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TO: Commissioner Rey Graulty

FROM: Martin M. Simons

SUBJECT: HB100 CD1

The legislature has received letters from State Farm, The Hawaii Insurers' Council and the National Association of Independent Insurers. This letter is intended to provide additional information relative to those letters and the issues raised by those parties.

State Farm has reduced its estimate of expected savings from those provided previously, asserting that the reduction is due to an increase in medical coverage and an increase in the liability limits from those which were included in the prior versions. They fail to mention that the deductible has been increased through the use of the "covered loss deductible" concept. In prior analyses, State Farm has estimated that the savings will increase by from 6% to 7% on the basic policy by moving the deductible from $5,000 to $10,000. That means that a 13% savings under a $5,000 deductible will increase to 19%-20% with a $10,000 deductible. The covered loss deductible will produce a result quite similar to that for a $10,000 deductible, and the resulting difference in pricing will also be similar. They also contend that the mandated rate reductions in each of the drafts has not changed when the lower end of the range of reductions has, in fact, been revised from 25% in previous proposals down to 20% in this Bill.

State Farm has provided the legislature with estimates based upon their current rate levels. The reductions in HB100 CD1, however, relate to reductions from the rates that were in effect on July 1, 1996. Since State Farm had reductions in the rates for the basic policy mandated coverages since July 1, 1996, these reductions should be added to those contained in their April 10, 1997 letter to the Senate President. Taking the above issues into account, it appears that State Farm is in agreement with the savings as they are stated in the Bill.

Absent from any of the industry responses and pricing analyses are the extremely favorable recent trends in claim frequency and average claim costs for automobile insurance in Hawaii. Following 1995 experience, which produced the lowest personal automobile loss ratios in the country, claim frequency and severity trends showed substantial additional improvements in 1996. The source of this information is the fast track data through the end of 1996 that is presented by the insurance industry to The National Association of Insurance Commissioners. In spite of the fact that the loss ratios have dropped dramatically, and insurer profits have risen accordingly, there has only been a modicum of rate reductions filed with the Insurance Division that incorporate much or even any of these improvements. As insurers file for rates under the new system, in order to assure that those rates are not excessive or inadequate, these favorable trends will have to be taken into consideration. HB100 CD1 gives the insurance commissioner the power, and in fact the duty, to do so.

In State Farm's analysis of the family that purchases higher than minimum limits, this family has purchased and continues to purchase $50,000 of PIP coverage. This includes medical as well as wage loss coverage in excess of the minimum. Medical coverage in excess of $10,000 is costly. The added benefit to many already protected Hawaii consumers is questionable. HB100 CD1 allows this family to purchase additional wage loss coverage up to their desired level without purchasing medical coverage in excess of the minimum. If the insurance industry expended the same amount of effort in educating this policyholder of the true benefits or lack thereof of purchasing high limits of medical coverage as they have in convincing the legislature of the shortcomings of HB100 CD1, perhaps this family would see a greater savings.

The insurance industry continues to contend that the savings in HB100 CD1 are due strictly from reductions in mandated coverages. Ignored in such a statement are criteria such as the following:

1) There has been a great deal of discussion through these proceedings as well as all of the automobile insurance discussions over the past years relating to the effect upon rates of the "padding" of claims. Claims padding occurs when claimants seek additional treatments and incur other additional economic losses in order to reach a threshold or in this case a deductible and thereby gain the ability to litigate against a negligent party to an automobile insurance case. Claim padding has been the single major cost driver under the monetary threshold, causing the threshold to become a moving target in order to keep a specific percentage of claims out of the litigation process. Insurers have alleged that the $5,000 deductible contained in HB100 CD1 will increase the amount of claim padding since the $5,000 level is substantially below the current monetary threshold of $13,900.

Actually, HB100 CD1 addresses the claim padding problem in several ways, and a comparison of the $5,000 to $10,000 deductible level with the current $13,900 monetary threshold is meaningless unless all of the issues are considered. HB100 CD1 does not permit the use of wage losses in attaining the deductible level while wage losses were used extensively to meet the monetary threshold. In addition, chiropractic and other alternative care provisions were used extensively to meet the monetary threshold. HB100 CD1 makes it virtually impossible to use alternative care expenses to pad claims in order to reach the deductible. Most important, once the monetary threshold was pierced, claimants were able to sue for every dollar of economic loss, including all those expenses that were "padded" to reach the threshold. The deductible reduces each claim that reaches litigation by an amount between $5,000 and $10,000 depending upon the medical expenses incurred since those are the only expenses that are used in deriving the ability to sue and the deductions are commensurate with coverage that is provided elsewhere in the policy. This process directly addresses and substantially reduces the abuse that was inherent under the monetary threshold. Comparisons between a $13,900 monetary threshold and a $5,000 to $10,000 covered loss deductible without taking these very significant differences into account are misleading at best.

2) HB 100 CD1 directly addresses the Legislature's concerns relative to the high average bodily injury liability claim cost in Hawaii. Each Bodily Injury Claim will be reduced under HB100 CD1 from their levels under the current monetary threshold. Claims are reduced by the deductible that previously included first dollar coverage due to the monetary threshold concept, providing for a direct reduction in the average claim cost. Even if claim expenses are padded to the same extent as they have been under the current system (which is unlikely under the restrictions included in the Bill), there will be a reduction in the average bodily injury claim cost that will impact upon the experience and the rates for all policyholders whether they purchase minimum limits or greater than minimum limits.

