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No-fault insurance

Withdrawal/Redaction Sheet

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DOCUMENT NO. AND TYPE	SUBJECT/TITLE	DATE	RESTRICTION
001. memo	from Elena Kagan to Ellen Seidman re Re: No-Fault (1 page)	05/08/1996	P6/b(6)

COLLECTION:

Clinton Presidential Records
Counsel's Office
Elena Kagan
OA/Box Number: 8284

FOLDER TITLE:

No-Fault Insurance

2009-1006-F
kc139

RESTRICTION CODES

Presidential Records Act - [44 U.S.C. 2204(a)]

- P1 National Security Classified Information [(a)(1) of the PRA]
- P2 Relating to the appointment to Federal office [(a)(2) of the PRA]
- P3 Release would violate a Federal statute [(a)(3) of the PRA]
- P4 Release would disclose trade secrets or confidential commercial or financial information [(a)(4) of the PRA]
- P5 Release would disclose confidential advice between the President and his advisors, or between such advisors [(a)(5) of the PRA]
- P6 Release would constitute a clearly unwarranted invasion of personal privacy [(a)(6) of the PRA]

C. Closed in accordance with restrictions contained in donor's deed of gift.

PRM. Personal record misfile defined in accordance with 44 U.S.C. 2201(3).

RR. Document will be reviewed upon request.

Freedom of Information Act - [5 U.S.C. 552(b)]

- b(1) National security classified information [(b)(1) of the FOIA]
- b(2) Release would disclose internal personnel rules and practices of an agency [(b)(2) of the FOIA]
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- b(4) Release would disclose trade secrets or confidential or financial information [(b)(4) of the FOIA]
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- b(7) Release would disclose information compiled for law enforcement purposes [(b)(7) of the FOIA]
- b(8) Release would disclose information concerning the regulation of financial institutions [(b)(8) of the FOIA]
- b(9) Release would disclose geological or geophysical information concerning wells [(b)(9) of the FOIA]

THE WHITE HOUSE

WASHINGTON

May 9, 1996

MEMORANDUM FOR JACK QUINN
BRUCE LINDSEY
KATHY WALLMAN

FROM: ELENA KAGAN *EL*

SUBJECT: NO-FAULT AUTO INSURANCE

Ellen Seidman of the NEC wants to put together a small working group, including representatives from the Counsel's Office and the Justice Department, to develop an administration position on various no-fault auto insurance proposals. Sen. Dole apparently may put forward such a proposal in the coming months, as another way of trying to make the point that the President is in the back pocket of the trial lawyers.

Does anyone have any objections to the formation of such a group? Thoughts on who should be in the group and/or what it should do?

E X E C U T I V E O F F I C E O F T H E P R E S I D E N T

08-May-1996 03:02pm

TO: Elena Kagan

FROM: Ellen S. Seidman
 National Economic Council

SUBJECT: No-fault

I'm going to put together the no-fault meeting. Can you help me with finding the person at DOJ who should be part of an us-level working group? i.e., either very senior and plugged in career or political, but we probably don't need John Schmidt himself, except perhaps to coopt him and avoid later problems. Ellen

Withdrawal/Redaction Sheet

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E X E C U T I V E O F F I C E O F T H E P R E S I D E N T

08-May-1996 03:34pm

TO: Elena Kagan

FROM: Ellen S. Seidman
 National Economic Council

SUBJECT: RE: No-fault

THE mission, which I had a BRIEF conversation with Bruce about already, is to figure out if we can have a position other than "just say no" in case Dole really does put forth the McConnell/Horowitz no-fault bill as a response to the products veto, challenging us to prove we're for consumers and not the trial lawyers. John Schmidt should love it, but I agree with your analysis. Ellen

E X E C U T I V E O F F I C E O F T H E P R E S I D E N T

08-May-1996 05:20pm

TO: Elena Kagan

FROM: Ellen S. Seidman
 National Economic Council

SUBJECT: RE: No-fault

As I understand it, would convert the entire auto liability system into a first-party pay system, in which you would buy the level of coverage you want from your own insurer, who would pay even if YOU won the tort case????? The catch, apparently, is no compensation at all for pain and suffering. This sounds nutty, but it's probably because the description I read is wrong, or I just don't understand. In any event, if it is this crazy, there should be plenty of room to be in favor of no fault without being in favor of this bill.
Ellen

