

Automobile Insurance

GLOSSARY

Basic coverage

The insurance a vehicle owner must carry as a condition of vehicle licensure.

Coordination of benefits

Applies when an accident victim has medical insurance in addition to automobile insurance; if the other coverage provides the same medical benefits as the automobile insurance, the other pays first.

Liability

A legally enforceable obligation.

Modified comparative negligence

A legal concept under which a person is prohibited from collecting damages for noneconomic loss if (1) s/he is 50 percent or more at fault for an accident or (2) does not have the required insurance coverage at the time of the injury.

No-fault, modified

Under Michigan's modified no-fault automobile insurance system, the insurer pays for medical expenses and lost wages resulting from an accident; lawsuits are permitted only in certain instances.

Noneconomic loss

Pain and suffering.

Personal injury protection (PIP)

Covers all reasonable and necessary charges for medical care, including rehabilitation.

Property protection insurance (PPI)

Covers up to \$1 million for damage to property of others.

Reinsurer

An insurer who assumes all or a part of the liability of an insurance company already covering a risk.

Residual liability insurance

Extra coverage for causing certain serious harm.

Tort

A civil wrong, injury, or damage other than breach of contract.

BACKGROUND

No-Fault Insurance

In the United States two compensation systems are used to provide reparations to persons injured in automobile accidents: tort and no-fault.

- A *tort* is a civil wrong, injury, or damage other than breach of contract. Under the traditional tort compensation system, the person at fault in an accident—or the person's insurer—pays the damages. This requires a finding of fault, sometimes by a court, before benefits are paid. Thirty-eight states rely primarily on a fault-based injury compensation system.
- Under a *true no-fault* system, fault—responsibility for the accident—is not at issue; one's own insurance company pays for medical expenses and lost wages regardless of who caused the accident, and policyholders give up the right to sue in every instance to recover damages. (No state has a true no-fault system.) The objective of the no-fault system is to eliminate the delays and costs of court disputes associated with the tort system, thus ensuring prompt payment of insurance benefits and return of a larger percentage of premium dollars to injured parties.

In 1973 Michigan enacted a *modified no-fault* system under which lawsuits are permitted only under certain conditions. Twelve other states and Puerto Rico also have enacted modified systems; limitations on lawsuits vary.

Before Michigan enacted a no-fault system, approximately 69,000 automobile injury lawsuits were filed each year. It is estimated that about a third of every premium dollar was spent for legal costs to determine who was at fault in an accident. While a lawsuit dragged on, the injured parties worried about medical bills and lost wages, and successful claims often were insufficient to cover an injured person's losses.

Those injured in hit-and-run accidents and single-vehicle mishaps faced particular problems under the tort system. With no identifiable party to sue, they had to turn to their own automobile policy to cover these losses. Under the tort system, however, policyholders typically opted for low medical benefits (frequently only \$2,000), thinking they would have the option in every instance of suing another party to recover higher losses. Furthermore, not all accident victims had health coverage to help them with additional expenses, and, although most individual and group health plans provide substantial benefits, they also may require significant copayments, stipulate large deductibles, or set maximum

benefit levels. If an injury is serious—such as to the spinal cord or brain—or results in permanent disability, medical and rehabilitation expenses can be extremely high.

Michigan Coverage

Michigan's no-fault law requires automobile owners to buy certain *basic* (mandatory) coverage as a condition of vehicle licensure: personal injury protection (PIP), property protection insurance (PPI), and residual liability insurance.

- Subject to certain limitations, *personal injury protection* pays for medical and rehabilitation expenses, lost wages, replacement services (for tasks of daily living that the injured person no longer can perform), survivor loss benefits (payments to dependents who, because of the accident, are deprived of economic support from the insured), and funeral and burial expenses. PIP covers family members living in a policyholder's household if they do not have their own no-fault policy, even if they are injured as a passenger in another's car or as a pedestrian.
- *Property protection insurance* pays up to \$1 million for damages caused by a policyholder's car to such property of others as buildings, trees, and road signs, regardless of who is at fault.
- *Residual liability* provides protection if a driver is sued or legally responsible for (1) an accident resulting in death, serious impairment of body function, or permanent, serious disfigurement; (2) an accident in which actual economic losses sustained exceed the benefits available from PIP coverage; or (3) property damage and body injury in an accident occurring outside Michigan. The basic no-fault policy limits the benefits that will be paid, but coverage with higher limits may be purchased.

Several *optional* coverages also are available, including protection against collision, automobile damage other than from collision, certain property damage liability, uninsured and underinsured motorists, and problems on the road.

