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NO-FAULT AUTO INSURANCE IN FLORIDA: TRENDS, CHALLENGES & COSTS

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Introduction

The No-Fault Auto Insurance system in Florida is under stress due to rising fraud and abuse that is responsible for higher insurance premiums. The cost to insurers to cover costs associated with rampant no-fault fraud is rising by 70 percent each year, and these costs will eventually be passed along to Florida drivers. Staged accidents, excessive or unnecessary medical treatment and inflated or questionable claims are driving up the cost of insurance. Both the severity and frequency of automobile personal injury claims are rising at an alarming rate, at a time when the number of traffic crashes has been trending down. If steps are not taken to address the factors contributing to rising no-fault fraud, Florida's "no-fault fraud tax" is expected to approach $1 billion in 2011.

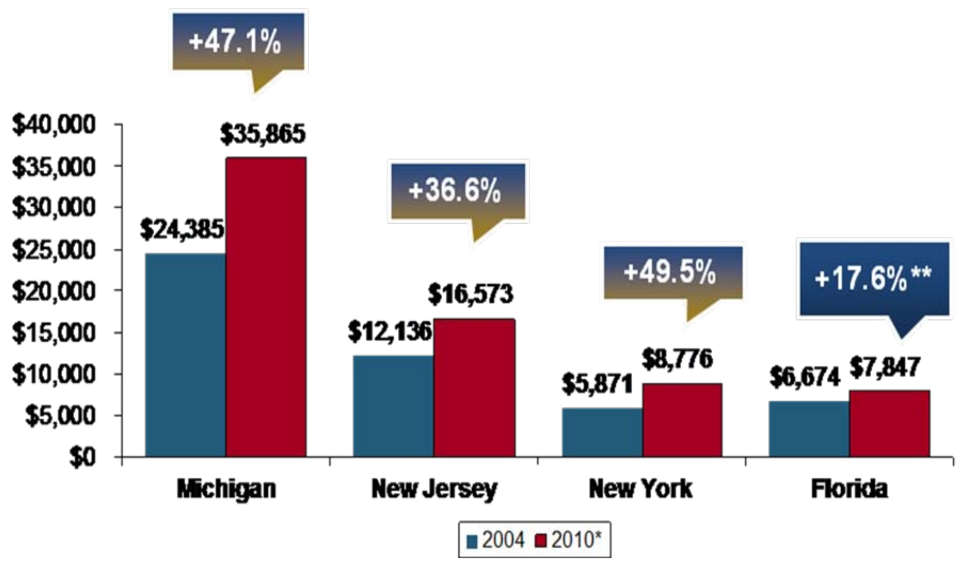
Florida is one of 12 states, along with Puerto Rico, that has a no-fault law. The first party (policyholder) benefit coverage is known as personal injury protection (PIP), so the terms "no-fault" and "PIP coverage" are used interchangeably to denote any auto insurance program that allows policyholders to recover financial loss from their own insurer. PIP is coverage that pays for medical care and other benefits if the policyholder has an auto accident.

The Florida PIP law is designed to help reduce the need for people to sue to cover the cost of injuries resulting from automobile accidents. But the $10,000 minimum requirement for PIP coverage in Florida has become a "dollar target" for medical expenses by those who take advantage of the system. Florida also has a verbal threshold, as opposed to the dollar target, which is designed to eliminate some of the incentive to inflate claims, but over time, the judicial interpretation of the verbal threshold has eroded.

