Mike Causey
Insurance Commissioner

November 8, 2023

Honorable Jake Johnson
Representative
300 North Salisbury Street, Room 306B1
Raleigh, North Carolina 27603-5925

Honorable Harry Warren
Representative
300 North Salisbury Street, Room 611
Raleigh, North Carolina 27603-5925

Re: **October 18, 2023 Request by the NC House of Representatives House Oversight and Reform Committee**

Dear Representative Johnson and Representative Warren:

Pursuant to the Committee's October 18 and 24, 2023 requests, below is my response to the *Report Prepared for the North Carolina House Oversight and Reform Committee* by Dr. Jonathan Murphy ("Murphy Report"). This response, along with the Commissioner's forthcoming written testimony, has been prepared in consultation with professionals of the North Carolina Department of Insurance ("DOI"), including its actuaries.

I. Introduction

Currently, the Commissioner is permitted by statute to review and, if necessary, challenge any request by an insurer to increase its rates, including any requests by insurers of private passenger and commercial vehicles (together, "auto insurers"). Although the Murphy Report purports to be about reforming the North Carolina Motor Vehicle Reinsurance Facility ("Facility"), its goal appears to be to convince the General Assembly to eliminate the Facility and instead allow auto insurers to increase their rates up to a statutory maximum for any reason at all, a so-called "flexible" rate, without any challenge by the Commissioner or North Carolina citizens.[1] Additionally, under this flexible rate system, the auto insurers would be able to request even higher rates annually than the maximum flexible rates.

If implemented, the recommendations in the Murphy Report would represent a radical departure from North Carolina's long history of permitting the Commissioner to represent the interests of the state's insureds with regard to insurance rates generally. As addressed below, however, many of the Murphy Report's core assertions about how the Facility operates are flawed, misleading, or unsupported.

Additionally, many of the Report's recommendations are based on changes passed by South Carolina in the late 1990s. But South Carolina has always had significantly higher auto premiums than in North Carolina. For example, South Carolina's rates were $526 higher in 2022 than those in North Carolina. As it stands, North Carolina's current system for regulating auto insurance is working effectively to keep rates for North Carolina insureds low, and the General Assembly should not follow the example of South Carolina, where, over 20 years after their reforms, rates remain significantly higher than in our State.

II. Overview of Auto Insurance in North Carolina

On behalf of those auto insurers that write nonfleet, private passenger auto ("PPA") insurance in this state, the North Carolina Insurance Rate Bureau ("Bureau") submits proposed PPA rate increases to the Commissioner for review. If the Commissioner objects to the Rate Bureau's proposed PPA rates, he may challenge the rates in a hearing.

Those North Carolina auto insurers that write commercial auto insurance, however, individually submit their companies' proposed rates to the Commissioner for review. If the Commissioner denies an individual insurer's requested rate, the insurer may request and receive a hearing.

PPA and commercial auto insurers in North Carolina are required to write automobile policies for all insureds who qualify as eligible risks. When an auto insurer writes or renews a policy for an insured, however, the insurer may choose to "cede" that policy to the Facility. By doing so, the insurer continues to service the policy but gives up any profit on the policy in return for relieving itself of any liability for claims under the policy. Policies that have been ceded to the Facility move into in the "residual market," while policies that auto insurers opt to retain remain in the "voluntary market."

When an insurer cedes a PPA policy to the Facility—i.e., upon "cession"—the policy is characterized as either a "clean-risk" policy or an "other-than-clean-risk" ("OTC") policy, depending on various factors. By statute, the rates for a clean-risk PPA policy do not change

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[1] As an example of a flexible rate statute, Dr. Murphy cites South Carolina, which permits auto insurers in that state to increase their auto rates by up to 7% each year without prior approval by the South Carolina insurance authorities. *See* SC Code § 38-73-905. South Carolina auto insurers also can seek even higher annual auto rate increases from the insurance authorities.

upon the policy being ceded, but the rates on an OTC PPA policy may increase upon cession. Unlike with clean-risk PPA policies, the Facility itself files proposed rates for OTC policies and for commercial auto policies, and these rates may be higher than the premium rates before the policies were ceded to the Facility. Nonetheless, the Commissioner may challenge those proposed higher rates in a hearing.

