

## Auto Insurance Reform for Canada's Tort Provinces

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Résumé de l'article

Parce qu'il est obligatoire et qu'il concerne la majorité de la population susceptible de conduire une automobile, il est dans l'intérêt de toutes les parties en cause de bénéficier d'un système d'assurance automobile efficace en termes de coût et de service. Bien qu'un système fondé sur la responsabilité en matière d'indemnisation des victimes d'accident fonctionne raisonnablement bien à l'égard d'un petit nombre de réclamants qui sont atteints de dommages sévères, il est moins efficace pour la majeure partie des victimes d'accidents ayant subi des dommages mineurs. Nous suggérons, dans cette étude, des moyens permettant aux régimes d'assurance de juridiction canadienne, dont l'indemnisation est basée sur la responsabilité, de contrôler les coûts et d'améliorer l'indemnisation des victimes d'accident. Les réformes que nous suggérons sont focalisées sur une meilleure coordination entre les secteurs publics et privés chargés des soins de santé ; sur l'établissement de bénéfices aux victimes, sans l'implication des tiers, ce qui permet de réduire les coûts du traitement de la réclamation sans augmenter les coûts d'ensemble ; sur la réduction ou la limitation du droit au paiement d'une indemnité en matière de dommages non pécuniaires découlant de blessures entraînant des séquelles non permanentes ; sur la recherche de mécanismes efficaces en matière de résolution des conflits ; et enfin sur la mise en place d'un système tarifaire qui est équitable du point de vue des assurés et qui est susceptible d'encourager la conduite prudente auprès des automobilistes.

## **Auto Insurance Reform for Canada's Tort Provinces**

**by Anne E. Kleffner and Norma L. Nielson**

### **ABSTRACT**

Due to its mandatory nature, and because a majority of the population drives, a cost-effective and efficient system of automobile insurance is in the interest of all parties involved. Although a tort system for compensating automobile accident victims works reasonably well for that relatively small number of claimants with serious losses, it does not work very well for the higher volume of relatively minor accidents. In this paper, we suggest means by which Canadian jurisdictions operating a system of tort liability can control costs and improve compensation for accident victims. Suggested reforms focus on improving coordination between public and private-pay aspects of health care; setting first-party benefits at a level which reduces the transaction costs without increasing aggregate costs; reducing or limiting access to payments for compensation for non-economic losses for non-permanent injuries; encouraging an efficient mechanism for dispute resolution; and developing a pricing system that is perceived to be fair by insureds while also providing incentives for safe driving.

**Keywords:** Automobile insurance; injury accident claims; non-economic damages; insurance price regulation; coordination between private payers and public health system; tort reform; no-fault insurance design; dispute resolution.

### **RÉSUMÉ**

Parce qu'il est obligatoire et qu'il concerne la majorité de la population susceptible de conduire une automobile, il est dans l'intérêt de toutes les parties en cause de bénéficier d'un système d'assurance automobile efficace en termes de coût et de

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service. Bien qu'un système fondé sur la responsabilité en matière d'indemnisation des victimes d'accident fonctionne raisonnablement bien à l'égard d'un petit nombre de réclamants qui sont atteints de dommages sévères, il est moins efficace pour la majeure partie des victimes d'accidents ayant subi des dommages mineurs. Nous suggérons, dans cette étude, des moyens permettant aux régimes d'assurance de juridiction canadienne, dont l'indemnisation est basée sur la responsabilité, de contrôler les coûts et d'améliorer l'indemnisation des victimes d'accident. Les réformes que nous suggérons sont focalisées sur une meilleure coordination entre les secteurs publics et privés chargés des soins de santé; sur l'établissement de bénéfices aux victimes, sans l'implication des tiers, ce qui permet de réduire les coûts du traitement de la réclamation sans augmenter les coûts d'ensemble; sur la réduction ou la limitation du droit au paiement d'une indemnité en matière de dommages non pécuniaires découlant de blessures entraînant des séquelles non permanentes; sur la recherche de mécanismes efficaces en matière de résolution des conflits; et enfin sur la mise en place d'un système tarifaire qui est équitable du point de vue des assurés et qui est susceptible d'encourager la conduite prudente auprès des automobilistes.

*Mots clés* : Assurance automobile; réclamations pour blessures découlant d'accident; dommages non pécuniaires; réglementation sur la tarification; coordination entre les systèmes publics et privés de soins de santé; réforme du régime fondé sur la responsabilité; concept d'une indemnisation sans égard à la responsabilité; règlement des conflits.

## INTRODUCTION

Increasing insurance settlements resulting in increasing insurance premiums have put the auto insurance debate in Canada front and centre. Attempts to decide what type of system is best for compensating those injured in auto accidents and who will pay the cost of those damages has remained unresolved for decades. Existing systems differ in terms of the role that fault plays in determining how claims are paid and in terms of what type of entity provides the insurance: the private insurance industry or a government crown corporation. In response to increasing costs and increasing consumer dissatisfaction, provinces that rely on a tort-based system for compensating auto accident victims turned their attention during 2002-2003 to proposals to reform their auto insurance systems. In this paper we describe the trends that have developed with regards to automobile insurance in the tort provinces and discuss a variety of measures that could be implemented in order to control costs and improve the efficiency of the system.

A key difficulty that arises in designing or reforming an auto insurance system is that different priorities result in different systems. Designing the best system in which auto accident claims can

be resolved requires first understanding that the design of the system inherently reveals the relative value placed on fairness, accountability, speed of settlement, and affordability. An important realization is that a “one-size-fits-all” system may not be the best available answer since there is a high frequency of relatively small automobile claims and a much smaller number of high severity claims. The fact that different parts of the Canadian population place fundamentally different values on the various objectives that may be seen as important in the system has produced the variability that exists in Canada’s system today. If one of the top priorities is to hold people accountable for causing harm, then the tort system could be considered the most appropriate. However, it is also generally perceived to be expensive and slow as a mechanism for compensating people. If quick settlement for economic losses is a top priority of the system, then a system focused less on fault and more on first party compensation may be more desirable. Or, if the top priority is to maximize the proportion of the system’s expenditures that reaches accident victims, a different system emerges as preferable.

## ■ TRENDS IN AUTOMOBILE INSURANCE

Several trends have contributed to recent cost increases in auto insurance, including limited global insurance capacity and rising prices for reinsurance. Some of these are well beyond the control of the Canadian insurance industry. Other trends, however, are intrinsic to the Canadian automobile insurance system. These are the focus of discussion in the remainder of this section.

