



# No-Fault Insurance in Minnesota



Background  
information presented  
to the Minnesota  
Legislature  
February 2005

# Minnesota No-Fault Automobile Insurance

## Summary

An automobile insurance policy covers several types of claims arising from accidents with cars. Some coverages are required by state law and some are optional.

**Liability** protects your assets when you are legally liable for an accident. The insurance pays, on your behalf, for injuries to people and damage to their car. This coverage is mandatory.

**No Fault** (also known as **Personal Injury Protection** or **PIP**) provides medical and wage loss benefits for you and your family. Fault doesn't matter. This coverage is mandatory.

**Collision** and **Comprehensive** cover damages to your car. Collision applies if you are in an accident with another car or object. Comprehensive covers losses that are not collisions, such as theft or hail, and also accidents involving deer. These coverages are optional.

**Uninsured** and **Underinsured** pay your medical expenses after No Fault is exhausted when the other driver is legally liable but either does not have insurance or does not have enough.

## Facts and Figures on Minnesota Personal Automobile Insurance.

- Personal Automobile Insurance is the largest line of property-casualty insurance countrywide and in Minnesota. In 2003, premiums totaled \$2.9 billion. No-Fault premiums accounted for slightly over \$500 million. Premiums have increased steadily over the past five years.
- The Minnesota market is competitive with approximately 200 companies selling insurance. However, the top five writers sell 50% of the business.
- Profits vary from year to year. The last two years have been profitable, but the three years before that had poor experience.
- No-Fault medical losses total about \$300 million a year.

## Comparisons with Other States.

- Automobile insurance in Minnesota costs significantly more than it does in the neighboring states. In 2001, the most recent year for which we have data, Minnesota annual premiums were \$809 per car. Premiums in Wisconsin and the Dakotas ranged from \$630 to \$648. In Iowa, annual premiums were \$596.
- The major difference between Minnesota and the neighboring states lies in the requirement for and the cost of No-Fault insurance. In Minnesota, the average annual premium for the mandatory coverages required by statute was \$409. The costs for mandatory coverage in the neighboring states ranged from \$232 in North Dakota to \$299 in Wisconsin.
- Compared to other states that have No-Fault, Minnesota No-Fault costs seem unusually high.

## Trends in No-Fault Insurance

- Data from recent filings indicates that the number of claims per insured car is declining slightly. The average cost per claim is increasing.
- Other states appear to be having problems with fraud.

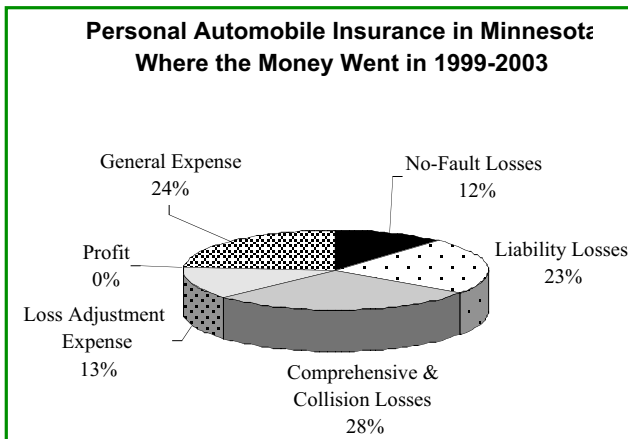
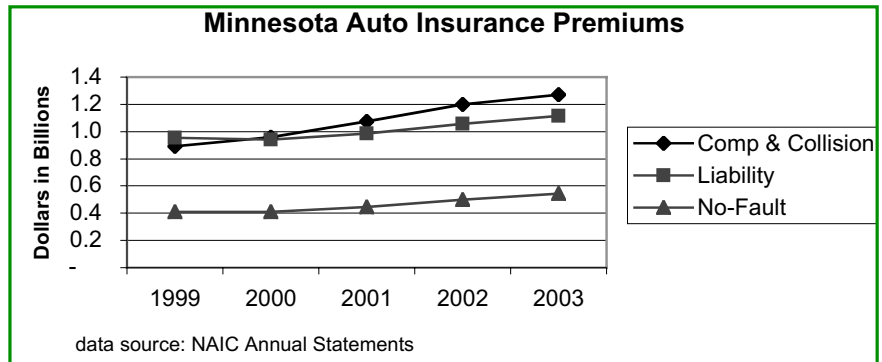
## Options for Reducing the Cost of No-Fault Insurance

- Repeal No-Fault.
- Make No-Fault medical benefits secondary to the injured person's medical insurance.
- Allow Auto Insurers to implement a managed care program .
- Decrease the amount of required No-Fault coverage.
- Increase the tort threshold.

