

# SENATE STAFF ANALYSIS AND ECONOMIC IMPACT STATEMENT

(This document is based on the provisions contained in the legislation as of the latest date listed below.)

Prepared By: Banking and Insurance Committee

BILL: SB 420

INTRODUCER: Senator Baker

SUBJECT: Repeal of Preinsurance Inspections for Motor Vehicles

DATE: April 13, 2006

REVISED: 4/21/2006

ANALYST	STAFF DIRECTOR	REFERENCE	ACTION
1. Emrich	Deffenbaugh	BI	Fav/1 amendment
2.			
3.			
4.			
5.			
6.			

## Please see last section for Summary of Amendments

☐

Technical amendments were recommended

☐

Amendments were recommended

☒

Significant amendments were recommended

### I. Summary:

Under current law, a private passenger vehicle must be inspected before it can be insured under a policy providing physical damage coverage under s. 627.744, F.S.<sup>1</sup> The inspection requires the insurer to take an imprint of the vehicle's identification number, record the vehicle's accessories and the location and description of any existing damage. There are numerous exceptions to the preinsurance inspection requirement including exemptions for new cars, temporary substitute vehicles, specified leased vehicles, and older vehicles and the law's applicability is limited to seven counties in Florida: Dade, Broward, Palm Beach, Orange, Pinellas, Hillsborough, and Duval.

Senate Bill 420 would repeal the motor vehicle preinsurance inspection requirement and thus remove an insurer's obligation to inspect a motor vehicle before providing physical damage insurance coverage.

Proponents of the bill argue that preinsurance inspections are expensive to administer, are not cost effective and inconvenience their insureds. Opponents of this legislation, including law enforcement officials, assert that instances of motor vehicle insurance fraud will increase if such inspections are eliminated. They state that preinsurance inspections are effective in preventing

<sup>1</sup> Physical damage coverage includes collision and comprehensive coverages.

fraudulent vehicle theft or vehicle repair claims since a vehicle must be visually inspected and pre-existing damages documented prior to being insured.

This bill repeals the following section of the Florida Statutes: 627.744.

## II. Present Situation:

### **Preinsurance Inspection of Motor Vehicles in Florida**

Presently, insurers are required to inspect a private passenger motor vehicle prior to insuring the vehicle under a policy providing physical damage coverage which includes collision and comprehensive coverage.<sup>2</sup> Physical damage coverage is an optional coverage in Florida that includes collision, which pays for repair and replacement of the insured's motor vehicle, regardless of fault, and comprehensive coverage, which pays for repair or replacement of an insured's vehicle for losses from incidents other than collision, such as theft, vandalism, or flood. The inspection involves the insurer taking an imprint of the vehicle identification number (VIN), recording the vehicle's accessories and recording the location and description of any existing damage.<sup>3</sup>

The inspection must be provided by the insurer or by a person or organization authorized by the insurer and the inspection form must be retained by the insurer with its policy records for the insured. The applicant may be required to pay the cost of the inspection, not to exceed \$5. An insurer that provides the inspection at no cost to the applicant may include the expense of the inspection within its rate filing. An insurer may defer an inspection for 30 calendar days following the effective date of coverage for a new policy, but not for a renewal policy, and for additional or replacement vehicles to an existing policy, if an inspection at the time of the requested coverage would create a serious inconvenience for the applicant and such hardship is documented in the insured's policy record.<sup>4</sup>

The inspection law currently applies to just 7 counties in the state: Miami-Dade, Broward, Palm Beach, Orange, Pinellas, Hillsborough, and Duval counties.<sup>5</sup> Numerous exceptions are contained in the law that apply to the following:

- policyholders who have been insured for 2 or more consecutive years, if the agent verifies the previous coverage;
- a new, unused motor vehicle as long as the insurer is provided with a bill of sale or copy of title;
- a temporary substitute vehicle;
- a motor vehicle leased for less than 6 months if the insurer receives specified documentation;
- a vehicle that is 10 years old or older;
- a renewal policy;

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<sup>2</sup> Section 627.744, F.S.

