

# NORTH CAROLINA GENERAL ASSEMBLY

## LEGISLATIVE RESEARCH COMMISSION

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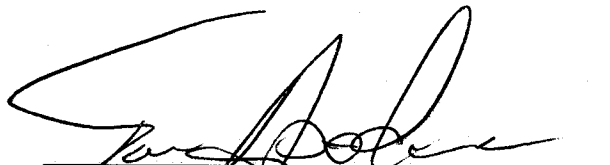
RALEIGH, NC 27601




April 10, 2012

TO THE MEMBERS OF THE LEGISLATIVE RESEARCH COMMISSION:

Attached for your consideration is the report to the 2012 Regular Session of the 2011 General Assembly. This report was prepared by the Legislative Research Commission's Committee on Automobile Insurance Modernization, pursuant to G.S. 120-30.17(1).

  
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Senator Thomas Apodaca  
Co-Chair

  
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Representative Fred Steen  
Co-Chair

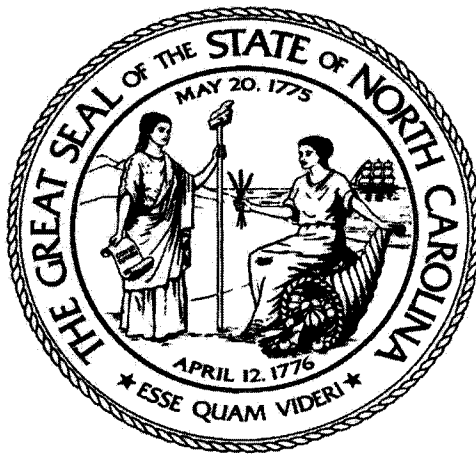
Co-Chairs  
Committee on Automobile Insurance Modernization  
Legislative Research Commission

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LEGISLATIVE RESEARCH COMMISSION

**AUTOMOBILE INSURANCE  
MODERNIZATION COMMITTEE**

**NORTH CAROLINA GENERAL ASSEMBLY**



**REPORT TO THE  
2012 SESSION  
of the  
2011 GENERAL ASSEMBLY  
OF NORTH CAROLINA**

**MAY 8, 2012**

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## TRANSMITTAL LETTER

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May 8, 2012

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TO THE MEMBERS OF THE 2012 REGULAR SESSION  
OF THE 2011 GENERAL ASSEMBLY

The Legislative Research Commission herewith submits to you for your consideration its report and recommendations to the 2012 Regular Session of the 2011 General Assembly. The report was prepared by the Legislative Research Commission's Committee on Automobile Insurance Modernization, pursuant to G.S. 120-30.70(1).

Respectfully submitted,

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Senator Philip E. Berger  
President Pro Tempore of the Senate

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Representative Thomas R. Tillis  
Speaker of the House of Representatives

Co-Chairs  
Legislative Research Commission

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## LEGISLATIVE RESEARCH COMMISSION MEMBERSHIP

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2011 – 2012

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Co-Chair

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Acting Co-Chair

Senator Peter S. Brunstetter  
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Senator Martin L. Nesbitt, Jr.  
Senator Richard Y. Stevens

**Speaker of the House of Representatives**

Representative Thomas R. Tillis  
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Representative Timothy K. Moore  
Acting Co-Chair

Representative John M. Blust  
Representative Justin P. Burr  
Representative Mike D. Hager  
Representative Edith D. Warren

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## PREFACE

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The Legislative Research Commission, established by Article 6B of Chapter 120 of the General Statutes, is the general purpose study group in the Legislative Branch of State Government. The Commission is co-chaired by the President Pro Tempore of the Senate and the Speaker of the House of Representatives and has five additional members appointed from each house of the General Assembly. Among the Commission's duties is that of making or causing to be made, upon the direction of the General Assembly, "such studies of and investigation into governmental agencies and institutions and matters of public policy as will aid the General Assembly in performing its duties in the most efficient and effective manner" (G.S. 120-30.17(1)).

The Legislative Research Commission authorized the study of Automobile Insurance Modernization, under authority of G.S. 120-30.17(1). The Committee was chaired by Senator Thomas Apodaca and Representative Fred Steen, Co-Chairs of the Committee. The full membership of the Committee is listed under [Committee Membership](#). A committee notebook containing the committee minutes and all information presented to the committee will be filed in the Legislative Library by the end of the **2011-2012** biennium.

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## COMMITTEE PROCEEDINGS

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The Legislative Research Commission's (LRC) Committee on Automobile Insurance Modernization met 4 times after the 2011 Regular Session. The Committee's Charge can be found [here](#). The following is a brief overview of the Committee's proceedings. Detailed minutes and information, including handouts and written remarks from each Committee meeting, are available in the Legislative Library.

For a brief overview of the current law governing the automobile insurance rate-making process, please see the Findings and Recommendations Section of this report.

