

# State Notes

## TOPICS OF LEGISLATIVE INTEREST

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### **The State of No-Fault Debate** **By Glenn Steffens, Fiscal Analyst**

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Recently, there has been debate about reforming Michigan's no-fault insurance law. The purpose of this article is to provide an overview of the history and current status of the no-fault insurance law, including the role of the Michigan Catastrophic Claims Association, and offer discussion on proposed changes to no-fault policy.

#### **A Brief History of Auto Accident Liability in Michigan**

Before 1973, Michigan had a tort-based system of recovery: an accident victim had to either settle with the at-fault party or go to trial to prove a case in order to recover damages. Lawsuits resulted in delayed and/or inadequate recovery for victims, leaving some without enough money to pay medical costs, or cover lost wages due to time off of work, at least until cases were decided or settled.

Many believed that reform was necessary to address this problem, and that a tort-based system was bad policy. In 1972, then-Governor Milliken indicated that the State needed to provide a better system of compensation for accident victims, reduce the amount of insurance premium dollars going toward attorney fees, reduce the burdens of taxpayer-funded courts, and consolidate coverage for accident victims under one system.<sup>1</sup> The State enacted significant auto insurance reform in 1973, shifting from tort-based liability to a no-fault system.

No-fault insurance reforms attempted to strike a balance between relieving burdens of constant litigation, guaranteeing victims' full and adequate recovery, and avoiding duplicative and overlapping benefits.<sup>2</sup> Under no-fault, accident victims generally gave up the right to sue at-fault parties. In exchange, victims received the right to guaranteed benefits such as medical care, rehabilitation, and wage loss, and all drivers received protection from lawsuits that do not involve intentional harm or very serious injuries.<sup>3</sup> This had the effect of significantly reducing vehicle accident litigation.<sup>4</sup> According to a 1978 report from the Insurance Bureau to then-Governor Milliken, no-fault reforms were not aimed at addressing high insurance rates.<sup>5</sup>

By limiting the types of damages that an accident victim can recover in court, no-fault insurance results in fewer court cases. An accident victim cannot recover medical expenses and lost wages by suing the at-fault driver; rather, he or she can file a claim with an insurance company.

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<sup>1</sup> "No Fault Insurance After Three Years", p.1. Insurance Bureau Report to the Governor. 10-6-1976.

Retrieved from [http://www.michigan.gov/documents/dleg/No-Fault\\_Insurance-After\\_3\\_Years\\_272412\\_7.pdf](http://www.michigan.gov/documents/dleg/No-Fault_Insurance-After_3_Years_272412_7.pdf) on 1-14-2014.

<sup>2</sup> "No Fault Insurance in Michigan: Consumer Attitudes and Performance", p.iv. Insurance Bureau report to the Governor. 4-4-1978. Retrieved from [http://www.michigan.gov/documents/dleg/No-Fault\\_Insurance-Consumer\\_Attitudes\\_272413\\_7.pdf](http://www.michigan.gov/documents/dleg/No-Fault_Insurance-Consumer_Attitudes_272413_7.pdf) on 1-14-2014.

<sup>3</sup> Drivers may still be sued for property damage and serious injury, but may purchase supplemental insurance to protect against liability in these cases.

<sup>4</sup> See "No Fault Insurance After Three Years", p.10, and "No Fault Insurance in Michigan: Consumer Attitudes and Performance", p.vi.

<sup>5</sup> "No Fault Insurance in Michigan: Consumer Attitudes and Performance", p.iv.



Noneconomic damages, such as pain and suffering, generally are not available to victims. A victim may sue an at-fault driver for noneconomic damages only in cases of intentional harm, death, "serious impairment of body function", or "permanent serious disfigurement".<sup>6</sup>

With regard to guaranteed recovery, an accident victim receives coverage for unlimited lifetime medical and rehabilitation expenses, and three years' worth of wage loss and replacement services. This addressed a major concern of reform proponents, since, under a tort-based system, a victim's recovery effectively is limited by the terms of an insurance policy and/or how deep the at-fault party's pockets are. Under a tort system, a victim has the right to prove fault and damages, but collecting on a court judgment is not always realistic. A victim under no-fault insurance can receive "full and adequate recovery", regardless of whether the at-fault party is in dire financial straits and/or uninsured.