<sup>3</sup> A VIN is a series of 17 letters and numbers that are unique to each vehicle and identifies its year, manufacturer, model, body type, engine type, restraint system and the assembly plant where the vehicle was built. A national VIN database is kept by the Insurance Services Office (ISO) and insurers may access that database to check VIN numbers.

<sup>4</sup> Section 627.744(6), F.S.

<sup>5</sup> Section 627.744(2)(g), F.S. These counties are designated based on a 1988 estimated population of counties over 500,000.

- any other vehicle or policy exempted by rule of the commission;<sup>6</sup>
- when the insurer's inspection service has no facility either in the city in which the vehicle is principally garaged or within 10 miles of such city;
- an insured vehicle that is insured under a commercially rated policy that insures five or more vehicles;
- when an insurance producer is transferring a book of business from one insurer to another; or
- when an insured's coverage is being transferred and initiated by a producer to a new insurer.

The preinsurance inspection requirement was passed by the Legislature in 1990 and the majority of the exemptions were enacted at that time.<sup>7</sup> The Staff Analysis by the House Insurance Committee of the 1990 legislation stated that the bill was intended to reduce fraudulent physical damage claims and thereby reduce collision and comprehensive motor vehicle insurance rates.<sup>8</sup> The analysis pointed out that this reduction would occur only if the reduction in claims costs exceeds the additional cost of the inspection itself. The analysis referred to the preinsurance inspection statute adopted by New York which reported significant overall savings in physical damage premiums as a result of the laws adoption which also required three color photographs of the vehicle, a provision not contained in the Florida law.

In 1990, the Department of Insurance (now the Office of Insurance Regulation) promulgated an emergency rule establishing procedures and forms to be used by insurers in implementing the preinsurance inspection law.<sup>9</sup> The department found that the purpose of the law was to "stem the escalating incidences of fraudulent private passenger automobile damage and theft claims in certain areas of the State of Florida and thereby assure the stability of physical damage insurance rates."

There are presently four other states (besides Florida) which have a preinsurance inspection requirement (Massachusetts, New Jersey, New York and Rhode Island) and these states all require photographic documentation of the vehicle.

### **Arguments for Repealing Preinsurance Inspections**

Representatives with the Florida Insurance Council (FIC) support the repeal of the preinsurance inspection law primarily because it is expensive to administer, is not cost effective and inconveniences their insureds. For example, officials with Progressive Auto Insurance<sup>10</sup> state that

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<sup>6</sup> The commission is the Financial Services Commission (Governor and Cabinet) and under this provision it must base the rule only on a determination that the likelihood of a fraudulent physical damage claim is remote or that the inspection would cause a serious hardship to the insurer or the applicant.

<sup>7</sup> Chapter 90-119, F.S. The law was subsequently amended in 1992 to add exemptions for producers transferring their book of business, for commercially rated policies, and in instances where there was no inspection facility (Chapter 92-318, L.O.F.). There was also a provision in that law directing the Department of Insurance (now the Office of Insurance Regulation) to study the preinsurance program detailing any cost savings to the consumer and insurance industry in Florida and make a report with appropriate recommendations to the Speaker of the House of Representatives and the President of the Senate. Committee staff was unable to locate that report.

<sup>8</sup> House of Representatives Staff Analysis of CS/SB 2670 (June 21, 1990).

<sup>9</sup> Rule 4ER90-5, Florida Administrative Code.

<sup>10</sup> Progressive represents about 7 percent of the auto market based on insurance sales by agents and approximately 10.6 percent of the auto market counting both agent sales and "on-line" computer transactions.

the company on average conducts approximately 7,000 inspections per month at a cost of \$9 per inspection, totaling \$63,000 a month, or \$756,000 per year. This cost is then built into the company's rates, since it does not charge consumers for inspections.<sup>11</sup> Industry-wide, Progressive estimates that there are 100,000 inspections done by all insurers in the state each month, at a cost of \$10.8 million per year.

