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Auto Choice Insurance

Auto Choice insurance

THE WHITE HOUSE

WASHINGTON

March 10, 1998

MEMORANDUM FOR THE PRESIDENT

FROM: BRUCE REED
GENE SPERLING

SUBJECT: Auto Choice

Overview:

This memorandum addresses the "Auto Choice" legislation introduced last April by a bipartisan coalition of Members of Congress. Over the last several months, an NEC-DPC inter-agency working group has spent considerable time analyzing the Auto Choice proposal and reviewing other auto-insurance reform options. It is the strong view of the working group that the benefits of the Auto Choice proposal do not justify the costs.

Although proponents of Auto Choice claim that it will reduce insurance premiums by approximately $250 per year for the average driver, the working group found little evidence that this proposal or any other no-fault insurance plan will lead to lower rates. In the three states that currently mandate insurance companies to offer drivers choice between no-fault and pre-existing insurance plans (New Jersey, Kentucky, and Pennsylvania), there was no evidence that insurance rates fell when choice was implemented. In addition, our analysis suggests that under Auto Choice, bad drivers will benefit more than good drivers.

Background:

"No-fault" insurance plans allow policyholders to recover financial losses from their own insurance companies, regardless of fault, while restricting their right to sue.

Under current state no-fault laws, motorists may sue for damages beyond what their insurance company pays (i.e., economic damages above the policy limit and non-economic damages such as pain and suffering) only if the case meets certain conditions. These conditions, known as a "threshold," relate to the severity of injury. They may be expressed in verbal terms (a descriptive or verbal threshold) or in dollar amounts of medical bills (a monetary threshold). Some laws also include the days of disability incurred as a result of the accident. The academic evidence shows that verbal thresholds can lower insurance premiums, but that monetary thresholds can actually lead to higher premiums because people have an incentive to exaggerate their medical bills so that they can sue for additional damages.

Proposals:

The working group has considered two options. The first is the Auto Choice legislation introduced by Senators McConnell and Moynihan and Representative Armey. Under this proposal, drivers in states that accept the new federal legislation have a choice between the existing system in their state and a no-fault plan called 'personal protection insurance' (PPI). A driver who chooses the PPI option gets first-party coverage for economic damages (mostly medical and lost wages), without regard to fault. The driver can sue or be sued for economic damages above policy limits, but cannot sue or be sued for non-economic damages ('pain and suffering') except in cases involving drug or alcohol abuse. A driver who opts to stay in the state's current tort system must purchase tort maintenance coverage (TMC) to cover accidents with PPI drivers.

Because of some of the problems associated with the Auto Choice proposal, CEA developed an alternative proposal, which achieves the same ends -- lower premiums -- but at less cost. This proposal would require insurance companies to offer premiums on a per-mile basis for those drivers who opted for no-fault coverage. Per-mile premiums would be charged based on an estimate of miles, with a rebate or surcharge issued every year after an odometer reading. Odometers could be read at regular inspections or by firms under contract with insurance companies. Insurance companies would compete in their per-mile premium, subject to current regulations; premiums would vary with region, driving record, type of car, and safety features, much as premiums vary now.

Analysis:

There are a number of problems with these proposals. Perhaps most important, neither of the proposals guarantees that insurance companies will pass on savings to consumers. There is little evidence that over the long-term consumers saved money in states that have implemented no-fault systems compared to the period when no-fault was not mandated. In addition, it is not clear why the Federal government should enter into a field that traditionally has been the responsibility of state governments and in which state innovation is thriving. Such involvement might also appear to conflict with our long-standing skepticism of other federal tort reform efforts.

The McConnell-Armey Auto Choice legislation has additional adverse consequences. The PPI plan initially will attract more bad drivers than good ones, because they will no longer have to be covered for non-economic damages. As bad drivers enter the PPI system, the premiums of safe drivers maintaining their current coverage will increase because of the need to cover losses incurred as a result of other drivers' fault. Then, as the premiums of drivers in the non-PPI system rise, more and more people will switch to PPI, thus further raising premiums for those left in the system -- the very safest drivers. The end result is the progressive penalization of safe driving -- and perhaps, in the end, the virtual collapse of the non-PPI option.

In addition, CEA is concerned that even if Auto Choice legislation were to succeed in driving down rates, it would have an unintended consequence: by increasing the number of miles driven, the legislation would lead to more accidents, highway deaths, congestion, and environmental degradation. To address this problem, CEA developed the per-mile premium option. We believe, however, that we could not sustain support for their proposal. While the average premium for drivers would decrease under CEA's proposal, opponents would counter that we are "taxing" each mile that middle-income families drive. They would also argue that monitoring miles driven is an example of "big government" intrusion into people's lives. CEA agrees that the current political environment does not allow us to propose per-mile premiums. They would like us, however, to work to facilitate the voluntary adoption of per-mile premiums by states, insurance companies, and individuals.

Although Auto Choice has wide bipartisan support -- from Senator McConnell to Senator Moynihan and from Grover Norquist to Mike Dukakis -- consumer groups, auto safety groups, environmentalists, and attorneys representing automobile accident victims will oppose this legislation.

