An Analysis of

Profitability and Pricing

In the

Michigan Auto Insurance Market

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Executive Summary

This report analyzes pricing and profitability in the Michigan auto insurance market based on data compiled by the National Association of Insurance Commissioners in three standard reports it publishes each year, as well as on data from other sources. It finds the following:

* **Michigan is different**.

Michigan is the only state that has effectively restricted the ability of people injured in auto accidents to file lawsuits; it is the only state that in exchange for such restrictions has enabled people severely injured in auto accidents to obtain full medical benefits from their own insurance company; it is the only state that has established a reinsurance mechanism--the Michigan Catastrophic Claims Association--to pay very expensive claims; and it is the only state for which the NAIC has consistently been unable to calculate profitability based on the data Michigan insurance companies report.

* **For liability coverage, Michigan drivers pay low rates and Michigan insurers earn high profits**.

- Michigan drivers paid lower bodily injury (BI) liability rates than drivers in any other state except North Dakota, and rates that are far lower than the national average. In 2009, for example--the latest year for which the NAIC has published state-by-state liability data--the countrywide average BI pure premium was $151, while in Michigan it was $61.

- Michigan drivers sue less often than drivers in any other state in the nation. Nationally, drivers on average are seven times as likely to sue as are drivers in Michigan: in 2009 Michigan frequency was 0.14%, whereas the countrywide average frequency was 1.01%.

- Notwithstanding Michigan's lowest-in-the-nation BI insurance rates, Michigan auto insurers earned substantially higher profits on BI insurance than insurers did countrywide.

* **For no-fault coverage, Michigan provides the most comprehensive benefits in the nation. Unfortunately, based on the available data it is impossible to determine how profitable Michigan no-fault insurance is**.

- Michigan provides coverage for lifetime benefits for all reasonable charges incurred for reasonably necessary products, services and accommodations for an injured person's care recovery or rehabilitation. In contrast, most other states--including those that restrict lawsuits--provide only minimal no-fault coverage. Nevertheless, what Michigan drivers pay for comprehensive benefits is not a great deal higher than what drivers in other states pay for minimal benefits. For example, Florida drivers in recent years have paid an average pure premium of between $153 and $191 for no-fault medical coverage that cuts off at $10,000; for an additional $150 or so, Michigan drivers receive lifetime medical benefits.

- Michigan drivers file fewer no-fault claims than drivers in other no-fault states. For example, in 2009 Michigan drivers filed no-fault claims at less than half the rate of New Jersey drivers, and only about a third of the rate of Florida and New York drivers.

- No one really knows how profitable no-fault auto insurance is for Michigan auto insurers. That is because, among other reasons, some insurers appear to include as their own losses losses that the MCCA is responsible for. As a result, the loss ratios--the percentage of the premium insurers project they will pay out in claims--that Michigan auto insurers report for no-fault coverage do not reflect their true experience and differ wildly among insurers. As a result, the NAIC has never been able to calculate the profitability of Michigan no-fault insurance, and has never included it in its annual state-by-state survey of insurer profitability.

- The MCCA has never disclosed the assumptions, estimates, and projections on which its surcharge is based. However, based on information in the financial statement the MCCA files with the Department of Insurance and Financial Services (Department), it appears that the annual per-car surcharge assessed by the MCCA and paid by policyholders has been approximately 15% higher than necessary over the long run. A reduction in these surcharges would reduce auto insurance premiums.

*** Michigan collision rates are the highest in the nation, while collision profitability in Michigan is lower than the countrywide average**.

Although the average collision claim in Michigan is less expensive than the average collision claim countrywide, Michigan drivers make more collision claims, on a per-capita basis, than drivers in any other state.

*** Recommendations**

The report recommends that the Department specify a standard methodology for insurers to use in calculating and reporting their estimated future no-fault claims payments, so that the true profitability of each insurer's no-fault business can be determined on an apples-to-apples basis. The report also recommends that the MCCA be required to make public the assumptions, estimates and projections on which the surcharge it assesses each year is based, and that the Director be empowered to disapprove the surcharge if she finds it excessive. Finally, the report recommends that the legislature determine whether, due to the availability of multiple types of coverage that pay for the same damage, or due to any other reason, Michigan drivers are paying excessive rates for collision coverage.

Introduction

This report is a follow-up to our May 2007 report entitled "An Analysis of the Profitability and Performance of the Michigan Auto Insurance Market." That report was based primarily on data from State Farm, AAA, and Allstate, who at that time were the three leading auto insurers in Michigan. Since that time, Auto-Owners has replaced Allstate as the third largest auto insurer in Michigan, and both AAA and Allstate have acquired additional insurers and have shifted business among their affiliated companies. Rather than focus solely on AAA, State Farm, and Allstate, therefore, this report looks at the Michigan auto insurance market as a whole, and also discusses company-specific data for the ten leading auto insurers in Michigan, who together account for 83% of the Michigan auto insurance market.

First, this report briefly explains the Michigan auto insurance market, and in particular what makes the Michigan market different from all other auto insurance markets. Second, it analyzes the profitability of the Michigan auto insurance market to the extent possible based on the data that exists. Third, it explains why calculating auto insurance profitability in Michigan is so difficult, with particular emphasis on the Michigan Catastrophic Claims Association (MCCA) and its effects. Finally, it makes recommendations that could facilitate the calculation of Michigan auto insurance profitability, could give the public a more accurate picture of the Michigan auto insurance market, and could potentially bring Michigan auto insurance rates down.

