please do not hesitate to contact Justin Horner, Policy Analyst, at 415-875-6166 or at jhorner@nrdc.org.

Sincerely,

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