Recommendation:

There is unanimous agreement among the NEC-DPC interagency working group -- including the Office of White House Counsel, the Office of the Vice President, CEA, OMB, Transportation, and Treasury -- that you should oppose the McConnell-Armey Auto Choice bill.

Assuming you agree, the remaining issue is when to announce your position. If we announce our opposition now, we may encourage supporters to bring the legislation up so as to to define their disagreement with us. By contrast, if we remain quiet, the legislation may die on its own. We therefore believe that it would be best to hold off any statement on the bill for now. If Auto Choice comes to the floor, you could oppose it in a speech or we could issue a Statement of Administration Policy.

Decision:

_____ Oppose Auto Choice, But Do <u>Not</u> Announce Position Unless And Until Bill Comes To Floor (RECOMMENDED)

_____ Oppose Auto Choice, But Announce Position Now

_____ Discuss Further

Automobile insurance

Paul J. Weinstein Jr. 01/29/98 12:51:21 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP, Thomas L. Freedman/OPD/EOP

cc:

Subject: OPINION: UNDER 'CHOICE' AUTO INSURANCE, YOU LOSE

Brutal article.

--------------------- Forwarded by Paul J. Weinstein Jr./OPD/EOP on 01/29/98 12:51 PM ---------------------------

ORSZAG_J @ A1
01/29/98 10:25:00 AM

Record Type: Record

To: See the distribution list at the bottom of this message

cc:

Subject: OPINION: UNDER 'CHOICE' AUTO INSURANCE, YOU LOSE

Date: 01/29/98 Time: 10:03

OPINION: Under 'Choice' Auto Insurance, You Lose

By Henry S. Monti, Providence Journal-Bulletin, R.I.
Knight Ridder/Tribune Business News

Jan. 29--If the "only opposition" to the adoption of auto "choice" insurance comes from trial lawyers, then why did Californians defeat a ballot initiative on this issue in 1996 by a 2-to-1 margin and states such as Georgia and Connecticut recently repeal their "no-fault" auto insurance laws ("Good news for drivers; bad news for lawyers," by Eric Peters, Commentary, Jan. 7)?

Auto "choice" insurance is nothing more than the same old failed no-fault scheme with a cheap new coat of paint. No state has enacted a no-fault program since 1976 -- and for good reason. Under this scheme, motorists involved in accidents file damage claims with their own insurers, without regard to who caused the accident. In our traditional system, fault is apportioned and bad drivers pay for their mistakes through higher premiums. No-fault motorists bear less responsibility for their driving habits, which means good drivers pay for bad ones.

The numbers simply don't add up for auto "choice" no-fault. In 1994, insurance premiums in the 13 no-fault states were 15 percent higher than in those states that apportioned fault under traditional insurance systems and tort laws. And the states that repealed their no-fault laws reduced motorists' premiums. Georgia experienced a 10 percent drop in premiums after the repeal of no-fault in 1991, while rates declined by 10 percent for liability and 6 percent overall in Connecticut after repeal in 1993.

The alleged "tax cut" under this latest no-fault bill would come at a very high price: the total elimination of damage awards for "noneconomic" injuries, including gross disfigurement, loss of a limb or vision, and loss of fertility. Especially damaging is the sham characterization of auto "choice" no-fault as some sort of financial salve for lower-income drivers. By forcing consumers to buy additional coverage at extraordinary costs just to retain some semblance of their legal rights, this insurance scheme merely creates a class-based justice system.

Yes, consumers with little or no means can purchase cheaper insurance, but is anyone going to explain to them that they will be denied justice when an accident leaves them with a lifetime of suffering?

Eric Peters and the others blowing the horn for auto "choice" insurance simply fail to acknowledge the insurance industry's profitability. A January 1997 Business Week article exposed the lucrative nature of this business, and noted that claims have been roughly flat for several years now. And insurance monitor A.M. Best reported industry profits to be a healthy $8 billion in 1997, following profits of $9.6 billion in 1996. Plummeting insurance costs because of safer cars, contained medical inflation and fewer young drivers on the road, not to mention insurance industry profits in the booming stock market, are just some of the reasons given for this windfall.

One thing is clear: Insurers don't want Congress to tinker with their money machine -- or their unique antitrust exemption -- and they have no intention of reducing premiums, regardless of what Congress or state legislatures do to our auto-insurance systems.

It is time our leaders stopped looking at auto "choice" no-fault insurance as some sort of unique "cure-all" and began realizing there must be better, more direct ways to address high auto-insurance premiums. High insurance rates are the result of many factors, such as expensive repair and medical costs, insurance fraud, and too many high-risk drivers -- factors that auto "choice" no-fault neither recognizes nor addresses.

No matter how hard you wax and polish it, auto "choice" no-fault remains a lemon. Rather than eliminating the rights of drivers, the insurance industry's focus should be on improving road safety and cleaning up their own cost-control problems so that any resultant expenses are not passed on to consumers.

Henry S. Monti is president of the Rhode Island Trial Lawyers Association.