I. The Michigan Auto Insurance Market

Michigan is the only state in the union which provides lifetime no-fault auto insurance medical benefits. Thus, in Michigan all auto accident victims, including those seriously injured, can be reimbursed for all their resulting medical expenses by their own insurance company. All other states either do not enable auto accident victims to obtain any compensation from their own insurers, or severely limit such compensation.

In exchange for the no-fault benefits it provides, Michigan strictly limits the circumstances under which the injured person can sue the driver who caused the accident: Michigan allows such suits only if the injured person has suffered "death, serious impairment of body function, or permanent serious disfigurement." MCL 500.3135(1). In contrast, states without no-fault systems allow auto accident victims to sue regardless of the severity of the injury, and the other states with no-fault systems allow suits for much less serious injuries than Michigan does.

Importantly, although Michigan no-fault insurance covers all medical expenses, individual insurance companies are responsible for their injured policyholders' medical expenses only up to a certain level; above that level, the Michigan Catastrophic Claims Association is responsible. The MCCA is an organization created by the state, run by the industry--all auto insurers in Michigan are members--and funded by policyholders. Each year the MCCA's actuaries estimate the total medical costs over the lifetimes of seriously injured people covered by current policies that will exceed the level at which the MCCA begins paying. That level is now $530,000, up from $250,000 in 1978, when the MCCA was established. The MCCA then divides this amount by the number of insured cars in Michigan to arrive at a per-car surcharge.

Each auto insurer bills its policyholders for this surcharge, which becomes part of the premium the policyholder pays, and remits the surcharge amount to the MCCA.

For 2013-2014, the MCCA per-car surcharge was $186, up from $175 in 2012-13 and $145 in 2011-12. As will be discussed in this report, different insurers may treat the estimated payments the MCCA projects it will make in different ways for purposes of calculating their loss ratio, which is the percentage of the premium dollar the insurer projects it will ultimately pay out in claims. All other things equal, the lower the loss ratio, the more profitable the insurer.

II. The profitability of bodily injury liability and no-fault coverage in Michigan

A. Data sources

Several different publications contain data on auto insurance profitability. They include the National Association of Insurance Commissioners' (NAIC) Profitability by Line by State Report; the NAIC's Market Share Report; the NAIC's Auto Insurance Database Report; and the Auto Insurance Report published by Risk Information, Inc. of Dana Point, CA. This section analyzes profitability-related data for Michigan auto insurance from the most recent versions, as of December 31, 2014, ofall four reports.

1. The NAIC Profitability by Line by State Report

The NAIC Profitability By Line By State Report (hereinafter Profitability Report) sets forth profitability data for each line of business in each state in each of the last ten years. That data is valid and reliable, with one exception: the data for auto liability coverage--which in the Profitability Report includes no-fault coverage--for Michigan. The NAIC notes, in its Qualifications section of the report, that "The profit reported for Michigan auto liability is not meaningful because of data reporting anomalies arising from the data related to the Michigan Catastrophic Claims Association." Profitability Report at 384. This qualification appears in the

NAIC Profitability Report every year. As a result, the report, solely because of the absence of valid and reliable no-fault data from Michigan, has always been incomplete.

In addition, the 2012 NAIC Profitability Report contains an additional Qualification that makes Michigan no-fault data even less reliable and valid than it has been in past years:

> The private passenger and commercial auto liability and total lines were impacted by the correction of an error in the past treatment of ceded reinsurance on auto unlimited no-fault claims by several insurers in a major insurance group. Past unpaid claims were mistakenly reserved for on a net basis. The correction has no impact on net data, but does impact direct no-fault experience for Michigan and New Jersey.

Profitability Report at 385. Thus, while the NAIC Profitability Report enables us to determine the profitability of Michigan collision and comprehensive coverage, which is discussed in section III of this report, it does not enable us to determine the profitability of either liability coverage or no-fault coverage in Michigan.

<u>2. The NAIC Auto Insurance Database Report</u>

<u>a. Auto liability data</u>

The NAIC also publishes a report called the Auto Insurance Database Report each year which, notwithstanding the warning in the Profitability Report, does include profitability-related data for liability and no-fault coverage in Michigan. Unlike the Profitability Report, the Database Report sets forth separate data for bodily injury (BI) and no-fault coverage. With those types of insurance broken out separately, there is no reason to expect the data reported by Michigan insurers for bodily injury liability, separate and apart from no-fault data, to be inaccurate. The most recent Database Report contains data for the years 2007 through 2009. It indicates that in each of those three years, Michigan drivers paid a lower pure premium for bodily injury liability coverage than drivers in any other state but North Dakota, and paid far less than half the national average. Specifically, from 2007 to 2009 the countrywide pure premium was $142, $141, and $151; Michigan's was $57, $57, and $61 in those same years.

Michigan, Florida, New Jersey and New York all have no-fault laws with so-called "verbal thresholds"--laws that describe the type of injury for which injured people are permitted to sue, and thus that prohibit people from suing for lesser injuries. The contrast between Michigan's BI pure premium and the BI pure premium in the three other lawsuit-restricting states is particularly striking, as Table 1 shows:

TABLE 1
BI Coverage 2007-2009
Leading No-Fault States v. Countrywide
Pure Premium ($)

State	2007	2008	2009
Florida	206	220	255
Michigan	57	57	61
New Jersey	215	214	214
New York	205	212	216
Countrywide	142	141	151

As Table 1 indicates, the BI premium in the three other major no-fault states has consistently been well over three times the BI premium in Michigan. At the same time, as Table 2 indicates, the Michigan system has enabled auto insurers to earn substantially higher profits on BI coverage in Michigan than on BI coverage in those three states or in the nation as a whole: the Michigan BI loss ratio has always been far below the BI loss ratio in Florida, New Jersey and New York, and substantially below the countrywide average BI loss ratio.

