Automobile

30M

Automobile insurance, or auto insurance for short, is one of the most common types of insurance in the industry. The following are standard coverages in auto insurance:

Section	Description
A	Liability Insurance
B	Medical Benefits
-	Uninsured & Underinsured Motorist Coverage
C	Collision & Other than Collision

Each U.S. state sets its own requirements for insurance coverages. In most states, Section A and Section B coverages are mandatory for automobile owners so that they meet financial responsibility limits, which describe the minimum amount of coverage needed as set by the state. If the vehicle is being financed, most financial institutions also require Section C coverage.

Under auto insurance, the insured parties are the policyholder named in the declarations and his/her immediate family members. Usually coverage is extended to an "invited driver" as well as an attached utility trailer. If the vehicle is used for business purposes, the vehicle should be insured under a commercial auto policy, not a personal auto policy.

Coach's Remarks:

As you go through this reading, avoid getting bogged down with "what if..." scenarios. The SOA will avoid any ambiguous or complicated cases. In other words, you are only expected to apply basic coverages in simple situations.

Liability Insurance - Section A

Section A is usually known as ***third-party liability***, and it consists of ***bodily injury (BI)*** and ***property damage (PD)***. This section provides indemnification (compensation) to the third party (innocent party) for an accident if the insured is liable. The insurer will not pay if the accident is caused intentionally by the insured or if the accident is covered under workers compensation.

- BI coverage pays for the costs associated with the injuries of the third party. These include medical expenses such as emergency services and hospital care, and funeral costs.

- PD coverage pays for the costs associated with repairing or replacing property of the third party.

Coach's Remarks:

Remember that Section A is **third-party coverage**. Thus, it does not provide compensation for the insured's BI and PD. For those coverages, see Sections B and C.

If the insured is sued, the insurer will provide legal defense for the insured, if the dispute is not settled out of court. If the courts decide that the insured is liable, the insurer will pay the assessed damages subject to the policy limit. Note that legal defense costs do not contribute to the policy limit. The insurer can also choose to stop providing legal defense if the policy limit is reached.

Liability coverage is mandatory in almost all jurisdictions. Some jurisdictions also specify the minimum level of coverage a driver must have. For liability coverage, the limits are usually separate for BI and PD; these are called ***split limits***. Some insurers may also specify the limits on a per-person basis or on a per-occurrence basis.

Consider an example where a liability coverage has split limits of $50/$100/$10. This means that the policy has limits of $50,000 per person and $100,000 per accident for bodily injuries and a limit of $10,000 per accident for property damages.

Note that purchasing higher levels of bodily injury coverage is advisable because these claims run into the millions of dollars, and the courts can demand the liable party's personal assets for payment.

The premium charged to the insured depends on various factors such as:

- Limit of coverage

- Garage location
- Use of vehicle (business vs. pleasure)
- Accidents, violations, claims history
- Personal attributes such as age, gender, and marital status*

*if not precluded by regulation

Medical Benefits - Section B

Section B for auto insurance has different names depending on the country and jurisdiction. It is known as ***medical payments (MP)*** in a tort jurisdiction, ***personal injury protection (PIP)*** in a no-fault jurisdiction, and ***accident benefits*** in Canada. (We will discuss these jurisdictions momentarily.)

Section B provides medical benefits such as income replacement, medical care, and rehabilitation to the insured and family members if they are injured during an accident. This is an example of ***first-party*** coverage, as the benefits are paid to the insured party. This coverage will not be triggered if the insured receives benefits from workers compensation. Note that property damages are not covered under Section B.

U.S. JURISDICTION

We will explain two different jurisdictions in the U.S. that determine how third party BI and medical payments are disbursed. Each state determines which jurisdiction it will follow. The two jurisdictions are the ***at-fault*** system and the ***no-fault*** system.

- **At-Fault (Tort)**
  The at-fault system is also known as the ***tort*** system. Under this jurisdiction, the injured party is required to prove that the other party is at fault to receive compensation under the third party liability section. Thus, disputes may be settled in court (although out-of-court settlements are more typical).

- **No-Fault**
  Under this jurisdiction, the injured party does not need to sue or prove that the other party is at fault to receive compensation. Instead of receiving the benefit under the at fault party's third party liability section, the injured party receives benefit under their PIP coverage.

To further elaborate these two jurisdictions, consider these explanations. In both jurisdictions, Section B provides coverage when you are injured, but there are some key differences:

- In a **tort jurisdiction**, the benefit of Section B coverage is that:
    - If you're at-fault in an accident and get injured, you're insured up to the policy limit.
    - If you're not at-fault and are injured, your insurer will cover your medical expenses up the policy limit while fault is being legally established, you are waiting for compensation from the at-fault party, etc.
- In a **no-fault jurisdiction**, since each insurer pays for the injuries of their policyholders, your medical payments will be limited to your PIP coverage.

As the above shows, a policyholder can file a medical payments claim regardless of fault or jurisdiction. However, as medical payments can run into the millions, in a no-fault jurisdiction, Section B coverage is more important than Section A. But, the reverse is true in a tort system, i.e., Section A coverage is more important than Section B coverage.

CANADA JURISDICTION

In Canada, all provinces practice some form of no-fault system. In addition to the regular no-fault jurisdiction, there are a few variations.