Autochoice

Paul J. Weinstein Jr. 01/08/98 05:10:52 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP

cc: Thomas L. Freedman/OPD/EOP, Mary L. Smith/OPD/EOP
Subject: Auto Choice Proposals

Attached are two auto choice proposals. One has been prepared by CEA. This proposal would encourage less driving and thus lower insurance rates, less emissions, and less accidents. However, it has many downsides as well, including greater government involvement in insurance and driving practices. Also attached is a summary and analysis of the McConnell/Armey Auto Choice bill. We are also pursuing a fraud option with the Justice Department. AC2.WP

Choice11.d

Please let me know what you think and whether or not you are interested in either of these proposals.

AUTO CHOICE

A bipartisan coalition of Senators has introduce a proposal for auto-insurance reform called 'Auto Choice.'

- Under this proposal, drivers in states who accept the new federal legislation have a choice between the existing system in their state and a strict no-fault plan (called 'personal protection insurance' (PPI)).

- A driver who chooses the PPI option gets first-party coverage for economic damages (mostly medical and lost wages), without regard to fault; a PPI driver can sue or be sued for economic damages above policy limits. PPI drivers cannot sue or be sued for non-economic damages ('pain and suffering'), although exceptions are made for accidents involving drug or alcohol abuse.

- A driver who opts to stay in the state's current tort system must purchase tort maintenance coverage (TMC) to cover accidents with PPI drivers.

Pros

- **Reductions in premiums for PPI drivers.** Drivers who choose the PPI option will see dramatically lower premiums. Premium savings come both from the reduction of substantial, unnecessary transaction costs such as lawyers fees and the elimination of pay-outs for pain and suffering. Premium reductions are estimated by the Joint Economic Committee (JEC) to be 32% of total auto insurance premiums ($45 billion), if everyone chooses the PPI option. About one-fifth of the premium reduction comes from reductions in transaction costs; the vast bulk of the premium reduction comes from the cessation of payments for pain and suffering.

- **Speedier processing of claims for PPI drivers.** PPI drivers will also have their claims processed faster under their first-party coverage than under the current third-party coverage.

- **Benefits for low-income PPI drivers.** Low-income drivers who elect the PPI option will particularly benefit. The tort system works to the disadvantage of lower income drivers who are less likely to be able to afford to wait out costly litigation and who - with third party payers - must insure against the potential losses of other drivers who have higher incomes and hence higher economic losses (lost wages).

- **Could reduce the number of uninsured motorists.** With the reduced premiums offered by PPI, some motorists who chose not to insure in a tort system may now be willing to purchase insurance.

- **The appeal of 'choice.'** The Auto Choice plan offers drivers who elect PPI all of the potential benefits of no-fault insurance while avoiding the political unpopularity of denying drivers their tort rights. Furthermore, the plan allows states the option to opt out of Auto Choice, in order to alleviate some of the federal-state issues.

Cons

- **More accidents, pollution, and congestion.** The reduction in premiums for those who choose no-fault will result in more drivers on the road. More driving means more accidents, pollution and congestion. In addition, reduced liability for negligence may result in less careful driving.

- **Premiums for safe TMC drivers may increase.** A TMC driver's liability is reduced since PPI drivers whom they hit cannot sue them. However, TMC drivers must now insure their own economic and non-economic damages if they are not at fault and are hit by a PPI driver. Therefore in a competitive insurance market, safe TMC drivers would see their premiums increase under Auto Choice; because safe drivers are by definition at fault less than 50 percent of the time, their reduction in premiums because in accidents in which they are at fault they do not have to compensate PPI drivers' economic and non-economic losses does not offset their increase in premiums from needing to now cover their own economic and non-economic losses when they are not at fault. This increase in TMC premiums for safe drivers would occur even if safe and bad drivers were randomly assigned to the two policy options. State regulation could in principle prevent the premium rise for safe TMC drivers, but it is not clear that current regulations in Choice states do this. *The JEC assertion that drivers who elect TMC will not see their premiums rise is thus highly suspect.*

- **Will there be a real choice?** In a competitive market, premiums for bad drivers who switch to PPI will fall more than premiums for good drivers who switch. The resulting self-selection of bad drivers into PPI will exaccerbate the above problem of rising TMC rates for safe drivers. As TMC premiums rise, more people will switch to PPI, thus further raising TMC premiums. These increases in TMC premiums could effectively remove any real 'choice' between the two systems. However, in the three states that currently offer Choice, state regulation prevents the competitive rate setting that would produce this self selection and hence 'choice' may be preserved.

- **Federal / state issues.** Even though the Auto Choice law allows states to opt out, it nevertheless represents Federal involvement in an area that up until now has been left to the states.