TABLE 2
BI Coverage 2007-2009
Leading No-Fault States v. Countrywide
Loss Ratio (%)

State	2007	2008	2009
Florida	81.2	84.8	98.1
Michigan	65.1	69.7	73.6
New Jersey	78.2	82.3	83.4
New York	70.3	76.0	80.0
Countrywide	69.5	71.0	76.7

The Database Report also indicates that Michigan drivers sued less often than drivers in any other state, and that drivers countrywide were more than seven times as likely to sue as were Michigan drivers: between 2007 and 2009 bodily injury frequency for Michigan was 0.13, 0.13, and 0.14, compared to 1.01, 0.97, and 1.01 for the nation as a whole. The average amount paid per injury, on the other hand, was greater in Michigan than any other state--$42,462, $43,293, and $42,645 in Michigan compared to $14,087, $14, 532 and $14,907 countrywide. BI frequency and severity for Michigan and the other three major no-fault states is shown in Table 3:

TABLE 3
BI Coverage 2007-2009
Leading No-Fault States v. Countrywide
Frequency and Severity

State	Frequency (%)			Severity ($)		
	2007	2008	2009	2007	2008	2009
Florida	1.08	1.10	1.25	19,024	19,907	20,435
Michigan	0.13	0.13	0.14	42,429	43,283	42,628
New Jersey	0.65	0.67	0.73	33,131	32,073	29,401
New York	0.76	0.74	0.77	26,922	28,782	28,297
Countrywide	1.01	0.97	1.01	14,063	14,507	14,886

In short, the state-by-state data in the Database Report clearly demonstrate that, with respect to BI liability insurance, the Michigan auto insurance system is working exactly as it is supposed to work: it has reduced the rate of auto insurance lawsuits in Michigan to 1/7 of the national average, it has ensured that only serious cases go through the court system, it has reduced BI rates in Michigan to approximately 40% of the national average and less than 30% of the rates in the other major no-fault states, and it has enabled insurers to earn profits on BI coverage that substantially exceed the national average.[1]

b. Auto no-fault data

The picture in Michigan for no-fault auto insurance, on the other hand, is much less clear,primarily because of the data anomalies the NAIC emphasized in its Profitability Report, which are examined in more detail in sections IIB and IIC of this report. Nevertheless, the Database Report includes separate no-fault data. We review that data here for Michigan with the caveat that it should be viewed in light of both the NAIC's warning and the discussion in this report.

As noted above, Michigan is the only state that provides no-fault coverage for lifetime medical expenses. One would therefore expect the Michigan no-fault premium to be the highest in the nation, and it is, as Table 4 demonstrates:

[1] The Database Report also includes state-by-state data on property damage (PD) liability coverage. Notably, PD insurance in Michigan, unlike PD insurance in all other states, provides coverage only for damage to property Michigan drivers cause outside of Michigan. (A separate coverage, Property Protection Insurance or "PPI" coverage, covers property damage Michigan drivers cause within Michigan. The Database Report does not include data for this type of coverage.) Not surprisingly, the pure premium for the limited property damage liability coverage in Michigan is by far the cheapest in the nation--approximately $8 in 2007, 2008, and 2009, compared to a countrywide average PD pure premium of $112-$114. The national property damage liability premium was thus approximately 12 times that in Michigan. Also not surprisingly, since Michigan PD coverage pays only in connection with out-of-state accidents, Michigan's PD frequency was also the lowest in the nation--for example, 0.39 compared to 3.88 in 2009. Its severity was also the lowest in the nation: $2,066 compared to $2,894 countrywide in 2009--although the out-of-state nature of the coverage would not seem to explain why. Interestingly, Michigan PD liability coverage was also the most profitable in the nation during the 2007-2009 time period: the Michigan loss ratio varied between 50 and 52, whereas the countrywide loss ratio varied between 75 and 76.

TABLE 4
No Fault Coverage 2007-2009
Leading No Fault States v. Countrywide
Pure Premium ($)

State	2007	2008	2009
Florida	162	153	191
Michigan	306	328	348
New Jersey	246	250	252
New York	146	163	173
Countrywide	124	125	137

Interestingly, however, the difference between the Michigan no-fault premium in states that offer dramatically lower no-fault medical benefits is perhaps not as great as one would expect: in Florida, for example, drivers in 2009 paid $191 a year for no-fault benefits that cut off at $10,000. For about another $150 a year, drivers in Michigan receive lifetime medical benefits.

The loss ratio Michigan auto insurers reported on their no-fault coverage was also higher than the national average, although in 2009 it was lower than the loss ratios auto insurers in both Florida and New Jersey reported. Interestingly, however, as Table 5 indicates, the difference between the countrywide and Michigan reported loss ratios for no-fault coverage substantially narrowed in 2009: the difference was almost 12 points in 2007, and almost 15 points in 2008, but less than 9 points in 2009.

