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ISSUE BRIEF

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Auto Choice Reform Proposals

Rising automobile insurance costs have led to various proposals for reform. This issue brief discusses the actuarial aspects and potential impacts of proposals to offer a choice of a first-party personal injury insurance system as an alternative to automobile insurance plans currently in place. Key conclusions of this Academy brief are:

- *If insureds opt to continue with their current coverages, the estimated savings in costs arising from the legislation may be overstated.*
- *Cost effects will vary widely from state to state.*
- *To the extent insureds choose the personal protection coverage, costs will tend to be shifted from trucks to cars, and from cars to motorcycles.*
- *The problem of stacking of limits in the present system could be perpetuated in the new system unless changes are made.*
- *If the proposed legislation does not include specific limits for each coverage component, total costs of the new system could significantly increase.*
- *Policymakers should base their decisions on costing models that clearly state their significant assumptions and should examine a range of cost estimates based on a sensitivity testing of each significant assumption.*
- *A number of language clarifications are needed in the proposed legislation.*

The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. The Academy is nonpartisan and assists the public policy process by providing independent actuarial information to elected officials and regulators. This issue brief is intended to bring the actuarial perspective into the public discussion of the issues. The Automobile Insurance Issues Task Force is composed of seven property/casualty actuaries with expertise in automobile insurance ratemaking. The task force members are employees of consulting firms, rating organizations, and insurance companies. They volunteer their actuarial services to the Academy and endorse this report even though it does not necessarily reflect the positions taken by each member's employer. Members of the Academy Automobile Insurance Issues Task Force are Michael J. Miller, FCAS, MAAA; Bruce Bassman, FCAS, MAAA; Patrick J. Crowe, FCAS, MAAA; Michael A. LaMonica, FCAS, MAAA; Dale Nelson, FCAS, FCIA, MAAA.



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Introduction

This issue brief presents the findings and conclusions of the Automobile Insurance Issues Task Force with respect to proposals to provide choice no-fault automobile insurance alternatives. To assist policymakers in their consideration of these proposals, it offers a description of the basic principles, a discussion of the conceptual issues, and some possible clarifications of bill construction.

Description of Choice No-Fault

H.R. 2021 in the U.S. House of Representatives and S.625 in the U.S. Senate are designed to implement a first-party personal injury insurance system that will function as an alternate, but not replace, whatever automobile insurance system is currently in place in a specific state.

The legislation creates a first-party personal protection coverage (PPC) that reimburses the insured for economic loss caused by injuries sustained in a motor vehicle accident without regard to fault. Economic losses include reasonable medical and rehabilitation expenses, loss of earnings, burial costs, expenses for

replacing services lost because of injury (for example, housekeeping services), remodeling costs to make the residence more habitable for the impaired person and loss of employment or employment opportunities.

The insured may choose the new PPC or elect to continue with whatever coverages are currently available under the state's current insurance system. If the insured opts for the new PPC, then the insured may enter a claim against an at-fault driver only for economic losses over and above those provided by PPC. The PPC insured may not enter a claim against the at-fault driver for pain and suffering or other general damages. If the PPC insured is at-fault, the only claim the other injured party can enter against the PPC insured is for uncompensated economic losses.

Conceptual Issues

Default Option

Sometimes insureds do not respond when required to make a choice between alternative coverages. In those cases, the statutes typically dictate which coverage is to be provided to the insured by the insurance company. This statutorily dictated choice is commonly referred to as the "default option." In states that have implemented "choice no-fault" insurance systems, experience indicates that among those insureds who actively choose an option, most choose the default option. The default option in the proposed legislation is not the new personal protection coverage, but rather whatever insurance coverages are currently in place in each state.

The more people who choose the PPC system, the greater the reduction in overall costs to the insurance system. If insureds opt to continue with their current coverages, the estimated savings in costs arising from the legislation may be overstated. It is also likely that the savings will vary substantially from one state to the next solely because of the option that most insureds elect.

Cost Shifting

Under the current tort reform system, the claim costs associated with liability insurance tend to be lower for light weight vehicles than for heavy weight vehicles. An obvious example is that an at-fault driver in a semi-truck can do far more damage to people in a private passenger car than vice versa. This is because cars usually weigh less than trucks but carry more passengers than trucks.

