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# The Cost of No-Fault Auto Insurance

**March 29, 2005**

## Executive Summary

This study examines state-by-state auto insurance premium data reported by insurance companies to the National Association of Insurance Commissioners. We compare three different auto insurance systems: *no-fault,* in which drivers involved in an accident seek compensation from their own insurer, regardless of fault, and the right to sue is restricted; *personal responsibility*, the traditional liability system in which the at-fault motorist's insurance policy provide payment to the innocent party for damage and injuries in an accident; and, *hybrid/choice no-fault*, which provides drivers with elements of both personal responsibility and no-fault coverage, or gives drivers a choice between personal responsibility and no-fault systems.

The study examines motorists' premiums across the three systems as well as premium trends among the different types of state systems.

No matter how the data are examined, no-fault schemes consistently cost the consumer more than personal responsibility or hybrid/choice systems. Premiums decrease for drivers when states repeal no-fault laws. Additionally, this study discusses how insurance regulation plays a critical role in maintaining lower rates.

Among the findings:

- Premiums are 19% higher in no-fault states than in personal responsibility states.
- States with some form of no-fault insurance are consistently the highest priced in the nation.
- Auto insurance premiums rose 92% faster in no-fault states than in personal responsibility states between 1998 and 2002.

- Six of the ten states with the greatest premium increases between 1998 and 2002 had mandatory no-fault systems.
- In states where mandatory no-fault laws were repealed, motorists experienced significant average premium savings: $145 lower in Connecticut, $76 lower in Georgia and $156 lower in Pennsylvania.
- Insurance premiums are 37% higher in Massachusetts, the first state to enact a no-fault law, than in California, a personal responsibility state with strong rate regulation.

The data suggest that the best way to lower insurance premiums is to repeal no-fault in its various forms, and institute stringent regulation of the insurance industry.

# The Cost of No-Fault Auto Insurance

By the Foundation for Taxpayer and Consumer Rights
March 29, 2005

## I. Introduction

In most states, auto insurance laws establish a *personal responsibility* system. That is, the basic and mandatory insurance policies are liability policies that provide coverage when a driver is at-fault in an accident and can be held responsible in court for the injuries and damage done to another person or their property. Only a few states maintain what is known as a *no-fault* system, in which drivers, after an accident, seek compensation from their own insurer regardless of fault, and the right to collect compensation from the at-fault motorist is limited[1]. Other states use *hybrid/choice no-fault* systems, either providing consumers with both liability and some no-fault coverage with no restrictions on the right to sue, or allowing consumers at least a theoretical option to choose between no-fault and personal responsibility systems.

In 1971, Massachusetts adopted the nation's first no-fault system. Although several other states enacted no-fault laws soon thereafter, no state has adopted a no-fault auto insurance system since 1976. Since 1980, six states and Washington, D.C. have repealed their mandatory no-fault laws.[2] As of 2002, ten states still had mandatory no-fault laws.[3] (Colorado has since repealed its no-fault law.) Another twelve states and the District of Columbia had hybrid/choice no-fault systems in 2002.[4]

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[1] Drivers in no-fault states are barred from going to court to collect compensation for injuries or pain and suffering unless they meet a specific threshold of damage. The conditions in some states are verbal and include only severe injuries such as death or severe disfigurement; in other states drivers' medical bills must reach a dollar threshold before the injured party is allowed to sue.

[2] Nevada repealed no-fault in 1980; D.C.'s mandatory law was repealed in 1986; New Jersey repealed its mandatory no fault law effective in 1989; Pennsylvania repealed its mandatory no-fault law effective July 1990; Georgia repealed its law effective Oct., 1991; Connecticut repealed its no-fault law effective in 1994; Colorado repealed its law in 2003.

[3] Colorado, Florida, Hawaii, Kansas, Massachusetts, Michigan, Minnesota, New York, North Dakota, Utah.

[4] Due to the range of different laws that apply in hybrid states, some analysts have classified certain states as hybrid that others consider personal responsibility states. For this analysis, we treat the most commonly disagreed upon states as follows: Washington is treated as a hybrid system because consumers are provided no-fault coverage in addition to their liability policy unless they reject the no-fault, while Wisconsin and South Carolina, which do not automatically provide additional no-fault coverage, are treated as personal responsibility states. Classifying them differently, nevertheless, would have a negligible impact on the overall conclusions of the report.

