

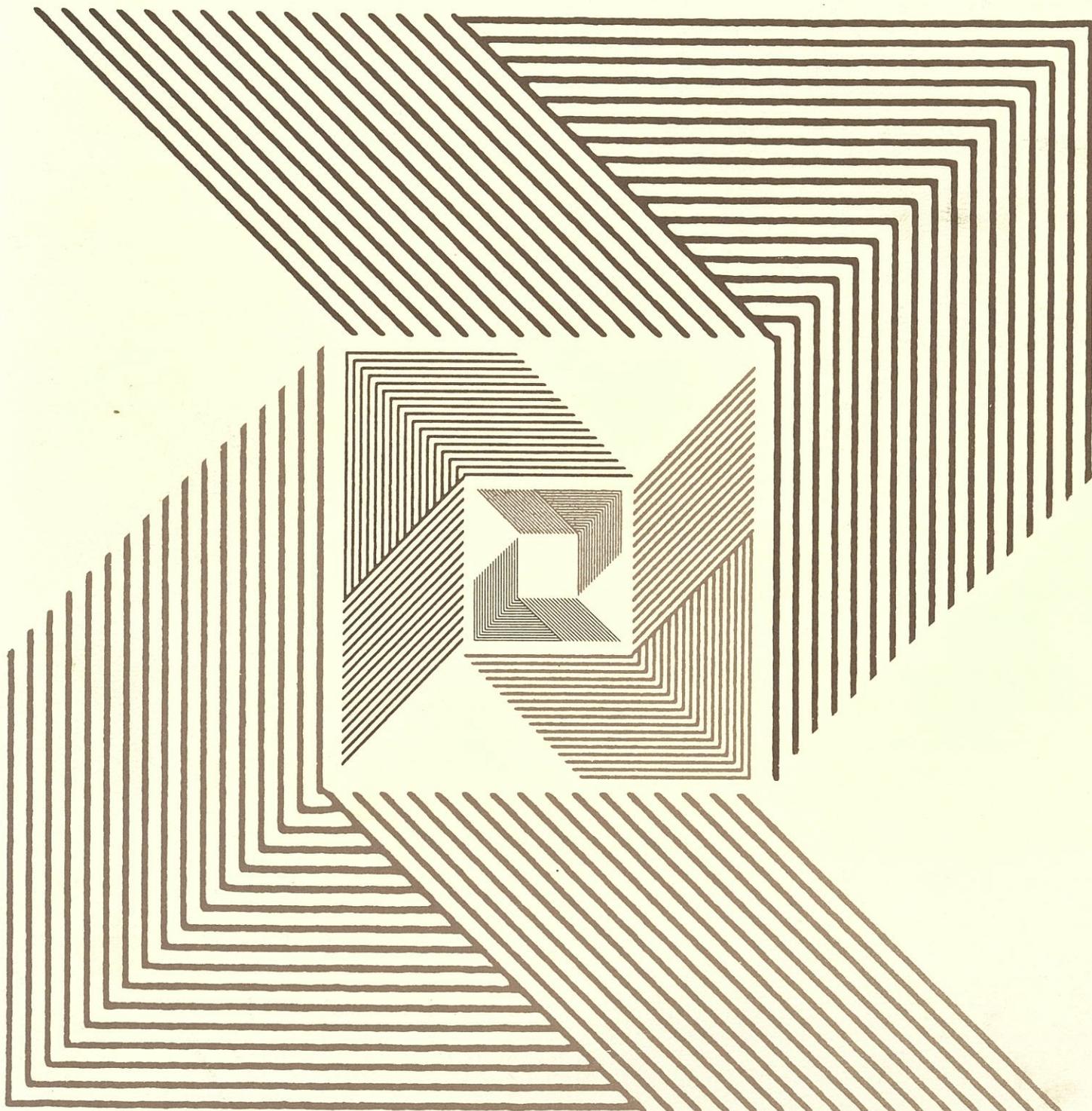
SPECIAL REPORT NO, 72-1

JANUARY 1972

A STUDY OF HAWAII'S MOTOR VEHICLE INSURANCE PROGRAM

CONDUCTED BY: HALDI ASSOCIATES, INC.

A REPORT TO THE LEGISLATURE OF THE STATE OF HAWAII



SUBMITTED BY THE LEGISLATIVE AUDITOR OF THE STATE OF HAWAII

THE OFFICE OF THE LEGISLATIVE AUDITOR

The office of the legislative auditor is a public agency attached to the Hawaii State legislature. It is established by Article VI, Section 7, of the Constitution of the State of Hawaii. The expenses of the office are financed through appropriations made by the legislature.

The primary function of this office is to strengthen the legislature's capabilities in making rational decisions with respect to authorizing public programs, setting program levels, and establishing fiscal policies and in conducting an effective review and appraisal of the performance of public agencies.

The office of the legislative auditor endeavors to fulfill this responsibility by carrying on the following activities.

1. Conducting examinations and tests of state agencies' planning, programming, and budgeting processes to determine the quality of these processes and thus the pertinence of the actions requested of the legislature by these agencies.
2. Conducting examinations and tests of state agencies' implementation processes to determine whether the laws, policies, and programs of the State are being carried out in an effective, efficient and economical manner.
3. Conducting systematic and periodic examinations of all financial statements prepared by and for all state and county agencies to attest to their substantial accuracy and reliability.
4. Conducting tests of all internal control systems of state and local agencies to ensure that such systems are properly designed to safeguard the agencies' assets against loss from waste, fraud, error, etc.; to ensure the legality, accuracy and reliability of the agencies' financial transaction records and statements; to promote efficient operations; and to encourage adherence to prescribed management policies.
5. Conducting special studies and investigations as may be directed by the legislature.

Hawaii's laws provide the legislative auditor with broad powers to examine and inspect all books, records, statements, documents and all financial affairs of every state and local agency. However, the office exercises no control functions and is restricted to reviewing, evaluating, and reporting its findings and recommendations to the legislature and the governor. The independent, objective, and impartial manner in which the legislative auditor is required to conduct his examinations provides the basis for placing reliance on his findings and recommendations.



**LEGISLATIVE AUDITOR
STATE CAPITOL
HONOLULU, HAWAII 96813**

**A STUDY OF
HAWAII'S MOTOR VEHICLE INSURANCE PROGRAM**

Conducted by
Haldi Associates, Inc.

A Report to the Legislature of the State of Hawaii

Submitted by the
Legislative Auditor of the State of Hawaii

Special Report No. 72-1
January 1972

FOREWORD

During the 1971 session of the legislature, over 30 bills were introduced to change various aspects of the motor vehicle insurance program in Hawaii. This surge of legislative proposals reflects the serious misgivings and growing doubt in the public mind over the adequacy, fairness and effectiveness of the existing auto insurance system.

The legislature conducted extensive public hearings during the 1971 session on the various proposals. However, the legislature found itself without a sound basis for the development of specific legislation. The legislative committees responsible for reviewing the various proposals noted the lack of evidence to support the numerous conflicting arguments and opinions presented in the hearings. Moreover, no complete actuarial analysis accompanied any of the proposals. The legislature concluded that the enactment of any proposal without reliable data and adequate study may be harmful to the public's interest. It was for these reasons that the legislature, through House Concurrent Resolution No. 93, H. D. 1, requested our office to conduct an overall study of the motor vehicle insurance program in Hawaii and to submit a report to the 1972 session.

Our consultant for the study was Haldi Associates, Inc. The study specifications prepared by our office instructed the consultant to: (1) evaluate the prevailing system of motor vehicle insurance in Hawaii; (2) formulate alternatives to the existing system and subject the alternatives to systematic analysis; (3) identify and recommend the alternative which analysis shows to be the preferred program; and (4) develop legislation and program plans for implementing the recommended alternative.

The report which has been developed conforms to both our general and detailed specifications. In our estimate, it is an objective and systematic study, and its conclusions and recommendations are sound.

Our assessment is shared by an eminent advisory review panel which reviewed the study at critical junctures and evaluated the final, proposed plan. The members of the panel were Jeffrey O'Connell, University of Illinois professor of law who, as co-author of the Keeton-O'Connell plan, is recognized as one of the pioneers in insurance reform; Guido Calabresi, Yale University professor of law widely known for his scholarly contributions in accident law and economics; and David A. Swankin, director of the Washington office of Consumers Union and an expert in consumer programs and consumer legislation.

While no panel member was obliged to support the recommendations of the study, each has done so. Professor O'Connell states that if Hawaii were to enact the plan proposed, it would have "... far and away ... the most benevolent, sensible, effective and efficient automobile insurance system in all the United States." Professor Calabresi concludes that "... the proposals made would, if enacted, seem certain to assure a very significant improvement in the motor vehicle insurance system offered to the citizens of Hawaii." Mr. Swankin observes that the proposed plan reflects many of the Consumers Union's standards for the optimum auto insurance system and that if Hawaii were to adopt the legislation as drafted, "it would be taking a giant step in behalf of long needed auto insurance reform." The comments of each member of the advisory panel are printed in full and in their original form beginning on page xv.

The reader who may wish to obtain a quick, initial understanding of the study should refer to chapter 1 which summarizes the major conclusions and recommendations. For an understanding of the basic reforms proposed, chapter 17 is valuable for its commentary on the specific features of the recommended plan.

In summary, our submission of this report to the legislature, without qualification or reservation, is an expression of our confidence that the reform plan proposed, if enacted, would result in the best motor vehicle insurance system yet established anywhere.

Clinton T. Tanimura
Legislative Auditor
State of Hawaii

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GLOSSARY OF TERMS

A number of technical terms are used repeatedly throughout this study. They are collected and defined here to assist the reader in understanding terminology common to both insurance and the law.

Assigned claims plan is a plan which establishes insurance protection for the recovery of benefits by victims of traffic accidents involving uninsured automobiles.

Collateral sources are other available sources of compensation for accident losses, such as accident or health insurance or workmen's compensation. These other sources can result in duplicate payments for the same injury or, alternatively, they may be considered as either primary or secondary to automobile insurance coverages. If primary, all amounts obtained from collateral sources will be deducted before making settlement awards from auto insurance. If secondary, auto insurance benefits will be deducted first.

Damages is a legal term for losses suffered by accident victims. Courts classify all damages as either *special* or *general*.

Special damages are tangible economic losses incurred by accident victims as of the date of settlement. In general, these losses include hospitalization and medical expenses, wage loss, cost of rehabilitation and replacement services, funeral expenses, and miscellaneous out-of-pocket costs.

General damages are those losses that are not precisely measurable in dollars. Such compensation typically involves payments for

estimated *future* medical expenses or wage losses and plaintiff's attorney fees. "General damages" is frequently referred to as "pain and suffering," but it would be more precise to restrict the use of "pain and suffering" to describe only the actual physical pain, discomfort or mental anguish suffered by a victim as a result of his injury.

Disfigurement losses are losses connected with scarring or permanent disablement, such as the loss of a limb or other part of the body.

First-party (or direct reimbursement) – This confusing and unfortunate terminology derives from awkward and obsolete legal language used in early insurance contracts. In those contracts, the insurer was referred to as "the party of the first part," the insured was "the party of the second part" and anyone else was "the party of the third part." First-party insurance is thus any compensation system whereby benefits are paid directly to a beneficiary by his insurer upon the happening of a contingency such as injury, death or damage to property. Examples of first-party insurance are automobile comprehensive coverage, medical payments, or general accident and health insurance. See also "third-party."

First-party fault – This term describes a system of paying benefits directly to the insured, but giving the insurer the right to recover such payments from another party if he is responsible for the loss. Two examples are auto collision insurance or uninsured motorists coverage.

No-fault – This term describes (1) a legislative exemption from legal liability or responsibility for loss based on negligence, and (2) any compensation

system in which accident victims recover for losses without having to prove the negligence or fault of somebody else. It is not to be confused with first-party insurance. Many reform plans call for some form of first-party recovery of losses, but not all would confer a legal exemption from liability on persons causing losses through negligence.

Strict liability — This term applies to any situation in which a loss is ascribed to a person for reasons of policy, regardless of the absence of negligence. Examples in tort law are manufacturers' liability for defective products, employers' liability for work injuries (workmen's compensation) and liability on persons conducting unusually hazardous activities.

Subrogation — This term applies to the assigning of certain rights to a person (usually an insurance company) who has compensated a loss. This includes the right to seek reimbursement from a party responsible for the loss.

Third-party — This term describes a compensation system by which payment for losses is obtained from a party who is neither the victim nor the victim's own insurer. Examples of "third parties" are negligent drivers, insurers of other drivers, and employers and their insurers under workmen's compensation plans. See also "first-party."

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ECONOMIC AND MANAGEMENT COUNSEL

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December 15, 1971

Mr. Clinton Tanimura
Legislative Auditor
State Legislature of Hawaii
State Capitol
Honolulu, Hawaii 96813

RECEIVED

DEC 30 1971

OFFICE OF THE AUDITOR

Dear Mr. Tanimura:

On behalf of Haldi Associates, Inc. and its sub-contractor Exotech Systems, Inc. I am pleased to submit our Study of Motor Vehicle Insurance Reform for the State of Hawaii. We would like to express our gratitude to you, your staff and the many other people who gave us their complete cooperation throughout the entire period of this study.

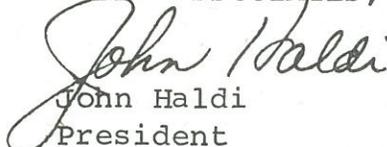
The people of Hawaii need and deserve a better motor vehicle insurance and accident compensation system. All feasible alternatives to the present system were examined with the single-minded purpose of ascertaining the one which would best serve all citizens of Hawaii. The major reform bill resulting from this analysis has been designed to give the people and the State of Hawaii what we believe is the finest system anywhere.

At this critical juncture in the nationwide evolution to a new motor vehicle insurance system, the Legislature and the State of Hawaii can, with timely and courageous action, move to the forefront and become the pioneer reform state. It is our hope that the Legislature will carefully consider the recommended bill and enact reform legislation.

We appreciate the opportunity to have participated in this important effort, and hope that these recommendations will in fact lead to a vastly improved insurance system for the benefit of everyone in Hawaii.

Very truly yours,

HALDI ASSOCIATES, INC.


John Haldi
President

ACKNOWLEDGEMENTS

We wish to express our gratitude to everyone who assisted us in this study. While it is not possible to extend individual recognition to all who had a role, we have tried to single out those who gave the most time and energy to the study effort. Even so, we have not been able to include everyone.

Special recognition must be given to Mr. Clinton Tanimura, the Legislative Auditor of the State of Hawaii, to Mr. Yukio Naito, Deputy Legislative Auditor and to Mr. Newton Sue, Legislative Analyst who served as project coordinator to the staff of Haldi Associates, Inc. Their full cooperation and assistance throughout all phases of the study are gratefully acknowledged. In addition, Yoshie Hoshino, Chiyoko Koito, Joyce Kanemura, Evelyn Goya and many others on the staff of the Legislative Auditor were most helpful. Their efforts are appreciated.

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Office of the Governor

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The Judiciary

Tom Okuda, Director, Traffic Violations Bureau

Department of Transportation

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U. S. State Antitrust and Monopoly Subcommittee

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U. S. Department of Transportation

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Howard Clark, Senior Insurance Analyst, Office of the Secretary

Board of Underwriters of Hawaii

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Harry G. Albright, Secretary

Hawaii Insurance Rating Bureau

David Walker, President
John D. Cavanah, General Manager

Hawaii Chapter, American Society of Insurance Management, Inc.

James B. Runyan, President

Fireman's Fund

Thomas Hopcroft, Claims Manager

First Insurance Company of Hawaii, Ltd.

Robert L. Stevenson, President
Larry Maloney, Assistant Vice President

Hawaii Insurance and Guarantee Company

R. D. Brumbaugh, Former President (now with Bayly, Martin & Fay of Hawaii, Inc.)
Alfred Ruffy, Vice President—Claims Manager
Wayne Calkins, Assistant Claims Manager

Island Insurance Company, Ltd.

William Hiraoka, President
Shigeo Iwamoto, Vice President
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Pacific Insurance Company, Ltd.

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Richard Decker, Vice President

Massachusetts Insurance Commission

C. E. Garnum, Commissioner of Insurance

Puerto Rico Automobile Accident Compensation Administration

Frank Fournier, Executive Director

A special note of thanks and recognition go to our Advisory Review Panel, Guido Calabresi, Jeffrey O'Connell and David Swankin, for their valuable assistance in advising us at critical stages of the study.

To two tireless typists, Mrs. Piilani Ramler and Miss Sally Watanabe go our sincere thanks for handling the gigantic task of translating the rough drafts into a polished final report.

Last, but by no means least, a special note of thanks and recognition to the members of the study team itself.

From Haldi Associates, Inc.

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December 1, 1971

COMMENTS OF THE ADVISORY REVIEW PANEL

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UNIVERSITY OF ILLINOIS AT URBANA-CHAMPAIGN
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December 23, 1971

Mr. Clinton Tanimura
Office of the Auditor
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Honolulu, Hawaii 96813

RECEIVED

DEC 27 1971

OFFICE OF THE AUDITOR

Dear Mr. Tanimura:

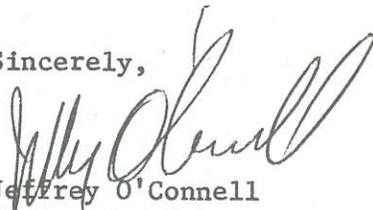
As you know, I have served as a consultant to Haldi Associates, Inc., in their study of alternative automobile insurance plans for the State of Hawaii.

I have now had a chance to review their final report and recommendations, including the proposed statute.

Let me say that I enthusiastically endorse that proposed statute for Hawaii as a vast improvement over the present tort liability system applied to auto accidents in Hawaii. Indeed were Hawaii to enact this statute it would have . . . far and away . . . the most benevolent, sensible, effective and efficient automobile insurance system in all the United States.

I so hope Hawaii will do it . . . and I would be glad to help in any way I can.

Sincerely,



Jeffrey O'Connell
Professor of Law

JOC:umt

YALE UNIVERSITY
LAW SCHOOL
NEW HAVEN, CONNECTICUT 06520

GUIDO CALABRESI

RECEIVED

December 23, 1971 DEC 27 1971

OFFICE OF THE AUDITOR

Clinton Tanimura, Esq.
Office of the Legislative Auditor
State Capitol
Honolulu, Hawaii 96813

Dear Mr. Tanimura:

I have read the draft report prepared for your office by Haldi Associates, Inc. together with the accompanying proposed statutes. As you know I served on the special panel which Haldi Associates retained to advise and review the project. At the time I agreed to serve on the panel, I made clear that I could in no way be bound to support the conclusions which the study might reach. I am very happy to be able to write you, however, that the report and the proposals which stem from it seem to me to be excellent and that they have my strong endorsement.

