Automobile Insurance Reform

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In response to the Committee's courtesy in inviting me to lead off at this hearing, I should like to describe the history and content of the Insurance Department's report on auto insurance, and then to touch upon a few other questions. My testimony will be brief, but several of us from the Insurance Department will be available throughout the hearing to answer questions.

Background

In 1967 Governor Rockefeller appointed a Committee on Compensating Victims of Automobile Accidents. The Committee was chaired by former Judge Van Voorhis of the Court of Appeals. The members included representatives of civic, labor, professional and consumer groups and government agencies. The Governor charged the Committee to study the present system of handling automobile accident costs and of compensating automobile accident victims, and to make recommendations for improvement.

In the deficiency budget for 1967-68 the Governor requested $50,000 for the initial expenses of the Committee, and in the state purposes budget for 1968-69 the Governor requested $300,000 to finance the full study. No funds were ever appropriated for the Committee. After intermittent efforts to carry on its work anyway, the Committee unanimously voted in the summer of 1969 to disband.

In acquiescing in the Committee's decision to disband, the Governor designated the Insurance Department to carry forward the study.

The Insurance Department's work was based principally on the large and impressive body of published material on automobile accident reparations; on the records of the VanVoorhis Committee; on a study of closed claims made by our examiners; on new analyses of existing data by our actuaries and statisticians; on new data furnished by the U.S. Department of Transportation; on responses to a request for comments which we issued to all members of the Legislature, other community leaders and the general public; and on the advice of a panel of leading scholars of accident law and automobile insurance.

The Department's report, entitled "Automobile Insurance...For Whose Benefit?", was submitted to the Governor on February 12, 1970, and released by him on February 16. Implementing legislation was submitted by the Governor on March 6, together with a special message urging enactment of the legislation at the session of the Legislature then in progress and now recently adjourned. The bill was not, however, reported out of committee in either house.

The Insurance Department's report has been a public document for two and a half months; it was widely and ably reported in the press and other media; and 20,000 copies

have been given out. Copies of the report, of an actuarial supplement to the report, of the implementing legislation, and of the Governor's statements on the subject are all available at this hearing. Accordingly, I shall not belabor the Committee with a detailed recital of what is in those documents, but I should like to summarize a few of the more important points.

Failures of the Present System

The report reviews at length the record of the present system of handling the costs of automobile accidents. The two main constituents of the present system are, first, the common law of liability for negligence or fault, and, second, liability insurance. Hence we have called the present system the fault insurance system. I should like to review with you some of our conclusions about the fault insurance system.

(1) **Slow Payment**. The Insurance Department's report finds the present system to be slow in paying benefits to automobile accident victims, a slowness that causes financial hardship and impedes rehabilitation. The average victim has to wait more than a year for a liability insurance payment—forty times as long as it takes him to collect on accident and health insurance. The victim who has to sue encounters court delays up to five years in the urban and suburban counties of this State. The human situation is even worse than these statistics, for the more serious the victim's loss the longer the delay.

(2) **Unpaid Victims**. The Insurance Department's report finds that the fault insurance system denies compensation to many victims. One out of every four people injured in an automobile accident collects absolutely nothing from the system.

The reason is that the law of negligence, which governs the right to recover liability insurance benefits, requires the victim to prove that someone else was exclusively at fault. This means the victim cannot get paid unless he can prove someone else was to blame. Even then, the victim gets nothing if he himself was, to the slightest degree, negligent or at fault.

This rule of the fault insurance system—that payment turns on proving someone else exclusively at fault—has large consequences, not only for the one in four who is left out entirely but also for everyone who has to deal with the fault insurance system. So let's digress to look at that rule for a minute.

Of the major lines of personal insurance, auto liability is the only one that makes you prove some stranger was exclusively at fault before you can collect from the insurance company. There is no such gauntlet to run in life insurance, health insurance, fire insurance, theft insurance or even in automobile collision or comprehensive insurance. Imagine how strange it would seem if the rules of the fault insurance system were extended there.

When you are ill you want your health insurance to pay your medical bills without requiring you to prove that your illness was caused by someone who carelessly sneezed on you on the bus. Nor would you tolerate a health insurer which sought to duck payment by

claiming you would not have gotten sick if, right after the sneeze, you had run home and gone right to bed. Yet that kind of proof and that kind of defense are the mainstays of automobile insurance today.

