

An Analysis of Michigan Auto Insurance Profitability and the Role of the Michigan Catastrophic Claims Association

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The State of Michigan has a unique personal automobile insurance system which requires drivers to purchase personal injury protection (PIP) coverage with uncapped benefits for catastrophic injuries. In connection with the No-Fault system, the Michigan Legislature created the Michigan Catastrophic Claims Association (MCCA) which reinsures private insurance companies for PIP claims over a certain threshold amount. The amount charged by MCCA to insurers for this reinsurance is included in the premiums charged to individual insurance company policyholders. The effect of this structure is to spread the cost of catastrophic motor vehicle injuries across all policyholders in the state.

In recent months, there have been proposals to radically alter this system. The purpose of this report is to review Michigan auto insurers' profitability and the role of the MCCA and to correct common misconceptions about the system.

The major findings of this report are the following:

- Michigan's No-Fault auto insurance system is unique and represents a very different system than other "no-fault" states. The effectiveness of the Michigan system is based on the comprehensive coverage provided in the No-Fault coverage.
- The traditional method of evaluating insurer performance and profitability – a loss ratio of incurred losses to earned premiums – is not available for the PIP coverage in Michigan because of reserving practices related to catastrophic claims and MCCA reimbursements.
- On a cash flow basis over an extended period of time, Michigan auto insurers have experienced a ratio of paid losses to written premium of 67%, indicating that, on average, Michigan insurers have achieved significant profitability.
- It is unclear to the Office of Financial and Insurance Regulation (OFIR) and the public how insurers account for MCCA reimbursements in rate filings. Insurers may be double-counting the cost of catastrophic claims by including the cost of MCCA assessments in rates, but not offsetting expected claims by the amounts of MCCA reimbursements.

- An evaluation of the MCCA's own estimates of the cost of providing current level of PIP benefits indicates that benefit costs are stable and not "growing exponentially" or "exploding."
- The MCCA has substantial assets to meet its substantial future liabilities. As of June 30, 2011, the MCCA has admitted assets of \$13.8 billion to meet estimated benefit payment obligations of \$13.7 billion.
- Available data indicate that the Michigan No-Fault coverage delivers comprehensive benefits in an efficient manner. Despite providing more extensive benefits than any other state, the average premium in 15 states exceeded the average premium in Michigan in 2008.
- Placing caps on No-Fault coverage amounts will not reduce the costs of care for consumers catastrophically injured in auto accidents, but will shift those costs to other types of insurance and to taxpayers in a manner that increases total costs to consumers and taxpayers.
- The Michigan Chamber of Commerce prepared by Sharon Tennyson report provides incomplete and misleading information about the Michigan auto insurance system and should not be relied upon by policymakers.

The Michigan No-Fault Auto Insurance System

Personal automobile insurance – in every state – includes the following main coverages¹:

- Third-party liability – bodily injury and property damage
- First-party medical benefits – personal injury protection (PIP)
- First party physical damage – collision and comprehensive
- First party bodily injury and property damage – Uninsured and underinsured bodily injury and property damage.

Most states are "tort" states in which the third party coverages, the bodily injury and property damage liability insurance of the driver causing the accident will pay for medical costs of injured victims and damaged property of those victims. In other states – "no-fault" states – drivers are required to maintain first-party medical coverage – personal injury protection. Regardless of fault in the accident, the individuals insured under the no-fault coverage receive payments for medical benefits from their own insurance company.

¹ Other smaller coverages, such as rental reimbursement, are also sold.

The Michigan no-fault system is unique because the PIP coverage provides lifetime medical benefits without a limit for injuries sustained in a motor vehicle accident. In other no-fault states, the minimum required PIP coverage is capped and consumers may have a choice to purchase additional PIP coverage.

The Michigan Catastrophic Claims Association

The Michigan no-fault system is also unique because of the existence of a public reinsurance mechanism to protect insurance companies from the high costs of catastrophic injury claims. The Michigan Catastrophic Claims Association (MCCA) reinsures private insurance companies above a certain threshold. This means that, in exchange for a fee paid by insurance companies to the MCCA, the MCCA will pay all claim amounts greater than the threshold, which is currently \$500,000. The MCCA will then reimburse the insurance company for coverage benefit payments in excess of \$500,000 for a single catastrophic PIP claim.