The Murphy Report nowhere specifies whether its calculations and conclusions are based on PPA policies, commercial auto policies, or the two combined. As of July 30, 2023, however, there were approximately 1.27 million ceded PPA policies in force and approximately 25,000 ceded commercial auto policies in force. Because the overwhelming majority of auto policies ceded to the Facility are PPA policies, the remainder of this response focuses on PPA policies, rather than commercial ones.

Further, although the Murphy Report concentrates on "drivers" who have been ceded to the Facility, under North Carolina law, auto insurers in fact are required to cede whole underlying PPA policies, not drivers, to the Facility. Even then, the Facility reports only limited data as measured by the number of PPA policies and instead focuses on the data applicable to individual "units of exposures," i.e., individual vehicles, under ceded PPA policies. Consequently, the remainder of this response focuses on premiums for ceded vehicles.

Currently, 1.57 million vehicles have been ceded to the Facility under PPA policies. Of these, 1.15 million vehicles were ceded as clean risks, while only 0.42 million vehicles cars were ceded as OTC. Thus, the policyholders for 73% of these vehicles were not charged additional premium upon their vehicles being ceded.

III. The Murphy Report

The Murphy Report requests that the General Assembly: (1) restrict the number of auto "drivers" that auto insurers may cede to the Facility; (2) allow the insurers to increase their auto rates annually by a statutorily set, flexible rate without "prior approval" by the Commissioner; and then (3) dissolve the Facility and create an "assigned-risk plan" that would require North Carolina auto insurers to write and bear the losses from auto policies for all eligible "drivers" but permit the insurers to charge higher rates to those "drivers" they deem to be "high risk."

What the Murphy Report obscures, however, is that North Carolina auto insurers almost certainly would oppose a limit on the liability they can cede to the Facility unless the insurers were guaranteed the flexible rate Dr. Murphy proposes. This is because, as Dr. Murphy admits, auto insurers in fact benefit from ceding their auto liability to the Facility, even where Dr. Murphy claims the insurers actually would profit if they retained the liability in the voluntary market. *See* Report pp 3, 9.

Indeed, as the Facility wrote in its April 5, 2022 *Presentation to the Joint Legislative Oversight Committee on General Government*, auto insurance "[c]ompanies need the option to keep or cede the risk (transfer the loss exposure)" to the Facility. *See* Presentation p 3, Attachment B hereto. Consequently, it is the Commissioner's position that the only instance in which the auto insurers would agree to limit their ability to cede liability to the Facility is if they are granted their proposed flexible rate so that, in return for keeping this additional liability on their books, the insurers can charge higher premiums at their option.

Additionally, North Carolina's auto insurers almost certainly would oppose the creation of an assigned-risk system unless they were guaranteed the rights to raise their rates annually by a set percentage, without prior approval by the Commissioner, and to seek then yet higher annual rates. It is also likely the auto insurers would insist on a high cap on rate increases without prior approval—such as the 7% cap the Report cites from South Carolina—in return for being assigned liability they otherwise would have ceded to the Facility.

A. The Murphy Report's Core Assertions About How the Facility Operates Are Flawed, Misleading, or Unsupported.

The Murphy Report relies on a series of vague and seemingly unsupported assertions about alleged flaws in the current operations of the Facility.[2] First, Dr. Murphy cites repeatedly to alleged statistics based on the number of "drivers" in the "residual market," i.e., the Facility. Nonetheless, as noted above, policies, not drivers, are ceded to the Facility, and the Facility does not report its operations based on drivers but rather based on vehicles under ceded policies. Indeed, it is unclear exactly where one would obtain data regarding individual drivers ceded to the Facility, and the Report contains no citations for its statistical assertions about drivers. Thus, the Report's apparent confusion about the very measurement of the data for its conclusions undermines those same conclusions.

Assuming for the sake of argument, however, that Dr. Murphy's various assertions are based on ceded policies or on vehicles under ceded policies rather than drivers, it is still impossible for the DOI to reconcile the Report's assertions with the actual, known data from the Facility. For example, despite extensive research, it is currently unclear to the DOI just where Dr. Murphy would have obtained data to support his claims that 25% of either North Carolina auto policies or vehicles have been ceded to the Facility and that this represents the largest percentage of auto policies or drivers in the residual market of any state in the country—if this is indeed what Dr. Murphy intends to state at page 3 of his report.

