

Texas Department of Public Safety

Texas Department of Insurance

**HB 3588 FEASIBILITY STUDY OF AN INTERFACE
MOTOR VEHICLE FINANCIAL RESPONSIBILITY
VERIFICATION SYSTEM**

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Section 1: Executive Summary

Introduction

The current Uninsured Motorist Rate (UMR) in Texas is estimated at 20 percent. House Bill 3588, passed during the 78th Regular Legislative Session, charged the Department of Public Safety and the Department of Insurance to jointly conduct a study to determine the feasibility, affordability, and practicability of using a database interface software system for the verification of liability insurance coverage on motor vehicles in Texas and to make a determination of whether such a system should be implemented in Texas. A task force was formed to include the staff of the Department of Public Safety, the Department of Insurance, and the Department of Transportation. The task force compiled and gathered information through surveys of other states, meetings with vendors of verification systems, and staff research and analysis.

This report provides background information on the uninsured motorists' problem in Texas and, in accordance with HB 3588, the report considers the following five factors to determine whether such an insurance verification system is feasible:

- Likelihood to reduce the number of uninsured motorists in this state;
- System reliability;
- Cost-effectiveness;
- Privacy protections; and
- Data security and integrity.

Definition:

Database Interface Software System: An electronic information delivery/interface system that allows for the direct exchange of various identifiers between the State and the various insurance industry databases to determine whether a person has motor vehicle liability insurance in force that complies with the Texas Motor Vehicle Safety Responsibility Act.

Discussion

The task force reached an affirmative finding on each of the five factors. While the task force finds that the implementation of a database interface software system is likely to reduce the UMR, the task force is of the opinion that this approach alone will not provide the reductions experienced in other states.

Based on a survey of the 27 states that operate some type of database reporting system, the average pre-implementation UMR was 25.85 percent, and the average post-implementation UMR is 9.39 percent, which is a reduction in the UMR of 16.46 points or 63.68 percent. Based on these numbers and the estimated UMR in Texas of 20 percent, it is possible that there could be a 12 to 13 point reduction in the UMR in Texas. This could mean a drop in the UMR to as low as 7-8 percent. Based on the experience of other states, the reliability of an insurance verification system is dependent on several identifiable factors. This is directly related to the design and implementation of the system.

The data obtained in two surveys conducted by the task force and the analysis conducted by the Texas Department of Insurance on possible automobile insurance premium savings indicates that it could be cost effective to implement and operate a database interface software system in Texas. The costs of implementation will vary depending on the type of verification system used as well as the format, frequency and comprehensiveness of any reporting that may be required.

Privacy is a major concern not only for state agencies but also for the insurance companies and consumers. Protection of personal information is one of the most important components of the system. Therefore, information and system security needs will be foremost in designing and implementing all phases of the system. Texas law imposes certain security standards on state agencies in order to reduce the risk that information will be improperly disclosed or systems accessed by unauthorized entities. The Department of Public Safety has the necessary experience to ensure data security and integrity.

Based on the foregoing analysis, the task force has determined that the database interface software verification system is feasible; however, in order to maximize the effectiveness of a system, the system must be capable of monitoring a driver's compliance with the Texas Motor Vehicle Safety Responsibility Act on an on-going basis.

It is the recommendation of the task force that Texas not implement the database software interface system at this time and that additional consideration be given to alternatives that will provide the maximum reduction in the UMR in Texas. The Departments believe that the most effective verification system is one that consolidates a database interface software system with a liability insurance cancellation reporting system. To that end the task force recommends issuing a Request for Information (RFI) that specifies the features needed for a consolidated system and requires potential vendors to tell how they will construct such a system for Texas and the costs of such a system.

Section 2: Reduction in Uninsured Motorist Rate (UMR)

The Uninsured Motorist Rate (UMR) in Texas is difficult to determine with absolute accuracy. Nationally, it is estimated by the insurance industry that the UMR ranges from a low of 5% to a high of 30%, with a national average of 20%. To evaluate the effectiveness of a verification program in Texas, it is necessary to first estimate the current uninsured motorist rate. For the purposes of this study, two nationally accepted methods of determining the UMR have been used:

Method 1: The number of motor vehicles identified as uninsured in crashes during the crash investigation. It is derived as follows:

$$\text{UMR}\% = \frac{\text{Number of Vehicles Uninsured in Crashes}}{\text{Number of Vehicles Involved in Crashes}} \times 100$$

The estimated UMR for Texas using this method is 20%.

Method 2: The number of insured vehicles ascertained by the Department of Insurance from the Private Passenger Automobile Statistical Plan and the Commercial Lines Statistical Plan is compared to the number of registered vehicles in Texas (from TXDOT).

The estimated UMR for Texas using this method is also 20%.

Based on the methodologies above, Texas appears to have at least a 20% UMR.*

While 47 states have implemented mandatory liability insurance statutes, some 27 states have opted for insurance verification programs. A survey sent to 19 states with either a random sampling or database reporting approach to verifying coverage resulted in 11 responses. This survey provided information concerning the individual state's experience regarding cost, UMR reduction, and error processing.

