



# Research Brief

## ***No-Fault Approaches to Automobile-Injury Compensation***

The subject of automobile insurance continues to provoke heated debate. A variety of interest groups have advanced conflicting claims about the pros and cons of fault-based and no-fault approaches to injury compensation. However, these claims are often difficult for policymakers and the general public to evaluate. These difficulties spring from two basic sources. First, widespread unfamiliarity with the features of the two different approaches clouds public discussion. The term *no-fault* itself breeds confusion, because it can apply to a wide range of compensation programs. Second, a lack of empirical research comparing alternative approaches has hampered policymakers' ability to weigh the likely effects of potential reform proposals. Most studies of no-fault have focused on a particular state's experience with a specific plan; absent from the public debate has been a systematic analysis of how no-fault would affect the cost and process of injury compensation.

### ***What If a State Adopted No-Fault?***

The ICJ has completed a study that estimates what would happen if a state switched to a no-fault approach to auto-injury compensation. Because those readers interested in the background and policy context may differ from those interested in detailed research results and the methodological issues associated with them, the ICJ has documented the results of the study in two separate reports. *No-Fault Approaches to Compensating People Injured in Automobile Accidents* (R-4019-ICJ) addresses a more technically versed audience. It presents the study's findings in

depth. These include detailed estimates of the effects of 21 different no-fault plans compared to the traditional fault-based approach. The report also describes the study's research methods and includes technical appendices showing estimates of how no-fault plans would affect specific states. A shorter companion piece, *No-Fault Automobile Insurance: A Policy Perspective* (R-4019/1-ICJ), reviews the policy debate, highlights the study's major findings, and outlines their policy implications. Addressed to policymakers and to general readers, the shorter report also anatomizes the design features of traditional and no-fault systems, defines key terms, and contrasts how the average injury case fares under the traditional system and under a sample no-fault plan.

The study estimates no-fault's effects on three outcomes:

- (1) The cost of injury compensation, including transaction costs (lawyer fees and claim processing);
- (2) Compensation compared to economic loss;
- (3) The timeliness of compensation.

In addition, the study examines how different no-fault plan designs would influence these effects and how these effects would vary between states. The study compares the actual experience of injured people in tort states with an estimate of how the same people would fare in a no-fault environment.

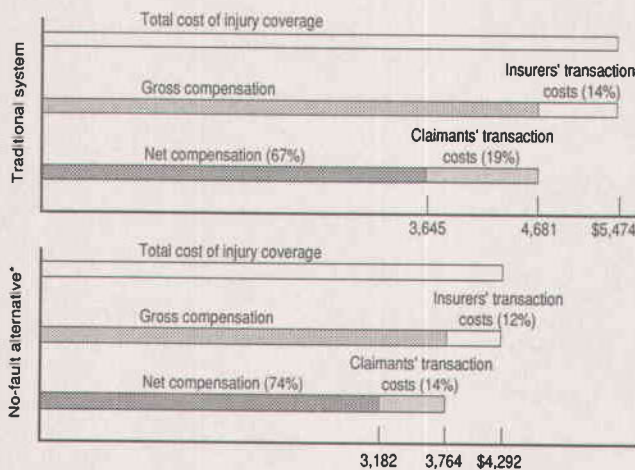
## No-Fault Can Save Money . . .

The study's main results:

- No-fault can reduce costs substantially compared to the traditional system, or it can increase costs. The net effect depends on the no-fault plan's provisions and the state's insurance environment.
- No-fault reduces transaction costs (lawyer fees and claim-processing costs) by approximately 20 to 40 percent.
- No-fault aligns injury compensation more closely with economic losses (medical costs, lost wages and other losses measured in monetary terms).
- No-fault generally speeds up compensation.

### . . . But a Typical Plan That Saves Also Reduces Compensation

Both reports illustrate the analysis by comparing in detail the effects of the traditional system and a sample no-fault plan. This no-fault plan reduces the total costs of injury compensation in the average case by 22 percent, including a one-third reduction in transaction costs. However, the no-fault plan also reduces take-home compensation by about 13 percent, from \$3,645 to \$3,182.



\*Verbal threshold, \$15,000 PIP benefit level.

### A Sample No-Fault Plan's Effects on Compensation and Transaction Costs

The sample no-fault plan also matches compensation more closely with economic loss. Under the traditional system, injured people with relatively low economic losses—below \$5,000—receive compensation that averages two to three times their economic loss. Injured people with much higher economic losses—\$25,000 to \$100,000, for example—receive compensation equal to just over half their economic loss, on average. Under the sample no-fault plan, less serious injury cases tend to recover amounts closer to their economic losses. People with less than \$5,000 in economic loss receive compensation that averages less than 1.5 times their economic loss. Those with more serious injuries (economic losses of \$25,000 to \$100,000) get back a slightly higher proportion of those losses.

### Policy Trade-Offs Are Inevitable

The critical trade-off in designing an automobile-injury compensation plan involves deciding how much to emphasize lower premiums versus preserving or increasing compensation. No-fault plans that reduce costs also reduce compensation to claimants with less serious injuries and have little effect on compensation for those with severe injuries. Plans that increase compensation to severely injured people tend to increase costs. Therefore, policy-makers choosing among the traditional system and no-fault alternatives confront difficult trade-offs in deciding whether to maintain the status quo, to cut costs, or to increase injury compensation.

The research summarized in this brief was carried out within RAND's Institute for Civil Justice. Research results are described in detail in R-4019-1CJ, *No-Fault Approaches to Compensating People Injured in Automobile Accidents*, by Stephen J. Carroll, James S. Kakalik, Nicholas M. Pace, and John L. Adams (239 pp., \$20). An overview of the policy context and research results appears in *No-Fault Automobile Insurance: A Policy Perspective* (R-4019/1-1CJ), by Stephen J. Carroll and James S. Kakalik, with David Adamson (23 pp., \$4).

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