### **The Michigan Catastrophic Claims Association: Limiting Unlimited Liability**

After Michigan adopted no-fault insurance, some felt that further reform was necessary to address the unlimited liability imposed on insurance companies. Insurance reserves had to account for unlimited lifetime benefits, which are difficult to calculate. Small insurance companies in particular had a difficult time planning for catastrophic claims. A single catastrophic claim could threaten to put all but the largest of insurers out of business.<sup>7</sup> The push for change was successful, and the Michigan Catastrophic Claims Association (MCCA) was established by law in 1978.<sup>8</sup>

Basically, the MCCA serves as a pool, funded by all insured drivers, that reimburses insurance companies for claims above a certain high cost, or "catastrophic" threshold. An insurance company is responsible for claims up to the threshold, and the MCCA reimburses an insurance company for any claims that it pays above the threshold. The catastrophic threshold is currently \$530,000.<sup>9</sup> Under the law, auto insurance companies are responsible for paying to the MCCA an assessment based on each company's share of insured vehicles. The MCCA sets the annual per-vehicle assessment, and insurance companies pass the cost on to consumers. Currently, the annual assessment is \$186 per vehicle.<sup>10</sup>

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<sup>6</sup> Whether either of the terms "serious impairment of body function" or "serious permanent disfigurement" applies to a specific case is decided by courts as a matter of law, meaning the question cannot go to a jury. Serious impairment generally means a condition that is observable by someone other than the victim, impairs a body function of value specific to the victim, and affects the victim's ability to lead his or her normal life. *McCormick v Carrier*, 487 Mich 180 (Michigan Supreme Court 2010). Whether a serious disfigurement exists is decided on a case-by-case basis, and typically depends on the location, visibility, and severity of the scar or disfigurement.

<sup>7</sup> "No Fault Insurance in Michigan: Consumer Attitudes and Performance", p.76.

<sup>8</sup> See MCL 500.3104.

<sup>9</sup> The catastrophic threshold is adjusted every two years based on changes in the consumer price index.

<sup>10</sup> The assessment is adjusted yearly and consists of three separate fees: 1) a claims allocation portion of \$156.44, 2) a deficit/surplus adjustment portion of \$29.19, and 3) an administrative expense portion of \$0.37. Since the creation of the MCCA, the amount of the assessment has fluctuated greatly. For example, the assessment was \$115.72 in 1994, \$5.60 in 2000, and \$71.15 in 2002. The average of annual assessments since 1978 is \$68.33.



The MCCA is an unincorporated, nonprofit association. All auto insurers in the State must be members. Its board of directors is made up of five voting insurer members and a nonvoting commissioner who is appointed by the Department of Insurance and Financial Services (DIFS). The statutory provisions establishing the MCCA give it broad discretion in creating a plan of operation and setting the annual assessment.

The MCCA's method of setting rates is one component of the no-fault reform debate. The statute does not expressly make the MCCA board subject to the Freedom of Information Act (FOIA) or the Open Meetings Act (OMA), so the public does not have the right of access to the board's decision-making process. Presently, there is litigation regarding whether the MCCA is subject to FOIA, and the extent to which the statute exempts the MCCA board from FOIA requirements.<sup>11</sup> In 2013, several bills were introduced to expressly provide that FOIA and the OMA apply to the MCCA.<sup>12</sup>

### **A Proposed Shift in Policy**

Many believe that reform is necessary to bring down auto insurance rates. Detroit residents have particularly high rates, with quotes in some areas ranging from \$3,059 to \$8,403 a year.<sup>13</sup> According to insure.com, auto insurance rates in Michigan are the second-highest in the nation, and the average annual premium in Michigan for 2013 was approximately \$2,520. In comparison, base rates for car insurance for Michiganders in 1977 ranged from approximately \$272 to \$907 per year, which equates to \$1,050 to \$3,500 per year when adjusted to present value.<sup>14</sup> Detroit residents' rates in 1977 were the highest in the State, and were up to 175% higher than rates for residents in other areas.<sup>15</sup> When inflation and increases in the consumer price index are considered, these data tend to suggest that insurance rates have been relatively stable.

Some have suggested that providing unlimited lifetime benefits has contributed to high insurance rates, and that capping these benefits could help reign in high premiums. For example, House Bill 4612 (H-1) would cap medical and rehabilitative expenses at \$1.0 million for motor vehicle accident victims who are State residents, \$250,000 for motorcycle operators and passengers, and \$50,000 for nonresidents.