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ISSUES
UPDATE

Ruth Gastel, Editor

March 1996

NO-FAULT AUTO INSURANCE

Key Points

- o The term "no-fault" auto insurance often is used loosely to denote any auto insurance program that allows policyholders to recover financial losses from their own insurance company, regardless of fault. But, in its strictest form, no-fault applies only to state laws that both provide for the payment of no-fault first-party benefits and restrict the right to sue.
- o Under current no-fault laws, motorists may sue for severe injuries and for pain and suffering only if the case meets certain conditions. These conditions, known as a threshold, relate to the severity of injury. They may be expressed in verbal terms (a descriptive or verbal threshold) or in dollar amounts of medical bills a monetary threshold. Some laws also include the days of disability incurred as a result of the accident. (Pure no-fault proposals go one step further, abolishing the right to sue in most cases).
- o Because high threshold no-fault systems restrict litigation, they tend to reduce costs and delays in paying claims. Verbal thresholds eliminate the incentive to inflate claims that may exist when there is a dollar "target" for medical expenses.
- o Currently 13 states and Puerto Rico have no-fault auto insurance laws. Florida, Michigan, New Jersey, New York and Pennsylvania have verbal thresholds. The other eight states use a monetary threshold: Colorado, Hawaii, Kansas, Kentucky, Massachusetts, Minnesota, North Dakota and Utah. Three states have a "choice" no-fault law. In New Jersey, Pennsylvania and Kentucky, motorists may reject the lawsuit threshold and retain the right to sue for any auto-related injury.

No-Fault Auto Insurance

Current Developments

With the number of uninsured motorists increasing, especially in urban areas where the cost of auto insurance is highest, the idea of pure no-fault is moving from concept to legislation. Pure no-fault abolishes lawsuits for most accidents. Depending on the system that currently exists in the states where it is being considered, and the level of benefits mandated, pure no-fault has the potential to considerably reduce the price of basic auto insurance coverage.

California: In January, the California Assembly passed AB 607, a pure no-fault bill that would abolish all lawsuits for bodily injury and death except for accidents caused by intentional misconduct, drunk driving or an uninsured driver. Minimum no-fault coverage would be \$50,000 per person but insurers would be required to offer up to \$1 million per person. Coverage for pain and suffering would be available.

Unlike Proposition 200, see below, the Assembly bill does not require drivers to purchase property damage liability coverage. Lawsuits by insured drivers for property damage are allowed, but lawsuits for property damage by uninsured drivers are prohibited unless the damage exceeds \$5,000. However, there is no restriction on lawsuits by uninsured drivers in cases where the other driver was guilty of drunk driving or intentional misconduct. Motorcycles are excluded from the no-fault system.

While the law does not specifically mandate a rate reduction, the no-fault law would be repealed if, during the law's first year in effect, statewide rates for minimum no-fault coverage were not 25 percent lower than the rates charged under the existing law. The California Senate is not expected to pass the bill.

However, Californians who vote in the state's presidential primary election will have another chance to show their support for a pure no-fault auto insurance system. A pure no-fault initiative and two tort reform initiatives will be on the March 26, 1996 ballot. The initiatives are being sponsored by the Alliance To Revitalize California, a group of consumer and business tort reform advocates led by former Silicone Valley business executive Thomas Proulx, the founder of Intuit. The two tort reform initiatives deal with attorney contingency fees and lawsuits brought by shareholders, see report on the liability system. Alliance supporters also include Andrew Tobias who tried unsuccessfully to get a pay-at-the-pump proposal on the ballot a couple of years ago and members of Voter Revolt, the group that sponsored Proposition 103, a 1988 initiative that among other things brought sweeping changes to the state's auto insurance system. (Harvey Rosenfield who founded Voter Revolt has left the organization and opposes the Alliance's three initiatives.)

No-Fault Auto Insurance

If approved by the voters, the new auto insurance system would require insurers to offer no-fault coverage with at least \$1 million in PIP benefits and at least \$5,000 in property damage liability. Drivers who wish to purchase only the minimum PIP coverage of \$50,000 must sign a waiver, indicating that they understand that this amount may not cover all their economic losses. Insurers must also offer \$250,000 in supplemental PIP coverage for pain and suffering to cover cases where an accident causes serious and permanent impairment or disfigurement. The legislation also sets out cost control measures, including fee schedules for medical care treatment based on those established for workers compensation, and mandates review by an independent peer review organization of the quality and appropriateness of health care treatment and services. Insurers will be required to pay two dollars per insured vehicle to fund anti-fraud measures. The law would go into effect on July 1, 1997.

