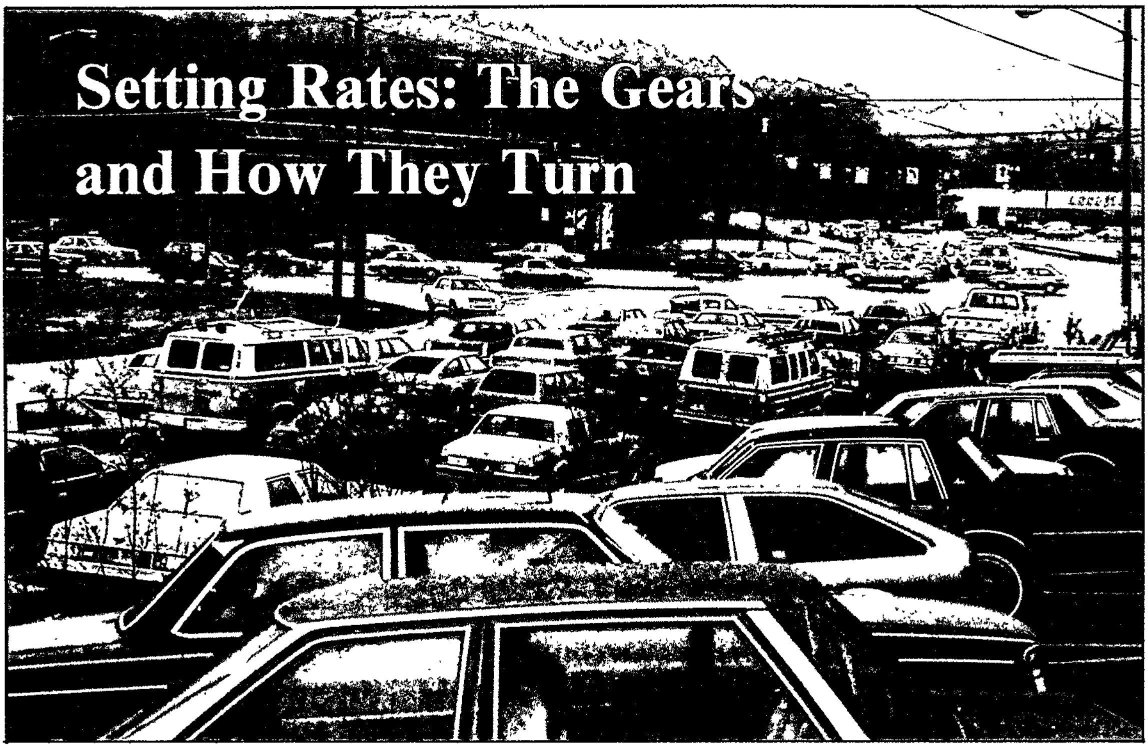
Setting Rates: The Gears and How They Turn



Automobile insurance rates depend upon a complex system of gears. In addition to the legislature, two agencies are critical to this ratesetting system: the N.C. Rate Bureau and the Department of Insurance. The other important gears in the system are: where a driver lives, years of driving experience, car use, driving record, and the N.C. Reinsurance Facility.

N.C. Rate Bureau. State law requires automobile insurers to belong to the Rate Bureau, which annually proposes a single schedule of liability insurance rates to the Commissioner of Insurance. This schedule applies: 1) to all policies that are *not* ceded to the Reinsurance Facility—called the voluntary market; and 2) to policies ceded but considered "clean risks." (A clean-risk driver has a clean driving record and has been driving more than two years.) Under the current "file-and-use" system, rate increases may automatically take effect after a 90-day waiting period. Increases not approved by the commissioner must be kept in an escrow account until final resolution of the increase, by the courts if necessary.

Commissioner of Insurance. The commissioner has the dual responsibility of reviewing rate filings for fairness and ruling on the filings in a formal judicial hearing. The commissioner may serve as the hearing officer *or* function as the chief investigator of the filing and designate a deputy as the hearing officer. In addition, the commissioner rules on rate "deviations" proposed by individual companies. Through deviations, legal only since 1977, companies can offer rates below (or above, which would be unlikely) the industrywide schedule filed by the Rate Bureau. Approval is usually automatic, especially for downward deviations. Deviations are generally not available to reinsured drivers.

Driver Residence. Rates are calculated according to a territorial classification. There are 14 territories in North Carolina: 9 for the largest cities, 2 "small cities" categories, 1 for military bases, and 2 for rural areas. Urban areas and military bases, where most accidents occur, have higher rates than do rural areas.

Years of Driving Experience. For drivers with less than two years' driving experience, rates are doubled.[8] Since most people obtain a driver's license soon after they become eligible, this surcharge applies mainly to 16- and 17-year-olds. Thus, teenage drivers, as a group, generally pay higher premiums than does the general population.

Car Use. Rates vary depending on five categories of car use, which, going from cheapest to most expensive, are: farm, pleasure, driving to work less than 10 miles, driving to work more than 10 miles, and business.

Driving Record. When drivers cause accidents, are convicted of violations, or receive prayers for judgment continued, they are assigned from 1 to 12 points under the *Safe Driver Insurance Plan* (SDIP).[9] Drivers with SDIP points pay surcharges on their liability premiums for three billing years, beginning when a policy is renewed following the accident or violation. It is important to distinguish this SDIP 12-point system from the Division of Motor Vehicles (DMV) 12-point system. The DMV points affect only whether you can legally have a driver's license; they have no relationship to insurance rates.[10] The SDIP system affects insurance rates; it has no effect on whether you can have a license. The two point systems are often confused by the public, but they are unrelated, both legally and administratively.

N.C. Reinsurance Facility. In North Carolina, auto insurers must offer liability coverage to all comers, but insurers may transfer liability policies to the N.C. Reinsurance Facility. A company does not have to offer collision and comprehensive coverage; no reinsurance facility exists for such coverage. The N.C. Reinsurance Facility is a complex mechanism, but in concept it is quite simple. It is a pool through which insurance companies share the losses of drivers they consider to be poor risks for liability coverage.

The Reinsurance Facility files a separate rate schedule with the commissioner for ceded policies having drivers with SDIP points or less than two years' experience. Clean risks in the facility pay voluntary market rates. The facility may impose rate increases without a 90-day waiting period. It must, however, put the proceeds in escrow, as companies do for increases in the voluntary market, if the increase is not approved and if the case is appealed into the courts.

To cover operating losses, the facility assesses insurance companies according to their share of the auto liability market. The companies pass along this charge through "recoupment" surcharges on *all* drivers with SDIP points *whether the drivers are insured through the facility or not.* All drivers with points also pay a surcharge intended to subsidize clean risks in the facility. In 1984, these surcharges together increased bills by 27.2 percent for drivers with points.[11]