Report Summary

LAC

Auto Insurance in South Carolina

Recommendations to

- Eliminate Recoupment Fees
- Increase Insurance Competition
- Improve Enforcement of Insurance Laws
- Replace the Reinsurance Facility

February 1997

The South Carolina Reinsurance Facility was created by the General Assembly in 1974 to provide insurance for drivers in the "residual market." Across the United States, the residual market generally consists of drivers who would have difficulty getting an insurance company to sell them a policy voluntarily, such as inexperienced drivers and those with bad driving records. In South Carolina, however, excessive regulation has greatly expanded the number of drivers in the residual market and has reduced competition among insurance companies.

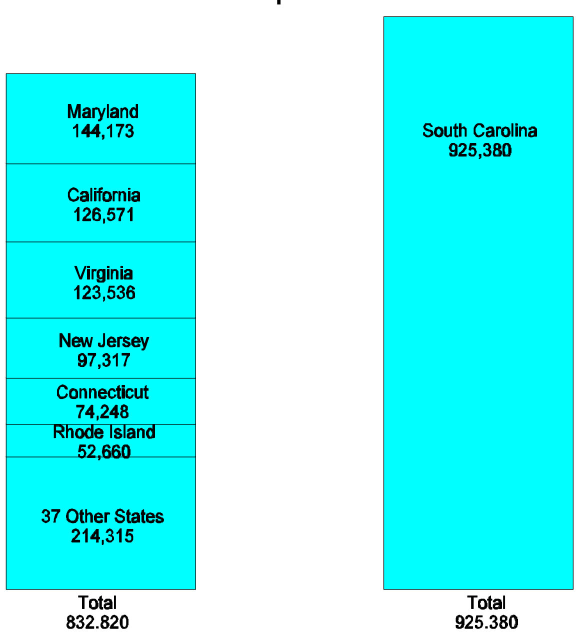
Why South Carolina's Reinsurance Facility is Large and Why it Loses Money

In 1993, South Carolina had a larger percentage of policies in the residual market than any other state. More than 42% (925,380) of South Carolina's policies were in its residual market, served by the reinsurance facility. Nationally, about 4% of policies were in the residual market. South Carolina had more policies in its residual market than the cumulative total of California, Florida, Maryland, Ohio, and 39 other states.

South Carolina's reinsurance facility is large because, in many cases, insurance companies have been required to charge the same premiums to high- and low-risk drivers. As a result, the premiums paid by many drivers have not been adequate to pay their projected accident claims and expenses. In addition, insurance companies have not been allowed to turn away customers. When faced with likely losses from customers who cannot be turned away, companies have complied with state law by serving the customers and ceding their policies to the facility.

From July 1988 through June 1996, South Carolina motorists paid recoupment fees of approximately $1.25 billion to subsidize the accident claims and expenses of drivers ceded to the reinsurance facility.

1993 Private Passenger Policies in SC's Residual Market Compared With 43 Other States



If insurance companies could refuse to sell any type of automobile policy on a customer-by-customer basis, some companies would reject high-risk drivers. At the same time, however, other companies, if allowed to charge adequate premiums, would voluntarily serve most high-risk drivers. Georgia is an example of a state with insurance market flexibility. In 1993, more than 99% of Georgia's private passenger policyholders were able to buy liability insurance without entering the state's assigned risk program for the residual market.

State law has also authorized the designation of a limited number of insurance agents who are paid for ceding *all* of their policies to the facility.

Because the premiums on policies ceded to the facility have been inadequate to pay for the accident claims and expenses generated by the policies, the reinsurance facility has routinely lost money. Initially, these losses are paid by the facility through its member companies. However, South Carolina motorists are required by state law to pay *"recoupment fees"* each year to reimburse the facility for prior losses.

In late 1996, the General Assembly and the department of insurance instituted reforms that are expected to reduce the size of the facility and its losses. For collision and comprehensive insurance only, insurance companies are now allowed more flexibility to vary rates based on driver risk and are allowed to turn away customers. For all private passenger automobile insurance, revised rating territories have been established. Most of these changes have been implemented by order of the director of insurance, who has stated that additional changes are planned for 1997. Although these changes are significant improvements, more needs to be done.

How Management of the Reinsurance Facility Has Contributed to its High Losses

The reinsurance facility has made decisions that have increased the facility's losses.

