

NO-FAULT AUTO INSURANCE IN MICHIGAN
*A Summary of Loss Trends and Estimates of the Benefits
of Proposed Reforms*

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Executive Summary

Michigan's auto insurance costs are among the highest in the country, and over the past few years they have risen faster than rates in the rest of the country. The price of auto insurance is influenced by a multitude of factors, but in Michigan much of the pressure on rates is attributable to the unique structure of the state's auto insurance laws, particularly its no-fault auto insurance system. Specifically, the state's exceptionally generous benefits and its lack of commonly used cost controls are pushing costs sharply upward—and at an unsustainable pace. Consider the following:

- Michigan is the only state that mandates *unlimited* benefits for no-fault insurance. No other state mandates limits above \$50,000. This makes Michigan's auto insurance system the biggest and possibly last blank check in the American health system. Not only does the "blank check" approach lead unambiguously to higher costs, it has proven itself irresistibly attractive to cost shifting from other health insurance programs.
- Michigan's auto insurance system does not utilize medical fee schedules, such as exist in most other states and in other lines of insurance such as workers compensation. Again, the lack of basic checks and balances in the system leads to inflated claims costs and makes the system more vulnerable to abuse.

These structural defects in Michigan's no-fault auto system make auto insurance in Michigan premiums among the most expensive in the country. Indeed, the size of the average no-fault claim in Michigan is double the next highest state, driven by what the RAND Institute labels "excess claiming behavior." So skewed is Michigan's no-fault system that the vast majority of claim costs – more than 40 percent – cover just the largest one-half of 1 percent of all claims.

Most states manage no-fault costs by limiting benefits and applying a fee schedule to control claim costs. Were Michigan to adopt a minimum \$250,000 no-fault limit and a fee schedule, premiums could fall by hundreds of millions of dollars.

Lower insurance costs would also help Michigan address its growing uninsured motorist problem. Michigan has climbed to seventh in the percentage of uninsured drivers, up from 15th four years earlier. Michigan's current no-fault system is far less generous to those who fail to purchase insurance.

For the vast majority of people filing no-fault claims, the proposed changes would have no impact. Their injuries aren't severe enough to approach the minimum proposed benefit limit. Controlling claim costs would give the system, and its beneficiaries, more "bang for the buck." Services would be provided more efficiently, so that for any given dollar outlay, claimants would receive more care than they do today.

For the tiny fraction of no-fault cases that would exhaust benefits under a limited benefit, fee schedule system, claim costs will shift to the health care system. This includes private insurance and a variety of government programs. Indeed, federal health care reform mandates unlimited lifetime benefits.¹ Other measures in the new health care law will ensure that injured persons will not lose coverage or exhaust annual coverage limits. By 2014, a handful of people – perhaps fewer than a dozen – will exhaust all health coverage options. These would be people who are eligible for public health care – generally Medicaid – but who, sadly, fail to enroll.

All other persons will enjoy unlimited medical coverage.

¹ Kaiser Family Foundation, Health Care Reform Implementation Timeline, found at: <http://www.kff.org/healthreform/8060.cfm>

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Michigan's High Insurance Costs: A Brief Overview

The high cost of auto insurance in Michigan is a well-documented problem—one that has been the subject of frequent and intense debate among the state's regulators, legislators and insurers. Little has changed since testimony in December 2009 and June 2010:

- The average automobile policyholder in Michigan spent \$907 in 2008 to insure a vehicle compared with \$789 nationally, a difference of \$118 or 15 percent (Figure 1).²
- Michigan ranks as the 11th most expensive state for auto insurance (based on 2008 data, the latest available), up from 16th in 2000.
- Michigan's average auto insurance expenditure is also much higher than all of its Midwestern neighbors, 26 percent more than the second most expensive state in the region, Illinois (Figure 2).³

Michigan's high costs are the result of powerful cost drivers with the result that claim costs have grown significantly faster than inflation. Consider the following:

- Between 1998 and 2011, prices as measured by the Consumer Price Index rose by 39 percent.
- Medical costs nationwide have risen by 66 percent.
- But the average no-fault (PIP) claim rose by *304 percent* from \$9,103 in 1998 to \$36,786 in 2011.⁴

Figure 3 shows how dramatically Michigan's no-fault costs have diverged from those of the rest of the country. The chart shows the average no-fault claim in Michigan has grown inexorably, until by 2009, Michigan's average claim was nearly four times as much as that of the average no-fault state.⁵

² Data from National Association of Insurance Commissioners (NAIC). Data for 2009 are the most recent available.

