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SCHIFF'S

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Reflections on the New York Auto Insurance Market

A Market in Turmoil

At $120 billion dollars in annual premiums, personal auto insurance is by far the single largest property-casualty line of business. New York State, the third largest auto insurance market in the nation, also happens to be one of the most complex markets. Brian Sullivan, editor of the indispensable Auto Insurance Report, *is the authority on auto insurance. On the following pages he explains, in his inimitable fashion, what's been going on in New York, and what is likely to happen in the future.*

It started in 1999. After several years of excellent profits, New York's auto insurance market began to collapse under the weight of rising liability claims.

Insurers have long been wary of New York, despite the double-digit profits of 1995-1998. Although areas of upstate New York look like benign rural Ohio, the big city is on everyone's list as medical-fraud central, auto-theft central, and auto-vandalism central.

Last year, insurers begged rate increases averaging 10% from regulators, on top of more than 4% increases in 2000. Still, it is not enough; insurers keep looking for more, and regulators—swamped by requests—struggle to keep up.

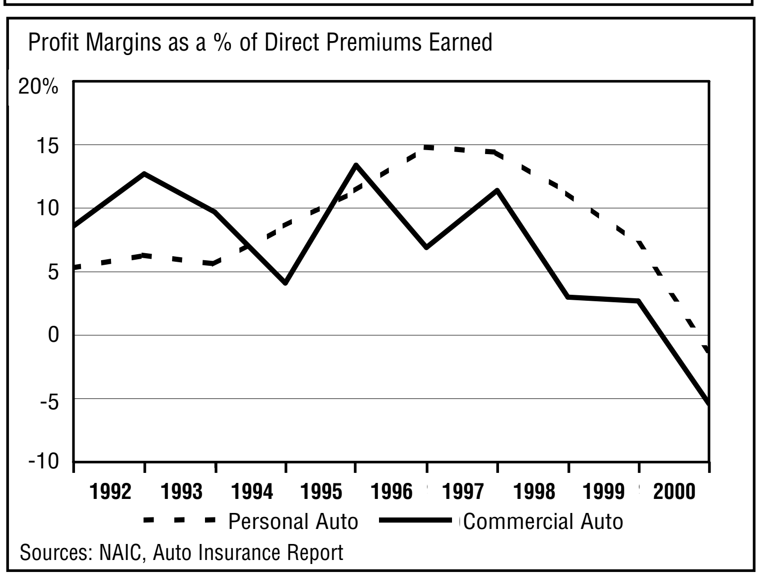
In 2000, New York personal-auto insurers posted an after-tax margin of -1.2%. Commercial auto insurers lost 5.4%. These results are way off the 14.8% peak profit margin in 1996 for personal auto, and the 13.4% peak profit margin in 1995 for commercial. A major deterioration in liability results has been the primary cause of the declining margins. (Personal-lines liability fell from a 15.6% profit in 1996 to a 6.7% loss in 2000; commercial liability fell from a 13.1% profit in 1995 to an 8.9% loss in 2000.)

If this were just a story about trying to keep up with rapidly rising claims costs, New York wouldn't be too different from most other states. But the market is far more complex than most, and conditions are exacerbated by a toxic mixture of local and statewide politics, and intensified by a governor's race.

The most immediate concern is an appellate court's mid-February decision to halt the insurance department's implementation of Regulation 68. (Regulation 68 would have reduced the reporting time for auto-accident injuries from 90 days to 30 days, and cut the time for submitting medical bills from 180 days to 45 days.) The appellate court's stay holds off the support of the State Supreme Court, which had ruled in favor of Regulation 68. The *New York Times* quoted State Supreme Court Justice William A. Wetzel saying that Regulation 68 was necessary to fix a no-fault system "diseased by fraud of a dimension which threatens the economic viability of the program and carries enormous financial consequences for insurers and insureds throughout the state."

Regulation 68 was an effort to rein in what John Cucci of the Alliance of American Insurers calls a "perfect storm" of structural problems fueling fraudulent claims: 1) Claimants do not need to report a claim for 90 days after an injury accident; 2) Claimants do not need to submit medical bills until 180 days after treatment; 3) Claimants who are disabled for more than 90 days can break through the state's no-fault "verbal threshold" and take their case to court; 4) Insurers must pay, or deny, the claim within 30 days; and 5) Once a claim is paid, it is virtually impossible for insurers to sue for fraud and recover money.

New York State Auto Insurance Profit Margins



The trial bar and medical profession are in love with these rules. They prevent insurers from getting involved in deciding treatment paths, which gives attorneys the freedom to build their cases without interference from insurers, and doctors the freedom to treat and bill as they please.