In 2005, Progressive provided comprehensive coverage for over 700,000 vehicles in Florida and incurred about 2,300 theft claims totaling \$19 million.<sup>12</sup> About 1,000 of the theft claims were investigated by the company's Special Investigative Unit (SIU) and 76 of those claims were determined to be insurance fraud. Of the 76 claims, about 10 vehicles were cloned (using a fake VIN). Representatives with Progressive claim that inspections are not cost effective since the company had a *negative* return on their (preinsurance inspection) investment of \$1,115,720.<sup>13</sup>

Insurance representatives point out that the preinsurance inspection law is ineffective due to the large number of exceptions and its applicability to only seven counties. Insurers also point to s. 626.9891, F.S., the law which created the anti-fraud SIU's within insurance companies, and state that these unit's address insurance fraud more thoroughly than inspections. These representatives argue that preinsurance inspections were created to eliminate "paper cars," but today, criminals have moved to more sophisticated fraudulent methods that are not necessarily detected by such inspections.

#### **Arguments Against Repealing the Preinsurance Inspection Law**

The national director of the Coalition Against Insurance Fraud (CAIF) states that preinsurance inspection programs are widely acknowledged among virtually all law enforcement professionals as effective anti-fraud measures and cost-stabilizing tools.<sup>14</sup> These programs can be extremely effective in reducing theft claims for non-existent or "phantom" vehicles or repair claims for "phantom" accidents. Coalition officials point out that preinsurance inspections inhibit the filing of fraudulent claims by documenting the existence of a vehicle (recording its VIN number) and documenting any pre-existing damage to a vehicle (recording the location and existence of any damage).

Florida motor vehicle theft rates decreased after the preinsurance inspection law was passed in 1990, according to the Coalition director. A study prepared for the Coalition found that two years after Florida's preinsurance inspection law was enacted, the seven counties with required inspections saw an 8.4 percent decrease in vehicle thefts whereas the surrounding counties suffered an 8.8 percent increase in vehicle thefts.<sup>15</sup> From 1990 thru 2004, motor vehicle thefts declined in Florida from 106,902 to 78,325.

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<sup>11</sup> Section 627.744(4), F.S. allows insurance companies to charge customers up to \$5 for an inspection.

<sup>12</sup> The chances of a Progressive car being stolen are approximately 1 in 300.

<sup>13</sup> Progressive estimates its theft claim severity to be \$8,428 per vehicle. The company determined its negative return by multiplying \$8,428 by 10 (number of cloned vehicles) and subtracting that amount from \$1.2 million (cost of inspections conducted by the company).

<sup>14</sup> Dennis Jay is Executive Director of the Washington, D.C., based Coalition. The CAIF is supported primarily by insurance companies. It serves as a national clearinghouse for fraud information and educates and speaks on behalf of consumers, insurers, legislators, regulators and others as to anti-fraud matters.

<sup>15</sup> *Auto Insurance Fraud, An Analysis of the Effectiveness of Anti-Fraud Programs*, Mark Cooper, Ph.D. (1993). The study reviewed preinsurance inspection laws in Florida, Michigan, Massachusetts, New Jersey and New York and found that in all those states the vehicle theft rate declined after the inspection program was implemented.

The Coalition study examined five states<sup>16</sup> which had enacted preinsurance inspection laws and found that the theft rate declined by 3.5 percent in those states, but rose 1.7 percent nationwide. The study concluded that these inspection laws are cost-justified since theft rates are reduced. Specifically, it cited New York as saving about \$100 million due to its decline in auto thefts whereas the costs of the preinspection program were estimated to be less than \$20 million in that state. Further, when California repealed its preinsurance inspection program in 1999, reported vehicle thefts rose from 168,480 in 1999 to 252,604 in 2004.<sup>17</sup>

Officials with Florida's Division of Insurance Fraud (DIF) within the Department of Financial Services and the National Insurance Crime Bureau (NICB) also echo the sentiment that preinsurance inspections help prevent automobile fraud.<sup>18</sup> One NICB representative stated that it is just common sense to realize that a physical inspection of a vehicle prior to insuring it will mitigate fraud and help reduce rates. Law enforcement officials also assert that the exemptions under Florida's law relieve most Floridians from going through the inspection process and that required inspections are aimed at those persons who have not had or maintained insurance coverage and those most likely to be involved in fraudulent activity.

