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From the Los Angeles Times

Major Shift in Auto Policies

Rates would emphasize safety and mileage, not ZIP Codes, for drivers insured by Auto Club. Adherence to Prop. 103 is a win for Garamendi.

By Marc Lifsher
Times Staff Writer

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In a move that could presage lower auto insurance premiums for many of California's 23 million drivers, the state's fourth-largest provider has agreed to base its rates on how safely and how much its customers drive rather than primarily on where they live.

The plan, to be announced today by the Automobile Club of Southern California and California Insurance Commissioner John Garamendi, would slice as much as \$133 million from the annual bills of the club's nearly 1 million policyholders. More broadly, it could compel the club's rival insurers to follow suit.

The shift is a victory for consumer advocates, who say that rates based largely on ZIP Codes saddle city dwellers with higher premiums than suburban and rural drivers with similar records. It also is a coup for Garamendi, who has been working to force insurers to comply with requirements approved by voters with the passage of Proposition 103 in 1988.

In revising how it sets rates, the Los Angeles-based Auto Club is breaking ranks with the state's other major insurers. It expects that 88% of the 993,000 drivers it insures will see their bills drop 7% on average, or \$134 annually.

Most other Auto Club customers will see their premiums rise less than 5% when the new rate-setting formulas take effect in December, said Thomas V. McKernan, the Auto Club's president and chief executive.

Proposition 103, the landmark auto insurance initiative, required that rates primarily be tied to a person's driving record, number of years licensed and total miles driven each year — not the ZIP Code where a vehicle is registered.

But changes in industry practice have been held up for the last 17 years. Insurers, which argued that where a driver lives is an essential factor in assessing risks and costs, persuaded former Insurance Commissioner Chuck Quackenbush to allow ZIP Codes to remain a priority in setting rates. Quackenbush's regulations and later court rulings kept the old rules largely in place.

In December, Garamendi announced that he would propose his own regulations aimed at fulfilling the mandate of Proposition 103.

"How safely you drive is more important than where you live," Garamendi said in an interview Friday. He said new regulations expected to be on the books this month would compel insurance companies to overhaul their market practices so they no longer "favor one ZIP Code and trash another ZIP Code," he said. The changes still face expected legal challenges from insurers.

Current rating systems, which rely heavily on geography, allow insurers to discriminate by charging high rates for motorists living in ZIP Codes they might not want to serve, Garamendi said.

A study last year by Consumers Union noted that a woman with 22 years of driving experience and a good record, residing in predominantly white Westchester, would pay \$1,443 a year with Farmers Insurance Group. The same driver would pay \$2,394 if she lived in the largely African American Baldwin Hills neighborhood, the study found.

Insurers, for their part, criticized the survey, saying their rates were based on the number of claims in an area, not the race or ethnicity of policyholders.

The Auto Club's decision to deemphasize ZIP Codes is historic and sends a message to other insurers that "they can respect the wishes of the voters and make money at the same time," said Harvey Rosenfield of the Foundation for Taxpayer and Consumer Rights. The Santa Monica attorney wrote Proposition 103 and has been working ever since to see it fully enforced.

"This will have tremendous consequences for the marketplace," Rosenfield said.

Garamendi's deal with the Auto Club also would send an important signal to lawmakers and insurance commissioners in other states that California's system could be good for both motorists and insurers, said J. Robert Hunter, director of insurance for the Consumer Federation of America. Hunter, a former Texas insurance commissioner and federal insurance administrator, helped Rosenfield write Proposition 103.

"The rest of the country now should look again at Proposition 103 in its entirety," Hunter said.

By voluntarily accepting Garamendi's rules even before they officially take effect, the Auto Club is distancing itself from the combative stance taken by rival insurers.

Garamendi's proposed regulations, which would greatly diminish the importance of ZIP Code rating, are under review at the California Office of Administrative Law. If cleared there, the rules would take effect after July 18.

Insurers would then have two years to comply fully with the new standards; they must show substantial progress during the first year, Garamendi said.

According to the Foundation for Taxpayer and Consumer Rights, both candidates running to succeed Garamendi, Democrat Cruz Bustamante and Republican Steve Poizner, have said they are committed to deemphasizing the use of ZIP Code rating for auto insurance.

Opponents of Garamendi's regulations say the politically ambitious commissioner, a Democrat running for lieutenant governor in November, would saddle them with unsound underwriting practices.

Rates would go up for more than 60% of motorists living in rural and suburban communities and go down for people living in such large cities as Los Angeles, San Francisco and Sacramento, insurers contend.

Garamendi's regulations "ignore factors that greatly contribute to risk associated with certain regions. Population density and congestion are two such factors," said a recent statement from an industry-supported coalition, Californians to Stop Unfair Rate Increases.

Five major insurance companies — including No. 1 State Farm Mutual Insurance Co. and No. 2 Farmers — spent more than \$2 million attacking Garamendi's rules in a television ad campaign just before the June primary election. They have indicated that they may sue the commissioner if he moves ahead.

The Auto Club does not foresee any problems working with the new regulations and does not expect rates to jump for most of its customers in suburban Orange and Riverside counties or sparsely populated parts of the high desert or Central Coast.

CEO McKernan credits solid profit in the last few years with providing the club a buffer that will allow it to keep rates low for most members. The club, which pays dividends to its members rather than to shareholders, has reduced losses as a result of fewer accidents, fewer lawsuits by accident victims against policyholders, generally safer vehicles and aging baby boomers who tend to drive more slowly and thus safely.

McKernan said his staff had been working with the California Department of Insurance for six weeks to find a way to switch to a formula emphasizing the three principal rating factors mandated by Proposition 103 without weakening the company's financial posture.

He said the Auto Club had a history of cooperating with regulators. In 1991, the club became the first insurer to agree to pay rebates to customers, based on calculated fair rates of return, as required by Proposition 103 and subsequent court rulings.

"The voters passed Proposition 103, and finally after all these years, there's a way to implement it," McKernan said. "We don't see why we'd want to litigate it and fight and fight and fight."

The Auto Club plans to aggressively market its generally lower rates with billboard, TV and newspaper advertising, just as it did with a similar 5% premium reduction in 2004, spokeswoman Carol Thorp said.

Garamendi's deal with the Auto Club, in splintering the once-unified industry opposition to changing rating formulas, will probably force other insurers to follow suit, said Jim Rogers, an auto insurance analyst and newsletter editor.

"This is absolutely a major break for Garamendi, and the Auto Club is the perfect company to get the break from because they can probably afford it the most," Rogers said.

"There may be some lawsuits, but I think Garamendi is going to get his way."

Garamendi said he was confident that he would win the fight with the politically powerful insurance industry.

"I think it's going to be very difficult to sustain a lawsuit in the face of the fourth-largest insurer in the state implementing the regulations and lowering its rates simultaneously," he said.

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Premium players

Top California auto insurance companies in 2005:

Company	Premiums received*	Market share
1. State Farm	\$2.46	12.77%
2. Farmers	1.87	9.70
3. Mercury General	1.83	9.48
4. Auto Club of So. Cal.	1.82	9.40
5. Allstate	1.75	9.08

*In billions

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Source: A.M. Best Co. (an insurance industry financial rating analyst)

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