TABLE 5
No Fault Coverage 2007-2009
Leading No Fault States v. Countrywide
Loss Ratio (%)

State	2007	2008	2009
Florida	79.7	77.7	101.4
Michigan	95.2	100.5	101.1
New Jersey	117.1	112.2	107.0
New York	76.7	86.8	88.1
Countrywide	83.2	85.3	91.9

One would also expect, based on its lifetime medical no-fault benefits, that Michigan's severity--average payment per claim--on no-fault coverage is the highest in the nation, and as Table 6 indicates it is. On the other hand, Michigan's frequency was the second lowest in the nation--its .80 was less than half the countrywide frequency of 1.80, almost exactly half of New Jersey's 1.63, and only about a third of Florida’s and New York’s.

TABLE 6
No Fault Coverage 2007-2009
Leading No Fault States v. Countrywide
Frequency (%) and Severity ($)

State	Frequency (%)			Severity ($)		
	2007	2008	2009	2007	2008	2009
Florida	2.41	2.30	2.57	6,691	6,636	7,447
Michigan	0.84	0.83	0.80	36,526	39,509	43,342
New Jersey	1.41	1.41	1.63	17,430	17,713	15,437
New York	2.31	2.35	2.35	6,299	6,922	7,358
Countrywide	1.76	1.73	1.80	7,049	7,262	7,583

To sum up: the no-fault loss ratio and severity data, and to a lesser extent frequency data, should not be relied on, for the reasons explained in sections IIB and IIC of this report. Nevertheless, the Database Report compiles Michigan no-fault data, and therefore we have included that data in this report.

3. The NAIC Market Share Report

The NAIC publishes another report, the Market Share Report, which sets forth loss ratio data for the ten leading insurers in each line in each state. Like the NAIC Profitability Report, it sets forth combined data for liability and no-fault coverage, and also separate data for physical damage coverage. The Market Share Report enables us to determine whether the loss ratios Michigan auto insurers report are likely to be accurate. Notably, the top 10 auto insurance carriers whose data is compiled in the Market Share Report all provide the same coverage, and have large enough books of business so that the mix of risks they attract is not likely to differ dramatically. Their loss ratios, therefore, can reasonably be expected to be reasonably close to each other. For physical damage coverage the loss ratios of the top ten carriers are in fact reasonably close to each other, in all states. To take a few examples, for Michigan and its two closest neighbors alphabetically--Massachusetts and Minnesota-- the difference between the highest loss ratio and lowest loss ratio of the top ten carriers for physical damage coverage in 2012 was 26 points or less: 25 points in Massachusetts, 26 points in Michigan, and 19 points in Minnesota, as Table 7 indicates.

TABLE 7
Private Passenger Auto Physical Damage – 2012 Loss Ratios of Top Ten Carriers

STATE		GROUP/COMPANY	EARNED PREMIUMS	LOSS RATIO	MARKET SHARE %	(%)CUMULATIVE MARKET SHARE
Massachusetts	1	Mapfre Ins Grp	469,286	55.72	27.90	27.90
	2	Liberty MutGrp	218,802	61.05	13.87	41.77
	3	Safety Grp	169,756	61.04	10.55	52.32
	4	Arbella Ins Grp	136,893	58.35	8.37	60.69
	5	Plymouth Rock Ins Grp	98,066	57.89	6.16	66.85
	6	Metropolitan Grp	75,853	50.79[2]	4.62	71.48
	7	AmicaMutGrp	57,302	61.56	3.45	74.92
	8	Travelers Grp	63,618	61.31	3.43	78.36
	9	The Hanover Ins Grp	52,692	55.63	3.28	81.63
	10	Berkshire Hathaway Grp	47,574	75.63[1]	3.05	84.68
Michigan	1	Automobile Club MI Grp	482,748	62.36	18.83	18.83
	2	State Farm Grp	382,253	76.44[1]	15.66	34.49
	3	Auto Owners Grp	273,401	65.94	11.00	45.49
	4	Allstate Ins Grp	217,520	52.84	9.27	54.76
	5	The Hanover Grp	185,101	62.55	7.58	62.34
	6	Progressive Grp	157,478	66.01	6.52	68.86
	7	Michigan Farm Bureau Grp	114,966	69.49	4.70	73.56
	8	Zurich Ins Grp	90,903	70.75	3.61	77.17
	9	Liberty MutGrp	80,781	50.53[2]	3.58	80.75
	10	Frankenmuth Grp	66,009	59.20	2.51	83.27
Minnesota	1	State Farm Grp	274,137	64.74	23.93	23.93
	2	American Family Ins Grp	140,445	51.98	12.15	36.08
	3	Progressive Grp	130,278	69.64[1]	11.51	47.59
	4	Zurich Ins Grp	93,293	54.13	8.01	55.60
	5	Allstate Ins Grp	61,913	43.44[2]	5.42	61.02
	6	Liberty MutGrp	36,937	50.44	3.44	64.47
	7	Auto Owners Grp	40,094	59.78	3.40	67.86
	8	United Serv AutoAssnGrp	33,551	59.13	2.94	70.80
	9	Automobile Club MI Grp	34,498	58.61	2.91	73.71
	10	Nationwide Corp Grp	26,227	59.18	2.31	76.02

[1] Highest Loss Ratio
[2] Lowest Loss Ratio

The maximum difference among carrier physical damage loss ratios in all other states is similarly modest. That is also the case for bodily injury liability coverage, which in the Market Share Report includes no-fault, in 49 states. In Michigan, however, the situation is starkly different, as shown in Table 8.