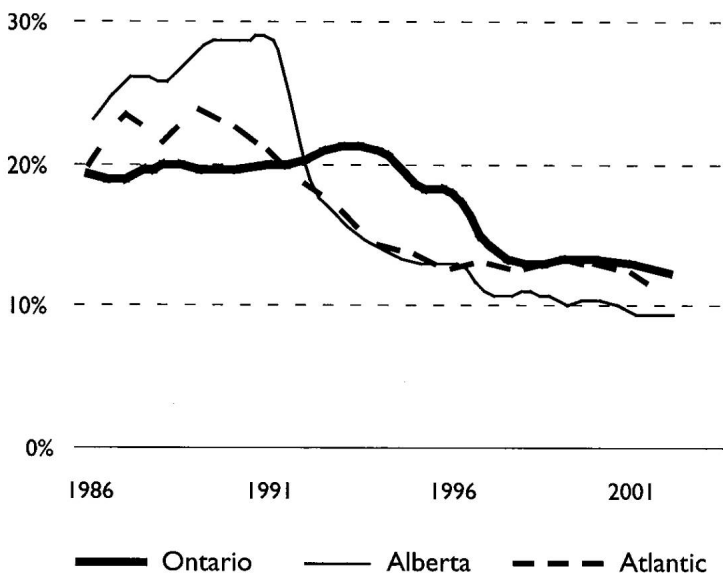
### □ Increasing Proportion of Injury Claims

Automobile insurance costs are related to a number of different factors. For example, increases in the average frequency and/or severity of automobile accidents would result in an increase in the aggregate cost of insurance. In contrast, reductions in the number of accidents would be expected to result in lower insurance costs. Figure 1 illustrates that the number of vehicle damage claims as a proportion of insured vehicles has declined substantially since 1991. Furthermore, the number of road fatalities has fallen from 6,061 in 1975 to 2,778 in 2001. Improvements in road safety and car safety are considered the key factors contributing to the achievement of these reductions. Despite an overall reduction in road fatalities and vehicle damage claims, the relative frequency of bodily injury claims

has been increasing at a pace faster than the growth in the number of cars on the road. In Alberta, for example, during the period 1986-2002 the number of vehicles with third party liability insurance increased from about 1.2 million to about 1.7 million, or 41 percent, yet the number of bodily injury claims increased 145 percent (from 7,844 to 19,190). During that same period the claim frequency per 100 vehicles for bodily injury claims increased from 0.65 to 1.12, yet the claim frequency per 100 vehicles for property damage claims decreased from 4.94 to 2.87 and the number of property damage claims decreased from 59,653 to 48,977 (Insurance Information Centre of Canada). The trend is easily observed in Figure 2 which shows the number of bodily injury claims has since 1991 been increasing steadily relative to the number of vehicle claims.

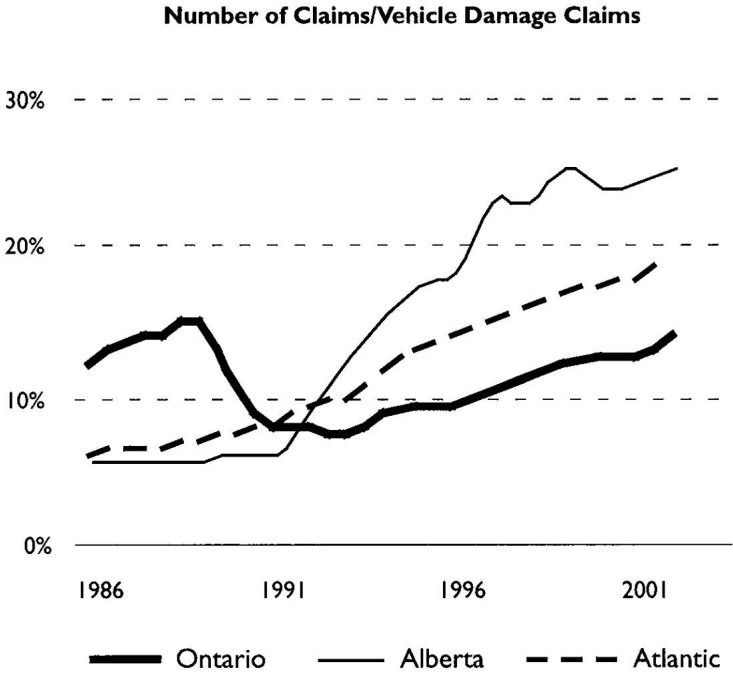
**FIGURE 1**  
**VEHICLE DAMAGE CLAIMS**

**Number of Claims/Insured Vehicles**



Source: Kovacs, 2003.

**FIGURE 2**  
**INJURY CLAIMS**



Source: Kovacs, 2003.

In addition to changes in the frequency of claiming, the severity of claims also is increasing. The claim costs for bodily injury losses in Alberta, expressed as a cost per insured vehicle, has increased from \$125.70 to \$421.85 or over 235 percent during the period 1986-2002. In comparison, the Consumer Price Index over that same time period increased by only 57 percent. In Nova Scotia the increase was from \$90 in 1986 to \$407 in 2002, or an increase of 350 percent compared to an increase of 50.3 percent in the CPI (Insurance Bureau of Canada).

In combination, the increased frequency and severity of bodily injury claims has significantly changed the make-up of auto insurers' total claim payments over the past decade. Whereas ten years ago the largest cost in the auto insurance system was repairing vehicle damage, now the cost of compensating accident victims for personal injuries is 50% higher than the cost of repairing vehicles. (Kovacs, 2003) This change in the composition of claims draws attention to

the importance of healthcare costs in the overall picture of auto insurance. Specifically, the Insurance Bureau of Canada (IBC) has reported that insurers in Alberta and the Atlantic region have experienced dramatic increases in medical and rehabilitation costs since 1990. The aggregate costs for these services have increased an average of 37% per year. While this statistic incorporates both price changes and utilization changes, it still provides a startling contrast to the 2.5% increase observed in general healthcare costs in Canada for the same period. The fact that such rates of increase are unsustainable offers one important indicator that the auto insurance system is in need of reform.

Reflecting these increasing costs, the premium increases have been substantial. Table 1 shows the change in average premium for 2001 and 2002 in all tort provinces with private systems of automobile insurance:

**TABLE I**  
**AVERAGE PREMIUM CHANGE**

	2001	2002
AB	4.3%	11.5%
NB	8.5%	16.1%
NFLD	4.3%	14.4%
NS	10.0%	18.5%
PEI	7.8%	12.8%

These increases followed a period of relatively stable prices from 1996 to 2000. Auto insurance premiums in Canada grew by 16% year-over-year during 2002 and exhibited an overall premium increase of 27% from 1997-2002. Insurers, who saw their payments for injury claims grow by 74%, not only implemented premium increases, but also were reducing or capping their exposure during that time (van Zyl, 2003).

A final indicator of difficulty in the auto insurance market is the increasing proportion of policies being placed in the Facility Association. During 2002, countrywide the market share increased by 62% over the previous year to 2.9% (van Zyl, 2003). The market shares of the Facility in each of the tort provinces for 2002 are shown below. For the Atlantic provinces, these numbers are nearly double the level observed in 2001.