A public opinion survey by Steinberg and Associates of Calabasas, California for the Hudson Institute suggests that the public is more likely to support the no-fault initiative if it is seen as part of an overall tort reform package designed to reduce the amount of litigation in the state. In addition, the study notes, the initiative will be viewed more favorably if pro-business and consumer groups are known to be supporting the measure. With no serious contest in the Democratic presidential primary, the voters most likely to cast a ballot on the initiative will be conservative Republicans.

A study by the Rand Institute for Civil Justice suggests that the typical California driver could see premium reductions of as much as one third under the pure no-fault system and drivers who purchased only the minimum PIP coverage limits could save as much as 53 percent on those coverages that are mandatory -- personal injury and property damage liability. Those who purchase \$1 million in PIP coverage under the plan would save about 39 percent on mandatory liability coverages.

A California Insurance Department study shows that 27.8 percent of vehicles in the state are uninsured, about 5.8 million motorists, with the percentage as high as 37 percent in Los Angeles County. The preamble to the Pure No-Fault Auto Insurance Act, which outlines the reasons why the ballot initiative should be approved, notes that policyholders in the state currently spend \$1 billion to subsidize uninsured motorists. The new system would significantly reduce cost shifting and fraud.

Hawaii: The legislature passed a pure no-fault law in May 1995 which the governor subsequently vetoed. In February 1996, a new pure no-fault bill was passed by the Senate. SB 2001 would abolish all lawsuits for bodily injury and death except for accidents caused by drunk driving, or intentional/criminal conduct. Minimum no-fault coverage would be set

No-Fault Auto Insurance

initially at \$250,000 per person and adjusted annually so that it covers 99 percent of all no-fault claims but insurers would be required to make coverage of \$1 million per person available. In addition, first party pain and suffering coverage would be available. Minimum property liability coverage under the Senate plan would be \$10,000.

In a change from the 1995 vetoed legislation, insured accident victims whose economic losses exceeded their no-fault benefits, a tiny fraction of those injured, would be allowed to sue to recover the remainder of their out-of-pocket expenses. Auto insurance coverage for medical expenses would be primary to health insurance coverage instead of secondary as it was in the original bill, which means that auto insurance premiums will be higher than they would have been under the 1995 legislation but employers who pay the bulk of health insurance premiums are more likely to support the new bill. The Senate plan also includes generous wage loss benefits which will further push up the price of coverage. Unlike the earlier version, this year's plan includes no mandated reduction in rates. The House has not yet developed its own reform legislation.

Currently, because a monetary threshold is always a target and Hawaii's at \$11,000, is higher than other states. Hawaii's average overall auto insurance premiums are second only to New Jersey and its average liability premiums are highest of all 51 jurisdictions. Under the pure no-fault system contemplated by the Senate bill, with its high level of benefits, policy holders would get more coverage per dollar of premium even if costs were not significantly lower. In 1995, the Senate passed a pure no-fault bill and the House originally passed a choice no-fault bill.

Michigan: Since proposal C was defeated by a 3 to 2 margin in November 1994, the Michigan auto insurance system has reverted to the old law with its unlimited medical care benefits. (Proposal C asked voters to approve a law that reduced premiums by 16 percent for policyholders that reduced their medical care (PIP) coverage to \$1 million.) However, because the Republicans gained control of the legislature, some reforms embodied in the revised no-fault law are being enacted piecemeal, starting with tort reform issues.

Early in November, the legislature approved a measure (HB4341) that would prevent uninsured drivers and drivers more than 50 percent at fault from collecting for pain and suffering in a lawsuit, and restore what are known as Cassidy standards. These standards, which determine when injuries meet the threshold for lawsuits, would require a judge rather than a jury to make the determination, except in certain head injury cases. These standards are generally considered more objective than those that have been in effect for the past few years. In addition, the bill would raise the dollar limit for auto cases that may be settled in small claims court from \$400 to

No-Fault Auto Insurance

\$500.

A controversial amendment added by the Senate that eliminated the tort threshold for accidents caused by drugged or drunk drivers was introduced as a separate bill. Meanwhile, Democrats reintroduced a measure that includes a 14-month rate freeze and more detailed reporting of losses and premium data.