There are many admirable features in the proposed legislative package, too many, in fact, to mention in a letter. I would, nevertheless, like to emphasize a few general ones which seem to me to characterize the approach taken, and then note some especially important specific features of the study. First, it seems clear that the minimum required benefits proposed offer far more comprehensive and economical coverage for victims of motor vehicle accidents than any existing comparable statute. Secondly, the proposals should not only lead to broader and more economical victim compensation, but they might well lead to a diminution in the severity of motor vehicle injuries, because the creation of incentives to vehicle design which will lead to passenger safety is a fundamental, if implicit, part of the proposals. Thirdly, the minimum required benefit package is considerably simpler and more intelligible than many proposals which have been seriously considered elsewhere.

On a somewhat more specific level, I would call to your special attention the following characteristics of the study. (1) The crucial importance of group marketing of insurance and its close relationship to first-party insurance coverage is properly emphasized. It is of paramount importance that group marketing not be fettered if the full benefits of motor vehicle reform are to be realized. (2) The study recognizes that some compulsory insurance is essential in dealing with motor vehicle accidents. But it equally recognizes that compulsory insurance requires safeguards to protect the consumer who is compelled to insure. For this reason the proposal deals strictly with "hunch

Clinton Tanimura, Esq.

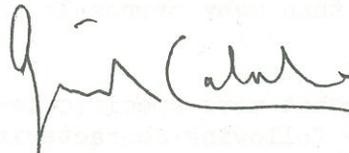
Page 2

December 23, 1971

ratings" and refusals to deal by insurers with respect to the minimum required benefits. On the other hand, while it gives the Commissioner of insurance the power to guarantee that certain options will be offered to consumers, it allows insurers considerable freedom in handling these, non-compulsory, parts of the package. (3) Unlike most proposals for motor vehicle insurance it faces squarely and realistically the problem of inflation. (4) It makes an important decision that once a society has decided that someone will be allowed to drive, that person should not be deterred from driving as a result of personal characteristics for which he is in no way responsible. Individual accident records, type of car driven, etc., if they can be shown to affect probable accident costs, remain, indeed become, major rating considerations. But the age at which one will be allowed to drive at a reasonable price and with broad insurance coverage is deemed to be a matter of general social policy rather than of market decision. (5) Unlike many current proposals, the study recognizes the significance of non-pecuniary losses and provides for their compensation. It does this both directly and by recommending options available to those who desire added coverage. This should be contrasted not only with many proposals considered elsewhere, but also with the existing system which, in practice, fails miserably and expensively to compensate victims of serious accidents for both pecuniary and non-pecuniary losses.

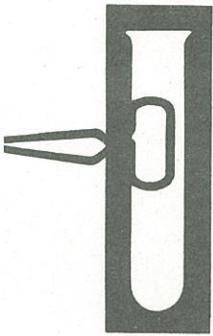
I am tempted to go on at length and deal with many details of the study and the statutes it proposes, but that would be inappropriate in a letter such as this. It is enough to re-emphasize that the study seems to have been a thorough one, that the economies foreseen by it appear to have been estimated with a good measure of conservatism, and that the proposals made would, if enacted, seem certain to assure a very significant improvement in the motor vehicle insurance system offered to the citizens of Hawaii.

Sincerely yours,



Guido Calabresi
John Thomas Smith Professor of Law
Yale University

GC/kl



CONSUMERS UNION / A NONPROFIT ORGANIZATION / PUBLISHER OF CONSUMER REPORTS

December 30, 1971

RECEIVED

JAN 3 1972

OFFICE OF THE AUDITOR

The Honorable Clinton T. Tanimura
Legislative Auditor
State Legislature of Hawaii
State Capitol
Honolulu, Hawaii 96813

Dear Mr. Tanimura:

As you know, I served in a personal capacity as a member of the Review Panel established by Haldi Associates, Inc., while they were studying legislative proposals to reform Hawaii's automobile insurance laws.

In April 1971, Consumer Reports published a major article on no fault auto insurance. I am attaching a copy for your information. In that article Consumers Union commented that in our opinion Federal no fault legislation is a necessity. We recognize, of course, that at least some states are ready, willing and able to move faster than the Federal government toward achieving a no fault system. Our measuring rod, in these instances, is whether or not the states meet the substantive standards set forth in our April article.

I am pleased that Haldi Associates, Inc. has adopted so many of the Consumers Union standards in their draft. If Hawaii were to adopt the bill as drafted, it would be taking a giant step in behalf of long needed auto insurance reform.

Sincerely,

David A. Swankin
Director
Washington Office

cc: John Haldi, Haldi Associates
Walker Sandbach, Executive Director, Consumers Union

→ Washington Office: 777 NATIONAL PRESS BUILDING, WASHINGTON, D.C. 20004/202-347-1910

National Office: 256 WASHINGTON STREET, MOUNT VERNON, NEW YORK 10550/914-664-6400

PART I
SUMMARY AND INTRODUCTION

CHAPTER 1

SUMMARY

A. Major Recommendations

This study of motor vehicle insurance makes two major recommendations for the State of Hawaii:

- . Adopt a complete no-fault insurance reform act.
- . Approve mass merchandising (group sales) of motor vehicle insurance.

Establishment of an exclusive state insurance fund is not suggested at this time. The State does not now have the capability to implement and operate a large motor vehicle insurance program whereas the private insurance system does have such capability. However, a state fund should be considered as a distinctly viable alternative if experience with the basic reforms proposed in this study indicates that the private insurance system is either inefficient or ineffective.

B. Evaluation of Existing System

Public policy objectives for a motor vehicle insurance system are specified in detail. The existing liability insurance system is evaluated against these objectives and is found to be deficient in several critical ways. Among the primary findings from this review are:

1. Hawaii motorists could have saved between \$5 and \$10 million in 1970 alone if motor vehicle insurance benefits were provided as efficiently as are accident and health insurance benefits.

2. Hawaii accident victims forego annually an estimated imputed cost of delay of over \$3.4 million. This is directly attributable to a time lag in settlement for the average claim of between 9 and 12 months.

3. A number of Hawaii accident victims receive no compensation whatsoever.

4. Current methods and procedures used in underwriting and marketing motor vehicle insurance in Hawaii are expensive, discriminatory and inequitable. They are largely the product of present disincentives to avoid litigation in the courts occasioned by the system of negligence law under which liability claims must be settled. One undesirable result of this system is that about 19 percent of all motorists in Hawaii have no insurance whatsoever.

C. Conclusions from Analysis

All important reform alternatives are formulated and analyzed in terms of cost and extent to which they fulfill the objectives for a motor vehicle insurance system. Major findings and conclusions are:

- . Complete no-fault will provide compensation for all accident victims.
- . Complete no-fault is the only insurance system which guarantees adequate care for all victims with serious injuries.

- Complete no-fault will cost less than either a modified liability system or a partial no-fault system with low tort liability exemptions.
- Mass merchandising will produce significant savings under any system.
- An exclusive state fund holds significant potential for further cost savings.

D. No-Fault Insurance Reform Plan

A specific no-fault plan is recommended for adoption. This plan includes the best features of other proposals and also includes several unique features. Among the more outstanding features are:

- Insurance for personal injury is compulsory for all motor vehicles.
- In addition to paying for all medical expense and lost wages, the plan makes

extra payments to those who suffer permanent disfigurement.

- Owners of motor vehicles are *strictly liable* for all damage to property other than cars. Compulsory insurance pays for all such losses without limit.
- Insurance rates for required coverage may not discriminate by age, sex, or marital status.
- Basic insurance underwriting procedures and abuses are made subject to public hearings and insurance commissioner appeals proceedings.
- Insurance carriers are held accountable for performance in delivery of basic benefits through continuous reporting of compensation performance and statutory penalties for late payment.
- The insurance commissioner is required to evaluate and report annually on the effectiveness of the plan.

CHAPTER 2

INTRODUCTION

Social problems associated with automobile accidents and suggested solutions to these problems are not new. Over forty years ago, the pioneer Columbia Report on automobile accident compensation documented and indicted the existing automobile insurance system for serious shortcomings which only now are becoming widely recognized.¹ This report proposed to abolish the fault principle and in its place make compensation more certain and more adequate by having insurers directly reimburse victims for their losses. Unfortunately, no substantive reform resulted from this report. Within the past decade, however, reform of motor vehicle insurance has had an active renaissance as both the traffic accident problem has become more acute and the consumer movement more vocal.

In more recent times, probably no book has triggered so much reaction and activity as has the work of Professors Robert Keeton and Jeffrey O'Connell, *Basic Protection for the Traffic Victim*.² This book, which was the product of a lengthy and scholarly research effort sponsored by the Harvard Law School, has led the insurance industry, government officials, attorneys and other professionals into an intensive debate over the problem of providing compensation for motor vehicle accident victims.

¹Report by the Committee to Study Compensation for Automobile Accidents to the Columbia University Council for Research in the Social Sciences. Press of the International Printing Company of Philadelphia, 1932, referred to hereinafter as the "Columbia Report."

²Cambridge: Harvard University Press, 1965.

The reform movement gained further momentum from the landmark study of the U. S. Department of Transportation, completed in 1970.³ This study and the recommendation of the Nixon administration that each state adopt reform legislation have led to the generation of dozens of specific plans and over 1,000 individual proposals for state and federal legislation. Most proposals to date center on a partial replacement of the law of negligence and substitute some variation of a first-party, direct-benefit reparations plan.

Key deficiencies attributable to liability insurance coverage have been identified: (1) compensation is socially incorrect—namely, those with relatively minor losses are overcompensated, more serious injuries are undercompensated, and at least 25 percent of all automobile accident victims receive no compensation whatsoever; (2) benefits returned to victims are only a fraction of the total cost of the system due to high administrative and legal expense caused chiefly by the underlying adversary procedure; (3) receipt of benefits is unreasonably delayed by the intricate and cumbersome machinery of the fault-finding process; (4) there is wasteful and uneconomic duplication among the many liability, medical, wage loss and property damage compensation systems that bear, in one way or another, on financial recovery by accident victims; and (5) the cost of automobile liability insurance is high and has been increasing sharply.

³U. S. Department of Transportation, *Auto Insurance and Compensation Study*, Vols. 1-24, Washington, D. C.: U. S. Government Printing Office, Cat. No.—TD 1:17, dates various, March 1970 through March 1971.

Hawaii has not escaped these problems. The House committee on housing and consumer protection found that a need exists to:

1. Provide for the fair compensation of persons sustaining property damage and personal injury as a result of motor vehicle accidents
2. Provide for the availability of motor vehicle liability insurance at reasonable rates
3. Provide for reasonable and fair compensation for services rendered to repair motor vehicle damage, to treat persons injured, and to recover damages
4. Establish a system which will encourage careful operation of motor vehicles and decrease motor vehicle accidents.⁴

A. Purposes and Scope of this Study

This study has four major purposes, which are to:

- . Evaluate the prevailing system of motor vehicle insurance in Hawaii
- . Formulate alternatives to the existing system in Hawaii and subject the alternatives to systematic analysis
- . Identify and recommend the alternative which will provide the optimum motor vehicle insurance system for the citizens of Hawaii
- . Devise legislation and a program plan for implementing the recommended alternative.

B. Overview

Part II of this study is a review of the objectives of a motor vehicle accident compensation system. The objectives are developed within a broad social outlook, using a hierarchy

⁴Hawaii State Legislature, House Standing Committee Report No. 882, April 13, 1971; re: HCR No. 93.

approach similar to that employed in Planning, Programming and Budgeting (PPB) systems. Objectives for an insurance compensation system are discussed separately from the legal objectives that form a basis within which any insurance system must operate. Chapter 3 contains a summary of the objectives used in this study.

Part III evaluates the performance of the Hawaii insurance system in meeting the objectives postulated in part II. Compensation of accident victims is reviewed first, including both the efficiency with which benefits are paid as well as the distribution of and delay in payments to victims. Results of a closed claim survey are reported here. This is followed by an evaluation of important factors in the buying and selling of insurance.

Particular attention is paid to the problems faced by high risk and currently uninsured motorists, with a view to identifying the shortcomings of the existing system which must be overcome if automobile insurance is to become compulsory in Hawaii. Part III concludes with a review of the traffic safety system, projects accident rates, and examines accident reduction possibilities. Chapter 7, "Evaluation Highlights," summarizes the most important findings of part III.

Part IV of this study explores all major alternatives which have been proposed for reform of the current motor vehicle insurance system. Key reforms are identified for actuarial analysis. These reforms span the entire range of all important alternatives, including a complete no-fault insurance system and an exclusive state insurance fund. The assumptions and results of the analyses are explained briefly in part IV and in detail in appendices D and E. Chapter 11 summarizes the analysis executed in part IV.

Part V contains the conclusions and recommendations which follow from the analysis. Major alternatives are assessed against the objectives specified in part II of this study. The central recommendation is made that the legislature adopt a complete no-fault insurance system. A detailed commentary on the specific, recommended plan is then presented, followed by a program and implementation plan for executing the recommendations. Appendix A contains the proposed legislation.

PART II
PUBLIC POLICY OBJECTIVES

CHAPTER 3

SUMMARY OF OBJECTIVES

Objectives for the insurance and legal systems should not be viewed too narrowly. Better perspective is achieved by developing objectives within a broader systems context, the approach followed here. As a first step, four public policy objectives applicable to collisions involving motor vehicles are postulated. These are to:

1. Prevent accidents
2. Reduce accident severity and minimize losses
3. Treat injured victims
4. Reduce hardships.

The first two objectives attempt to prevent personal injury as well as damage to automobiles. The last two objectives are concerned exclusively with personal injuries or losses arising from personal injuries. The social concerns of these four objectives are to minimize injuries, provide for those who become injured in automobile accidents, and reduce crash damage to motor vehicles. The objectives and roles of the insurance and legal systems are developed within this framework.

A. Insurance Objectives

The main public policy objective for any accident insurance system is:

1. To provide the most effective and efficient means of insuring against and reducing losses associated with accidents.

Within this basic objective, design of the insurance system should seek to attain and be measured against eight important subobjectives:

1. Compensate personal injury losses adequately
2. Pay compensation promptly
3. Guarantee payments
4. Make personal injury protection universally available at reasonable cost
5. Assess costs equitably
6. Operate simply
7. Complement related activities
8. Account for performance.

The rationale for these subobjectives, some of which have far-reaching implications, is discussed in chapter 5.

B. Legal Objectives

1. **Criminal justice system.** The functions or objectives of criminal law are to (a) determine guilt, (b) impose punishment and (c) deter harmful behavior. Punishment of socially undesirable actions is a function solely of criminal law, not civil law. These objectives apply to persons involved in automobile collisions as well as to those who commit other harmful actions. While the criminal justice system can levy fines and impose

other punishment, it has no means of compensating accident victims, and it provides no basis for determining how various parties involved in an accident share or bear the losses which arise from an accident. These are functions solely of the civil law.

2. Civil liability system. The system of negligence law currently applied to automobile accidents in Hawaii traces its historical roots to the early common law of England. Originally, criminal and civil law were one. When they split, the principle purpose of the civil liability system was to compensate victims of accidents. Over time, however, the compensation principle was seriously eroded by the rise of negligence theories, which were originally devised and still remain as barriers or impediments to compensation of accident victims. Most proposed legal reforms aim, directly or indirectly, at reducing or diluting the negligence barrier.

Despite the fact that most liability claims are paid by the insurance system, negligence cases paradoxically take no formal account whatsoever of the insurance system's existence. It is perhaps for this reason that so many proposed legal reforms do not give explicit consideration to the capabilities or needs of the insurance system. In short, what the insurance system requires of the civil law is a legal basis for determining the extent to which each involved party will bear the cost or share the losses of any accident.

There exist essentially three different legal bases for allocating losses from accidents: strict liability, liability on a negligence or "fault" basis, or no liability, commonly known as "no-fault." Selection of the legal basis from these three alternatives will determine the design of the insurance system, which in turn will permit motorists to share risks of losses assigned to them under the law.

One of the most important points to understand is that the existing liability insurance system almost totally negates as a possible objective of the civil liability system either (1) deterrence or (2) making a negligent driver pay. The purpose of liability insurance, from the purchaser's viewpoint, is to assure the driver that he need not fear the financial consequences of a collision. This dilutes any deterrent effect which the law might have. Since most drivers are covered by some form of vehicle liability insurance, when an accident does occur, it is not only the driver held to be negligent, but all insured drivers who actually pay the losses. Thus, the existence of insurance makes it virtually impossible to force any individual driver to pay, no matter how negligent he might have been. For these reasons, it should be recognized that the assignment of blame within the existing tort system *serves only one useful purpose*: it provides a basis for compensating victims. However, a negligence approach to civil liability is basically irreconcilable with the social objective of taking care of *all* accident victims.

CHAPTER 4

POLICY OBJECTIVES RELATED TO MOTOR VEHICLE ACCIDENTS

The insurance and legal systems should serve the society in which they exist as well as possible. For this reason, in developing insurance and legal objectives, the broader social and economic context within which these systems function should be explicitly recognized.¹ In terms of motor vehicle insurance reform, the transportation system and society's transportation needs are of principal interest in the development of objectives for the insurance and legal systems.

A. Transportation System Considerations

A transportation system enables persons and goods to be moved among different places in a variety of ways. For our purposes here, "increasing mobility and choice of means of mobility for all at decreasing cost" adequately expresses the continuing objective for the transportation system. A goal such as economic development is served by transportation, and the above objective is consistent with such a goal. Within the transport system exist different transport modes suitable to the air, sea or land environment. Only those which operate on land, such as motor vehicles, bicycles, or pedestrians, are of concern to this study. Their activity, called traffic, in achieving desired social and economic mobility, also produces accidents, crashes or collisions. These are not desired; the social and economic consequences of such accidents, crashes or collisions are significant costs of the road transport system.

¹In systems analysis, this principle for ordering and relating topics is usually called a hierarchy of objectives; the PPB system employs this principle.

The transportation system objective, to provide mobility and choice at minimum cost, requires that the social cost of traffic accidents be reduced wherever feasible. Four specific objectives are derived from this requirement. Two objectives translate into preventive functions prior to and in anticipation of collisions (precrash functions), and two translate into specific functions after a crash has occurred (postcrash functions). Precrash functions are mainly oriented toward the population and the traffic system as a whole; postcrash functions are oriented toward specific system components — vehicles and individuals. Precrash and postcrash objectives have different implications for insurance and legal objectives.