Better as a package:
Auto Choice and Per-Mile Premiums

Per-mile premiums plus Auto Choice package would save money AND increase safety

By itself, Auto Choice would save $ but could compromise safety

Per-mile premiums plus Auto Choice will save lives and save more $

Drivers will choose, if offered the package, to leave tort system to save $

Per-mile premiums could save thousands of lives per year

Linking premiums closely to miles driven will reduce driving and hence accidents

Potential $20 billion in premium savings under per-mile plan in addition to $45 billion in Auto Choice savings

Initially insurance companies would set per-mile premiums to keep total premium constant, assuming driving patterns are unchanged

Premiums would fall as people drive less and accident costs fall

Premiums would fall for the vast majority of drivers; only those who drive more than twice as much as the average driver in their insurance pool (e.g. similar age, experience, part of country, etc.) would potentially see higher rates

Huge incidental benefits

Reduced traffic congestion from fewer miles driven AND fewer accidents

Reduced smog and health-harming pollutants from fewer miles AND less congestion

Reduced emissions of greenhouse gases from fewer miles implies LOWER ABATEMENT COSTS. Carbon emissions would fall by about 5% of the 2010 baseline.

Better as a package: Auto Choice and Per-Mile Premiums

Aaron Edlin with Amy Finkelstein and Mark Rainey

The Proposal:

Amend the Auto Choice plan so that in states that don't opt out, if a driver chooses no-fault her premium is quoted on a per-mile-driven basis. As under Auto Choice, drivers could opt to keep current insurance coverage instead.

Per-mile premiums could be charged based upon an estimate of miles, with a rebate or surcharge issued every year or two after an odometer reading. Odometers could be read at existing emissions or safety checks or by firms under contract with insurance companies.

Insurance companies would compete in their per-mile premium, subject to current regulations; premiums would consequently vary with region, driving record, type of car, and safety features, much as premiums vary now.

The Package Advantage: Saving Costs without Risking Safety.

Auto Choice could reduce premiums by 32%, according to the Joint Economic Committee. Many argue, however, that no-fault would increase drivers' carelessness and make driving more dangerous. One recent empirical study suggests that if everyone chose no-fault, there would be thousands of extra fatalities each year.

By packaging Auto Choice with a per-mile premium, however, safety should increase and premiums should fall still further. The reason is that a per-mile premium discourages driving.

Huge incidental benefits include reduced traffic congestion (from fewer miles driven and fewer accidents) and reduced smog and other health-harming pollutants (from fewer miles and less congestion). Reduced emissions of greenhouse gases from fewer miles implies **lower abatement costs** to achieve Kyoto agreement. Carbon emissions would fall by about 5 percent of baseline 2010 emissions under our package plan; they would rise under the current Auto Choice proposal.

Per-Mile Premiums could save 9,000 lives per year.

A fundamental problem with current auto insurance systems is that insured drivers face too little of the accident costs associated with the amount of driving they do. Accidents increase the more miles people drive. Insurance rates take this into account somewhat, but the connection is far too weak for two reasons:

Insurance firms typically have coarse mileage groupings---e.g. one rate for over 6000 miles and one for under 6000 miles/year. Odometers are rarely checked and under self-reporting, fraud and mistaken estimates of yearly mileage are big problems. Experience rating helps somewhat, but to a very limited extent. (If the cost of insurance rose for extra accidents by the cost of accidents, insurance would be a loan, not insurance.)

Furthermore, a driver's own insurance company does not face the full accident cost of the driver driving an extra mile: safe drivers, who are not at fault in accidents, cost their own insurance company little because the other driver's insurance company typically pays the accident costs. Yet, even safe drivers create a substantial social cost simply by being on the road because they are another potential target or obstacle for bad drivers.

As a result, drivers do not actually face and certainly do not perceive the true cost of driving an extra mile. Drivers consequently drive too many miles.

This problem is alleviated if mileage is verified every year or two and insurance premiums are proportionate to miles driven. Initially, per-mile premiums would probably be approximately 4 cents per mile. **Although this would not increase the total cost of driving** (since it would simply substitute for current premiums), it would increase the cost of driving an extra mile substantially. The increase in the *marginal* cost of driving would be roughly equivalent to an 80 percent increase in the retail price of gasoline! We might therefore expect **miles driven to fall by roughly 16 percent**, conservatively taking the low end of results from studies of the responsiveness of miles driven to the price of gasoline. Roughly 9,000 lives could be saved per-year under a mileage based premium system.

Potential $20 billion in savings on premiums from Per-Mile Premiums in addition to Auto Choice Savings of $ 45 billion

Insurance companies would set per-mile premiums in a competitive process subject to current regulations. Initially per-mile premiums would probably be set so that total premiums cover total accident costs, assuming that driving patterns remain unchanged. Total insurance premiums would quickly fall, however, because accident costs will fall as drivers drive less. A rough estimate of the fall in total premiums is 22% or $21 billion, in addition to the fall of $45 billion from Auto Choice.

A large pool of winners: savings for almost all drivers

Per-mile premiums would undoubtedly be set to vary with a driver's age, the region of the country, urban vs. suburban, driving record, car model, safety features, just as under the current insurance system. Competition would demand such market segmentation. Hence safe drivers, for example, would face lower per-mile rates, and hence lower total insurance costs, than bad drivers, just as they do under the current system.