When any insurance company cedes a policy to the reinsurance facility, it is also required to cede the premium, minus expenses. The facility, however, has not penalized or required reimbursement from insurance companies when the amount they charge for policy premiums is found to be lower than the amount required by state laws and regulations.

In 1995, the reinsurance facility authorized payment of an ineligible claim of almost $1 million in order to protect a company from "substantial hardship."

Over 40% of the policies ceded to the facility are sold by insurance agents designated to sell policies exclusively for the facility. Claims on policies sold by these designated agents are investigated and paid by three designated insurance companies that contract with the facility. The facility pays the companies a percentage of the claims they pay. Therefore, designated companies have a financial incentive to maximize accident claim payments.

TOP 20 DESIGNATED AGENT COMMISSIONS IN FY 94-95

Designated Agent	County	Gross Commission
Agent 1	Richland	$755,801
Agent 2	Greenville	$696,428
Agent 3	Charleston	$611,378
Agent 4	Richland	$608,689
Agent 5	Richland	$575,664
Agent 6	Charleston	$568,165
Agent 7	Charleston	$560,505
Agent 8	Florence	$482,981
Agent 9	Charleston	$449,353
Agent 10	Sumter	$406,296
Agent 11	Anderson	$368,998
Agent 12	Spartanburg	$358,521
Agent 13	Horry	$345,977
Agent 14	Aiken	$342,038
Agent 15	Richland	$341,067
Agent 16	York	$340,795
Agent 17	York	$333,391
Agent 18	Horry	$317,858
Agent 19	Spartanburg	$296,530
Agent 20	Greenville	$266,762

DESIGNATED AGENTS IN AREAS ALREADY SERVED BY VOLUNTARY COMPANIES

City	Number of			Population
	Total Agents	Designated Agents	Voluntary Agents	
Columbia	615	12	603	251,498
Charleston	364	7	357	240,019
Florence	168	5	163	67,020
Sumter	153	4	149	84,568
Orangeburg	77	2	75	43,128
Bennettsville	23	1	22	15,751
Cheraw	27	2	25	13,063
Lake City	38	4	34	11,631
Loris	24	3	21	11,189
Westminster	20	2	18	8,882
Latta	15	3	12	6,435
St. Stephens	12	2	10	5,629

South Carolina law states that the reinsurance facility "may," but is not required to, designate agents to sell policies exclusively for the facility. Some designated agents work in areas of the state already served by agents of voluntary companies (such as State Farm, Allstate, and others). This, in part, is because the facility has not complied with state law, which requires consideration of market need when granting designations to agents who sell private passenger policies only.

Designated agents are not needed because without them there would be a sufficient number of insurance agents selling auto insurance. Reforms we recommend would lead to even more agents and companies selling auto insurance in South Carolina.

The facility pays designated agents 12% commission while voluntary companies pay their agents an average of 10% commission. The table above lists the top 20 commissions paid to designated agents in FY 94-95.

Why an "Assigned Risk Plan" May Be Better Than Other Systems

There are three systems commonly used to provide access to insurance for drivers in the residual market. It is important to note that there is variation among states using similarly named systems.

Reinsurance Facility

Under a reinsurance facility system, each insurance company is required to sell a policy to any willing customer. Following the sale, the company may cede the policy and its premium to a joint risk pool of all insurance companies. Facility policies are serviced by the companies to whom the drivers originally applied. Losses and profits on facility business are shared among the insurance companies. New Hampshire, North Carolina, and South Carolina have reinsurance facilities.

Joint Underwriting Association

A joint underwriting association (JUA) is similar to a reinsurance facility in that both are joint risk pools of all insurance companies. Under a JUA system, however, each insurance company is allowed to refuse to sell a policy, except for reasons prohibited by antidiscrimination laws. Drivers who are initially unable to obtain insurance are referred to one of a number of servicing carriers that sell and service policies for the JUA. The losses and profits on JUA business are shared among all automobile insurance companies. Florida, Hawaii, Michigan, and Missouri have JUAs.