Michigan's no-fault law, considered a model by some no-fault advocates, came under fire because of rising premiums. Michigan is the only state that does not cap medical care payments. As a result, payments under the personal injury protection coverage rose 35 percent for the four years 1989-1993. Efforts to reform the law through a statewide ballot initiative in 1992 failed, due, in part, to the complexity of the initiative and to opponents' success in depicting it as anti-consumer, industry observers say.

Massachusetts: A choice no-fault bill with a pure no-fault component has been introduced in the House by Rep. Anne Paulsen. The bill includes a provision designed to make coverage more affordable in areas where the rates are highest. Under the proposal, drivers that live in communities where rates are 50 percent higher than the statewide average would have the option of purchasing a policy that provided \$7,000 in PIP benefits, instead of the standard \$20,000. The idea was modeled on a Colorado law that allows insurers to offer to drivers whose family income falls below a certain level what is known as an income-sensitive policy. This policy offers an alternative package of PIP benefits, generally lower than the standard one, for a significantly reduced premium.

Despite the new proposal, industry observers expect little change on the auto insurance front because the November 1994 elections brought only minor changes to the make up of the legislature. Rates have stabilized and there was little interest in a choice no-fault system in the last session. Nevertheless, the state's no-fault law is still vulnerable to new assaults by the state's trial bar, industry observers warn. Early in 1994, a bill to repeal the no-fault law was passed by the Senate.

Average auto insurance premiums in Massachusetts are among the highest in the country. Increases over the five years 1987-1991 were higher than the national average and, in 1993, the state ranked fourth highest in overall and third highest in average liability premiums. Currently, Massachusetts has a monetary threshold of \$2,000. Rates are set by the state.

New Jersey: New Jersey drivers pay auto insurance premiums that are among the highest in the nation, largely because of the urban nature and traffic density. Governor Christine Todd Whitman has said that reducing auto insurance premiums through tort reform is a major priority of her

No-Fault Auto Insurance

administration. While some had championed a major overhaul of the system, including giving consumers several coverage options and the opportunity to reduce their premiums by rejecting coverage for pain and suffering, the Governor now favors a more incremental approach to change. Among the measures being proposed to lower the price of auto insurance are a managed care option (see report on controlling medical care costs); a "direct repair" option, something akin to managed care for cars (insurers would negotiate reductions in repair charges with selected repair shops in return for a large volume of business); fee schedules for the treatment of various common types of auto accident injuries; and a reduction in PIP insurance coverage, now at \$250,000. PIP benefits in neighboring New York State are capped at \$50,000.

An insurance department report shows that as of June 1994, 3.8 million drivers had opted for the strong verbal threshold, 85.8 percent of insured motorists, up from 80.7 in 1991. Those who selected the limitation on lawsuits saved about 25 percent on their liability insurance premium.

Other States: In Oklahoma, a House committee on insurance and public safety is considering the possibility of adopting a no-fault auto insurance system.

Impact of No-Fault Laws on Medical Claims: A study by the Rand's Institute for Civil Justice suggests that strong no-fault laws with a verbal threshold can reduce fraudulent medical claims -- claims for non-existent soft tissue injuries, such as strains and sprains, as well as build-up of legitimate claims for both "hard" injuries (fractures and other objectively verifiable injuries) and soft tissue injuries. Strains and sprains lend themselves to exaggeration because they are not easily verifiable.

In a verbal threshold state, accident victims can only sue for pain and suffering if their injuries meet the level of seriousness set out in the law, usually defined as death, dismemberment, serious disfigurement, fractures or other severe impairment. Since soft tissue injuries would not meet the tort threshold definition, there is little point in inflating their severity or creating fictitious injuries. However, in dollar threshold states, there is a clear incentive to exaggerate the seriousness of any injury, both hard and soft tissue, to build up claims. According to the ICJ researchers, dollar thresholds actually create a greater incentive to boost medical care bills than traditional tort liability auto insurance systems, especially where the threshold is high as in Hawaii, because there is a target to aim for. In tort states, compensation for pain and suffering flows from the first dollar of the medical care claim.

No-Fault Auto Insurance

Background

Currently, state auto liability insurance laws fall into four broad categories: those based solely on the traditional tort liability system; those that require an insurance company to pay first-party (policyholder) benefits, regardless of who was at fault in the accident, but retain the right to sue as in tort liability states; those that provide no-fault first-party benefits but restrict the right to sue except under certain conditions; and those that provide a choice between the traditionally liability system and a no-fault system with a verbal threshold. These alternative systems have evolved over time as consumers, regulators and insurers have sought ways to lower the cost and speed up the delivery of compensation for auto accidents.

