

# **Why the Standard Automobile Insurance Market Breaks Down in Low-Income Zip Codes**

**A per-mile analysis of Texas auto insurance  
based on testimony before the  
Texas House Committee on Insurance  
April 6 and 13, 1999**

**Report to the Texas House Committee on Insurance**

**by**

**Patrick Butler, Ph.D., Insurance Project Director  
National Organization for Women  
Washington, DC  
and  
Texas NOW  
Austin, TX**

**July 2000**



## Table of Contents

Executive summary .....	1
1. Introduction .....	5
a. Identifying multiple problems caused by <i>per-car</i> premium rates .....	5
b. Mandating a <i>per-mile</i> option — HB 3099 .....	6
c. Using a per-mile measure of cost and profit .....	6
d. Considering testimony – List of House Bills .....	7
2. What angers car owners in higher income zip codes .....	8
a. Large differences in the profit made on each customer — Table 1 .....	8
b. Having to pay for insurance while a car is inoperable .....	9
c. Losing the option to suspend insurance .....	10
d. Low-mileage drivers having to pay for unlimited mileage .....	11
e. Having to pay a premium for each car when cars outnumber drivers .....	12
3. What angers car owners in low income zip codes .....	13
a. Being branded as non-standard as shown by the Birnbaum study .....	13
b. Being rejected by standard agents as unprofitable .....	15
c. Seeing unavailable low premiums in TDI consumer guides — Table 2 .....	16
d. Being blamed for market breakdown .....	18
4. What angers some car owners in all zip codes .....	20
a. Being overcharged for insuring an older car .....	20
b. Being scapegoated for owning an uninsured car .....	21
5. Attaining healthy markets .....	23
a. Diagnosing the causes of consumer anger .....	23
b. Deregulating premiums .....	23
c. Using a database to identify uninsured cars .....	25
d. Prescribing a <i>per-mile</i> option .....	26
e. Enforcing compliance under a <i>per-mile</i> option .....	30
1. Using current methods .....	30
2. Using a database to identify uninsured miles driven .....	33
f. Solving consumer anger .....	35
Index: bills, legislators, subjects, and witnesses .....	36

## Executive summary

**Per-mile insurance option** In April 1999 Rep. Lon Burnam introduced testimony before the House Insurance Committee on HB 3099—the per-mile option act—“*to make insurance more affordable and accessible to the people that we represent.*” Instead of having to pay a fixed premium (i.e., fixed charge) for each car, policyholders could choose to insure cars at cents-per-mile rates. Supporters testified that the option would eliminate the extra profits companies now get from low mileage drivers—predominantly women, older drivers, and lower income drivers. But we must also examine how the option might affect other problems.

This report reviews testimony on some dozen bills and applies the option as a remedy to problems identified. These problems were emphatically summarized by an insurance company president who told the Committee that “*Consumers are angry about the cost of car insurance. They are angry about lack of availability. People don’t like to get rejected, they don’t like to get cancelled.*” He was referring particularly to the unprofitable situation companies say characterizes low income areas in Texas. This situation was confirmed by a former Austin insurance agent who testified that she “*wrote no policies [east of I-35]....[and] was the most profitable agent in the region State Farm had.*”

When the Committee asked industry representatives to explain why the standard (i.e., lower cost) companies like State Farm refuse to sell in low income areas, they merely repeated that these zip codes are less profitable because they produce higher losses. But this report rejects the industry's implication that low income drivers are less careful. On the contrary, the report finds that the industry practice of charging a fixed premium per car actually makes market failures inevitable.

**Problems in higher income zip codes** Key to understanding why the standard market breaks down in low income zip codes is understanding why it does not break down in higher income zip codes. In higher income areas profits are maintained at the expense of owners of cars driven less than average mileage. Despite a wide range in how much cars are exposed on the road to risk of accident, premiums vary at most by a discount or surcharge. Consequently, companies make extra profits on some customers. As one witness pointed out, while cars are not running “*there's no possible way they're going to cause an accident and there's no way they're going to cost the insurance any money.*” Thus the company makes pure profit—has a zero loss ratio—on premiums received for insuring idled cars. Testimony for the per-mile option on behalf of lower mileage groups quoted insurers on the profitability of women “*because her use of the car is substantially less*” and how it was possible to “*make a killing on older drivers*” because “*they hardly drive at all.*”

Another source of extra profits is extra cars. A witness described his household of two drivers with five cars noting that “*we can only have two on the street at one time if we are not together, yet*







## 1. Introduction

### a. Identifying multiple problems caused by *per-car* premium rates

During two April, 1999 hearings, the Texas House Committee on Insurance considered some dozen bills designed to reduce the cost of automobile insurance and the number of uninsured cars. Testimony on the bills affirmed that people living in low income areas are more likely to be branded as “non-standard” and to have to pay a higher premium than if they lived elsewhere. Asked to explain why, industry representatives merely blamed higher losses without naming any cause. In fact, their inability to come up with an explanation became an issue for committee members when considering HB 1092 (to regulate county mutual premiums).

