John Locke Foundation

spotlight

No. 432 – March 26, 2013

N.C.'s Auto Insurance System

Seven Things to Understand

KEY FACTS: **• North Carolina's automobile insurance system guarantees profits to insurers.**

• North Carolina's current system makes it difficult—and undesirable—for insurers to offer innovative new products in the state.

• Residents across the Southeast states pay relatively low rates for automobile insurance; there's no evidence that North Carolina's system provides cheaper average rates than systems in other nearby states.

• North Carolina's automobile insurance system imposes a special tax on all drivers in order to subsidize coverage for risky drivers.

• More than a fifth of North Carolina drivers cannot find a private insurer willing to write them liability coverage.

• State regulation does not keep auto insurance rates in North Carolina lower than those in other states.

• Currently pending legislation still gives the insurance commissioner authority over most rate requests and would not result in significant short-term rate increases for anybody.

200 W. Morgan, #200
Raleigh, NC 27601
phone: 919-828-3876
fax: 919-821-5117
www.johnlocke.org

more >>

1 North Carolina's automobile insurance system guarantees profits to insurers.

North Carolina's current automobile insurance system makes it literally impossible for insurers to lose money. Not only is the commissioner required to assure that they earn a reasonable rate of return, but insurers set their rates collectively through a legally mandated, but privately run organization, the North Carolina Rate Bureau. Under the law, they have the legal right to "cede" any policies they feel won't make money to a special reinsurance facility that's subsidized through the clean risk surcharge. Although it's not visible to consumers, the rate bureau system also serves to reduce other methods that insurers might use to compete with each other by distinguishing risky drivers from less-risky ones. Since all insurers use the same fundamental rate plan, there's far less opportunity for insurers to try new ways of managing risks. The overall results are pretty good for the insurance business (which is why some insurers, including the state's largest, defend the current system) but bad for consumers.

2. North Carolina's current system makes it difficult—and undesirable—for insurers to offer innovative new products in the state.

Because it imposes a one-size-fits-all system for auto insurance, consumers in the state can't choose many insurance products that are widely available elsewhere. North Carolinians can see these products described in the litany of national television ads for auto insurance, a market that in most states is highly competitive. In recent years, insurers have rolled out policies with deductibles that drop the longer you avoid an accident, policies that offer discounts for drivers with good credit, policies that give regular rebate checks, policies that offer deep discounts to those who provide real-time driving data to their insurer, and many other features. If the market for autos worked the way North Carolina's market for auto insurance does, Ford, Chrysler, and General Motors, along with all of the foreign car makers, would get together to define what their product – a "car" – should be. They would determine how big it can be, how fast it can go, what color it should be, even how many cup-holders it can have. That sort of market can hardly be described as "competitive," no matter how many companies are in it.

3. Residents across the Southeast states pay relatively low rates for automobile insurance; there's no evidence that North Carolina's system provides cheaper average rates than systems in other nearby states.

Taken as a whole, North Carolina's auto insurance rates are relatively low, but that's because rates in North Carolina are typical of those in surrounding states. According to data compiled by the website insure.com, North Carolina and the states that it borders have rates several hundred dollars below the national average. According to insure.com, average six-month rates in North Carolina ($511) and South Carolina ($554) are virtually the same. So are rates in Tennessee ($614) and Virginia ($648). Rates change from year to year. While North Carolina had lower rates than its neighbors in 2012, it had the second highest rates of that group of states in 2011. Quite simply, there's no evidence that North Carolina's system provides cheaper average rates than systems in other nearby states.

4. North Carolina's automobile insurance system imposes a special tax on all drivers in order to subsidize coverage for risky drivers.

North Carolina's auto insurance system imposes a special tax called a "clean risk surcharge" that helps subsidize rates for high-risk drivers. As a result of this surcharge and other government red tape, the least risky drivers—who tend to be older and female—pay *far more* than they do for auto insurance in similar states. On the other hand, risky drivers pay less than they do elsewhere. This is the opposite of how insurance is supposed to work.

5. More than a fifth of North Carolina drivers cannot find a private insurer willing to write them liability coverage.

All 50 states and the District of Columbia maintain "residual" insurance markets for drivers who cannot find automobile insurance from a private carrier. In most states, these markets are extremely small and are mostly made up of repeat drunk drivers and others with truly awful driving records. Because of burdensome regulations, however, North Carolina has more drivers in its residual market than all other states **combined**. In fact, 81 percent of all drivers in residual markets in the United States live in North Carolina. This shows that the current system just isn't working the way it should.

Jurisdiction	Number of Residual Market Policies	Percentage of drivers in the market (%)
Virginia	915	.015
North Carolina	1,543,260	21.61
South Carolina	1	.0000003
Tennessee	15	.000004
United States	**1,899,121**	**1.003**

Source: Automobile Insurance Plans Service Office, 2010

6. State regulation does *not* keep auto insurance rates in North Carolina lower than those in other states.

Auto insurers must, at least, break even in order to keep doing business in a state. No matter what regulators do, so long as a market is competitive, average premiums collected for automobile insurance will tend to roughly equal the cost of doing business. Over any given ten-year period, in fact, property and casualty insurers as a whole will collect in premiums about what they pay out in claims and expenses; they make their profits primarily by investing premium dollars. Rates in North Carolina and other nearby states are lower than the national average for a variety of reasons, including caps on tort damages, reasonably tight enforcement of vehicle safety standards, demographics, and relatively low traffic density. Moreover, insurers who find they cannot justify offering collision or comprehensive physical damage coverage to particular drivers at the rates set by the Rate Bureau will typically ask those consumers to sign a Consent to Rate Form, which allows the company to charge higher rates.

7. Currently pending legislation still gives the insurance commissioner authority over most rate requests and would *not* result in significant short-term rate increases for *anybody*.

Whatever their merits—or demerits—reform proposals currently before the legislature would not result in significant short-term rate increases for any drivers. Insurers would compete more vigorously for the least risky drivers, and this might eat into some of the profits the current system guarantees them. But even risky drivers who currently receive subsidies from everyone else—so called "clean risks"—would not see massive rate increases. The insurance commissioner would retain the power to deny rates that are excessive, insufficient or discriminatory. The only difference would be that, when an insurance company requests a rate increase of less than 12 percent, the commissioner would have to demonstrate a reason to challenge that request. Moreover, the best estimates we have are that even "clean risk" drivers would see their rates increase by only about $1.50 per month immediately following the reforms.

Alan Smith is co-founder, Midwest director, and a senior fellow for the R Street Institute

R.J. Lehmann is senior fellow, public affairs director and co-founder of R Street.