In the early 1990s, the concept of pure no-fault, which prohibits most lawsuits for bodily injury, began to garner support. Pure no-fault addresses several societal concerns: the waste of resources and the inequities in the liability system and the need to have affordable coverage for medical care and rehabilitation costs. The first attempt at a pure no fault system was "pay-at-the-pump," a scheme to pay for no-fault auto insurance through a fee collected on gasoline sales. The "pay-at-the-pump" initiative campaign failed in all states in which the plan was considered, including California, due to opposition to the gasoline usage-based fee but the pure no-fault idea has been incorporated into a variety of legislative proposals in both Hawaii and California.

Variations on the No-Fault Concept

In the 1960s, the traditional auto liability insurance system became the target of public criticism. Dissatisfaction was expressed not only by those purchasing auto insurance but by companies and agencies marketing it and by state officials regulating it. The debate focused on the often expensive and time-consuming process of determining who is at fault -- legally liable -- when accidents occur.

To reduce the delays and inefficiencies of the system, legislation was introduced in the 1970s in many states that allows accident victims to recover such financial losses as medical and hospital expenses and lost income from their own insurance companies. In the states which have adopted such laws, the major variations involve: dollar limits on medical and hospital expenses, funeral and burial expenses, lost income and the amount to be paid a person hired to perform essential services that an injured non-income producer is unable to perform.

Twenty-four states, the District of Columbia and Puerto Rico, now have laws that allow policyholders to obtain compensation for auto accidents from their own insurers. Of these, 13 states and Puerto Rico have placed restrictions on the right to sue either through a monetary threshold which

No-Fault Auto Insurance

allows a suit to be filed for pain and suffering when medical expenses reach a certain stipulated amount, or through a descriptive or verbal threshold which allows suits only when the injury incurred meets the criteria for a serious injury as defined (hence the term verbal or descriptive) by state statute. These are the only true no-fault states.

The states where first-party insurance benefits have been added on to the traditional liability system are known as "add-on" states. In add-on states there are no restrictions on lawsuits, first-party coverage may not be mandatory and first-party benefits may be lower than in true no-fault states. Pennsylvania, formerly an "add-on" state, began offering consumers the choice between a verbal threshold and no restrictions on lawsuits in July 1990. (New Jersey and Kentucky also offer such a choice). This is Pennsylvania's second no-fault law. An earlier law was repealed in 1984.

The District of Columbia has neither a true no-fault nor an add-on law. It offers drivers the option of no-fault benefits or fault-based coverage. In the event of an accident, a driver who originally chose to receive no-fault benefits has 60 days to decide whether to receive these benefits or to take the other party to court. This means that, in effect, there are no restrictions on lawsuits.

In the late 1980s, Project NEW START, a national non-profit consumer organization devoted to promoting a new auto insurance policy, developed legislation that would offer motorists a choice between a traditional liability-based policy and a strict no-fault policy. Motorists who chose the no-fault program would have had the option to purchase personal injury protection above the basic limits, and also coverage for pain and suffering. In the first full year after the law took effect, drivers who chose the no-fault policy would have seen their premiums reduced by a significant amount -- at least 20 percent of the statewide average premium for insurance required by the state's financial responsibility law, according to the plan. Another version of choice no-fault was known as the O'Connell plan, after University of Virginia Law Professor Jeffrey O'Connell, who, along with Robert E. Keeton, first proposed a no-fault accident compensation system in 1965. This plan allowed a policyholder who chose the tort system and was involved in an accident with a no-fault driver to file a claim under the uninsured motorist provision of the policy. The no-fault driver could not sue and was immune from suits.

Various modifications of these basic proposals have since been introduced in many states, along with measures known as "no-frills" policies that would provide no-fault basic coverage for economic losses to all good drivers in the state for a standard statewide premium. In California, for example, the policy would have provided \$15,000 in coverage for a premium of about \$220. Additional levels of coverage, including bodily

No-Fault Auto Insurance

injury and property damage liability, would have been available to those who wanted a higher level of protection. The premium for this additional protection would have been calculated based on traditional rating factors not state or regional averages. The California proposal was not enacted into law, however.

A critical decision in developing a choice no-fault system is how the choice law is framed. In New Jersey, applicants for insurance are presumed to have opted for the verbal threshold on lawsuits unless they specifically reject it; in Pennsylvania, the opposite is true. Pennsylvania policyholders are assumed to want unrestricted access to the courts unless they specifically request the verbal threshold. As a result, more than 80 percent of policyholders in New Jersey have policies restricting lawsuits whereas only about 25 percent have this kind of policy in Pennsylvania.