³ NAIC data from Insurance Information Institute, found at: http://www.iii.org/facts_statistics/auto-insurance.html.

⁴ Insurance Services Office, Property Casualty Insurers Association of America: *Fast Track* Monitoring data.

⁵ Sharon Tennyson, PhD., *The High Costs of Michigan's No-Fault Auto Insurance: Causes and Implications for Reform*, p. 1.

The consequences of high auto insurance costs extend far beyond the impacts on family budgets and into the domain of public policy. Liability insurance coverage is compulsory in Michigan and every other state in order to protect people who are injured (or their property damaged) in automobile accidents. However, in part because of the high cost of auto insurance in Michigan, many drivers choose not to purchase coverage—weakening this public policy objective. In fact, 19 percent of drivers on Michigan roads in 2009 were uninsured, despite a state law requiring them to buy insurance. Michigan has the nation’s seventh-highest rate of uninsured motorists, and it is climbing. Four years earlier, the state was ranked 15th.⁶

When discussing no-fault, it’s important to remember the uninsured motorist problem. The current no-fault system is designed to help drivers who can afford its relatively high cost. It is limited in helping the more than one million drivers who have no auto insurance at all because they can’t afford it.⁷

It is worth mentioning, as was documented at both the 2009 and 2010 hearings, that despite the high cost of auto insurance in Michigan, the state’s auto insurers do *not* earn above-average returns. Profits over the past decade have been, on average, *zero*. In recent years, even a risk-free investment in Treasury bonds has done better.

Figure 4 shows that the average rate of return in Michigan’s private passenger auto insurance market was -0.4 percent between 2000 and 2009. (The U.S. personal auto market overall returned 7.2 percent.) This slim return is even more extraordinary considering that a *risk-free* investment in 10-year U.S. Treasury notes over the same span of time would have provided a rate of return of 4.5 percent, as shown in Figure 5.⁸

From this analysis it is clear that above-average auto insurance costs in Michigan are not the result of high profits, but of high costs in the system itself, particularly in no-fault insurance.

Of the 22 states (plus the District of Columbia) that offer no-fault coverage, Michigan is easily the most expensive.⁹ Figure 6 shows the average no-fault claim paid in Michigan as of June 30 was \$36,786. That’s more than *seven times* that of the median state (\$5,269, in Kentucky). It’s more than twice as high as second-ranked New Jersey (\$17,025).

Another valuable comparison is the size of losses per vehicle, and by that measure, Michigan is again highest in the nation (Figure 7). Michigan no-fault losses in 2009 totaled \$325 per vehicle – more than *five times* that of the median state

⁶ Insurance Research Council, *Uninsured Motorists* (2011 ed.), p. 32.

⁷ Michigan had 7.1 million licensed drivers in 2009 (Federal Highway Administration at: <http://www.fhwa.dot.gov/policyinformation/statistics/2009/dl22.cfm>). If 19.5 percent (op cit. Insurance Research Council) are uninsured, then about 1.4 million Michigan drivers are uninsured.

⁸ Hartwig, testimony before Michigan House Insurance Committee, Dec. 3, 2009.

⁹ No-fault coverage is compulsory in 13 jurisdictions and optional in the remaining 10.

(Pennsylvania, \$60) and 64% higher than the second most expensive state (New Jersey, \$198).¹⁰

Since auto insurer profits are *below* average and no-fault costs are well *above* average, the only way to meaningfully reduce auto insurance premiums is to attack the state's high cost structure.

How Michigan's No-Fault System is Unique

A no-fault insurance system tries to keep injury claims out of the tort system, where the responsibility for costs rests on the person who caused the accident. A person injured in an auto accident purchases no-fault or Personal Injury Protection (PIP), insurance to pay for his own injuries. In Michigan, an injured person can sue a third party for damages if the accident causes a fatality, or leaves an injured person with serious impairment of a body function, or serious permanent disfigurement.

Michigan's no-fault law differs from every other state's in three important respects:

1. Unlimited Benefits

First, Michigan has no upper limit on what a claim can cost. Other states mandate a minimum limit. Insureds in other states have the option to buy higher limits if they wish, and most insurance companies offer a choice of limits. In most states, the minimum limit is \$10,000 or less. Figure 8 shows minimum limits by state. In Michigan there is no upper limit, and it is the only state with that characteristic.

This means Michigan's largest no-fault claims run in the millions of dollars while those of other states top out at less than \$1 million. The unlimited benefit is unique in American auto insurance. It is not offered for any other coverage in any other state. In Michigan, it is mandatory. State law does not allow drivers to choose a lower, fixed dollar limit.