And even though in some regions rural drivers drive much more than urban drivers, total insurance costs for these rural drivers would fall by the same proportion that urban drivers' total costs would fall. This is because insurance companies currently set rural drivers' rates to reflect both that they drive a lot more than urban drivers and that their chance of having an accident per mile driven is smaller than for an urban driver. With per-mile premiums, the insurance companies would no longer have to increase rural premiums to reflect their greater mileage; but they would set rural per-mile premiums lower than urban per-mile premiums to account for the former's lower per-mile accident rate. As a result, a typical rural driver and a typical urban driver would benefit equally from the package proposal.

Although total premiums would fall dramatically on average for a pool of drivers with a given risk profile, some very high-mileage drivers in a pool might pay higher accident rates. Drivers who drive more than twice the average mileage of drivers with their risk profile might face higher premiums. For example, although most rural drivers would see their insurance premiums plummet, a rural driver who drove over twice the average distance that a rural driver drives per year could see a rate increase. The same applies to very high-mileage urban drivers, safe drivers, bad drivers, etc.

Huge Incidental Benefits of Per-Mile Premiums

A 16% fall in vehicle miles would yield:

Abatement cost savings. The reduction in driving will reduce emissions of greenhouse gases substantially. This will save large abatement costs that would otherwise be incurred to meet the Kyoto agreement. Carbon emissions, for example, would fall by about 5% of baseline 2010 emissions. If marginal abatement costs were $100/ton, abatement cost savings would be over $8.5 billion.

Less smog and other pollution. Fewer miles would lead to a nationwide reduction in emissions of NOx, a greenhouse gas that also contributes to smog and particulate pollution. In major metropolitan areas, NOx emissions might fall by one-seventh of the amount needed to attain EPA's recently promulgated ozone air quality standard. These reductions in NOx emissions from per-mile premiums could exceed the reductions that would result from **all** the controls identified by EPA in the analysis in support of its recent ozone air quality standard.

Less traffic congestion. Fewer miles implies less traffic congestion, because of less crowding. Reduced accidents will further alleviate congestion. The reduction in congestion-related travel delays in major metropolitan areas would be substantial. For example, in the San Francisco Bay area, and in the Los Angeles area, such delays per driver per year would fall by approximately 30 percent (20 and 23 hours respectively).

Better than gas taxes. Raising gas taxes to address these environmental issues raises the total cost of driving. But the per-mile premium package addresses the same issues while lowering the total cost of driving.

Linking Auto Choice with Per-mile Premiums to redress Auto-Choice's problem.

States and individuals that opt into Auto Choice create a hazard for others. Per-mile premiums offset this hazard, and so they should be required for those who choose no-fault. Possibly, this linkage should be waived for states that already have no-fault, if this compromise is necessary to gain political support.

Linking the no-fault choice with per-mile premiums would give us the best of both worlds. Lives could be saved, not lost, and the total insurance cost of driving would fall on average by over 20% more than it would under Auto Choice alone.

CHOICE is central to this package proposal, as it is to Auto Choice

It is important to keep in mind that states can choose whether to opt into the package of Auto Choice and per-mile premiums or to keep their tort and insurance system as it is.

If a state opts in, drivers can choose whether to keep their current insurance or switch to the new package. Those who choose the keep their current insurance would not face per-mile premiums.

Drivers will also choose whether to keep driving their current amounts or reduce their driving. Unlike current gas taxes, per-mile premiums do not increase the total cost of driving. In fact, because of the savings from no-fault, total premiums should fall immediately, even if driving miles stayed constant. Furthermore, people will CHOOSE to reduce miles to save even more on premiums. The great feature is that one person's choice to reduce miles will actually reduce the per-mile charge for others!

Implementation.

A mileage-based premium system could be easily implemented. Insurance companies could simply read a car's odometer once every year or two. Alternatively, odometers could be read during existing emission or safety checks. Per-mile premiums could be charged based upon an estimate of miles, with a rebate or surcharge issued every year or two after an odometer reading.

It is difficult to be sure whether insurance fraud would increase or decrease under per-mile premiums. Currently, there is undoubtedly significant misreporting given that some insurance companies will cut premiums 15 percent for customers who claim to drive less than 7500 miles per year. Under a per-mile system, where odometers were checked, there would likewise be an incentive to tamper with odometers. Tampering with odometers is not, however, a trivial matter that the typical person can do for herself. Moreover, it is a crime, and probably not the easiest or safest way to steal a few hundred dollars a year.

For the vast majority of Americans, odometers are tamper-proof. Although everyone selling a used car already has a substantial financial incentives to set back the odometer (setting back the odometer 30,000 miles typically increases value by $2,100), odometer fraud today occurs mostly in the wholesale used car business. Therefore, it is currently difficult for someone who might want to adjust his odometer to find someone who can do it. There is also a significant risk involved in such tampering. For example, whenever a franchised dealer services a vehicle manufactured by the company granting the franchise, a computerized record is made which includes the vehicle's mileage. Companies currently exist that use this and other sources to collect motor vehicle histories and sell them to prospective purchasers; these companies could similarly sell the histories to insurance companies to deter odometer tampering.

There are already large incentives to tamper with odometers to increase the value of a used car. The resale value of a used car may decline by as much as 7 cents per mile, whereas average per-mile premiums under the package plan would be about 4 cents per mile.