In 1992, Professor O'Connell and Michael Horowitz, Senior Fellow at The Manhattan Institute, proposed another choice no-fault program estimated to lower prices nationwide by 20-30 percent. Under the O'Connell/Horowitz plan, drivers could choose no-fault or tort liability but the entire system would be converted to a first-party payment system. Thus drivers choosing compensation under the tort system would be paid by their own insurers up to the level of coverage that they had elected to purchase. (Under the current system, the level of coverage is selected by the person being sued.) Drivers electing the limit on tort liability would be able to sue for actual damages in excess of their own coverage and would be compensated for reasonable attorneys fees. The savings would come principally from the elimination of the pain and suffering component in the personal injury protection package. Potential pain and suffering payments now act as an incentive to build up medical claims to the tort threshold.

The various pure no-fault proposals considered in Hawaii and California incorporate some elements of these plans but go one step further in that they eliminate almost all lawsuits.

The jurisdictions which have forms of true no-fault auto insurance and the dates on which the laws originally became effective are shown below.

Compulsory first-party/liability insurance; some restrictions on lawsuits:

Colorado, April 1, 1974
Hawaii, September 1, 1974
Kansas, January 1, 1974
Kentucky, July 1, 1975
Massachusetts, January 1, 1971
Michigan, October 1, 1973
Minnesota, January 1, 1975

No-Fault Auto Insurance

New Jersey, January 1, 1973

New York, February 1, 1974

North Dakota, January 1, 1976

Pennsylvania, July 1, 1990 (earlier law passed on July 19, 1976)

Utah, January 1, 1974

Compulsory first-party, optional liability insurance; some restrictions on lawsuits:

Florida, January 1, 1972 (compulsory property damage liability)

Puerto Rico, 1970

States that have repealed their no-fault laws:

Nevada: effective 1974; repealed 1980

Pennsylvania: effective 1976; repealed 1984 (reenacted 1990)

Georgia: effective 1975; repealed 1991

Connecticut: effective January 1, 1973; repealed 1993

Georgia repealed its no-fault law effective Oct. 1, 1991. In states with weak no-fault laws (Georgia's monetary threshold was \$500) costs tend to increase more rapidly than in states with a verbal threshold because weak laws provide the broad benefits of a no-fault system without sufficient offsetting savings -- almost as many cases go to court as in a traditional tort-based system. In addition, personal injury benefits (PIP) were low. Minimum coverage provided only \$2,500 per accident for medical costs (although policies with higher limits could be purchased.) The combination of low mandatory PIP coverage and a low monetary threshold pushed many cases where injuries were minor into the courts, driving up costs.

Then in 1993, Connecticut repealed its no-fault law. The law had been comparatively ineffective because its threshold for lawsuits was only \$400.

Effectiveness of No-Fault Auto Insurance

As noted earlier, insurers generally favor laws that provide for verbal thresholds on suits instead of dollar thresholds. One of the disadvantages of having a "dollar target" for medical expenses is that it may encourage the submission of fraudulent claims. In addition, unless the law includes a provision that enables the threshold to be adjusted to keep pace with inflation, (medical costs, for example, have been increasing at a rate of close to 10 percent a year) its effectiveness in curbing litigation is gradually eroded.

By limiting the number of lawsuits to cases involving serious and permanent injuries, a greater percentage of the premium dollar can be used

No-Fault Auto Insurance

to compensate accident victims. The New York Insurance Department estimated that claimants received about 60 cents of every personal injury premium dollar in 1986 compared with 44 cents in 1969. (Bodily injury liability claims fell from about 146,500 in 1973 to 32,200 in 1984). In addition, New York's program stabilized rates. Rate increases averaged less than 5 percent a year in the seven-year period following major revision of the law in 1977, and since 1984 they have been well below that figure, averaging about 3.5 percent. Over the five-year period, 1987-1991, the increase in the average auto insurance premium in New York state was 14 percent compared with the U.S. average of 21 percent.