Likewise, it is currently unclear to the DOI where Dr. Murphy would have obtained data to support his claims that all consumers whose policies or vehicles are in the Facility tend to pay up to "35 percent higher" premiums than drivers in the voluntary market—if this is indeed what Dr. Murphy intends to state at pages 3 and 4 fn 3 of his Report. Again, the Report itself has no citation for these conclusions. And, as noted, the only known data demonstrates that the premiums for 73% of the vehicles covered by ceded PPA policies remained the same upon being ceded.

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[2] Of course, the Commissioner welcomes any further clarification or explanation by Dr. Murphy of his data and his conclusions.

The Report next leaps to the conclusion that its unsupported, alleged 35% increase in premiums for all ceded "drivers" does not afford the Facility sufficient funds "to cover the risk of this pool" of ceded "drivers." Report p 4. But even assuming that the Report intends to refer to the risk posed by policies or vehicles rather than drivers, Dr. Murphy makes no attempt to identify how much "risk"—i.e., how much potential liability—has actually been transferred to the Facility based on ceded policies or vehicles.

Dr. Murphy also repeatedly uses the term "high-risk" drivers to refer to those drivers who allegedly experience higher rates upon cession and who supposedly will benefit if the General Assembly accepts the Report's three legislative recommendations. For example, the Report states that so-called high-risk drivers "tend to pay lower premiums" in the voluntary market than they pay when their policies are ceded to the Facility. Report p 4, fn 2.

"High-risk" driver, however, is an insurance industry term separate from the clean-risk standard that North Carolina uses to determine whether a PPA policy experiences a rate increase upon cession. Likewise, the North Carolina statutes do not refer to a "high-risk" standard in determining what increases there may be in the rates for ceded commercial policies. As the Facility stated in its April 5, 2022 Presentation: "A ceded policy is <u>NOT</u> indicative of a 'bad' risk." Attach. B, p 3.

But even if it somehow were possible to compare the Report's high-risk standard to the statutory standards actually used to determine whether an auto policy or a vehicle experiences a rate increase upon cession, such a comparison would be meaningless without data regarding how many high-risk drivers—within the insurance industry's understanding—have been ceded to the Facility and what liability exposure these ceded high-risk drivers carry with them. Notably, Dr. Murphy offers no such data in the Report.

Another important point that the Report fails to emphasize is that, in assigned-risk systems such as that Dr. Murphy advocates, auto policies are assigned based on the number of participating auto insurers, meaning that the consumer has no choice whatsoever in which auto insurer will write the consumer's policy. For example, a consumer in an assigned-risk state can be compelled to obtain a policy from an auto insurer with a notoriously poor history of handling legitimate claims. Meanwhile, under North Carolina's current system, consumers can elect the auto insurer of their choice, and that insurer will continue to service the policy even where it is ceded to the Facility.

B. South Carolina's Elimination of Its Facility and Its Adoption of a Flexible Rate Without Prior Approval Plus an Assigned-Risk System as Compared to North Carolina's Current System.

Dr. Murphy bases his recommendations that North Carolina reform the Facility on the experience that South Carolina allegedly had in eliminating its own facility and adopting a system permitting auto insurers to increase their premiums by up to 7% a year for any reason, without obtaining prior approval from the South Carolina authorities, and then permitting the insurers to seek yet further annual increases, all while replacing the state's facility with an assigned-risk system.

Dr. Murphy asserts that South Carolina "saw premiums fall for many drivers from the start" of its legislative reforms. Report p 6. In support of this assertion, Dr. Murphy cites a 2013 study ("2013 Study") of South Carolina auto rates between 1998, when the reform began, and 2009, by which time the initial reform measures were complete. *See* "Effects of Regulatory Reforms in the South Carolina Auto Insurance Market" by Patricia M. Danzon, Robert W. Klein, Sharon Tennyson, *Journal of Insurance Regulation*, vol. 32 (2013) at https://www.researchgate.net/publication/292323010.

