

HEARING ON NO-FAULT AUTO INSURANCE FRAUD IN NEW YORK STATE

Testimony Delivered

by

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Thank you, Senator Breslin and members of the Committee.

Good morning. My name is Robert Hartwig and I am President and Economist for the Insurance Information Institute, a national property/casualty insurance trade association based in New York City.¹ I am also a Chartered Property Casualty Underwriter (CPCU) and have worked on a wide variety of insurance issues during my 17 years in the property/casualty insurance and reinsurance industries—including New York’s first no-fault automobile insurance crisis a decade ago. I have authored many reports on these issues and made hundreds of presentations before insurance, regulatory and legislative bodies.

In my testimony today I will address the problem of rapidly escalating no-fault auto insurance claim costs in New York State. In the context of this discussion I will focus on the following issues:

- (i) The magnitude of New York’s State’s no-fault problem measured in terms of dollars, rate of claim cost increase and cost relative to other states;
- (ii) Drivers of claim costs in New York’s no-fault system; and
- (iii) History of no-fault fraud and abuse in New York

Scale and Scope of New York’s No-Fault Fraud and Abuse Problem

My fellow panelists will have much more to say regarding the precise nature of the fraud and abuse that is occurring in New York’s no-fault system as well as about what can and should be done about it. But the bottom line is that no-fault fraud is the major driver of cost in New York’s private passenger auto insurance system today. Indeed, New York may have once again recaptured the dubious distinction as the nation’s auto insurance fraud capital. Attacking the state’s rampant no-fault fraud and abuse is the only way to meaningfully contain costs and reduce future pressure on auto insurance rates.

New York State’s automobile insurance system—the fourth largest in the United States—is currently under siege. The attack originates with certain dishonest and unscrupulous

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medical service providers who file inflated, and often, bogus medical claims with the state's auto insurers. These medical providers partner with equally unscrupulous lawyers who sue insurers that dare to challenge these bogus claims—choking New York's court system in the process. But there is no better way to describe the damage that the current epidemic of fraud and abuse is causing than by letting the numbers speak for themselves.

The scale of fraud and abuse in New York State's no-fault auto insurance system today is truly breathtaking. Consider the following:

- No-fault fraud and abuse in New York cost consumers and insurers approximately \$229 million in 2009 (**Figure 1**).
- The cumulative cost of no-fault fraud and abuse in New York State since 2005 is (at least) \$617 million. (**Figure 2**).
- If nothing is done to contain runaway no-fault auto insurance claims costs, the cost of fraud and abuse will rise to an estimated \$241 million in 2010—for a total of \$858 million since 2005. Cumulative no-fraud costs will exceed \$1 billion by early 2011 in the absence of meaningful reforms (**Figure 2**).
- New York's no-fault "Fraud Tax" totaled an estimated \$1,561 or 22% of every no-fault claim in 2009 (i.e., the per claim cost of no-fault fraud and abuse). The no-fault fraud tax will rise to an estimated \$1,644 per claim (22.4% share of no-fault claim cost) in 2010 if no reforms are enacted (**Figure 3**).
- The average cost of a no-fault auto insurance claim in New York State skyrocketed to \$8,690 by the 3rd quarter of 2009, up \$3,075 or 55% from \$5,615 at the end of 2004 (**Figure 4**).
- No-fault claim costs as of the 3rd quarter of 2009 are near the highest in New York's history, just 5.9% short of their all-time record high of \$9,235 in the 1st quarter of 2002 (**Figure 4**).
- New York's no-fault average claim costs—at \$8,690 per claim—are the third highest in the US (as of the 3rd quarter of 2009), behind only two other deeply troubled no-fault states, Michigan and New Jersey (**Figure 5**).
- The average cost per no-fault claim in New York is now 64% higher than the US median of \$5,289 (**Figure 5**).

These sobering statistics leave little doubt that New York's no-fault fraud and abuse problem is serious. Cumulative fraud costs since 2005 will soon approach the \$1 billion mark. This literally means that scamsters and fraudsters in the state are picking the pockets of drivers and their insurers to the tune of hundreds of thousands of dollars each and every day. No-fault fraud is indeed a lucrative business, earning crooked medical providers and their accomplices nearly \$628,000 *per day*, on average, in 2009, despite the best efforts of insurers and law enforcement agencies to thwart their activities.