No doubt injured consumers *also* enjoy these rules, as they are unencumbered by insurance-company cost controls, and can work with their attorneys to maximize their legal claims. Supporters of the current system argue that consumers need the freedom to manage their affairs after a serious accident, and that it's unfair to pressure injured victims to fuss with complex paperwork immediately.

There is ample evidence that faced with an all-or-nothing situation, insurers will lean in the direction of paying claims they might otherwise question. This is seen not only in New York, but also in states where *third-party* "bad faith" lawsuits are permitted. But there's little doubt that the rules result in high costs and a higher incidence of fraudulent claims, which drives up the price of insurance for all. A report released last month by the Insurance Research Council stated the following: "For 65% of New York PIP claimants with high-suspicion claims, their first medical bill arrived at the insurer more than 45 days after their first treatment. Among claims with no suspicion, the percentage was 34%." (See "Claiming Behavior in New York's No-Fault Auto Insurance System," www.ircweb.org.)

PIP claimants who hold off filing their claim for more than 45 days are more likely to follow costly treatment paths such as MRIs and alternative care. They're also more likely to hire attorneys. Even if this has nothing to do with fraud—and often it does not—preventing insurers from becoming involved early in the process leaves scant opportunity for cost control. While this feels good to claimants—and plays well with managed-care-weary legislators—ultimately it costs big money.

While the courts hash out the timeframe for claim reporting, the state legislature is chewing on an expired law that allowed insurers to file and use small rate changes without prior approval, and to non-renew 2% of their book of business each year. The old "flex rating" law expired on August 3. Since then insurers have had to file every change with the insurance department and wait for approval. The lack of flex rating has had little impact on current prices (the 10% rate requests of the past year would have required prior approval, anyway), but could be problematic going forward. But insurers are fighting for reinstatement of the system, which enabled them to take cost-of-living increases and make administrative adjustments without undue paperwork (or political struggle).

continued

'The Long-Term View'

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9:00 a.m. It wouldn't really matter what **M. R. "Hank" Greenberg**, chairman and CEO of *American International Group*, talks about, because. . .well, let's face it — *anything* he has to say about the insurance business is worth listening to. For the record, though, Hank will: 1) tell us what he's been thinking about, 2) share his outlook on the industry, and 3) have a ~~debate~~ ~~argument~~ ~~fistfight~~ chat with the ever-inquisitive David Schiff.

10:30 a.m. Devotees of eloquent prose about complex accounting matters cherish three fine books: *Unaccountable Accounting*, *More Debits than Credits*, and *The Truth About Corporate Accounting*, by **Abraham J. Briloff**, certified public accountant and Distinguished Professor Emeritus at *Baruch College*. Abe has been a leader in exposing dubious, inconsistent, and incongruous accounting practices. He also has a longstanding interest in the insurance business, where such practices have a habit of turning up. He will tell you what's been troubling him lately.

11:20 a.m. Most insurance companies don't do things the way *Cincinnati Financial* does. And only a handful have posted long-term results as great as Cincinnati Financial has. **Robert Morgan**, who retired as CEO of Cincinnati in 1999, spent more than three decades building a company that was started (and still revered) by independent agents. Cincinnati has delivered value to its insureds and has made a fortune for its shareholders. Bob will give us something that's hard to find these days: an independent point of view.

Noon Decent food and fine conversation.

1:00 p.m. **Stephen Way** began working at Lloyd's when he was 15. He eventually came to America, where he founded *HCC Insurance Holdings* at the advanced age of 25. HCC is now a large specialty insurer and underwriting manager. In a no-holds-barred discussion, Stephen will tell us how this came about, and share his thoughts on capital preservation, diversification, underwriting discipline, and much more.

1:45 p.m. **Glenn Daily** is a rare breed: a fee-only insurance consultant who specializes in life insurance and annuities. He is an innovative thinker, prolific author, and consumer advocate. Glenn's talk, currently titled "Clueless Consumers: A real options analysis," will delve into a variety of subjects that will be of interest to anyone in the life insurance business, anyone who owns life insurance or annuities, or anyone who might want to own life insurance or annuities.

2:45 p.m. "We applaud owners who reward executives on premium growth," says **Jack Byrne**, chairman of *White Mountains Insurance Group*. "This often provides fine opportunities for us later." During his career, Jack has resuscitated GEICO, fixed Fireman's Fund, and built up White Mountains. Jack is *not* interested in: market share, producing a predictable stream of quarterly operating earnings, or managing his business according to generally accepted accounting principles. His strategy is simple — to increase intrinsic business value per share. Jack will tell us what interests him these days.