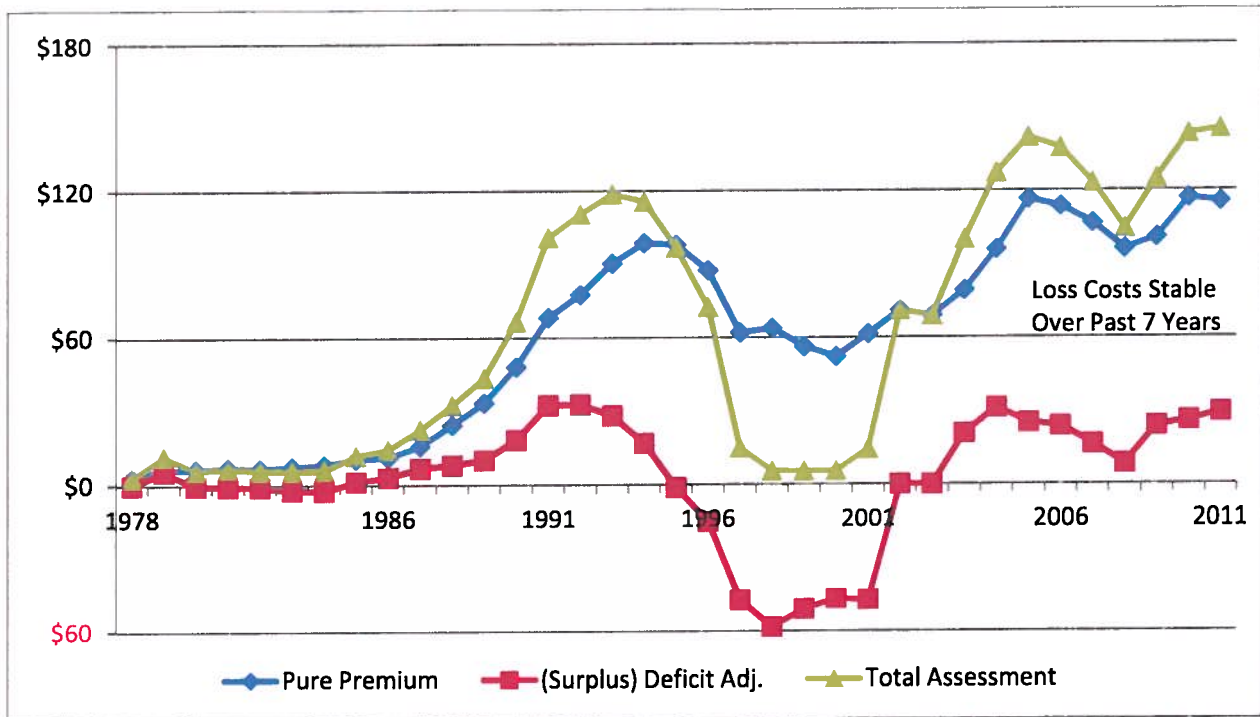
The MCCA sets the fee for this reinsurance on a per-insured-vehicle basis annually. The fee is currently \$145.00 per insured vehicle.² The fee is based on three components – the estimated cost of coverage provided (“pure premium”), a deficit or surplus adjustment and an administrative fee. The pure premium represents the expected cost of coverage for the current vehicle being insured, while the deficit/surplus adjustment is set to collect additional funds if the prior pure premium amounts were inadequate or rebate funds if the prior pure premium amounts were excessive.

The history of the fee and components is shown in Figure 1.³ The chart shows that the pure premium was stable from 1997 through 2002, rose significantly through 2005 and has been relatively stable from 2005 through 2011. Figure 1 also shows that the deficit/surplus adjustment was erratic from 1997 through 2003 – jumping around between surplus rebates of \$58 to deficit adjustments surcharges of \$51. In more recent years, the deficit adjustment has also fluctuated from a high of \$31 in 2004 down to \$8 in 2008 and back up to \$29 in 2011.

² The MCCA charges a lower fee for “historical” vehicles and different fees for commercial vehicles.

³ The source of the data is the Michigan Office of Financial and Insurance Regulation information sheet, “Michigan Catastrophic Claims Association (MCCA), Updated April 21, 2011” available at http://mi.gov/documents/cis/MCCA_FAQ_2007_190996_7.pdf

Figure 1: History of the MCCA per-Vehicle Assessment and Components



The pure premium component is the MCCA’s estimate of the cost of insuring a vehicle for the PIP benefits greater than the retention amount paid by insurers (greater than the threshold, currently \$500,000 at which point the MCCA pays PIP benefits for a claim). While the total amounts paid in benefits by the MCCA increases each year⁴, the pure premium is the best measure of whether the cost to provide current PIP benefits to drivers are “growing exponentially.” *The pure premium from 2005 to 2011 was stable – \$116.43 in 2005 and \$115.38 in 2011. These data indicate PIP benefit costs are relatively stable and not “growing exponentially” or “exploding.”* Further analysis of the financial condition of the MCCA follows later in the report.

⁴ Shown below in Table 3.

Profitability in Auto Insurance

There are two key measures of performance in auto insurance which relate to insurer profitability – the loss ratio and the combined ratio. The loss ratio is the ratio of dollars of claims to dollars of premium and the combined ratio is the ratio of all expenses – claims, claim settlement expenses, sales, underwriting and administrative expenses and taxes, licenses and fees – to dollars of premium. If the loss ratio decreases, the combined ratio decreases and the insurer's profitability increases.⁵

There are two types of loss ratios typically used: paid-to-written and incurred-to-earned. There are four key terms to understand.

Paid losses are straightforward – the dollar amount of claims paid by the insurer during the experience period. The experience period can be any length, but is typically a year, which is the time period used in this report. A claim paid this year may be for a policy from the current year or from a previous year (because, for example, the claim took a long time to settle). Paid claims are a measure of cash flow and do not match the claims paid during the year to the exposures (coverage provided) during the year.

Incurred losses are paid losses plus changes in claim reserves during the year. A claim reserve is an amount set aside by an insurer in anticipation of future payments for a claim. For example, a policyholder may file a PIP claim and, after an initial review, the insurer might estimate the total amount of payments on that claim will eventually be \$10,000. The insurer will set up a claim reserve for that amount. After time, as the insurer makes claim payments, the insurer will reduce the amount of the claim reserve by the amount paid. After time, the insurer may also revise the estimate of the ultimate claim cost and adjust the claim reserve up or down. Incurred losses, because they consider changes in reserves, attempt to measure the ultimate cost of claims associated with the policies in force during the experience year.