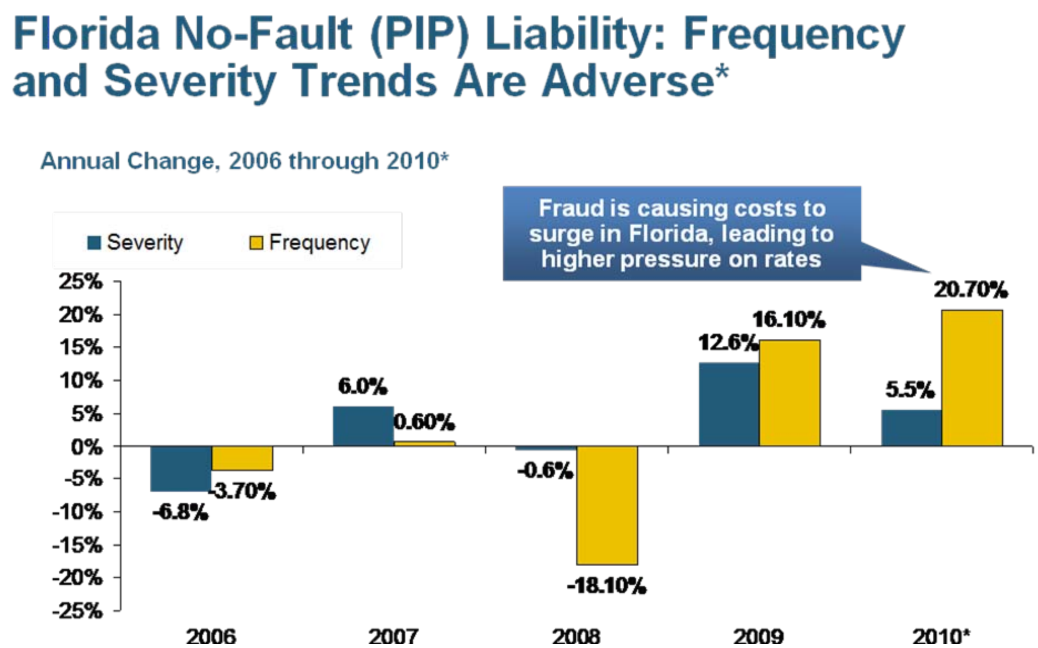
Several states have growing problems in their no-fault systems. Florida has the fourth highest average claim cost in the U.S., known as claim severity. Severity is the size of the loss, one of the criteria used in calculating premium rates. No-fault claim severity in Florida has increased by 23.7 percent since 2006. Insurance companies analyze their own claims history and use that information to determine the premium rates necessary to cover future losses. The average severity (size of a loss) in 2006 was $6,344. By the third quarter of 2010, the average severity of a no-fault claim was $7,847.

Insurers also look at claims frequency, which is the number of times a loss occurs. This is also a factor used in calculating premium rates. There was a significant decline in frequency in 2008, attributed to the PIP reforms of 2007, which established a medical fee schedule to help combat fraud. However in 2009, frequency spiked more than 16 percent and increased by nearly 21 percent in 2010. Overall, no-fault claim frequency surged by 46.2 percent between the second quarter of 2008 and the third quarter of 2010. The combined impact of rising frequency and severity of claims is driving up the cost of pure premium, which is defined as the premium needed to pay for anticipated losses without considering other costs of doing business. The only reasonable explanation for this dramatic rise: no-fault fraud and abuse.

Increase in No-Fault Claim Severity: 2004-2010*



*2009 figure is for the 4 quarters ending 2010:Q3.
** Since 2006, the increase in Florida was 23.7% (average severity that year was $6,344).
Source: Insurance Information Institute research from ISO/PCI Fast Track data.



Source: ISO/PCI Fast Track data; Insurance Information Institute.

Florida's Anti-Fraud Statute

Florida statute (626.9891) requires insurers with $10 million or more in direct annual premiums to have either an in-house investigation unit or to contract with an outside entity to investigate possible fraudulent claims. Insurers with less than $10 million in direct premiums must adopt an anti-fraud plan. In either scenario, insurers must have detailed plans for detecting and investigating possible fraudulent acts and are required to report suspected fraud to the Florida Division of Insurance Fraud.