TABLE 8
Private Passenger Auto Liability – 2012 Loss Ratios of Top Ten Carriers

STATE		GROUP/COMPANY	EARNED PREMIUMS	LOSS RATIO	MARKET SHARE %	(%)CUMULATIVE MARKET SHARE
Massachusetts	1	Mapfre Ins Grp	655,559	66.30	26.66	26.66
	2	Liberty MutGrp	284,369	63.34	11.92	38.58
	3	Safety Grp	274,296	56.36	11.29	49.87
	4	Arbella Ins Grp	217,598	59.41	9.06	58.93
	5	Plymouth Rock Ins Grp	146,963	62.05	6.34	65.28
	6	Metropolitan Grp	113,377	56.34	4.58	69.85
	7	Travelers Grp	102,588	60.57	3.92	73.77
	8	Berkshire Hathaway Grp	85,859	52.84	3.81	77.58
	9	AmicaMutGrp	82,529	69.95[1]	3.46	81.05
	10	Progressive Grp	78,705	49.33[2]	3.39	84.44
Michigan	1	State Farm Grp	795,521	215.64	19.97	19.97
	2	Automobile Club MI Grp	684,739	236.31	17.17	37.14
	3	Auto Owners Grp	371,577	118.15	9.29	46.43
	4	Progressive Grp	351,689	81.38	8.65	55.08
	5	Allstate Ins Grp	280,155	355.67[1]	7.52	62.60
	6	The Hanover Grp	268,051	94.46	6.77	69.37
	7	Zurich Ins Grp	190,692	111.89	4.54	73.91
	8	Michigan Farm Bureau Grp	174,630	65.19	4.30	78.21
	9	Liberty MutGrp	98,490	30.84[2]	2.70	80.92
	10	Nationwide Corp Grp	106,914	186.17	2.58	83.50
Minnesota	1	State Farm Grp	366,462	57.01	22.33	22.33
	2	Progressive Grp	259,869	57.96	15.67	38.01
	3	American Family Ins Grp	185,583	46.54[2]	11.06	49.07
	4	Zurich Ins Grp	158,111	58.13	9.60	58.67
	5	Allstate Ins Grp	80,845	61.97	5.01	63.68
	6	Liberty MutGrp	49,215	54.90	3.18	66.86
	7	Berkshire Hathaway Grp	47,994	59.05	2.93	69.80
	8	Automobile Club MI Grp	49,350	80.41[1]	2.87	72.67
	9	Auto Owners Grp	43,403	62.37	2.66	75.33
	10	Nationwide Corp Grp	41,196	61.89	2.53	77.86

[1] Highest Loss Ratio
[2] Lowest Loss Ratio

As Table 8 indicates, the difference between the highest and lowest loss ratios for such coverage in Massachusetts and Minnesota was 21 points in Massachusetts and 34 points in Minnesota. Not including Michigan, the differential in all other states is of the same magnitude. In Michigan, however, the differential was 325 points: Allstate had a reported loss ratio of 355.67, while Liberty Mutual had a reported loss ratio of 30.84. A difference of that magnitude--325 points, or more than 1,000%--cannot be explained by true differences in loss experience. It can be reasonably attributed only to other factors. Those will be discussed in subsection C of this section.

4. The Risk Information, Inc. Auto Insurance Report

An organization called Risk Information, Inc. (RRI), in Dana Point, CA, compiles auto insurance data based on data originally published by SNL Financial. Table 9 shows the loss ratios for the ten leading Michigan auto insurance carriers between 2009 and 2011, as compiled by RRI.

TABLE 9
Leading Michigan Personal Auto Insurers
Groups Ranked by Total 2011 Direct Premium Written (000)

Group Name	2011 Premium	Mkt Share 2011	Loss Ratio 2011	2010 Premium	Mkt Share 2010	Loss Ratio 2010	2009 Premium	Mkt Share 2009	Loss Ratio 2009
Auto Club Insurance Assoc (Michigan)	$1,144,042	18.6%	77.3%	$1,102,113	18.8%	94.7%	$1,052,002	18.7%	91.8%
State Farm Mutual	$1,113,546	18.1%	276.9%	$1,088,683	18.5%	199.0%	$1,064,279	18.9%	174.2%
Auto-Owners Insurance Co.	$622,526	10.1%	97.5%	$592,103	10.1%	80.8%	$560,919	9.9%	151.6%
Progressive Corp.	$502,989	8.2%	78.6%	$490,220	8.4%	102.2%	$477,725	8.5%	123.8%
Allstate Corp.	$455,766	7.4%	159.5%	$419,682	7.2%	88.8%	$392,047	7.0%	88.8%
Hanover Insurance Group Inc.	$438,269	7.1%	80.8%	$436,789	7.4%	89.1%	$392,047	7.0%	88.8%
Michigan Farm Bureau	$278,424	4.5%	72.2%	$250,361	4.3%	67.5%	$233,681	4.1%	93.5%
Farmers Insurance Group	$242,872	3.9%	87.3%	$177,238	3.0%	78.1%	$187,679	3.3%	78.0%
Liberty Mutual	$159,658	2.6%	106.1%	$143,092	2.4%	48.6%	$131,543	2.3%	65.0%
Frankenmuth Mutual Insurance Co.	$155,658	2.5%	75.1%	$140,797	2.4%	71.6%	$120,002	2.1%	65.4%
Nationwide Mutual Group	$151,274	2.5%	459.5%	$158,952	2.7%	168.6%	$ 181, 305	3.2%	172.9%