In various but unsuccessful attempts to expand no-fault to other states, the industry has asserted that limiting motorists' ability to bring lawsuits reduces insurance premiums for all drivers. When low rates fail to materialize in no-fault states, insurers defend the scheme with proposals to institute "choice" systems that maintain no-fault insurance and restrictions on lawsuits but allow consumers the alternative of purchasing a liability policy resembling a personal responsibility system. Insurance company attempts to appease consumer frustration with high rates in no-fault states have also led to industry bids to reduce expenses by drastically cutting the benefits that are paid under the no-fault system.

Determining whether no-fault insurance and related hybrid systems result in higher or lower auto insurance costs is of major importance in the debate over auto insurance reform.

This report compares motorists' premiums across the three systems as well as premium trends among the different types of state systems.

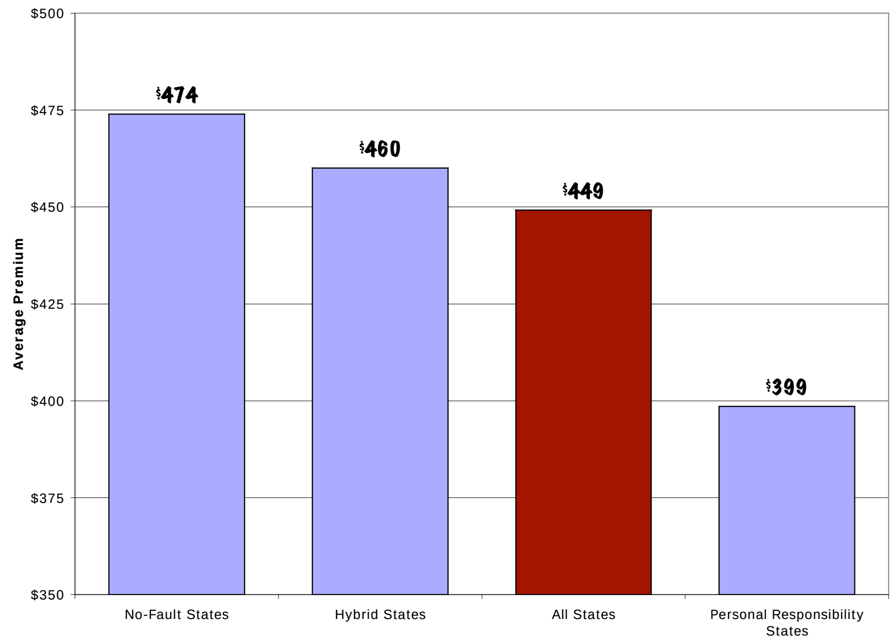
*Premiums are 19% higher in no-fault states*

This study summarizes data drawn from annual reports compiled from insurance company data and published by the National Association of Insurance Commissioners (NAIC), most recently, *2001/2002 Auto Insurance Database Report* (September 2004). This is the most recent data available. The study examines "average premiums and expenditures, liability average premium" as reported by the NAIC because it is the portion of the insurance policy directly affected by distinctions between liability and no-fault coverage.

## II. No-Fault and Hybrid/Choice States Consistently Have Higher Average Auto Premiums Than Personal Responsibility States.

The average auto insurance premiums in states with a no-fault system are 19% higher than in personal responsibility states, and hybrid/choice states are 15% more expensive than in personal responsibility states. The average annual premium for basic coverage countrywide in 2002 was $449; in no-fault states it was $474; it was $460 in hybrid states; and in personal responsibility states the premium averaged $399. *See Figure 1*

**Figure 1. No-Fault & Hybrid/Choice States' Premiums Were Higher Than Average**




**No-fault states are consistently the most expensive states.** Of the five states where auto insurance was most expensive in 2002, four were no-fault or hybrid/choice states, as were seven of the ten highest-priced states. *See Table 1*