Hard-to-Insure Drivers

Insurers may deny coverage to motorists who have a poor driving record or who have been convicted of a serious violation, such as driving under the influence of drugs or alcohol. These drivers may find coverage with a company specializing in insuring people with less-than-perfect driving records or through the Michigan Automobile Insurance Placement Facility.

Lawsuits

Advocates of a no-fault system believe that for such a system to be effective, it must be in balance: If benefits are high, the barrier to lawsuits also must be high; otherwise, premiums become excessive.

Although all existing no-fault plans permit lawsuits under certain conditions specified in the law, they differ in the degree to which they limit lawsuits. Some states establish a specific level of medical expenses—a *dollar* threshold—that must be incurred before an injury is considered serious enough to permit a lawsuit. For example, if the medical expense threshold is \$500, one who incurs medical expenses above that amount may sue the at-fault driver for damages. Dollar thresholds vary from state to state. Michigan uses a *verbal* threshold, that is, one described rather than quantified in the law. A suit for noneconomic loss (pain and suffering) is permitted in Michigan only when a victim's injuries result in death, permanent serious disfigurement, or serious impairment of body function. Verbal thresholds also are used in Florida and New York. Because these verbal thresholds are more successful than dollar thresholds in limiting lawsuits, Michigan, Florida, and New York are considered to have the most effective no-fault systems in the country.

Two landmark decisions by the state supreme court have interpreted the question of what constitutes a "serious impairment of body function." In the first case, *Cassidy v. McGovern* (1982), the court restricted the right to sue, ruling that (1) subjective complaints of pain are not enough to meet the threshold—injuries must be "objectively manifested" and "subject to medical measurement"; (2) an injury has to affect an important body function, such as walking, talking, thinking, lifting, or reproducing; (3) an injury has to

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be so serious as to impair a person's ability to live a "normal life"; and (4) if the judge is not satisfied that the verbal threshold has been met, a case may be dismissed without submitting the facts to a jury.

In 1986, in *DiFranco v. Pickard*, the court reversed itself, rejecting the *Cassidy* interpretation, but in 1995, P.A. 222 put the *Cassidy* threshold into law: Thus, to sue for noneconomic loss, a person must have suffered an objectively manifested impairment of an important body function that affects his or her general ability to lead a normal life. In addition, whether an injury meets this threshold will be decided by a judge, not a jury. The act also prohibits a person from collecting damages for noneconomic loss if s/he (1) is 50 percent or more at fault for an accident (this concept is referred to as *modified comparative negligence*) or (2) does not have the required insurance coverage at the time of the injury.

Insurance Rates

Levels

Nationwide, automobile insurance rates increased more than 10 percent from 1991 to 1995, according to the National Association of Insurance Commissioners (NAIC); in Michigan they rose a little more than 11 percent. This is an improvement over 1987–91, when rates rose 22 percent nationwide and 18 percent in Michigan. (Note: The NAIC simply divides the premium dollars paid for private passenger auto insurance by the total liability car years written in the state. It ignores differences in state laws, coverages chosen, value of cars, and other variables.)

- For 1996 (the latest year for which data have been compiled), the annual state-by-state comparison of average automobile insurance premiums by the NAIC shows that Michigan was 32d highest among the 50 states and the District of Columbia; in 1994 Michigan ranked 26th. (In this comparison, the Michigan average considers only mandatory coverage.)
- The 1996 average combined Michigan premium (for both mandatory and optional coverage) was \$835, slightly above the national average of \$774

but far below the average in the costliest states: New Jersey (\$1,259) and Hawaii (\$1,093). Iowa had the least expensive average premium: \$507. In comparing combined average premium, Michigan ranked 15th highest in the country.

Rate Setting Methodology

Prior to 1996, Michigan's Essential Insurance Act restricted the methods insurers could use to set rates. For example, an insurer could not divide the state into more than 20 territories, and the rate in the least expensive territory could be no less than 45 percent of the rate in the most expensive. These restrictions were designed to make insurance more available and affordable for urban residents. These constraints were repealed by P.A. 98 of 1996, thereby allowing insurers greater flexibility to develop rates based simply on cost, not territory. Companies are free to set their own rates without the prior approval of the insurance commissioner.

Also in 1996, legislation was enacted to allow insurers to establish premium-discount plans, as long as the plans reflect reasonably anticipated reductions in losses or expenses. For example, an automobile policyholder may be offered a discount if s/he also purchases homeowner's, life, or health insurance from the company.