The loss ratios in Table 9 are the companies' loss ratios on all their business combined. However, because the insurers' loss ratios on physical damage coverage and liability excluding no-fault are all within a narrow range, the combined loss ratios reflect almost entirely differences in no-fault ratios. Those loss ratios clearly do not reflect reality, for two reasons. First, just as with the 2012 data in the NAIC's Market Share Report, the variation in loss ratios between similar companies of similar size in the same business is simply too great to be explained by differences in risk selection or quality of operations. For example, State Farm and AAA have consistently been the two largest auto insurers in the Michigan market, with approximately 18% of the market and more than $1 billion in premium. They each have reputations as well-run companies. Yet in 2009 State Farm's loss ratio was almost twice AAA's, in 2010 it was more than twice AAA's, and in 2011 its loss ratio of 276.9% was more than three times AAA's 77.3%. It strains credulity to believe that State Farm's true loss experience was more than three times as bad as Auto Club's.

Even greater differences in the reported loss ratios of two other almost-identically sized companies exist. For example, Frankenmuth Mutual and Nationwide Mutual each account for approximately 2.5% of the Michigan auto market and wrote a little over $150 million in premium in Michigan in 2011. Yet in 2009 and 2010 Nationwide's reported loss ratio was more than twice as high as Frankenmuth's, and in 2011 it was more than six times Frankenmuth's. It is not realistic to believe that those two similarly-sized, well-established auto insurers have true loss experience that differs by 600%.

There are also year-to-year differences in loss ratios of the same company that can not truly reflect real differences in loss experience. For example, Allstate reported a loss ratio of 88.8 for both 2009 and 2010, but then a loss ratio of almost double that level--160--in 2011.

Conversely, Auto Owners reported a loss ratio of 152 in 2009 but the following year reported a loss ratio of barely half that--81. Given the large premium volume written by each company it is not reasonable to believe that either company's true loss experience has changed in one year to the extent indicated by its reported loss ratio.

B. Possible explanations for unrealistic Michigan auto no-fault insurance loss ratios

The most striking aspect of all the Michigan auto insurance data is the dramatic difference in the loss ratios Michigan auto insurers report on their no-fault coverage. The magnitude of those differences is unique in the United States. Possible explanations include the following:

*Some companies appear to include the amount that the MCCA is responsible for--any amount exceeding $530,000 per claim--while other companies don't. As a practical matter, they shouldn't, since the amounts for which the MCCA is responsible are paid for by a surcharge which drivers, not insurers, ultimately pay. On the other hand, as a technical legal matter the insurer is liable to the MCCA for the surcharge the insurer requires its insureds to pay. Some insurers may therefore be using that as a rationale for characterizing losses the MCCA pays as their own estimated losses, thus increasing the estimated losses they report, which increases their loss ratios.

* Some insurers may treat the per-car surcharges they pass through to their policyholders differently than other insurers. For example, even though they collect the surcharge from their policyholders some insurers may treat it as a loss.

* Some insurers may change accounting methods from year to year--e.g., in one year they may not include projected amounts that are the responsibility of the MCCA, whereas in the next year they may.

* Some insurers may change their reserving methodology to reflect changes in the MCCA's reserving methodology. For example, Risk Information found that in the early 2000's insurers increased their reserves--and thus reported higher loss ratios--to "reflect changes in MCCA catastrophe loss modeling." The MCCA may have changed its reserving methodology in other ways since then, and individual insurers may have changed their reserving practices to reflect those changes too.

Due to the above factors, and possibly others, reported loss ratios will continue to vary wildly among companies and to have little relation to reality unless and until the Department mandates a specific loss reserving and reporting methodology that all insurers must follow.[2]

C. How MCCA Over-reserving Distorts Auto Insurers' Loss Ratios

Because drivers pay for claims for which the MCCA is responsible through a surcharge based on the MCCA's estimated future payments that becomes part of the premium, these estimated payments have a significant effect on each policyholder's premium. If the MCCA's estimate turns out to be too low, then premiums will have been too low; conversely, if the MCCA's estimate of its future payments turns out to be too high, then premiums will have been too high.

Notably, even under the best of circumstances, and assuming all good faith, the MCCA has a difficult job. Its ultimate payments are dependent, for example, on how long each seriously injured person is going to live; on the type of care that person will need for the rest of his or her

[2]A standard reserving and reporting methodology would not, however, ensure non-excessive rates, since the Department has no practical authority to disapprove excessive rates. Unlike in most states, in Michigan the commissioner may disapprove a rate increase, regardless of how high it is or how high a rate of return it produces, only if "a reasonable degree of competition does not exist" in the market. MCL 500.2109(1)(a). Because many different auto insurers do business and have always done business in Michigan, that standard has never been met and could not be met. Moreover, even if the commissioner were somehow to find rates excessive, he has no authority to order refunds to policyholders who paid excessive rates. MCL 500.2114(2).

life; on the cost of that care; and on technological advances that may occur, and the extent to which they raise or reduce costs. In addition, actuaries tend to be conservative, in the sense that they prefer to err on the side of collecting too much premium rather than too little. That tendency is likely to be particularly strong when both the magnitude and timing of the company's liabilities are so uncertain, as is the case with the MCCA.