**Tuesday, December 6, 2011**

The first meeting of the LRC Automobile Insurance Modernization Committee took place on Tuesday, December 6, 2011 at 9:00 AM in Room 1228 of the Legislative Building. The Committee heard the following presentations:

- **Ms. Rose Vaughan Williams, Legislative Counsel, N.C. Department of Insurance**, maintained that under the current system, the State has rates among the lowest in the nation. Ms. Williams also noted the stability of the current market, appropriate market concentrations, and the relatively low number of uninsured drivers in the State. Moreover, competition among insurers is plentiful as exemplified by the large number of companies writing in the State.
- **Mr. Raymond Evans, General Manager, N. C. Rate Bureau and the N.C. Reinsurance Facility** gave an overview of the North Carolina Rate Bureau, the Safe Driver Insurance Program, the Reinsurance Facility and the clean risk subclassification within the Facility.
- **Ms. Sue Taylor, Director of Insurance Operations, N.C. Rate Bureau**, discussed the automobile ratemaking process. In her presentation, Ms. Taylor noted that the Bureau has the responsibility to analyze and propose fair and adequate rates for automobile policy holders in the State and must submit a filing to the Department of Insurance for auto insurance rates by February 1<sup>st</sup> of each year. The Department of Insurance reviews the filing and the Commissioner of Insurance approves or disapproves the filing. Insurers then take the approved rate and apply their underwriting criteria and possible downward deviations for discounts from the approved rate. Upward deviations from the approved rate are not allowed.
- **Mr. Evans** discussed the Safe Driver Incentive Plan. Mr. Evans noted the Plan, which is required by statute, attempts to apportion losses among all drivers by requiring those drivers with losses to pay higher premiums. Mr. Evans also provided background information on the N.C. Reinsurance Facility. He noted that, like the Rate Bureau, the Facility is not a state agency and does not lobby. The Facility was created because N.C. is a mandatory liability state, meaning that all drivers in NC must have liability insurance and insurers must provide liability

insurance and other required coverages to all eligible risks in the State who seek insurance from them. Insurers are able to cede those risks which they would prefer not to insure to the Facility.

- **Ms. Edith Davis, Director of Operations, N.C. Reinsurance Facility**, provided the Committee an overview of the Facility. With regard to the size of the Facility, Ms. Davis indicated that twenty-one percent of all N.C. exposures are reinsured by the Facility. There are three distinct populations in the Reinsurance Facility. The smallest one is Commercial, including trucks, vans and vehicles. The next is "other-than-clean risks". The State allows the Facility to file rates for that population. This rate is known as the Facility rate. The third population in the Facility is known as "clean risks." Clean risks in the Facility pay rates equal to voluntary rates filed by the Rate Bureau and approved by the Commissioner. The Facility is authorized to receive the proceeds of a "clean risk surcharge," which is the difference between the actual rate charged and the actuarially sound and self-supporting rate for clean risks in the Facility. The surcharge, which averages approximately \$17 per car annually, is collected from all insured in the State by insurers.
- **Mr. Tim Hovis, Staff Attorney, Research Division** gave an overview of legislation considered during the 2011 Session on this issue. Mr. Hovis noted two proposals filed during the 2011 Session: (1) SB490, Automobile Insurance Regulatory Modernization, which would implement a "flex band" rating system in which rate filings submitted by individual insurers increasing or decreasing rates no more than set percentage are deemed to meet the required standard necessary for approval; and (2) HB834/SB 477, Reduce Overpopulation of the Reinsurance Facility, in which upward deviations filed by insurers up to the approved Facility rate are allowed and are presumed to meet the required standard necessary for approval. Mr. Hovis reviewed and compared the two bills. **See Appendix D, Attachment 1, Comparison of SB490 and HB834/S477.**
- **Ms. Williams** was recognized for closing comments. Ms. Williams reiterated the Departments' opposition to changes in the current automobile insurance system. She pointed out that, while some out-of-state auto insurance companies support reform, not all insurers are in favor of these proposals. The Department believes these reforms to the current system are being promoted to allow auto insurance companies to charge higher premiums to drivers. As noted by Ms. Williams, the law already allows downward deviations from the approved rate. Moreover, savings to drivers from the elimination of the recoupment surcharge would be small compared to the increased rates all drivers would be required to pay under the proposed reforms.

**Wednesday, January 25, 2012**

The second meeting of the LRC Automobile Insurance Modernization Committee was held on Wednesday, January 25, 2012 at 9:00 am in Room 1228 of the Legislative Building. At this meeting, the Committee heard several presentations given by insurance industry representatives and others. Speaking in favor of reform to the current system were the following:

- **Mr. Steve Pociask, President, American Consumer Institute**, referenced two primary factors related to the current system: (1) hidden fees brought on because of the residual market (the Reinsurance Facility); (2) the lack of competition in the industry due to the rate approval process centered around the Rate Bureau. Mr. Pociask argued that both factors lead to higher cost for consumers. He indicated that current regulations are anti-consumer because they protect the current market instead of encouraging price competition. Changing the current Rate Bureau system would encourage price competition by giving insurers increased rate flexibility.
- **Mr. John McMillan, Insurance Federation of North Carolina**, noted that every state has some sort of residual or shared market with respect to automobile private passenger liability insurance. This residual market was created to protect other drivers, not just the insured. North Carolina's residual market, the Reinsurance Facility is very large compared to other states and is listed in the Insurance Fact Book as having 80% of the entire residual market for the country. Mr. McMillan pointed out that North Carolina is the only state with a Rate Bureau that proposes a base rate for all the drivers in the state. Because companies do not have the opportunity to deviate upwards, the only alternative a company has is to cede insureds to the Reinsurance Facility if the Bureau approved rate is insufficient. Senate Bill 477/HB834 would allow companies to file deviations up to the Facility approved rate. With this change, many policies that would have been ceded to the Facility would be retained by the companies. In addition, because "clean risks" ceded to the Facility can only be charged the Bureau approved rate, the bill would eliminate the clean risk subclassification in the Facility. Doing so would allow those drivers to be charged an actuarially sound rate and eliminate the need for the clean risk surcharge. Mr. McMillan agreed that N.C. does have good liability rates, but these rates are due primarily to the cost of living, tort laws and other factors unique to North Carolina.
- **Ms. Liz Reynolds, State Affairs Manager, National Association of Mutual Insurance Companies (NAMIC)**, referenced the work done following the 2011 Session by NAMIC and the Property Casualty Insurance Association of America (PCI) to bring together a coalition of insurers (FAIR NC Coalition) to find an approach to improve an outdated, inefficient, and unfair auto insurance system.
- **Mr. Dave Stoller, State Farm and FAIR NC Coalition**, presented the FAIR NC proposal. Mr. Stoller stressed that the proposal would not change the State's regulation of market conduct, financial solvency, licensing, or other regulatory systems. It also would not eliminate the Rate Bureau or the Reinsurance Facility or the Commissioner's ability to approve rates. Noting the size of the State's residual market and the clean risk classification within the Facility, Mr. Stoller indicated that the Coalition's proposal would do three things: (1) eliminate the clean risk classification and the recoupment surcharge over five years by moving these drivers gradually to a fair rate; (2) allow companies the option of staying within the Rate Bureau system or, in the alternative, moving to a "flex band" rating system; and (3) implements a "flex band" system that presumes that rate filings within a certain limit set by statute are acceptable. This would allow rates to be adjusted quickly and in small increments as market forces change. Mr.

Stoller concluded by saying that, while N.C.'s rates are relatively low, they are not among the lowest. He stressed that there was no casual connection between the approved maximum rate or rate cap set by the Commissioner and the average rate paid by consumers. N.C.'s low average rates are a function of the State's tort system, safe roads, and other factors. Finally a flex band system would allow reduce costs, allow larger discounts, lead to more innovative products, and increase the number of insurers, leading to more competition among insurers.

The following speakers made remarks in opposition to changes proposed to the General Assembly and the Committee:

- **Mr. R. Lee Morton, Regional Vice President/N.C. Operations, Nationwide Insurance**, began his remarks by stating that if SB 490 or similar legislation implementing a flex band system were enacted in N.C. approximately 992,000 clean risks presently assigned to the Reinsurance Facility would see an increase in their automobile insurance premium by an average of \$150/policy. Moreover, the Commissioner of Insurance will lose his authority to prevent automatic rate hikes for consumers who by state law are required to buy automobile liability insurance. Additional unintended consequences include the following: (1) rate stability would no longer exist; (2) common policies and forms submitted by the Rate Bureau and approved by the Department would be replaced by individual company policies and forms; (3) the number of uninsured motorists would rise because of higher insurance premiums, resulting in increased premiums and costs for all; and (4) markets for other lines of insurance, such as property insurance, may be affected by these changes. Mr. Morton concluded by noting that, under current law, insurers can already discount rates and the State already has among the lowest rates in the country.
- **Steve Carroll, Executive Vice President and General Manager, N.C. Farm Bureau Mutual Insurance Company** noted that automobile liability insurance is a statutorily mandated coverage as much, if not more, for the protection of the public as for the insured driver. With this in mind, the N. C. Reinsurance Facility was created to enable all drivers to purchase liability insurance. Mr. Carroll made the following points concerning the current Rate Bureau system: (1) the current system provides a large data pool which facilitates accurate and predictable rates; (2) appeals of rate making decisions are pursued by one entity rather than a multitude of individual companies; (3) forms under the current system are uniform leading to less consumer confusion in the purchase of auto insurance; (4) current rates are competitive nationally as exemplified by the number of companies in the State and the number of discounts offered to consumers; (5) the current system emphasizes good underwriting and risk selection which is particularly important for small companies and state insurers competing with large national carriers.
- **Glenn Jernigan, Registered Lobbyist, GMAC Insurance** noted that while N.C.'s system may be unique, it works. This is evidenced by the fact that it currently produces the 8<sup>th</sup> lowest rates in the nation. Mr. Jernigan asked if the potential savings of approximately \$17.00 per year through elimination of the

recoupment surcharge be worth the risk of allowing insurance companies to increase their overall rates by as much as 15% every 365 days, with little or no ability to block these rate increases. Changes to the current system could translate into significant increases in premiums for drivers who need vehicles to get to work, to transport their children and for other uses. In conclusion, Mr. Jernigan maintained that neither consumers nor the Commissioner were asking for changes in the current automobile system. Rather, changes were motivated by a desire for higher rates.