One consequence of an unbounded benefit is that a relatively small number of claims winds up generating the preponderance of insured losses. A 2007 actuarial study looked at 70,000 Michigan PIP claims. Figure 9 shows how those claims were distributed. Claims exceeding \$400,000 made up 0.5 percent of no-fault claims but were 42.6 percent of paid no-fault losses.¹¹

But the lack of a policy limit is only one factor allowing claim costs to drift inexorably higher.

2. No Cost Controls

There are no cost controls on automobile claims in Michigan. Other states have a fee schedule that sets payments for certain treatments.

¹⁰ Insurance Services Office, *Private Passenger Auto Fast Track Data: Second Quarter 2011*, Sept. 30, 2011, *passim*. The loss per vehicle is also called loss cost or pure premium.

¹¹ Michael J. Miller, *Private Passenger Automobile: Analysis of No-Fault Legislative Reforms*, Insurance Institute of Michigan, June 2007, p. 5.

Fee schedules are commonplace. Medicare and Medicaid use fee schedules. Most states recognize them for health insurance. Michigan has a fee schedule for workers compensation. However, there is none for personal automobile insurance in Michigan.

Under a fee schedule, the vast majority of treatments are placed into categories, known as CPT codes. For example, audiometric (hearing) tests fall into CPT codes 92551 and 92596, depending on the type of test and its complexity. Each CPT code has a cost assigned to it. The cost varies by type of practitioner, the expense of operating the practice and the cost of malpractice insurance.

A practitioner submits a claim using a CPT code and is reimbursed according to the schedule. An anesthesiologist, for example, might receive \$42 plus \$2.80 for every minute that a patient received anesthesia.¹² The schedule is updated annually to adjust for medical claims inflation. As with a claims limit, a fee schedule could achieve substantial savings by preventing high reimbursements and cost shifting from other lines of business.

Cost shifting occurs when one insurance policy fails to reimburse a claim adequately. For example, hospitals frequently receive less in Medicaid claims than the services cost. So hospitals tack the shortfall onto a more generous system. In a February 2010 report, the Insurance Research Council estimated that in 2007, \$1.2 billion was shifted from other coverages onto auto liability coverages – and that estimate excluded any shifting in no-fault states like Michigan.¹³ Hospitals will also be motivated to use generous no-fault reimbursements to offset the costs of treating the uninsured.

Without policy limits and fee schedules, Michigan's system is the most generous in the country– arguably the last blank check in the American health care system. It would appear to be extraordinarily vulnerable to cost-shifting.

Michigan's shortcomings cost the state millions of dollars, perhaps billions. A RAND Corporation study compared Michigan no-fault claims with those of other states. After controlling for the type of accident and the injuries received, Michigan claims were 57 percent *more* expensive than the nationwide average.

The RAND study found that Michigan residents were:

- 19 percent more likely to seek reimbursement for a hospital stay.
- 25 percent more likely to seek reimbursement for an emergency room visit.
- More likely to seek reimbursement for X-rays, computed tomography (CT) scans, and more likely to purchase durable medical equipment.

¹² These examples are taken from Michigan's 2009 *Health Care Services Manual* (for workers compensation) found at: http://www.michigan.gov/documents/wca/09_Manual_282233_7.pdf

¹³ Insurance Research Council, *Hospital Cost Shifting and Auto Injury Insurance Claims*, February 2010, p. 4.

Controlling costs like these through fee schedules and the introduction of policy limits would bring auto insurance premiums in the state down significantly.

Will the Injured Be Left Untreated?

Michigan's highest-in-the-country no-fault claim costs are in large part due to the state's unique unlimited benefit structure and general lack of cost controls. Although no-fault systems in states with caps provide benefits that are sufficient to meet the needs of accident victims, a frequently raised objection in Michigan is that any cap, no matter how generous, would leave some individuals without coverage after reaching the limit of their benefit. The reality is that a cap on no-fault benefits will have little impact on the ability of Michigan accident victims to obtain treatment. Consider the following:

- Few claims cost more than \$250,000. Indeed, even in the absence of a fee schedule, 99.1% of no-fault claims in Michigan settle for *less* than \$250,000 (Figure 9), which means that only 0.9% of claims settle for more than \$250,000, according to the actuarial analysis by EPIC Consulting (using 2007 claims data). In other words, only about one in 100 claimants incurs expenses that exceed a \$250,000 threshold. A \$250,000 limit on no-fault claims would exceed minimum limits in New York, which provides the most generous capped benefit in the country.
- Adoption of benefit limits and fee schedules will also deter fraud and abuse, leaving more money in the system to treat legitimate claims. The incentive to cost shift is also reduced. The very simple fact is that any steps Michigan would take to reduce its current "blank check" appeal to unscrupulous individuals will reduce many abusive costs while removing others entirely.