Insurers also report suspected fraud to the National Insurance Crime Bureau (NICB), an insurer-funded, nonprofit organization of more than 1,000 members, including property/casualty insurers. The NICB is the nation's leading organization dedicated to preventing, detecting and defeating insurance fraud and vehicle theft. The NICB gives a closer review to claims that are considered questionable and investigates them based on one or more indicators of possible fraud. A single auto insurance claim may be referred to the NICB for several reasons, and these "questionable claims" are flagged because they possess indicators of:

- Staged accidents
- Excessive medical treatment
- Faked or exaggerated injury
- Prior injuries (that are unreported in the new claim)

- Bills for service not rendered
- Solicitation of the accident victim(s)

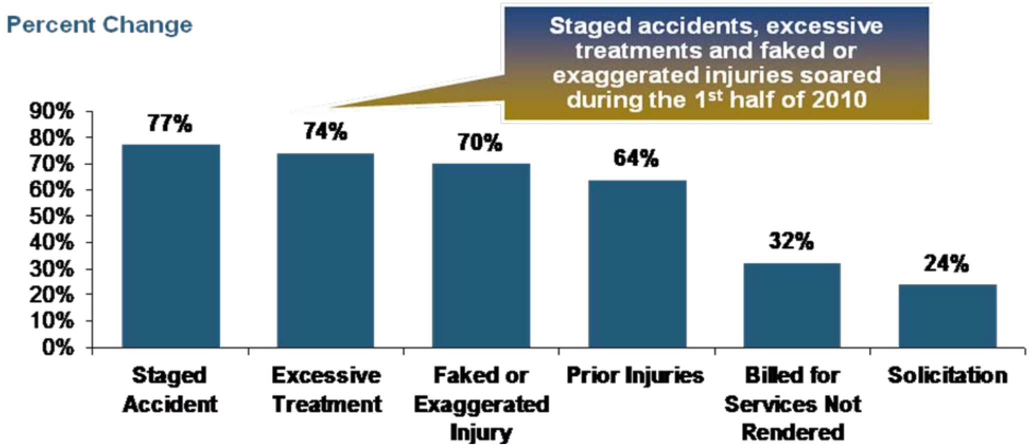
A single claim may contain several referral reasons. Questionable claims involving staged accidents surged 52 percent in 2009. For 2010, early estimates suggest an even larger increase.

Insurers are proactive in fighting fraud not only because the law requires it, but because it lowers the cost of insurance for all policyholders. However, fraud fighting is not an easy or inexpensive endeavor. Criminals are becoming more sophisticated in their methods, and the challenge is to keep up with them and guard against whatever game plan they devise. Insurers invest in fraud investigation tools and technology, and they hire and train professionals within their Special Investigation Units (SIU) to detect and investigate suspicious claims. Many of these insurance investigators have had previous experience serving the public in law enforcement. Both in-house SIUs and those who are outsourced work with insurers' claim adjusters to help prevent fraud and improve bottom line performance, which, in turn, saves consumers from being victimized by fraud schemes.

Staged Accidents, Excessive Medical Treatment Driving Costs Up

Referrals of questionable claims to the NICB are increasing. The top reasons that Florida insurers referred vehicle claims for car damage to the NICB during the first half of 2010 were related to questionable theft, faked damage or a phantom accident, meaning a car crash that never actually occurred. Top reasons Florida insurers referred casualty claims for personal injury during the first half of 2010 were related to faked or exaggerated injury, staged accidents and being billed for services that were never delivered.