An Analysis of Costs Drivers in New York's No-Fault Auto Insurance System

The average policyholder in New York spent \$1,047 in 2007 (latest available) to insure their vehicle compared to \$795 nationally, a difference of \$252 or 31.7 percent. The state ranks as the third most expensive in the country.

What keeps New York's auto insurance costs high relative to most other states? The cost of just about everything is higher in New York, including medical care, legal services and motor vehicle repair—all important inputs into the cost of auto insurance claims that contribute to a high base cost for insurance. But what factors are driving costs and pressuring insurance rates in New York today?

While the cost drivers influencing the price of auto insurance in New York are similar to those in other states in most respects, there is one glaring exception—its \$50,000 threshold for no-fault auto insurance claims is the highest dollar threshold in the United States. It should come as no surprise that the richest benefits in the country come with some of the highest costs. Consider the following facts about costs:

- Between 2004 and 2009, prices for all goods and services as measured by the Consumer Price Index rose by 13.6 percent;
- Medical costs in the U.S. rose by 21.1 percent between 2004 and 2009;
- The costs of the average No-Fault (PIP) claim in New York State rose by 47.7 *percent* during the same period of time.²

² Property Casualty Insurers Association of America *Fast Track* Monitoring data.

Moreover, New York's no-fault system operates without several checks or balances found in other states. Consider that in New York there are no medical treatment guidelines or utilization reviews/controls. Such safeguards against fraud and abuse exist in most other states and in other lines of insurance like workers compensation. They are also found ubiquitously throughout the general healthcare system in private and government sponsored plans alike. Given current trends in medical costs in the United States, future auto insurance costs in New York are likely to continue grow indefinitely.

The inescapable conclusion: if nothing is done to contain runaway no-fault claim costs it is a virtual certainty that costs and premiums will continue to rise indefinitely and that someday New York could hold the dubious distinction of the state with the most expensive auto insurance in America. This is because New York's highest-in-the-country \$50,000 threshold, absent certain standard cost control measures commonly used elsewhere, exposes the state's drivers to the full force and fury of runaway healthcare costs. Quite literally, New York's no-fault system is one of the last and greatest blank checks in the US healthcare system. As shown in Figure 6, medical costs have been rising at a much faster pace than overall inflation for 25 years with no end in sight. This fact makes high threshold states vulnerable to medical cost inflation and more susceptible to medical fraud and abuse. Nationally, extreme concern over rapidly rising healthcare costs and the affordability of medical care have sparked an intense public policy debate as well as federal legislation designed to reform the entire US healthcare system.

History of No-Fault Fraud in New York: Past Reforms Saved Money

The recent rapid escalation in no-fault claim costs is not the first in New York's history. In the five years following the 1997 Presbyterian decision, no-fault claim severity (cost) rose by 63 percent, peaking at \$9,235 in the first quarter of 2002—the current record but which could soon be eclipsed if present trends continue. The explosion in costs that began in the late 1990s precipitated a crisis in New York's auto insurance markets and contributed to sharp increases in auto insurance premiums—becoming front page news in the process (see **Figures 7-9**). The average expenditure on automobile insurance in New York State rose from \$930 in 1999 to \$1,172 in 2004—an increase of 26 percent.

New York's no fault crisis of a decade ago bears many similarities to the situation today. Although claim frequency remains well below levels recorded in the earlier crisis, the fraud and abuse that are today driving costs higher were largely present then. A vigorous and concerted effort by New York's auto insurers, the New York Insurance Department and its frauds bureau, the state Attorney General and district attorneys throughout the state helped bring the situation under control. No-fault frequency and severity began to decline in the second quarter of 2002, a trend that continued until the end of 2004.

New York drivers benefited tremendously as perpetrators of fraud and abuse were driven from the system. The average expenditure on auto insurance in the state *fell* from \$1,172 in 2004 to \$1,047 in 2007 (latest available)—a decline of 10.7 percent—double the percentage decline experienced nationally over the same period (**Figure 10**).

