

OVERVIEW

THE AUDITOR
STATE OF HAWAII

Study of Insurance Ratemaking Procedures Under Article 14, Chapter 431, Hawaii Revised Statutes

Summary

In House Concurrent Resolution No. 354, the 1993 Legislature requested the State Auditor to conduct a study of casualty insurance ratemaking under Article 14, Chapter 431, Hawaii Revised Statutes. The Legislature expressed concern that the Hawaii statutes allowed insurers the flexibility to manipulate operational expenses, profits, and losses in order to seek higher insurance rates. The Legislature was also concerned that procedures followed by the Insurance Division of the Department of Commerce and Consumer Affairs might not be effective in controlling any manipulation of operational expenses, profits, and losses in insurance rate filings.

We contracted with the Casualty Actuarial Practice of KPMG Peat Marwick to conduct the study. Our consultant evaluated Article 14, Chapter 431, HRS and compared key provisions of Article 14 to model insurance rating laws promulgated by the National Association of Insurance Commissioners (NAIC) and the rating laws of selected states. The consultant also reviewed approximately 100 rate filings for different types of casualty insurance, including personal automobile liability and physical damage, homeowners, workers compensation, and general liability. The review focused on the consistency and accuracy of information provided by insurers seeking rate increases and the division's review of insurers' equity bases in determining an adequate return on equity. In addition, the consultant reviewed and evaluated the flexibility the Insurance Division allowed insurers by projecting losses and loss adjustment expenses and in the treatment of expense provisions in casualty rate filings.

KPMG Peat Marwick found that Article 14, Chapter 431, HRS, is a reasonable form of rate regulation. Article 14 follows actuarial principles of casualty insurance ratemaking and requires prior approval of insurance rate requests before the rates can be implemented. It is modeled upon the NAIC *Property and Casualty Model Rating Law*, and compares favorably with similar statutes in other states. Our consultant found that the law allows reasonable loss experience to be used in rate filings and does not contain unusual minimum experience requirements for fire insurance. In addition, the Insurance Division's standards and procedures used in reviewing insurance rate increase requests are fair and thorough and that the division uses sound judgment in reviewing rate requests.

The NAIC has two model laws—one is a prior approval law (on which Hawaii's law is modeled) and the other is an open competition model. Our consultant believes that changing Hawaii's law from prior approval to open competition in the marketplace may reduce insurance costs to consumers. A number of studies have shown that competitive rate regulation is at least as effective as prior approval rate regulation and much less costly to implement.

Recommendations and Response

We recommend that the Legislature consider changing Hawaii's casualty insurance ratemaking laws to let the marketplace establish rates through open competition. Should it consider changing the law, we recommend that the Legislature follow as a model the NAIC *Property and Liability Model Alternative Competitive Pricing and Appropriate Support System Act*.

The department agrees with our findings and believes that its methodology in reviewing rate filings is compatible with prior approval or open competitive rating laws.

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