Reserves are hardest to estimate for “long-tail” coverages – those in which the claim settlement and payout occur over a multi-year period. Reserves for “short-tail” lines are easier to estimate because the claims settle quickly. Collision and comprehensive physical damage coverage are examples of short-tail lines, while bodily injury liability and catastrophic PIP are long-tail lines.

⁵ The ultimate measure of profitability is return on equity or net income divided by the capital invested and at risk in the enterprise. Because different insurance companies will have different amounts of capital relative to premium, the same combined ratio will produce different returns on equity for insurers with different premium to net worth ratios. Insurers' revenue comes from premiums paid by consumers and income from invested assets. Insurers earn investment income on the capital, or surplus, supporting the enterprise and from reserves, which are funds set aside from insurers for, among other things, losses the insurer expects to pay in the future. For some lines of insurance in which the insurer holds reserves for a long time – such as bodily injury liability or catastrophic personal injury claims – insurers earn sufficient investment income to enable the insurer to be profitable even with a combined ratio greater than 100%. Stated differently, in some lines of insurance, an insurer can pay out more than \$1.00 in claims and all other expenses for each \$1.00 collected in premium and achieve desired profitability because of investment income.

Written premium is the amount of premiums collected by insurers during the year regardless of when during the year the premium is collected. If an insurer collects an annual premium of \$1,200 anytime during the year, the written premium is \$1,200, assuming the policy stays in force and no refund is made to the consumer. Written premium is a measure of cash flow and does not match the premium collected to the exposure (coverage provided) during the year.

Earned premiums are the amount of premium associated with insurance coverage provided during the year. If an insurer collects an annual premium of \$1,200 on January 1, the insurer earns \$1,200 of premium during for the year, assuming the policy stays in force during the year and no refund is made to the consumer. If the insurer collects an annual premium of \$1,200 on July 1, then \$600 is earned for the current year and \$600 will be earned in the next year. If an insurer collects an annual premium of \$1,200 on December 1, then \$100 is earned for the current year and \$1,100 will be earned in the next year. Earned premium matches the premium with the exposure (coverage provided) during the year.

Three of these four measures are objectively measured and not subject to manipulation or errors in judgment. The fourth measure – incurred losses – is subject to error because of errors in reserve judgments. In most cases, the errors in reserve judgments are simply a function of the insurer not knowing the future with certainty. Claims may turn out to be more or less expensive than originally estimated.

The two commonly-used loss ratios are paid losses to written premium (“paid LR”) and incurred losses to earned premium (“incurred LR”). The incurred LR is typically used by insurers to develop and justify rates because it best matches claims with the coverage (exposure). The incurred LR is also generally used to evaluate insurer profitability because it best matches the ultimate cost of claims during a particular period with the premiums earned during that period.

The paid LR is a measure of cash flow profitability during a particular period, but is typically not used to evaluate insurers’ rates or, consequently, profitability because of a couple of key issues. Written premium, the denominator of the paid LR, will not reflect the insurer’s exposure for the period if the number of policies sold during the period is growing or shrinking significantly. For example, if the number of policies grew rapidly during the period, the written premium will be more than the earned premium and will overstate the coverage provided by the insurer during the period.

Losses paid during a particular period may be from policies in force during that period or an earlier period. Again, if the number of policies is growing or shrinking significantly, there will be poorer matching of claims with the policies in force during a particular period.

Over an extended period of time – many years – paid LRs and incurred LRs should be close to one another as reserves are released, incurred claims become paid claims and written premiums become earned premiums.

On a countrywide basis, auto insurers have routinely over-estimated future liability claims (reserves) and, consequently, incurred losses. Data compiled by Downing and Partners Securities, LLC show that insurers reduced liability reserves from initial estimates in each year from 2003 to 2010 by a total \$15.5 billion. From 2001 to 2009, the incurred loss ratio for auto liability coverages declined from initial estimates in each year – by up to 4.3% of incurred loss ratio.⁶

In evaluating the profitability of auto insurance in Michigan, the preferred incurred LR measure is not valid or useful because the incurred losses for the PIP coverage are distorted – and meaningless – because of reserving practices for catastrophic claims associated with MCCA reimbursements to insurers.

Table 1: Michigan Auto Insurance Premiums, 2006-2010

<i>Earned Premium (\$ Millions)</i>				
<u>Year(s)</u>	<u>PIP</u>	<u>Other Liability</u>	<u>Physical Damage</u>	<u>Total</u>
2006	\$2,330	\$987	\$2,807	\$6,124
2007	\$2,260	\$952	\$2,689	\$5,901
2008	\$2,170	\$914	\$2,601	\$5,685
2009	\$2,165	\$917	\$2,534	\$5,616
2010	\$2,376	\$928	\$2,477	\$5,781
2006-10	\$11,300	\$4,699	\$13,108	\$29,107

<i>Written Premium (\$ Millions)</i>				
<u>Year(s)</u>	<u>PIP</u>	<u>Other Liability</u>	<u>Physical Damage</u>	<u>Total</u>
2006	\$2,317	\$979	\$2,765	\$6,062
2007	\$2,222	\$940	\$2,646	\$5,807
2008	\$2,152	\$908	\$2,575	\$5,634
2009	\$2,209	\$917	\$2,511	\$5,638
2010	\$2,476	\$930	\$2,465	\$5,871
2006-10	\$11,376	\$4,674	\$12,962	\$29,012

⁶ Reported in *Auto Insurance Report*, May 16, 2011. This means, for example, an initial estimate of a 70.0% loss ratio was overstated and the actual loss ratio was 65.7 if the loss development yields a reserve reduction of 4.3%.