Summary

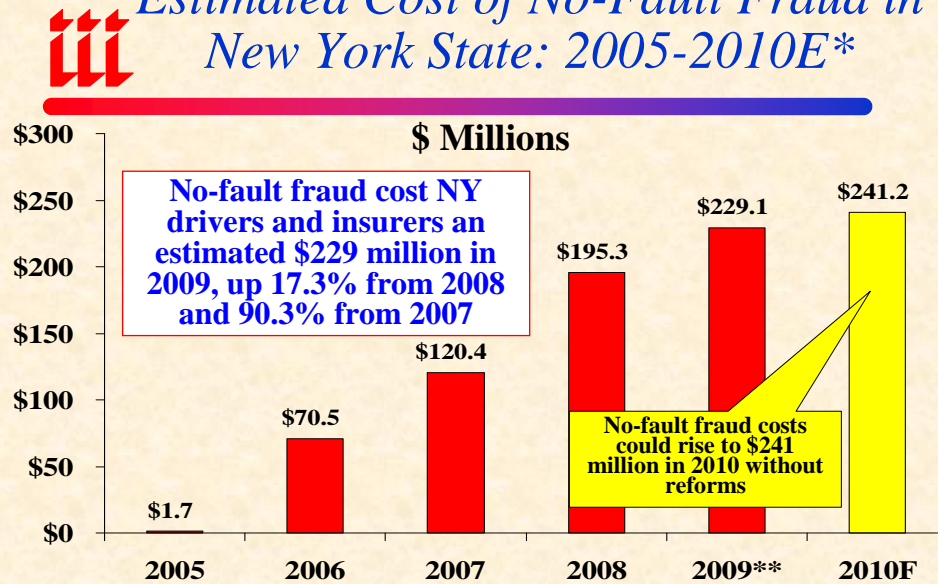
New York's large and competitive auto insurance market is threatened, as it was a decade ago, by rampant fraud and abuse. To date, no-fault fraud and abuse has cost New York's drivers and their insurers at least \$617 million since 2005. If the problem is not addressed, the cost in 2010 alone will approach a quarter billion dollars. Already, nearly \$1,600 or 22 percent of every no-fault claim paid effectively constitutes a "fraud tax" paid by the state's drivers and insurers. This fraud tax, which consists primarily of bogus and excessive services billed by certain medical service providers, goes directly into the pockets of these unscrupulous providers and their accomplices. Despite the best efforts of insurers and law enforcement to combat this fraud and abuse, the system currently does provide enough in the way of checks and balances to protect the state's no-fault system from those determined to exploit the system. In the absence of meaningful reforms the ultimate impact, as was the case during New York's last no-fault fraud epidemic, will be to put upward pressure on auto insurance rates.

Solutions for containing New York's emerging crisis must necessarily focus on cost drivers and you will hear about many of these solutions from the other panelists speaking here today. But because the state has the highest no-fault dollar threshold in the country,

it remains attractive to those who perpetrate fraud based on the perception that the insurers who pay the bills are a “deep pocket.”

Thank you for you for the opportunity to testify before the Committee today. I would be happy to respond to any questions you may have.

Figure 1. *Estimated Cost of No-Fault Fraud in New York State: 2005-2010E**



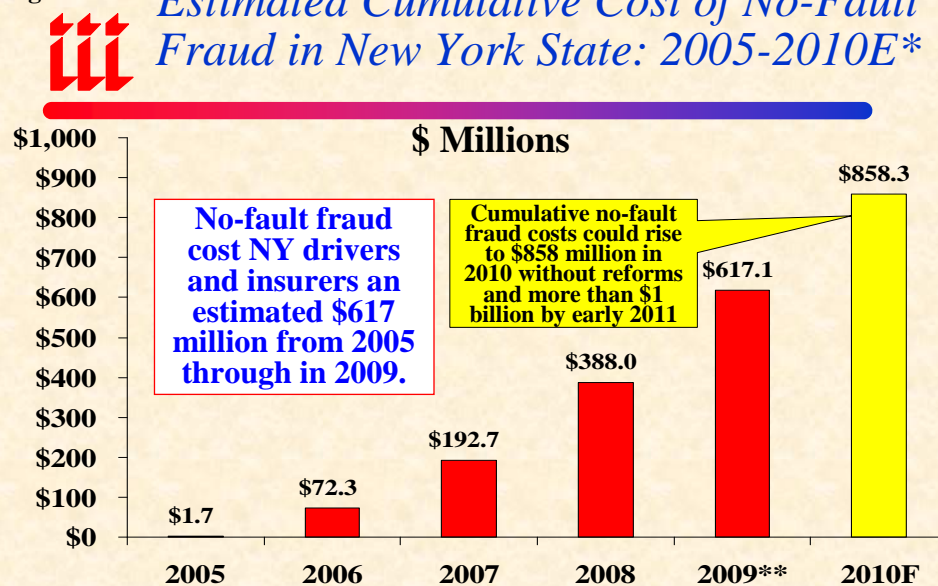
*No-fault severity reached a post-reform low in 2004, hence selection of 2005 as the first year of analysis. Actual no-fault losses in 2005 and beyond are higher than estimates indicate due to base level of fraud imbedded in 2004 data.