**Table 1**

| Most Expensive States, 2002 | | | |
|---|---|---|---|
| 1. | New York | $741 | no-fault |
| 2. | New Jersey | $659 | choice no-fault |
| 3. | Massachusetts | $624 | no-fault |
| 4. | Rhode Island | $610 | personal responsibility |
| 5. | Delaware | $605 | hybrid |
| 6. | Connecticut | $600 | personal responsibility |
| 7. | Nevada | $564 | personal responsibility |
| 8. | Florida | $560 | no-fault |
| 9. | Wash. D.C. | $558 | hybrid |
| 10. | Colorado^ | $555 | no-fault |

^ CO repealed no-fault in 2003

*No-fault states have highest premiums every year*

Table 2 below shows that states with some form of no-fault are a majority of the top ten most expensive states for auto insurance in the nation. Since 1989 (the oldest data reviewed for this analysis), the three most expensive states each year had some form of no-fault in all but two years.[5] Every year, without exception, a no-fault or hybrid/choice state was the most expensive in the nation in which to buy auto insurance. And, each year during the period surveyed, no-fault and hybrid/choice states made up at least six of the ten most expensive auto insurance markets.

**Table 2**

| **Year** | **Number of states with some form of no-fault in Top 10 Most Expensive** | **Highest Priced Insurance Market in USA (*type of system*)** |
|---|---|---|
| 2002 | 7 | New York (*no-fault*) |
| 2001 | 6 | New York (*no-fault*) |
| 2000 | 6 | New York (*no-fault*) |
| 1999 | 6 | New Jersey (*choice no-fault*) |
| 1998 | 6 | New Jersey (*choice no-fault*) |
| 1997 | 6 | New Jersey (*choice no-fault*) |
| 1996 | 6 | New Jersey (*choice no-fault*) |
| 1995 | 6 | Hawaii (*no-fault*) |
| 1994 | 6 | Hawaii (*no-fault*) |
| 1993 | 7 | Hawaii (*no-fault*) |
| 1992 | 7 | Hawaii (*no-fault*) |
| 1991 | 8 | Hawaii (*no-fault*) |
| 1990 | 8 | New Jersey (*choice no-fault*) |
| 1989 | 8 | New Jersey (*choice no-fault*) |

## III. Premiums Rise Faster in No-Fault States.

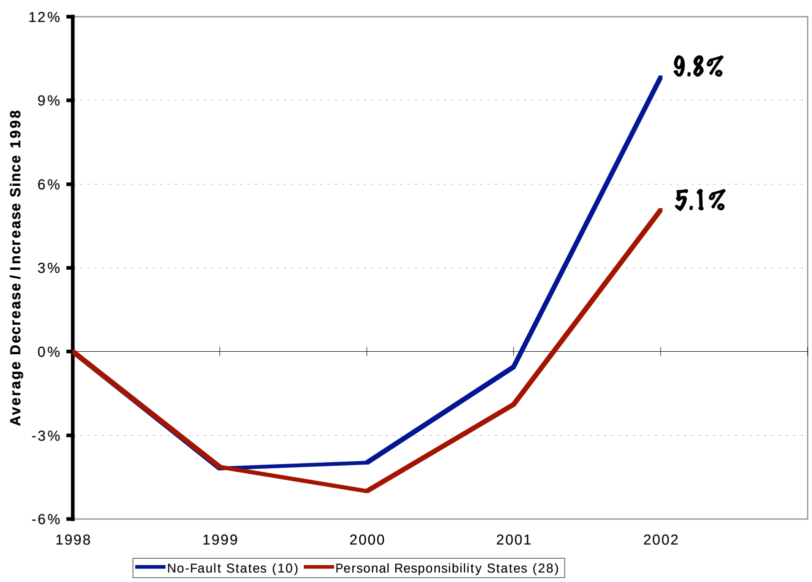
In addition to higher premiums, customers in states with no-fault systems face higher percentage increases. For example, between 2001 and 2002, average premiums increased 7% in personal responsibility and hybrid/choice states, while increasing 10% in no-fault states.

[5] In 1989, California was the second most expensive (see Section VI). In 1998, Connecticut was third, though only 83 cents more expensive per policy than no-fault state Hawaii.