- **Jeff Butler, President Able Auto/Cycle Insurance Inc., Vice President of Alliance of Agents of N.C.** began by recounting his conversations with consumers who, when told the rationale for the recoupment surcharge, did not object to the surcharge. He believed the current system to be a good one that allows companies to look at the risk posed by applicants and to decide whether to write the risk or cede it to the Facility. Clean risks are ceded to the facility because the company does not believe it will be able to make a profit providing insurance to that applicant. Mr. Butler noted that a clean risk is not someone who does not have any violations, but is someone who does not have any violations for which insurance points can be charged. If the clean risk classification is eliminated then almost 1 million people will see rate increases. Mr. Butler noted that, under a flex rating system, rate increases by insurers are limited to a set percentage annually in the aggregate. This means that some individual insureds will see increases much larger than the set percentage. Mr. Butler concluded by noting that competition has never been stronger in the State than it is today and any changes in the current system will only raise the rates in N.C.

Following the presentations in favor of and opposing reforms, Mr. **Eli Lehrer, Vice President of the Heartland Institute**, addressed the Committee. A short summary of his remarks is provided below:

- Mr. Lehrer began by explaining that he did not speak for any company or individual, but was a proponent of a free market system. He made the following points: (1) in his opinion, rates are average in N.C. and no reform is going to greatly raise or lower rates; (2) the Facility is a way of assuring that companies cannot lose money writing auto insurance in N.C.; (3) because of the current Rate Bureau process, the more innovative and interesting products offered by the auto insurance industry are not sold in the State; and (4) the residual market (the Reinsurance Facility) in N.C. is enormous, with seventy-eight percent of all drivers in the country who are in a residual market, and serves as a subsidy for insurance companies. Mr. Lehrer concluded with the following: (1) the Rate Bureau is expensive and anachronistic and insurers should have to take responsibility for their own rates; (2) Second, the range of rating factors allowed should be expanded and sex, for example, should be allowed as a rating factor; (3) insurers will offer innovative and new products if allowed to file their own rates; and (4) abolishing the Facility may be disruptive in the short term, but it should be phased out and profit guarantees eliminated.

**March 6, 2012**

At the third meeting of the LRC Automobile Insurance Modernization Committee, the Committee began with a presentation by **Mr. Tim Hovis, Staff Attorney, Research Division**. Mr. Hovis discussed a chart comparing the FAIR NC Bill and SB 477/HB 834, and gave an overview of issues presented at the January 25<sup>th</sup> meeting of the Committee. **See Appendix D, Attachment 2**. In the chart comparing the two legislative proposals, Mr. Hovis noted that the FAIR NC proposal gives insurers the option of remaining under the jurisdiction of the Rate Bureau or opting out of the current system and filing rates directly with the Commissioner through a new "Flex Rating" band system. Under this system, rate filings by individual insurers increasing or decreasing rates no more than 12% aggregated for all insurers are deemed to meet the necessary standard and are approved upon filing.

Mr. Hovis next referred to that portion of the chart addressing SB477/HB834. As noted in previous meetings, this proposal leaves the Rate Bureau jurisdiction intact and allows individual insurers to file upward deviations with the Commissioner. Deviations filed by individual insurers up to the rate charged by the Reinsurance Facility are presumed to meet the necessary standard. Currently, the Facility rate is approximately 20 to 30% higher than the Rate Bureau base rate. **See Appendix D, Attachment 2, Comparison of FAIR NC Bill and SB 477/HB 834**.

The final page of Mr. Hovis' report is an "Overview of Issues" from the January 25<sup>th</sup> meeting. He reminded the Committee that the list is not an exhaustive list, but is a compilation of the major points made by presenters. **See, Appendix D, Attachment 2**.

After discussion and debate on the issue of reform, the Committee agreed not to recommend specific legislation but to note areas in which there was agreement and recommend further study of this complicated issue.

#### *Technology to Detect Uninsured Motorists*

The Committee then turned to the issue of uninsured motorists. Chairman Apodaca noted that he had received several complaints from constituents about the statutory requirement for uninsured motorist coverage and the premium charged for this coverage. Specifically, he wanted the Committee to hear about the use of technology to detect uninsured drivers.

**Ms. Amy Jo Johnson, Staff Attorney, Research Division**, presented draft legislation, Technology to Catch Uninsured Motorists. She described the current system in place for identifying drivers who have a lapse in financial responsibility. Ms. Johnson then explained that the draft proposal would direct the use of electronic verification systems as a means for identifying vehicles without financial responsibility and make other adjustments to Article 13 of Chapter 20: The Financial Responsibility Act. In doing so, the process of notifying individuals when the Division of Motor Vehicles is made aware of a potential lapse would be modified and the civil penalty for a lapse of financial



responsibility would be increased to \$300.00. The bill draft would direct a revocation of the vehicle's driver license in addition to the current penalty of title revocation and remove the misdemeanor criminal penalty for lack of financial responsibility. The draft proposal would also modify the appeals process.

Brian Weibel, C.N.A. G.S.E.C., FDI Group, made a presentation on the technology associated with electronic verification systems. He explained Automatic License Plate Recognition (ALPR) technology as well as the National Law Enforcement Technology System (NLETS), both of which are currently in use and combine with the electronic verification system implemented in the draft proposal.

Following discussion of the developing technology in this area and the draft proposal, Chairman Apodaca stated that the Committee would continue to discuss the issue and monitor the development of technology to detect uninsured motorists.