Representatives with the Florida Auto Theft Intelligence Unit and the Florida Peace Officers Assn. assert that repealing preinsurance inspections would eliminate a very important anti-fraud program. Also, an official with CARCO<sup>19</sup>, a company which conducts preinsurance motor vehicle inspections, opposes the bill. The CARCO official argues that relying on the Special Investigative Units to investigate motor vehicle fraud is not sufficient because SIUs only investigate fraud after the fraud is suspected. CARCO's position is that it is easier to deter fraud after insurance companies have all information pertaining to the vehicle they are insuring.

### **III. Effect of Proposed Changes:**

**Section 1.** Repeals s. 627.744, F.S., which requires preinsurance inspection of private motor vehicles under a policy providing physical damage coverage. The inspection requires the insurer to take an imprint of the vehicle's identification number, record the vehicle's accessories and the location and description of any existing damage. There are numerous exceptions to the preinsurance inspection requirement including exemptions for new cars, temporary substitute vehicles, specified leased vehicles, and older vehicles and the law's applicability is limited to seven counties in Florida: Dade, Broward, Palm Beach, Orange, Pinellas, Hillsborough, and Duval.

**Section 2.** Provides that the bill will become effective upon becoming a law.

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<sup>16</sup> New York, New Jersey, Florida, Massachusetts and Michigan. These large states represent one-fifth of the nations' population and more than a quarter of the nation's auto thefts.

<sup>17</sup> Progressive officials counter this argument by stating that there were other reasons California's theft rate increased.

<sup>18</sup> The NICB is a not-for-profit organization that receives support from approximately 1,000 property/casualty insurance companies. It partners with insurers and law enforcement agencies to facilitate the identification, detection and prosecution of insurance criminals.

<sup>19</sup> CARCO is oftentimes hired by insurers to conduct the preinsurance inspection of vehicles.

**IV. Constitutional Issues:****A. Municipality/County Mandates Restrictions:**

None.

**B. Public Records/Open Meetings Issues:**

None.

**C. Trust Funds Restrictions:**

None.

**V. Economic Impact and Fiscal Note:****A. Tax/Fee Issues:**

None.

**B. Private Sector Impact:**

This bill may save customers the cost of preinsurance inspections to the extent that insurers build in the price of preinsurance inspections to a customer's insurance cost. According to Progressive, that is \$9 per inspection. However, claims costs could increase under the bill to the extent that more fraudulent claims are filed as a result of the elimination of preinsurance inspections

According to the Office of Insurance Regulation, the private sector will be affected to the extent that vehicle inspections can be demonstrated to reduce insurance fraud, and those savings contribute to the stability of the motor vehicle market.<sup>20</sup>

**C. Government Sector Impact:**

None.

**VI. Technical Deficiencies:**

None.

**VII. Related Issues:**

None.

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This Senate staff analysis does not reflect the intent or official position of the bill's sponsor or the Florida Senate.

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<sup>20</sup> Office of Insurance Regulation Legislative Analysis.

## VIII. Summary of Amendments:

### **Barcode 435394 by Banking and Insurance:**

Deletes mandatory preinsurance inspection of vehicles by insurers, but allows insurers to provide 'voluntary' inspections and continues to allow insurers to charge insureds \$5 for an inspection and prohibits the fee from being considered as part of the premium. It requires that if the inspection is done, that it must include taking color photos of the vehicle (in addition to the current requirements of recording a VIN number and recording accessories and damages to the vehicle). It also requires an insurer to reduce premiums in policies issued after Oct. 1, 2006 in an amount equal to the expense previously included in its rates for the inspections, unless the insurer notifies the Office of Insurance Regulation that it will uniformly conduct preinsurance inspections as a condition of providing collision and comprehensive coverage and that such inspections comply with the requirements of this section (i.e. color photograph, etc.)

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