**TABLE 2**  
**PROPORTION OF VEHICLES INSURED THROUGH**  
**THE FACILITY ASSOCIATION 2002**

AB	1.28%
NB	4.85%
NFLD	6.63%
NS	4.94%
PEI	6.53%

The increasing frequency of bodily injury claims, the increase in healthcare costs for auto insurers that greatly exceed general increases in healthcare costs, increasing premiums and increasing market shares of the Facility Association all help to illustrate that change is needed. Before discussing possible reforms, the next section delves into some of the factors that have contributed to the overall trends reported earlier.

## ■ **FACTORS CONTRIBUTING TO INCREASING PAYMENTS FOR INJURY CLAIMS**

A number of elements comprise the total cost of automobile injury claims. In addition to the frequency and severity of accidents, the aggregate cost of claims is also driven by the propensity of insureds to file claims and the amount they claim. Below we discuss four factors that have contributed to the recent increases in auto insurance costs. These are: increases in the cost of treating accident victims, changes in claiming behavior that have resulted in an increase in the proportion of bodily injury claims, resulting in an increase in the administrative costs and settlement amounts for those claims, an increase in the amounts paid out for non-economic damages (pain and suffering awards), and attorney involvement in auto claims.

### **Increasing Cost of Treating Accident Victims**

As cited earlier, the cost of treating those injured in auto accidents has risen dramatically. Furthermore, according to the IBC,



“medical services funded by insurers are typically more costly per treatment and require longer periods of recovery than those patients treated through either workers’ compensation or provincial medical plans.” Several factors contribute to auto insurers’ increasing expenditures for health care:

- Increases in the cost of medical services and supplies, i.e., the price per unit purchased.
- Increases in the number of units of health care purchased, caused either by an increase in the number of injuries or an increase in the quantity of health services utilized per injury.
- A shift in the treatment of auto accident claimants to include more privately delivered care. This shift, partially attributable to a reduction in the services covered under the public health system, can result in higher aggregate costs of treatment (Harris, 2000) because fee-for-service charges are incurred each time treatment is delivered outside the public system. This may be beneficial to the insurer if, for example, it reduces the time a disabled patient must wait for a diagnostic test such as CAT or MRI.

Since health care costs make up such a substantial proportion of aggregate auto insurance claims costs, a key objective must be ensuring that treatment is available to those injured in auto accidents in a manner that is comparable to what is provided to other citizens with similar injuries. Stated simply, the treatment costs and access for a patient presenting with a broken leg should be approximately the same, in all circumstances regardless of how the injury was caused.

#### **Increasing Propensity to File a Claim**

The evidence in the previous section demonstrates a clear trend toward more injury claims despite improvements in road safety. The ratio of injury claims to damage claims tripled over the past decade. In Alberta, it increased five-fold. These statistics suggest changes in the propensity of individuals to file such claims. This, in turn, may be attributed to a number of different factors:

- First, consumers may have a better understanding than in the past of the coverage provided by auto insurance and this could result in more legitimate claims from the same number and same types of accidents.

- Second, the increase in the proportion of injury claims may be driven by a decrease in the rate of filing of vehicle damage claims, either because fewer insureds carry collision insurance or those who do carry the coverage are less inclined to file vehicle damage (only) claims with their insurer.
- Third, the increase in the proportion of injury claims may be tied to reductions in public health care services. When those injured in auto accidents require care that is either not available in public hospitals or not paid by the public plan, it is necessary for them to find the money to pay out-of-pocket for such care. This results in more injury claims being paid by auto insurers; note, however, that to the extent those injuries were occurring previously and were being treated by the public health system, the observed increase would represent a change in measurement rather than a change in actual amounts expended.
- Finally, part of the increase may be explained by fraud. Insureds may be filing claims for non-existent injuries, or exaggerating injuries in order to receive accident benefits or compensation for pain and suffering.

Evidence of fraud and buildup is revealed in consumer attitudes. In Canada, 24 percent of survey respondents say they know someone who has submitted an exaggerated or fraudulent insurance claim (National Polling Analysis, 1998). In 1997, 41 percent of Canadians believed it was easy to cheat an insurance company and, despite massive media campaigns, 4 percent said it was acceptable. A 1996 study estimated general insurance (property and casualty) fraud across Canada cost \$1.3 billion a year. A recent report from an independent research study indicates that more than 26 percent of all personal injury insurance claims contain some element of fraud. For the year 2000 fraud in personal injury claims alone cost \$500 million (*Premeditated and Opportunistic Fraud in Personal Injury Claims, 2003*).

### **Non-economic Damages (Pain and Suffering)**

Persons injured in auto accidents may receive payment for both economic and non-economic damages. One factor that has contributed to the rapid increase in claim costs in both the Atlantic provinces and Alberta is the increase in frequency and size of payments for bodily injury claims including pain and suffering. Table 3 shows the increase in the average cost (claim payment plus loss adjustment expenses) per bodily injury claim over the period 1992-2002.

**TABLE 3**  
**AVERAGE COST PER CLAIM: BODILY INJURY**

	1992	2002
AB	24307	37574
NF	34586	42881
NB	26600	58160
NS	27755	53625
PEI	29621	49082

On average claim costs increased 71 percent over the ten-year period from 1992 to 2002. Although precise numbers on the portion of the increase due to payouts for pain and suffering are not available for all tort provinces, recent pain and suffering awards for a minor, non-permanent injury in Nova Scotia averaged about \$20,000 (Insurance Bureau of Canada). Such minor, non-permanent injuries account for the bulk of automobile insurance claims and have been identified by insurers as a major factor contributing to escalating costs. The accumulation of thousands of such claims results in noticeably higher costs within the system that must be distributed to all drivers.

#### **Attorney Involvement**

Research consistently finds attorney involvement to have significant explanatory power in predicting higher settlement values for claims. Indeed, this relationship has become so well known that Derrig and Weisberg (2004) refer to it as “conventional wisdom.” While precise data are not available on the extent to which the formal representation of claimants has changed over time, the cumulative effects of an increase in the number of practicing attorneys, attorney advertising<sup>1</sup>, growing consumer sophistication, and increased access to information via the Internet are all factors that influence the frequency of claimants consulting attorneys.

The understanding of the relationship between attorney involvement and settlement value is still preliminary, but research suggests the higher claim payment amounts likely result from a combination of (1) greater experience at negotiation, (2) additional expenses, and (3) asymmetric information. While the first of these possible is potentially consistent with achieving the objective of fairer compen-

sation; the other two are not. Results in Derrig and Weisberg (2004) support the argument that the attorney's involvement may serve to "anchor" the negotiations at a higher level.

## ■ **OPTIONS FOR AUTO INSURANCE REFORM FOR TORT JURISDICTIONS**

A wide range of reform measures are possible in tort provinces without undertaking any fundamental change to the underlying auto insurance system. In the search for opportunities to improve efficiency and fairness of the system, two key areas must be addressed. First, reducing costs – both administrative costs and claims costs – and second, regulatory issues that may serve to either improve or worsen the situation. Both are important for a well-functioning insurance market. In the remainder of this section we discuss possible reforms related to delivery of health care, to reducing costs of the tort system, and to the areas of regulation.