Since this section addresses the UMR, the evaluation statement will be limited to the UMR results reported in those responses. The average pre-implementation UMR was 25.85%. The average post-implementation UMR is 9.39% resulting in an average reduction in the UMR of 16.46 points or 63.68%. Based on these numbers and the estimated UMR in Texas of 20%, it is possible that there could be a 12 to 13 point reduction in the UMR in Texas, which could mean a drop in the UMR to as low as 7%-8%. The highest reductions in the UMR were in states that had a database reporting/verification system.

*It is important to note that this UMR might be too low by several percentage points, depending on the accuracy of the information reported.

Section 3: System Reliability

Currently, Texas has an event-based motor vehicle verification system. Under this type of system, proof of coverage must be presented at certain times, such as vehicle registration, motor vehicle inspection, and during crash investigation or citation issuance. While this is a less intrusive approach, it has not proven to be effective. Without verification or authentication, this system does not provide incentive for voluntary compliance and it results in successful dodges. For example, fraudulent insurance cards may be used for the required proof of coverage. In addition, valid policies may be obtained for vehicle registration and inspection and then cancelled following the initial transaction. Upon cancellation, the motorist still has what appears to be a valid and authentic insurance card.

Based on the experience of other states, the reliability of a system that utilizes a database to collect and compare pertinent information for identification of motor vehicle owners who are not in compliance with the state's financial responsibility laws can be evaluated based on several factors, including:

- timeliness (reporting requirements vary by state from once a quarter to once weekly);
- accuracy (error rates can be reduced by increasing the number of identifiers used for the comparison, including vehicle identification number, policy number, driver's license number, etc.);
- incentive for voluntary compliance or "forced compliance" feature (consumers run the risk of being identified as uninsured);
- less opportunity to dodge or game the system (use of fraudulent insurance cards and cancellation of policies after vehicle registration and inspection are ineffective);
- reduction in uninsured motorists' rate (those states that have some type of database verification system reported the greatest reduction in the UMR).

The task force identified two types of insurance verification systems that are primarily used to determine compliance with mandatory financial responsibility laws in other states: the database reporting system and the random sampling system. While these approaches have proven effective in reducing the UMR, the task force identified significant shortcomings with each. For the database reporting system, the primary concern is with the error match rates associated with combining insurance company databases and motor vehicle registration information. Due to the number of registered vehicles in Texas this could place a significant burden on those insured individuals identified as uninsured due to the error match rate. This is also a significant concern for the insurance industry. For the random sampling system, the primary concern is that verifying or confirming coverage on a limited number of registered vehicles does not provide for "forced" compliance with insurance requirements.

It is the opinion of the task force that the problems with database reporting systems that have been experienced by other states can be reduced or eliminated by careful and thoughtful design and implementation of the system. For example, reducing the number of properly insured vehicle owners who are identified as uninsured can be reduced by increasing the number of identifiers used for the comparison. Education and monitoring can assist in ensuring insurance company compliance with system requirements which is essential to system operation reliability.

SECTION 4: COST EFFECTIVENESS

This analysis of the cost effectiveness of a database interface software system for the verification of liability insurance coverage on motor vehicles in Texas is based on data obtained in two surveys conducted by the task force and an analysis developed by the Texas Department of Insurance to estimate the reduction in Uninsured Motorist/Underinsured Motorist (UM/UIM) premiums that could result from the implementation of such a system.

One survey was sent to 14 groups of insurers to obtain information about verification programs currently implemented by 27 states, including:

- the type of information collected by insurers and their agents;
- how that information is exchanged by the insurers; and
- problems that insurers have encountered in establishing reporting/verification systems.

Another survey was sent to the state law enforcement agencies in the 27 states that have insurance verification systems to obtain information about the systems, including:

- implementation,
- operation,
- costs associated with the reporting system, and
- the effect of the reporting system and the state's enforcement on the states uninsured motorists' rate.

The information provided by the respondents to the two surveys coupled with the analysis conducted by the Texas Department of Insurance on possible premium savings indicates that it could be cost effective to implement and operate a database interface software system in Texas. The task force believes, however, that identifying the specific operating requirements through a Request for Information will enable the development of a more precise estimate of costs associated with the system. Nevertheless, the task force believes it is possible to determine a reasonable measure of cost effectiveness to implement and operate such a system by comparing the estimated cost to insurers to the estimated cost and savings to automobile insurance policyholders.

The insurers' survey responses indicate that the costs of implementation will vary depending on the type of verification system used as well as the format, frequency and comprehensiveness of any reporting that may be required. One of the insurer respondents noted that nationwide "private passenger automobile insurers spend \$50 to \$65 million annually to develop and maintain these systems."

The TDI analysis estimating the reduction in UM/UIM premium that could result from the implementation of a database interface software system indicated that the estimated reduction would likely be in the range of 8% to 17% and would only apply to the UM/UIM portion of the automobile premium. This translates to an estimated total premium dollar savings in the range of \$80 million to \$170 million annually. It is important to note that this estimated reduction is relative to *what the uninsured motorist's rates would be in the absence of the implementation of HB 3588*. Several factors other than the number of

uninsured drivers can impact the costs of uninsured/underinsured motorists' rates, including costs to repair vehicles, medical costs, and overall accident rates.