Even more notably, the average auto insurance premium rose 92% faster in no-fault states than in personal responsibility states between 1998 and 2002. Figure 2 below shows that states with mandatory no-fault systems saw their average premium increase an average of 9.8% between 1998 and 2002, while the average rate of growth in personal responsibility states was 5.1% during the period. Although hybrid/choice states saw an increase of only 2.8% between 1998 and 2002, the relatively low increase is largely attributable to a 1998 New Jersey law mandating a 15% rate rollback in the wake of escalating premiums under that state's choice no-fault system. (Even with this mandated reduction, New Jersey's rates were the highest in the country in 1999.)

*No-fault rates grew 92% faster than traditional states*

**Figure 2 Cumulative Premium Increase Between 1998 - 2002**




Of the ten states with the greatest increases in the nation in auto liability premiums between 1998 and 2002, six have mandatory no-fault systems. *See Table 3*

**Table 3**

**Top 10 Premium Increases 1998-2002**

| State | % Increase | State | % Increase |
|---|---|---|---|
| Colorado* | 21.53% | Wyoming | 15.73% |
| Montana | 20.88% | Florida* | 15.68% |
| Michigan* | 20.22% | Massachusetts* | 15.24% |
| Vermont | 16.76% | Alaska | 13.90% |
| New York* | 15.79% | Utah* | 11.19% |

* no-fault state

## IV. Repealing No-Fault Lowers Auto Insurance Premiums.

No-fault systems have failed to deliver promised premium savings. Since the first mandatory no-fault law was passed in Massachusetts, six states and Washington, D.C. have repealed them. Four of these, Pennsylvania, Georgia, Connecticut and Colorado[6], repealed their mandatory no-fault laws since 1989. Auto insurance rates in Pennsylvania, Georgia and Connecticut are significantly lower in 2002 than they would have been had mandatory no-fault systems remained in place. *See Figure 3*

**Georgia** repealed its no-fault law effective October 1991. The state was the 17th most expensive in the nation in 1989 before the no-fault law was repealed. Georgia rapidly fell to 32nd by 1992, and has not risen above 29th since. In 2002 the state's average premium was well below the national average.

Average premiums in Georgia increased just 9% between 1991 and 2002, compared to the 31% increase in average premiums

### WHY NO-FAULT FAILS

No-fault increases auto insurance premiums because it increases the overall costs of the auto insurance system. Restrictions on the right to sue do not offset the higher costs of no-fault.

**Twice the people covered.** Under no-fault, both the innocent victim and the person who caused the accident are paid -- regardless of who is at fault. Paying both parties is vastly more expensive than under personal responsibility systems, in which the liability policy of the at-fault driver covers the innocent driver only.

**More Claims & Fraud.** Because insurance companies are required to provide benefits up to the limits of the no-fault policy, and consumers do not need to meet the safeguards and requirements of the legal system, policyholders have incentives to increase medical treatment. Additionally, the easy availability of medical benefits and wage loss encourages unnecessary and even fraudulent claims. Individuals who are not covered by other forms of health care may file claims under the no-fault system for injuries or illnesses not caused by the operation of a motor vehicle.

**Litigation.** No-fault does not significantly reduce litigation costs. Litigation over property damage (and nearly every car accident involves damage to the driver's vehicle) continues under no-fault, because no-fault retains the liability system for property claims. Moreover, in no-fault states like Michigan, suits brought by motorists against their own insurance company for failure to pay no-fault benefits have skyrocketed. An analysis published in the Insurance Counsel Journal, a publication for insurance defense attorneys, concluded: "Whatever the advantages of no-fault, a reduction in court cases and court costs would not appear to be one of them." (July 1986, at page 389).

**Additional Insurance Required.** Under no fault, motorists must still purchase property damage liability protection; uninsured/unregistered motorist coverage; and under-insured coverage.

**No-fault encourages reckless driving.** Studies show that drivers operate vehicles more recklessly when they are relieved of personal responsibility under no-fault laws. (See, for example, "Effects of Tort Liability and Insurance on Heavy Drinking and Drinking and Driving," Sloan, et. al., Journal of Law and Economics (April, 1995)).