### □ **Issues Related to Delivery of Healthcare**

The provincial health care systems across Canada are large political entities not designed primarily for the treatment of auto accident victims. Ensuring that such a system has procedures and policies in place to deal with this specific minority of patients requires explicit attention.

#### **Improve Coordination between Public and Private-Pay Aspects of Health Care**

Canadians injured in auto accidents are inextricably tied to the public health care system. Still the public health system is not the sole provider of medical services to accident victims. An injury victim may choose to get services through the public system or at private clinics. Either way the auto insurance company pays. While that auto insurance company is obligated by government-imposed contract language to pay "all reasonable expenses incurred within two years from the date of the accident" (subject to available limits), it has little or no control over availability of needed services in the public system. And, even when services are readily available, it is not permitted to influence which provider will be selected by the patient.<sup>2</sup>

The auto insurance system should neither provide nor permit economic incentives to health care providers to prefer treating one

patient over another. Furthermore, within the system of privately delivered care, different payers may face different bills. A standardized approach should apply to private fee-for-service patients – including both auto accident claimants and workers compensation claimants. This objective could be achieved in more than one way. For example, given the mandatory nature of automobile insurance, the government could be justified in either (a) extending treatment guidelines and provincial fee schedules to apply when auto insurance pays or (b) adopting a fee-for-service model within the public sector that applies whenever public health services are consumed, including by automobile accident victims. Under either of these approaches, the system would encourage public and private providers of health care to compete for the business of insured patients on a “level playing field” and further require that competition be on two extremely rational bases – quality of care and price.

### **Emphasize Effective Rehabilitation and Early Recovery**

A top priority needs to be early access to medical care in order to facilitate a patient’s recovery. This is an area where no-fault provinces have an advantage over fault provinces. Changes are needed in tort jurisdictions to de-emphasize the necessity to resolve monetary compensation issues before medical care commences. Within a tort system change is needed that de-emphasizes the need to resolve monetary compensation issues before medical care can begin. For example, to overcome problems that arise when insurers delay decisions regarding the acknowledgement of fault, insurers in New South Wales agreed to, within a few days of receiving notification, provisionally admit liability for the first \$500 of treatment. This allows victims to seek medical treatment immediately when the most effective remedies can be implemented. Similarly, if Lloyd’s of London can issue a Standard Form of Salvage Agreement that is recognized worldwide to guarantee fair payment later for work to salvage sinking ships, why cannot auto insurers within a single province be part of a similar system to assure payment to health care providers?

Finally, a key to improving the coordination between the automobile insurance and the health care system is communication regarding future improvements. For example, one area of agreement found in two recent reports on health care reform in Canada (Mazankowski, 2001; Romanow, 2002) is that technology can contribute to improving the efficiency of the system. Whether ultimately achieved through the deployment of electronic data interchange (EDI)

or SmartCard systems, auto insurers should be included in the process of its design and should be assured access to the cost savings achieved by the technology and accompanying standardization.

## □ **Issues Related to Reducing Costs of the Tort System**

Aggregate costs in a tort system can be curtailed (1) by reducing the average amount paid on each claim, (2) by reducing the number of claims, and/or (3) by reducing the cost of resolving claims. This section explores possible mechanisms to achieve each of these types of changes.

### **Reduce Severity of Average Claim Settlement**

#### ***Reduce Payments for Non-economic Damages***

One of the most controversial features of the recent reforms proposed or adopted in Alberta and the Atlantic provinces is a cap on non-economic damages.<sup>3</sup> An important question to address regarding non-economic damages is what impact the availability of such damages has on people's claiming behavior and recovery. A study by Cassidy et al. (2000) examined the interaction between claiming behavior for auto accidents and treatment patterns. They studied 7,462 whiplash injury claimants<sup>4</sup> in Saskatchewan and examined claims that occurred before and after that province converted from a tort-liability to a no-fault system of compensation for automobile accident victims.

Cassidy et al. found the legislative elimination of compensation for pain and suffering to be associated with (1) a decreased incidence of whiplash, (2) an improved prognosis for those diagnosed with the injury, and (3) a significant reduction in the time required to close the claim, a proxy found in other studies for time to recovery. These Canadian results, while criticized by some (e.g., Freeman et al., 2000), are not an anomaly. Deyo (2000) summarizes the literature from other countries in the following quote from the editor's introduction to the topic in the *New England Journal of Medicine*:

"The credibility of the findings reported by Cassidy et al. is supported by the results of other studies. In 1987, the state of Victoria in Australia instituted a series of changes in response to a tripling of whiplash claims over a period of six years. Under the new policies, claims were allowed only if an accident was reported to the police, and the first \$317 of medical expenses was paid by the claimant. The first five days of lost earnings were non compensable, and only patients with serious impair-

ment could sue. By 1988, the number of claims had fallen by 68 percent. In Lithuania, few drivers have personal-injury insurance, disability compensation is rare, and public awareness of whiplash injury is low. In a retrospective cohort study conducted in Lithuania, persons who had been involved in rear-end collisions had no more neck pain or headache one to three years after the collision than a control group of uninjured persons.<sup>5</sup>

... The vast majority of claimants undoubtedly have real symptoms, but how these symptoms are labeled, evaluated, and treated may have important effects on their perceived severity and duration. The mere act of assigning a diagnostic label may increase illness-related behaviour, and many physicians believe that excessive testing leads to the conviction that one has a disease, as well as to anxiety and overreaction. Patients may choose to file insurance claims not only because of the severity of their symptoms or disability, but because of an inability to cope with symptoms, anxiety about their implications, and a conscious or unconscious desire for retribution.” (Deyo, 2000)

These results, if taken at face value, seem to indicate that improvements in health can be achieved at lower costs. However, cause and effect are difficult to define. Possible reasons for the improvement in health are that patients receive medical attention earlier, encounter fewer conflicting medical opinions, and suffer fewer depressive and stress-related problems that aggravate the initial injury when claim delays grow. Clearly, examining the evidence to determine what modification to the system has achieved improved health with less utilization of medical resources is worthwhile.

Setting limits for pain and suffering awards for minor injuries has been a controversial subject. If consumers are not willing to accept such limits as a method for controlling system costs, then passing any such reform is unlikely. However, evidence suggests that most consumers are willing to accept such a trade-off. A study conducted by Pollara Inc. in July 2003 surveyed Albertans regarding their awareness of the various factors surrounding rising auto insurance rates. According to their findings, 63% of Albertans would support limits on compensation for pain and suffering for minor, non-permanent injuries, while 21% advocate removing the option to sue for pain and suffering altogether.