DISCUSSION

In the past decade, to improve availability and affordability, insurer and consumer representatives in almost every state have undertaken a review of their automobile insurance system. In recent years, the Michigan Legislature has enacted major reforms that many observers believe have slowed average premium increases: returning to the *Cassidy* threshold in suing for noneconomic damages, repealing territorial rating restrictions, and permitting insurers to offer additional premium-discount plans. These and other changes and a decline in rate increases have quieted such other calls for reform as mandating premium rollbacks under various circumstances and eliminating insurers' limited exemption from federal antitrust laws.

Three questions are the subject of current debate.

- Is it prudent to refund a portion of the Michigan Catastrophic Claims Association's (MCCA) current surplus, and should certain administrative changes made in the MCCA's operation?
- Should no-fault medical costs be reduced?
- Should policyholders be permitted to opt out of purchasing liability coverage?

MCCA Rebate and Administrative Changes

One factor insurers consider when setting rates is the amount they are assessed for funding the Michigan Catastrophic Claims Association. The MCCA, which is funded by assessments imposed on Michigan automobile insurers, compensates the insurers for no-fault medical claims exceeding \$250,000 for each injured person. Insurers' assessments are passed on to all drivers and for many years have accounted for a large portion of automobile insurance premium increases. The per car fee has been as high as \$118.69 and as low as \$3.00; the 1998 fee is \$5.60.

The MCCA was created as a private association, not a state agency, and acts as a reinsurer regulated by the Michigan Insurance Bureau. The MCCA annually must submit financial statements to the bureau, attesting to its financial stability and internal control structure, including an actuarial opinion on the soundness of the methods it uses to determine assessments.

By 1998 the MCCA's surplus from which to pay future claims had reached about \$2.5 billion, an amount many observers believed substantially exceeded that necessary to protect the fund's solvency. Insurers say the surplus accumulated primarily because of a drop in the number of anticipated claims (on which they base current rates, to be sure that they have sufficient money on hand to pay the anticipated claims), lower-than-expected short-term inflation, and the expectation that future claim costs would drop.

Claiming that the MCCA's surplus was excessive and that policyholders had been overcharged, many Democratic legislators, consumer advocates, and a Democrat gubernatorial hopeful called for the MCCA

to refund \$1 billion to its member insurers by June 1, 1998, and legislation was introduced to accomplish a refund. Governor Engler came out in support of returning a portion of the surplus to insurers and ultimately to policyholders and indicated a preference for accomplishing it through a credit on insurance bills; he and others claimed that this is more efficient than a refund and avoids the problem of having to use a policyholder's past payments to determine eligibility for the refund.

Following the governor's announcement and House passage of refund legislation, the MCCA board voted to proceed with a \$1.2 billion refund, which is expected to be issued to insurance companies on or before June 30, 1998. The insurers then will determine how to return the money to their policyholders, which they point out is not a simple matter. Most insurers are expected to do so by giving policyholders a credit on their insurance bills; others may issue checks.

Opponents of the refund, primarily in the insurance industry, argued that it threatens the continued availability of unlimited medical benefits for Michigan drivers and is fiscally irresponsible. They contend that even small swings in the stock market can cause major problems and rate increases. They also point out that when the MCCA had a deficit of about \$890 million in the late 1980s, it did not take drastic action (i.e., levy a huge assessment increase to wipe out that deficit), and they believe that in the interest of the MCCA's financial stability, a similarly moderate approach should have been applied to the surplus. They point out that the MCCA already had implemented a surplus reduction plan: Since 1995 it has given policyholders a surplus credit, dropping the total annual assessment per car from almost \$97 in 1995 to under \$6 in 1998.

To assure more openness in the MCCA assessment process, HBs 4993-96 have been introduced to

- add four members of the general public to the MCCA's five-member board of directors,
- require the MCCA to submit to audit by the auditor general every four years, and

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- require the MCCA to operate under the Open Meetings and Freedom of Information acts.

Advocates of these measures contend the association has been able to set rates without disclosing its actual costs and that permitting more public scrutiny will prevent overcharges in the future.

Opponents to these changes point out that the MCCA is a private entity, thus it is inappropriate to add public members to its board and require it to conform to legislative audit procedures and the Open Meetings and Freedom of Information acts in the same way that public entities must. They point out that the MCCA is backed by the full faith and credit of Michigan automobile insurers, not the State of Michigan, and since the state bears no financial responsibility even if the fund were to go bankrupt, it should not be tampering with it.

Medical Care Costs

Insurers maintain that to reduce automobile insurance rates, something must be done to contain medical costs.