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[6] One state, Nevada, repealed its mandatory no-fault law in 1980. Washington, D.C. amended its law to make the no-fault system optional in 1986. Both changes occurred before period covered by this study. New Jersey has an optional no-fault system, which is discussed in Section V of this report.

in no-fault states for the same period. Had Georgia maintained its no-fault system, that increase would have meant an average premium of $448 for Georgia drivers in 2002. Instead, drivers pay an average of just $372 a year for a basic insurance policy.

**Connecticut** repealed its no-fault law effective January 1, 1994. Average liability premiums in Connecticut increased 41% from 1989 through 1993, but fell 10% between 1993 and 2002 upon the repeal of mandatory no-fault. During the same period, average premiums in no-fault states rose 12%. If Connecticut had kept its no-fault system and followed this growth trend, the basic insurance premium would have reached $746 by 2002. Connecticut rates were $599 in 2002 under its personal responsibility system.

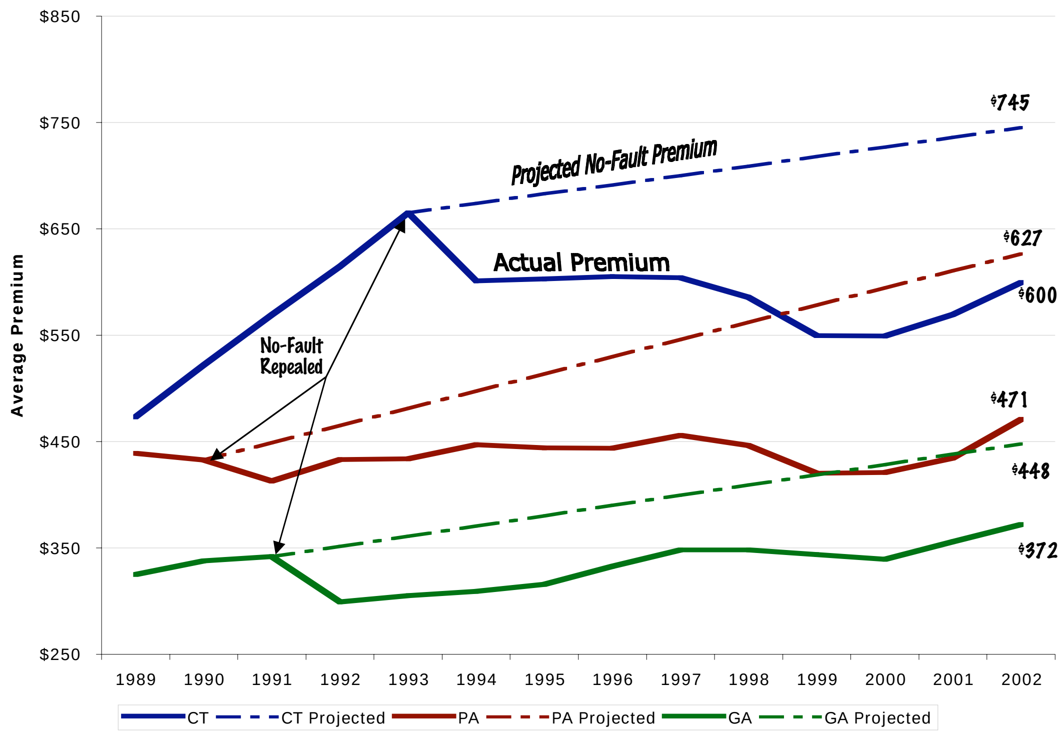
**Pennsylvania** amended its no-fault law in July of 1990. Drivers now have the option of traditional personal responsibility or no-fault coverage, but customers must actively choose to give up the right to hold the at-fault driver responsible in court. Because insurance policies default to the personal responsibility system if the policyholder fails to make a choice, a majority of Pennsylvania drivers have coverage under the personal responsibility system.

Average premiums in Pennsylvania increased just 9% between 1990 and 2002, compared to an average increase of 45% during that time for states with mandatory no-fault coverage. If Pennsylvania had maintained its no-fault system and followed that average trajectory, the average premium would have reached an estimated $629 by 2002. Instead, premiums were $471 on average in 2002.