### *Diminished Value*

Chairman Apodaca introduced Ms. Rose Vaughn Williams, Legislative Counsel, Department of Insurance to review the law on diminished value. Ms. Williams explained that the term "diminished value" refers to those situations in which a car has been damaged in an accident and then repaired. Often, even after repair, the resale value of the vehicle may be less than if it had not been damaged. The damage results in a reduction or diminution in the resale value of the car. In North Carolina, there is no statute that sets out that there is right to a third party diminished value claim when a car is damaged by the negligence of a third party. The right to assert a claim is not in statute, but exists in the "common law." In Chapter 20, the North Carolina statutes do require liability policies to include a process for how certain claims for diminution in value can be resolved if who is at fault for the accident is not an issue. Ms. Williams then explained this process. Ms. Williams also noted that both the case law and the pattern jury instructions given by judges in N.C. assumes there is a right to assert a claim for diminished value in third party claims. The N.C. Administrative Code does have one brief reference to diminution in value for third party claims.

The right to make a claim against your own insurance company, a "first party claim" does not exist clearly in contracts of insurance, however. When looking at other state's laws on this issue, Ms. Vaughn Williams of the 23 states who responded to the Department's survey on this issue, only Louisiana had a written law governing diminished value claims and it applied only to third party claims. Many states are like North Carolina in that their law on diminished value claims is in the common law, not in statute, and there is no clearly recognized claim for diminished value in first party claims.

**April 10, 2012**

At its fourth and final meeting prior to the 2012 Short Session, the Committee voted to approve its report and forward the report to the Legislative Research Commission.



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## FINDINGS AND RECOMMENDATIONS

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### BRIEF OVERVIEW OF CURRENT LAW

Article 36 of Chapter 58 requires the N.C. Rate Bureau to file rates and rating plans for nonfleet private passenger motor vehicle insurance jointly for all insurers with the Commissioner for approval. Current law allows individual insurers to deviate from the approved base rate if the deviation is also approved by the Commissioner. Companies can deviate downward from the base rate, but upward deviations are not allowed.

An insurer cannot deny auto insurance coverage to eligible risks. However, insurers may cede to the N.C. Reinsurance Facility any eligible risk it chooses for liability and other required coverages. The Facility is required to establish a separate classification for owners and operators who are "clean risks." Basically, a clean risk is someone who has at least two years of driving experience and does not have a violation for which insurance points may be charged in the preceding three years.

The rates for clean risks may not exceed the maximum rate approved by the Commissioner for clean risks outside of the Facility. The difference in an actuarially sound rate for clean risks in the Facility and the rate actually charged to these clean risks is recouped by a surcharge on all policies in the State, known as the "recoupment surcharge."

For drivers other than clean risks (i.e. drivers with insurance points) who are ceded to the Facility, the Facility files with the Commissioner a "Facility rate." The Facility rate serves as the base rate for these drivers ceded to the Facility and is approximately 20 to 30% higher than the base rate approved by the Commissioner for clean risks.

### BACKGROUND

Over the course of four meetings, the Committee heard from a number of speakers concerning reform of the current system. Reform proposals submitted to the Committee included the following: (1) a proposal to give insurers the option of using a "flex band" rating system in which rate filings submitted by individual insurers increasing or decreasing rates no more than set percentage are deemed to meet the required standard necessary for approval; and (2) a proposal in which upward deviations filed by insurers up to the approved Facility rate are allowed and are presumed to meet the required standard necessary for approval. See **Appendix D, Attachment 2, Comparison of FAIR NC Bill and HB834/S477**.

Arguments raised by these presenters in favor of and in opposition to these proposals are discussed below.

### *Arguments Supporting Reform*

Of concern to many in support of change was the size of the N.C. Reinsurance Facility which was cited as representing 80% of the residual market in the country with a population of almost 1.4 million. Because of the Facility's size and the fact that rates for clean risks in the Facility cannot exceed the approved Bureau rate, all drivers in the State must pay a "recoupment surcharge." As argued by many in favor of reform, this surcharge is a hidden subsidy of riskier drivers paid for by safe drivers. Elimination of the surcharge is cited as a major reason for reducing the population of the Facility.

In addition, as an argument for change, many presenters pointed to the current Rate Bureau system as antiquated and providing a mechanism for information sharing and collusive price setting by insurers. Because upward deviations from the base rate are not allowed, the base rate approved under the current system operates as a cap on rates. Moreover, the current system of group filing through the Rate Bureau does not encourage individual insurers to offer the most innovative products. In short, in their opinion, the current system protects the market share of insurers and does not allow for maximum competition.

Many supporting change acknowledged that the State's current rates are relatively low. However, those supporting reform attribute these lower rates to other factors such as State's cost-of living, tort laws, and safe roads.

In short, reform of the current system would eliminate the need for the surcharge, allow for greater competition and reduced rates, and lead to more innovative products.

### *Arguments Opposing Change*

With regard to the Reinsurance Facility, many opposing reform of the current system pointed out that, under current law, automobile liability coverage is required for all drivers in the State. The purpose of the Facility is to encourage all drivers to comply with current law and acquire liability coverage. If the current system were changed and the Facility depopulated by elimination of the clean risk classification, approximately one million clean risks currently in the Facility will see an increase in premiums. According to those opposed to reform, because of this increase, fewer drivers will purchase insurance leading to an increase in the number of uninsured drivers and, ultimately, an increase in costs for all drivers.

