CPAN Analysis of the Michigan Catastrophic Claims Association Finances

In January of 2012, the Coalition Protecting Auto No-Fault (CPAN) conducted an analysis of the Michigan Catastrophic Claims Association's (MCCA's) finances and claims reserving practices. The analysis was conducted by Birny Birnbaum, former chief economist at the Texas Department of Insurance.

CPAN's analysis reviewed public MCCA financial documents, including MCCA financial reports (annual statements), independent audits, Office of Financial and Insurance Regulation statements, and MCCA news releases.

These documents have been used by the MCCA and Michigan insurance industry representatives to claim a lack of financial sustainability in the MCCA, and as justification for proposed legislation that would cap auto insurance benefits in Michigan and impose strict cost controls on Michigan health care providers that treat auto accident survivors.

After thorough review of these documents, the data show several discrepancies that call into question the legitimacy of the insurance industry's calls for reform. These discrepancies include:

- **A.** The MCCA reports show the catastrophic claims fund is stable, sustainable, and operating as designed.
- **B.** The MCCA uses a questionable approach for its "Incurred But Not Reported" (IBNR) claim reserves, which inflates the fund's reported deficit.
- **C.** The MCCA is governed by a board of directors made up of insurance industry representatives who control and can manipulate claims data.
- **D.** Information provided to OFIR by the MCCA on the cost of claims is based on data that is not available for independent examination, and it uses procedures that are unsound.
- **E.** There are numerous cost controls already in place to help keep Michigan's no-fault system in a sound financial position.

The full summary of CPAN's findings is below:

A. MCCA Reports Show the Catastrophic Claims Fund is Stable, Sustainable, and Operating as Designed

i. **In 2011 total MCCA assets *increased* by $2.4 billion**. This increase occurred even though it took in $1 billion in premiums vs. $1.2 billion in incurred losses. In 2010 there were $1.8 billion in incurred losses.

ii. **In 2011, *incurred losses declined by 33%* from the previous year, despite 700 net additional claims.**

iii. **Loss reserves were virtually unchanged from 2010 to 2011: $13.6 billion to $13.7 billion.**

iv. The MCCA had a net income of $450 million in 2011, versus a projected deficit of $480 million in 2010. Fund revenues also improved by nearly *$1 billion in one year*. Moreover, **the overall MCCA projected *deficit was cut* by even more: $1.5 billion.**

v. **The MCCA's financial condition is hugely affected by performance of its massive investment portfolio.** The value of MCCA investments was devastated by 2008 financial market collapse. But as the economy continues to improve, the value of MCCA investments will improve (and are already improving), thus further reducing or eliminating MCCA's reported deficit.

In 2009, the MCCA held $7 billion in common stock. By 2011, this figure grew to $11 billion.

B. MCCA's Questionable Approach to "Incurred But Not Reported" (IBNR) Claim Reserves Should be Investigated.

i. IBRN claim reserves are estimates of future claims that have not yet been reported for past coverage. In the most recent MCCA financial statement, IBNR reserves are $2.8 billion compared to $11 billion in claims reserves for the 13,522 reported open claims as of June 30, 2011.

The IBNR claim reserve – 25% of reported claim reserves – appears very high. **In effect, the MCCA is estimating that catastrophic claims that occurred prior to June 30, 2011 <u>but have not yet been reported</u> will cost one-quarter as much as the 13,522 claims reported and still open as of June 30, 2011.**

This is equivalent to saying that there are over 3,000 catastrophic claims that occurred prior to June 30, 2011 but somehow have not yet been reported. Given that the MCCA has historically added about 500 to 700 claims each year (new claims filed less claims closed), it seems unlikely that the MCCA will receive such a large number of claims for events that occurred in the past.

ii. **If IBNR claim reserves were adjusted to 15 percent of reported claim reserves, there would be <u>no deficit</u>**. If IBRN claim reserves were 10 percent – the equivalent of two additional new years of reported claim reserves – the MCCA would be in surplus.

C. The MCCA is Governed by a Board of Insurers Who Control and Can Manipulate Claims Data:

i. The MCCA's 6-Member Board includes: Auto Club Insurance Association, Auto-Owners Insurance Company, Farmers Insurance Group, Progressive Insurance Company, State Farm Mutual Automobile Insurance Company, and the State Insurance Commissioner – who is a non-voting, *Ex-Officio* member.

ii. The 2011 Independent Auditor Report of the MCCA indicates that the MCCA's funding projections are dependent upon the information provided by its member organizations. The report states:

> "The methods of estimating unpaid losses and loss adjustment expenses are continually reviewed and updated, and any adjustments resulting there from are reflected in the current operations. Management believes that the provision for unpaid losses and loss adjustment expenses is adequate; however, inasmuch as <u>these estimated amounts are based on member reported information</u>, present value, investment yield and mortality assumptions (determined by actuarial tables that incorporate actual emerged Association mortality and closure experience) the ultimate settlement of these liabilities may be significantly greater or less than such estimates."

D. Information Provided to OFIR by the MCCA on the Cost of Claims is Based on Data Unavailable for Independent Examination, and Uses Procedures that are Unsound.

In answering questions to OFIR about the estimated future cost of new claims, the MCCA states that "rates and reserves are set on an aggregate basis." This is actuarially unusual, as the aggregated approach lends itself to big swings in projected pay-out estimates. This analysis should be done on an individual claims basis.

E. There are Numerous Cost Controls Already in Place:

i. **No Fault's health care coverage is *not* unlimited.** The statute says insurance companies are only required to cover "reasonable charges for reasonably necessary" care. [MCL 3107(1)(a)].

ii. In exchange for getting this often-life-saving, reasonably necessary coverage, **consumers had to give up the right to sue for non-economic/quality of life damages** except in instances of "serious impairment of bodily function." This is the *most restrictive* language in the U.S. For every auto injury lawsuit in Michigan, eight lawsuits are filed in Ohio.

iii. **There are several *internal cost controls* presently employed in the hospital setting, including:**

a) *Medical Audits:* when an insurer contests the reasonableness of a procedure recommended by the doctor, after consulting with the provider, the insurer can ask for a "second opinion" from an independent "Medical Authority."

b) *Case Manager Review:* insurers frequently engage Case Managers to review and evaluate the reasonableness of a patient's course of treatment.

c) *Denial of Coverage:* Insurers can, and quite often do, deny paying for certain medical treatments they deems unreasonable.

iv. **External cost controls that keep Michigan's auto insurance system sustainable include:**

a) *Insurers' exposure for health care costs is capped at $500,000.* Every penny above that amount spent on health care is borne collectively by Michigan policyholders – not insurers – through the annual MCCA assessment on policies: The current 2011-2012 premium assessment is $145.

b) *Michigan drivers have the highest rate of seat belt use in the nation.*

c) *Serious auto accidents in Michigan are down by 54 percent since 1996.*

d) *Michigan has toughest-in-the-nation DUI and Work Zone Safety laws*

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