As a no-fault state Pennsylvania was the 6th most expensive in the nation as a no-fault state in 1989. Ending mandatory no-fault dropped the state out of the top ten costliest states and it fell to 17th place nationally by 2002.

**Colorado** is the most recent state to repeal its mandatory no-fault law. The Rocky Mountain state passed a no-fault insurance law in 1974. In the 13 years between 1989 and 2002, average auto insurance premiums rose 75%. Colorado's premiums climbed consistently, moving it from the 20th to the 10th most expensive state to buy auto insurance nationally. Colorado motorists faced a 19% average premium increase between 2001 and 2002 alone, driving lawmakers to repeal the no-fault system, effective July 2003, and restore a traditional personal responsibility system.

**Figure 3 Drivers Realize Large Savings After No-Fault Repeal**




## V. The Failure of "Choice No-Fault" in New Jersey

New Jersey switched from a no-fault state to a hybrid/choice state when it dropped its mandatory no-fault law in 1989. However, New Jersey is more properly described as a "choice no-fault" structure because it uses an optional system in which all motorists are enrolled in no-fault unless they actively choose a personal responsibility policy. As such, the majority of New Jersey drivers remain in the no-fault system by default and the data corroborate the failure of choice no-fault to meet the goal of lowering premiums.

*New Jersey Topped Most Expensive List Even After "Choice" System Enacted*

As a result of its orientation toward the no-fault system, New Jersey has been among the top three most expensive states for auto insurance in every year but one since 1989. Even after moving to the "choice no-fault" scheme, New Jersey was the most expensive state in the nation four times between 1989 and 2002.[7] By 1997, New Jersey's system had led to the most expensive average premium anywhere in the country. In response, lawmakers enacted new restrictions on

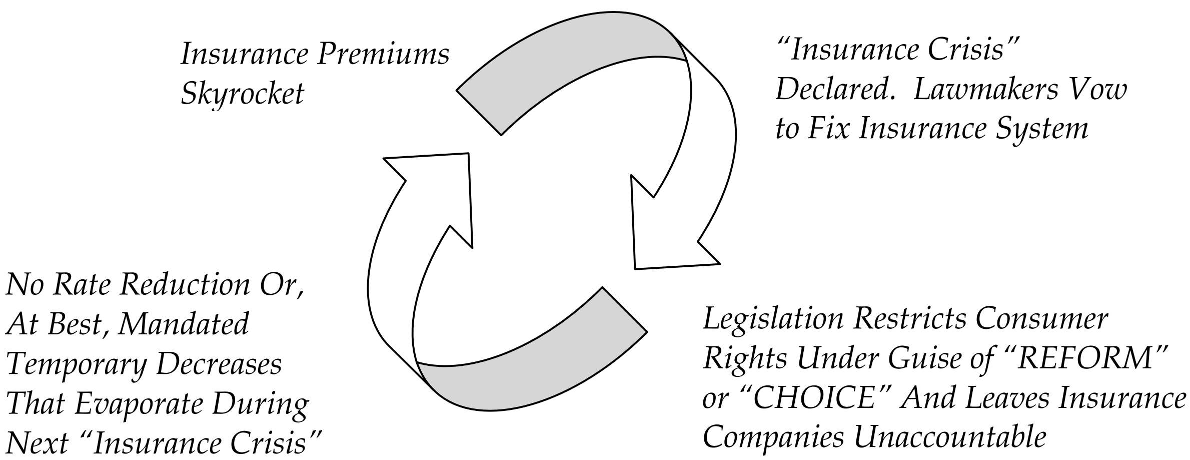
[7] Only New York (in 2002) averaged a higher premium than the $738 average that New Jersey's choice no-fault system yielded in 1997.

accident related medical care and motorists' legal rights and mandated a rate rollback. This 15% rollback still left New Jersey atop the nation in average premium and did not last. Between 2000 and 2002, premiums in New Jersey rose again, by more than 12%.