Florida Casualty Referrals for Fraud: 1st Half 2010 vs. 1st Half 2009



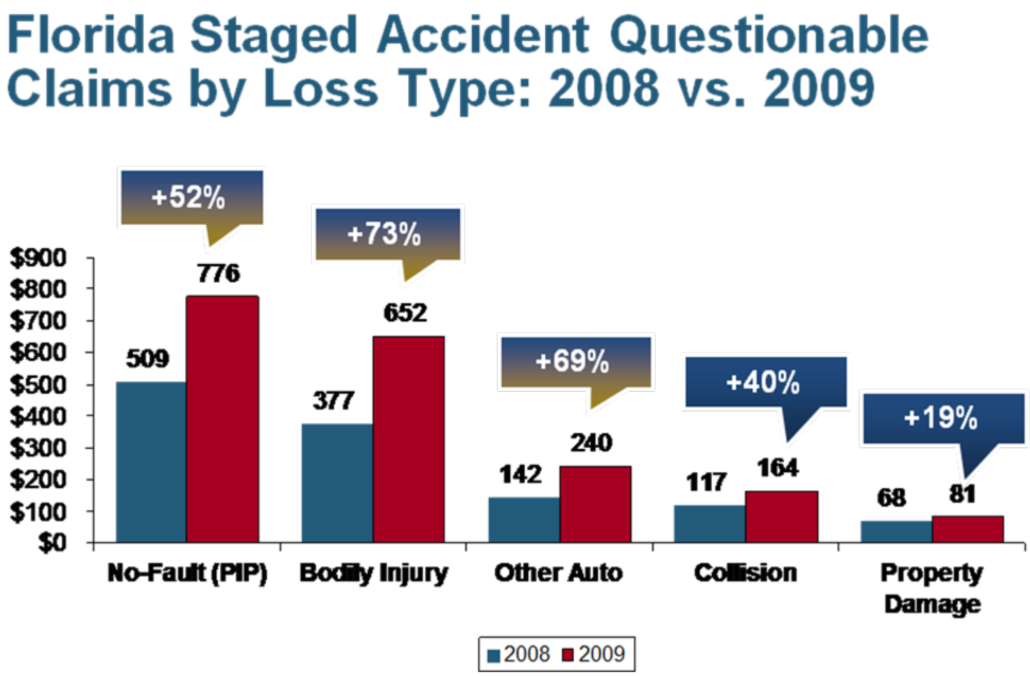
Source: National Insurance Crime Bureau; Insurance Information Institute.

Staged accidents are more common in no-fault states, and they typically involve organized rings. The NICB ranks Florida as number one for questionable claims involving staged accidents. On the metropolitan level, Tampa Bay is in first place for questionable claims involving staged accidents, and Miami is ranked in second place. A familiar scenario for most staged accidents is that the “victim” vehicle that orchestrated the accident often contains several passengers who can each file medical claims against the driver’s auto insurance carrier. A no-fault insurance policy provides coverage to the driver, members of his or her household who do not own a vehicle of their own, certain passengers who lack no-fault coverage, and certain licensed drivers who are using the car with the owner’s permission.

The cost of staged accidents rose for all factors related to a claim between 2008 and 2009.

- No-fault (PIP) up by 52 percent.
- Bodily injury up by 73 percent.
- Collision up by 40 percent.
- Property damage up by 19 percent.
- Other auto cost, such as (TBD), up by 69 percent.

Bodily injury pays for death or serious and permanent injury to others when a driver is found to be legally liable for an accident involving his or her automobile. The insurer will pay for injuries up to the limits of the policy and provide legal representation if the driver is sued. Collision pays for the repair or replacement of the vehicle if it collides with another car, flips over or crashes into something, regardless of who causes the accident. Property damage pays for certain damage, up to the insurance policy limit that an insured driver causes to another person's property, if they are legally liable for the accident. The damage may involve a car, but is not limited to another vehicle and may apply to a fence, building or an animal.