The preceding discussion has established that very few claims would exceed any given claims benefit limit even before the adoption of fee schedules. For those few individuals whose claims might exceed benefit limits, the traditional health care system would become the provider and financier of services. According to the Kaiser Family Foundation and as displayed in Figure 10, 87 percent of Michigan residents had some form of health insurance coverage in 2008/2009 (compared to 83 percent for the U.S. overall).¹⁴ This means that nearly nine out of 10 individuals in the state, including those injured in automobile accidents, were covered by health insurance.

This has direct implications for the ability to finance high cost no-fault claims that exceed the benefit cap. For example, 87 percent of the 0.9 percent of claimants with injury costs that would exceed a \$250,000 cap could be expected to have other health insurance coverage. This means that just 0.8 percent of such claims are truly without health coverage. Consequently, the vast majority of claims exceeding any cap that is adopted could be expected to be absorbed by existing private and public health insurance programs.

¹⁴ Kaiser Family Foundation, *Kaiser State Health Facts*, www.statehealthfacts.org.

Comprehensive health reform, signed into law by President Obama earlier this year as the Patient Protection and Affordable Care Act (PPACA), will further reduce the ranks of the uninsured, especially among low income individuals. In Michigan, by 2014 only 1.5 percent of residents will lack health insurance.¹⁵ As a result, a tiny handful of people will lack health care coverage after a catastrophic auto accident.

These very few people are, unfortunately, the people that social services agencies are unable to reach. For example, they would be eligible for Medicaid or Medicare but would not enroll. It is difficult to envision any program, anywhere, that would be able to reach this unfortunate few.

A risk to Michigan drivers that may be as great is the problem with the uninsured. Figure 11 compares the impact of this legislation with the current situation among Michigan residents who lack auto insurance. Figure 11 shows that with a \$250,000 minimum limit, a tiny handful of people who have purchased PIP coverage will lack health care coverage after a catastrophic auto accident. These would be people who are eligible for medical services, usually Medicaid, but who never enrolled. The rest of Michigan's insured motorists would be in line to receive unlimited health benefits through a combination of no-fault, liability and health insurance coverages. Uninsured drivers face a different situation; they have no PIP coverage.

Based on 44,425 insured PIP claims and a 19% uninsured motorist rate, we estimate that more than 10,000 uninsured drivers will be injured in auto accidents. Of those, about 1,400 will lack health insurance and face a more precarious situation than those who can afford the present auto insurance structure.

Summary

Michigan's auto insurance costs are among the highest in the country and have been rising at an unsustainable pace. Pressure on rates is attributable to the uniquely generous benefit structure of the state's no-fault system, which allows for unlimited benefits. No other state provides an unlimited benefit and consequently no other state has no-fault claim costs as high as Michigan. Cost pressures originating with the state's unlimited benefit provision are compounded by the lack of fee schedules. In effect, Michigan's no-fault system is a "blank check," quite possibly the last to be found anywhere in the U.S. health care system. Consequently—and unsurprisingly—Michigan's no-fault system has proven to be irresistibly attractive to cost shifting from other health insurance programs.

Adoption of a capped no-fault benefit structure and a binding fee schedule would significantly reduce the cost of auto insurance in Michigan.

Despite the potential for significant savings for drivers throughout the state, concerns about coverage for individuals who might exhaust their benefits under a capped system have proved to be an obstacle to reform. The reality is that the vast

¹⁵ Center for Healthcare Research and Transformation, *Impact of Health Reform on Coverage in Michigan*, June 2010, p. 2.

majority of claims would never reach any given limit—more than 99 percent of claims in 2007, for example, were settled for less than \$250,000. Moreover, nearly 90 percent of Michigan residents have access to health insurance coverage from other private and public sources. Recent health care reform legislation will further reduce the ranks of the uninsured.

The bottom line is that Michigan residents would enjoy substantial savings from the implementation of basic benefit and fee schedule reforms. Such reforms would result in a significant purge of the excess costs that today are exerting upward pressure on rates. Lower system costs will allow Michigan to maintain its no-fault system without compromising the quality or quantity of care delivered.