**2009 figure is estimated based on 4 quarters ending 2009:Q3 (latest available).

Source: Insurance Information Institute analysis and research.

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Figure 2. *Estimated Cumulative Cost of No-Fault Fraud in New York State: 2005-2010E**



*No-fault severity reached a post-reform low in 2004, hence selection of 2005 as the first year of analysis. Actual no-fault losses in 2005 and beyond are higher than estimates indicate due to base level of fraud imbedded in 2004 data.

**2009 figure is estimated based on 4 quarters ending 2009:Q3 (latest available).

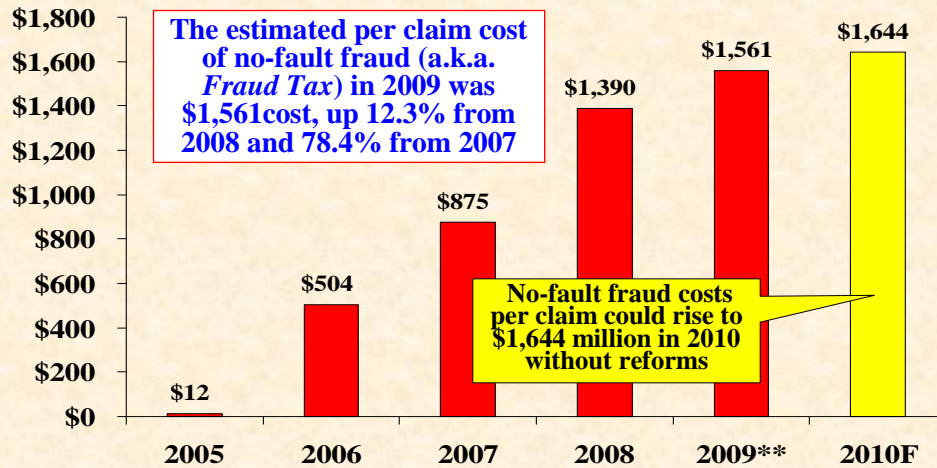
Source: Insurance Information Institute analysis and research.

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Figure 3.



Estimated Per Claim Cost of No-Fault Fraud in New York State: 2005-2010E*



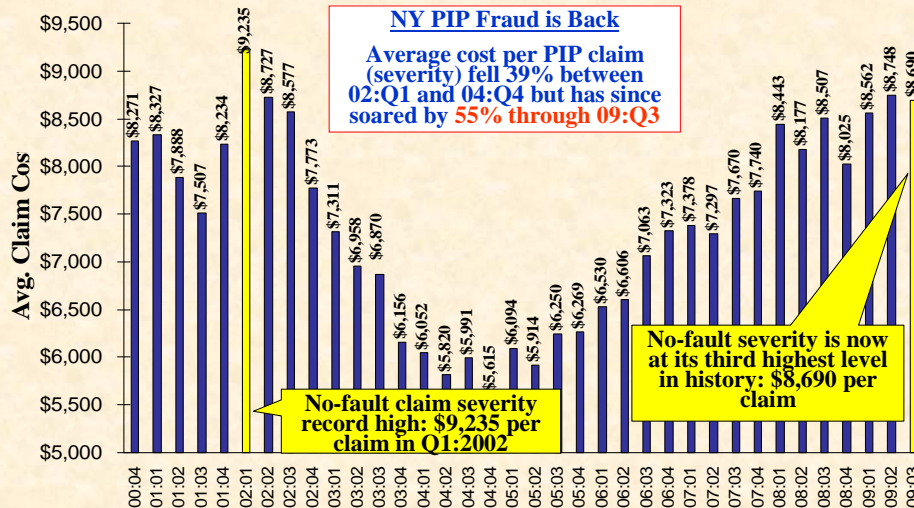
*Estimated cost is based on the difference between annual cost increases according to the medical cost component of the Consumer Price Index relative to actual no-fault severity growth. 2010E figures assumes medical cost and no-fault severity trends are unchanged from 2009.
 **2009 figure is estimated based on 4 quarters ending 2009:Q3 (latest available).
 Source: Insurance Information Institute analysis and research.