Mr. Jay Thompson (an attorney representing the Association of Fire and Casualty Companies in Texas, AFACT): There’s loss data on every coverage. There is zip code data by coverage and you can find that.

Rep. Glenn Lewis: But Jay...it is very difficult to convince a lot of us that those things are based on losses and [also that] the fact that where the premiums are higher happens to be in low income and minority communities...is purely coincidence.

Rep. Miguel Wise: In fact most of us think it is intellectually dishonest to come over here and tell us that there is no red-lining or green-lining because it's due to the money, whether you are making a profit. When you don't have the number of [standard] companies available in the poor districts that you have in the affluent parts of Houston.

Despite such skepticism, nobody pressed industry representatives to answer the obvious question: Are poor people really less careful drivers? The current lack of explanation for the higher losses claimed by the industry implicitly says “yes” and defames drivers living in low income areas as less careful than those living in higher income areas. But a good case can be made for a non-invidious reason. We begin by assuming until insurers prove otherwise on a per-mile basis that *driving care is not related to income level or zip code*. (Economic theory actually predicts more care when insurance is minimal or absent.) Key to understanding why the standard market breaks down in low income zip codes is understanding why it does not break down in higher income zip codes.

In higher income zip codes, however, market stability comes at the expense of owners of cars driven less than average. These customers are seen as a source of extra profit by insurers, who sometimes refer to landing their business as “skimming the cream.” Because these people, along with many who drive average mileage and more, think their premiums are too high, legislators feel pressured to propose remedies. But often the remedies for higher income zip codes—such as increasing punishment of owners of uninsured cars, or allowing companies complete freedom in setting premiums—would aggravate problems for people living in low income zip codes. Such conflicts would be avoided by identifying a single cause—and remedy—for the problems in both







































































Organization (cont.)

NOW (National Organization for Women), 11, 18, 20, 32  
OPIC (Office of Public Insurance Counsel), 15  
TDI (Texas Department of Insurance), 16–17  
TMRA (Texas Motorcycle Rights Association), 9, 12–13, 14, 18, 21  
Trans Texas Alliance, 26

Representative

Bonnen, 7  
Burnam, 1, 7, 12, 13, 15, 26  
Chavez, 7, 9, 33  
Dutton, 7, 24  
Eiland, 3, 24, 29  
Gutierrez, 7, 19, 26  
Jones, J., 7, 12  
Lewis, G., 5, 14, 16, 19, 25–26, 29  
Moreno, J., 7, 12, 32  
Olivo, 7, 15  
Seaman, 16  
Smithee, 3, 7, 24, 30, 32  
Thompson, 7, 27, 35  
Wise, 5, 24  
Wolens, 7, 21

State

California, 10, 23  
Nevada, 19, 25, 29  
New Jersey, 10  
Pennsylvania, 10, 11, 32  
Utah, 2, 21–22  
Virginia, 10

Subject

Car pooling, 19, 29  
Code - Insurance, 11  
Code - Transportation, 32  
ID card, 25, 30, 31, 33, 34  
Law of Large Numbers, 6, 14, 28  
Per-car insurance  
  cost-measuring, 6  
  estimated future mileage, 8  
  suspension of coverage, 9–11  
Per-driver insurance, 2, 7, 13

Subject (cont.)

Per-mile insurance  
  cost-measuring, 6  
  example, 3, 29  
  GPS system, 3, 4, 27, 28, 29, 35–36  
  odometer, 3, 6, 8, 11, 13, 21, 26, 27, 29, 33, 34, 36  
  odometer fraud, 3, 30–32, 33  
  payment methods, 29  
Profiling by  
  car age, 4, 11, 20–21, 34  
  common sense (*not* statistics), 20–21  
  credit history, 7, 20, 25  
  driver age, 1, 7, 11–12, 20–21  
  driver sex (women or men), 1, 7, 11, 20–21  
  minimum liability insurance only, 15  
  no prior insurance, 22  
  slice and dice, 24, 28  
  underwriting guidelines, 15, 16, 25  
  zip code, 15–16, 23–24, 24  
Rollback, 8, 24  
Skimming, 5, 18, 24, 25  
Texas Manual rule, 8, 10

Witness

Akins (Trans Texas Alliance), 26–27  
Atkinson (former Utah state rep.), 2, 22  
Aycock (former agent), 1, 12, 15–17  
Birnbaum (economist, self), 13, 16, 17–18  
Butler (National NOW), 10, 28, 30, 32  
Geiger (AFACT), 12  
Graves (Progressive), 1, 15, 23  
Huxel (Farmers Insurance), 24, 28  
Kallerman (retiree, self), 11–12  
Kosub (agent, self), 3, 34  
Maltsberger (TMRA), 9, 22  
Martin (agent, AIAT), 19, 25, 29, 31, 33  
Murphy (agent, AIAT), 25  
Schmidt (TMRA), 1, 12  
Schneider (Consumers Union), 13, 15, 26  
Sommerfeld (Texas NOW), 1, 11, 20  
Strain (TMRA), 1, 9, 14, 21  
Thompson (AFACT & Progressive), 4, 5, 14, 19, 27–28, 28, 29, 35