**Facts and Figures on Minnesota Personal Automobile Insurance**

Personal Automobile Insurance is the largest line of property-casualty insurance countrywide and in Minnesota. Minnesota annual premiums total \$3 billion.

Premiums have been increasing steadily over the past five years. Over the past five years, premiums grew 30%, from \$2.3 billion to \$2.9 billion. In 2003, premiums were up 6%. The greatest increase has occurred in physical damage and No-Fault. Comprehensive and collision premiums grew 43%; No-Fault increased 32%; liability was up 17%. Liability and no-fault are required by statute.



Of the \$3 billion in total premium, about 63% pays for losses. Over the past five years, No-Fault medical costs and wage losses averaged 12% of the premium dollar. Another 28% paid for damages to the policyholder’s car from auto accidents or theft or other causes. “Innocent drivers” in accidents received 23%. Costs to settle claims averaged 13%, with these costs being higher for liability losses (15%) as opposed to comprehensive and collision (10%). Costs of issuing a policy and general business expenses associated with running a company accounted for about a fourth of the premium. In total, in the past five years, the personal auto insurance industry spent on losses and expenses what it collected in premiums.

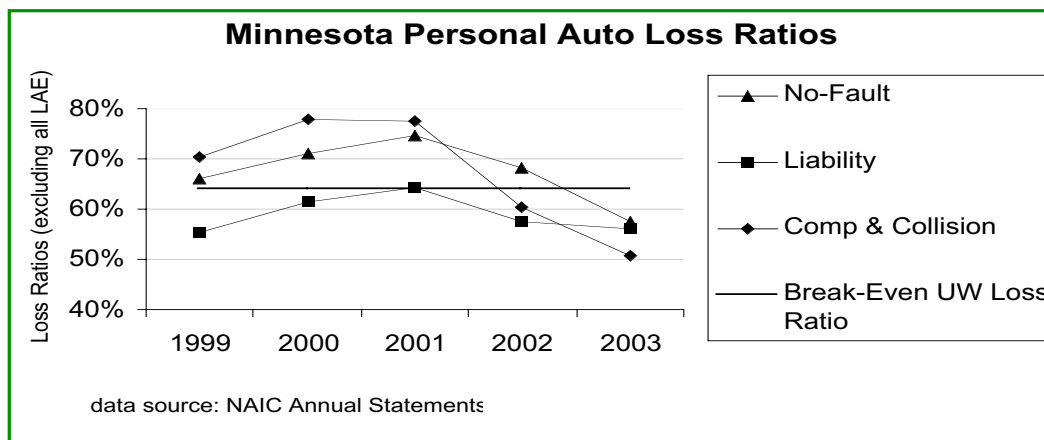
The American economic system depends heavily on competition as the most effective way to achieve prices that are fair and not excessive. The same factors that work in the economy in general also function in the insurance industry. Minnesota laws require insurance rates to be adequate, not excessive, and not unfairly discriminatory. However, in dealing with excessive rates, the legislature has expressed a strong preference for letting competition work: “Rates are presumed not to be excessive if a reasonable degree of price competition exists at the consumer level with respect to the class of business to which they apply.” (MN §70A.04)

Personal automobile insurance has the necessary characteristics to be a competitive market. There were 189 companies writing auto insurance in Minnesota in 2003; 125 of these had over \$1 million in premium. Although State Farm Mutual writes 22% of the market, this does not appear to be an undue concentration. Consumers have many choices.