B. Precrash Objectives

The two precrash objectives provide the rationale for a large number of activities by local, state and national government. Since 1966, these objectives have been coordinated in a nationwide highway and traffic safety program in which Hawaii participates.² The desired effect of these two objectives is to reduce the total economic and social loss from motor vehicle collisions. They are:

Prevent collisions. Consistent with the goal of mobility, decrease the number of collisions such that the total loss is minimized.

²Federal Highway Safety Act of 1966.

Reduce severity and minimize injury and damage. Take all feasible prior actions to reduce the severity of those collisions which do occur.

Increased research activity on highway traffic safety sponsored by government and industry has begun to yield results. Safety program standards for states and safety standards for motor vehicle manufacturers are two well-known examples. While this study is not a report on the state-of-the-art of highway traffic safety research, one finding being documented independently in several efforts is particularly relevant to the insurance and legal issues addressed here.³ Namely, traffic accidents can be extremely complex events with many different interacting contributing factors—i.e., many collisions do not have a single cause. Legal and insurance concepts based on assumptions of simple causality are therefore invalid.

1. Prevent collisions. This objective is of key significance to governments attempting to reduce the cost of accidents and hence of insurance. From the viewpoint of broad social policy and choices, preventive action falls into two classes: (a) activities to reduce motor vehicle traffic and (b) activities to prevent collisions in traffic. To reduce traffic and thereby reduce collisions (as well as air pollution) requires that public policy encourage alternatives to individual motoring such as some form of mass transit or bicycling.

Prevention of collisions in traffic requires many activities by the highway and traffic safety programs. These activities are not discussed at length in this report. However, one aspect of traffic collision prevention of particular interest to the development of insurance and legal systems objectives is driver avoidance of collisions and of the risk of collisions. In operational terms, avoidance has meaning and purpose; safe driving does not. Activities directed toward increasing the avoidance of collision risks include driver preparation, licensing and rehabilitation; traffic policing and traffic law enforcement by police and

courts, respectively; and programs to inform drivers in advance of specific cost consequences of collisions. Refraining from violating traffic laws by a driver is a means, not an end. That legal sanctions (or the threat thereof) have a deterrent effect is conventionally alleged, but such allegation has not been conclusively demonstrated for socially significant offenses.⁴

The objective of prevention affects insurance and legal systems indirectly but importantly. Neither insurance nor legal objectives, nor activities undertaken to accomplish them, should conflict with efforts to prevent collisions. If possible, moreover, the legal and insurance systems should contribute to loss reduction. Specific ways in which insurance and legal objectives relate to the prevention of collisions will be discussed in chapters 5 and 6.

2. Reduce severity and minimize injury and damage. Reduction in the cost of those collisions that do occur is the aim of this objective. The insurance and legal systems should contribute in whatever ways each most effectively can.

Other parts of the traffic management system have primary responsibility for attainment of this objective. For example, highway and vehicle design changes are mandated by federal standards to reduce severity of collisions for both motor vehicles and occupants.⁵ Since injuries become more serious if appropriate treatment is delayed, the emergency medical services component of the state's traffic program is charged with improving the capability to respond more swiftly and effectively. Reduction of the cost to repair collision damage is not yet an objective of the federal government, but it is the subject of a substantial research effort by the Insurance Institute for Highway Safety, and of a major investigative effort by the U. S. Senate Commerce

⁴Zimring, Franklin E., *Perspective on Deterrence* (A monograph series on Crime and Delinquency Issues, National Institute of Mental Health, Center for Studies of Crime and Delinquency), Washington, D. C.: U. S. Government Printing Office, 1971.

⁵More needs to be done to minimize injuries to others. For example, no motor vehicle design has been mandated to reduce injury to pedestrians or bicyclists.

³Baylor College of Medicine, Houston, Texas, Department of Psychiatry, *Multidisciplinary Investigations to Determine Relationship Between Vehicle Defects, Failures and Vehicle Crashes*, Final Report, Contract -DOT-FH-11-7254, March 1971.

Committee. This activity resulted in a bill which was approved by the U. S. Senate on November 3, 1971. The proposed legislation would require the Secretary of Transportation to report to the Congress within two years on the feasibility of rating automobiles by crash damage characteristics, and to establish standards for crash damage.⁶

C. Postcrash Objectives

As a matter of public policy, what should be done when a collision has occurred? Damage to vehicles (other than clearing the scene of the crash to prevent additional collisions) is not a matter for affirmative public policy and action. Injury to persons is. The postcrash objectives postulated here address the question of what must be done for any person injured in a collision.

- **Treat all victims.** Minimize the extent of personal injury of automobile accident victims and restore all victims to their prior condition as nearly as possible.
- **Reduce hardship.** Minimize undue economic, psychological, or social hardship of all automobile accident victims and their immediate families.

These objectives are stated without qualification. It is not public policy to provide medical care only for the "innocent" and withhold treatment from persons who might be held responsible for contributing to the collision or for violating some traffic law. Each of these two objectives has significant implications for insurance or legal objectives.

1. Treat all victims. The social objective of restoring injured persons to their precrash condition as nearly as possible requires that all necessary health care, including rehabilitation counselling and treatment, be provided. Effective health care requires promptness to avoid worsening the injuries; effective rehabilitation requires that treatment be started before the effects of injuries become set. The operational objective is therefore

the effective and efficient delivery of health care and rehabilitation services to crash victims. In those severe injury cases where complete restoration is not medically possible and some disfigurement or disability remains, the objective of complete restoration must be tempered to that of ameliorating the effect of the disfigurement or disability.

A corollary to the objective of effective and efficient delivery of health and rehabilitation services is that providers of such services be fairly and promptly compensated. This corollary also has significance for the insurance system because the insurance pool now constitutes the principal source of payment. Delivery of such services must not be withheld or delayed because of uncertainty about payment by the insurance system.

2. Reduce hardship. The goal of reducing economic, psychologic, and social hardships of all motor vehicle collision victims has direct insurance and legal implications. Prevention of economic hardship—a social objective already expressed in other income protection laws—is a basic insurance objective and function.

The reduction of psychologic and social hardship has implications which are perhaps less obvious but equally real. For example, fears or worries can be reduced by *guaranteeing with certainty* that timely and adequate economic resources will be available to all victims; hence, some minimum guaranteed compensation becomes an important objective. Such a guarantee assumes greatest significance for those unfortunate victims who, despite the best health care and rehabilitation services, suffer *permanent* disfigurement or disability. No insurance or legal system can eliminate the pain and grief of the victim or his family, but as a matter of public policy the sudden and difficult adjustment to a different life style can be ameliorated by guaranteeing specified resources.

D. Insurance Implications

It should be noted that when public policy determines it to be socially necessary to provide all motor vehicle injury victims specified benefits with certainty and without qualifications, it creates a distinction between basic protections which should

⁶S. 976, Motor Vehicle Information and Cost Savings Act.

apply to everyone and other protections which need not apply universally.⁷ Insurance systems which deliver basic protections—such as health care, independent of age—are essentially social insurance systems and are typically priced or financed by a formula which does not take full account of expected payout to the individual (i.e., “risk” to the insurance company). Other loss protection systems not delivering these basic, socially mandated benefits are generally priced on the basis of loss expected from different risk classes. The appropriateness of pricing criteria for social insurance therefore becomes a subject for explicit and affirmative public policy.⁸

It should also be noted that underwriting criteria differ markedly for mandated social

⁷Economists classify goods falling in the first category as *merit goods*. Rules governing the pricing and distribution of merit goods may differ from economic rules applied to the pricing and distribution of other goods.

⁸It is probably for this reason that the pending Hart-Magnuson bill on no-fault auto insurance would make rate classifications subject to federal regulations.

insurance. Under such circumstances, for example, the activity of trying to avoid altogether certain “high-risk” categories serves no socially useful function whatsoever. Typical underwriting effort could, in fact, be antisocial.⁹

E. Conclusions

The policy objectives specified here focus on end results desired by society: specifically, minimizing accidents and injuries and providing for those who do become victims. These policy objectives reflect the systems approach used throughout this study. They also have direct and overriding importance for the insurance and legal systems which apply to motor vehicle accidents. Objectives specified for these systems must be consistent with society’s more fundamental goals if they are to work in harmony towards achievement of desired end results.

⁹For example, if the typical underwriting activity of avoiding “high risks” were applied to social security insurance, the result would be an effort to avoid writing coverage for those expected to live the longest.

CHAPTER 5

INSURANCE OBJECTIVES

The primary issue in the current debate over automobile insurance reform is whether the insurance system should function within the framework of tort liability, within a system that virtually precludes recourse to tort action, or within some combination of the two. Regardless of which legal system is adopted, however, any insurance system must *provide protection against specified potential losses associated with the risk of motor vehicle collisions*. This is a function of insurance and the insurance system.

Insurance is essentially a contractual pooling of resources by many, for purposes of sharing risks and reimbursing losses which any one individual cannot or does not wish to bear. A motor vehicle insurance system is a set of elements, such as privately owned insurance companies, performing activities which provide the public with a means of insuring against the risks of loss and with compensation for loss in the event an accident does occur. The system is regulated by an official who is accountable to the public for the system's performance.

A. Primary Insurance Objective

Insurance protection should be provided efficiently and effectively. *Efficient* means that the long-run cost of providing coverages and benefits be at a minimum, and that a substantial portion of the auto insurance premium be used to defray

losses of victims.¹ To do less is not in the best interests of the insurance buyer or the general public. *Effective* means that the insurance system should, wherever possible, *provide others with correct incentives* concerning motor vehicle collisions. The role and importance of *correct incentives* will be illustrated by three examples from the activities of:

- . Compensation
- . Selling and underwriting
- . Auto design.

1. **Compensation.** The expensive adversary process used to settle liability claims gives even the smallest tort claim a high nuisance value. In order to avoid expensive litigation costs arising from bodily injury claims, insurance carriers have a strong incentive to settle small claims with substantial overpayments. Insurance companies also have every incentive to delay settlement and payment of claims, especially those involving serious injuries and potentially large settlements. Insurance companies earn interest on their unpaid losses while settlement is pending, and if long delay can cause sufficiently severe hardship to the claimant, it may reduce the ultimate size of the settlement. The result is a serious and inequitable distortion in the existing system: inadequate

¹The emphasis on long-run cost minimization means that insurers should take affirmative action to maintain quality and to control costs of services provided by others, such as rehabilitation or auto repair services.

settlement of claims involving serious injuries and excessive compensation for minor injuries.²

2. Selling and underwriting. Under the present system, private insurance companies are inclined to avoid selling insurance to about 25 percent of the vehicle-owning population because they are considered poor risks. Insurance carriers also prefer to sell the least amount of desirable liability coverage and too much of other coverages. For example, carriers prefer to sell more of collision coverage with a deductible of \$50, instead of \$100 or \$250, and less of liability coverage of \$100,000/\$300,000. Increasing liability coverage from \$10,000/\$20,000 to \$100,000/\$300,000 increases a carrier's potential exposure up to \$280,000, whereas reducing a deductible from \$100 to \$50 increases exposure by only \$50 at roughly the same premium differential.³ The net result, inadequate liability coverage and unnecessary collision coverage, is poor economy for the consumer.⁴

3. Auto design. Insurance ratings could have significant effects on auto design. When rates were increased on more powerful cars, they dramatically reduced sales of these "muscle" cars. Similarly, encouraging auto manufacturers to produce bumpers that can absorb low speed impact will presumably have an effect on collision repair costs. Despite all of its complexity, however, the existing rating system gives no significant incentives to automobile manufacturers for loss reduction. Premiums for most coverages depend not on the car but on the driver and use of the car.

To summarize this section, the major public policy objective guiding selection of the best motor vehicle insurance program is:

²Legal incentives unfortunately work in the same direction. Lawyers are likely to create (at low cost to themselves) "nuisance value noise" over small claims, since they typically work on a contingent fee basis and receive a percentage of the total settlement. In cases with large losses, however, when an attorney is offered a settlement for some fraction of that which might be obtained after a lengthy court trial, the attorney has every incentive to bargain hard for his client but urge his client-victim to settle for less than his full losses rather than prosecute. The legal incentive system is entirely consistent with the conclusion reached in the study conducted by the U. S. Department of Transportation: On average, small claims are substantially overpaid and valid large claims are seriously underpaid.

³The cost differential between \$50 and \$100 deductible—\$50 worth of extra insurance coverage—is \$26 per year.

⁴A person can deduct from his taxable income his share of any accident as a casualty loss but cannot deduct his annual premium.

To provide the most effective and efficient means of insuring against and reducing the losses associated with motor vehicle collisions.

B. Subobjectives or Operating Characteristics

The desirable operating characteristics or subobjectives postulated for the insurance system are:

- (1) Compensate personal injury losses adequately
- (2) Pay compensation promptly
- (3) Guarantee payments
- (4) Make personal injury protection universally available at reasonable cost
- (5) Assess cost equitably
- (6) Operate simply
- (7) Complement related activities
- (8) Account for performance.

Chapter 4 postulated two major postcrash objectives concerned exclusively with providing for injured victims: treatment of injuries and reduction of hardships. Subobjectives (1) – (3) above relate directly to these objectives. Before victims can be compensated for losses, however, financial resources must exist. The existence of such a pool has been assumed throughout, and the primary insurance objective stated above is that the insurance system which operates this resource pool should do so efficiently. Up to this point, the discussion has not been explicit about who should pay into this pool and on what basis premiums should be assessed. Subobjectives (4), (5) and (6) relate directly to these questions which were touched upon in the discussion of postcrash objectives. The need to complement related activities was identified in the discussion in chapter 4 concerning objectives of collision avoidance and reducing injury potential. Accountability for performance is a basic requirement for any public system. Operating characteristics (7) and (8) express these subobjectives.

A multiplicity of subobjectives like these may not all be mutually consistent. For example, the higher the collision losses, and the higher the compensation to victims, the higher will be the premium which some motorists must pay. If compensation is too generous, universal availability at reasonable cost then becomes impossible. The challenge obviously is to arrive at a satisfactory compromise among conflicting subobjectives. This will be discussed after each subobjective has been examined in more detail.

1. Compensate personal injury losses adequately. All personal losses of collision victims can be classified as follows:

- a. Tangible
 - i. Out-of-pocket
 - . past
 - . future
 - ii. Disfigurement (amputations, scarring, etc.)
- b. Intangible (pain and suffering).

All tangible out-of-pocket losses (past and future) will be referred to hereafter as *personal injury losses*. The above classification scheme, which makes several useful distinctions for an insurance study, will be used to specify this objective (compensate personal injury losses adequately) more precisely.

Only tangible out-of-pocket losses which have already occurred are susceptible to accurate accounting measurement; losses attributable to all other sources must be estimated. Courts classify only measurable losses as "special damages" and group all estimated losses together as "general damages."

For insurance purposes, the court classification is unfortunate and not very useful. The three components of general damages (future out-of-pocket losses, disfigurement losses, and pain and suffering) contain two types of easily insured losses and one type of loss which is extremely difficult to assess and hence difficult and costly to insure. These distinctions constitute an important consideration in the design of an insurance system.

Namely, future out-of-pocket losses can either be paid on a continuing as-incurred basis (e.g., future wage loss) or estimated by a generally acceptable formula; hence these losses are easily insurable. Disfigurement losses can readily be paid on a scheduled basis, as are workmen's compensation benefits or death and disability benefits, and if so scheduled these losses are also easily insurable. By contrast, there exists no generally acceptable method for estimating or scheduling true "pain and suffering" losses. Because of the uncertainty and unevenness with which juries hand down pain and suffering awards, these losses are difficult and expensive to insure.⁵

Each category of loss is defined in more detail in the following paragraphs.

a. Personal injury losses. These constitute (1) medical or health care payments; (2) past and future wage losses, including wage loss resulting from disability; (3) out-of-pocket expenses normally incurred when an accident disrupts one's usual activities—e.g., help to care for children if parents are hospitalized or bedridden; (4) rehabilitation services to enable a person to return to his usual activity as quickly as possible; and (5) in the event of death, funeral expenses and dependent's loss of support.

To provide adequately for losses of all injured victims, personal injury losses should be compensated to the extent that they are or will be incurred. Repayment should cover a substantial majority of or all loss, but it need not exceed losses. Double coverage and excess compensation for the same injury are not efficient and not socially desirable.⁶ Moreover, seriously injured victims should not be excluded or treated separately. They need adequate compensation as much as or more than other victims. Therefore, personal injury losses should be payable virtually without limit.

b. Disfigurement losses. Irreparable loss of limb, damage to facial features, permanent total or

⁵It has been proposed that insurers offer "pain and suffering" coverage on an optional first-party basis. However, no insurer has yet offered such a policy, and at present this loss is noninsurable on a first-party basis.

⁶Double coverage should not be part of any legislatively prescribed, minimum insurance package.

partial disability, or similar losses which make it impossible for victims to return to their usual state of social enjoyment are defined as disfigurement losses. These losses are real and substantial to those victims who sustain them. Thus, from a humanitarian viewpoint, it would be highly desirable, within the bounds of economic feasibility, to provide extra compensation to ameliorate the adjustment of those victims suffering disfigurement losses.

c. **Pain and suffering.** The most difficult compensation issue is that commonly referred to as pain and suffering. The U. S. Department of Transportation estimates that, on a national basis, 50–60 percent of all insurance benefits paid under the broad heading of “bodily injury” are for general damages. As explained above, these payments include some estimated wage and disfigurement losses. It is also from general damage awards that attorneys of victims must be compensated (which frequently amounts to one-third or more of the entire award). Thus, the amount which a victim receives for pain and suffering is whatever residual is left after the above deductions. Insurance reform advocates allege that the magnitude of payments for pain and suffering long ago crossed the threshold of scandalous and now borders on the absurd.⁷ Most complete no-fault reform plans totally eliminate pain and suffering awards.

In terms of the factual evidence concerning pain and suffering, it is hard to ignore the many studies which show that minor injuries receive gross overcompensation chiefly because of their nuisance value. These same studies also indicate that the more serious injury cases tend to be grossly undercompensated, even after all general damages (including pain and suffering) paid in these cases are taken into account. To abolish pain and suffering awards would not by itself correct in any way for undercompensation of serious losses. The issue is whether the subjective of adequate compensation properly includes payment for pain and suffering as the most efficient way of providing for all accident victims. The appropriate concern for public policy is whether an alternative system of insurance will compensate all victims

⁷Jeffrey O’Connell, *The Injury Industry*, Urbana: University of Illinois Press, 1971. Also, Marc Franklin, “Replacing the Negligence Lottery: Compensation and Selective Reimbursement,” 53 *Virginia Law Review* 4 (May 1967) pp. 792–3.

more fairly in relation to their losses. Within this goal of adequate compensation, alternative systems must be appraised on the merits of their specific provisions.