Table 1 shows the written premium and earned premium for the three categories of coverage (PIP, other liability, physical damage) in Michigan over the five-year period 2006-2010. The earned premium and written premium track each other closely. PIP premium declined from 2006 to 2008 and increased in 2009 and 2010. The increase in written premium from 2009 to 2010 was 12%. Other liability declined from 2006 through 2009 and increased slightly from 2009 to 2010. Physical damage premium declined by over 10% from 2006 to 2010.

The PIP share of total premium increased from 38% to 41% (earned premium) and 42% (written premium) over the period primarily because of declines in physical damage premium over the period.

Total Michigan auto insurance premium declined each year from 2006 to 2009 and increased slightly in 2010, but total premium in 2010 was less than in 2006.

Table 2: Paid and Incurred Loss Ratios for Michigan Auto Insurance, 2006-2010

<u>Year(s)</u>	<i>Incurred Loss Ratio</i>			<u>Total</u>
	<u>PIP</u>	<u>Other Liability</u>	<u>Physical Damage</u>	
2006	86.1%	52.3%	58.2%	67.9%
2007	93.9%	47.1%	62.2%	71.9%
2008	124.7%	58.4%	65.4%	86.9%
2009	199.6%	50.3%	62.3%	113.3%
2010	180.8%	68.8%	61.1%	111.6%
2006-10	136.7%	55.3%	61.8%	89.9%

<u>Year(s)</u>	<i>Paid Loss Ratio</i>			<u>Total</u>
	<u>PIP</u>	<u>Other Liability</u>	<u>Physical Damage</u>	
2006	66.8%	54.9%	60.0%	61.8%
2007	72.2%	51.6%	63.2%	64.8%
2008	80.1%	55.0%	65.8%	69.5%
2009	81.9%	55.1%	63.5%	69.4%
2010	79.3%	58.6%	61.9%	68.7%
2006-10	76.0%	55.0%	62.8%	66.8%

Table 2 shows paid and incurred loss ratios by major coverage each year and the entire period from 2006 to 2010. The table illustrates the problems with relying on the incurred LR for evaluating PIP and overall Michigan auto insurance profitability.

As expected, the incurred and paid LRs for Physical Damage are similar and within a relatively small range of 58% to 65% (incurred LR) and 60% to 65% (paid LR). With physical damage coverages (comprehensive and collision), the claims settle relatively quickly and are easier to estimate at the time of loss. Over the entire five-year period from 2006 to 2010, the incurred and paid LRs are very close – 62% and 63%, respectively.

The other liability paid and incurred LRs vary a bit – with a range of 47% to 69% for the incurred LR but only in a range of 52% to 59% for the paid LR. Bodily injury liability claims typically take longer to settle than physical damage claims and are more complicated to reserve for. However, over the entire five-year period from 2006 to 2010, the paid and incurred LRs for other liability are nearly identical at about 55%.

The incurred loss ratio fails as a meaningful indicator of insurer experience and profitability with the PIP coverage. The PIP incurred LR jumps from 86% to 200% and back down to 180%. Were these the actual incurred loss ratios, insurers would be losing large amounts of money in Michigan. That is clearly not the case, as indicated by the relatively stable paid LR for PIP over the period. If insurers were experiencing the massive claims indicated by the 200% and 180% incurred LRs, the paid LRs would also be increasing.

The fact that the incurred loss ratio is not valid for evaluating Michigan auto insurer profitability is confirmed by the National Association of Insurance Commissioners (NAIC). The NAIC annually publishes a report, *Profitability by Line by State*, which calculates the return on equity for each line of insurance for each state. When presenting the Michigan auto insurance liability profitability calculation, *the NAIC Report states, “The profit reported for Michigan auto liability is not meaningful because of the data reporting anomalies arising from the data related to the Michigan Catastrophic Claims Association.”*⁷

While the jump in PIP paid LR from 67% to 80% is noteworthy and suggests marginal profitability for PIP coverage, the data do not suggest a system in crisis. In fact, by looking at the paid LR over an extended period from 2006 to 2010, insurers in Michigan, in aggregate, achieved a 67% paid LR for all personal auto insurance. A 67% paid LR over an extended period indicates insurers, in aggregate, achieved significant profitability over that period.

⁷ See, for example, *Report on Profitability by Line by State in 2009*, p 63.

The Mystery of Insurers' Treatment of MCCA Reimbursements

In evaluating the loss ratio experience for Michigan auto insurers, we assume that the results in Table 2 reflect the reimbursements paid by MCCA to insurers – that the paid and incurred claims reported by insurers are reduced by the reimbursements received or expected from the MCCA.

In fact, it is unclear if these reimbursements – proceeds to insurers from MCCA reinsurance – are included in the loss data.