(3) **Overpayment of Small Claims**. The Insurance Department's report finds that the present fault insurance system pays the claimant with a small loss far more than the accident cost him. This is not a new finding. The same conclusion has been reached in study after study. Nor is it just an old finding, for the preliminary data from the U.S. Department of Transportation's extensive, current study of claim files shows that three out of every four New York claimants with economic losses under $200 got paid more than double their economic loss through the fault insurance system.

The overpayment of these small claims, while called "pain and suffering" by lawyers and insurance men, typically bears no relationship to actual pain or actual suffering. It has a simpler explanation. The standard of liability and the measure of damages in automobile liability cases are vague and uncertain, leaving wide latitude for bargaining between the victim or his lawyer and the insurance adjuster. Only one percent of claims is decided by a court; the rest are bargained. To an insurance company the typical small claim has a nuisance value. The claim is overpaid to get rid of it.

The overpayment of small claims under the fault insurance system might be unobjectionable if the payment were not passed along to consumers as higher insurance rates. But in fact these overpaid small claims cost consumers dearly. An estimated 25% of all auto liability insurance awards go for payments in excess of economic loss to victims whose economic losses are under $1,000. And as we shall see, every dollar of claim payment costs $2.25 in premiums.

(4) **Underpayment of Large Claims**. The Insurance Department reports finds that the present system deals far less generously with the seriously injured victim. When you cut through the rhetoric of the defenders of the present system, a rhetoric heavy with solicitude for the seriously injured, you confront the shocking fact that victims with large medical costs and wage losses do not recover from the fault insurance system even the full amount of their medical costs and wage losses.

Again, the Department's finding is not new. The underpayment of the seriously injured was revealed by a Columbia University study in 1932. The finding was confirmed by a leading study six years ago. The most recent, as well as the most dramatic and best documented, finding as to the underpayment of the seriously injured is in the voluminous national survey of serious injury cases released yesterday by the U.S. Department of Transportation. That survey found that the seriously injured traffic accident victim or his survivors were compensated, from all sources, for less than half of their actual economic loss; and that auto liability insurance contributed less than one-third of the reparations that were made—or one-sixth of the economic losses of seriously injured victims.

The reason for the underpayment of large claims is simple and is the corollary of the reason why the present system pays too much on small claims. The typical large claim

is underpaid because the seriously injured victim cannot wait for his money and can be bought out cheaply.

The fact that the present system underpays the seriously injured is a fact of the utmost importance to any government with a humane and progressive tradition. It is a fact that is often obscured by rhetoric and by the occasional spectacular award. The occasional big award illustrates nothing more than that any lottery pays off sometimes. But the real news is that day in and day out the fault insurance system is shortchanging the very people who need the money most.

If government has compassion, if government has the heart to respond to unorganized need and inarticulate misery, then those facts—and make no mistake about it, those are facts—cry out for reform more eloquently than any report or any testimony.

(5) **Waste**. As if the failings already mentioned were not enough to discredit the present fault insurance system, the Insurance Department report goes on to trace what the system does with the consumer's premium dollar.

Over half of the money paid into the system goes to the overhead expenses of the system. And a very large proportion of what gets through the machinery is, as I just discussed, misallocated, with too much going to small claims and too little going to large claims.

Specifically, the report finds that 56 cents of each premium dollar is kept by the insurance companies, insurance agents, insurance adjusters, plaintiff's lawyers and defense lawyers who operate the system. Of the 44 cents that go to victims as a class, 21½ cents go for other than economic loss, typically in overpayment of small claims. Another 8 cents go to pay over again economic losses that have already been compensated from another insurance source such as health insurance. That leaves only 14½ cents out of the premium dollar to pay for the net economic losses of the victims of automobile accidents.

That kind of waste might be tolerable—indeed the facts have been known and tolerated for a long time—if auto insurance were cheap. Once it was cheap. But no longer.

Today the average cost of the auto insurance which New York law compels every car owner to buy is $125 per car per year. Today the typical car owner, who rightly decides that he has to buy more insurance than the law requires if he is to protect himself, pays $250 per car per year for automobile insurance. If he drives for forty years, he can figure on paying $10,000 for auto insurance during his lifetime, and that is at today's prices.

But the price of auto insurance has been going up—95% since 1950. At least as long as inflation continues in the general economy, the prospect is for the price of auto insurance to continue to go up.

With the price of auto insurance high and rising, waste and inefficiency in the auto insurance system become less and less tolerable. The Insurance Department report predicts that the waste and inefficiency of the fault insurance system would be enough to doom the present system some day even if there were nothing else wrong with it.