2. **Pay compensation promptly.** Losses should be paid when recognized, or as soon as is reasonable thereafter. The suffering and expenses of victims and their families can be increased needlessly if payment is not made swiftly. Moreover, access to medical care may be limited if there is no assured provision for payment of such care. Providers of medical care and rehabilitation services should also be paid promptly.

Not knowing whether or when compensation will be forthcoming to meet the extra medical and rehabilitation expenses as well as the normal cost of running a household creates great psychological hardship if victims are deprived of economic sustenance for long periods. Regardless of the magnitude of the loss, every positive and negative incentive should be provided by the insurance system to ensure that claims are paid promptly and fairly.

3. **Guarantee payments.** Policyholders and victims frequently believe that the motor vehicle liability insurance system is capricious and unreliable.⁸ In many instances, damages have been inflicted by parties who, for whatever reason, have no coverage whatsoever or whose liability insurance is inadequate to cover the loss. Policyholders experience seemingly arbitrary and capricious cancellation or nonrenewal of policies, often after many years of paying premiums and filing no claims.⁹

The present liability system and financial responsibility laws require the majority of motorists to pay for insurance covering *other* motorists. In the event of a collision with an uninsured motorist, however, the insured motorist will likely collect nothing *unless he has also paid for his own protection*. In other words, a motorist can pay as much as several hundred dollars for

⁸U. S. Department of Transportation, “Public Attitudes Toward Auto Insurance,” in *Auto Insurance and Compensation Study*, Washington, D. C.: U. S. Government Printing Office, March 1970.

⁹In some states insurance companies have become insolvent, leaving policyholders and victims unprotected. However, Hawaii has not experienced this problem.

automobile liability insurance and still have no protection whatsoever for himself, his family or guests.

Under the present system, a person who wants *guaranteed* coverage must carry first-party insurance on his own car plus liability insurance for all other cars. Present financial responsibility laws governing motor vehicle insurance are therefore weak as regards guaranteed protection. As a matter of public policy, guaranteed protection for those motorists who pay for insurance should be included in any motor vehicle insurance system. These rights should extend to all motor vehicle accident victims, whether driver, passenger, bicyclist or pedestrian, as specified in chapter 4. Regulation of the insurance system should assure with certainty that benefits are delivered.

Certainty of loss compensation requires certainty of financial integrity of the system that delivers these benefits. To assure the financial integrity of a system to compensate all persons injured by motor vehicles requires that no motor vehicle owner be allowed to avoid contributing to the pool of resources.

4. Make personal injury protection universally available at reasonable cost. For an insurance program to offer basic protection to the entire citizenry, adequate minimum coverage must be readily available and economically within reach of all car owners. The cost of such basic personal injury protection should be affordable and should not prohibit any driver from making necessary journeys to work and market.¹⁰ The ability to pay, then, is a proper criterion to use in determining the acceptability of any proposed rate structure.

To a substantial degree, this objective can be achieved by making the insurance system as efficient as possible. As indicated earlier, efficiency implies the elimination of all unnecessary costs of delivering benefits or buying and selling of insurance. In this regard, the many costs associated with the adversary process and restrictions on mass merchandising are both suspect.

¹⁰The state's role is not to guarantee that persons can afford motor vehicles they would like but that they can afford insurance premiums required for personal injury protection. Collision coverage on one's own car, a replaceable object, should be optional.

Even the most efficient insurance system cannot provide adequate coverage to all at an affordable cost if too many drivers contribute disproportionately to the losses which must be compensated. Total losses from motor vehicle injuries must be kept to a level which the compensation system was designed to serve; if not, the cost of adequate insurance will rise to a level which will be unaffordable to many. In this context, the precrash objectives of minimizing the number of collisions and the losses from collisions assume added significance, since reform of the insurance system does not, per se, reduce the number or severity of collisions.

Differentials in the present rate structure are based to a substantial degree on age. If a family has a young teen-age driver, the differential occasioned by this driver literally "swamps" all other differentials in the rate structure. Individual drivers under age 25 pay substantially higher insurance rates even though they tend to earn less than do people over 25; hence, the present rate structure is highly regressive.¹¹ It is true that, on the average, younger drivers are more frequently involved in collisions, including the more serious ones. The effect of the present mandated risk classification system, however, is to prejudge without exception all younger drivers. Not only is the present rate structure regressive, but it also completely fails to focus on any loss producing factor which is controllable by consumers. One can do nothing about his age except lie. Thus, the most important differential in the rate structure gives no socially significant loss reduction incentive to anyone, unless it was meant as an incentive to parents not to permit teen-age children to drive.¹²

5. Assess costs equitably. In broad terms, losses are a function of the vehicle, the driver, and the highway traffic environment. Therefore, a universal motor vehicle insurance system would ideally base rates on (a) the vehicle's ability to minimize injury, (b) each individual driver's ability to avoid collisions, and (c) the general highway

¹¹See chapter 9 for more details on the rate structure.

¹²It is possible to question whether a person should be permitted to drive before reaching the age of 18 or 20. The age at which people should be permitted to drive is a difficult decision which must be made collectively by the legislature. Once this driving age has been fixed, however, it is not a proper function of the insurance system to subvert or partially abrogate this decision.

traffic system.¹³ By applying a very simple exposure factor, the rating territory in which a person lives, the present rate structure partly satisfies criterion (c), but it does not satisfy criteria (a) or (b).

It must be stressed that equitable and effective cost assessment should emphasize *variables which are controllable* (not variables such as age, race or sex, over which no one has any control) somewhere within the system in order to provide proper incentives to drivers and responsible officials. The discussion in the following paragraphs describes briefly the nature of reforms necessary to achieve this subobjective.

a. Ability of vehicles to minimize injury. Motor vehicles differ significantly both in their potential for inflicting injury and in their ability to absorb collision impact with minimum injury to occupants. For example, motorcycles cause little damage to larger vehicles, but their drivers and passengers are highly vulnerable. At the other end of the size spectrum, large trucks have great damage and injury causing potential, but their drivers are relatively secure. Cars differ widely in both regards, depending chiefly on size and weight.¹⁴

A no-fault system should provide incentives to select vehicles which minimize injury *to oneself and occupants*.¹⁵ In fact, if no-fault insurance rates do not differentiate among vehicles on the basis of their potential to injure occupants, owners of relatively safer vehicles will be subsidizing owners of less safe vehicles. Equitable cost assessment does not require the average motorist to subsidize those who knowingly, willingly, and needlessly expose themselves to high risks. A premium structure which differentiates among private passenger motor vehicles, including

¹³According to subobjective 6, the rate structure should also be simple.

¹⁴U. S. Department of Transportation, *Annual Report, 1970*, under the National Traffic and Motor Vehicle Safety Act, Chapter 2. This report also identifies the disproportionately high vulnerability of the occupants of minibus or van-type passenger vehicles within their weight class.

¹⁵In theory, tort liability and no-fault insurance systems provide strikingly different incentives. Under tort liability, minimizing potential damage *to others* should be an incentive in selecting a vehicle.

motorcycles, on the basis of potential injury to occupants, would be a socially desirable feature of a publicly mandated insurance coverage. Excluding age, sex, race and other uncontrollable variables should encourage insurance actuaries and statisticians to study the injury potential of motor vehicles instead. Results of such studies and of the decisions by consumers made in response to the injury price of a vehicle, should in turn encourage manufacturers to compete more on the basis of safety and less on socially unnecessary and undesirable features such as racing performance.

b. Ability to avoid collisions. Drivers who contribute disproportionately to losses present a genuine dilemma to any insurance system, as well as to society at large. They expose both themselves and others to the disproportionate risk of loss. It is doubtful, however, whether the insurance system has the ability or is the proper institution to rehabilitate drivers with poor risk avoidance skill or behavior. Any system must be assumed to contain a group of risks who are worse than average. Denying coverage to such risks does not solve the fundamental problem; it only exposes the owner, his family, passengers and others to the risk of uncompensated loss, which is socially undesirable. In the event of an accident, this imposes hardships on the family or other innocent victims which are probably undeserved.

From an underwriting viewpoint, the most difficult problem is to identify which individuals are high, normal or low risk.¹⁶ Gross schemes such as age, which incorrectly classify well over 50 percent of the group as high risk,¹⁷ are neither equitable nor socially desirable. The challenges to actuaries and underwriters are (1) to develop more accurate ways of classifying drivers, (2) to translate these findings into more meaningful classifications and restrictions, and (3) to give individuals proper and meaningful incentives as regards controllable variables.

The insurance industry took its first step in this direction when it increased rates on "muscle cars" on the assumption that owner-drivers of such cars

¹⁶When such identification is made, the next step is to assist these people to improve their driving skill and risk classification.

¹⁷Statistically, this is classified as type II error or false positive.

were more likely to be "aggressive" rather than "defensive" drivers. By this simple but highly effective action, consumers and manufacturers were (1) informed that certain of their products were contributing to social loss, (2) told that as a group they would henceforth have to shoulder the burden of that loss, and (3) provided a means of avoiding that loss. It is this type of investigation and action that the industry needs far more of.¹⁸

How should premiums for high-risk drivers be priced? If high-risk drivers can in fact be identified with greater accuracy than at present and if they can be provided with clear means of improving their risk classification, equitable cost assessment does not preclude high risks from being charged higher premiums even for a basic package.¹⁹ Within these restrictions, it is to be hoped that automobile actuaries or other technicians can create a rate structure which is both more equitable and more useful.

c. General highway-traffic safety system. This system includes a great number of factors, such as density of traffic, road conditions and traffic engineering results. Collectively, these factors are reflected in the accident profile of reasonably defined geographic areas. Residents of less densely populated islands should not be required to subsidize residents of Oahu. Equitable rate adjustment thus includes area rating patterns as now exist.

6. Operate simply. A creative and soundly conceived rate structure might encourage risk avoidance driving behavior. However, before any differentials in the rate structure can have any desirable effect on driver behavior, the rates and the rate differentials resulting from certain actions *must be clearly understandable to the average motorist*. It is doubtful whether the average motorist understands many of the

differentials, surcharges and discounts which exist under the present system. The insurance system should also streamline its operation and avoid needless complexity that imposes added processing costs, confuses buyers and creates ambiguity or uncertainty about benefits. A basic policy, offered at rates known and published, and clearly separated from any voluntary additional protection, would be a desirable feature of a universal insurance system designed for all motorists. In the design of optional coverages, the criterion of simplicity means that only important distinctions should be authorized, rather than a myriad of minutiae designed more for advertising purposes than for basic consumer protection.

It is also desirable that the determination and payment of benefits be a simple, easily understood process. Under liability coverages, the need to establish fault in order to receive compensation adds measurably to the complexity as well as the cost. A simple but correct system should also eliminate duplicate coverage and entitlement as well as duplicate payment for the same injury.

At the claims processing stage, simplicity means that, although other coverages might be primary from a financial viewpoint, auto insurers should assume primary responsibility for helping victims effect claims from all other sources. Since auto insurers would have a contingent liability for uncompensated losses, it would be in their own interest to provide a comprehensive one-step claims service if other coverages were primary.

7. Complement related activities. Previous discussion has indicated how the insurance system might better complement other activities which work toward the same broad public policy objectives. An appropriate criterion for assessing operational features of any insurance plan should be that they are consistent with and support activities which seek to minimize total losses from collisions. Examples mentioned include discouragement by the insurance system of motor vehicles with high injury potential and encouragement of risk avoidance in driving behavior. The insurance system can also contribute to improving the rehabilitative functions of the traffic safety system. The insurance system is in a unique position to find cases in need of treatment and put a price tag on that need through compilation of loss data and characteristics associated with each case. The traffic safety system

¹⁸One insurance company in the Washington, D. C., area administers a voluntary driving test over an "obstacle course." Drivers passing the test are given discounts from their usual rates. Other insurance companies might investigate this or similar ideas. Equitable cost assessment certainly does not preclude discounts for better-than-normal risk avoiders.

¹⁹Rates on optional collision coverage for certain individuals might be quite high, even to the point of denying coverage to some, so that in a no-fault system, the driver's car would be financially at stake every time he ventured on the road.

cannot do this because it measures only convictions for violations. Analogous loss data can be provided for specific vehicles and locations which can then receive special attention by the cognizant authorities.

In other words, the same analytic activity required by the insurance system to concentrate on defining controllable variables for underwriting could also be utilized to complement the diagnostic needs of the traffic safety management system. The present relation between the insurance system and the traffic safety system works in exactly the opposite direction: drivers classified by the traffic safety system as violators of the traffic law are reported to the insurance system at a cost of 50 cents. They are then classified as high risks, with consequences to the insured motorist being

premium increases ranging from 5 to 150 percent (see chapter 9).

8. Account for performance. A regulated industry that operates under many statutory protections and exemptions and uses the public's financial resources extensively should report to the public on its performance with respect to these objectives. It should also be accountable for such performance in ways that are consistent with best public management practices. Examples of measures by which the industry should report its performance might include (a) the time to effect settlement on claims, (b) the number and kind of claim disputes, (c) efficiency of the system, and (d) similar factors that describe effectiveness in accomplishing the purposes for which the industry exists.

CHAPTER 6

LEGAL OBJECTIVES

This chapter defines legal objectives in the context of motor vehicle insurance. It explores the role of the legal system in meeting the public policy objectives specified in chapter 4. To secure a clear understanding of the legal system's role in motor vehicle transportation, it is necessary to discuss the two major components of the system separately—the criminal justice system and the civil liability system. The following attempts to do this. We examine first the evolution of the two legal subsystems and then discuss the effect each has on the specific objective of minimizing and compensating auto accident losses. We then examine the impact of automobile insurance on the civil liability system in compensating victims of motor vehicle accidents.

A. Evolution of the Two Legal Subsystems

Both the criminal justice system and the civil liability system as they exist in the United States today have their origin in the ancient common law of Great Britain. In its early development, the British legal system did not distinguish between civil and criminal law. A single network of justice performed those functions now performed by the two separate systems. Any infraction against the standard of behavior required by the feudal system was treated as a breach of the king's peace and was subject to trial and punishment. The single system imposed fines or imprisonment and also decreed compensation in favor of any victim.

In order to determine whether a wrongdoer was liable for compensation, the courts did not apply the standard of reasonable care that now

forms the core of a negligence suit. Instead, a wrongdoer was liable for compensation if it could be shown simply that he *caused* the injury or loss alleged by the plaintiff. His moral blameworthiness was not an issue, nor could he defend himself on grounds that he exercised every precaution to avoid injuring the plaintiff. Compensation was based on what is now termed "strict liability," a concept that is still applied today in many situations where society wishes to provide compensation without arguing issues of negligence or fault (e.g., product liability or workmen's compensation).

Eventually, the unified system of justice and compensation came apart. This took place as a result of the development of new philosophies toward the rights of individuals who are subject to punishment by fine, imprisonment or death for committing offenses against society. The adoption of a bill of rights and a body of constitutional law required the judicial system to become restrained in order to protect those rights recognized as inherent in every individual regardless of the nature of his behavior. However, since a more restrained system of justice meant that compensation for losses inflicted by a wrongdoer would be less readily obtainable, that function was assumed by the rapidly emerging civil law of torts.

B. The Criminal Justice System

The criminal justice system that has evolved since the separation of the function of compensating individuals has focused on the "rights of society." The objective of the criminal justice system today is to enforce the collective

judgments of a society regarding the behavior of individuals. It operates in the interest of the public welfare by:

1. Determining whether someone is guilty of violating the law;
2. Imposing punishment; and
3. Discouraging or deterring future harmful behavior.

The purpose of these tasks is to help maintain an orderly community life.

In the context of motor vehicle transportation, the increasing complexity of the transportation system has made it necessary for society to enact laws regulating traffic. The objective of traffic law is to provide for the safe and efficient use of public highways. Without traffic regulations, the conduct of a driver can lead to harmful effects, viz., accidents and attendant injuries, deaths and damage to property. Whenever behavior contravening the criminal traffic code is detected by the enforcement authorities, the criminal justice system intervenes. Of course, the application of the criminal justice system to traffic law violations is not perfect. Many instances of unlawful behavior are not detected.¹

The criminal law system imposes a fine or term of imprisonment for behavior contrary to law. In a sense, the fine or term of imprisonment "compensates" society for the wrongful act of the defendant. In a larger sense, however, a fine or a term of imprisonment is imposed as a means of deterring future, potentially harmful behavior. Experts disagree on the extent of the criminal law's ability to discourage future harmful behavior. Some even contend that the law has no deterrent effect whatsoever. Regardless of what position one takes on this issue, the important point is that one of the *objectives* of the law is to deter harmful conduct. In view of the community's desire to

¹In the traffic environment thousands of violations occur daily without calling upon the violator to account for his actions. Indeed, a sociologist might say that some violations have become institutionalized to the point where it is considered abnormal not to commit them. Exceeding a 25 mile-per-hour speed limit is a good example.

promote an orderly existence, this goal is valid even though its attainment is difficult or sometimes impossible. Further, the concept of deterrence requires that the law be viewed as only one of many social elements operating to encourage or discourage certain behavior.

Although the criminal law imposes a fine or term of imprisonment for behavior contrary to law, it is powerless to compensate the victim of a crime. This means that if a violation of the traffic code results in a serious accident, the victim must recover his personal losses through other means. (In those accidents which do not involve a violation of the traffic law, the criminal justice system is of course not applicable.)

C. Civil Liability System

The task of compensating victims of wrongful acts committed by another became the responsibility of the civil liability system. In taking up this duty to provide compensation for losses suffered at the hand of another, the civil law followed the fact-finding and adversary tradition of its ancient predecessor. Thus, today, the civil liability system continues to determine whether harm has been committed by another and, when it finds that this has occurred, it requires retribution for any resulting loss. Trials continue to be held at which responsibility is assigned to some individual, and the duty to compensate is enforced through the judgment and execution process.

The essence of the civil liability system is to provide the means for settling conflicts and disputes between two parties. The potential for conflict is inherent in traffic. In 1896, when there were only four automobiles in the United States, two of them managed to collide in St. Louis, injuring occupants in both cars.² The primary objective of the civil liability system as it applies to automobile accidents, therefore, is to determine the rights and obligations of those who suffer harm or loss as a result of an auto accident—in other words, to allocate or assign responsibility for bearing losses to the parties involved.

The civil law has traditionally performed its assigned function by:

²Daniel P. Moynihan, in foreword to O'Connell, *op. cit.*

1. Determining whether the individual has suffered harm as a result of someone else's actions,³ and
2. When this has occurred, imposing a duty to compensate the victim for his loss.

As with the criminal justice system, it is frequently alleged that awarding victims compensation for their losses will discourage or deter future harmful behavior. And as occurs with the criminal justice system, there is no real evidence to indicate that any effective deterrence in fact occurs.