On March 6, 2007, Office of Financial and Insurance Services Commissioner Linda A. Watters issued Bulletin 2007-040-INS concerning reporting by insurers of fees paid to and reimbursements received from the MCCA. The bulletin provides the relevant information regarding treatment of MCCA assessments and MCCA reinsurance for financial reporting, statistical reporting and rate filings. For financial reporting (in insurers' statutory annual statements), the MCCA assessment is treated as a reinsurance expense and the MCCA reinsurance is treated as a reinsurance credit to loss reserves. Stated differently, for financial reporting, the assessments are expenses and expected recoveries are a credit against (and thereby reduce) loss reserves.

For statistical reporting -- data reported to statistical agent and designed for ratemaking purposes -- the MCCA assessment is included in the amount of written premium reported by the insurer for the PIP coverage. According to the bulletin, *the insurers report all expected PIP claims without consideration of MCCA reimbursements*. The statistical reports provided to the Commissioner are industry aggregate reports, meaning that there is no individual insurer information in the reports from statistical agents. Consequently, the statistical agent reports show the industry aggregate claim costs (paid and incurred claims amounts) for PIP without consideration of MCCA reimbursements:

Incurring Losses: Account for the actual incurred loss amounts in whole dollars. Personal Injury Protection (PIP) losses should not be reduced by reimbursements from the Michigan Catastrophic Claims Association (MCCA). Also, do not include allocated loss adjustment expenses.⁸

For rate filings (and the development of rates by insurers), the Bulletin speaks only to MCCA assessments and how to treat these assessments as expenses. The Bulletin is silent on how to treat expected MCCA reimbursements for determining expected losses in the *ratemaking* analysis.

The bulletin raises the possibility of insurers' filing rates which count the MCCA fees as expenses, but do not count MCCA reimbursements in estimating expected PIP losses. Inquiry was made to the Office of Financial and Insurance Regulation regarding this issue:

⁸ OFIS Bulletin 2007-0040-INS

The bulletin directs insurers to include the MCCA assessment as an expense in the PIP rate development, but is silent about how to treat MCCA reimbursements for determining PIP expected claims in the rate development. The bulletin directs insurers to report ultimate claims without consideration of MCCA reimbursements to statistical agents, though.

It seems like PIP rates should include either ultimate losses without the MCCA assessment or expected losses after MCCA reimbursements with the MCCA reimbursement, but not ultimate losses and the MCCA assessment.

For example, assume no other expenses other than claims and MCCA assessment. Assume \$800,000 ultimate losses (before MCCA reimbursement) and \$200,000 of eventual MCCA reimbursements. Assume that MCCA assessment is \$200,000. Premium should be \$800,000 -- either \$800,000 in ultimate claims or \$600,000 in net claims plus \$200,000 MCCA assessment, but not \$1 million (\$800,000 ultimate claims plus \$200,000 MCCA assessment).

Can you tell me how insurers are developing PIP rates (i.e., expected claims based on ultimate losses or ultimate losses net of expected MCCA reimbursements), and what guidance, if any, OFIR has provided beyond the information in the Bulletin?⁹

OFIR responded as follows:

OFIR has not provided any guidance beyond the Bulletin. The filings insurers submit do not include the description of the data measured for determining new or revised PIP rates.

One thing to keep in mind with regard to PIP base rates is that, per our rate filing statutes, we have no ability to deny or take action against based rates unless the agency finds them inadequate based on the definitions in MCL 500.2109 or MCL 500.2403. Our statutes do not give us the ability to find base rates excessive or unfairly discriminatory and thus they can be set at what ever price an insurer chooses to charge, given they are not inadequate.

Thus, the detail of ultimate loss or net of MCCA reimbursement is not something we focus on from a rate filing perspective.¹⁰

It is unclear to OFIR and the public how insurers account for MCCA reimbursements in rate filings. Insurers may be double-counting the cost of catastrophic PIP claims by including the cost of MCCA assessments in rates, but not offsetting expected claims by the amounts of MCCA reimbursements.

⁹ E-mail from Birny Birnbaum to OFIR, August 25, 2011

¹⁰ E-mail from OFIR to Birny Birnbaum, August 26, 2011

The Financial Condition of the MCCA and the Difficult of Estimating Lifetime Benefits

The following table shows some key financial information reported in the MCCA's annual statutory statements.¹¹ Two key facts emerge from the data:

- The MCCA has substantial resources to pay PIP claims now and into the future; and
- Reserve estimates are volatile and lead to frequent and significant changes in the financial condition of the MCCA.

Table 3, lines 1 through 3 summarize assets and the principal liability – reserves for future expected benefit payments (loss reserves). Line 3 shows the nominal estimate of loss reserves – the actual dollars expected to be paid for decades into the future. Line 2 shows discounted loss reserves, which are the present value of the loss reserves. The discounted loss reserves represent the current dollars estimated to meet all future benefit payments for claims from inception of the MCCA to present. Line 1 shows the admitted assets – assets available to pay claims.

As of June 30, 2011, the MCCA reported \$13.8 billion in assets available to pay current claim obligations compared to an estimated \$13.7 in current claim obligations (loss reserves).

Admitted assets (line 1) were about equal to the principal liability – discounted loss reserves (line 2). The 2011 results are an improvement over the \$2 billion deficit in 2009 and 2010.