Under the PPC system, costs currently borne by the at-fault driver in the heavier commercial vehicles will now be borne by the not-at-fault, injured passengers in cars. There will also be a shifting of costs from the at-fault driver in cars to the injured passengers in trucks, but the shifting of costs from trucks to cars will be greater than the shifting of costs from cars to trucks. There will also be a net shifting of costs from private passenger cars to motorcycles. Thus while there is cost shifting in two directions, the net effect is likely to be from heavier commercial vehicles to lighter, privately owned vehicles.

The degree of cost shifting will be dependent upon which coverage options are elected. To the extent that PPC is allowed to satisfy a state's financial responsibility requirements, it is reasonable to expect that most commercial trucking companies will opt for PPC, thus increasing the effect of the cost shifting to the lighter vehicles.

Stacking of Limits

Courts have tended to require that the limits of the current uninsured motorist coverage be added together, or stacked, when determining the limit of coverage that applies to a single claim. This stacking of limits has caused claim payments to be higher than what was originally contemplated when the uninsured motorist coverage was first introduced, though insurance companies have taken some steps to mitigate the problem.

The proposed legislation also creates this potential stacking problem with the new tort maintenance coverage (TMC). Unless there is clear language in the statute prohibiting limit stacking, it is likely that courts will allow a TMC insured with coverage limits of \$100,000 on each of two cars to recover as much as \$200,000 from a single injury. Whether or not stacking of limits is allowed has clear implications with regard to the total cost of the new insurance system. If stacking of limits is to be allowed, an option would be to permit the insured to reject stacking in favor of a lower premium charge.

Coverage Limits

Typically, first-party insurance coverages for economic loss include specific limits for each coverage component (i.e. medical, wage loss, replacement services, death, etc.). The proposed legislation includes no inside limits on each non-economic coverage component, thereby potentially causing a significant increase in the total cost of the PPC coverage.

Costing

The cost savings associated with the proposed legislation will likely vary significantly from one jurisdiction to the next and from one insured to the next. For instance, an insured currently with the minimum required coverage in a particular state may not realize the degree of premium reduction “promised” by the cost saving estimates.

This difference between what can be delivered and what is promised is partly because cost savings are typically published on an average basis and partly because the costing models do not always fully reflect state specific conditions. In our view, the decision-making process would be improved if the significant assumptions underlying each costing model were clearly stated and a range of cost estimates were published based on a sensitivity testing of each significant assumption.

In addition to these conceptual issues, the task force found a number of areas in the draft bills that need clarification. These are addressed in the following section.

Bill Construction

As with any piece of legislation, there are always some ambiguities in the language. The following areas need clarification:

- The term “non-economic loss” is not defined in H.R. 2021, nor is it usually defined by state law. One option would be to use the definition of economic loss in S.625 in the House bill.
- If a state implements the new coverages, will the insurers be required to offer the new coverage or will it be optional for insurers? HR 2021 says “an insurer may offer a choice between” the PPC and tort maintenance systems, but S.625 says “a person shall have the right to choose.”
- The language describing attorney fees “calculated on the basis of the value of the attorney’s efforts as reflected in payment to the attorney’s client” lacks precision. Is it intended that an attorney will automatically receive a fee equal to some fixed percentage for uncompensated economic losses?
- Is the inclusion of “resident relatives and dependents” in the definition of uninsured overly restrictive? For example, should a child be precluded from making a claim for injuries resulting

from being struck as a pedestrian just because the parents opted to be uninsured?

- HR 2021 allows the named insured to choose the PPC system on behalf of any person permitted to use the vehicle. This provision will likely generate litigation in those cases where the person permitted to use the vehicle chose a different option on his or her own insurance policy than that chosen by the owner.
- The language is not clear whether an insured with the tort maintenance coverage (TMC) first recovers economic losses or non-economic losses from that coverage. This matters in cases when the TMC insured may need to recover uncompensated economic losses from an at-fault PPC insured. The language is also not clear as to whether the TMC insured can recover uncompensated economic losses and non-economic losses from the current uninsured motorist coverage in those cases when injured by an at-fault PPC insured.

CONCLUSION

The Academy commends the Congress for addressing serious automobile insurance issues. The Academy neither endorses nor opposes legislation designed to implement choice no-fault as an alternative to current tort liability insurance, nor does the Academy advocate any particular solution to the issues raised here. The Academy recommends that policymakers consider the default option, cost shifting, stacking of limits, coverage limits, and costing issues as presented in this paper, as well as the legislative language issues identified.