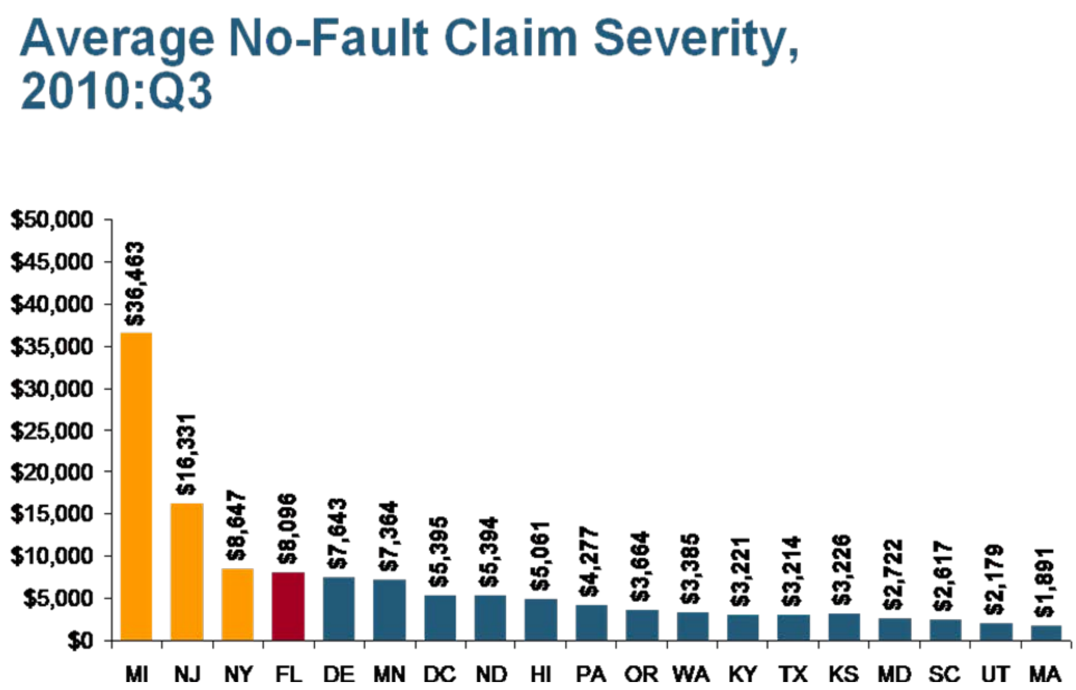


Source: National Insurance Crime Bureau; Insurance Information Institute.

No-Fault Challenge in the U.S.

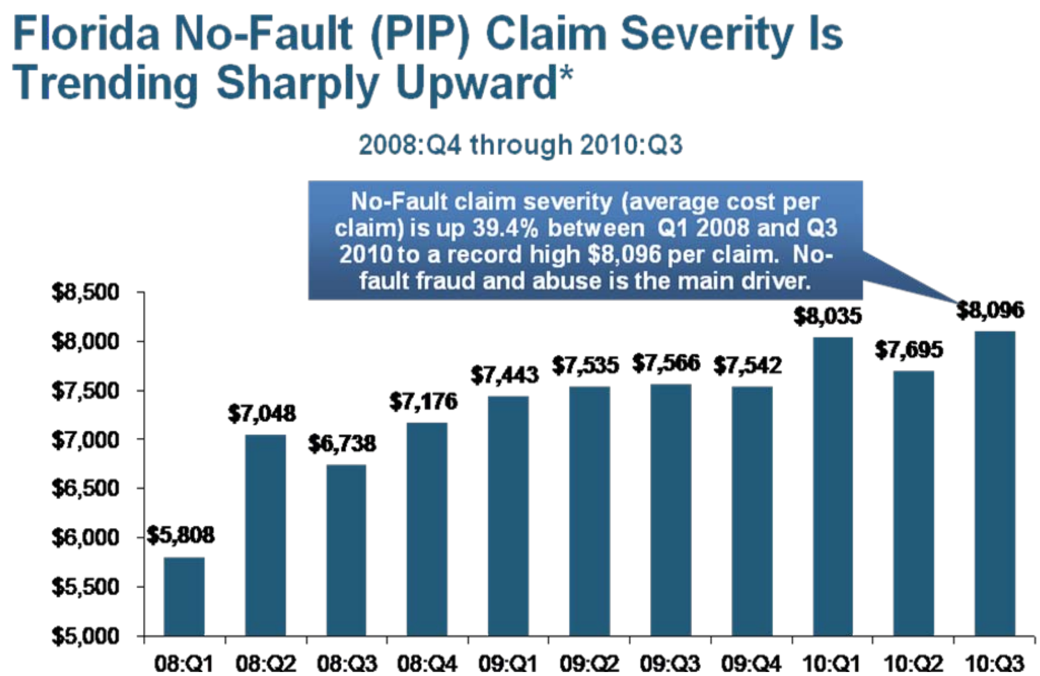
Several states have growing problems with rampant fraud and abuse in their no-fault systems. Michigan, New Jersey, New York and Florida are currently the largest states experiencing the most severe problems, with claims severity up sharply. Florida has the fourth highest average auto no-fault claim cost (severity) in the country. Michigan is unique among no-fault states in that its no-fault law offers unlimited medical care under PIP coverage. Not surprisingly, Michigan's auto crash costs are higher than elsewhere in the country. Using a statistical model, RAND found that Michigan claims were 57 percent higher than the average auto insurance claim, which resulted in premiums that were 17 percent higher. The higher costs were partly attributable to claimants using a different mix of medical services. In particular, according to the study, Michigan claimants are 19 percent more likely to claim reimbursement for a hospital visit and 25 percent more likely to claim for emergency room use. They are also more likely to claim for x-rays and CT scans, to purchase durable medical equipment and to claim for lost wages, taking advantage of the generous benefits the law requires insurers to offer. According to the American Insurance Association, the state's average PIP claim for the 12 months ending October 31, 2009 was $32,490, double the average for New Jersey, the state with the second most costly PIP claims. As a result, insurance in urban areas is virtually unaffordable for many residents.