The volatility of MCCA financial results is shown in lines 4 through 9 with premiums, losses and loss ratios. Lines 4 and 5 show premium declines from 2007 to 2009 followed by premium increases from 2009 to 2011. While premiums were shrinking and growing, paid losses (Line 7) increased steadily. As Figure 1 shows, the MCCA reduced the assessment from \$141.70 in 2005/6 to \$104.58 in 2008/9 before increasing again to \$124.89 in 2009/10 and \$143.09 in 2010/11. The chart shows that the assessment reduction from 2005 to 2009 resulted from lower estimates of prospective claims (pure premium) and of existing claims (deficit adjustment). The assessment increase from 2009 to present resulted from higher estimates of prospective claims (pure premium) and existing claims (deficit adjustment).

¹¹ The MCCA annual experience reporting period is July 1 through June 30. For example, the year 2011 in the table refers to the period July 1, 2010 through June 30, 2011. The data in the chart are taken from the MCCA statutory annual statements of 2011, 2009 and 2008. The loss ratios are calculated.

Table 3: Key Financial Results for the MCCA (\$ Millions)

	2011	2010	2009	2008	2007
1 Total Admitted Assets	13,807	11,436	10,348	10,913	10,726
2 Loss Reserves (Discounted)	13,743	13,569	12,563	11,462	10,977
3 Loss Reserves (Not Disc)	71,579	65,861	61,050	61,109	58,158
4 Earned Premium	981	828	783	884	975
5 Written Premium	1,014	862	751	860	964
6 Losses Incurred	1,133	1,816	1,863	1,194	1,006
7 Losses Paid	959	810	762	710	669
8 Incurred LR	115%	219%	238%	135%	103%
9 Paid LR	95%	94%	101%	82%	69%
10 Net Underwriting Gain	(201)	(1,007)	(1,116)	(322)	(142)
11 Net Investment Gain	648	527	96	400	751
12 Net Income	449	(480)	(1,019)	78	609
13 Surplus	(1,035)	(2,528)	(2,571)	(908)	(633)
14 One Year Loss Development	919	812	(4,055)	(1,290)	2,035
15 Two year Loss Development	1,618	(2,704)	(4,730)	1,189	(104)

Figure 1 (on page 4) shows how volatile the estimates for benefit payments for existing and future claims have been over time. In the late 1980's and early 1990's, the MCCA quintupled its estimates of benefit payments – pure premium went from about \$16 to \$90 and the deficit adjustment went from about \$6 to over \$30. Then, in the mid- to late-1990's the MCCA dramatically reduced the estimates of benefit payments – pure premium shrunk by almost half to just over \$52.00. The MCCA decided it had far too much money in reserve, so it offset the pure premium with a surplus adjustment (rebate) as high as \$58. Starting in 2003, the MCCA reversed course again and increased pure premium and added a deficit adjustment charge again. The MCCA reversed course yet again in 2007 and 2008 by reducing both component amounts before reducing these amounts before changing again and increasing both components in 2009.

The volatility of reserve estimates and MCCA financial results is further illustrated in lines 6 through 15 of Table 3. Line 10 shows the net underwriting gain or loss – the difference between premiums and claims. Net underwriting gain or loss is influenced by reserve estimates because incurred claims involve reserve estimates. Despite paid losses growing steadily from 2006 through 2011 (Line 7), incurred losses jumped in 2009 and 2010 before declining dramatically in 2011. Line 8 shows incurred loss ratios jumping from 103% to 238%

As a result of the big jump in incurred claims in 2009 and 2010, the net underwriting gain and net income deteriorated. 2009 results were further damaged by unrealized capital losses on investments. Line 13 shows that policyholder surplus – the MCCA’s capital – declined to negative \$2.5 billion, meaning that liabilities exceeded assets by that amount. The larger the surplus deficit, the greater the deficit adjustment component of the assessment must be.

The changes in surplus from 2008 to 2009 and from 2010 to 2011 are startling – a decline from \$-908 billion in 2008 to \$-2,571 billion in 2009 – a change of negative \$1.7 billion – and an improvement from \$-2,528 billion in 2010 to \$-1,035 billion in 2011 – a change of positive \$1.5 billion.

Lines 14 and 15 show how MCCA financial results are driven by reserve estimates. Line 14 shows the change in total loss reserve estimates from 2010 to 2011, not including loss reserves for 2011. For example, the 2011 column of Line 14 compares the 2010 loss reserves for all claims occurring in 2010 or earlier with the 2011 estimate for those same claims. The 2011 estimate was \$919 billion less than the 2010 estimate. The 2010 column of line 14 compares the 2010 loss reserves to 2009 and the 2009 column compares the 2009 loss reserves to the 2008 loss reserves. In 2009, the MCCA changed its estimate of expected benefit payments – loss reserves – by over \$4 billion. Stated differently, from one year to the next, the MCCA decided the same claims would now cost \$4 billion more than a year earlier. Line 15 performs a similar comparison as shown in Line 14, but compares the loss reserves in the current year to that of two-years prior.

The data show a stark picture of volatility in MCCA results, not from massive increases in actual benefit payments or claims, but from changes in estimates of future benefit costs or loss reserves.

It is not surprising that MCCA loss reserves are volatile. It is inherently difficult to estimate future benefit payments that may go several decades into the future. Layered on top of this complex problem is estimating future medical cost inflation or new medical treatments that may extend an injured consumer’s life or return her a more active life. And layered on top of all this is the fact that the MCCA loss reserves are primarily a compilation of loss reserves established by hundreds of insurers in Michigan. If a large insurer changes its loss reserves for existing catastrophic PIP claims, that change ripples through to the MCCA.