If awards for pain and suffering are capped for minor injuries then one issue that has to be addressed is the definition of “minor injury.” In New South Wales, Australia, several different options were considered regarding non-economic loss awards. To achieve the desired level of savings, non-economic loss awards were eliminated for persons whose injuries do not exceed a ten percent permanent

impairment of the whole body. In addition, claims for economic loss do not include the first five days of loss of earnings; beyond that the loss is capped at net weekly earnings of \$2500(Au). Recent reform in New Brunswick, Nova Scotia, and PEI has established a \$2,500 cap for non-economic damages resulting from minor injuries; in Alberta the cap is \$4,000.<sup>6</sup> Whether or not such a dollar cap can remain effective and not be eroded remains to be seen.

### ***Coordinate Benefits***

Any time an accident victim experiences a disability that entitles him or her to collect from more than one source – e.g., workers compensation, employment insurance, CPP, employer-sponsored plans and/or personal insurance plans – the system must check carefully to assure that people are not rewarded financially for remaining disabled. It represents a significant moral hazard when injured parties are overcompensated and, therefore, have an incentive to make or extend a claim. To avoid the problems associated with overcompensation, it is recommended that any system established to determine personal injury awards take into consideration amounts recovered from such sources.

Though much of the public debate about auto insurance reform has ignored these provisions, the Alberta legislation (Bill 53) that will come into force on proclamation contains such coordinating language. It provides

- that awards for loss of earnings must be reduced by income tax (unless the award is subject to income tax), CPP contributions, and premiums for Employment Insurance and
- that damages be reduced by payment received by or on behalf of the claimant for “medical, dental, disability, rehabilitation, income continuation or replacement and hospitalization benefits paid on a no-fault basis and received by or on behalf of a resident of a jurisdiction other than Alberta under a contract of automobile insurance.”

The eventual effect of this type of change on system-wide costs is difficult to predict. However, auto insurers should experience a reduction in the average severity of income replacement claims.

The mechanism for implementing the new legislation will be that employer-sponsored benefit plans will likely be the first to pay several types of health care costs and income replacement benefits directly to covered workers following an auto accident. However, employers may be eligible to pursue reimbursement under the subro-



gation provisions of their plans. The employee will not be entitled to compensation for those amounts already covered. By reducing the likelihood of an individual having an opportunity to 'double dip', the system sees a corresponding reduction in the incentives to exaggerate the claim amounts or to malingering.

### **Reduce Volume of Third-Party Liability Claims**

The literature relates several factors to the frequency with which auto accidents become third-party claims. One important factor is the role of fault in determining compensation, especially in relatively minor accidents. Reducing or eliminating issues of fault and negligence from consideration in determining compensation directly reduces the number of third party liability claims that remain to be resolved and reduces loss adjustment expenses by a corresponding amount. This reduced complexity also reduces one of the reasons that people tend to seek attorney involvement and that, in turn, could further reduce adjustment costs.

An overall reduction in the volume of third-party claims can be achieved by increasing the level of first party accident benefits, restricting tort claims for minor injuries, or offering those in tort provinces the choice to give up some or all of their legal rights relating to automobile accidents and have no-fault coverage instead.

### ***No-Fault***

The most comprehensive reduction in third-party claims would be achieved by replacing the tort system with a system of no-fault. In essence such a shift would indicate that, at least in some instances, speeding up the system and potentially reducing its cost is more important than holding people accountable for their negligence.

No-fault systems can be one of three forms: pure, modified or add-on. Quebec and Manitoba have pure no-fault systems whereby persons injured in an auto accident may not sue an at-fault party under any circumstances. In exchange, they receive compensation for economic losses according to a schedule of benefits. In contrast, Ontario, Saskatchewan, and most U.S. states that have no-fault employ a modified no-fault system whereby a person may sue an at-fault party only if their injury meets a defined threshold. The threshold may be defined as either a *dollar threshold* or a *verbal threshold*. An add-on no-fault system provides for no exemptions from tort liability and imposes no limitations on recoveries for non-economic damages. First party coverages in this system augment existing tort-liability

coverages. All other provinces and territories, except Newfoundland and Labrador, were considered add-on jurisdictions until the recent caps were instituted for minor injuries.

Proponents of no-fault claim it reduces system costs, matches compensation more closely with economic loss, and results in more timely payment to injured parties. Whether these outcomes are achieved depends on the particular provisions of the plan. Generally, adopting no-fault has the following effects:

- A reduction in transaction costs because fewer liability claims need to be resolved.
- A reduction in amounts paid out for non-economic losses for injuries below the threshold.
- An increase in aggregate compensation costs for injury because more people are eligible for compensation.

The magnitude of savings, or indeed the materialization of savings, when no-fault replaces the traditional tort system depends on the threshold and level of benefits of the specific no-fault plan.<sup>7</sup> A number of studies have examined the effect of no-fault on the price of auto insurance and on the levels of victim compensation. The results of these studies are mixed, primarily because there is substantial variation among the provisions regarding the threshold and benefit levels. Cummins and Weiss (1998) review the research and conclude that no-fault plans, particularly those with stringent thresholds, reduce claim costs. Browne and Puelz (1996) reach a similar conclusion, and note that low dollar thresholds actually increase claim sizes. In the aggregate, a no-fault system likely reduces the transactions costs related to settling a claim, but this reduction often is offset by higher benefits for injured parties. For example, New York experienced a 20 percent increase in the average amount paid for personal injury protection claims in the year 2000. This is in contrast to a 6 percent increase in other no-fault states and is five times the medical care inflation rate for metropolitan New York (Insurance Research Council, 2001).

Whether no-fault reduces the system's cost depends in part on whether the system includes restrictions on claims for non-economic damages. According to Carroll and Kakalik (1991) the reduction in system costs is substantially higher for plans that prohibit claims for non-economic losses (a reduction of 80%) versus plans that allow claimants to sue for non-economic losses if seriously injured (a 20 - 40% reduction). Since transaction costs account for about one-third of total costs, the net reductions from the latter plans equate to approximately 10% of the total costs of injury compensation.

The experience in Canada is somewhat different than in the U.S. due to factors such as the presence of universal health care, a less litigious environment, and higher minimum automobile insurance coverage requirements. See Table 1 for details. Also, the incentive to claim for non-economic damages in Canada is distinctly different from the U.S. as the amounts awarded are more standardized, frequently limited, and not typically awarded as a multiple of economic damages. These differences are expected to affect both incurred losses and loss adjustment expenses. Regarding the former, given that large claims for pain and suffering are uncommon in Canada and since health care is available on a universal basis, the increase in incurred losses is expected to be less pronounced than in the U.S. if a province moves from tort to no-fault. Regarding loss adjustment expenses, the savings are expected to be less in Canada because of the less litigious nature of Canadians.

“Automobile Insurance in Canada: A Comparison of Liability Systems” (Kleffner and Schmit, 1999) provides evidence that no-fault has not reduced auto insurance costs in Canadian provinces but rather, aggregate costs actually increased due to very generous first-party benefits (for example, in Quebec and Manitoba there is no time or amount limit on medical payment benefits). A more recent study (Gunton, 2001) finds that threshold no-fault plans can reduce auto insurance rates by 22.8 percent, while a pure no-fault system can reduce rates by 39.2 percent. One-third of the savings are attributed to reduced transaction costs and the remaining two thirds to a reduction in non-economic losses.