(6) **Duplication of Other Insurance**. The Insurance Department report finds that the premiums which consumers pay into the fault insurance system often go to pay duplicate benefits.

Many auto accident victims are entitled to payments from such sources as health insurance and income continuation plans. But under the "collateral source rule" of the fault insurance system, these other benefits are disregarded in setting the amount of a liability insurance award.

In a state like New York, where health insurance and wage loss insurance are very widespread and auto insurance is universal, the result is that a lot of people are paying duplicate premiums to support duplicate benefits. But duplicate benefits are a bad buy, remembering that every dollar in auto insurance benefits costs $2.25 in premiums.

One person who is penalized the worst by the present arrangement is the employee with good fringe benefits for health care and loss of income. Were auto insurance not a liability system with a collateral source rule, this employee could see his progressive fringe benefits reflected in an immediate lowering of his auto insurance premiums. But today, no matter how progressive his fringe benefits, the employee's auto insurance premiums are unaffected. All he gets is a chance at redundant benefits if he is injured some time in the future, and redundant benefits are a bad buy.

If a person wants to pay twice, he should be free to do so. But why should his own government compel him? No one is saying it is not nice to get double benefits. The point here is that it isn't free. Premiums are not so low, nor people so rich, that the law should make anyone pay more than once for protection.

(7) **Traffic Safety**. Last year the automobile killed 56,000 Americans. That is more American deaths in one year than in the Vietnam war since its beginning. Last year the automobile injured 4.6 million other Americans. That is four times the number of Americans wounded in all of World War II.

Against that gory background, some defenders of the fault insurance system still insist that the present system somehow deters unsafe driving. That is nonsense. The Insurance Department's report points out that under the present system the standard of legal fault is vague; determinations of fault are made long after the event; the extent of liability is in no way proportional to the degree of carelessness; the liability is not just of the driver but of the vehicle owner whether or not he was driving; and, most important, the liability is insured against.

Automobile liability insurance is compulsory in this State. The wrongdoer, assuming there is one in an accident and his fault can be proved, does not pay. The insurance company pays. Through premiums, we all pay.

Neither reckless driving nor last-moment mistakes—undeterred by fear of death, injury, imprisonment, fine or loss of license—can possibly be deterred by fear of civil liability which is covered by liability insurance. The contrary belief would be nonsense

and, if people really believed it, dangerous nonsense, because we would be trusting for our safety in a system that cannot help.

(8) **Other Criticisms**. The Insurance Department's report also criticizes the fault insurance system on other grounds—pointing out how it encourages overreaching and dishonesty, how it clogs the courts, how it renders the insurance mechanism unstable and prone to breakdown and anti-social conduct, and, finally, pointing out how the present system is socially and economically regressive, with underwriting, rating and claims practices that penalize most the young, the old, the poor, the different, the unsophisticated.

Now, if the foregoing are some of the defects in the fault insurance system, what is the cause of the defects? What kind of change is necessary to get at those defects?

Why the Present System Fails

The Insurance Department report traces the operating defects in the present system to the system's most fundamental principles and to an irreconcilable conflict between those principles.

The present fault insurance system is based on the common law of negligence or fault. The law holds that a person who has suffered a loss can recover damages from another person only if he can prove that that other person was exclusively at fault and can further prove that the faulty act was the cause of the loss.

The legal rules, which antedate the invention of the automobile, were not designed to compensate accident victims. They were designed to make wrongdoers pay for what they did.

The purpose of the legal rules has been undercut by the development of liability insurance, which every car registered or driven in this State has to carry. Liability insurance is designed to do nothing more than reimburse wrongdoers for what they might have to pay for negligently causing damage to another. If the law of negligence is designed to make sure wrongdoers pay, liability insurance is designed to make sure wrongdoers never pay. In this conflict, liability insurance has prevailed. It has rescued the wrongdoer. It assures that any cost which the law would shift to a wrongdoer shall be immediately lifted from him.

But if liability insurance has undercut the law of negligence as far as it concerns making wrongdoers pay, the law of negligence has prevailed in determining which victims shall be paid. The law of negligence lets the victim collect from the insurance company only if the victim can prove that the insured was exclusively at fault.

It is no wonder that such a system fails both the accident victim and the insurance consumer, and it is of the utmost significance that the failures of the present system are traceable to its most fundamental principles.

Over the years, New York and other states have repeatedly tried to patch up one or another of the defects in the fault insurance system without challenging its fundamentals.