Based on the estimated \$50 to \$65 million compliance costs spent annually by all insurers in all states operating reporting/verification systems, compliance costs for insurers for such a system in Texas will be far less than that amount which compares favorably to the estimated premium savings of \$80 to \$170 million to Texas automobile insurance consumers.

The annual cost to the states of operating a database verification system varied from \$240,000 (Georgia) to \$3 million (Florida).^{*} The Legislature has provided that the establishment and maintenance of the system is to be funded by the payment of a \$1 fee to be paid by each person applying to register or renew the registration of a motor vehicle. There are approximately 15 million registered motor vehicles in Texas. The approximate \$15 million dollars generated from this funding source far exceeds the highest costs reported by any state regarding the annual costs of operating a reporting system.

While funding was originally provided for implementation of the system under HB 3588, 78th Regular Legislative Session, the authorization for funds to conduct the feasibility study was enacted in HB 2, Third Called Session, 78th Legislative Session.^{**} In HB 2, the authorized funding through August 31, 2005 was directed only to conducting the study without authorization of funding to implement the selected system until September 1, 2005. Therefore, funds to implement the system cannot be accessed until September 1, 2005 subject to appropriation by the Texas Legislature. To date, no state funds other than normal DPS and TDI operating funds have been expended on conducting the feasibility study.

* It is important to note the task force is not confident that states have reported all expenditures related to verification programs they manage. For Texas, estimated costs could be compared to Florida due to its similar demographics.

** The revenue generated by the \$1 fee assigned to vehicle registrations in HB 3588 was also dedicated to the Driver License Reengineering Project (DLRP). This funding does not provide sufficient revenue to fund the DLRP and the implementation of an insurance verification program simultaneously.

SECTION 5: PRIVACY

Privacy is a major concern, not only for state agencies, but also for the insurance industry and consumers. A review of Texas Transportation Code (TRC) §601.453, indicates that additional sanctions and/or penalties for misuse of information provided are necessary. While specific contractual obligations can be assigned, agencies cannot create offenses and penalties. According to §601.453(d), an offense under this subsection is punishable as a Class B misdemeanor. It would be preferable to mirror TRC Chapter 730, Motor Vehicle Records Disclosure Act, §730.013(d), that states “An offense under this subsection is a misdemeanor punishable by a fine not to exceed \$25,000.” This offense should also apply to anyone that has access to this data. Prohibitions on the use of information received should also be defined.

Dependent upon the approach taken in Texas, the exchange of personal information can be limited or in some cases eliminated. The technical security issues surrounding the exchange of information between a selected vendor and the insurance company are addressed in the next section.

SECTION 6: DATA SECURITY/INTEGRITY ISSUES

Verification of insurance information may require the exchange of personal information between the Department of Public Safety, Department of Transportation and the insurance industry. Protection of personal information must be considered one of the most important components of the system. In addition, the linking of Department of Public Safety, Department of Transportation and insurance industry systems introduces opportunities for system breaches and unauthorized access to other data repositories and systems within the departments. Therefore, information and system security must be considered throughout the lifecycle of any insurance verification program, regardless of the approach used to verify the information.

An insurance verification system must comply with the provisions of the Information Security Standards (1 TAC 202.1 – 202.8) adopted by the Department of Information Resources. These rules provide for a comprehensive approach for agencies to use to reduce the risk that information will be improperly disclosed or systems accessed by unauthorized entities. These security standards require agencies to follow formal processes to establish the risks associated with the disclosure of information or access to systems, the consequences of disclosure and the appropriate security strategies to mitigate risks.

The Department of Public Safety has already established interconnected systems with external entities through which personal information is provided. These interconnected systems use the TexasOnline infrastructure for this connectivity and interaction, and follow the TexasOnline standards for Data Transfer Requirements (Version 1.0, April 15, 2002) and System Environment Specifications (Version 2.1, September 23, 2003). These specifications have been developed in accordance with the Information Security Standards referenced above and the security requirements established by the TexasOnline Authority. Insurance verification applications (i.e., web applications, file and data transfers, etc.) should mirror these specifications and requirements that are currently used by the Department of Public Safety.

SECTION 7: RECOMMENDATION

The task force is not aware of any state that currently has a database interface software system that provides the required verification and on-going monitoring components necessary to achieve the objectives of Chapter 601, Subchapter N, Transportation Code. The task force recommends that Texas not implement a database interface system at this time and that specific information be obtained on designing a system that meets all of the requirements of Chapter 601, Subchapter N, Transportation Code.

To that end the task force recommends issuing a Request for Information (RFI) that specifies the features needed for a Texas database interface software system and requires potential vendors to tell how they will construct such a system for Texas, the costs of such a system, and how a monitoring application will be incorporated into this system. The information obtained in the RFI will enable the task force to present a proposal to the 79th Legislature which the Legislature can use to consider statutory authority and funding to implement a system that combines the benefits of instant verification through industry databases with the monitoring of identified uninsured motor vehicles.