Specifically, Dr. Murphy claims: "Premiums rose in the 1990s due to increasing claims. In 1999, after the reforms passed, the South Carolina Insurance Services Office requested an 18.5 percent reduction in *premiums*." Report p 6 (emphasis added). The South Carolina Insurance Services Office ("ISO"), however, is not a government agency but only a private entity that gathers data and makes recommendations. More importantly, the 2013 Study in fact states that the ISO only filed for an 18.5 percent decrease in "*advisory loss costs*." *See* 2013 Study p 18 at https://www.researchgate.net/publication/292323010 (emphasis added).

Advisory loss costs are not recommended rates, let alone actual rates. Rather, they are only a portion of a proposed rate which represents insurer payments to cover to cover claims under a policy, as opposed to insurer overall losses or expenses. Contrary to Dr. Murphy's suggestion that actual rates decreased by 18.5% (apparently in 2020 or 2021, given that the filing was for 1999), the 2013 Study shows that South Carolina's rates dropped by far less in those years and in fact increased for five out of the ten years between 1999 and 2009. *See* 2013 Study p 26 at https://www.researchgate.net/publication/292323010.

Dr. Murphy also claims that: "Over the past decade, premiums in South Carolina have risen 25.5 percent compared to a 43.0 percent increase in North Carolina. … In 2022, South Carolina's premiums averaged $1,478 compared to $952 in North Carolina." Report p 8. At the same time, Dr. Murphy warns off any review by the General Assembly of South Carolina auto insurance rates in the context of the average rates among the States. *Id.*

Despite extensive research, the DOI is currently unaware of the origin of the alleged data for Dr. Murphy's 25.5% versus 43% increases and his measure of average rates between North and South Carolina, and the Report itself cites no source for these numbers. But the data of which the Commissioner *is* aware starkly illustrates why Dr. Murphy may be attempting to avoid discussion of many differences in the rate experiences between the two states.

According to the Commissioner's data, between 2005 and 2021, the average automobile premiums per vehicle increased by only an average of 1.49% per year in North Carolina versus 2.61% in South Carolina. *See* Commissioner's Data, Attachment A. In this time period, North Carolina's average premiums increased from $639.78 to only $811.20, while South Carolina's average premiums increased from $753.84 to $1,137.66. *Id.* Further, at all times between 2005 and 2021, North Carolina remained within the top 15 states with the most affordable auto insurance premiums, while South Carolina sunk from the 27th most unaffordable state to the 37th most unaffordable state. *Id.*

The Murphy Report attempts to explain away what it admits are South Carolina's "high" premiums as compared to the North Carolina and national averages by attributing any differences to South Carolina drivers allegedly being more accident prone than North Carolina drivers. Report p 8. The Commissioner's position, however, is that a primary driver of South Carolina's high premiums—if not *the* primary driver—is that South Carolina has a significantly higher number of uninsured drivers than North Carolina.

Where a state has a high number of uninsured drivers, auto insurers must increase the premiums on those drivers who are insured in order to cover liability caused by the uninsured drivers. As of 2019, only 7.4% of drivers were uninsured in North Carolina, making it and South Dakota, which had the same percentage of uninsured drivers, tied for tenth in states with the least percentage of uninsured drivers. *See* "Facts and Statistics, Uninsured Motorists," Insurance Information Institute, at https://www.iii.org/fact-statistic/facts-statistics-uninsured-motorists. Meanwhile, for the same year, 10.9% of South Carolina drivers had no insurance, making South Carolina 28th among the 50 states with the highest percentage of uninsured drivers. *Id.*

Dr. Murphy also appears to argue that, based on South Carolina's experience, the proposed elimination of the Facility in North Carolina combined with the introduction of flexible rates would prevent North Carolina auto insurers from colluding to always allow themselves annual premium increases at the maximum flexible rate, which in South Carolina is 7% per year. Report pp 14-15. This argument is based on Dr. Murphy's notion that, upon such collusion by the existing insurers, other unidentified auto insurers would enter the North Carolina market and charge less annually than the maximum flexible rate.