It is not surprising, therefore, that the Annual Statement filed by the MCCA contains data indicating that the per-car surcharge assessed by the MCCA each year has consistently been excessive. Specifically, Schedule P in that Statement sets forth the amount the MCCA in the year it collects the premium estimates that it will ultimately pay out for all claims that arise in that year, and then also sets out revised estimates, made in each of the next nine years, of its ultimate payments for claims arising in the initial year. Schedule P thus allows the reader to determine how accurate the MCCA's initial estimates of its ultimate liabilities have been.

Table 10
MCCA:
Initial Incurred Loss Estimates v. 2013 Incurred Loss Estimates
(in $billions)

Year	Initial Estimate of Incurred Loss for Year	2013 Estimate of Incurred Loss for Year	Difference in Dollars	Difference in Percent
Prior	36.941	36.883	- .058	-0.2
2004	3.840	3.181	- .659	-17.2
2005	5.015	2.848	-2.167	-43.2
2006	4.960	3.688	-1.272	-25.6
2007	5.356	3.651	-1.705	-31.8
2008	4.979	3.356	-1.623	-32.6
2009	4.760	3.571	-1.189	-25.0
2010	4.848	3.853	- .995	-20.5
2011	5.874	3.826	-2.048	-34.9
2012	5.478	4.831	- .647	-11.8
Totals:	**82.051**	**69.638**	**-12.363**	**-15.1**

As Table 10 indicates, over the long run--since the inception of the MCCA--the MCCA's initial estimates of its ultimate payouts have been proving to be 15.1% too high. (Based on the data available today, the MCCA's initial estimates for 2011, 2008, 2007, and 2005 are proving to be even more inflated--by 34.9%, 32.6%, 31.8%, and 43.2%, respectively.)

The premium Michigan drivers pay for no-fault insurance are therefore likely to also be too high, for two reasons. First, if the MCCA's initial estimates of its ultimate liabilities are proving to be 15% too high, then the surcharge which is calculated based on those estimates must also be 15% too high. Second, some insurers appear to be including liabilities for which the MCCA is responsible--those exceeding $530,000 per claimant--in their own loss estimates. Excessive MCCA-estimated losses thus result in excessive estimated losses for those insurers, who shouldn't be including MCCA estimates as part of their own estimates in any event.

Due to the MCCA's substantial impact on the loss ratios Michigan auto insurers report and its having kept the assumptions, estimates, and projections on which its surcharges are based non-public, there now seems to be a consensus across the political spectrum that the MCCA should change. For years consumer groups have called for the MCCA to disclose the data on which it relies to justify its surcharge, and CPAN has filed a court challenge seeking to make such data public. More recently, conservative organizations have also been calling for reform of the MCCA. One such organization, the Heartland Institute, explains the MCCA in this way:

> Although run almost entirely by the insurance industry itself and operating without any real government oversight, the MCCA is still a creature of state law and often involved with politics. It deserves further study, and all options—including privatization and abolition—should be considered.

The Heartland Institute recommends either making the MCCA an arm of state government or privatizing it. As an arm of state government it would be subject to open records laws, and the assumptions, estimates, and projections it uses to make rates would be public. If privatized, it would pay the same taxes as any other co-op, would follow the same laws, would be unable to compel insurer participation, and would have no involvement with politics. Whatever happens, the Heartland Institute concludes, "the MCCA should change; the current situation makes very little sense." The Heartland Institute, Michigan Auto Insurance Reform: The Case for Choice and Consumer Power, at 21-22 (June 2010).

III. The profitability of physical damage coverage in Michigan

Unlike no-fault coverage, the true profitability of Michigan physical damage coverage--collision and comprehensive--can be determined from the NAIC's Profitability Report. That report sets out both the loss ratio and rate of return on physical damage insurance for each of the last 10 years in each state and for the nation as a whole. By either measure, physical damage coverage in Michigan is slightly less profitable than it is countrywide: as Table 11 indicates, the Michigan loss ratio over the last 10 years was 61.9%, compared to 58.7% countrywide, and the

Michigan rate of return was 10.7%, compared to 11.7% countrywide. The profitability of auto physical damage coverage in Michigan is therefore in line with, although slightly lower than, the national average.[3]

TABLE 11
Physical Damage Profitability: Michigan v. Countrywide (2002-2011)

		Michigan	**Countrywide**
Loss Ratio (%)	2002	66.7	62.0
	2003	61.1	58.3
	2004	56.7	53.4
	2005	59.3	56.7
	2006	58.3	55.8
	2007	62.3	58.1
	2008	65.4	60.9
	2009	62.3	58.2
	2010	61.1	58.5
	2011	66.0	64.7
	AVG	61.9	58.7

		Michigan	**Countrywide**
Rate of Return (%)	2002	7.3	9.1
	2003	15.2	14.7
	2004	20.2	19.2
	2005	14.9	15.3
	2006	15.1	13.9
	2007	9.3	11.5
	2008	4.5	7.5
	2009	8.5	10.2
	2010	9.4	10.4
	2011	2.7	4.9
	AVG	10.7	11.7

The NAIC's Database Report also contains data for physical damage coverage broken out separately for collision coverage--damage caused by another vehicle--and comprehensive coverage--damage caused by non-collision events such as contact with an animal, vandalism, or falling objects. For collision coverage, Michigan's $287 pure premium was the third highest in the nation in 2007 (behind Louisiana and Washington, DC), and its $296 and $289 in 2008 and 2009, respectively, were almost 50% higher than the countrywide average.