An important finding of the Insurance Department's report is that such steps will not in the future yield useful results. After analyzing such palliatives as small claim arbitration, supplemental first-party benefits and comparative negligence, the report concludes that "further attempts to modernize the fault insurance system by tinkering with it, while leaving its essentials intact, are sure to be expensive and self-defeating. The operators of the present system would just be buying themselves time with other people's money."

The Need for Fundamental Change

The defects in the present system are indeed fundamental. The key to real improvement is fundamental change. The essence of sound, fundamental change has to be (1) the discarding of case-by-case determinations of legal fault as the prerequisite to payment, (2) the replacement of vague and indeterminate measures of damages with clear and objective measures of compensation, and (3) the elimination of the conflict of purpose between accident law and accident liability insurance.

The Department's report discusses what we believe to be the criteria for a fair, humane and efficient system of compensating the victims of automobile accidents and distributing the costs of those accidents. From the criteria the report develops and sets out in detail a proposal for fundamental reform of our automobile insurance system.

A Proposal for Fundamental Change

The proposal would abolish negligence law claims and lawsuits based on the operation of motor vehicles in this State. It would require that every vehicle owner carry insurance to protect the occupants of his vehicle and pedestrians hit by his vehicle. Insurance benefits would be payable without requiring the claimant to prove that anyone else was at fault. The compulsory insurance would pay full compensation to all victims for net economic loss resulting from personal injury, such as medical expenses and income loss, or resulting from damage to property other than automobiles.

The proposed compulsory insurance would pay considerably more in cases of serious injury than does the present one. It would pay faster, with less haggling, and its benefits would be paid periodically rather than in a lump sum — all qualities that would help the victim get the money and the care he needs when he needs them.

It is useful to note that while the proposed compulsory insurance would provide generous benefits, it would compensate only for economic loss and only for that economic loss not already compensated by some other, more efficient kind of insurance. The reason is simple. We are talking about compulsory insurance, about the coverage that everyone is required by law to pay premiums for. In our judgment, government should exercise that kind of compulsion on its citizens with restraint.

But as the report indicates, and as I emphasized in testimony on March 10 before the Assembly Insurance Committee, the Legislature would always be free to change the level or types of benefits provided by the proposed compulsory insurance. For the proposal would set up an insurance system that would be amenable to rational decisions

by the makers of public policy as to the best balance of costs and benefits. The changes from fault law to compensation, from vagueness to precision in measures of awards, from insurance for strangers to insurance for yourself, from waste to efficiency, from complexity to simplicity—all are basic to real reform. The level of benefits and the consequent level of premiums within a reformed system are not basic, but would be proper subjects of continuing legislative review.

For example, while we have recommended that a reformed system provide unlimited compensation for net economic loss, the Legislature might reasonably decide to set limits on that compensation in order to hold down premiums for the compulsory insurance. In the other direction, while we have recommended that compulsory insurance under a reformed system cover only net economic loss, the Legislature might reasonably decide it was worth the extra premiums to include, in the compulsory coverage, benefits for certain objective though non-economic consequences of an accident, such as dismemberment or loss of function. Such non-economic loss could be compensated within a reformed system far better than it is today. It is to be distinguished from what is also called "pain and suffering" under the fault insurance system but which is just the bargained over-payment of small claims.

The best level of benefits, and consequent level of premiums, within any compulsory insurance system is, of course, a matter for debate and for careful government decision. The point is that in a fundamentally reformed system the Legislature could make those decisions and could be confident its decisions would be implemented efficiently and applied even-handedly to all citizens however situated. That is impossible under the fault insurance system.

We have been talking about compulsory insurance, but it is useful to keep in mind that consumers would remain free to buy additional coverage if they wished. Four out of every five people injured in an automobile are members of the car owner's family. Under the proposal, the car owner would be buying insurance largely to protect himself, his family and his car. He would be in the best position to decide what he needed and what he could afford.

The proposal would reduce premiums substantially, both as to compulsory coverages and as to the combination of compulsory and optional coverages which the typical motorist might be expected to buy. The consumer would see less of his premium dollar eaten up by the operating expenses of the system. He would see a fairer share of his premium dollar going to pay for net economic loss—57 cents as against 14½ cents today. The consumer would know his premiums were supporting benefits mainly for himself, his family and friends, rather than mainly for adversary strangers.

The Insurance Department's actuaries estimate that the proposed compulsory insurance should cost the average consumer about 56 percent less than compulsory automobile insurance costs him today. For the typical driver who buys additional coverage today on an optional basis, comparable coverage under the proposal should cost 33 percent less. These cost comparisons are based on the best available actuarial data and on conservative assumptions, although, as the report emphasizes, they are, of necessity,

estimates. But it would hardly be in the interest of a regulatory agency, which would have continuing responsibility for any new system, to exaggerate its estimate of premium savings.