The civil liability system operates under a set of rules different from that of the criminal justice system. This is necessary because the impact of the moral force that punishes an infraction against society's collective judgment is far greater than that which imposes the duty to compensate for infliction of harm on another individual. Commission of a crime can result in loss of liberty or, in some cases, loss of life. Since life and liberty are of such fundamental importance, the rules by which the criminal justice system may take them away are carefully drawn and rigorously observed. The standard of evidence is just one example of the difference in rules. To obtain a criminal conviction, proof of guilt beyond a reasonable doubt is required. However, to establish a right to compensation in a civil case, the plaintiff need only produce a fair preponderance of evidence that the action of the defendant caused him harm.

The difference in the standard of evidence permits the criminal system to support the civil system, but not vice versa. In other words, a criminal conviction for a traffic violation can be used as evidence in a civil action, but an assignment of blame and any resulting judgment or award in a civil case, no matter how much detailed evidence is developed and presented during the trial, do not in any way affect or improve the workings of the criminal justice system. This means that the billions of dollars of resources and manpower now devoted each year (nationally) to civil

³This function is sometimes described as "determine guilt" and obtain restitution of damages from "wrongdoers." In this study, however, the terms *guilty* and *wrongdoer* are reserved solely for application to criminal proceedings.

investigations and trials have absolutely nothing to do with improving the overall enforcement of traffic laws. The sole purpose of such proceeding is to determine the extent to which compensation will be paid to accident victims. Consequently, it should be clearly recognized that the only socially useful purpose served by fault finding or assignment of blame is the objective of compensating accident victims.⁴

D. Impact of Auto Insurance on the Civil Liability System

To determine the impact of automobile insurance on the civil liability system in compensating accident victims requires first an examination of the "negligent" theory which lies at the heart of the civil system.

1. **The negligence theory.** The theory of negligence arose early in the nineteenth century to mitigate the harshness of the old notion of strict liability. This new theory was considered to be better suited to a nation undergoing rapid industrial growth. As the number of injuries occurring in the course of industrialization multiplied, American interpreters of the common law were ready to intervene on behalf of fledgling commercial enterprises by imposing additional requirements on those seeking to recover for injuries they suffered. Recovery was no longer automatic merely on proof that the defendant caused the injury. Instead, the negligence theory required the plaintiff to show that the defendant failed to exercise "reasonable care" and that the defendant's behavior was the "proximate cause" of the injury. In addition, the plaintiff now had to show that he was among that class of persons to whom the defendant owed a duty of care.⁵

The development of legal barriers to compensation did not stop with the introduction of the standards of "due care" and "proximate cause." Defense attorneys convinced the courts

⁴In those rare instances where a judgment exceeds a person's liability coverage, a financial sanction may be effectively imposed.

⁵The confusion that attended the introduction of such unfortunate terminology is well documented in the annals of American jurisprudence and to this day agreement as to their meaning has not been reached.

that if a standard of care was to be formulated, it ought to be applied to all members of society, including the injured victim himself. They argued that if the victim himself was behaving in a manner that violated the standard, he should not be entitled to compensation. This argument prevailed and became known as the doctrine of contributory negligence. It meant that an injured victim would be denied compensation from a negligent person if it could be shown that the victim behaved in a manner that contributed to the injury, no matter how slightly or how seriously he was injured.⁶

It is possible that these developments in negligence law reflect a growing awareness of the complexity of many accidents, which could be due to (unproven) defects or breakdown of machinery over which neither the plaintiff nor defendant has any real control. A critical weakness of negligence law as it applies to automobile accidents is its implicit conclusion that the drivers involved are *totally* responsible for all damages associated with a collision. In far too many instances, however, this conclusion is simply not accurate. Other factors beyond a driver's control can contribute to collisions or the severity of damages—e.g., poorly designed cars and roads, or inadequate health and rehabilitation services.⁷ Any legal system which assigns responsibility for all damages only to drivers is somewhat deficient. By the same token, any compensation system which depends critically on such assignment of responsibility is equally deficient.

2. Liability insurance. It should be noted that throughout its development and to this day the negligence system has never taken any formal account of the existence of the insurance system. Today, an insurance firm probably is contractually bound to provide for the defense of a defendant in most automobile accident cases. Automobile liability claims are probably paid by insurance companies in over 80 percent of all cases. Yet, the existence (or nonexistence) of insurance is not

⁶If the theory of strict liability was considered harsh on defendants, the doctrine of contributory negligence was equally harsh on the person seeking recovery.

⁷Safety-related recalls of automobiles now number in the millions.

considered relevant and is inadmissible as evidence in a negligence case. It is possibly for this reason that some people delude themselves into thinking that one outcome of a tort liability suit is that "the negligent driver pays." The refusal to formally acknowledge the existence of the insurance system as a compensation mechanism in and of itself may also explain why many proposed legal reforms tend to be so narrow in scope. To obtain proper perspective on the institutions and alternatives which are available as solutions to today's problems, it is absolutely necessary that one examine the legal and insurance systems *jointly*.

It is true that the early applications of the civil law, prior to the widespread existence of liability insurance, did force those who inflicted harm on others to compensate the victim. However, the widespread desire to see victims *adequately* compensated, plus a financial responsibility law in almost every state, have brought an end to the era of direct compensation by defendants of negligence suits.⁸ If it is desired to force a negligent driver to pay, then liability insurance should be abolished. Such a move would, of course, leave a great number of victims with no meaningful recourse for compensation. It would also be totally inconsistent with the public policy objective of taking care of victims. Hence, abolishment of liability insurance would be too high a price to pay for the principle of making the negligent or blameworthy driver pay.

The point which needs to be clearly understood is that it is totally unrealistic to talk in terms of both widespread liability insurance and "making the negligent driver pay." The basic principle of insurance is a sharing of cost. Each time an insurance company settles a claim, *all insured motorists pay a little*;⁹ the "negligent" driver's contribution to that particular claim is probably no more than a few pennies, however negligent or blameworthy he may be.

⁸Automobile collisions can easily assume such serious proportions that there is no conceivable way by which many defendants could themselves ever compensate the victims. Without an insurance system, there would be little or no compensation in these cases. It is common knowledge that it does no good to sue an "empty pocket."

⁹All motorists should be vividly reminded of this fact each time there is an across-the-board rate increase.

The threat of being judged to have caused a collision and being assessed with a monetary judgment is the only means by which civil law can deter accidents, if deterrence is indeed an objective of the civil system. If drivers do not view this potential sanction as a viable and conscious threat, then it is illogical to deduce or believe that negligence law will in any way affect personal behavior (i.e., driving habits) or deter accidents.¹⁰ Negligence law perhaps does constitute a viable threat for anyone who possesses assets which he might lose from involvement in an accident, *but adequate liability insurance effectively removes any real threat of financial sanction*. Consequently, the more widespread and adequate is liability insurance, the more is any possible deterrent effect of negligence law diminished. Thus, when a negligence law is combined with universal liability insurance, it is not realistic to consider deterrence a valid, realizable objective. Within the law, deterrence is a function solely of the criminal system.

3. Demand for reform. The demand for reform escalated with the rise in automobile accident losses. As early as 1932, when the volume of traffic injuries reached magnitudes comparable to the incidence of diseases, the pioneer Columbia Report¹¹ raised the question of whether the tort-negligence model provided the most efficient mechanism for society to compensate annual losses of millions of dollars. This study, which explicitly considered an insurance system as a means available to society, concluded that there exist better ways than negligence action of insuring that accident victims will be compensated. However, rather than abolish the negligence doctrine and replace it with a combination of a good insurance system and an appropriate law, some states have attempted to restore access to compensation by enacting a comparative negligence law which gives a victim the right to compensation if he can show that his own negligence was *not as great* as that of the defendant. His recovery is diminished by whatever percentage the jury believes corresponds

¹⁰This is particularly true in the vast majority of cases where an insurance company settles by negotiation rather than by court award and payment is made in spite of the fact that the defendant has no conviction and no proven culpability.

¹¹Report by the Committee to Study Compensation for Automobile Accidents to the Columbia University Council for Research in the Social Sciences, *op. cit.*

to the victim's contributory negligence. The defendant is liable only for the difference between his negligence and that of the plaintiff.¹²

In a historical context, then, the negligence theory, including its modern variations, is a deliberately formulated impediment to the ancient right of recovery based on strict liability. It developed for reasons that were consistent with a desire not to impede the early growth of an industrialized society, but it nonetheless constitutes a barrier to adequate compensation of persons who become victims of automobile accidents.

In recent years, the inefficiencies of the present system have pushed premiums up so fast that demands for reform have been renewed with increased vigor. Numerous studies in recent years have documented and discussed the tort system's inadequacies and inefficiencies regarding compensation of victims. Hawaii's compensation experience under the tort system, discussed in chapter 8, is not appreciably different from that of other states.

E. Alternatives to Negligence

As indicated in the preceding discussion, concepts of negligence and making the wrongdoer pay came into existence long before the insurance system. The insurance system has since shaped and molded itself to the existing law. It is in no way necessary, however, for an accident insurance system to be based upon theories of fault or negligence. In fact, most insurance such as fire, theft or accident and health is based merely on the occurrence of an undesired event, without regard to fault or negligence. In an automobile accident situation, what the insurance system needs from the civil law is simply a determination of which parties are responsible for bearing the losses.

The question which arises is, if insurance and compensation are not to be based on liability for negligence, then on what legal system should they be based? In broad terms, three alternative legal approaches have been defined:

¹²In 1969 the Hawaii contributory negligence law was changed to comparative negligence; see Hawaii Revised Statutes section 663-31.

1. *No liability to other parties*: each person driving on a public road does so at his own peril and each person insures himself and his car against that risk
2. *Strict liability to other parties*: any car involved in an accident is automatically and fully responsible for damages to the other party
3. *Shared liability*: the individual damages in an accident are summed and then divided by some formula among the victims or their insurers.

Construction of a broad-based insurance system on either of the last two alternatives would be somewhat impractical for the majority of accidents. However, some authors have advocated that within a basic no-fault system, either of these last two approaches might be applied to large commercial vehicles.

The alternatives outlined here can be combined in various ways to develop specific detailed alternatives for analysis and comparison; this is done in chapters 12 and 13.

F. Summary and Conclusions

At one time the functions of the criminal justice and the civil liability systems were performed by a single body of law which was capable of imposing criminal punishment and simultaneously requiring a person to repair any loss he inflicted through his unlawful behavior. Gradually, as the law concerned itself with the rights of persons accused of a crime, two separate systems emerged—one capable of enforcing society's collective judgments by imposing criminal fines or imprisonment, and the other capable of restoring the well being of an injured victim.

The compensation objective of the civil law became subject to restrictions in the interest of encouraging the growth of commercial activities essential to an industrialized society. It became thwarted to some extent as a result of the formulation of the negligence theory and the defense of contributory negligence.

Every state has moved in the direction of making liability insurance for automobile accidents more or less compulsory, so that today liability insurance is quite widespread. However, neither negligence law nor legal reformers have explicitly acknowledged the effect of the present insurance system. On the one hand, adequate liability insurance enables a great deal more compensation to be paid to victims than would otherwise occur. On the other hand, it prevents effective financial sanctions from being imposed on individual drivers who might be responsible for accidents and thus thwarts any deterrent effect which the civil law might otherwise have.

Any serious reform for the future must take into account the full potential of the insurance system as the major source of compensation for losses from automobile accidents. In this regard, what an insurance system requires from the civil law is simply *a basis for determining which parties are responsible for bearing the losses arising from any accident*. Once such basis is provided, an insurance compensation system can be designed whereby risks of losses can be shared by all motorists. It should be clearly recognized that fault-finding, in and of itself, is not necessary for the functioning of an insurance system. Nor should fault-finding be an end objective of the civil law; compensation to accident victims should continue to remain the major function of the civil law. The role of fault-finding as an end objective properly resides only in the criminal law.

PART III
EVALUATION OF HAWAII INSURANCE SYSTEM

CHAPTER 7

EVALUATION HIGHLIGHTS

Part III evaluates the current performance of the insurance industry in delivering loss protection efficiently and compensating traffic accident victims effectively.

Chapter 8 examines the performance of the insurance industry in (a) compensating losses adequately, (b) paying them promptly and (c) guaranteeing payments. Efficiency is also examined in terms of benefit (or loss) payout levels. Chapter 8 reports on a closed claim survey of 1970 automobile insurance loss experience for Hawaii and compares carrier and court compensation patterns.

Chapter 9 assesses the problems of buying and selling insurance in terms of (a) universal availability at reasonable cost, (b) whether costs are determined equitably and (c) whether the loss protection system operates simply. The procedure used to establish rates for the average driver is examined, including "safe driver" surcharges as well as the cost and value of deductibles for the average driver in Hawaii. Lastly, the insurance market for the high risk driver is explained. This includes the nature of high risk premiums, the non-standard market and the operations of the assigned risk plan.

Chapter 10 addresses the complementary role of the traffic safety system in contributing to the reduction of accidents and the prevention of losses. Separate evaluations are made of the present status and areas of improvement for traffic law enforcement; highway, vehicle and driver safety; emergency medical care services and vehicle repair. Lastly, prospects for both the insurance and traffic

safety system are gauged in terms of the level of projected traffic accident involvements and injuries for the next decade.

Major findings detailed in chapters 8, 9 and 10 are as follows:

A. Compensation Delivery

By any reasonable performance standard, traffic accident compensation in Hawaii is deficient with regard to every dimension cited earlier. Further, it is extremely costly to both the motor vehicle owner and the traffic victim. Among the principal findings are the following:

1. If motor vehicle insurance were as efficient as certain other forms of insurance, Hawaii motorists could have saved as much as \$5 to \$10 million in 1970 alone.

2. Accident victims in Hawaii pay an implicit cost of \$3.4 million annually in the form of substantial delays in receipt of reparations. This is attributable to an average delay in settlement of between nine and 12 months for all claims. The situation is better for smaller claims than for the larger serious injury awards. However, for those claims involving amounts of over \$10,000, the delay can reach as long as two years.

3. Accident victims who receive court awards appear to fare no better, unless their claims substantially exceed \$10,000 in value. Below this level, court awards are typically less than half the value of those negotiated with insurance carriers.

Perhaps for this reason, less than 1 percent of all accident claims are settled in court.

4. The system is perverse in that it rewards slowness in delivery of benefits. Insurance carriers who take the longest time to settle have the greatest opportunity to maximize investment income from unpaid losses.

B. Purchasing Motor Vehicle Insurance in Hawaii

1. The industry sells to a great many motorists \$50 or \$100 deductible collision coverage and then applies a so-called "safe driver" plan which severely penalizes them if they file a claim against their deductible coverage. Most drivers probably do not understand this until it is too late. When one fully understands the "system," it says loud and clear that average drivers should carry \$250 or \$500 deductible, save the premium difference and make claims on their own insurance company as little as possible. When the safe driving plan is used to penalize a driver, there is no hearing and no appeal. The insurance industry administers "justice" by acting as judge and jury.

2. The rating system is based chiefly on variables over which the average driver has no control whatsoever. Undesirable aspects are emphasized, and potentially desirable rating criteria are used minimally or not at all.

The insurance system also fails to attain any of the objectives which relate to the buying and selling of insurance. The rate structure is not simple, nor is guaranteed *affordable* protection available to all motorists in Hawaii. About 10 percent of all motorists are classified by the insurance industry as "high-risk" and another 20 percent are uninsured. Little is known about the uninsured group, but most are presumed to be in the so-called high-risk group.

3. The rating system is extremely harsh on young drivers. In many instances it practically forces them to drive without insurance—or not drive at all. Neither of these alternatives is socially desirable, but rather than moving towards a solution to this social problem, competition in the insurance industry seems to be leading farther away. A number of the State's uninsured motorists probably fall into the youth category.

4. In terms of penalty points against drivers' licenses, the traffic safety system classifies less than 5 percent of the population as "high-risk," whereas the insurance industry classifies almost 30 percent as high-risk. The negligence liability system, within which all insurance companies must live, probably accounts for this difference in outlook. About half of all motorists which the industry insures but considers to be "high-risk" are not known to have any record of accidents or traffic violations. For such people the "system" appears to prejudge rather harshly.

5. The insurance industry is itself a "victim" of the negligence legal system. The liability insurance system provides a completely rational explanation for their actions. Improvement does not appear possible without reforming the entire system, insurance and legal.

C. Traffic Safety System Effectiveness

A wholly integrated traffic safety system does not currently exist in Hawaii or in any other state. Traffic law enforcement and insurance systems work at cross purposes in providing incentives for effective reporting of vital accident data. Highway, vehicle and driver safety programs also appear susceptible to upgrading to meet basic loss avoidance and accident prevention goals. Vehicle repair, while beyond both state and individual vehicle owner control, can be improved through changes in federal law regarding the establishment of collision standards.

1. **Traffic law enforcement.** As evidenced by data from the City and County of Honolulu, license revocations, suspensions and citation of drunk drivers are approximately one-tenth of comparable national data. Despite these significant differences, Hawaii's accident rate is at about the same level as the national average. One of the more constructive aspects of traffic code enforcement in Hawaii is the fact that the court sentences guilty drivers to take a mandatory defensive driving course conducted by the police department. In contrast, other jurisdictions which have adopted stricter enforcement policies resulting in higher driver license suspension rates do not appear to have achieved desired deterrent effects.

2. **Highway, vehicle and driver safety.** Present highway safety activities are skewed in the direction of human factors accident analysis. The program provides little information on traffic accident problems through refined reporting of basic accident data. Little verification is done on vehicle defects resulting from massive auto producer recalls beyond those identified in the State's periodic inspection program. Suggestions are made for changing this current status by: (a) devising more consistent standards for accident reporting, (b) instituting random roadblock vehicle inspections and recall verification programs to spur better preventive maintenance by owners, and (c) designing a graduated program of driver training for youths and others.

3. **Emergency medical care services.** Provision for emergency care services appears adequate to fit the metropolitan needs of urban Oahu. However, it could stand upgrading in the more distant rural

areas of Oahu and on the neighbor islands. Suggestions are made for improving delivery of emergency care services by (a) developing a statewide air evacuation capability, (b) purchasing remote telemetry-equipped ambulances for ground based evacuation systems, and (c) integrating both state/county and commercial radio communication networks.

4. **Vehicle repair.** Hawaii's owners pay a high price for repair of damaged vehicles. Current estimates indicate that the average value of property damage claims will rise by more than 18 percent per year. Parts and inventory problems of local suppliers as well as monopolistic control of supplies by auto producers account for a majority of current repair cost premium charges. As noted, this problem is essentially beyond effective state action. Some control over the spiraling cost of vehicle repair may result from pending federal legislation establishing national repair standards for vehicle collisions.