Most insurers favor repealing Michigan's mandate that all automobile insurance policies provide *unlimited* medical benefits, pointing out that this is the only state in which there is such a mandate. They believe consumers should be permitted to choose between unlimited medical coverage or some reduced maximum (e.g., \$1 million or \$5 million). They contend that consumers are being forced to purchase more coverage than they likely ever will need. They also argue that the mandate places an unfair hardship on policyholders of limited means, especially the very poor, who are required to buy unnecessary coverage since medical benefits already are available to them under Medicaid.

Supporters of maintaining unlimited medical benefits fear that if given the option, many motorists—without understanding the benefit they would be losing—would purchase less medical coverage so as to reduce their premium. They contend that unlimited medical and rehabilitation benefits are the tradeoff

for limiting consumers' rights to file lawsuits, and this is why Michigan's no-fault law is so well regarded. They further claim that making unlimited medical benefits optional would not save consumers enough on premiums to warrant the change.

Another matter of concern to no-fault automobile insurers is *cost shifting*. This is a practice whereby some health care providers charge private-sector insurance payers higher prices to make up for lower payments they receive from such public payers as Medicare and Medicaid. No-fault automobile insurers are particularly vulnerable to this practice because they—unlike health maintenance and preferred provider organizations—may not tell a policyholder which provider s/he must see for delivery of personal injury benefits; they have little control over how or by whom the expensive care they must pay for is delivered. To eliminate cost shifting and contain health care costs, some have proposed that fee schedules be established for no-fault medical expenses similar to those in place for Medicaid, Medicare, and workers' compensation coverage. Fee schedules set out the maximum a health care facility or provider may charge insurers for treatment, service (e.g., diagnostic tests), accommodation (room and board), and medicine.

Care providers point out that establishing fee schedules for no-fault medical expenses could negatively affect some hospitals' financial solvency and reduce their ability to provide uncompensated care to the poor and uninsured. The hospital industry contends that just as it is unfair to limit automobile insurers' revenue without also giving them a way to reduce expenses, it is unfair to limit hospitals' revenue without also giving them a way to reduce expenses. The Michigan Health and Hospital Association proposes that applying managed-care principles to no-fault health care delivery would promote cost effectiveness.

Some insurers are engaging in a form of utilization review—that is, they are examining health care services to ascertain whether they are reasonable and necessary for the injury the patient sustained. Some give policyholders a discount on their premium if

they opt to have all *nonemergency* medical treatment received after an automobile accident precertified by a health care professional. The health care professional reviews and authorizes treatment, which is administered by the policyholder's doctor. Unlike some other managed-care programs, which limit a person's choice of provider, this option allows policyholders to use their provider of choice.

Some insurers contract with a hospital and/or health care provider network for cost breaks and then offer policyholders the *option* of a premium discount if they agree to use that hospital and/or network. An automobile insurer, however, cannot *require* a policyholder to use a designated provider.

A number of insurers argue that if medical benefits were limited, assessments charged by the Michigan Catastrophic Claims Association would decrease significantly.

Coordination of Benefits

Michigan's no-fault law requires insurers to offer coverage at reduced rates to policyholders who agree to *coordination of benefits*. This means that if a policyholder has other coverage that provides the same medical benefits as his/her automobile insurance, the other pays first. When benefits from the other are exhausted, the no-fault policy pays all additional medical expenses. This provision of the law also has been upheld by the courts, with the result that some self-insured health benefit plans completely exclude coverage for automobile-related injuries, in which case the injured person is responsible for all medical expenses. If the injured person has automobile insurance, it may pay the expenses; if not, personal resources must be used.

Residual Liability Insurance

To further reduce litigation costs and thus lower insurance premiums, some have proposed that policyholders be allowed to opt out of purchasing residual liability coverage, which would save them money. Supporters of this measure say it could save drivers up to \$100 per vehicle. The plan's critics say the anticipated savings would not be realized because most motorists likely would continue to carry the

liability insurance. Those most likely to drop the coverage, they argue, would be irresponsible drivers who then would be effectively immune from having to pay for any damages they cause.

Other

There are a number of other steps that from time to time are suggested as ways to curb automobile insurance costs. Since none is receiving public debate at this time, the following are mentioned here but not discussed:

- Stemming insurance fraud
- Improving highway and traffic safety through programs to reduce drunk driving
- Creating "preferred-provider organizations" for automobile repair services
- Requiring that rate increases receive prior approval from the state insurance commissioner
- Permitting insurers to require that the lowest-price part be used in repairing collision damage, even if it is manufactured by someone other than the original equipment manufacturer
- Requiring insurers to disclose to policyholders their profit ratio, percentage of premium dollar used to cover operating and administrative costs, and percentage of the premium dollar paid in dividends to policyholders and shareholders

See also Health Care Costs and Managed Care; Traffic Safety.

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