**Top Writers of Personal Automobile Insurance in Minnesota**

|                                 | 2003 Written Premium | Market Share |
|---------------------------------|----------------------|--------------|
| State Farm Mutual Auto Ins Co   | \$638,748,000        | 22%          |
| American Family Mutual Ins Co   | 335,350,000          | 11%          |
| Illinois Farmers Ins Co         | 260,261,000          | 9%           |
| Progressive Northern Ins Co     | 149,672,000          | 5%           |
| Allstate Ins Co                 | 89,848,000           | 3%           |
| Progressive Northwestern Ins Co | 71,863,000           | 2%           |
| Western National Mutual Ins Co  | 69,395,000           | 2%           |
| American Std Ins Co Of WI       | 65,515,000           | 2%           |
| Owners Ins Co                   | 59,564,000           | 2%           |
| Mutual Service Casualty Ins Co  | 51,358,000           | 2%           |

Profits in personal automobile insurance vary from year to year. In insurance, the loss ratio measures profitability by comparing losses incurred to premium income. The break-even loss ratio (before investment income) varies by company and coverage, but is around 63% in personal automobile insurance. With a 63% loss ratio, an insurance company would have enough premium income to pay losses and all expenses, but the only profits would come from investment income. Comprehensive and Collision and No-Fault were quite unprofitable in 1999, 2000 and 2001. The losses were somewhat offset by the profits in Liability. All coverages were profitable in 2003.



Profits also vary by company. The table below shows the loss ratios for the past three years for the top five writers in Minnesota.

| <b>Minnesota Loss Ratios* (LR)</b> |            |            |            |
|------------------------------------|------------|------------|------------|
|                                    | LR<br>2001 | LR<br>2002 | LR<br>2003 |
| Minnesota Totals                   | 72%        | 61%        | 54%        |
| <b>Top 5 Writers in Minnesota</b>  |            |            |            |
| State Farm Mutual Auto             | 89%        | 72%        | 52%        |
| American Family Mutual             | 66%        | 56%        | 54%        |
| Illinois Farmers                   | 61%        | 52%        | 52%        |
| Progressive Northern               | 60%        | 54%        | 53%        |
| Allstate                           | 61%        | 50%        | 45%        |

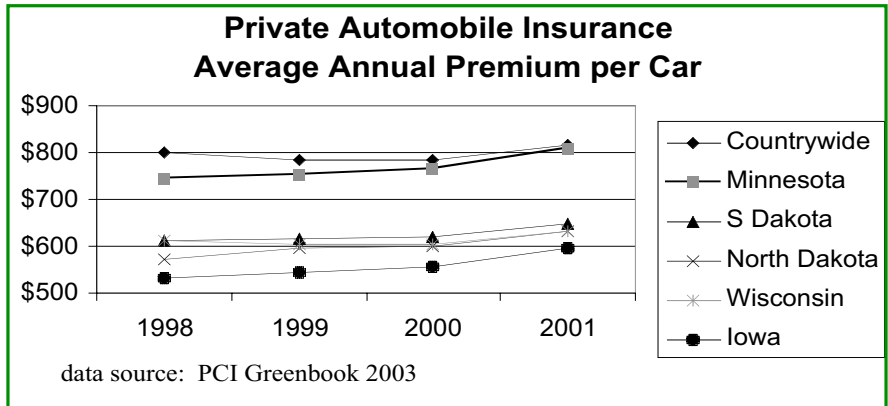
data source: NAIC Annual Statements

\*The Loss Ratios exclude all Loss Adjustment Expense.

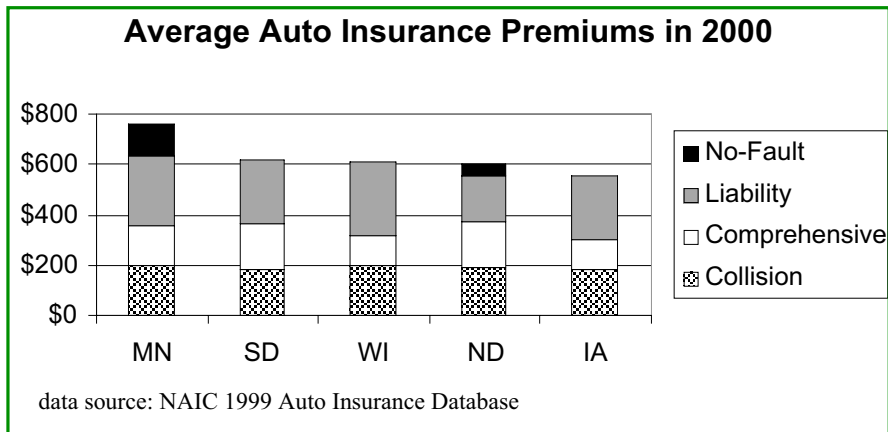
**Comparisons with Other States**

On a countrywide comparison of private passenger automobile premiums, Minnesota is in the middle of the states, ranking 22nd, with an average annual premium of \$809 per car in 2001, the most recent year for which we have data. Currently, Minnesota is slightly below the countrywide average of \$817. Historically, Minnesota has been ranked lower (see graph below). Minnesota costs per car have been increasing faster than those in most states.