Odometer fraud is significantly more difficult than changing ones own oil. As an illustrative calculation, suppose that 20 percent of people currently change their own car oil, and suppose that 10 percent of these people would set their odometers back. If these people reduced their miles in half, this would raise premiums for everyone else by approximately one percent, much less than per-mile premiums are apt to save from accident reduction. Fear of insurance fraud is not a good reason to oppose per-mile premiums.

Maintaining existing insurance markets. Unlike Pay-at-the-Pump, per-mile premiums do not interfere with the free and competitive operation of insurance markets. Insurance companies would continue to compete for business in the same way under this package proposal. Per-mile premiums therefore do not raise the specter of increased government interference in insurance markets. Additionally, a per-mile charge would vary with the quality of the driver, which affects accidents, not with fuel efficiency, which does not. Insurance companies could continue to adjust insurance premiums for any characteristics of the driver or the car that they currently use to calculate expected accident costs; per-mile premiums would vary in the same way that fixed premiums currently do.

Why don't insurance companies already use per-mile premiums?

Externality. One reason insurance companies do not already use per-mile premiums is that many of the benefits from a per-mile charge are not realized by the driver or her insurance company, but are realized by other drivers and other insurance companies. The reason is that part of the cost of accidents that extra miles cause are borne by other drivers and their insurance companies. Keep in mind that even a safe driver causes accidents by being an extra target that bad drivers can hit. For this reason accident reductions are more than proportionate to the percentage reduction in miles. Driving is much like entering an obstacle course. The fewer times you enter, the fewer total obstacles you will hit. If the obstacle course were held constant as driving is reduced, then we would expect a roughly proportionate reduction in accidents. But there are fewer obstacles when there are fewer miles driven, so the per-mile collision rate will also fall!

Adverse Selection. Another reason insurance companies don't already offer per-mile premiums is that if a company offers a per-mile package under the current system (without the cost savings from Auto Choice), this option would only be chosen by low mileage drivers, or by the few drivers who manage to tamper with their odometers. If the per-mile price is set to break even given present per-mile accident costs, insurance companies would lose money. Two reasons: first, fraud by the few who tamper with odometers; second, although drivers who drive low miles have lower total accident costs, they may have somewhat higher per-mile costs, because they have less driving experience. Therefore, to break even, insurance companies would have to raise the per-mile charge. As they did so, however, the adverse selection would get worse: only odometer-tampering drivers and very low mile drivers would remain. Breaking even would therefore require a still-higher charge, leading to a still smaller and adversely selected group of buyers. Ultimately, the market may be too small to be viable or disappear entirely.

Cost/Hassle. A final reason that some companies may not have switched is that it seems like a costly hassle to check odometers. The hassle will be reduced, however, if many companies in a state switch to per-mile at once. Then, a single facility could check odometers for all insurance companies. Perhaps it could be done when emissions or vehicle safety is checked.

Autochoice insurance

Paul J. Weinstein Jr. 02/06/98 05:05:58 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP

cc: Thomas L. Freedman/OPD/EOP, Jonathan Orszag/OPD/EOP
Subject: Auto Choice

Erskine has requested a memorandum updating him on auto choice/no fault insurance. John Orszag and I are working on a informational memorandum that could be submitted to him next week. I hope we have a draft to you by next Wednesday.

In addition, we met with Morley W. on Thursday to discuss auto choice. Morley thinks supporting no-fault is a mistake. It can be characterized, in his view, as adopting the same system that exists in New Jersey (which has the highest rates in the country) and which would hurt women drivers while helping bad drivers. His points are well taken. Having taken a closer look at the data, neither Orszag nor I can see any significant trend that indicates that states that have moved to no-fault system have experienced significant declines in auto insurance rates.

Morley suggested a new anti-fraud idea. Putting a V-Chip in new car odometers so that insurance companies could check the mileage without a trip to the insurer or having mileage charges at the gas pump. This would give insurers an incentive to lower rates to drivers who drive less.

There are problems. Would require new regulations or maybe even legislation, would cost automakers money, would sound big brother like (although less than are other options). Still, the idea is worth exploring.

Autochoice

discretionary spending and a per-capita cap on Federal Medicaid spending. Each side faces political peril in acceding to the wishes of the other, but, perhaps in a sign of how far negotiations have gone, one source said, "We may have no choice" when asked if congressional Republicans were willing to incur the wrath of Republican governors by agreeing to per-capita caps on Medicaid. Several congressional Republican sources report that House Budget Committee Chairman John Kasich continues a heavy schedule of education sessions with his House Republican colleagues, both to inform them of where the talks are and to sound out whether a deal is possible.