On the issue of increased competition, those opposed to reform pointed to the large number of insurers in the State and the availability of discounts as evidence of a strong and competitive auto insurance market. Insurers are free under the current system to discount rates if they choose to do so. Moreover, those opposed to reform believe rates approved under the current system are among the lowest in the country and are particularly low when compared to other populated states.

Moreover, opponents maintain that if the current system were changed to allow for individual filings by companies, common policies and forms would no longer be used and consumers would no longer be able to compare rates and coverages between companies, leading to increased confusion on the part of consumers.

Other reasons cited by those opposed to change included the following: (1) rates in the automobile insurance market would no longer be stable and could have an unintended impact on other lines of insurance; and (2) any savings to consumers from the elimination of the clean risk classification and discontinuance of the surcharge would be small compared to potential rate increases if the current system were reformed.

## **FINDINGS AND RECOMMENDATIONS**

**Recommendation I:** The Committee finds that proposals to reduce the population of the Reinsurance Facility and thereby reduce or eliminate the recoupment surcharge should be considered. Moreover, the Committee agrees that price competition between insurers benefits consumers and should be promoted. However, the Committee finds that reform of the current system should not create confusion among consumers or increase the number of uninsured drivers.

Understanding that this is a complex issue, the Committee recommends that the 2013 General Assembly build upon the information and proposals discussed in these meetings and enact legislation providing for a smooth and measured transition from the current system for automobile insurance rate regulation to a system more reliant on free market principles that reduces the population of the Facility, eliminates the need for the hidden recoupment surcharge, encourages competition, and also allows for more innovative products and benefits for the consumer.

**Recommendation II:** As noted in the Proceedings section of this report, at its meeting on March 6, 2012, the Committee heard presentations concerning the use of electronic verification systems as a means of identifying vehicles without the financial responsibility required pursuant to G.S. 20-309. It was explained in these presentations that technology currently in place in North Carolina, such as Automatic License Plate Recognition (ALPR) and the National Law Enforcement Technology System (NLETS), has the ability to combine with cutting-edge electronic verification technology and equipment for law enforcement agencies to enhance the detection of these uninsured motorists efficiently.

As reflected in the Committee's discussion of reforms to the automobile insurance system noted in Recommendation I of this report, uninsured motorists increase costs for all drivers in our State. The Committee finds that emerging technology to detect uninsured drivers may prove beneficial in addressing this problem and recommends that the General Assembly continue to monitor the development of technology to detect uninsured motorists.

**Recommendation III:** The Committee also discussed the issue of diminished value at its meeting on March 6, 2012. As explained at that meeting, the term "diminished value" refers to those situations in which a car has been damaged in an accident and then, after repair, the resale value of the vehicle is still less than if it had not been damaged. The damage results in a reduction or diminution in the resale value of the car.

The right to assert a third party claim of diminished value against another driver is recognized in North Carolina's common law, but does not exist in statute. For this reason, the Committee considered whether some insurers have been reluctant to compensate drivers for diminished value in third party claims. In such instances, often, drivers must aggressively pursue such claims to obtain relief.

The Committee finds that legislative action may be needed to improve the efficient and reasonable administration, payment, and processing of claims of diminished value and recommends that the General Assembly continue to study this issue, including the possible implementation of statutory provisions recognizing a claim of diminished value.

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## COMMITTEE MEMBERSHIP

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2011-2012

**President Pro Tempore of the Senate**  
**Appointments:**

Senator Thomas Apodaca, Co-Chair

Senator Richard Gunn  
Senator Eleanor Kinnaird  
Senator Robert Rucho

**Speaker of the House of Representatives**  
**Appointments:**

Representative Fred Steen, Co-Chair

Representative Justin Burr  
Representative Susi Hamilton  
Representative Harry Warren  
Representative Jerry Dockham

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## COMMITTEE CHARGE

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**Automobile Insurance Modernization** – (a) Study issues relating to the method and manner of establishing automobile insurance rates in North Carolina, to ensure consumers are receiving the fullest possible benefit from marketplace competition among insurers on pricing, product, and coverage options. The study may include, but is not limited to, review of the insurance regulatory systems in other states; model laws and recommendations of the National Association of Insurance Commissioners and the National Conference of Insurance Legislators, the North Carolina Rate Bureau, the North Carolina Reinsurance Facility, and the Safe Driver Incentive Program; current and proposed restrictions and regulations on automobile insurance pricing, underwriting, and related issues; the method and effectiveness of assuring voluntary and involuntary automobile insurance markets; and the effect of modernizing the automobile insurance regulatory system upon the revenues, expenses, and operations of the Department of Insurance and the State of North Carolina; and the use of electronic verification systems by law enforcement agencies and officers to electronically identify motor vehicles operating on the public streets and public vehicular areas without financial responsibility as required pursuant to G.S. 20-309.

(b) Study issues related to enforcement and administration of safety and emissions inspection requirements set forth G.S. 20-183.2, et seq. The study may include, but is not limited to, review of current penalties assessed against motor vehicle owners, safety inspection station licensees and emission inspection licensees; review of new technologies available to increase the efficiency and effectiveness of the Department of Motor Vehicles' enforcement of inspection requirements; and review of the appeals processes governing the issuance, suspension and revocation of any of safety and/or emissions licenses issued by the Division and any fines assessed thereby.