CHAPTER 8

COMPENSATION OF ACCIDENT LOSSES

This chapter evaluates the Hawaiian insurance industry's record in terms of its efficiency and effectiveness in achieving objectives associated with compensation of victims. These are listed in chapter 5 as:

- . Compensate losses adequately
- . Pay compensation promptly
- . Guarantee payments.

Efficiency and effectiveness provide two separate and distinct criteria for evaluation. Both are important. From a social viewpoint, efficiency means that insurance companies process claims promptly and at minimal cost. Effectiveness is concerned with the extent to which victims are paid in proportion to their losses. It is alleged, for example, that the insurance system overcompensates many small claims and grossly undercompensates the majority of victims with serious injuries and large losses.¹

The evaluation in this chapter uses three primary sources of data: (1) industry data published by the insurance commissioner, (2) a closed claims survey undertaken in cooperation with several major insurance companies in Hawaii,² and (3) court records of 53 accident cases.

¹See U. S. Department of Transportation, Volume I, *op. cit.*, pp. 50-51.

²Specifically, First Insurance of Hawaii, Pacific Insurance Co., Ltd., Island Insurance Co., Ltd., Hawaiian Insurance Group and State Farm Insurance, whose cooperation and assistance are gratefully acknowledged.

The evaluation of the compensation of losses is preceded by a brief picture of the losses themselves. It shows that the accident profile in Hawaii is of serious dimensions and is worsening rapidly. Accidents and injuries have been growing at a compound annual rate of 12 - 13 percent and, if present trends continue, injuries will be occurring at a rate of 30,000 per year by 1980.

A. Accident Trends in Hawaii

Motor vehicle accidents in Hawaii increased substantially during the past decade. While registered motor vehicles increased 75 percent from 1960 to 1970, the total number of reported accidents increased by 151 percent.³ The number of people injured increased by about the same percentage as did accidents, 147 percent. The only component of the injury profile which did not increase more sharply than the number of cars registered was deaths from automobile accidents. The number killed increased 58 percent over 1960. These data are summarized in table 8-1. It should be noted that the data in this table are based solely on police records, which do not include any unreported incidents.

The difficulty or even impossibility of restoring injured victims to their previous condition makes bodily injuries by far the most important loss

³In 1970, there were 415,297 registered motor vehicles in Hawaii. They include: passenger cars and taxicabs (87%), trucks (10%), motorcycles and motor scooters (2%), buses and other miscellaneous motor-driven vehicles (1%).

Table 8 – 1
Traffic Accidents, State of Hawaii, 1960–1970

| | 1960 | 1970 | Percent Increase 1960–1970 |
|--|---------|---------|----------------------------------|
| Population | 632,722 | 769,913 | 22 |
| Number of motor vehicles registered | 230,791 | 404,463 | 75 |
| Estimated vehicle miles traveled (millions) | 1,990 | 3,409 | 71 |
| Number of accidents | 7,254 | 18,172 | 151 |
| Number of persons injured in accidents | 4,754 | 11,744 | 147 |
| Number of persons killed in accidents | 96 | 152 | 58 |

Source: Hawaii State Department of Planning and Economic Development, *State of Hawaii Data Book*, Honolulu: 1971, pp. 118, 119. (A portion of the data in the source document is from Hawaii State Department of Transportation, Highways Division, *Major Traffic Accidents, Summary and Analysis*.) The source document notes in footnote 1 that the 404,463 motor vehicles registered in 1970 is exclusive of 10,834 scooters and motorcycles.

associated with these accidents. The number of personal injuries and deaths from motor vehicle accidents and a general description of the nature of the accidents in 1970 are given in table 8–2. The percentage distribution in this table shows that pedestrians suffered a disproportionate number of injuries and deaths. Further, a higher proportion of motorcyclists and bicyclists suffered serious injuries than all other classes of traffic victims. Of those injured when riding inside an automobile, about 55 percent were drivers and 45 percent were passengers. In 1970, the total injury rate from motor vehicle accidents for the population was approximately 16 per thousand, which is close to the national average.

Property damage is the other loss from motor vehicle crashes. Automobiles themselves account for the majority of all property damage; in 1970, it is conservatively estimated that 44,000 cars were damaged in crashes, or roughly 10 percent of all registered vehicles.⁴ While this compares “favorably” with the national average of 20 percent (estimated by the National Safety Council), it nevertheless constitutes a substantial amount of damage.

⁴Hawaii State Department of Transportation, *Major Traffic Accidents, Summary and Analysis, 1970*, Honolulu: June 1971; data adjusted to account for estimate of unreported motor vehicle damages.

Table 8 - 2

Distribution of Hawaii Traffic Accidents by Type - 1970

| Accident Type | Percent Distribution | | |
|------------------------------------|----------------------|----------|--------|
| | Accidents | Injured | Killed |
| 1. Motor vehicle in traffic . . . | 68.6 | 69.2 | 31.6 |
| 2. Parked motor vehicle | 6.8 | 2.8 | 2.6 |
| 3. Bicyclist | 1.0 | 1.7 | 1.3 |
| 4. Pedestrian | 3.5 | 5.3 | 23.7 |
| 5. Animal | 0.3 | 0.2 | - |
| 6. Fixed or other object | 14.7 | 14.5 | 33.6 |
| 7. Ran off road | 3.2 | 3.8 | 3.9 |
| 8. Overturned on road | 1.1 | 1.6 | 3.3 |
| 9. Other non-collision | 0.9 | 0.9 | - |
| Total | 100.0 | 100.0 | 100.0 |
| Actual number | (18,172) | (11,744) | (152) |

Source: Derived from data in Hawaii State Department of Transportation, *Major Traffic Accidents, Summary and Analysis, 1970*, Honolulu, June 1971.

B. Efficiency of Providing Compensation

The end objective of any insurance system is to protect against individual losses by providing compensation for such losses as they occur. Questions of efficiency concern (1) how much does this protection now cost?, and (2) how much might (or should) it cost?

Since insurance is a regulated industry, it must file for rates before the insurance commissioner. Efficiency will be examined on the basis of rate filing information and actual cost-performance data. In turn, data concerning costs of compensating victims who sustain losses from

motor vehicle accidents will be assessed against other insurance systems in Hawaii.⁵

1. **The industry's loss-payout target.** Most auto insurers in Hawaii belong to the Hawaii Insurance Rating Bureau (IRB). All members of the rating bureau submit a joint rate filing with the insurance commissioner. In order to justify a rate increase, they submit a breakdown of expenses by major categories. These "expense loadings" are

⁵See appendix C for a comparison of Hawaii and national experience.

Table 8 – 3

Components of Premium Dollar Expense Loadings
Used for Ratemaking in Hawaii, 1971

(Private Passenger Cars)

| | Bodily Injury Coverages (Percent) |
|--------------------------------|--------------------------------------|
| Losses | 54.1 |
| Loss adjustment expenses | 10.0 |
| Acquisition costs | 20.0 |
| General administration | 6.5 |
| Taxes, licenses and fees | 4.4 |
| Underwriting profit | 5.0 |
| | 100.0 |

Source: Data obtained from Insurance Services Office, New York, Hawaii Rate Filing, Oahu District, 1971.

instructive in understanding both insurance rates and industry performance. The expense loadings used in the most recent filing are shown in table 8 – 3. As this table indicates, only 54.1 cents out of each dollar is allocated to “losses,” or the compensation of victims; 45.9 cents is routinely allocated to various items of overhead expense, including a 5 percent underwriting profit. A fifth of the premium dollar is devoted to acquisition costs.⁶

In other words, if losses during a year were to exceed 54.1 percent of premiums, machinery is automatically put in motion to obtain a rate increase. This means that under the present system and over the long run, losses are theoretically expected to average 54.1 percent of the premium dollar. Stated alternately, the industry reckons and attempts to operate on a basis whereby the delivery of \$1 worth of insurance compensation will cost the motorist an average of \$1.85.

Greater efficiency is obviously desirable. However, the industry has operated in this

⁶The bulk of these, 14.8 percent, comprise commissions and fees paid to general agents and insurance salesmen. In other states where mass merchandising methods have been employed, these costs have been reduced substantially.

income-expense “lockstep” for some time, and the insurance commissioner does not have the means at his disposal to bring about greater efficiency. Only by a major reform—or perhaps by a series of major reforms—is the industry likely to change its basic approach (as evidenced in its rate filings) and attempt to achieve greater efficiency.⁷

2. **The record, 1960–1970.** An auto insurance policy typically contains six different coverages which a person may elect. In reporting losses, however, the insurance commissioner uses only three categories: (a) bodily injury,⁸ (b) property damage liability and (c) collision.⁹ For these three reporting categories the distribution of losses incurred in 1969 and the average size of claims were as follows:

⁷Inefficiency of the present automobile insurance system has been fully documented in numerous places. See, for example, A. Conard, et.al., *Auto Accidents Costs and Payments: Studies in the Economics of Injury Reparations*, Ann Arbor: University of Michigan Press, 1964; or State of New York Insurance Department, *Automobile Insurance – For Whose Benefit?* 1970, pp. 34–37 and references cited therein.

⁸Includes losses paid under medical payments and uninsured motorists coverage.

⁹Includes losses paid under comprehensive coverage.

| | Distribution of Losses among Auto Lines (Percent) | Average Claim Value |
|---------------------------------|--|---------------------------|
| Bodily injury | 55 | \$1,944 |
| Property damage liability . . . | 17 | 298 |
| Collision | 28 | 381 |
| Total | 100 | |
| Amount | \$32,981,000 | |

In 1969, bodily injury losses accounted for more than half of automobile insurance payouts and were more than six times the average value of property damage liability awards. For these three categories the 1960–1970 record of motor vehicle insurance loss payouts is shown in table 8–4 and figure 8–1.

It will be noted that both table 8–4 and figure 8–1 show data for *losses paid* and *losses incurred*.¹⁰ The distinction between these two is:

¹⁰H. Dennenberg, et.al., *Risk and Insurance*, Englewood Cliffs, N. J.: Prentice-Hall, 1964, pp. 418–420.

losses paid represents benefits paid to victims during the year in which recorded and *losses incurred* is a bookkeeping entry which includes anticipated future losses for accidents *reported* during the year. Although incurred losses are often paid within the same year, it is very typical for a loss incurred in one year to become a loss paid out in a subsequent year. On a cash flow basis, the ratio of losses paid to premiums earned represents the most accurate picture of current loss experience. From the viewpoint of determining a net financial position, the ratio of losses incurred to premiums earned represents an accrual concept of losses. As figure 8–1 shows, on either a paid or incurred basis, bodily injury claims comprise approximately 50 percent of total claims.

Table 8–4 and figure 8–2 reflect loss ratios. As shown there, loss ratios in recent years have exceeded the industry's 54.1 percent target, thus triggering a series of substantial rate increases. Rates have more than doubled since 1965. In general, the two loss ratios reflect substantial differences for bodily injury coverage, whereas the differences are minor for collision or physical damage. The ten-year totals in table 8–4 for bodily injury loss payments show

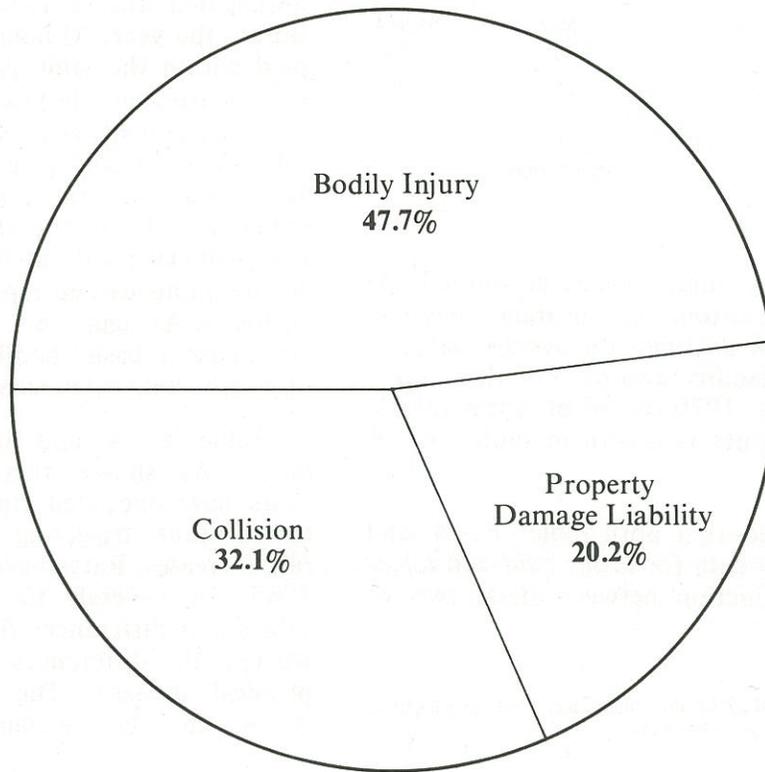
Table 8–4
Ratio of Losses Paid and Losses
Incurred to Earned Premiums (in Percent) for
Automobile Insurance Coverages
State of Hawaii, Selected Years, 1960–70

| Years | Bodily Injury | | | Property Damage Liability | | | Physical Damage | | |
|--------------------|---------------|-----------------|------------|---------------------------|-----------------|------------|-----------------|-----------------|------------|
| | Losses Paid | Losses Incurred | Difference | Losses Paid | Losses Incurred | Difference | Losses Paid | Losses Incurred | Difference |
| 1960 | 47.8 | 64.8 | +17.0 | 61.1 | 66.6 | +5.5 | 65.3 | 70.1 | +4.8 |
| 1963 | 53.4 | 69.2 | +15.8 | 51.2 | 50.6 | –0.6 | 53.1 | 52.2 | –0.9 |
| 1966 | 49.5 | 73.7 | +24.2 | 55.8 | 59.7 | +3.9 | 57.6 | 57.4 | –0.2 |
| 1969 | 70.0 | 82.7 | +12.7 | 74.3 | 77.0 | +2.7 | 64.4 | 65.7 | +1.3 |
| 1970 | 68.5 | 75.8 | + 7.3 | 66.7 | 71.9 | +5.2 | 59.3 | 61.5 | +2.2 |
| Total (1960–70) | 60.2 | 76.0 | +15.8 | 61.4 | 64.6 | +3.2 | 58.6 | 60.4 | +1.8 |

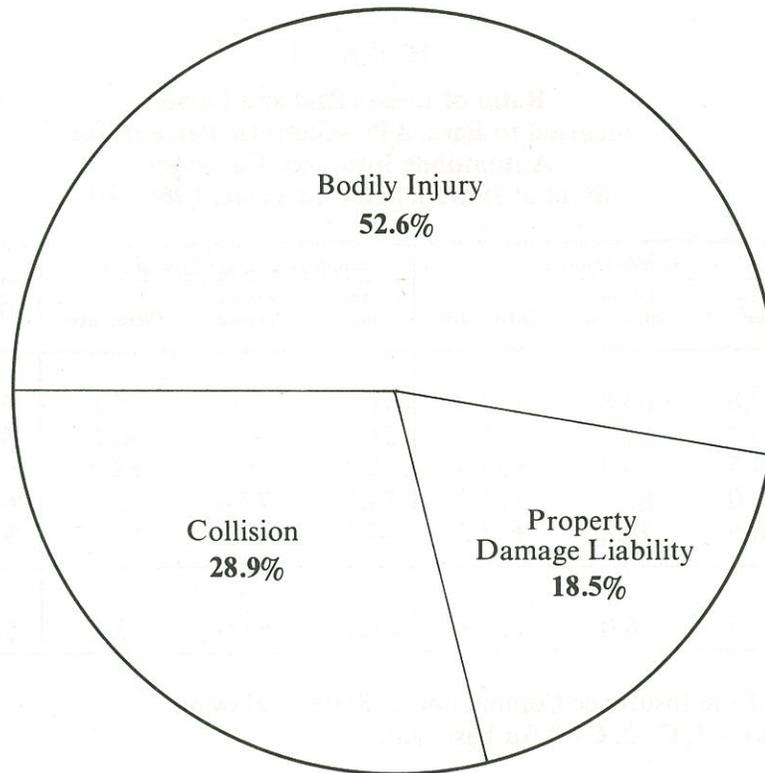
Sources: Reports of the Insurance Commissioner, State of Hawaii.
See tables C–1, C–2, C–3 for basic data.

Figure 8-1
WHERE INSURANCE BENEFITS WENT, 1960-1970

A. Losses Paid



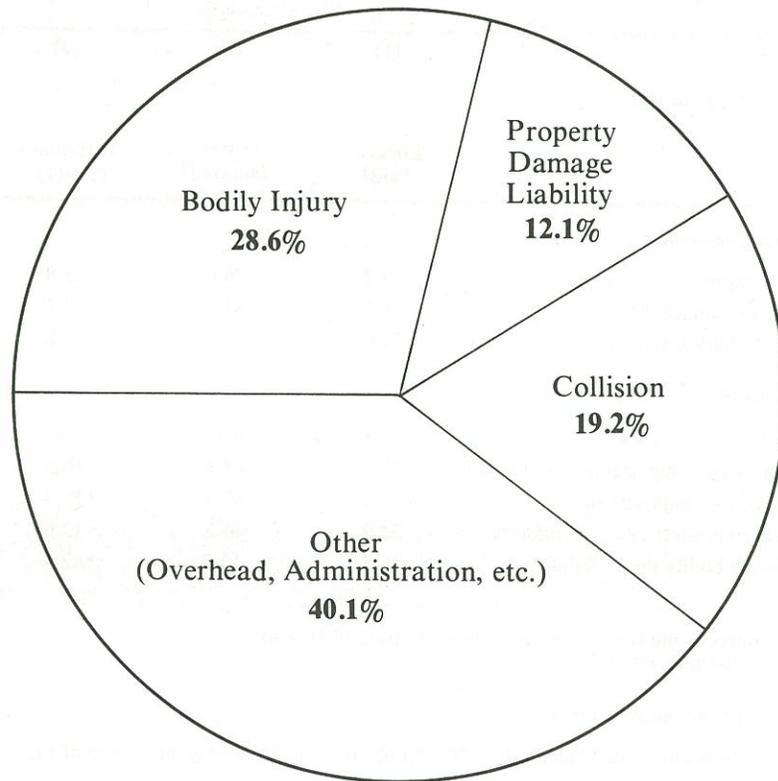
B. Losses Incurred



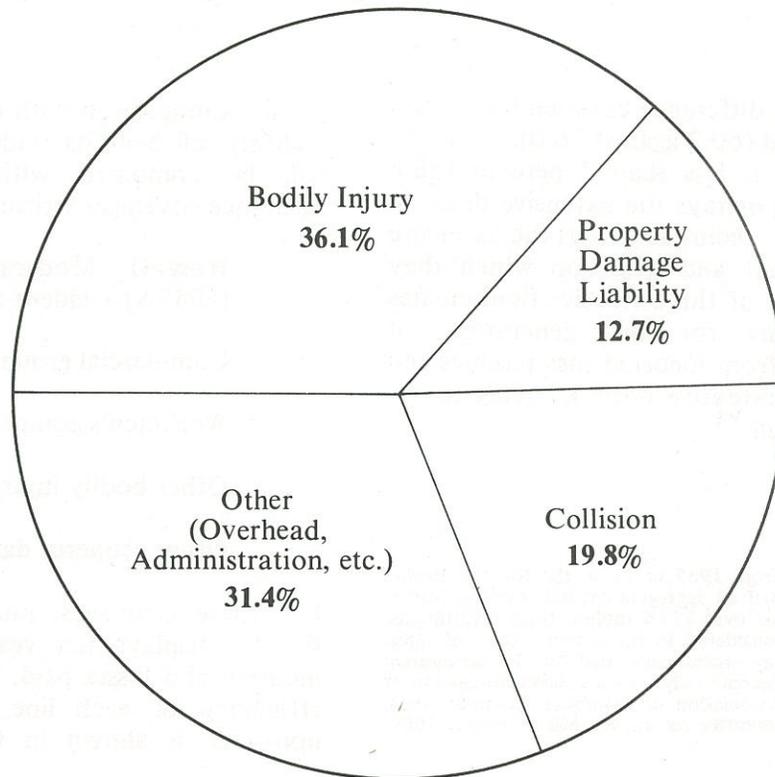
Source: Derived from data shown in Appendix C, Tables C-1, C-2 and C-3.