o Bipartisan Bill To Cut Auto Insurance Costs Introduced. Today, GOP Sens. Mitch McConnell, Slade Gorton, Rod Grams and Democratic Sens. Pat Moynihan and Joseph Lieberman will introduce a bill they claim will save consumers $45 billion each year by lowering legal costs. The Auto-Choice Reform Act addresses what the sponsors see as excessive costs of personal injury lawsuits and their role in rising auto insurance premiums. The legislation would allow drivers to purchase as an alternative a less expensive policy that would reimburse them for monetary losses regardless of fault, but would eliminate the option to sue for non-monetary damages. The Joint Economic Committee estimates the legislation would save consumers $45 billion each year by reducing the average auto insurance policy by 32 percent. This would result in a savings of $243 to the average consumer. "This common sense auto insurance reform has two important features," says McConnell in a statement, "It gives consumers choice in auto policies and the ability to realize tremendous savings."

o White House Has No Plans To Back Off Labor Executive Order; All Nominations May Be Put On Hold. After a meeting yesterday, the White House still does not plan to back down in a major showdown with the Republican Congress. The issue has now entrapped the nomination of Alexis Herman to be Labor secretary and may spread to other White House appointments.

Republicans say they are upset with promises, made by President Clinton and Vice President Gore to big labor leaders, to issue an executive order regarding how Federal construction contracts are awarded. The order would ask all Federal agencies to consider the use of project labor agreements. Republicans claim the executive order would result in Federal construction being performed only by union shop contractors, which in turn would strengthen the clout of big labor while costing the taxpayers more money.

Yesterday, GOP Sens. Don Nickles and Judd Gregg met with a group of White House officials led by Deputy Chief of Staff John Podesta. A White House official said this morning that, during yesterday's meeting, "both sides explained their view on this issue and no progress was made toward reaching some sort of solution." The confrontation may soon escalate, said the official, who added: "Senator Gregg has taken the view that he wants to hold all nominations if we don't back off the executive order." Saying it is "not likely" the White House would change its position on the issue, the official said the Republican position, "at this point, is, 'Pull

Autochoice

Paul J. Weinstein Jr.
04/15/97 03:59:35 PM

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP

cc:
Subject: Auto Choice

FYI. We are getting copies and will analyze these bills.
--------------------- Forwarded by Paul J. Weinstein Jr./OPD/EOP on 04/15/97 04:03 PM ---------------------------

Carolyn A. Filak
04/15/97 03:40:06 PM

Record Type: Record

To: Paul J. Weinstein Jr./OPD/EOP

cc:
Subject: Auto Choice

Moynihan- Working on an Auto Choice bill to be released at the end of the month.
Call Cassandra Henley, 224-4451

Lieberman- Releasing Auto Choice bill on Friday along with a packet of information.
Call Laurie Rubenstein , 224-2681

Auto-choice

February 13, 1997

MEMORANDUM FOR **ERSKINE BOWLES**

FROM: **GENE SPERLING**

SUBJECT: **"Choice" No-Fault Auto Insurance**

Both you asked me to look into whether the "choice" no-fault auto insurance plan devised by Jeffrey O'Connell and Michael Horowitz, supported by Senator Dole in last year's election, and now proposed for implementation in New Jersey by Governor Whitman might be something we would think a good idea as a matter of policy. My preliminary response is that the Administration should not reject the plan out of hand -- it has positive features, including some that go beyond auto insurance premium reduction, that suggest a closer policy look is appropriate. During the 1970s, the Carter Administration supported national no-fault. There is still staff at Commerce and DOT who were part of that effort and have some expertise in the field. Before deciding to pursue any form of no-fault, we should bring these agencies into the process.

One preliminary question is what "support" for a "choice" no-fault plan might mean. It could be as little as using the bully pulpit to say this is a good idea and states should look into it. Or as much as supporting federal legislation to require states to adopt choice plans. A lesser alternative would be to provide federal incentives, such as increased highway safety or medicare funds, for states that adopt choice plans (presumably ones that meet certain statutory stantards). Simply authorizing states to adopt such plans is a legally meaningless act, since they can do so already. These degrees of support implicate issues of federal preemption of state tort law as well as questions related purely to no-fault.

<u>What is no-fault?</u>

No-fault auto insurance is essentially first party coverage: if you're injured in an auto accident, your carrier pays for your injuries1 and your right to sue the other party (if there is one) is either non-existent ("pure" no-fault) or circumscribed. Almost all no-fault policies get their savings from the fact that only economic damages are covered -- no pain and suffering. No state has pure no fault. Depending on how you count, about 13 states and Puerto Rico have some form of no-fault. In New York and Michigan, which require extremely serious and objectively verifiable injuries to get into court, it is reasonably effective in holding down costs and keeping cases out of court (although New York premiums are high for other reasons). In other states, which have weak verbal or dollar thresholds, or a right to choose to litigate after an accident, it has been less effective.

"Choice" no-fault is a system under which drivers would be given the option of choosing either a pure no-fault policy with fairly high policy limits (e.g., $250,000) but no access to court or a more expensive policy which allowed court access but in which the policy-holder's insurance company would pay, no matter who was at fault -- as is the case with uninsured motorist coverage today. Governor Whitman has proposed a variation of this system. There would be four policies: pure no-fault at the $250,000 level (which would have a premium reduction of 20-25%); pure no-fault with an ability to collect for pain and suffering on a first party basis (which would result in a premium reduction of about 8%); no-fault but with access to court with a high verbal threshhold (reduction unstated but should be some); and the traditional second-party liability system with unfettered access to court.