3) The limitations placed upon chiropractic visits will impact upon the experience for all of Hawaii's automobile insurance purchasers by reducing the amount of claim dollars paid for these providers. In addition, the family referred to in State Farm's analysis who purchase more than the minimum coverages, will now have the option to purchase alternative care protection or not. It is now the purchaser rather than the State who will make those decisions. If families wish to save additional money by eliminating alternative care providers and by accepting limited chiropractic coverage, they may now do so.

4) Under the current system, insurance purchasers are required to purchase coverage for wage losses regardless of whether they are wage earners or not and regardless of whether they have wage loss coverage elsewhere or not. This includes retired people as well as those with wage loss coverage through a program provided by their employer. HB100 CD1 provides the opportunity for people to save money by not having to purchase coverage for funds they will never collect or for losses that are covered elsewhere. These are real savings provided for automobile insurance policyholders whether they purchase minimum limits or higher limits of coverage.

5) HB100 CD1 gives the Hawaii automobile insurance purchaser several other options that were not available in the past, including the ability to purchase wage loss coverage without having to purchase commensurate medical coverage.

6) As has been stated several times, the reductions stated in the Bill are from rates that were in effect on July 1, 1996. The reductions include the impact of the revised medical fee schedules that are further revised in HB100 CD1. It is the language of HB100 CD1 that gives the commissioner the power to reduce rates for the impact of these prior revisions. These decreases should have been taken immediately by all

insurers, but it has been found necessary to include language such as that which is contained in HB100 CD1 to get those reductions to a substantial number of Hawaii's automobile insurance purchasers, regardless of the levels of insurance purchased.

7) The replacement of the current unlimited Bodily Injury liability limits with limits that are specific and definable will impact upon the rates paid by all Hawaii policyholders, regardless of the limits purchased.

8) The significant and substantial reductions in claim frequency and average claim cost that have been all but ignored by much of the insurance industry will impact upon the calculation of rates for all Hawaii policyholders, regardless of the limits purchased. These improvements have continued throughout 1996. HB100 CD1 gives the Commissioner the ability, given this highly profitable situation, to provide savings for all policyholders in the State, and will provide savings regardless of the limits purchased.

9) While the effects of the increased fraud provisions are not necessarily definable at this time, the fraud sections of HB100 CD1 will produce savings for all Hawaii policyholders, regardless of the limits purchased. These savings will take place over the next few years.

10) The effect of the elimination of peer review will similarly take some time to find its way into the rates. If the elimination of peer review does provide for less delays and faster claim payments, and if those faster claim payment processes do, in fact, save money, as many believe will occur, then the experience will allow for additional rate reductions for all Hawaii policyholders over the next few years, regardless of the limits purchased.

I have refrained from giving specifics of the rate reductions since these reductions will vary between insurers and each of the individual savings are interrelated. A change in one item will impact upon others, and the misuse of these estimates could be detrimental to the process. Keeping this in mind, I request that these numbers be viewed as guides to areas within the Bill that provide for savings and the amount of estimated savings derived from each item. The actual savings will be determined from individual insurer filings, the actual statistical information included in those filings and, if required, the discovery material obtained in the rate hearing process. Please refrain from adding or otherwise combining these estimates (either the minimums or maximums) as this will produce erroneous expectations. The following numbers are meant to provide an estimate of what is expected to be found within the rate filings submitted to the commissioner given the information available to us at this time. If I sound overly cautious, it's because of a fear that these estimates may be misused, and that such misuse will result in our inability to adequately defend the reductions in court. These are some of the reasons for a wide range of expected reductions such as that which is included in HB100 CD1. The resulting rate reductions that are expected to be derived from HB100 CD1 are between 20% and 35% for mandated coverages from the rates that were in effect on July 1, 1996, derived in light of the following:

PIP revision from $20,000 PIP to $10,000 medical with limited chiropractic coverage, no other alternative care coverage and no wage loss coverage =

approximate savings of 12% to 17%.

BI revision from 25/unlimited with monetary threshold to 20/40 BI liability with covered loss deductible =

approximate savings of 4% to 8%

Reduction from previous med fee schedule change =

approximate savings of 5% to 8%.

Reductions to be effected due to Commissioner's ability within HB100 CD1 to reduce rates based upon favorable experience =

approximate savings of 7% to 15%.

Additional future reductions due to fraud provisions are not defined or included.

Additional future reductions due to peer review elimination are not defined or included.

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I sincerely hope that this additional information will assist the legislature in making their decision. It is unfortunate that there doesn't seem to be a magical solution; one that will please all the parties involved in providing and purchasing automobile insurance in Hawaii. Throughout this process, I have attempted to assist you in responding to requests presented by the legislature for information and clarification of individual issues, concerns and proposals and to aid the decision makers in arriving at a workable solution to Hawaii's automobile insurance problems. As is now obvious to all, the process of amending automobile insurance legislation is a technical and extremely complex and difficult one.