Figure 8-2
WHERE THE INSURANCE DOLLAR WENT, 1960-1970, LOSSES PAID

A. Losses Paid



B. Losses Incurred



Source: Derived from data shown in Appendix C, Tables C-1, C-2 and C-3

Table 8-5
Comparative Loss Payout Ratios for
Selected Lines of Insurance

| Lines of Insurance | (1) Losses Paid ¹ | (2) Losses Incurred ¹ | (3) Difference (2)-(1) | (4) Premium Required to Deliver \$1 of Paid Benefits ² |
|---|------------------------------------|--|------------------------------|---|
| <i>Automobile insurance:</i> | | | | |
| 1. Bodily injury | 60.2 | 76.0 | +15.8 | \$1.66 |
| 2. Property damage liability | 61.5 | 64.6 | +3.1 | 1.63 |
| 3. Collision/physical damage | 58.6 | 60.4 | +1.8 | 1.71 |
| <i>Other coverages:</i> | | | | |
| 4. HMSA | 91.5 | n/a | - | 1.09 |
| 5. Commercial group accident and health | 75.1 | 81.6 | +6.5 | 1.33 |
| 6. Workmen's compensation | 52.7 | 68.1 | +15.4 | 1.90 |
| 7. Non-auto property damage liability . | 33.9 | 46.5 | +12.6 | 2.95 |
| 8. Non-auto bodily injury liability . . . | 28.5 | 40.9 | +12.4 | 3.51 |

Source: Reports of the Insurance Commissioner, State of Hawaii.
See also appendix C.

¹Percent of premiums earned.

²Values in column (1) divided into 1.00 in order to convert to a common base of \$1.

almost a 16 percent difference between losses paid versus losses incurred (60.2 against 76.0), while the margin in collision is less than 2 percent (58.6 against 60.4). This portrays the extensive delay in settling bodily injury claims as well as the extensive degree of adjustment and litigation which they entail. The existence of this extensive float creates favorable conditions for the generation of investment income from incurred loss reserves and implicitly involves extensive costs of delay to the traffic accident victim.¹¹

¹¹During the period from 1965 to 1970, the top five Hawaii automobile insurers incurred an aggregate net underwriting loss of \$4.1 million, while earning over \$12.6 million from investments. This latter item is not considered in the determination of rates. Premium rate increases are specifically tied to the accounting standard of underwriting income only. For a detailed discussion of this issue, see National Association of Insurance Commissioners, *Report of the Special Committee on Automobile Problems, 1969*, pp. 116-142.

3. Comparison with other forms of insurance.
Delivery of benefits under automobile coverages can be compared with five other forms of insurance coverages written in Hawaii:

- . Hawaii Medical Services Association (HMSA) accident and health coverage
- . Commercial group accident and health
- . Workmen's compensation
- . Other bodily injury liability
- . Other property damage liability.

For these coverages, plus auto insurances, table 8-5 displays ten year ratios on both losses incurred and losses paid. Further, the comparative efficiency of each line of insurance, auto and non-auto, is shown in terms of the amount of

premiums required to deliver a dollar's worth of benefits. Several observations can be made.¹²

a. In general, direct reimbursement insurance systems such as health plans or group accident and health coverages (lines 4 and 5) deliver benefits more efficiently than do third party liability systems. Using either loss payout indicator, both lines of insurance deliver in the form of benefits more than three-fourths of total fees or premiums received. By contrast, third party systems of settlement—the two auto lines (excluding collision), workmen's compensation and the non-auto liability coverages—have loss payouts ranging from almost three-quarters down to less than one-third. As can be seen from column 4, while it costs \$1.66 to deliver \$1 of bodily injury benefits under auto insurance, a major non-commercial health plan in Hawaii, HMSA, can deliver the same \$1 of benefits for \$1.09.¹³ If automobile insurers could deliver \$1 of benefits for \$1.10 to \$1.33, as do group accident and health insurers, the Hawaiian motoring public could have saved approximately \$5 – 10 million in 1970 alone, and the insurance carriers would still have made an underwriting profit.

b. Delivery of benefits under the existing auto coverages compares favorably with experience under workmen's compensation (line 6), which is a third-party, strict liability system of coverage (i.e., no fault-finding process is necessary). Stated otherwise, both systems are about equally inefficient. The obvious lesson is that if motor vehicle insurance reform is to achieve greater efficiency, *it absolutely must avoid any kind of costly and time-consuming alternative to court actions such as the "administrative hearing" procedures which workmen's compensation utilizes to determine awards.*

¹²Basic data for these calculations are displayed in appendix C.

¹³The losses paid (reflected in column 3 of table 8 – 5) do not reflect net benefits received by victims, because any attorney's fees which the victim must pay are included in losses paid. Hence, these figures understate the relative inefficiency of liability coverage because insured victims do not have to hire attorneys in order to collect benefits under HMSA or commercial group accident and health insurance.

c. If other liability insurance coverages represent any kind of yardstick, the auto liability system could be much worse than it is. To illustrate, if auto liability worked on the same ratio as other liability coverages (lines 7 and 8), auto insurance premiums would increase another 50 – 100 percent.

C. Promptness and Guarantee of Loss Compensation

The previous section focused on the efficiency of loss compensation. This section studies how effectively accident victims are compensated. Promptness and certainty of payment are the two principal dimensions. To answer these two questions, five of Hawaii's major automobile insurance carriers assisted in a sample survey of claims closed during 1970 from their files.¹⁴ Topics reviewed here include:

- . How much the traffic victim in Hawaii receives.
- . The average time to settlement.
- . The distribution of awards between tangible and intangible losses.

1. **Compensation.** Claims in the sample survey generated \$1.2 million in settlement awards involving payments for bodily injury, property damage liability and plaintiffs' legal expenses (see table 8 – 6). Of the total, more than 77 percent was accounted for by bodily injury awards, of which more than 60 percent was attributable to general damage payments. Plaintiffs' legal fees constituted less than 7 percent of the aggregate amount.

An analysis of special damages is shown in table 8 – 7. More than half the special damages were for medical expenses and less than two-fifths were for lost wages.

¹⁴Appendix C displays a validation of the sample results and a comparison with results of similar national surveys conducted by the U. S. Department of Transportation and the American Insurance Association.

Table 8 - 6

Aggregate Settlement Awards by Category
Survey of Closed Claims
Hawaii, 1970

| Settlement Category | Distribution (Percent) |
|---------------------------------|---------------------------|
| Bodily injury | |
| Special damages | 17 |
| General damages | <u>60</u> |
| Total | 77 |
| Property damage liability | 16 |
| Plaintiffs legal fees | <u>7</u> |
| Total | 100 |
| Amount | (\$1,162,252) |

Source: Haldi Associates survey of closed automobile insurance bodily injury claims.

Table 8 - 7

Aggregate Value of Special Damage Awards by Category
Sample Survey of Hawaii Closed Claims, 1970

| Award Category | Amount | Distribution (Percent) |
|---------------------------------|--------------|---------------------------|
| Medical and hospitalization ... | \$107,339 | 54 |
| Wage loss | 83,485 | 42 |
| Miscellaneous | <u>7,951</u> | <u>4</u> |
| Total | \$198,775 | 100 |

Source: Haldi Associates survey of closed automobile insurance bodily injury claims.

Distribution of awards by the amount paid for both bodily injury and property damage liability awards is indicated in table 8-8. Almost three-quarters (74 percent) of bodily injury settlements were below \$1,500 in total compensation; the average value of bodily injury claims settled in the survey was \$1,760. Only 7 percent had awards of \$5,000 or greater. Slightly less than half (49 percent) of the total sample did not effect property damage liability awards in conjunction with the settlement of bodily injury claims. Of the 51 percent that did, two-thirds received awards of \$500 or less.

Table 8 - 8
Distribution of Closed Claims by Value and Type
Sample Survey - Hawaii, 1970
(Percent)

| Value Range | Bodily Injury | Property Damage Liability |
|----------------|---------------|---------------------------|
| \$ 0 | 11 | 49 |
| 1 - 500 | 38 | 34 |
| 501 - 1,500 | 25 | 16 |
| 1,501 - 5,000 | 19 | 1 |
| 5,001 - 10,000 | 5 | --- |
| 10,000+ | 2 | --- |
| Total | 100 | 100 |
| Number | (512) | (512) |

Source: Haldi Associates survey of closed automobile insurance bodily injury claims.

Table 8-9 shows changes in the amount paid out for both special and general damages by the size or value of the settlement. More than 78 percent of the total bodily injury awards were made for general damages. This proportion tended to vary with the value of the total award. For awards between \$1 - \$500, the split between general and special damages was nearly even. As the value of the total award increased, however, the proportion of general damages also increased. Almost four-fifths of the awards ranging between \$1,500 and \$5,000 went for general damages. For bodily injury claims settled over \$10,000, more

than 94 percent was attributed to general damages.¹⁵

Table 8 - 9
Bodily Injury Awards by Size and Type
Sample Survey of Closed Claims
Hawaii, 1970

| Value Range | Distribution (Percent) | | Amount (\$ in 000) |
|----------------|------------------------|---------|--------------------|
| | Special | General | |
| \$ 1 - 500 | 49 | 51 | \$ 79,813 |
| 501 - 1,500 | 30 | 70 | 147,080 |
| 1,501 - 5,000 | 19 | 81 | 299,971 |
| 5,001 - 10,000 | 28 | 72 | 155,338 |
| 10,000+ | 6 | 94 | 219,180 |
| Total | 22 | 78 | \$901,382 |

Source: Haldi Associates survey of closed automobile insurance bodily injury claims.

2. Time to settlement. Based on survey data, in 1970, it took an average of nine months to receive compensation in Hawaii. Thirty percent of the sample claims were settled in less than two months, while 27 percent took longer than one year (see table 8-10).

Table 8 - 10
Time to Settlement
Sample Survey of Hawaii Closed Claims, 1970

| Time to Settlement in Months | Number | Percent Distribution |
|------------------------------|--------|----------------------|
| 0 - 2 | 154 | 30 |
| 3 - 5 | 71 | 14 |
| 6 - 9 | 97 | 19 |
| 10 - 12 | 51 | 10 |
| 13 - 24 | 113 | 22 |
| 24+ | 26 | 5 |
| Total | 512 | 100.0 |

Source: Haldi Associates survey of closed automobile insurance bodily injury claims.

¹⁵ Relative overpayment of minor claims and underpayment of serious injury claims has been much discussed in the literature concerned with automobile insurance reform. See State of New York Insurance Department, *Automobile Insurance - For Whose Benefit?* 1970, pp. 25-29, and references cited therein.

A more instructive way of examining the survey results is to stratify them by size of award and time to settlement. This is done in table 8-11 which displays the sample bodily injury claims by whether they were settled in less than or more than one year. Just as the type of compensation varied widely with the total value of the award, so too did the likelihood of receiving it. The first observation concerning table 8-11 concerns the rather conspicuous fact that a greater percentage of claims which received nothing took longer to close than did claims which were settled for \$5,000 or less. The average time to settle claims with no awards was more than 13 months. More than four-fifths of awards below \$1,500 in value were settled in less than one year. As the value of the award increased past \$1,500, however, the time to settlement changed sharply. By the time a settlement award reached the \$10,000 cutoff point, nearly three-quarters of the claims took longer than a year to settle.

Table 8 - 11
Time to Settlement by Value of Award
Sample Survey of Closed Claims - Hawaii, 1970

| Value Range | Number of Claims | Percent Distribution | |
|--------------------|------------------|----------------------|-----------------|
| | | Less Than 1 Yr. | More Than 1 Yr. |
| \$ 0 | 57 | 54 | 46 |
| 1 - 500 | 193 | 89 | 11 |
| 501 - 1,500 | 125 | 78 | 22 |
| 1,501 - 5,000 | 96 | 57 | 43 |
| 5,001 - 10,000 | 27 | 52 | 48 |
| 10,000+ | 14 | 28 | 72 |
| Average—all claims | 512 | 73 | 27 |

Source: Haldi Associates survey of closed automobile insurance bodily injury claims.

If the time to settlement is weighted by the size of claim, it took just over one year to settle a bodily injury claim.¹⁶ Because of this untimely receipt of compensation, traffic accident victims in

¹⁶Based on aggregate data, the average settlement time is one year and 23 weeks. See appendix C for details.

Hawaii incur an imputed cost of delay of as much as \$3.4 million.¹⁷

3. **Negotiated vs court settlements.** An interesting question is whether the traffic victim gains or loses as a result of taking his claim to court. Table 8-12 displays a profile of the in-court versus negotiated settlements that were closed during 1970. Note that the two sets of data diverge completely in terms of the distribution by value. Over half of the court cases closed in 1970 had awards of more than \$10,000, whereas two-fifths of the negotiated settlements were for less than \$500.

The most interesting fact revealed by table 8-12 is that in 1970 the traffic accident victim in Hawaii appears to have *lost financially* by going to court if the award was below \$10,000. Above that benchmark, the victim appears to have been rather handsomely rewarded for his efforts. The average court award in the range \$1 - \$500 was *less than half* that of the insurance carrier negotiated claim, whereas above \$10,000 it was 243 percent of the negotiated settlements. These results must be tempered by the fact that less than 1 percent of all bodily injury claims were settled in court and that the average time to settle the larger valued claims out of court took, on average, close to two years.¹⁸

D. Summary and Conclusions

This evaluation of the current tort liability insurance system has dealt with its efficiency at delivering compensation and its effectiveness in terms of paying promptly and with certainty. By any reasonable performance standard, it is deficient with regard to all three dimensions. Further, the insurance system is extremely costly to both the motor vehicle owner and the traffic victim. Among the principal findings are the following:

¹⁷This estimate is based on \$19 million of bodily injury losses paid in 1970 and assumes that the victim has to pay typical charge account interest rates of 1½ percent per month (18 percent per year).

¹⁸For estimates of the value of motor vehicle insurance settled in court, see appendix C.

Table 8 - 12
 Comparison of Survey Sample and
 Court Settlement Experience - Hawaii, 1970

| Amount Category | Average Value of Awards | | |
|---------------------|-------------------------|--|--|
| | Survey Sample | U.S. District and State Circuit Courts | Court (2) as Percent of Sample (1) |
| | (1) | (2) | (3) |
| \$ 1 - 500 | \$ 413 | \$ 217 | 52 |
| 501 - 1,500 | 1,176 | 906 | 77 |
| 1,501 - 5,000 | 3,124 | 2,809 | 89 |
| 5,001 - 10,000 | 5,753 | 3,558 | 61 |
| 10,000+ | 15,655 | 38,064 | 243 |
| Average claim award | \$ 1,760 | \$21,259 | 1,207 |

| Amount Category | Percent Distribution | | |
|-----------------|----------------------|--|-------------------------|
| | Survey Sample | U.S. District and State Circuit Courts | Percent Differential |
| | | | |
| \$ 1 - 500 | 42 | 6 | +36 |
| 501 - 1,500 | 28 | 6 | +22 |
| 1,501 - 5,000 | 21 | 15 | + 6 |
| 5,001 - 10,000 | 6 | 21 | -15 |
| 10,000+ | 3 | 52 | -49 |
| Total | 100 | 100 | |
| Number | (455) | (53) | |

Source: Haldi Associates survey of closed automobile insurance bodily injury claims.

1. If motor vehicle insurance were as efficient as certain other forms of insurance, Hawaii motorists could have saved as much as \$5 to \$10 million in 1970 alone.

2. Accident victims in Hawaii pay an estimated imputed cost of \$3.4 million annually in the form of substantial delays in receipt of reparations. This is attributable to an average delay in settlement of between nine and 12 months for all claims. The situation is better for smaller claims than for the larger serious injury awards. However, for those claims involving over \$10,000, the delay can reach as long as two years.

3. Accident victims in Hawaii appear to fare no better by going to court unless their claim substantially exceeds \$10,000 in value. Below this level, court awards are typically *less than half* the value of those negotiated with insurance carriers. For this reason, perhaps, less than 1 percent of all accidents are settled in court.

4. The system is perverse in that it rewards slowness in delivery of benefits. Insurance carriers with the longest times to settlement have the greatest opportunity to maximize investment income from loss reserves.

CHAPTER 9

BUYING AND SELLING OF INSURANCE

This chapter evaluates the performance of the Hawaiian insurance industry in achieving the three objectives postulated in chapter 5 which relate specifically to the buying and selling of insurance:

- . Make protection universally available at reasonable cost
- . Assess cost equitably
- . Operate simply.

In 1970, the Hawaiian driving public purchased motor vehicle insurance costing \$54.5 million. Motorists purchasing this insurance were segregated by the insurance industry into three risk categories: preferred, high and assigned. These risk categories are not unique to Hawaii. The pattern exists in every jurisdiction in the country. It reflects a pattern designed by the industry to isolate profitable risks for competition and segregate undesirable risks into industry-wide insurance pools. What is significant in assessing the availability of coverage and the financial burden on the Hawaii driving public is the recent changes in the size of each of these groups.