Minnesota is surrounded by states with some of the least expensive automobile insurance costs in the nation. In 2001, South Dakota, North Dakota and Wisconsin ranked 46th, 47th and 48th respectively and Iowa had the lowest costs in the nation. Iowans pay an average annual premium of \$596 per car, which is \$213 less than Minnesota's.



In comparing Minnesota with the neighboring states, the cost of No-Fault coverage is the major difference for the higher premiums. One would expect Minnesota collision costs to be higher because of the traffic density in the Twin Cities. However, collision costs per car are very similar among these states. For comprehensive, Minnesota is the middle with the Dakotas being higher and Wisconsin and Iowa being lower. One would also expect Minnesota liability costs to be less



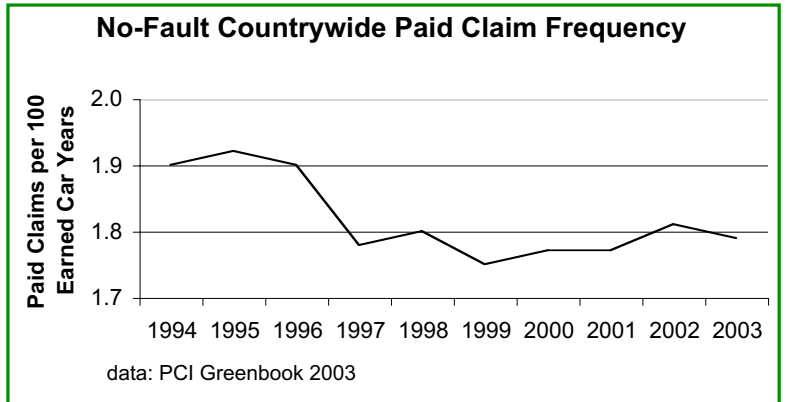
because of No-Fault, but that's not the case. Minnesota is slightly less than Wisconsin, but significantly higher than the other three states. The No-Fault cost appears to be the major driver for the premium differences. Although North Dakota also has No-Fault, costs there are much less than in Minnesota.

Minnesota requires insurance for auto liability, no-fault, uninsured motorist (UM) and underinsured motorist (UIM). Minnesota is the only state requiring all four. Liability insurance is required by 47 states; 14 require no-fault and 1 requires medical; UM and UIM are required by 21 states and 4 states, respectively. Minnesota liability limits are also somewhat higher. Minnesota requires 30/60/10 limits, which means that \$60,000 is available for all persons injured in an accident, subject to a limit of \$30,000 for one individual, and \$10,000 is available for property damage. The Dakotas both require 25/50/25; Wisconsin requires 25/50/10; Iowa's limits are 20/40/15.