Dr. Murphy's theory that more insurers would enter the North Carolina market to offset any collusion by the existing insurers to charge the maximum flexible rate is purely speculative. Respectfully, the Commissioner submits that it is just as likely, if not more so, that no new insurers would appear but that, if they did, they would not willingly charge lower premiums than the rest of the market.

Finally, the Murphy Report claims that South Carolina's reforms led to a "below-average share of drivers in the residual market." Report p 3. As the 2013 Study clarifies, however, the South Carolina reforms completely *eliminated* the requirement that many drivers obtain *any* auto insurance *at all*, even at minimum limits. *See* 2013 Study p 10 at https://www.researchgate.net/publication/292323010. Obviously, eliminating any requirement that many drivers obtain any auto insurance at all would lead to a decrease in the percentage of drivers in the residual market.

IV. Conclusion

North Carolina's PPA insurance rates are among the lowest in the nation, and, on behalf of North Carolina consumers, the Commissioner has had the longstanding ability to review, challenge, and hold a hearing on any proposed rate increases by North Carolina auto insurers. The Murphy Report, although couched in terms of a critique of the Facility, recommends dismantling our current system for regulating auto insurance rates and replacing it instead with a system permitting auto insurers annually and unilaterally to increase their annual premiums up to a high maximum flexible rate and then seek even greater annual increases, while also forcing North Carolina consumers to give up their ability to select the auto insurer of their choice. However, the Murphy Report provides no certainty that such changes would lead to lower rates for North Carolina consumers. Even more troubling, South Carolina's experience makes this appear unlikely. We should not make the drastic changes recommended by the Murphy Report when it appears unlikely that they would result in lower premiums for consumers.

Sincerely,

Mike Causey
Insurance Commissioner

ATTACHMENT A

NAIC

Private Passenger Auto

Average Premiums per Insured Auto by State

Liability plus Collision plus Comprehensive

Year	North Carolina*	US Rank	Countrywide	South Carolina	US Rank
2005	639.78	8	831.58	753.84	27
2006	632.67	9	817.06	756.11	28
2007	615.82	9	797.45	761.87	29
2008	605.53	9	789.49	749.30	29
2009	626.02	12	785.42	737.74	28
2010	620.32	9	791.85	737.77	29
2011	614.65	8	797.73	748.26	31
2012	624.85	9	814.63	772.14	33
2013	634.34	8	841.23	794.40	32
2014	659.14	8	869.47	827.30	32
2015	656.21	6	896.66	870.57	32
2016	686.04	6	945.02	930.76	35
2017	731.63	6	1,008.53	1,025.22	36
2018	786.52	10	1,058.10	1,097.80	36
2019	787.42	10	1,071.74	1,115.78	36
2020	773.58	9	1,046.38	1,111.43	37
2021	811.20	11	1,061.67	1,137.66	37
avg annual increase	1.49%		1.54%	2.61%	

* adjusted upwards to include all recoupments

SOURCE: multiple NAIC average auto premium reports (each report shows five years)

ATTACHMENT B

Presentation to the Joint Legislative Oversight Committee on General Government

By the
North Carolina Reinsurance Facility
April 5, 2022

This presentation is incomplete without the accompanying discussion; it is intended for the information and benefit of the Joint Legislative Oversight Committee on General Government.

North Carolina Reinsurance Facility (NCRF) Representatives

Joanna Biliouris, NCRF General Manager

Terry Collins, NCRF Chief Operating Officer

Mickey Spivey, Counsel

The Facility was created to…

"… assure the availability of motor vehicle insurance to any eligible risk …" **NCGS 58-37-35**

- Liability insurance is mandatory
- "Take all eligible comers"
- Companies need the option to keep or cede the risk (transfer the loss exposure)
- A ceded policy is <u>NOT</u> indicative of a "*bad*" risk
- Drivers able to choose their company

NCRF Legislative History

"There is created a nonprofit unincorporated legal entity to be known as the North Carolina Motor Vehicle Reinsurance Facility consisting of all insurers licensed to write and engaged in writing within this State motor vehicle insurance…"

NCGS 58-37-5

- Created by the Legislature in 1973 – NCGS Ch. 58, Art. 37
  - Statutes dictate Why, What, & How
  - Nonprofit unincorporated legal entity
  - 550+ member companies
  - Not a state agency and receives no state funds

Administered by the Board of Governors

"...full power and administrative responsibility for the operation of the Facility."