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## STATUTORY AUTHORITY

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### NORTH CAROLINA GENERAL STATUTES ARTICLE 6B.

#### **Legislative Research Commission.**

##### **§ 120-30.17. Powers and duties.**

The Legislative Research Commission has the following powers and duties:

- (1) Pursuant to the direction of the General Assembly or either house thereof, or of the chairmen, to make or cause to be made such studies of and investigations into governmental agencies and institutions and matters of public policy as will aid the General Assembly in performing its duties in the most efficient and effective manner.
- (2) To report to the General Assembly the results of the studies made. The reports may be accompanied by the recommendations of the Commission and bills suggested to effectuate the recommendations.
- (3), (4) Repealed by Session Laws 1969, c. 1184, s. 8.
- (5), (6) Repealed by Session Laws 1981, c. 688, s. 2.
- (7) To obtain information and data from all State officers, agents, agencies and departments, while in discharge of its duty, pursuant to the provisions of G.S. 120-19 as if it were a committee of the General Assembly.
- (8) To call witnesses and compel testimony relevant to any matter properly before the Commission or any of its committees. The provisions of G.S. 120-19.1 through G.S. 120-19.4 shall apply to the proceedings of the Commission and its committees as if each were a joint committee of the General Assembly. In addition to the other signatures required for the issuance of a subpoena under this subsection, the subpoena shall also be signed by the members of the Commission or of its committee who vote for the issuance of the subpoena.
- (9) For studies authorized to be made by the Legislative Research Commission, to request another State agency, board, commission or committee to conduct the study if the Legislative Research Commission determines that the other body is a more appropriate vehicle with which to conduct the study. If the other body agrees, and no legislation specifically provides otherwise, that body shall conduct the study as if the original authorization had assigned the study to that body and shall report to the General Assembly at the same time other studies to be conducted by the Legislative Research Commission are to be reported. The other agency shall conduct the transferred study within the funds already assigned to it.

## SUPPORTING DOCUMENTATION

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### ATTACHMENT 1

#### Comparison of S490 and H834/S477

	S490	H834/S477
<b>Rate Bureau</b>	Removes private passenger automobile insurance from Rate Bureau's jurisdiction; Allows individual insurers to file rates with the Commissioner through a new " <b>Flex Rating</b> " band system	Leaves Rate Bureau jurisdiction over base rates intact; Allows individual insurers to file upward <b>deviations</b> with the Commissioner from the approved base rate
<b>Flex Rating versus Deviations</b>	<b>Flex Rating</b> <ul style="list-style-type: none"> <li>Rate filings by individual insurers increasing or decreasing rates no more than 15%, aggregated for all insureds, are <b>deemed</b> to meet the standard and are approved upon filing (New Art. 37A) (Standard under current law is not excessive, inadequate, or unfairly discriminatory)</li> <li>May be used upon filing or as specified by the insurer</li> <li>Allows a filing, or combination of filings, up to 15% in a 12 month period</li> <li>Commissioner may disapprove filing by written order specifying a reasonable future date the filing is not effective, if rate is inadequate or unfairly discriminatory</li> <li>Order is prospective only</li> <li>Filing(s) greater than 15% are subject to Commissioner's disapproval and refund to insureds (Article 40)</li> </ul>	<b>Deviations</b> <ul style="list-style-type: none"> <li>Deviations filed by individual insurers above the Rate Bureau base rate up to the rate charged by the Reinsurance Facility for other than clean risks are <b>presumed</b> to meet the standard (Standard under current law is not excessive, inadequate, or unfairly discriminatory)</li> <li>Currently, the Facility rate is approximately 20% higher than the Rate Bureau base rate and is filed by the Facility with the Commissioner.</li> <li>Deviation takes effect upon filing</li> <li>Commissioner may disapprove the deviation by written order specifying a reasonable future date the filing is not effective</li> <li>Order is prospective only</li> </ul>
<b>NC Reinsurance Facility Changes</b>	<p>Eliminates "clean risk" subclassification to an actuarially sound rate over a 4 year period</p> <p>Moves the SDIP and corresponding insurance points system from the Rate Bureau to the Facility (anticipates that</p>	<p>Eliminates "clean risk" subclassification to an actuarially sound rate over a 5 year period</p> <p>Leaves the SDIP in the Rate Bureau applicable to all drivers to all drivers</p>

## Appendix D

	<p>the need for the point system will be reduced with Flex Rating)</p> <p>Requires the Facility surcharge to be set out separately on premium statements</p>	<p>Eliminates the Facility surcharge at the end of the 5 year period</p>
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## ATTACHMENT 2