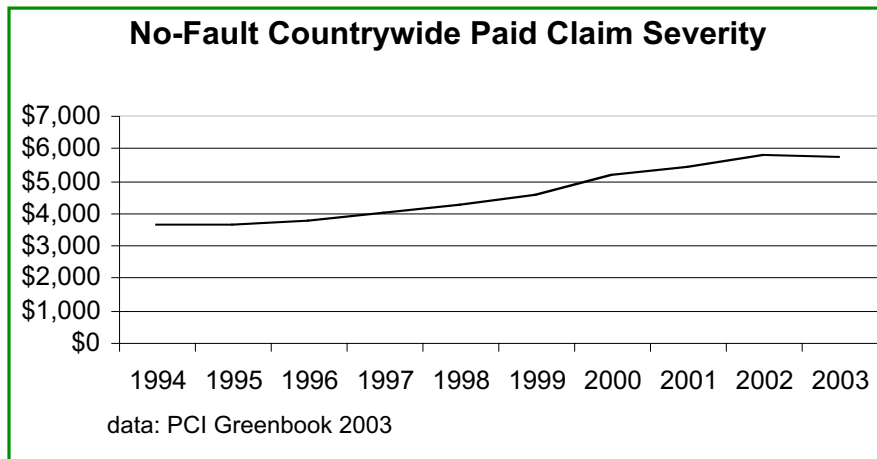
No-Fault costs seem unusually high in Minnesota. Most states do not have No-Fault coverage; there are only twenty that do. Among these states, Minnesota was 7th highest in No-Fault costs in 1999. Minnesota does not seem to have higher costs for other types of auto insurance: Minnesota is 45th in costs for Bodily-Injury Liability, 37th for Property Damage Liability, 38th for Collision. Although Comprehensive costs are relatively high (Minnesota was 6th), this is a ranking shared with other plains states (North Dakota was 1st; South Dakota was 7th) and may be related to weather, i.e., hail. However, with No-Fault, Minnesota simply has more claims and a higher average cost than the other No-Fault states.

**Trends in No-Fault Insurance**

Countrywide data from the Property Casualty Insurers Association of America indicates that on a countrywide basis the number of claims per insured car dropped in 1997 from the 1.9 level to 1.8. Since then, the frequency has remained at about the same place.



No-Fault Severity has been steadily been increasing.



Trends in Minnesota appear similar. A review of the most recent auto filings from the largest three writers in Minnesota indicates that these companies expect the frequency of their No-Fault claims to be relatively flat and the severity to be increasing.

**No-Fault Trends Filed in Minnesota**

|                  | Frequency | Severity |
|------------------|-----------|----------|
| State Farm       | 0.6%      | 7.2%     |
| American Family  | 0.0%      | 3.5%     |
| Illinois Farmers | -1.0%     | 3.0%     |

Several states are having problems with fraudulent no-fault claims. Minnesota is aware of these problems and will be developing an insurance fraud unit to help deal with this issue.

## Possible changes to reduce the cost of No-Fault Insurance

The suggestions below will all reduce the medical cost of No-Fault insurance. Exact savings are difficult to measure. In 2003, No-Fault premium in Minnesota totaled \$542 million. About \$300 million was spent on No-Fault medical costs. Reductions in claim costs do not transfer completely into premium reductions. This is because some portion of an insurance company's expenses is for fixed costs (rent, utilities, etc.) that do not decrease proportionally to reductions in claims costs.

### **Repeal No-Fault**

No-Fault has not worked out as well as expected. In addition, it has become rather expensive and is susceptible to fraud. Georgia, Connecticut, Pennsylvania and Colorado have either returned to the tort system or repealed mandatory No-Fault. Colorado changed its law in 2003.

### **Make No-Fault Medical Benefits Secondary to the Injured Person's Medical Insurance**

If No-Fault medical benefits became secondary to the policyholder's health policy, costs would be transferred from the automobile insurance system to the health care system. Efficiency might be improved since it seems likely that the health care system is better equipped to manage health care costs than the automobile insurance system.

Coordinating benefits would be a problem. No-fault provides some coverages that most health plans do not. Rehabilitation benefits, in particular, are more generous under No-Fault.

### **Allow Auto Insurers to implement a managed care program**

Minnesota Statute §65B.44 Subd. 1(c) prohibits the use of managed care services to no-fault claimants. Allowing insurance companies to implement a managed care program would help control No-Fault costs. There are, of course, costs to setting up a managed care system and it is quite possible that smaller insurance companies would not be able to afford to implement one, particularly if Minnesota's law required special considerations unique to Minnesota.

### **Decrease the amount of No-Fault coverage (currently, \$20,000 medical and \$20,000 wage loss)**

Decreasing coverage would save some money since the larger claims would be reduced. Many claims would still be completely covered. In 1999, the average No-Fault loss in Minnesota was \$5700.

### **Increase the tort threshold (currently \$4000) or change the tort threshold from a monetary to a verbal one.**

There is always pressure on the threshold. In some instances, medical costs are inflated in order to gain access to the tort system. A monetary threshold erodes over time and verbal thresholds may also prove less effective than originally intended.