The no-fault concept and strong restrictions on filing suit were given additional support by a study on bodily injury claim costs, the findings of which were made public in March 1989. The study, "Compensation for Automobile Injuries in the United States," conducted by the then All-Industry Research Advisory Council (now the Insurance Research Council), shows that states with strong no-fault laws were more successful in holding down auto injury costs during the 10-year period, 1977-1987, than other states. New York's average bodily injury costs rose 73 percent, Florida's 71 percent and Michigan's 112 percent. (These states, all three of which have strong no-fault laws, also had much lower overall injury costs, especially Michigan.) The average rise in bodily injury costs nationwide was 146 percent.

A 1995 study by the Insurance Research Council "Trends in Auto Injury Claims," shows that Americans are more likely to file claims for auto accident injuries than in 1980 (even though accident rates have dropped significantly during the past decade or so) but that this tendency was reduced in no-fault states. There 61 injury claims for every 100 property damage claims in 1993 in California (nearly twice the 1980 number of 31) but only 8 in Michigan, 9 in Kansas, 12 in Minnesota and 16 in New York. While California topped the list, other traditional tort states also had a high ratio of injury claims to total accidents: Louisiana (49), South Carolina (47) and Nevada and Arizona (45). In Los Angeles, there were 99 injury liability claims for every 100 property damage claims.

A 1991 study by the RAND Corporation's Institute for Civil Justice (ICJ) showed that no-fault laws could lower premiums by as much as 12 percent in California and by somewhat lesser amounts in other states, and at the same time eliminate some of the inequities in compensation typical of the traditional liability system.

Under a no-fault system with a verbal threshold and a \$15,000 PIP benefit level, total injury coverage costs would decrease by 22 percent, ICJ researchers found. Accident victims' net compensation would rise from 67 percent under the traditional system to 74 percent under no-fault as

No-Fault Auto Insurance

transaction costs, such as legal fees, were lowered for both insurers and claimants. Total transaction costs would be reduced by 39 percent. The elimination of compensation for non-economic losses would also reduce net compensation for claimants with injuries below the threshold level.

The ICJ study also found that under the proposed system, accident victims would receive compensation closer to their actual economic losses. Under the traditional system, claimants with minor injuries tend to receive compensation averaging two to three times their economic loss while those who are severely injured receive much less -- just over half on average.

There is a wide variation in no-fault laws, with significant differences in monetary thresholds and in other benefits provided. For example, monetary thresholds range from \$1,000 in Kentucky and to \$4,000 in Minnesota and \$11,000 in Hawaii, "the medical rehabilitative limit" computed by the commissioner. In Utah, the medical benefits limit is \$3,000 and in Michigan there is no limit on the medical benefits a claimant may receive.

A 1989 Insurance Services Office study of the profitability of private passenger automobile insurance for the years 1980-1988 shows that the rise in auto liability losses was slower in no-fault states with a verbal threshold or a high monetary threshold for filing suits than in other states. However, the growth in loss costs (losses per insured car) was slower in states without a no-fault law than it was in no-fault states with a low tort threshold. Similarly, high threshold states showed the lowest rate of increase in the number of bodily injury liability claims and low threshold states showed the highest. Low threshold states also experienced the greatest rate of increase in average personal auto liability premiums during the period. The states studied in the high threshold category were Florida, Hawaii, Minnesota and New York. (Data from four of the 51 jurisdictions were excluded from the study because major legislative or judicial changes significantly affected auto insurance during the period studied).

Key Sources of Additional Information

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"Compensating Auto Accident Victims." U.S. Department of Transportation, 1985.



RAND

***The Effects of a Choice
Auto Insurance Plan
on Insurance Costs***

Allan F. Abrahamse, Stephen J. Carroll

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Preface

Escalating auto insurance premiums have been a major public policy issue at the state level for the last three decades. *No-fault* auto insurance, born in the 1960s, was one response. It offered cost savings and speedier, more certain compensation to auto accident victims. But because it required claimants to give up rights to seek compensation through the courts, many states found it an unappealing alternative. *Choice* auto insurance addresses this concern by giving drivers the option of selecting a traditional auto insurance plan or a no-fault plan. This report estimates how a choice plan would affect auto-insurance costs in each state.

The Institute for Civil Justice has been conducting research on auto-insurance issues since its inception in 1979. This study will be of interest to policymakers in each state concerned with insurance matters, to insurers, and to consumers.

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Summary

No-fault automobile insurance plans offer cost savings and speedier, more certain compensation to auto accident victims. But for motorists to obtain those benefits, the state must deny them traditional tort rights unless the costs or nature of their injuries exceeds a specified threshold. Many states confronted with this trade-off have been unwilling to impose no-fault.