## VI. Regulation Is Key To Breaking The Insurance Rate Hike Cycle.

Serious insurance reform will mitigate the seemingly endless cycle of insurance rate escalation, in which insurance companies insist that restrictions on lawsuits will lower their prices. *See Figure 4*

**Figure 4 What Happens When the Insurance Industry Drives "Reform**




In this cycle, insurance premiums rise dramatically in conjunction with a broader economic downturn, as insurers' investment returns falter. The public becomes agitated about rising premiums. Insurers allege that lawsuits are driving premium increases. Legislative proposals backed by insurers invariably seek to limit the legal rights of consumers (or, in states with existing limitations, the right to collect compensation from the at-fault motorist is further restricted). Such amendments are enacted, and sometimes even include a temporary rate rollback. However, these reductions quickly expire and premiums begin to rise again. (New Jersey's 1998 rollback savings had virtually evaporated by 2002.) The problem of high insurance rates continues, customers have fewer rights, insurers remain unaccountable, and the insurance rate hike cycle begins again.

**California voters broke the insurance cycle.** California, a personal responsibility state, faced an "insurance crisis" with massive increases in the price of business, homeowner and auto liability insurance between 1985 and 1987. When an insurance industry-driven ballot initiative limiting consumers' legal rights failed to produce savings, and efforts in the state legislature to enact reforms were blocked by the insurance lobby, California voters enacted the "Insurance Rate Reduction and Reform Act," Proposition 103, in November, 1988. Insurers spent $80 million in an unsuccessful effort to defeat the grassroots voter initiative and pass a no-fault law at the ballot.

Proposition 103 mandated a 20% rollback in auto, homeowner and business premiums; it instituted stringent controls on insurance company profiteering, waste and inefficiency; allows members of the public to challenge any company's proposed rate change; ended monopolistic insurer practices by repealing the industry's exemption from antitrust laws; and made the insurance commissioner an elective office.

Proposition 103's rollback and prior approval rate regulation requirements took effect in May 1989, when the California Supreme Court upheld all but two provisions of the initiative, including its 20% rollback.[8] In total, approximately $1.2 billion was returned to policyholders as part of the rollback.

In subsequent years, using the rate regulation provisions and the rules allowing public intervention to block excessive rates, insurance commissioners and consumer groups saved California drivers more than $23 billion on auto insurance rates alone, according to a 2001 study by the Consumer Federation of America.[9]

NAIC data show that compared to the nation, Proposition 103 has succeeded in restraining increases in the price of car insurance, particularly in the area of auto liability insurance, in which double-digit rate increases were common prior to the voter initiative:

- The average auto liability insurance premium <u>decreased</u> by 12.84% in California between 1989 and 2002, while the average premium throughout the rest of the nation <u>increased</u> 51.3% in the same period.

- California is the only state to see a decrease during that period.

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[8] The Court altered the legal standard by which an insurance company could obtain an exemption from the rollback; Proposition 103, as written, permitted exemptions only for those insurers who could show that full compliance would pose a "substantial threat of insolvency"; the Supreme Court ruled that such a standard might deprive insurers of their constitutional rights to a fair return, and substituted a "fair profit" test. The court also invalidated, on technical grounds, a section creating a citizen consumer advocacy board.

[9] *Why Not the Best? The Most Effective Auto Insurance Regulation in America* by J. Robert Hunter, Consumer Federation of America, June 2001.

- In 1989, California had the 2nd highest average liability premium in the nation. In 1995, it ranked 11th. By 2002 California had fallen to 20th.

**Regulation and accountability promote competition and lower rates.** California's Proposition 103 removed the special exemption from anti-trust laws that most states still provide insurance companies. Forcing companies to compete rather than allowing them to conspire, in conjunction with regulatory oversight of insurance rates, has earned California consumers a vibrant and reasonably priced insurance marketplace. A comparison between California and Massachusetts helps explain the value of regulated competition. *See Table 4*

*California is only state with overall premium decrease since 1989*

In California, each insurance company is required to propose its own insurance rate, and justify it with its own data, before consumers get the bill. Under California's antitrust rules, companies cannot collude to share data and set rates jointly, another practice that drives up rates in other states. No company is allowed to implement a rate that is deemed excessive, inadequate or unfairly discriminatory, regardless of the rates approved for any other company.