Available Data Indicate that the Michigan No-Fault System Delivers Comprehensive Benefits in an Efficient Manner.

Despite providing more extensive benefits than any other state, the average premium in many states exceeds the average premium in Michigan. Table 4 reports the most recent average auto premiums published by the National Association of Insurance Commissioners.¹² The average premium for liability coverages – PIP and other liability – was \$493.88 in 2008, just above the countrywide average of \$471.09 and below the average liability premium of 15 other states. The fact that Michigan drivers received far greater benefits than drivers in other states and still pay less than drivers in 15 other states indicates that the No-Fault system is efficiently delivering benefits.

Table 4 also shows that the Michigan average premium declined from \$980.32 to \$907.09 from 2004 to 2008. Although 2008 data are a few years old, the decline in average premium does not suggest a crisis of exploding auto insurance costs in Michigan.

Table 4: Michigan Average Premium and Rank Among States

	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>	<u>2004</u>
Avg. Liability Premium	\$493.56	\$507.22	\$494.02	\$486.76	\$488.18
Rank	16	15	18	20	21
Avg. Collision Premium	\$386.91	\$394.81	\$415.41	\$435.92	\$465.34
Rank	3	3	2	2	1
Avg. Comp. Premium	\$151.55	\$153.62	\$158.31	\$166.28	\$174.64
Rank	24	23	21	20	17
Avg. Expenditure	\$1,032.02	\$1,055.65	\$1,067.74	\$1,088.96	\$1,128.16
Rank	11	12	12	12	9
Avg. Total Premium	\$907.09	\$927.92	\$925.09	\$930.54	\$980.32
Rank	11	12	12	13	10

¹² National Association of Insurance Commissioners, *Auto Insurance Database Report 2007/2008*, published in 2010. Average liability, comprehensive and collision premiums are calculated by dividing written premium by written car years. Average expenditure is the sum of the average liability, comprehensive and collision average premiums. Average total premium is the sum of liability, comprehensive and collision written premium divided by liability written car years. Average total premium is less than average expenditure because there are fewer policies with comprehensive and collision than for liability.

“Choice No-Fault” Will Cost Consumers and Taxpayers More than the Current System

Changing the current Michigan No-Fault system to allow consumers to “choose” their level of PIP benefits does nothing to address the costs of providing health care to people catastrophically injured in motor vehicle accidents. At best, a “Choice No-Fault” system will simply shift these health care costs to consumers through higher health insurance costs or taxpayers through greater public health expenditures. In fact, overall costs will rise because the delivery of the remaining health care benefits will be less efficient and the absence of rational health care services will increase public expenditures for a variety of social services. There will also be additional costs for litigation as no-fault claims shift to tort claims.

If there is a problem with the cost of PIP auto insurance coverage – and this report shows that PIP costs are stable, it is a problem with rising health care costs generally and not a problem with the No-Fault method of delivering benefits to catastrophically-injured consumers. The statement, “Michigan consumers can no longer afford unlimited PIP coverage,” is nonsensical. Changing the current No-Fault system will not reduce the number of people catastrophically injured in motor vehicle accidents or the cost of providing health care for those consumers. Consequently, it makes no sense to say that society can no longer afford to provide health care for these consumers; reducing PIP benefits will simply shift those costs to other institutions. The question is not whether the health care benefits will be provided, but are there more efficient and lower-cost methods to provide those benefits than the current No-Fault system. The answer is no.

If the problem is inflated costs for the No-Fault benefits, reducing benefit levels will not logically lead to lower costs for those health service but fewer services at the inflated costs. If there are inflated costs for No-Fault benefits, the logical approach is to identify those costs and control them – in the same manner that other benefit delivery systems attempt to control costs.

“Choice No-Fault” Will Threaten the Solvency of the MCCA.

Given a “choice,” most consumers will opt to pay less for insurance and accept caps on PIP benefits – not because consumers want capped benefits, but because many consumers must save money wherever they can. If the majority of consumers opt for PIP benefit caps under the MCCA threshold, it is unclear if those consumers will be assessed a fee for the MCCA, since they will not be entitled to any benefits provided by MCCA. As more and more consumers opt for lower PIP coverage, then the MCCA fee is assessed on fewer and fewer vehicles, with the result that the deficit adjustment part of the assessment must increase for the consumers who continue with uncapped PIP benefits. If 90% of consumers opt for lower coverage, than the deficit adjustment component must increase ten-fold to recoup the same amount of funds to close the deficit. As the assessment rises dramatically, more consumer will opt out, further reducing the base of vehicles over which the deficit must be assessed. The result is the “death-spiral” found in health insurance and long-term care policies.

The Tennyson Chamber of Commerce Report

The Michigan Chamber of Commerce prepared by Sharon Tennyson report provides incomplete and misleading information about the Michigan auto insurance system and should not be relied upon by policymakers.

The Tennyson report calls for radical change in the Michigan No-Fault system based on the premise that “projections of future costs lead to the conclusion that the system is unsustainable in the future.” This conclusion is based on an analysis of average PIP claim cost and pure premium (average loss per insured vehicle) for liability coverages.¹³

These two data sets are unreliable for the purposes used by Tennyson. Fast-track data are data submitted by a sample of insurance companies and, consequently, represent a minority of the total market. Further, Tennyson does not explain if the data presented are average paid or average incurred claims. As discussed extensively above, the use of incurred losses is not reliable for evaluating PIP claim costs.