<u>15 total members, 12 voting members:</u>

- 7 insurance companies
  - 2 NC member companies selected by the Commissioner of Insurance (COI)
- 5 insurance agents selected by the COI
- COI is ex officio non-voting member
- 2 non-voting public members appointed by the Governor

NCGS 58-37-35

What does the Facility NOT do?

- Sell insurance policies
- Service policies
- Adjust claims
- Reinsure physical damage coverages
- Lobby

Companies are required to provide the same level of service to ceded policies as they do to retained policies

What does the Facility Reinsure?

- Motor vehicle insurance (defined as the following liability coverages)
  - Bodily Injury
  - Property Damage
  - Medical Payments (excluding motorcycles)
  - Uninsured Motorists
  - Underinsured Motorists

NCGS 58-37-1

- Motor vehicle Physical Damage insurance (Collision, Comprehensive, etc.) is retained by the insurance company.

Who does the Facility Reinsure?

<u>Eligible risks</u> (summary only)

- Resident of NC who
  - owns a motor vehicle registered **or** principally garaged in NC; or
  - has a valid NC drivers license; or
  - is required to file proof of financial responsibility in order to register a motor vehicle or obtain a NC drivers license
- A non-resident who
  - owns a motor vehicle registered **and** principally garaged in NC; or
  - is a member of the armed forces (including spouses) stationed on or deployed from a base in NC who intends to return to their home state; or
  - is an out of state student enrolled in school in NC who intends to return home upon completion of time as student

NCGS 58-37-1

How does it work?

- Companies make a choice:
  - Keep (**retain**) and charge voluntary rates
  - Cede (**reinsure**), charge Facility liability rates and send the liability **premium** to the Facility
- Companies issue and service policies, including adjusting any claims
- Regardless of choice, companies must treat all policies the same
- On ceded policies, Facility <u>reimburses</u> companies:
  - Cost of writing and servicing policies
  - Cost of adjusting claims
  - Claim payments for accidents

Surcharges utilized by the Facility

The statutes provide for two types of surcharges:

- Clean Risk Surcharge
  - Allows the Facility to recoup any shortfall created by a difference between the actual rate charged and the actuarially sound and self-supporting rates for clean risks reinsured in the Facility.
  - Placed on the liability premiums of all ceded and retained private passenger auto policies.
- Loss Recoupment Surcharge
  - Allows the Facility to recover net operating losses from prior time periods.
  - Placed on the liability premiums of all ceded and retained private passenger auto policies and / or commercial auto policies.
- Surcharges are evaluated each quarter and adjusted as necessary

NCRF Fiscal Year Income Statement

Income Statement		
Fiscal Year through	**September 30, 2021**	**September 30, 2020**
Income		
Earned Premiums	$1,105,947,441	$1,068,676,263
Clean Risk Recoupment	243,943,492	169,839,416
Investment Income	23,536,781	28,767,080
Membership Fee Income	57,700	56,500
Other Income	139,732	269,217
Total Income	**$1,373,625,146**	**$1,267,608,477**
Expenses		
Losses Incurred	$990,892,904	$936,543,231
Ceding & Claims Expenses	442,239,070	406,681,509
Salaries & Administration Expenses	3,694,064	3,664,063
Outside Services Expenses	2,701,709	2,782,209
Other Operating Expenses	2,549,401	2,741,986
Total Expenses	**$1,442,077,148**	**$1,352,412,998**
Net Income/(Loss) Before Loss Recoupments	**($68,452,001)**	**($84,794,281)**
Loss Recoupments	$126,751,611	$69,712,133
Net Income/(Loss) After Loss Recoupments	**$58,299,610**	**($15,082,148)**

NCRF NORTH CAROLINA REINSURANCE FACILITY

Checks and Balances

- Responsibilities defined by statute
- Plan of operation approved by the COI
- Rates and forms reviewed by the COI
- Statutorily required review of financial statements by outside independent auditors who are approved by the legislature

Questions?

Thank you for the opportunity!