DEPARTMENT OF TRANSPORTATION VIEWS ON AUTOMOBILE INSURANCE REFORM

ADDRESS BY CHARLES D. BAKER*

What did the Study show to be wrong with the present system? First, the liability insurance system has limitations in its coverage. Only those who can prove that others were at fault while they were not (or were less at fault) have a legal right to recover their full losses. What does this mean in fact? It means that in more than half the automobile accidents where someone was killed or seriously injured, no benefits were received from the tort liability system. In 10 percent of the cases nothing was received from any system of reparation.

Second, the system looks imbalanced in the way it distributes compensation losses. One would expect that the victim suffering the large economic losses would also have significant intangible losses. One would not anticipate, however, that this type of victim would have a poorer chance of being fully compensated — particularly for his economic losses — than the less seriously injured. Our Study indicates that this is, alas, the case. Only half the total compensable economic losses of seriously or fatally injured victims are compensated — only one third where losses exceed $25,000! Small economic losses fare much better — victims suffering under $500 damage recovered in total through the tort system four-and-one half times their economic loss. You may argue with some of the precise percentages cited here, but unless one is prepared to challenge the conclusions fundamentally, one is forced to the view that compensation is erratic.

And then there is efficiency. Unfortunately it seems that the system has a very high cost/benefit ratio. By our calculations, it costs a dollar to produce a dollar in net victim benefit. Put another way, one premium dollar out of every two does not go to the accident victims. Further not only is the system's cost efficiency in question, it appears that this benefit is poorly timed — it's either too late or too early! Despite commendable

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efforts on the part of the industry to introduce "advance" or partial payment plans, the system looks to be quite slow in providing benefit payments, particularly in terms of when they are needed.

One major problem with this is that there are indications that rehabilitation suffers because slowness of payment discourages early rehabilitative efforts. In fact, the system at times places a premium on deferment of payment beyond the time when rehabilitation could be most effective. Unfortunately, the payment looks to be slowest where the need is greatest — when victims suffer permanent impairment and disfigurement. Nor does the system encourage minimization of very large personal injury losses by the timely use of comprehensive rehabilitation programs for the seriously injured.

It is not just the victim who suffers. As it presently operates, the system places great strains on the insurance industry itself. For many companies, what once were underwriting profits, are turning to underwriting losses, and it's alleged by some that capital may actually be withdrawing from the market. Granted, the threat of capital withdrawal is not a new phenomenon, but actual withdrawal on a large scale would be. I don't think I have to point out to you people what a serious problem this would present, not simply to the industry but to the nation.

But what about the legal profession? The Bar? ALTA? The judiciary? Let me dwell on the latter! The judiciary is feeling the strain! At a time when other demands overburden our legal system, the judiciary handles more than 200,000 auto accident disputes a year — in terms of judge time alone, more than 17 percent of the country's total judiciary resources? Thus we place high demands on our already strained courts. If there is no better alternative — so be it — but, as I'll note in a minute, there is!

But before that, there is another "institutional" issue. Insurer insolvencies have been concentrated among specialty insurers serving the high risk market. This has presented complex problems for consumers, regulators, and the insurance industry in general. And the very complexity of the problem makes them so resistant to solution that they could lead to greater centralization and a loss of local initiative and freedom in insurance regulation.

So, what do we as a nation do? Nothing? I think almost everyone would agree that given the inadequacies of the present system, this is cer-

tainly no answer at all. We at DOT think that reform is clearly called for and just as clearly we are convinced that the objective of this reform should be no fault — not just first party — but a contract relationship between insurer and the policyholder which pays benefits when there is loss — regardless of where the fault lies. On this, we and many in and out of the industry — perhaps not all, but many nonetheless — are in accord. But how best to accomplish this? Here is where the going gets complicated! As you are probably aware, there is some difference of opinion about this. Senator Hart and Congressman Moss (among others) have recently proposed legislation that empowers the Federal government to mandate Federal standards for auto insurance and, in effect, also create an insurance "czar" who will execute most insurance regulation. The Administration's approach is different and places responsibility for establishing the principles of change with the Federal government but leaves the detailed implementation as well as regulation to the States. This is the plan that Secretary Volpe presented to Congress last month.

The Department fully endorsed the no-fault approach and urged the Congress to enact a "concurrent resolution" setting forth the basic principles of a reparations system toward which the States should strive, urging them to so move with dispatch!

Why the State approach? In the first place, this Administration is very strongly committed to the belief that the functions of government should be performed and the effective decisions of government made as close to the people as possible (in this case, at the State level). Is this a bad precept? In the face of the clamor for active citizen participation in practically every important issue, I hardly think so! Given the clear call by the electorate for responsibility in the hands of local officials that the electorate can see (and get at), this proposition cannot be dismissed. But some would have us be expedient! "Rise above principle!" Well, I don't think so!

The policy seems clear enough to me! If the States can do the job, then they should. If they cannot, or will not, then Washington has a call for pre-emption, but in my view not until then!

Now, it is our belief that the insurance institution and State regulation have been held at fault for what are really intrinsic inadequacies in the reparations system itself. States regulate now and can continue to do so. Under the present system, various states and regions of the country vary in terms of limits and deductibles. There are clear reasons why this should

continue. It would not be fair to impose the standards of New York City, say on Alaska or vice-versa. The States should be allowed to accommodate to their specific situations, given some overall principles for basic uniformity. Is it bad to recognize that Alaska is not New York? Hardly. Alaska is no more New York than Texas is Illinois. Broad similarity? Of course! Special differences? Who can argue that point?

I believe that the States will act, and act quickly. One State has already enacted a no-fault plan and at last count, 27 others had either submitted proposals or were thinking about doing so. And of course, if they don't move, it is certain that in some form the Federal government will. And can we all learn from the movements in the several States? I went to Harvard and yet even so I am not prepared to lay claim to all knowledge! As these fundamental changes come into play we can all learn!

In recent weeks there's been a lot of flak in the media concerning the various parties and proposals involved in the insurance reform controversy. There are those who fear that the predominance of the legal profession in the State legislatures will hinder any effective reform at that level, and others who feel that Federal pre-emption of State regulation of insurance is a clear violation of States' rights. One very vocal critic of the Administration position has had some rather pithy comments about the Department's position. So be it, public airing is good for all of us — even public hot airing!

Gentlemen, we are moving toward no fault! Everyone — the beleaguered legal profession and its courts, the consuming public, and the insurance industry itself — stands to benefit! And I believe that the States can and will step up to the challenge! When the tumult and the shouting dies, the lawyers and the actuaries depart — we'll see a new march forward in the vital industry we know as insurance.