Choice auto insurance was proposed as a response to this policy concern. Under a choice auto insurance system, drivers elect to be insured under either the traditional system or a no-fault plan. Those who opt for tort retain traditional tort rights and liabilities. Those who choose no-fault neither recover nor are liable to others for noneconomic losses for less serious injuries incurred in auto accidents. The plan does not affect existing insurance coverage for property damage resulting from auto accidents.

In principle, the no-fault option should cost less. But in practice, how much would a choice plan reduce the premiums motorists who chose no-fault pay? And what would happen to motorists who opted for tort?

As an initial step toward understanding these effects, we estimated how a plan that offers a choice between tort and absolute no-fault would affect the costs of auto insurance in each of the states that now relies on the traditional tort system. The plan we analyzed is the most extreme version of choice: Motorists who elect absolute no-fault neither recover nor are liable for noneconomic loss for any auto accident injury, no matter how serious. As such, the results of these analyses suggest the upper bound on the savings that can be accomplished in each tort state via the choice approach.

We also estimated the effects of an analogous choice plan on auto insurance costs in each of the states that has already adopted some form of no-fault auto insurance. In each of these states, we considered a plan offering a choice between the state's current no-fault plan and absolute no-fault. The results of these analyses suggest the upper bound on the savings that can be accomplished in each no-fault state by extending the no-fault concept to its limit.

Approach

In each state, we estimated the average costs auto insurers incur in compensating a representative sample of accident victims under the current system. We then estimated the average costs insurers would incur under the choice plan for those same accident victims on behalf of either drivers who opt for the current system or drivers who elect absolute no-fault. We compared average costs per insured driver under the current system to average costs for drivers who elect either the current system or absolute no-fault under the choice plan to determine how the adoption of the choice plan would affect auto insurance costs for drivers who elect either type of insurance.

Our data were collected in the late 1980s; thus, our results pertain to the auto insurance system then in place in each state. Because we focused on the relative costs of absolute no-fault and the current system in each state, any factors that proportionately affect costs under both the current system and the choice plan net out in the comparison. Our results are insensitive to changes in such factors over time.

Results

In the tort states, we estimated that the costs of compensating accident victims on behalf of drivers who elect no-fault would generally be at least 60 percent less than what they would be under the traditional tort system. The costs of compensating victims on behalf of drivers who choose to remain with tort under choice might increase, but probably by no more than 10 percent, and it is likely that the costs would decrease.

If auto insurance premiums are proportional to the costs insurers incur on behalf of those they insure, the adoption of a choice plan would allow drivers in tort states who are willing to waive their tort rights to buy personal injury coverage for about 40 percent of what they have to pay to buy that coverage under the tort system. (Because coverages for personal injury and property damage each account for roughly half of total auto insurance compensation costs, a 60-percent reduction in the costs of personal injury coverage should translate into a roughly 30-percent reduction in a driver's total auto insurance premium.) Drivers who prefer to retain their full tort rights could do so, at essentially the same costs as under the tort system.

In no-fault states, the effects of the choice plan on the costs of compensating accident victims are similar to the results for the tort states, with a few exceptions. In most of these states, if auto insurance premiums are proportional

to the costs insurers incur on behalf of those they insure, adopting a choice plan would allow drivers willing to waive the limited tort rights available under their state's current no-fault plan to buy absolute no-fault personal injury coverage for roughly 60 percent less than what they have to pay to buy that coverage under their state's current no-fault system. This translates into a 30-percent reduction in a driver's total auto insurance premium.

In four no-fault states, these savings are considerably lower. Drivers in these states who choose absolute no-fault will pay about 30 percent of what they pay for personal injury coverage under the current no-fault system, which translates into a 15-percent reduction in a driver's total auto insurance premium.

In most (four) no-fault states, drivers who preferred to retain their current no-fault plan would pay no more (15 percent more) for personal injury coverage than under the current system. That would imply no change (5-10 percent increase) in a driver's total auto insurance premium.

Sensitivity Analysis

We examined the sensitivity of our results to the fundamental assumptions that underlie the analysis. We varied one or another of the assumptions and repeated the entire analysis until we had systematically considered all reasonable possibilities in each state. The results map out the effects of adopting the choice plan for all reasonable assumptions in each state. Accordingly, policymakers interested in the implications of the analysis for a specific state can focus on the combination of assumptions mostly likely to apply in that state. Because the mapping shows how the results vary as each of the assumptions varies, it indicates the sensitivity of the results to variations in the assumptions.

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