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Figure 4.



NY No-Fault Claim Severity, (2000:04 – 2009:03)



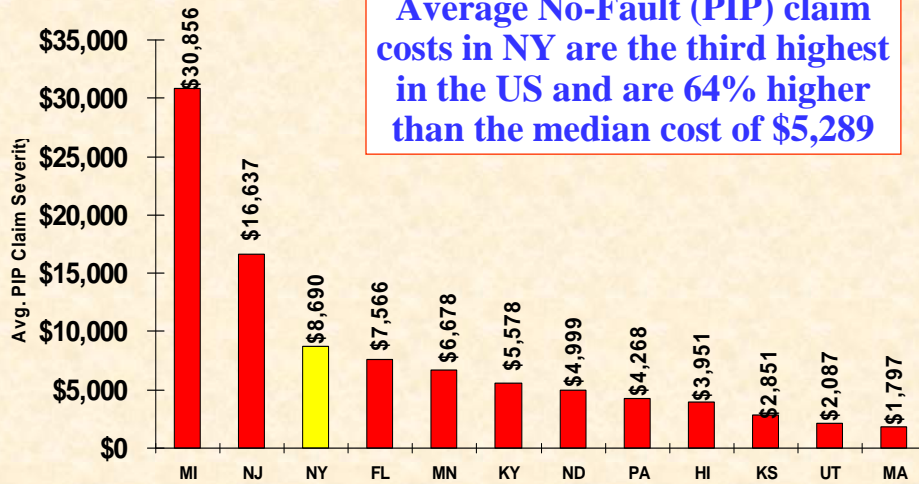
Sources: Insurance Information Institute based on ISO/PCI Fast Track data.

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Figure 5.



Average PIP (No-Fault) Claim Cost as of 2009:Q3*



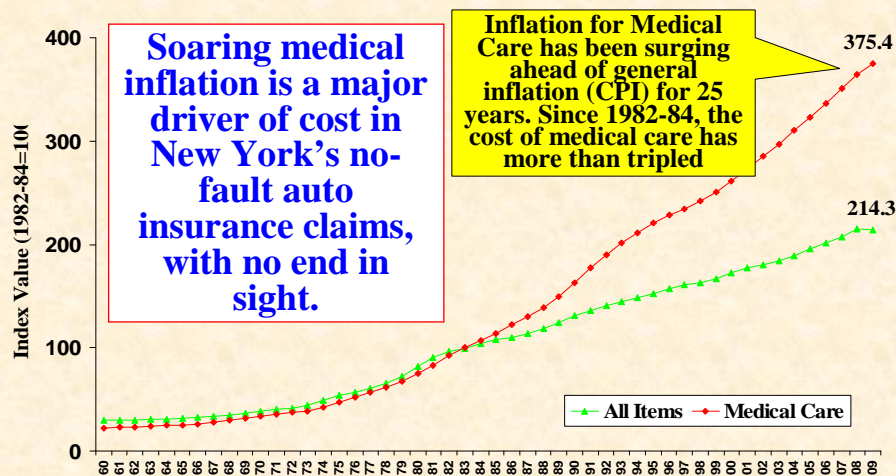
Sources: Insurance Information Institute based on ISO/PCI Fast Track data.

Figure 6.



Consumer Price Index for Medical Care vs. All Items, 1960-2009

(Base: 1982-84=100)



Source: Department of Labor (Bureau of Labor Statistics); Insurance Information Institute.

Figure 7.



No-Fault Fraud Was Front Page News in 2001-2002

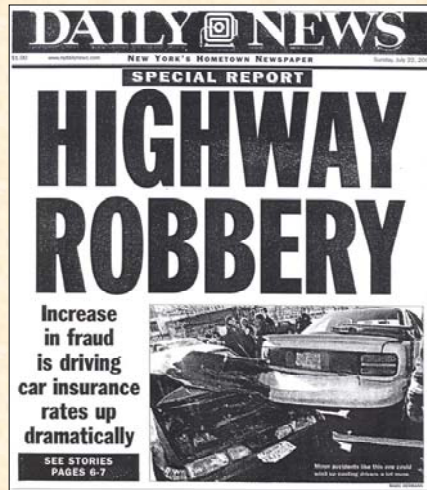


Figure 8.