3:45 p.m. As usual, **David Schiff**, editor of *Schiff's Insurance Observer*, will interrogate the speakers and, when necessary, *force* them to answer brazen questions. David will have his say on the great insurance issues of the day and will discuss where he sees value (or the lack thereof).

4:30 p.m. Socialize with insurance mavens and observers. Discuss the day's events or make deals over cocktails while taking in the view from the top of the New York Athletic Club.

Further, insurers are upset that they have lost the ability to manage their business through non-renewals of bad risks. True, there is a laundry list of reasons why an insurer can get off a risk, but for many risks it is a costly, time-consuming struggle. There are key legislators who never liked flex rating, and have little interest in seeing it reinstated. Assemblyman Pete Grannis (Democrat, Manhattan) chairs the Assembly's Insurance Committee, and has been pushing for rate rollbacks as well as the creation of a state-funded insurance consumer advocate, perhaps as a quid pro quo for his acceptance of the return of flex rating and the 2% rule. Political insiders suggest that Democrats in the legislature have little incentive to smooth over insurance issues at this time, preferring, instead, to keep the pot boiling in a way that will trouble Republican governor George Pataki, who will be standing for reelection this fall. Pataki faces some formidable Democratic foes (Andrew Cuomo, former Secretary of Secretary of Housing and Urban Development, and H. Carl McCall, New York State Comptroller). As long as Pataki's election is not a foregone conclusion, the legislature will give him little. There may come a time, however, when Pataki's lead looks too strong to overcome, and the legislature will run the risk of holding off so long that the auto-insurance market spirals into crisis. If that happens, and Pataki can pin the woes on Democrats in the legislature, there could be political hell to pay (a glance across the river at New Jersey offers painful reminders of what happens to politicians caught on the wrong side of an auto insurance crisis), so it is possible that legislators may be willing to deal with insurers by late summer or early fall. Until then, however, legislative movement will be difficult.

In addition to its legislative turmoil and structural woe, New York is hustler's paradise. "Not everybody has a set of Pings (wonderful but costly golf clubs) in his trunk, but you wouldn't know it by the claims records," said one insurer. [Note: The editor of *Auto Insurance Report* was born in the Bronx.]

In theory, New York has a good no-fault law. No-fault was conceived as a system where drivers would trade some of their right to sue in return for quick and easy settlement of first-party claims. The idea was to enable drivers to collect from their own insurer regardless of fault, eliminating all the legal hassling. But eliminating fault completely was never politically tenable, so "thresholds" were created in an attempt to keep small cases out of court while allowing those with serious injuries access to the courts so they could sue for pain and suffering. In most states the threshold was set at a dollar amount of medical bills. These became easy targets regardless of the size of the threshold.

New York, like Florida and Michigan, chose a "verbal" threshold that defined serious injury with words, not dollars. This was viewed as a tighter restriction on tort rights, and in Michigan this has been the case. But in New York and Florida the threshold has been steadily weakened by court rulings that expanded the definition of serious injury. While New York's no-fault law does indeed keep some cases out of court, a determined claimant can almost always find a doctor and a lawyer willing to work together to build a legal case. Governor Pataki is the latest in a long line of public figures who have called for a tightening of the verbal threshold (only possible at the legislative level), but with the absence of a market crisis this seems to be a political impossibility.

Although many in New York are unhappy with high rates, the public seems unwilling to surrender more of their tort rights in return for lower rates. This is particularly true when insurers balk at the idea of a rate rollback tied to reform legislation. Insurers—uncertain of how reforms will actually work in the marketplace, and burned in New Jersey where the rate rollback preceded the implementation of reforms by years—are loathe to give anything away. Thus, politicians are reluctant to play ball with the industry.

Could a market crisis be brewing? Could New York pass New Jersey and become the nation's most expensive personal auto insurance market?

The NAIC's report on average insurance expenditures is normally released in April, but last year slipped to June. Although the data is more than a year old and often reflects long-dead trends, it always causes a stir, and politicians are nervous.

Last year's report showed that in 1999 New Yorkers had the nation's third highest average auto-insurance expenditure—$943—down 1.8% from 1998. Only New Jersey and the District of Columbia were higher, with average expenditures of $1,034 and $988, respectively. But these had fallen 9.2% and 4.2% from 1998, and, with a 15% rate rollback working its way through New Jersey and competition increasing in D.C, these states should not experience a major rise in average expenditure. New York's approved rate requests in 1999 exceeded 4%, which should raise New York's average expenditure to about $980 for 2000. Thus, it's likely that New York, New Jersey, and D.C. will all be close when the 2000 figures are finally released. (Our guess is

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that New Jersey will hold the top spot until the 2001 data is released, at which time New York will ascend to the top.)