Assigned Risk Plan

Under an assigned risk plan, each insurance company *initially* is allowed to refuse to sell a policy, except for reasons prohibited by antidiscrimination laws. Drivers who are initially unable to buy insurance are assigned to insurance companies in proportion to company market share. *The losses and profits incurred by an insurance company from assigned drivers are not shared with other companies. As a result, the assigned risk system may give companies greater incentive to minimize costs and claims paid than other residual market systems.*

Forty-one states have assigned risk plans:

Alabama	Illinois	Nebraska	Rhode Island
Alaska	Indiana	Nevada	South Dakota
Arizona	Iowa	New Jersey	Tennessee
Arkansas	Kansas	New Mexico	Texas
California	Kentucky	New York	Utah
Colorado	Louisiana	North Dakota	Vermont
Connecticut	Maine	Ohio	Virginia
Delaware	Minnesota	Oklahoma	Washington
Georgia	Mississippi	Oregon	West Virginia
Idaho	Montana	Pennsylvania	Wisconsin
			Wyoming

Ways to Improve Enforcement of Insurance Laws and Improve Traffic Safety

At least 10% (285,000) of South Carolina motorists drive without liability insurance. The number of uninsured motorists has been increasing.

ESTIMATES OF UNINSURED VEHICLES

Year	Percent Uninsured	Number of Uninsured Vehicles
1974	9%	150,000
1985	11%	251,343
1988	11%	272,502
1995	10%	285,299

The South Carolina highway patrol and local law enforcement agencies, however, have not adequately enforced laws that require motorists to have liability insurance. When some motorists do not pay premiums and recoupment fees, the remaining motorists are required to pay higher premiums and recoupment fees.

South Carolina law requires confiscation of the motor vehicle when a person is found, for the fourth time or more, driving under the influence or driving with a suspended license. However, the highway patrol and local law enforcement agencies have not consistently confiscated motor vehicles. Violations could be deterred by improved law enforcement.

South Carolina is one of 23 states that do not have zero tolerance laws for drivers under age 21 found drinking. Also, South Carolina is one of two states which does not have an "illegal *per se*" law which states that a person whose blood alcohol concentration is at or above a certain limit is deemed to be in violation of the law, regardless of whether there are behavioral signs of intoxication. South Carolina does not have an administrative license revocation law which allows for the immediate confiscation of drivers' licenses for failing a blood alcohol test.

Additional policy changes could help improve traffic safety and ultimately reduce insurance costs. For example, South Carolina does not have a "graduated" driver's license system, in which each applicant would be required to pass through multiple stages of training and experience prior to licensure. Eight states have graduated licensure systems. Studies show that young drivers are involved in more vehicle accidents than the population as a whole.

ACCIDENT RATES BY AGE

Age	Accidents Per Million Miles
16	43
17	30
18-19	15
20-24	5
25 and older	3

General Recommendations

Reforms in the regulation of automobile insurance will eliminate the need for recoupment fees and the reinsurance facility. It is also likely that additional insurance companies will enter the market, increasing competition. To accomplish these reforms, the General Assembly should consider amending state law to:

- ❏ Give insurance companies increased flexibility to set insurance premiums.
- ❏ Allow insurance companies to refuse to sell insurance to any driver for reasons other than race, religion, ethnicity or related factors.
- ❏ Replace the reinsurance facility with an assigned risk system.
- ❏ Eliminate recoupment fees.
- ❏ Eliminate designated insurance agents.

If the General Assembly decides to retain the reinsurance facility, it should consider amending state law to require that policies ceded to the facility be ceded at self-sustaining premiums. In addition, the reinsurance facility board and management should enact incentives for insurance companies to reduce claims payments and expenses.

If recoupment is not eliminated, the General Assembly should consider amending state law to prohibit insurance agents from earning commissions on recoupment fees.

If the General Assembly decides to retain the designated agent system, it should consider amending state law to prohibit the facility from appointing designated agents unless there is a need.

To increase highway safety and control insurance rates, the General Assembly should consider amending state law to:

- ❏ Increase penalties for driving under the influence, driving without insurance, and driving with a suspended license. In addition, the highway patrol and local law enforcement agencies should improve their enforcement of these laws and confiscate cars as required.
- ❏ Establish a "graduated licensing system," in which each applicant passes through multiple stages of training and experience prior to licensure.
- ❏ Make 16 the minimum age for obtaining a restricted driver's license.
- ❏ Enact a "zero tolerance" law for underage drinkers.
- ❏ Provide for the administrative suspension of drivers' licenses for drivers with a blood alcohol concentration at or above the legal limit.

This document summarizes our full report, *Auto Insurance in South Carolina.* A full report of this and all LAC audits are available free of charge. Audits published after January 1995 can also be found on the Internet at www.lpitr.state.sc.us/reports/lacbrief.htm. If you have questions, contact George L. Schroeder, Director.