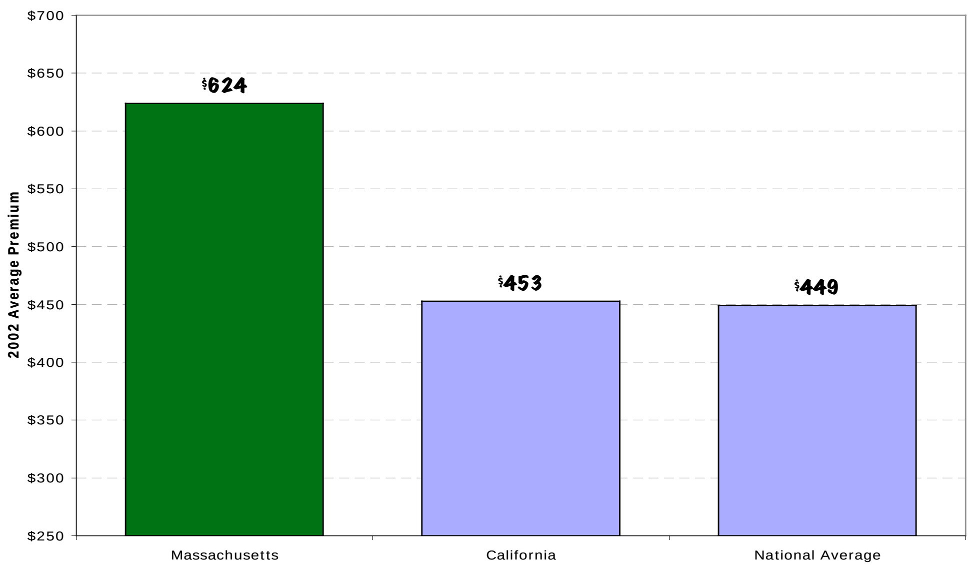
In Massachusetts, an insurance industry organization provides a proposed annual rate for all insurance companies in the state and the Insurance Commissioner sets a single rate based on the data. Because of the exemption from antitrust rules in Massachusetts, a single rate is set industry-wide rather than on a per company basis. Although companies can request lower rates, they seldom do.

**Table 4**

| California | Massachusetts |
|---|---|
| Each Insurer Individually Accountable, Subject to Regulatory Scrutiny | Insurers Subject to Single-Rate System, Individual Companies Not Accountable |
| Insurers Subject to Antitrust Laws | Insurers Exempt from Antitrust Laws |
| Personal Responsibility State | No-Fault State |
| Elected Insurance Commissioner | Appointed Insurance Commissioner |
| 200+ Companies Sell Auto Insurance | 19 Companies Sell Auto Insurance |
| **Average Premium: $453** | **Average Premium: $624** |

Auto insurance premiums in Massachusetts are 38% higher than in California. California premiums, which had been 53% more expensive than the national average in 1989, were virtually at the national average by 2002. Massachusetts' premiums veered in the other direction, with its average premium 26% above the national average in 1989 and 39% higher than the nation as a whole in 2002. *See Figure 5*

**Figure 5. Massachusetts' Average Premium Is Far Above National Average**




Massachusetts has remained among the top ten most expensive states in the nation to buy auto insurance coverage – and in the top five during nine of the past fourteen years – from 1989, when our study begins through 2002. In marked contrast, California has enjoyed a steady decline in premiums since the passage of Proposition 103. During that period, California motorists' premiums fell by nearly 13%, while Massachusetts premiums increased by more than 46%.

## VII. Conclusion

After thirty years of experimentation with no-fault throughout the country, the only conclusion that can be drawn is that the system has failed. Premiums in no-fault states are not only consistently higher than in other states, but have also increased faster than other states, even as injured people face restrictions on their right to collect compensation from irresponsible drivers. Despite insurance industry efforts to expand no-fault, voters have rejected insurer led ballot initiatives to create no-fault insurance in California, Arizona and Florida. However, in most states that presently have no-fault laws, efforts to repeal no-fault have been blocked by the insurance industry, which wants to maintain the limited liability and high income of the no-fault system.

The data suggest that the best way to lower insurance premiums is to repeal no-fault in its various forms, and institute stringent regulation of the insurance industry.