From July 2011 through June 2012, the MCCA saw nearly \$640.0 million in claims that were for more than \$1.0 million from 3,558 claimants.<sup>16</sup> With roughly \$931.0 million in claims paid

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<sup>11</sup> In March 2013, the Court of Appeals stayed a 30<sup>th</sup> Circuit Court Order regarding FOIA issues pending appeal. The 30<sup>th</sup> Circuit Court ruled that the MCCA was subject to FOIA, and that the MCCA "must disclose general rate calculation information", but is not required to disclose certain personal information. *CPAN v MCCA*, Case No. 12-68-CZ, 12-26-2012.

<sup>12</sup> See Senate Bills 102 and 103, and House Bills 4543 and 4551.

<sup>13</sup> Kaffer, Nancy. "No relief in sight for sky-high car insurance rates." *Detroit Free Press*. 12-13-2013.

<sup>14</sup> "No Fault Insurance in Michigan: Consumer Attitudes and Performance", p.49. These base rate estimates do not include extra costs due to variables such as driver age, miles driven, and the insured's location. The rates include collision and comprehensive coverage. The report includes multipliers to account for these variables, which range from 87% of the base rate (for an adult driving a vehicle for limited farm use) to 380% of the base rate (for a single male under 21). The estimates are based on a late-model car in 1977.

<sup>15</sup> "No Fault Insurance in Michigan: Consumer Attitudes and Performance", p.51.

<sup>16</sup> Data provided to House Fiscal Agency via email from the MCCA in early May, 2013.



between 2011 and 2012, 68.6% of MCCA reimbursements were for claims over \$1.0 million.<sup>17</sup> If benefits were capped at \$1.0 million, it is logical to assume that the claims allocation portion of the MCCA assessment could have been reduced by 68.6%, for a total annual assessment of \$78.68, which would have produced \$107.32 in savings.<sup>18</sup> If passed on to consumers, these savings could reduce the average auto insurance premium by approximately 4.3%.

A similar proposal was offered by opponents of unlimited coverage in the late 1970's, when insurance companies were responsible for the full amount of claims. At the time, a cap of \$100,000 (\$385,000 at present value) was considered. After review, the Insurance Bureau determined the following: 1) the potential savings from a cap would be too small to justify the limit; 2) placing the residual risk on consumers would be inconsistent with the goal of full and adequate catastrophic loss recovery; and 3) limiting benefits would threaten to increase the likelihood of lawsuits, which would undermine the goal of reducing court dockets.<sup>19</sup>

The Insurance Bureau's determination about potential savings was based on the Bureau's conclusion that a cap would have reduced rates by \$6 per year, or \$23.10 in 2014 dollars.<sup>20</sup> As discussed above, the savings that a cap currently would generate could be \$107.32, more than four times the savings identified by the Insurance Bureau in the late 1970s.

As noted above, one purpose of no-fault reform was to provide full adequate recovery to victims. Some have suggested that Medicaid could fill the gap left by a cap on benefits. However, no-fault benefits generally are broader than Medicaid benefits. For example, Medicaid does not cover wage loss, replacement services, or home or vehicle modifications. Also, to be eligible under Medicaid, an individual must have both income and resources that are below a certain threshold. If a cap on no-fault benefits were in place, a claimant would have to meet those thresholds before obtaining additional coverage.

Unless a claimant had supplemental insurance, or could sue the at-fault driver for these economic damages, a claimant could not recover costs for care that occurred between the time the claimant reached the \$1.0 million cap under no-fault and when he or she became eligible for Medicaid, assuming he or she ever met the threshold. If a victim had enough assets to afford treatment, recovery would be available only through supplemental insurance coverage.

In conclusion, given the historical reasons for the State's initial adoption of no-fault, placing a cap on benefits in order to lower auto insurance rates would represent a policy shift away from guaranteeing victims' full and adequate recovery in favor of controlling high insurance rates, or at least a shift in what is considered to be "full and adequate recovery" for accident victims.

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<sup>17</sup> Michigan Catastrophic Claims Association press release dated 3-16-2012.

<sup>18</sup> This does not account for potential changes to the administrative expenses and deficit/surplus adjustment portions of the MCCA assessment, and does not factor in additional savings that would be realized through the lower caps for motorcycles and nonresidents. The current annual assessment total is \$186, with the current claims allocation portion accounting for the majority of the assessment at \$156.44. At a 68.6% reduction, the 2013 claims allocation portion would be \$49.12.

<sup>19</sup> "No-Fault Insurance in Michigan: Consumer Attitudes and Performance", p.76.

<sup>20</sup> "No-Fault Insurance in Michigan: Consumer Attitudes and Performance", p.76.