- **Threshold No-Fault**
  This system operates similarly to a regular no-fault system. However, if the cost of injuries exceeds a specified threshold, the injured party can sue the at-fault party for compensation.

- **Government Monopoly**
  Certain provinces practice a ***government monopoly***, where the provincial government is the sole provider of auto insurance. From a financial standpoint, it does not matter who is at fault because there is only one payer in this case. However, fault will still be determined, which will impact the at-fault party's premium going forward.

Coach's Remarks:

Remember that the kind of jurisdiction only matters in regards to medical payments.

Uninsured & Underinsured Motorist Coverage

This section protects the insured and family members from ***unidentified***, ***underinsured***, or ***uninsured*** motorists in the case of an accident. Under this coverage, the insured is covered by their own insurer for the amount that the liable motorist is personally responsible for.

Collision & Other than Collision - Section C

Section C provides protection to the policyholder's vehicle under two subsections:

- **Collision**
  Collision coverage indemnifies the insured if a covered auto is damaged by colliding with an object, such as another vehicle or a lamppost.

  In the case of a collision, the insurer reserves the right to either pay the insured the loss or pay to repair or replace the vehicle. The insurer will choose to pay the less expensive of the two, and this is known as the ***collision limit***.

  Note that the policyholder can file a collision claim regardless of who is at fault. If the insured is at-fault, their car will be repaired/replaced. If they are not at-fault, the insurer will repair/replace the policyholder's vehicle and then seek compensation from the guilty party.

- **Other Than Collision (OTC)**
  Other than collision (OTC) is activated when the vehicle damage is a result of other perils such as hail, theft, fire, or vandalism. Under this coverage, certain perils are generally excluded. Examples of excluded perils are war, acts of terrorism, wear and tear, road damage to tires and radiation contamination.

  If coverage is provided for all perils (except those typically excluded), then it is called ***comprehensive coverage***. If coverage is only provided for specific perils listed on the policy, then it is called ***specified perils coverage***.

Below are some factors that may impact the premium for this coverage. Note that different insurers have different pricing models; these are just a few examples. Notice that for OTC coverage, personal attributes of the insured are generally not considered. This is because they generally do not correlate with the events that result in OTC claims.

Factor	Collision	OTC
Type of vehicle	✓	✓
Garage location	✓	✓
Accidents, violations, claims history	✓	×
Use (business vs. pleasure)	✓	×
Age*	✓	×
Gender*	✓	×
Marital status*	✓	×

*if not precluded by regulation

Other Components

SUBROGATION

Subrogation is the ability of the insurer to assume their insured's rights to sue an at-fault party to recover indemnification costs.

As a result, subrogation tends to lower premiums for collision coverage, but raise premiums for liability coverage. The latter is to reflect the risk of being sued by the insurer of the innocent party.

If the recovered cost is higher than the indemnification given to the insured, the difference must be paid to the insured. Insurers are not allowed to profit from subrogation.

SALVAGE

If the insurer needs to indemnify the full value of the vehicle, the insurer has the right to *salvage* the vehicle to recover any remaining value. The insurer will take ownership of the vehicle and typically sell it to a salvage vendor. It is in the insurer's interest to do so if the cost to repair the damaged vehicle exceeds the vehicle's full value.

Like subrogation, insurance companies are not allowed to profit from this provision. Therefore, if the salvage value is greater than the indemnification, insurers are required to pay the insured the difference in excess of the full value.

Example 1.1.4

Trudy has an automobile policy with Truckers Insurance Company. Courtney has an automobile policy with Coupe Insurance Company.

They have the following coverages on a per-accident basis:

Per Accident Coverage	Trudy	Courtney
Third Party Liability Coverage (Bodily Injury/Property Damage)	$100,000	$200,000
Medical Payments Coverage	$5,000	$10,000
Uninsured/Underinsured Motorists Coverage	$20,000	$40,000

In addition, both have collision coverage with a $0 deductible.

Trudy is at fault in a car accident with Courtney that occurs in a tort jurisdiction where they both live. Both cars are totaled and have no salvage values. Their insurance companies settle out-of-court and compile the following summary of damages:

Damages	Trudy	Courtney
Automobile Repair/Replacement Costs	$10,000	$20,000
Medical Payments	$35,000	$115,000

Determine the amount that Truckers Insurance Company must pay.

Solution:

Trudy is at-fault and thus is responsible for Courtney's damages totaling $20,000 + $115,000 = $135,000. However, Trudy has a limit of $100,000 in third party liability coverage (Section A) per accident, and thus Truckers will only pay $100,000 to Courtney. (Trudy is responsible for the remaining $35,000.)

Trudy sustains damages of $45,000 herself. She has medical payments of $35,000, but only $5,000 in coverage (Section B). As a result, she will only receive $5,000 from Truckers for her medical payments. Her car damages are $10,000, and her collision coverage (Section C) will reimburse her for that entire amount.

To summarize, Truckers Insurance will pay the following to Trudy and Courtney:

	Trudy	**Courtney**
Third Party Liability Coverage	-	$100,000
Medical Payments Coverage	$5,000	-
Uninsured/Underinsured Motorists Coverage	-	-
Collision Coverage for Damage to Auto	$10,000	-

Thus, the total that Truckers Insurance pays is **$115,000.**