**Appendix: Expenses in Automobile Insurance**

**General Expenses**

Of the \$2.9 billion collected in automobile insurance premiums in 2003 in Minnesota, approximately \$700 million was spent on insurance company general expenses. In reporting these numbers to the state, insurers are required to split out acquisition costs.

- Payments to agents, termed Commissions and Brokerage in the Annual Statement, are about 8% of General Expenses.
- Other Acquisition expenses are about 7%. Most of Other Acquisition is salaries and employee costs (almost 60%) with items such as advertising, rent, equipment and postage/telephone in the 5% to 10% range.
- The remaining General Expense category is 5% of premium and covers the other costs of running a company. This category is also 60% salaries. Other significant cost items are underwriting reports, rent and equipment.

**Industry Underwriting Expenses for Personal Automobile Insurance  
as a Percentage of Written Premium**

|                            |       |
|----------------------------|-------|
| Commissions & Brokerage    | 8.4%  |
| Other Acquisition          | 7.2%  |
| General Expenses           | 5.0%  |
| Taxes                      | 2.5%  |
| Total Underwriting Expense | 23.1% |

These dollars are associated with a large number of policies and policy transactions. The table below shows these costs on a per policy basis. For example, the average Liability/No-Fault premium in 2002 was \$455. Of this amount, \$38 went to the agent. Another \$11 was paid in taxes. The remaining \$56 was spent by the company in evaluating and processing the policy and includes all costs not connected with settling claims. These are items such as salaries and benefits for employees, computer expenses, rent for the building, postage and telephone. In total, it costs the average company \$94, before taxes, to issue/renew and support a liability/PIP policy. If the policyholder wants to add comprehensive coverage, the company spends another \$40; collision adds \$49. Personal automobile insurance involves many relatively small transactions requiring individual attention, all of which add to costs.

**Underwriting Expenses per Policy for Personal Automobile Insurance**

|                              | Liability & No-Fault Insurance | Collision Insurance | Comprehensive Insurance | Total Personal Auto |
|------------------------------|--------------------------------|---------------------|-------------------------|---------------------|
| 2002 MN Written Premium      | \$1,532,615,795                | \$614,866,676       | \$549,926,402           | \$2,697,408,873     |
| 2002 MN Policies Written     | 3,369,901                      | 2,577,319           | 2,857,075               |                     |
| Commissions per policy       | \$38                           | \$20                | \$16                    | \$74                |
| Other Acquisition per policy | 33                             | 17                  | 14                      | 64                  |
| General Expenses per policy  | 23                             | 12                  | 10                      | 44                  |
| Taxes per policy             | <u>11</u>                      | <u>6</u>            | <u>5</u>                | <u>22</u>           |
| Total Underwriting Expense   | \$105                          | \$55                | \$45                    | \$205               |
| Average Premium              | \$455                          | \$239               | \$192                   | \$886               |

Data Source: NAIC 2001/2002 Auto Insurance Database Report

note: The policy number is the total number of exposures, in car-years, of all policies issued in 2002.

The American economic system depends heavily on competition as the most effective way to achieve prices that are fair and not excessive. In a competitive environment, different insurance companies will have different philosophies on selling and pricing and different expense structures. Some companies believe that



if more money is spent on choosing policyholders, then the claims costs will be reduced. Some companies write very selectively. Other companies try to write a variety of policyholders but will price based on different driver and/or automobile characteristics. For example, USAA Casualty Insurance Company has a personal automobile liability expense ratio of 13.4%, one of the lowest in the industry. This company sells direct to the policyholder, eliminating agent costs, and only writes members of the military community and their families. This approach has been very successful for them, but obviously would not work for all carriers. The table below shows the countrywide expense costs of the major personal auto insurance writers in Minnesota.