Medical payments under New York's no-fault's PIP are rising dramatically, in part due to fraud and abuse. PIP average claims costs in the third quarter of 2009 stood at $8,690, after Michigan and New Jersey. Since the end of 2004, claims costs have risen 55 percent and fraud investigations have more than doubled. In 2008, the number of arrests for no-fault fraud was 52 percent higher than in 2007. A newly released study on New York's no-fault system by the Insurance Research Council (IRC) shows how prevalent fraud is in the New York City area. About one in every five claims settled appears to have some element of fraud and as many as one in three appears to be inflated, according to the IRC.



Source: IPSO/PCI Fast Track data; Insurance Information Institute

It is not only the severity of accidents that is rising; the frequency has also been increasing. Frequency is the number of times a loss occurs, and it is another of the criteria used in calculating premium rates.



*Claims frequency is defined as the number of claims per 100 earned car years.
Source: ISO/PCI Fast Track data; Insurance Information Institute

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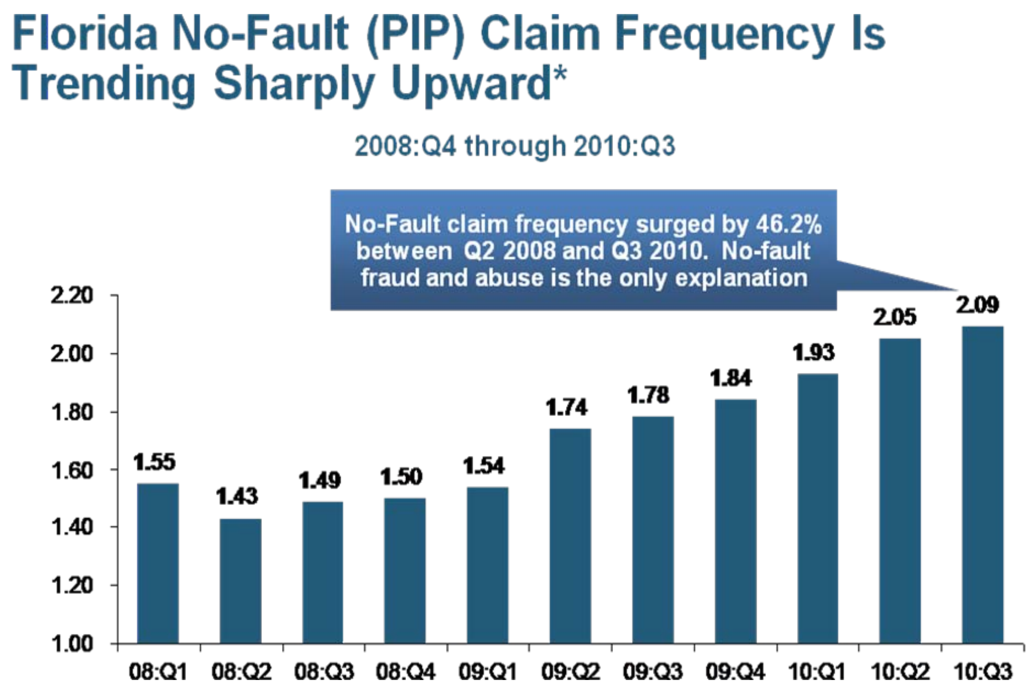
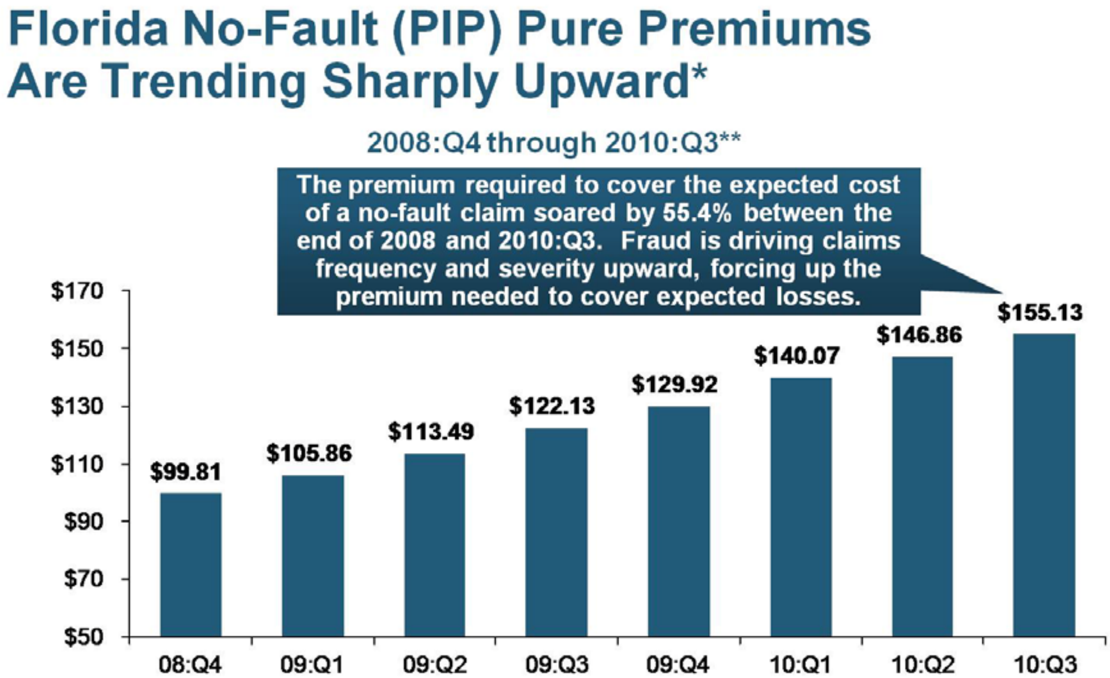


*Claims frequency is defined as the number of claims per 100 earned car years.
Source: ISO/PCI Fast Track data; Insurance Information Institute

How Fraud Impacts Rates

Because fraud is driving up claims frequency and severity, premiums must rise to cover the expected losses. The "pure premium" related to no-fault is rising sharply. Pure premium is defined as the premium required to pay for expected losses, and it excludes expenses and other costs of doing business.