Even if adopting no-fault does not reduce the aggregate costs of the system, it may still be preferable if claim settlement is quicker and if a larger share of economic losses are compensated. As explained by Carroll and Kakalik (1991), no-fault plans match compensation more closely with economic loss by increasing the fraction of economic loss that is compensated and by reducing the amount of compensation paid to people in excess of their economic loss. The pattern of compensation seen in the tort system (over-compensation of small losses, under-compensation of large losses) does not occur in no-fault. Rather, less serious injury cases tend to recover amounts closer to their economic losses, and more serious injury cases get back a higher proportion of their economic losses. In addition, no-fault plans generally speed up compensation which helps to facilitate recovery.

These changes are not without cost, however. Evidence suggests that no-fault insurance affects driving behavior and in fact produces more accidents and a higher fatality rate than observed in tort jurisdictions (Devlin, 1999; Cummins and Weiss, 1999). The

societal decision to adopt such a system signals a willingness to accept this trade-off for the more timely settlement of claims and the more equitable distribution of compensation.

### *Adjust the Level of Accident Benefits*

Even in jurisdictions that rely on a tort system of compensation for auto injuries, one section of the auto insurance policy provides some coverage for injuries without reference to fault – Accident Benefits (AB). Table 4 summarizes the limits and conditions for receiving AB in all provinces and territories. The effectiveness of AB in achieving the desired goals for a compensation system depends on both the level and administrative details of those benefits. Lower first party AB produces a greater number of third party liability claims. Savings may be achieved by increasing first party benefits because claims can be settled without relying on resolution of liability. However, a higher first-party benefit level increases system-wide costs by expanding the number of injured parties who are eligible for compensation.

Ideally, the benefit level should be set such that the reduction in transaction costs will cover the increase in injury payments.<sup>8</sup> This can be estimated by examining the population of auto claims involving bodily injury (perhaps for the past 5 years) to determine the percentage of claims that exceed the present limits for AB and result in a third party claim. Based on the transaction costs of these claims, researchers could conclude whether it would be more efficient to provide higher levels of AB. Canadian data are needed to set the appropriate first party benefit level and to support findings comparable to those in Carroll and Kakalik (1991):

“[o]ut of the \$5,474 spent per injured person in tort states, claimants take home an average of \$3,645 or 67% in compensation. The remaining is spent on the insurers’ transaction costs (14%) and on the claimants’ transaction costs (19%). A no-fault plan with a verbal threshold and \$15,000 benefit level reduces the transaction costs about 39 percent (equaling a 13 percent savings in totally injury coverage costs). By eliminating compensation for non-economic losses to people below the threshold, the plan also reduces the overall average amount claimants take home, from \$3,645 to \$3,182 (equaling a 9 percent savings in total injury coverage costs).”

**TABLE 4**  
**AUTO INSURANCE SYSTEMS AND RESULTS BY PROVINCE (2002)**

	AB	BC	MB	NB	NF	NWT & Nunavut	NS	ON	PEI	Q	SK	YK
Administration	Private	Public w/ private competition for optional & excess coverage	Public w/ private competition for optional & excess coverage	Private	Private	Private	Private	Private	Private	Public for Bodily injury; Private for property damage	Public w/ private competition for optional & excess coverage	Private
Compulsory minimum 3 <sup>rd</sup> party liability	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$200,000	\$50,000	\$200,000	\$200,000
Medical payments	\$10,000; chiro- practic \$500/ person, time limit 2 yrs	\$150,000	No time or amt. Limit, includes rehab.	\$50,000/ person, time limit 4 yrs.	\$25,000, time limit 4 yrs.	\$25,000/ person, time limit 4 yrs	\$25,000/ person, time limit 4 yrs	\$100,000/ person (\$1 million if injury catastrophic)	\$25,000/ person, time limit 4 yrs.	No time or amount limit	\$5,000,000/ person	\$10,000/ person, time limit 2 yrs
Funeral expense benefit	\$2,000	\$2,500	\$6,644	\$2,500	\$1,000	\$1,000	\$1,000	\$6,000	\$1,000	\$3,951	\$5732	\$2,000

Maximum Disability Benefits	\$300/wk, 80% of gross wages	\$300/wk, 75% of gross wages	\$63,000/yr, 90% of gross wages; indexed	\$250/wk	\$140/wk	\$140/wk, 80% of gross wages	\$140/wk.	80% of net wages to max. \$400/wk, \$185/wk if not employed	\$140/wk.	90% of net wages; max income gross \$52,000/yr; indexed	90% of net wages; max. income gross \$57,788/yr; indexed	80% gross wages; max \$300/wk.
Time Period	104 wks total disability	104 wks temp, lifetime total disability		104 wks partial, lifetime if total	104 wks partial. Life if total.	104 wks temp. disability, lifetime if totally disabled	104 wks, partial, lifetime if total disability	104 wks max, longer if unable to pursue any suitable occupation	104 wks, partial disability, to age 65 if totally disabled	temp 3 yrs; lifetime if permanently disabled		104 wks, temp. or total disability
Right to sue for pain & suffering	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes, with qualifications	Yes	No	Yes, unless on PIPP no-fault system	Yes
Right to sue for economic loss exceeding no-fault benefits	Yes	Yes	No	Yes	Yes	Yes	Yes	Yes, with qualifications	Yes	No	Yes, but award is reduced by other insurance benefits	Yes

\* Lawsuits are not permitted with respect to injuries sustained in automobile accidents in Quebec. Victims are compensated by their government insurer for their injuries whether or not the accident occurs in Quebec.

## *Choice No-Fault*

Having all drivers in a given jurisdiction be covered by either a tort or a no-fault system may be unnecessarily restrictive. One alternative allows individual Canadians to decide for themselves whether the price differential that results from no-fault is sufficient for them to give up some of their rights under the legal system. Public opinion research suggests that a substantial portion of consumers would be willing to accept a series of changes that would (a) limit their recourse to the legal system if it (b) increases their compensation following minor injuries and (c) speeds up their receipt of that payment.

Choice systems can be designed in a variety of forms, with the selection generally affecting a party's right to sue for non-economic damages. In a theoretical examination of equity considerations, Powers (1992) found a choice system to be both more "tort equitable" in that it did not involuntarily restrict the rights of automobile accident victims to seek recovery and more "rate equitable" because it permitted premium reductions to recognize lower costs associated with less litigious insureds. It does not involuntarily restrict injured parties from using the tort system, but does offer lower rates to those who voluntarily forego their right to do so. Simulated results in the U.S. (Carroll and Abrahamse, 1998; Joint Economic Committee of the U.S. Congress, 1998) estimate that implementation of choice could reduce overall American automobile insurance premiums by 21 - 24 percent while simultaneously yielding payment relative to economic loss that is more consistent across injured parties (Carroll and Abrahamse, 1999). The cost savings are attributed to a reduction in transaction costs and lower amounts of compensation to injured parties. The costs of compensating accident victims on behalf of drivers who elect no-fault have been estimated to be at least 60 percent less than they would have been if those drivers had been insured under the traditional tort system (Abrahamse and Carroll, 1998). These results, while encouraging, generally depend too heavily on simplistic assumptions about the distribution of losses across those who select tort and those who select no-fault. For example, they assume no adverse selection and that increases in claim frequency will not be sufficient to offset cost reductions associated with the elimination of non-economic damages.