In a real sense, however, New York has already surpassed New Jersey in the pain of paying auto-insurance costs. New York has a relatively low median income, despite its relatively high cost of living: in 1999 the median income for a family of four was $59,755, the 19th highest in the nation. The *Auto Insurance Report* PAIN [Personal Auto Insurance Nastiness] Index looks at the ratio of auto-insurance expenditures to family income. In this measure, New York currently ranks third in the nation, below D.C. (which it probably passed in 2000), and Louisiana, the nation's most painful market. (Despite its high premiums, New Jersey has the nation's second-highest median income, and ranks ninth on the PAIN Index.) If there was data available for New York City, it would be a good bet that the city's PAIN Index would be very high indeed.

The PAIN Index helps guide us to the states where political pressures will be intense because the "real' cost of auto insurance is so high. Politics is one of the reasons why New York is so bad today—frightened legislators consider the issue of auto insurance to be radioactive and want nothing to do with it. But this teetering-on-the-edge-of-crisis situation provides a real opportunity. After the initial knee-jerk reaction of killing all the insurance companies, it's likely that legislators will be forced to face up to the hard decisions needed to lower claim costs, which could include shortening the time for reporting claims, tightening the verbal threshold, and enacting New Jersey-style medical treatment protocols and a tougher medical fee schedule.

In 1995, New York raised the minimum insurance limits from $10,000/$20,000 to $25,000/$50,000, bringing New York in line with most other states. Not surprisingly, this had a dramatic impact on the price for the minimum limits of liability. Drivers who already had higher limits saw their rates increase by only $15 or so (to help subsidize rates in the assigned risk plan). Although 90% of drivers in the standard market already had higher limits, about 90% of assigned risk customers had the old minimum limits, and were hit with rate increases ranging from a few hundred dollars to as much as $1,000. More pain for urban drivers.

Though we're not talking about a giant amount of money, auto insurers continue to deal with issues resulting from the attack on and collapse of the World Trade Center. Thousands of cars were lost in the attack, many of them on the streets surrounding ground zero. It was initially assumed that cars in underground garages that survived the collapse would be permanently impregnated with toxic dust, largely asbestos. About 900 largely intact vehicles have been shipped to the Fresh Kills landfill in Staten Island, where they were to be buried. But two weeks ago the New York Department of Health declared that the vehicles could be cleaned, and their owners have been instructed to pick up the cars and receive cleaning instructions. Most of these cars, however, have already been declared total losses and are now the property of insurers. ▪

Letter to the Editor

I was looking for some information about Minnesota Mutual, and I went through the company's website recently. Other than a link to a document entitled "Audit Committee's Report to Members," there appears to be nothing that identifies the company as a mutual holding company, or even makes reference to the corporate structure. They've come a long way since their old website, which identified the policyholders as the *owners* of the company. It's remarkable how mutuality has been sanitized from the Minnesota Mutual website.

Brendan Bridgeland, Director
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Cambridge, Massachusetts

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New York State Auto Insurance Profit Margins

Profit Margins as a % of Direct Premiums Earned

	2000	1999	1998	1997	1996	1995	1994	1993	1992	1991	Average
Personal Auto Liability	-6.7%	4.1%	9.4%	14.5%	15.6%	10.2%	6.8%	1.2%	1.5%	-1.1%	5.6%
Personal Auto Physical Damage	9.4	13.5	14.6	14.2	13.2	14.0	12.0	13.6	14.3	15.0	13.4
TOTAL	**-1.2**	**7.2**	**11.2**	**14.4**	**14.8**	**11.4**	**8.6**	**5.6**	**6.3**	**5.3**	**8.4**
Commercial Auto Liability	-8.9%	1.9%	1.3%	11.1%	5.8%	13.1%	3.1%	8.7%	12.9%	7.4%	5.6%
Commercial Auto Physical Damage	9.5	6.2	11.3	12.7	11.8	14.0	8.6	13.8	11.8	13.2	11.5
TOTAL	**-5.4**	**2.7**	**3.0**	**11.4**	**6.9**	**13.4**	**4.1**	**9.7**	**12.7**	**8.6**	**6.7**

Sources: NAIC, Auto Insurance Report