The premium required to cover the expected cost of a no-fault claim soared by 87.1 percent between the beginning of 2008 and the third quarter of 2010. At the start of 2008, the pure premium was $90.28. By the third quarter of 2010, pure premium had risen to $168.89. These rising costs are now being reflected in auto premiums being paid by Florida drivers.



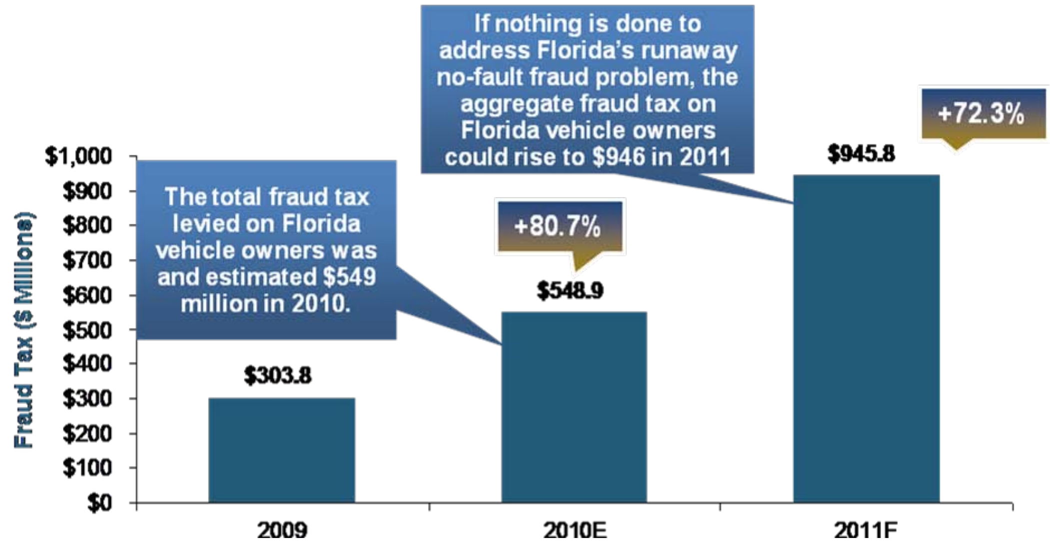
Source: ISO/PCI Fast Track data; Insurance Information Institute

Florida No-Fault Fraud Tax

In 2010, the average Florida driver's fraud tax was $48.62 per vehicle. This means the fraud tax on a typical family with two cars was nearly $100 last year. If the trend continues–with no measures taken to stem the growing problems with runaway no-fault fraud–the fraud tax per vehicle could rise to $83.79 in 2011, an increase of 72.3 percent. This may not seem like a significant amount to individual policyholders, but it is a pocket being picked by those who are taking advantage of the loopholes in the state's no-fault law. Consider that when the "fraud tax" is multiplied by the state's 11.22 million insured vehicles, Florida drivers and their insurers could pay an estimated $1.5 billion in fraud taxes by the end of 2011 if the problem is left unchecked. The 2011 estimate is based on the assumption the pure premium will increase by 25 percent, considering that the pure premium increased 27 percent in the year ending with third quarter 2010.

Auto insurance fraud is a crime, and all Floridians pay for it. Auto insurers are paying out more than they should in no-fault claims and their policyholders are paying out more in premiums.

Florida's No-Fault Fraud Tax: Estimated Aggregate Annual Cost, 2009-2011F ($ Millions)



*2010 estimate is based on data through Q3:2010. 2011 forecast is based on an assumed increase in pure premium of 25% (pure premium increased 27% in the 4 quarters ending with 2010:Q3). Estimates assume 11.288 million insured vehicles in FL in 2009-2011 (11.288 million is 2008 actual figure from AIPSO).

Source: Insurance Information Institute calculations and research from ISO/PCI and AIPSO data.