New Jersey and Pennsylvania implemented programs, in 1989 and 1990 respectively, that permit customers to choose between the fault and no-fault regime for their automobile insurance. In 2003 Saskatchewan also gave residents the choice to have tort coverage rather than no-fault. Schmit and Yeh (2003) offer some of the first

empirical evidence related to such choice no-fault systems. In New Jersey, which switched from no-fault to choice, they find an increase in attorney involvement, settlement duration, and variability in payment, as expected. In Pennsylvania where choice replaced a tort-only system, they find weak evidence of decreased attorney usage, as expected, but weak evidence of longer settlement duration and strong evidence of increased variability in payment relative to loss, contrary to their expectations. Hence, they “conclude that the ultimate effect of choice remains uncertain.”

Jurisdictions that adopt a choice system must decide explicitly what type of system will be the default option. Experience in the U.S. indicates that consumers tend to choose the default option specified by the government. Hence, the materialization of any savings will depend on the default option, the number of consumers who choose no-fault, and the threshold to sue, if any.

### ***Improve Dispute Resolution***

Auto insurance claim disputes typically arise over the degree of fault associated with an accident and/or the value of a claim. Both types of disputes may extend the time to settlement over a long period, increasing expenses and in some instances, hindering the recovery of injured parties. To address the costs associated with disputes and the delay in treatment they can cause, simple, cost-effective dispute resolution mechanisms are needed. For example, when New South Wales was experiencing an increase in the number of third-party liability claims and a corresponding increase in claim settlement costs and in the number of claimants using attorneys, it was decided that an improved mechanism was needed for settling disputes. Its subsequent reform package created a dispute resolution mechanism to settle non-serious claims. The specific reforms included a streamlined process to reduce the extent of disagreement in measuring compensation (based on early notification of potential claim and provisional admission of liability by insurers); however, access to the court system for final determination was preserved for cases where liability is disputed or where injury issues are very complicated.

Providing effective alternatives for settling claims disputes is an important way to help control claim settlement costs and facilitate recovery. Alternative Dispute Resolution (ADR) encompasses a broad range of processes that may be used to resolve disputes outside the courts, such as negotiation, mediation, and arbitration.<sup>9</sup> Mechanisms like arbitration and mediation can benefit both sides in



a dispute. Transaction costs are significantly lower for both parties and the time to resolution is substantially shorter. In most instances ADR can produce resolutions more quickly and more cost effectively than the court system which, in turn, generally produces a higher degree of satisfaction with the settlement process.

The use of ADR in resolving auto accident claims would be greatly aided by designing a single set of rules to govern dispute resolution under automobile insurance policies for a given province. Fairness would be increased under such a system by ensuring consumers access and balance in the proceedings. A uniform ADR procedure also serves to reduce the time and expense by standardizing procedural matters. Specifically, the government could either (1) establish its own dispute resolution body that can handle all disputes about auto insurance benefits, or (2) amend the language of the auto insurance policies to specify the circumstances under which alternative dispute resolution mechanisms apply.

British Columbia already has passed such legislation. Since 1998 it has allowed any party to a motor vehicle action to initiate mediation by delivery of a Notice to Mediate (NTM) in a specified form to every other party to the action and to the Dispute Resolution Office (DRO). The Regulation resulted in 819 NTMs between April 14, 1998, and February 8, 1999. A survey sent to the population of cases completed (about 30%) found that the two main objectives of senders of an NTM are to speed up the negotiation/settlement process and to get both parties talking. Seventy-two percent of senders (71/98) rated their achievement of these objectives at a "4" or "5" on a five-point scale. Further, in 71% of the mediated cases (108/152), all issues were resolved, and in 75% (114/152) all or some issues were resolved. In cases where there was not complete resolution of issues, 64% of respondents (25/39) still felt there were positive outcomes.

Trakman (1998) provides a Canada-wide examination of ADR that focuses on the opinions of Canadian judges and lawyers regarding the time and cost efficiency of a specific set of ADR options. His results provide strong support for the use of both court-annexed and private ADR with sixty-two judges, representing 96.9% of the judges sampled, supporting the wider use of ADR; lawyer respondents were similarly supportive. Despite overall support for the use of ADR, respondents rated litigation highly for its fairness and they generally favored streamlining that system rather than abandoning it. At the same time litigation rated low for its cost efficiency, time efficiency, and predictability of results.

## **Regulation Issues**

Public policy makers need to recognize that auto insurance in all its forms operates in an environment that is both defined and constrained by the laws they pass and the implementing regulations that follow. To a very real extent, added laws and regulation can create problems as easily as it can solve them. With that caveat clearly stated, those writing the laws and regulations must carefully consider their role in regulating insurance and the effects such regulation can have on insurers' ability to pay claims and insureds' incentive to drive safely.

### ***Price Regulation***

In its choices regarding oversight of prices any province's system of regulation must balance the need for insurers to remain solvent against the extent to which social pricing is considered desirable. Because rate freezes and rollbacks increase the gap between claims costs and premium revenue, they can result in insurers deciding to pull out of certain markets. Such potential consequences must be understood and carefully considered in advance of implementing any such change in regulation. Despite these concerns during 2003 the tort provinces that have private auto insurance systems instituted rate freezes, or rollbacks, for auto insurance. Rate freezes and rollbacks are a response to the high prices charged for the relatively small portion of the driving pool classified as high risk – primarily new drivers. These drivers face premiums sufficiently high (up to \$6,000 per year) to be viewed as unaffordable, particularly for young drivers. A number of options exist to address the problem:

- Social pricing that eliminates individual rating factors.
- Establish an “acceptable” premium for all new drivers while still retaining experience risk rating to the extent practical in order to achieve the highest level of fairness to all insureds; or,
- Pay as you drive premiums.

For the reasons outlined above, 2003 reforms in Alberta and the Atlantic provinces also put tighter controls on insurers' ability to set rates. Specifically, they prohibit the use of certain rating factors, such as age, gender, and marital status, following a trend seen in British Columbia, Saskatchewan and Manitoba that previously eliminated the use of age as a rating variable. In these provinces accident data show a higher proportion of young drivers who are the principal owners of vehicles; injury collision rates among young

drivers are higher than in other provinces; and the rates of injury per million passenger kilometers are consistently higher than found in provinces where risk-based pricing is used (Kovacs and Leadbetter, 2003).