Sparking Interest in Action

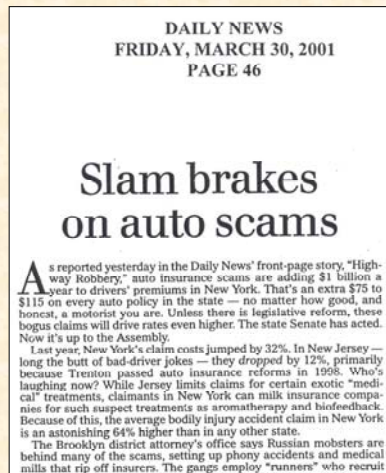
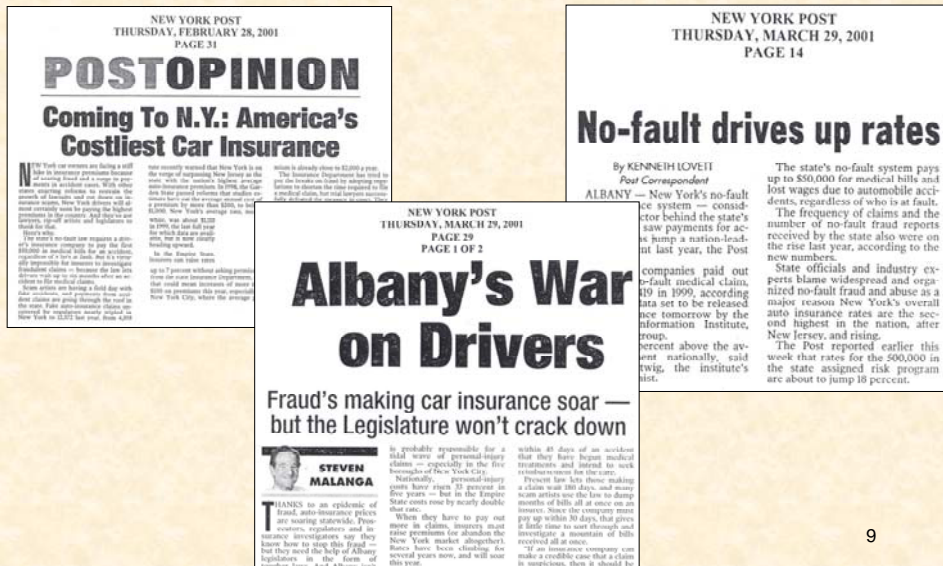


Figure 9.



Urgent Calls for Reform

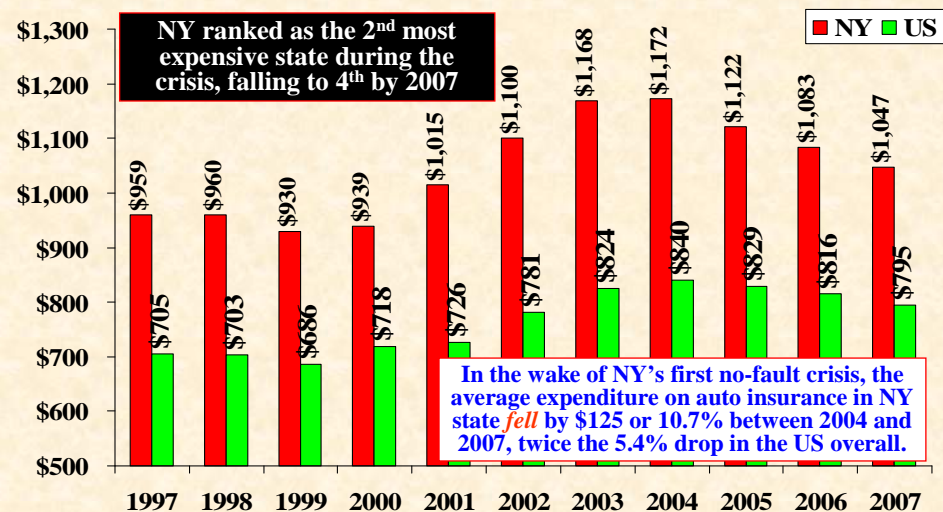


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Figure 10.



Average Expenditure on Auto Insurance, NY State vs. US: 1997-2007*



*Latest available as of December 2009.
Source: NAIC; Insurance Information Institute.

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