Problems and opportunities

The usual rationale for moving to no-fault is that it drives down insurance premiums, and the usual response is that it unfairly keeps injured parties from exercising their constitutional right to access to court. A collateral argument is that first party systems "punish" both good drivers and bad drivers who get into accidents, whereas the current system places the burden on the bad driver. This set of arguments does not tell the whole story.

Flaws in the Argument in Favor

Theoretically, no-fault should reduce automobile insurance premiums. A 1996 study by the Rand Institute for Civil Justice concluded that pure no-fault would reduce personal injury premiums by about 60%, and total premiums -- after taking into account the 50% of the typical premium that is for property coverage -- by about 30%. There are several reasons this has not been borne out in practice in the states that have adopted no-fault, and some additional reasons why certain states are likely to benefit less in any event.

- As noted above, no state has pure no-fault. Where there are weak verbal threshholds or dollar threshholds, not only do cases continue to get to court, but there is pressure to inflate medical expenses to exceed the threshold.
- While legal costs are a significant part of the premium dollar, other costs are also important in determining how fast premiums go up, such as the rate of increase in medical costs (leaving aside any impact of no-fault on these costs). Moreover, automobile insurance is a competitive business in most states and insurance companies regularly

cycle through periods of declining and rising premiums.

- In states with a very high proportion of single-car accidents -- i.e., most rural states -- no-fault does not change the complexion of the payout system, and therefore should not have much effect on premiums, which are usually fairly low in the first place. Rand claims that the proportion of uninsured motorists doesn't matter much, but admits they don't really know.
- Even Rand, generally supportive of no-fault, admits that the most seriously injured individuals will probably get less compensation than under the current system. (The least seriously injured will cease being overcompensated.)

<u>Additional benefits from no-fault</u>

Even if there were no premium reduction, however, no-fault might have other benefits:

- As a medical matter, people who are injured who receive high quality medical and rehabilitative treatment quickly are more likely to recover fully. By keeping cases out of court, no-fault reduces the temptation to keep the plaintiff injured for the jury. Moreover, it provides the money to get the rehabilitation that's needed.
- This was important in the 1970s, but probably has gotten even more important since because:
  - Fewer people have medical insurance today; and
  - Seatbelts and airbags save lives, but those saved are often severely injured.
- High verbal threshold no-fault probably reduces fraud in the medical care system, and should reduce volume pressures on the civil justice system.

<u>Flaws in the Opposition</u>

The part of the argument in opposition that is stated in constitutional terms is basically unanswerable, except to note that in general not everyone has access to the civil justice system because of the cost and time involved in using the system. (The efforts of Republicans to get rid of contingency fees and institute loser pays would, of course, exacerbate this problem, and undoubtedly no-fault's opponents will lump any support on our part with these changes we oppose.) Portions of their argument relating to the lack of reduction in premiums in no-fault states or the fact that many rural states have much lower premiums than no-fault states ignore the different economics of the states and/or the problems related to low threshholds, but clearly need to be taken into account in determining the practical real-life impact of adopting no-fault.

Summary

No-fault generates significant public interest at the state and local level when auto insurance premiums are increasing rapidly (which appears not to be the case today), and may have real policy benefits. However, there are serious questions about the extent of the benefits and the appropriateness and efficacy of dealing with the issue at the federal level. If we have any thought of pursuing this issue, I suggest bringing together an NEC interagency team, including Justice, Commerce and DOT, to further investigate existing information and develop options and recommendations.

Auto-choice

Paul J. Weinstein Jr.
04/07/97 03:59:43 PM

Record Type: Record

To: Elena Kagan/OPD/EOP

cc:
Subject: Re: Auto Choice

--------------------- Forwarded by Paul J. Weinstein Jr./OPD/EOP on 04/07/97 04:03 PM ---------------------------

Ellen S. Seidman 04/01/97 12:16:24 PM

Record Type: Record

To: Paul J. Weinstein Jr./OPD/EOP

cc:
Subject: Re: Auto Choice

NOFAULT.M

Now it's my turn to tell you that DPC is a mite bit disorganized. Elena has been working on this. Attached is a memo I did earlier, which she looked at, but finally decided she didn't have time to really review, so we just sent it forward from the NEC. (Actually, I'm not entirely certain it ever got formally sent, but Gene did give a copy to Sylvia.) I'll be happy to talk. This is another of those issues Kathy's going to have to do until we get another lawyer or someone who's into law and economics on the staff. ellen

PS I also have a mess of stuff created by Rand, which is generally supportive of no-fault, and a piece by the trial lawyers who are -- big surprise -- opposed.

File - AutoChoice Insurance

[redacted]

Record Type: Record

To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP

cc:

Subject: AutoChoice Insurance

I have read through the materials on Auto-Choice Insurance. I have long-supported no-fault insurance legislation, since my days working on the House Banking Committee. I believe the Auto-Choice proposal is stronger, since no driver wouble be deprived of his right to sue.

If you agree, I would like to discuss this proposal with Mark Mazur and Ellen Seidman.

Please advise.