Exhibit 3 of the Tennyson report shows pure premium liability coverages from 1997 through 2007. The data show a spike for Michigan in 2005, but the 2006 and 2007 values are similar to those of 2001 and 2002 and do not demonstrate a spike in pure premium. Further, the analysis goes only through 2007; it is not reasonable or reliable to use a data set ending four years earlier to draw a conclusion about “unsustainable costs.”

The Tennyson conclusion about growing costs is thoroughly refuted by the MCCA assessment data, discussed above, which show that PIP pure premium has been stable for at least five years and that the MCCA financial condition improved dramatically in 2011 from 2010.

Tennyson attempts to demonstrate growing costs by referencing NAIC average premium data in Exhibit 4 of the report. Tennyson uses total average premium – for all coverages, including collision and comprehensive. This analysis is flawed in several ways. The average premium presented for Michigan in 2007 is not that reported in the NAIC report. The choice of comparison years – 1997 and 2007 – is arbitrary and without rationale. The chart does not use the most recent data, available for 2008 and presented above in Table 4. Finally, the data do not support Tennyson’s conclusion that auto insurance costs are growing “unsustainably” – average liability premiums and average total premiums have declined.

Tennyson then presents a chart showing MCCA payments increasing each year in Exhibit 6 of the report. Tennyson argues that the MCCA are growing rapidly “due to accumulation of catastrophic losses.” It is unclear what Tennyson finds troubling in these data. It is expected that MCCA reimbursements will increase each year as more claims are added to existing claims which may last for many years. The issue is not that claim benefits payments by MCCA are

¹³ Tennyson Report, Exhibits 2 and 3.

increasing each year, but whether MCCA has collected sufficient premium to pay those benefits. As discussed above, the MCCA has almost \$14 billion in assets available to pay for about \$14 billion in expected benefit payments.

The Tennyson report argues that claim costs are excessive, but provides no empirical evidence to support this contention. Tennyson argues that unlimited benefits are bad and must produce excessive costs, but the argument is not grounded in sound economic principles or argument. If consumers are able to choose whatever benefits they want in an unlimited way, the excessive costs argument may hold some water. But within the PIP system, consumers don't "choose" benefits, but receive benefits judged necessary by medical professionals. As discussed above, there may be excessive costs for some PIP health care services, but it is not a result of uncapped PIP benefits.

In her testimony before the House Insurance Committee on October 4, Tennyson presented data showing that Michigan's rank among states for uninsured motorist rates had declined – meaning that Michigan's uninsured motorist rate was now higher than more states than it had been a few years earlier. First, this is not surprising because the uninsured motorist rate is closely tied to the state's unemployment rate. The most recent analysis by the Insurance Research Council of uninsured motorist rates by state was in 2009 when the Michigan unemployment rate was 13.4%. The previous studies by the Insurance Research Council were for 2004 and 2007 when the Michigan unemployment rate was about 7%. Second, the uninsured motorist rate in Michigan is driven largely by the territorial rating practices of insurers which cause extremely high premiums in the Detroit area and, consequently, very high unemployment rates in certain parts of Michigan.

In sum, the Tennyson report presents oddly-selected and disparate data points, misinterprets the data and combines the misinterpretations in a manner which misrepresents the state of the Michigan auto insurance market and the condition of the Michigan PIP system.

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Birny Birnbaum is a consulting economist and former insurance regulator whose work focuses on insurance regulatory issues. Birny has served as an expert witness on a variety of economic and actuarial insurance issues in California, New York, Texas and other states. Birny serves as an economic adviser to and Executive Director for the Center for Economic Justice (www.cej-online.org), a Texas non-profit organization, whose mission is to advocate on behalf of low-income consumers on issues of availability, affordability, accessibility of basic goods and services, such as utilities, credit and insurance.

Birny has authored reports on insurance markets, auto insurance, credit scoring, redlining, title insurance and credit insurance for CEJ and other organizations. Birny served for 12 years on the National Association of Insurance Commissioners Consumer Board of Trustees. He has authored reports to numerous public agencies, including the California Department of Insurance, the Florida Insurance Commissioner's Task Force on Credit Scoring, the Ohio Civil Rights Commission, the Michigan Insurance Consumer Advocate and the Cities of New York and Philadelphia.

Birny served for three years as Associate Commissioner for Policy and Research and the Chief Economist at the Texas Department of Insurance. At the Department, Birny provided technical and policy advice to the Commissioner of Insurance and performed policy research and analysis for the Department. Birny was also responsible for the review and approval of auto insurance rate filings and for the development of data collection programs for market surveillance.

Prior to coming to the Department, Birny was the Chief Economist at the Office of Public Insurance Counsel (OPIC), working on a variety of insurance issue. OPIC is a Texas state agency whose mission is to advocate on behalf of insurance consumers. Prior to OPIC, Birny was a consulting economist working on community and economic development projects. Birny also worked as business and financial analyst for the Port Authority of New York and New Jersey. Birny was educated at Bowdoin College and the Massachusetts Institute of Technology. He holds two Master's Degrees from MIT in Management and in Urban Planning with concentrations in finance and applied economics.