It is important to note—and this has frequently been misinterpreted—that the estimated premiums for the proposed compulsory insurance include not only the basic coverage for net economic losses of occupants and pedestrians for injuries in New York accidents, but also include liability insurance, at today's levels, for out-of-state driving and for wrongful death. For the typical driver who has optional insurances too, the estimates for the proposal also include collision insurance. Finally, it is important to keep straight that the proposed change in auto insurance would have no effect on the rates charged for health insurance, disability income insurance or any other coverage which would be primary to auto insurance. Those insurances pay auto accident victims today and they would continue to do so under our proposal. The difference is that our proposal would eliminate duplicate payments, which is one reason it would bring auto insurance premiums down.

The fault insurance system protects careless drivers better than accident victims. It does not and cannot deter unsafe driving or otherwise promote highway safety. By contrast, the proposal would reinforce highway safety efforts in several ways. It would permit the accident compensation system to yield undistorted data for use in systematic approaches to highway safety. It would impose special cost burdens on drunken driving and would give commercial vehicle owners an economic incentive to improve driving conditions for, and to promote safe driving by, their employees.

The proposal should also advance traffic safety by enabling insurance premiums to vary as among makes and models of car, according to each car's ability to protect occupants and to resist damage. Insurance premiums could then, for the first time, be used to encourage car makers to make safer cars. That can only be done if the car owner is insuring his own car, rather than insuring some car he will run into and whose make and model obviously cannot be foreseen. It is ironic that when the State's largest auto insurer, a vigorous opponent of reforms such as we propose, recently announced a premium discount for sturdier automobiles, the insurer proposed the discount only on collision insurance—a first-party, no fault coverage that would be the main insurance for vehicle damage under our proposal.

Traffic safety is mainly the responsibility of other laws and institutions. The proposal would in no way interfere with such other efforts as traffic law and enforcement, strict licensing of drivers, and civil actions against automobile manufacturers and others for bad design, fabrication and maintenance of roads and vehicles. But at least we can have an accident reparations system that helps, and does not hinder, those important other efforts.

Conclusion

To sum up, the Insurance Department concluded after its study that the present automobile liability insurance system is unsound, that it deals badly with both accident

victims and insurance consumers, and that it does so for reasons that are fundamental and that call for fundamental change. The Governor's proposal would make such a fundamental change.

In writing the report, we in the Insurance Department were guided by the belief that the Governor, the Legislature and the public were entitled to be told the facts about automobile insurance, and to have presented to them an alternative that would be more in the interest of insurance consumers and accident victims.

As you consider all this, I would respectfully commend to your attention three things.

Number one, the context in which any alternative should be considered is the present fault insurance system. That's what we have today, and some people have an immense interest in seeing to it that the fault insurance system is what we have tomorrow and henceforward. It is not necessary for me to impugn their motives to warn you away from their logic and their tactics. By all means consider their criticisms of our proposal and of all other proposals for really meaningful reform. But don't let them get too quickly off the subject of the present system and its fundamental defects. For the present system is their system. The past, with or without palliation, is their program for the future. Let them defend it.

Number two, please separate carefully what is essential to reform from what is not. Disagreement about levels of benefits for compulsory insurance, about compensating non-economic losses, about whether auto insurance should be primary or secondary to other sources, about whether auto physical damage insurance should be compulsory, about second-level cost transfers, about interstate questions—all are important, but none is of the essence of fundamental reform. You have our recommendation on each point, but you could decide each one differently and still achieve fundamental reform of auto insurance. What is of the essence, what must be done to secure real improvement, is to do away with the fixing of legal fault as the prerequisite to insurance payment, to do away with vague and open ended measures of the amount of insurance payment, and to do away with a system in which the consumer pays for insurance whose benefits go to everyone but himself.

Third and last, we should all remember that tottering institutions—defensive and fearful, out of touch with their roots, out of touch with reality, out of touch with the needs of the people they profess to serve—such institutions, however formidable and entrenched, eventually fall. The institution known as the fault insurance system was not first criticized by the Insurance Department. The fault insurance system has been exposed again and again as slow, wasteful, unfair and inhumane, living only on myth and momentum and on the dexterity of its operators at confusing the issues and obstructing change. But change will come. Eventually change always comes. Here at least we have all had ample warning and a chance to influence what is bound to happen.