[3] The NAIC Profitability Report also contains additional detail for physical damage coverage for the most recent year covered by the report--2011--both for Michigan and countrywide. Those data show that in 2011, physical damage insurers in Michigan were slightly less efficient than countrywide: they spent 9.9 cents and 17.2 cents of the premium dollar on loss adjustment expenses (primarily claims adjusters' and defense lawyers' fees) and selling expenses (primarily agents' commissions), respectively, compared to 9.6 cents and 17.1 cents countrywide. On the other hand, they paid substantially less in taxes, licenses and fees than did physical damage insurers countrywide: the countrywide average was 2.2% of premium, whereas Michigan insurers paid only 1.5%. Further, Michigan physical damage insurers paid less in dividends to their policyholders than the countrywide average: the countrywide figure was 4/10 of 1%, whereas in Michigan it was 1/10 of 1%.

One might reasonably expect a high collision premium to be the result of such factors as a high accident rate, high traffic density, and high auto repair costs. The NAIC Database Report, however, indicates that Michigan's traffic density is just slightly above the national average, and that its accident rate and auto repair costs are substantially below the national average. Those factors therefore do not explain Michigan's high collision rate. It may be, however, that in Michigan collision coverage pays for some of the costs that property damage liability pays for in non no-fault states: notably, both Michigan and the other major no-fault states have relatively high collision premiums, as Table 12 indicates.

TABLE 12
Collision Coverage 2007-2009
Leading No Fault States v. Countrywide
Pure Premium ($)

State	2007	2008	2009
Florida	213	189	182
Michigan	287	296	289
New Jersey	228	223	225
New York	240	246	241
Countrywide	206	199	195

An additional wrinkle in Michigan that may contribute to the high collision premium is the choice drivers have among three different types of collision coverage: broad collision, which has no deductible if the other driver is at fault; standard collision, which has a deductible regardless of who is at fault; and limited collision, which covers the driver with no deductible if he is not at fault, but provides no coverage if he is at fault. It is possible that the availability and structure of these different coverages, and their associated transaction costs, has also raised the cost of collision coverage in Michigan.

Another interesting aspect of Michigan's collision coverage is its high frequency and low severity, as shown in the following table:

TABLE 13
Collision Coverage 2007-2009
Leading No Fault States v. Countrywide
Frequency (%) and Severity ($)

State	Frequency (%)			Severity ($)		
	2007	2008	2009	2007	2008	2009
Florida	5.95	5.54	5.44	3,581	3,407	3,343
Michigan	9.11	9.49	9.49	3,150	3,119	3,050
New Jersey	5.65	5.77	5.95	4,043	3,867	3,784
New York	6.08	6.20	6.37	3,940	3,970	3,792
Countrywide	6.04	5.88	5.79	3,414	3,392	3,369

Michigan's high frequency and low severity is exactly the opposite of its low frequency and high severity for no-fault coverage. That is consistent with the theory that Michigan collision coverage pays for costs that in other states is paid for by PD liability coverage.

Finally, as Table 14 indicates, Michigan collision coverage has consistently been less profitable than the countrywide average, while its relationship to profitability in the other no-fault states has varied.

TABLE 14
Collision Coverage 2007-2009
Leading No Fault States v. Countrywide
Loss Ratio (%)

State	2007	2008	2009
Florida	74.7	67.4	67.8
Michigan	70.0	74.0	73.2
New Jersey	63.2	64.3	65.7
New York	72.6	74.3	72.2
Countrywide	68.6	67.5	67.0

Unlike the case with no-fault and collision coverage, whether or not a state has a no-fault system does not appear to be correlated with the level of comprehensive rates. This makes sense: whether a driver hits a deer, or has his radio stolen, or finds his car damaged by hail has nothing to do with the type of insurance system that exists in the state. Of the four major no-fault states, in 2009 the Florida comprehensive premium of $61 and the New Jersey premium of $46 were both substantially lower than the countrywide average comprehensive premium of $79, whereas New York's $86 and Michigan's $103 premium exceeded the countrywide average. The states with the highest comprehensive premium were Colorado, Kansas, and South Dakota, all with premiums of more than $150, while the three states with the lowest comp premium were New Jersey at $46, Maine at $45, and Hawaii at $42. Michigan's loss ratio on comprehensive insurance was the 14th highest in the nation at 72.7, compared to a national average of 67.0.

IV. Recommendations

1. The Department should specify the methodology insurers should use in reporting their loss ratios in their Annual Statements filed with the Commissioner, as well as the methodology they should use in reporting to the MCCA. By mandating a standard reporting methodology, the Department could enable the public to know the true condition of the Michigan auto insurance industry. It could also enable the NAIC to publish a complete Profitability Report, covering all lines and all states, for the first time.

2. The Department should require the MCCA to make public the assumptions, estimates and projections on which its rates are based. The public would thereby obtain a more accurate picture both of the MCCA's true financial condition and of the profitability of no-fault insurance.

3. The legislature should give the Director the authority to disapprove excessive MCCA assessments to the extent that they are based on unreasonable or unjustifiable assumptions, which could reduce no-fault rates.

4. The legislature should determine the extent, if any, to which property damage liability (PD), property protection insurance (PPI), and collision coverage provide coverage for the same perils, and eliminate any redundant coverage, thus reducing total premiums.