#### Countrywide Expense Ratios for Private Passenger Auto Liability

|                            | 2003 Written<br>Premium<br>in Minnesota | Commissions<br>to Agents | Other<br>Acquisition<br>Expense | General<br>Expenses | Taxes | Total |
|----------------------------|---|--------------------------|---------------------------------|---------------------|-------|-------|
| Totals                     | \$2,930,449,000                         | 8%                       | 7%                              | 5%                  | 3%    | 23%   |
| <b>Top 5 Writers in MN</b> |   |                          |                                 |                     |       |       |
| State Farm Mutual Auto     | \$638,748,000                           | 8%                       | 10%                             | 3%                  | 2%    | 22%   |
| American Family Mutual     | 335,350,000                             | 11%                      | 5%                              | 3%                  | 1%    | 20%   |
| Illinois Farmers           | 260,261,000                             | 1%                       | 10%                             | 6%                  | 4%    | 21%   |
| Progressive Northern       | 149,672,000                             | 7%                       | 3%                              | 8%                  | 2%    | 20%   |
| Allstate                   | 89,848,000                              | 12%                      | 5%                              | 5%                  | 3%    | 25%   |

data source: NAIC Annual Statements and Best's Aggregates and Averages, 2004 Edition

#### Loss Adjustment Expenses

On average, insurance companies have spent 13% of the premium dollar on claims settlement. In Minnesota in 2003, that would be approximately \$380 million.

Loss adjustment expense (LAE) is the cost of settling claims. This can be internal company costs for salaries and overhead or payments to external legal counsel. Insurance companies report LAE in two categories, "Defense and Cost Containment" and "Adjusting and Other".

- "Defense and Cost Containment" (D&CC) expenses include defense, litigation and medical cost containment expenses, whether internal or external. Expenses for surveillance, litigation management and fees for appraisers, private investigators, hearing representatives and fraud investigators are included in addition to attorney fees. Other costs associated with engaging experts and fees for rehabilitation are also included.
- "Adjusting and Other" (A&O) is all other loss adjustment expense. These expenses include such items as fees of adjusters (but not if engaged in a contentious defense), attorney fees incurred in the determination of coverage, and fees for appraisers, private investigators and fraud investigators, if working in the capacity of an adjuster.

In personal auto, loss adjustment expenses are approximately 10% of premium for collision and comprehensive. There is not a great deal of litigation for these coverages. Of the 10% total, 9% pays for general claim settlement costs and 1% is for all litigation, internal and external.

Although the Senate Committee is particularly interested in No-Fault insurance, we do not have separate expense data for this coverage. No-Fault data is reported with Liability and Medical costs. For these coverages combined, general claim settlement costs are again about 10% of premium. However, the litigation costs are higher, totaling 5% of premium. Although we would expect that the litigation costs for No-Fault are less, there is no any data on that question.

**Loss Adjustment Expenses in Personal Auto**  
(as a percentage of Earned Premium)

|                             | D&CC | Adj/Other | Total LAE |
|-----------------------------|------|-----------|-----------|
| Liability & PIP & Medical   | 5%   | 10%       | 15%       |
| Collision and Comprehensive | 1%   | 9%        | 10%       |
| Total Personal Auto         | 3%   | 10%       | 13%       |

Loss adjustment expenses also vary by insurance company, as can be seen in the table below.

**Countrywide Loss Adjustment Expense Ratios for Private Passenger Auto Liability**

|                                   | 2003 Written Premium in Minnesota | Loss Adjustment Expenses |
|-----------------------------------|-----------------------------------|--------------------------|
| Totals                            | \$2,930,449,000                   | 14%                      |
| Number of companies in MN         | 189                               |                          |
| <b>Top 5 Writers in Minnesota</b> |                                   |                          |
| State Farm Mutual Auto            | \$638,748,000                     | 15%                      |
| American Family Mutual            | 335,350,000                       | 14%                      |
| Illinois Farmers                  | 260,261,000                       | 18%                      |
| Progressive Northern              | 149,672,000                       | 15%                      |
| Allstate                          | 89,848,000                        | 15%                      |

data source: NAIC Annual Statements  
Best's Aggregates and Averages, 2004 Edition

Unfortunately, claims settlement costs may increase in the near future. Fraud has become a growing concern for personal automobile insurance. Staged accidents and abuse of medical treatments has occurred in Minnesota. The legislature has addressed these concerns by establishing a fraud investigation unit within the Department of Commerce. This unit is funded through an assessment on the insurance industry.

**Trends in Expenses**

As a percentage of premium, expenses have not varied a great deal over the past ten years. Underwriting expenses have ranged from 13.2% to 15.5% of premium and are currently at 14.8%. Loss Adjustment Expenses have ranged from 11.1% to 13.2%, and have a 2003 value of 12.4%. Commissions in 2003 were at 8.4% and have ranged from 7.4% to 9.1%.