Such evidence in provinces that have adopted social pricing suggests that a system that both achieves affordability for young drivers and still provides incentives for safe driving would be most desirable. Alberta has proposed a pricing structure that would charge new drivers a maximum benchmark premium and drivers would then move up and down a grid based on whether their driving experience produced an at-fault claim or a claim-free year. After six claim-free years premiums reach the maximum discount of 65 percent. Such a mechanism provides the right incentive for drivers to drive safely. However, a key factor in the long-term viability of such a plan is whether the benchmark premium and the incremental amounts charged for at-fault accidents are sufficient to cover the claim costs of high risk drivers.

A primary reason given for the new restrictions on auto insurance rating is the objection to rating criteria that seemingly discriminate based on age, gender, or marital status. One alternative to using such criteria involves premiums that vary with the amount driven. For the vast majority of car owners, the insurance price is fixed in much the same way as the lease or loan payment. In the words of a Nobel-prize-winning economist (Vickrey, 1968) over thirty-five years ago, “the premium structure thus has the general effect of promoting excessive use of a given stock of cars and undue stinting on the ownership of cars.” Often referred to as Pay-as-you-Drive or Per-Mile Premiums, this method has been pilot tested in both the U.S. and the U.K. Empirical evidence indicates that a 10% reduction in mileage reduces insurance claims by 12-14%, though approximately one-third of that cost savings accrues to a party other than the insurer of the vehicle that remained undriven (Litman, 2000).

As mentioned, one appealing aspect of the ‘pay-as-you-drive’ idea is that it reduces the importance of sometimes controversial variables such as age, gender, and marital status in the pricing of insurance. If successful in reducing auto usage, other appealing aspects include fewer injuries, lower congestion, and reduced vehicle maintenance expense as well as potentially contributing to meeting Canada’s commitment to reduce greenhouse gases. Though many jurisdictions have discovered they do not explicitly contravene such an approach, a careful examination of the statutes and regulations of other jurisdictions has revealed a need for enabling changes before such a non-traditional product could be introduced.

## *Taxes*

Another item controlled by government that directly impacts the price of automobile insurance is taxes. Property-casualty insurance companies are subject to (1) general tax rules that apply to all corporations, (2) certain rules that have particular application to financial institutions, and (3) taxes that are unique to insurance companies. Cumulatively these contribute noticeably to the overhead amounts incorporated into the price of auto insurance. While a detailed review of this issue is beyond the scope of this paper, the government seeking to make auto insurance more affordable may find some solutions in its own tax laws.

## ■ CONCLUSION

Recent trends in the Canadian automobile insurance industry have caused dissatisfaction among consumers, financial difficulties for companies, and political challenges for governments. After all the debate it appears that what Canadians want in their system of auto insurance is prompt settlement in an amount that provides access to needed medical care and fair compensation for other types of losses. Increasingly, however, they also realize that in order to improve the overall performance of the system – including financial health for insurers as well as fair compensation and pricing for consumers – the root problems that led to the recent crisis need to be addressed. To achieve these goals, the following recommendations are suggested:

1. Improve coordination and standardization to the medical system when it is accessed by accident claimants.
2. Set first-party benefits at a level which reduces the transaction costs associated with third-party liability claims without increasing aggregate costs.
3. Reduce or limit access to payments for compensation for non-economic losses for non-permanent injuries.
4. Encourage and facilitate an efficient mechanism for dispute resolution.
5. Develop a pricing system that provides incentives for safe driving, is affordable for new drivers, and is perceived to be fair by insureds.

It is not essential that all of these items be embarked upon simultaneously in order to improve the existing auto insurance system. Implementing even one or two could make a significant difference in the effectiveness of the compensation system for auto accident victims and with their overall satisfaction as automobile insurance consumers.

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## □ Notes

1. Until the *Jabour* case was resolved in August of 1982, the Code of Professional Conduct of the Canadian Bar Association, in Canon 5(3), provided that "solicitation of business by circulars and advertisements ... is unprofessional." (Wilson, 1984).
2. It is worth noting that the insurance industry was permitted to address escalating costs of auto repair through a system of "designated repair facilities." This has been a contributing factor to the shift in proportion of claims dollars away from that cost item.

3. Until recently it has been difficult to find unbiased research that looks at this issue. However, a study by Biondi and Gurevitch published in late 2003 examines precisely that issue in the arena of medical malpractice claims. While claims of professional liability are somewhat different than those following auto insurance claims, both are environments that mandate insurance protection be provided to protect innocent victims. Biondi and Gurevitch (2003) is better than many earlier studies because of the quality of the dataset used. Specifically, that study includes claims that are settled both in and out of court; it also includes self-insurance pools as well as private insurers. The report that the number of claims is more than 15 percent lower in states with non-economic damage caps and that the rate of premium increase in jurisdictions without caps, at 6.8 percent, has been more than double the 3.0 percent rate observed in jurisdictions with caps.

4. The whiplash cases examined by Cassidy et al. (2000) almost certainly represent a significant portion of injuries generally classified as sprain or strain injuries. Other studies show that fully 85% of auto injury claimants report sprain or strain injuries and, for nearly three-quarters of those claimants, the sprain or strain was their most serious injury (*Injuries in Auto Accidents*, 1999).

5. Deyo (2000) cites several pieces of medical research to support the statements contained in this quote:

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6. In Newfoundland policyholders have the option to purchase additional coverage to provide pain and suffering payments for minor injuries.

7. The threshold level has been shown to affect people's incentive to claim. There is substantial evidence that dollar thresholds result in individuals "building up" their claims in order to exceed the threshold. (Carroll, Abrahamse, Vaiana, 1995). As a result, low monetary thresholds have been shown to result in higher premiums than tort (Cummins and Weiss, 1991) as minor accidents and injuries are seen as opportunities to enter a "personal injury lottery" (Derrig, Weisberg and Chen, 1994). See Carroll, Abrahamse, and Vaiana (1995) for a discussion of the incentive effects of non-economic damages in the U.S. In contrast to dollar thresholds, jurisdictions with verbal thresholds define injuries for which an accident victim is allowed to seek general damages. If an injury does not meet the definition, the injured party may not seek general damages. Verbal thresholds, therefore, are generally better at reducing incentives to submit excessive medical claims. However, if a verbal threshold is not carefully defined, it too can create incentives for build-up. For example, if an injury must be "serious and permanent" in order to meet the threshold, it is possible for claimants to continue to receive medical treatment as evidence that their injury is not minor.

8. Realizing the savings from reduced legal costs depends on implementation, Ontario adopted a no-fault system for minor injuries in 1990 and the first full year of no-fault (1991) health-care costs associated with minor accidents cost \$204 million. By 2002, the healthcare costs were \$1.51 billion and rising at a rate of almost 18% per year. (Insurance Bureau of Canada, 2003).

9. For a list of the most common types of ADR in Canada, see Stitt (1998).