## Comparison of FAIR NC Bill and H834/S477

	FAIR NC	H834/S477
<b>Rate Bureau</b>	Gives insurers the option of remaining under the jurisdiction of the Rate Bureau or opting out of the current system and filing rates directly with the Commissioner through a new " <b>Flex Rating</b> " band system	Leaves Rate Bureau jurisdiction over base rates intact; Allows individual insurers to file upward <b>deviations</b> with the Commissioner from the approved base rate
<b>Flex Rating versus Deviations</b>	<b>Flex Rating</b> <ul style="list-style-type: none"> <li>• Rate filings by individual insurers increasing or decreasing rates no more than 12%, aggregated for all insureds, are <b>deemed</b> to meet the standard and are approved upon filing (New Art. 37A) (Standard under current law is not excessive, inadequate, or unfairly discriminatory)</li> <li>• May be used upon filing or as specified by the insurer</li> <li>• Allows a filing, or combination of filings, up to 12% in a 12 month period</li> <li>• Commissioner may disapprove filing by written order specifying a reasonable future date the filing is not effective, if rate is excessive, inadequate or unfairly discriminatory</li> <li>• Order is prospective only</li> <li>• Filing(s) greater than 12% are subject to Commissioner's disapproval and refund to insureds (Article 40)</li> </ul>	<b>Deviations</b> <ul style="list-style-type: none"> <li>• Deviations filed by individual insurers above the Rate Bureau base rate up to the rate charged by the Reinsurance Facility for other than clean risks are <b>presumed</b> to meet the standard (Standard under current law is not excessive, inadequate, or unfairly discriminatory)</li> <li>• Currently, the Facility rate is approximately 20% to 30% higher than the Rate Bureau base rate and is filed by the Facility with the Commissioner.</li> <li>• Deviation takes effect upon filing</li> <li>• Commissioner may disapprove the deviation by written order specifying a reasonable future date the filing is not effective</li> <li>• Order is prospective only</li> </ul>
<b>NC Reinsurance Facility Changes</b>	Eliminates "clean risk" subclassification to an actuarially sound rate over a 5 year period	Eliminates "clean risk" subclassification to an actuarially sound rate over a 5 year period  Eliminates the Facility surcharge at the end of the 5 year period

**Overview of Issues From January 25<sup>th</sup> Meeting**

***Arguments Supporting Proposed Changes*** (Steve Pociask, ACI; John McMillan, IFNC; Liz Reynolds, NAMIC; David Stoller, State Farm and FAIR NC Coalition)

- Drivers ceded to the Facility in NC represent 80% of the residual market in the country-- 1, 392,804 drivers of 1,727,895 drivers nationally.
- The recoupment surcharge is currently 4.3% of liability coverage, but has been as high as 10%.
- The recoupment surcharge is a hidden subsidy paid for by safer drivers. By subsidizing riskier drivers and making it less expensive for these drivers to obtain insurance and drive, the recoupment surcharge contributes to speeding, accidents and insurance claims.
- The current Rate Bureau system is antiquated, allows for sharing of information between insurers and leads to collusive price-setting that protects the market share of insurers. It does not allow for maximum competition. Changes in the system would allow for increased competition resulting in lower prices for consumers.
- N.C.'s rates are low, but not the lowest in the South or the 8<sup>th</sup> lowest in the country. The base rate approved by the Commissioner serves as the maximum rate or a cap on rates. The average rate paid by consumers is not related to the maximum approved rate. The average rate is a reflection of the losses, costs and expenses of insurers and is directly related to other factors such as the State's tort system, safe roads, and cost-of-living.
- Points Related Specifically to FAIR Coalition Proposal (See chart summarizing legislation):
  - Eliminates the need for the surcharge by depopulating the Facility
  - Allows for greater competition between companies and more premium discounts to drivers
  - Allowing companies to opt out of the Rate Bureau and file individually leads to more innovative products
  - Reduces administrative costs and expenses of filings under the current system
  - Increases the number of companies competing in the State
- Points Related Specifically to S477/H834 (See chart summarizing legislation):
  - Eliminates need for Recoupment surcharge by depopulating the Facility
  - Allows for greater competition between companies and lower premiums for most drivers
  - Rate Bureau continues to file rates with the Commissioner and Commissioner retains ability to approve rates under current law

***Arguments Opposing Proposed Changes*** (R. Lee Morton, Nationwide; Steve Carroll, Farm Bureau; Glenn Jernigan, GMAC; Jeff Butler, Able Auto/Cycle Ins. Co. and Alliance of Agents)

- Automobile liability insurance coverage is required under state law for all drivers for the protection of the public. The Facility was created to encourage all drivers to comply with state law and acquire liability coverage. There are approximately one million clean risks in the Facility who will see an increase in premiums if the current system is changed. As a result of this increase, the number of uninsured drivers will increase which will ultimately increase costs for everyone.
- Current market is strong and competitive as evidenced by the large number of auto insurers in the State and the number of available discounts. Insurers are free to discount rates under current law if they choose to do so.
- NC has the lowest rates in the Southeast, the 8<sup>th</sup> lowest in the country, and the lowest rates among the 10 most populated states.
- If the current system for automobile insurance is dismantled, rates in the automobile insurance market will no longer be stable but will change on both ends, high and low.
- If companies file individually, each filing will be different and consumers will no longer be able to compare rates and coverages between companies. In addition, policies and forms will no longer be filed by the Rate Bureau and approved by the Department, but will vary between insurers leading to increased confusion by the consumer.
- Dismantling the current system for auto insurance could have an unintended impact on other lines of insurance.
- Savings to consumer from the discontinuance of the recoupment surcharge is small compared to the potential rate increases under a flex rating system.