For each classification of motorist, cost and availability go together. The two-thirds to three-fourths of all who qualify as standard or preferred risks find insurance readily available. For those whom the insurance industry considers to be poor risks, however, the story is different. The insurance companies in Hawaii operate on a competitive basis, but they do not compete for every vehicle owner's business.

The number of drivers considered poor risks by carriers has grown substantially in the last two years. These drivers are either forced out of the market altogether or into a special, high-priced area of the market. They have few options, compared with the average driver. For one reason or another—e.g., low income, high rates, or both—15 to 20 percent do not buy insurance at all. Because of the close correlation between cost and availability, this chapter is organized around the two groups of motorists—the average driver and the high-risk driver.

An evaluation of the third objective, simplicity of operation and understandability by the general public, is easily derived from the discussion on cost and availability. Succinctly stated, the system is so complex that *complete ignorance* or *complete bewilderment* probably best typifies the average consumer's understanding of the current auto insurance system.

A. The Average Driver

The average driver not only can select his insurance carrier at will, but he can also buy several optional coverages. The most serious problems in the buying and selling of insurance concern the high-risk driver, but the average driver also has some significant problems. The principal insurance problems confronting the average driver are (1) rapidly escalating rates and (2) how to select the most economic coverages for adequate protection. The increasing frequency of accidents and

inefficiencies of the existing insurance system put the first problem beyond his control. The complexity of the system makes the second difficult.

1. **Coverages offered.** Hawaiian insurance companies issue three types of policies: Family Auto Plan (FAP), Special Auto Plan (SAP), and Basic Auto Plan (BAP) for assigned risks. The most expensive plan is BAP, discussed in section B of this chapter. The remaining discussion pertains only to SAP and FAP policies, generally referred to as "standard" policies. These policies offer six different coverages:

- . Bodily injury (B.I.) liability
- . Property damage (P.D.) liability
- . Comprehensive
- . Medical payments
- . Uninsured motorists.
- . Collision

Everyone required to comply with the financial responsibility laws must carry the first two coverages, bodily injury and property damage liability, at a minimum specified level. Except for uninsured motorist coverage, the driver who represents an average risk has a choice of a wide range of options to suit individual need, circumstance, and situation. The range of policy

terms offered and the basis for payment of losses for these six basic coverages are illustrated in table 9 - 1. Under three of the six coverages in existing policies, the basis for compensating losses is commonly described as first-party no-fault.¹

The different coverages offered arise directly from the law governing automobile accidents. Since the law of negligence applies to automobile accidents, every driver risks becoming a party to a liability lawsuit. To protect against this risk, the insurance companies offer and the majority of drivers carry liability coverage. However, the law does not make liability coverage compulsory, and Hawaii consequently has about 60,000 uninsured owners. For this reason, most insured drivers also carry uninsured motorists coverage to protect themselves against loss from being hit by an uninsured motorist. Under this coverage, motorists collect from their own insurer, but in order to do so they must first prove that the other party was negligent. Hence, this coverage represents an interesting curiosity in the insurance field: first-party tort liability.

¹For definition of technical terms, see glossary in front of study.

Table 9 - 1
Summary of Major Features of Family Automobile Insurance

| Coverage | Basis for Payment | Policy Terms | | |
|---------------------------|------------------------------|--------------------|-------------------|------------------|
| | | Minimum | Typical | Maximum |
| Bodily injury liability | Third party - tort liability | 10/20* | 50/100* | 100/300* |
| Property damage liability | Third party - tort liability | \$5,000 | \$5,000 | \$25,000 |
| Comprehensive | First party - no-fault | \$ 100 deductible | \$ 50 deductible | Full |
| Collision | First party - no-fault | \$1,000 deductible | \$ 100 deductible | \$ 25 deductible |
| Medical payments | First party - no-fault | \$ 500 | \$1,000 | \$ 5,000 |
| Uninsured motorists | First party - tort liability | 10/20* | 10/20* | 10/20* |

*Figures are in thousands of dollars (e.g., 10/20 = 10,000/20,000). The first figure refers to the insurance carrier's maximum liability to any one individual, and the second figure is the carrier's maximum liability to all individuals involved in any one accident.

2. **Determination of premiums.** The premium for an individual driver is determined by multiplying a base rate by a "factor." Base rates are established for each element of coverage (e.g., 25/50 B.I. liability, \$50 or \$100 deductible collision) within each geographic rating territory. Rates for a territory are based upon claim experience for prior years. Hawaii has four rating territories corresponding to the four counties. Base rates in the City and County of Honolulu are about double those in other counties. The multiplying factor is determined by many considerations, including:

- . Age group
- . Sex
- . Marital status
- . Number of operators
- . Use of car (business, pleasure, farm, etc.)
- . Distance to work (more or less than 10 miles)

- . Driver education
- . Vehicle characteristic
- . Driver record.

Based upon all factors except driving record, the applicant will be assigned to one of 217 possible categories. These categories have been developed and promulgated by automobile actuaries, and the driver is given no options and makes no decisions regarding his classification. The result of applying this classification scheme yields a tentative multiplier factor of between 0.90 and 3.65.²

The range of rates corresponding to these tentative factors is shown in table 9 – 2, which presents the cost of the various coverages in table

².90 is a factor for pleasure use when "only operator in household is a female age 30–64"; 3.65 is factor for business use by "youthful driver age 17 or less with Driver Training not eligible for Good Student Credit." Source: Hawaii Insurance Rating Bureau (IRB), *Rating Manual*, Honolulu: January 1, 1970, pp. 5 – 6.

Table 9 – 2

Cost Summary of Major Features of Family Automobile Insurance

| Coverage | Policy Terms | | | Sample Premiums | | | | | |
|---------------------------|-----------------------|---------------------|--------------------|--|---------|--------------|--|---------|--------------|
| | | | | 35 Year-Old Married* Extent of Coverage | | | Family with 2 Teen-Age Drivers – 2 Cars** Extent of Coverage | | |
| | Minimum | Typical | Maximum | Mini- mum | Typical | Maxi- mum | Mini- mum | Typical | Maxi- mum |
| Bodily injury liability | 10/20* | 50/100* | 100/300* | 82 | 100 | 122 | 312 | 422 | 466 |
| Property damage liability | \$5,000 | \$5,000 | \$25,000 | 45 | 45 | 47 | 172 | 172 | 185 |
| Comprehensive | \$100 deductible | \$50 deductible | Full | 10 | 13 | 28 | 44 | 56 | 124 |
| Collision | \$1,000 deductible | \$100 deductible | \$25 deductible | 17 | 68 | 135 | 77 | 303 | 454 |
| Medical payments | \$500 | \$1,000 | \$5,000 | 10 | 13 | 18 | 40 | 48 | 141 |
| Uninsured motorists | 10/20* | 10/20* | 10/20* | 4 | 4 | 4 | 7 | 7 | 7 |
| | | | | \$168 | \$243 | \$354 | \$652 | \$1,008 | \$1,377 |

*Less than 10 miles work, standard car, 1 year old.

**Less than 10 miles work/school, 2 standard cars, new and 1 year old. 18 and 19 year-old drivers with driver training.

Source: Hawaii Insurance Rating Bureau, *Rating Manual*, rates in effect on September 1, 1971 applicable to Honolulu County.

9-1. For example, a 35 year-old married man who drives less than 10 miles to work can expect to pay from \$127 for minimum financial responsibility coverage up to \$354 for full coverage. Insurance for a family with two cars and two teen-age drivers ranges from between \$484 to \$1,377 per year.³

Honolulu insurance rates are compared with a representative sample of 22 other major metropolitan areas in figure 9-1. As this comparison shows, present Honolulu rates are not only in line with these other cities, but if experience elsewhere is any guide to the future, Honolulu rates could easily become somewhat higher. Rates for Honolulu may seem high to Hawaii motorists, but in fact Honolulu is in the lowest fourth of the range of premium costs shown in figure 9-1. This comparison is presented to point out that increased urban growth and density plus poor traffic management have also led to high insurance costs elsewhere.

3. Additional surcharges: the safe driver plan.

The multiplier factor associated with the 217 classification scheme can be increased, depending upon the driving experience of the applicant. The safe driving plan penalizes drivers who are found guilty of moving traffic violations or who have been involved in accidents where the damages exceeded \$100. The penalty applies for three years. Factors specified in the safe driving plan are commonly known within the industry as the point system. Table 9-3 illustrates how the plan affects rates of a driver owning a standard performance automobile. In theory, under this plan, a driver's premium may be increased by as much as 250 percent depending on how many points have been charged against the driver. In fact, however, a driver who accumulates more than two points is generally considered to be in the "high-risk" category, which has an even more disastrous effect on his premium and coverage.

³All dollar figures in this chapter refer to IRB rates used by all stock companies in Hawaii. These companies sell 65-70 percent of all auto insurance in Hawaii. Rates for other companies, commonly referred to as "independents," may differ from IRB rates.

Table 9-3
Safe Driving Point System

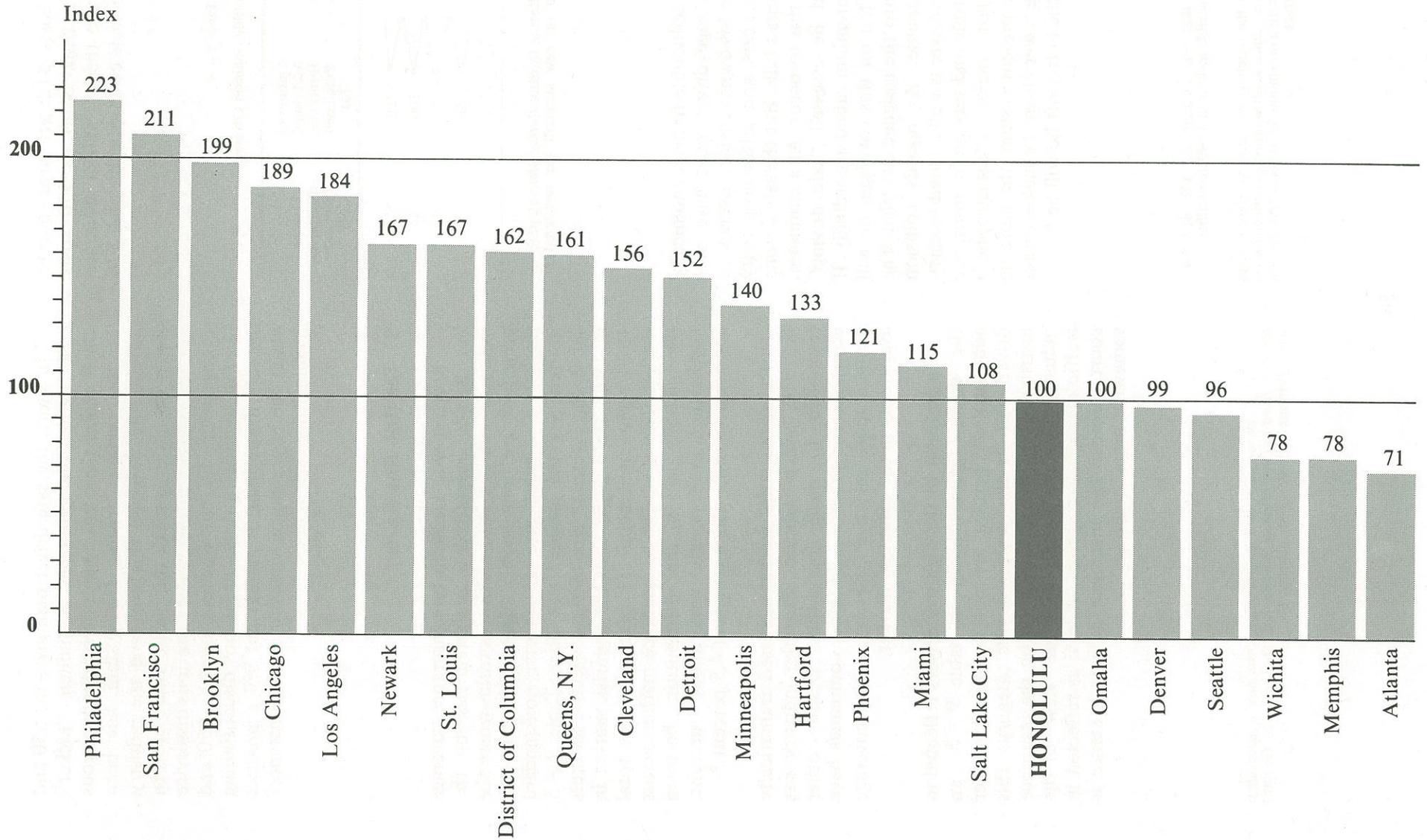
| Number of Driving Record Points | Percentage Increase in Premium |
|---------------------------------|--------------------------------|
| 0 | 0 |
| 1 | 40 |
| 2 | 50 |
| 3 | 150 |
| 4 | 220 |

The full implications of the safe driver plan seem to be little understood by the general public. If a driver reports an accident not involving anyone else, he will be given one point and his premium will subsequently increase by 40 percent over the next three years. Thus, if the damage to his car is less than \$250, it will probably pay him not to file a claim. In a two-car collision, the point system can be more costly to *both* drivers to report the accident and file claims provided that (a) damage to neither car exceeds \$250 and (b) there is a chance that both drivers will be considered at fault by their respective insurance companies. For instance, if "A" is hit by "B," A has a choice of filing a claim with his own or with B's insurer. If A files with his own company and if his company is successful in collecting from B's insurance company, no points are supposed to be assessed against A. But if the two insurance companies cannot agree, both drivers may be considered at fault and each will be assessed points, thus raising both their premiums in subsequent years.

4. Value of deductibles. In table 8-5 it was shown that motorists pay between \$1.63 - \$1.71 for each \$1 which the insurance system pays for automobile repairs. Couple this with the fact that having one's car repaired under his own collision coverage may increase his insurance premiums by 40 percent for three years, and the question which the average motorist should ask immediately is: how worthwhile is the \$50 or \$100 deductible collision coverage?

In table 9-4, columns 3 and 4 show the additional premium required to reduce the deductible coverage on a standard new car from \$500 by steps to \$50. As one moves down the scale, the incremental costs become increasingly significant. For example, to lower the deductible from \$500 to \$250 costs only \$12-i.e., this \$250

Figure 9-1
COMPARISON OF INSURANCE RATES IN HONOLULU AND OTHER METROPOLITAN AREAS



of added insurance costs \$12 per year—but to lower the deductible from \$100 to \$50 costs \$26—that is, to purchase the last \$50 of insurance at the low end of the scale costs an additional \$26 per year.

Table 9 - 4
Cost of Deductible Collision Coverage

| Amount of Deductible (1) | Total Cost of Insurance (2) | Amount of Additional Insurance Purchased (3) | Cost of Additional Insurance (4) |
|--------------------------|-----------------------------|--|----------------------------------|
| \$500 | \$ 35 | \$250 | \$12 |
| 250 | 47 | 100 | 15 |
| 150 | 62 | 50 | 16 |
| 100 | 78 | 50 | 26 |
| 50 | 104 | | |

Source: Hawaii Insurance Rating Bureau, *Rating Manual*, p. R-2, April 1971; based on new standard car registered in Honolulu.

In order for \$50 deductible to be economically worthwhile,⁴ the average driver must have over \$100 of repairs under his own collision coverage at least once every two years, and suffer no penalty for submitting such repair bills. But the safe driving plan will not permit this to occur. At a minimum, such a driver would be assessed “safe driving” points and have his premium raised accordingly. If he collected very often on this coverage, he will more likely be put into the assigned risk plan. The conclusion is inescapable. As regards collision coverage, the average driver is well-advised to carry \$250 or \$500 deductible and rely on his insurance company only for major (“catastrophe”) situations. Under the present system, the more he “self insures” and the fewer claims he makes on his insurance company, the better off he will be.⁵

⁴“Worthwhile” means that one recoups the \$26 difference which one pays for \$50 deductible instead of \$100 deductible.

⁵For those who finance the purchase of their car, these savings may not be possible, of course, since lending agencies almost always insist on collision coverage with a maximum \$100 deductible for the duration of the finance contract.

In short, the safe driver plan gives the \$50 and \$100 deductible coverages a hidden “kicker” which makes these coverages potentially disastrous for the average driver. The system has been purposefully designed this way, and the industry should do more to make the public aware of it. In fact, the industry probably does a serious disservice to the public by not discontinuing the \$50 and \$100 deductible options—or by not discontinuing the safe driver plan. It should not sell a product which the buyer can in virtually no circumstances meaningfully cash in on.

B. The High-Risk Driver

A driver who wants to buy insurance coverage but is not considered a preferred risk by the insurance industry is forced into a realm where the premiums are considerably higher. The high-risk market is divided into two parts: nonstandard insurers and the assigned risk plan. Table 9 - 5 shows the estimated size of the respective markets in 1970. On a dollar basis, the high-risk market in 1970 represented about 11 percent of the total market. This is similar to insurance markets across the nation, as is the distribution between nonstandard insurers, who write about 7 percent, and assigned risks, which represent 4.5 percent.⁶

The assigned risk market increased dramatically in 1970, which indicates how the industry has responded to rising loss ratios. Despite other competitive pressures, insurance companies have become more selective, thus restraining coverage availability in the voluntary market.

In addition to the high-risk drivers reflected in the dollar figures shown in table 9 - 5, an additional 19 percent are not insured. All other drivers fall in the preferred risk category. This distribution of risk classification by the insurance industry contrasts sharply with the “view” of the traffic management system, at least as reflected in court records. The insurance industry’s stance is somewhat more “rigorous.”

⁶U. S. Department of Transportation, *Insurance Accessibility for the Hard-to-Place Driver*, Washington, D. C.: U. S. Government Printing Office, 1970, chapter IV.

Table 9 - 5
Automobile Insurance Premiums Written in Hawaii
By Standard and Non-Standard Insurers
1970

| Kind of Coverage | Distribution (Percent) | | | | |
|---------------------|------------------------|---------------|-------------------|--------------|--------------|
| | Non-Standard | Assigned Risk | Total "High-Risk" | Standard | Total |
| Liability | \$2,715,279 | \$2,238,818 | \$4,954,097 | \$36,547,695 | \$41,501,792 |
| Physical damage | 1,404,265 | 438,248 | 1,842,513 | 16,184,164 | 18,026,677 |
| Total all coverages | \$4,119,544 | \$2,677,066 | \$6,796,610 | \$52,731,859 | \$59,528,469 |
| | 6.5 | 5.4 | 11.9 | 88.1 | 100.0 |
| Liability | 7.8 | 2.4 | 10.2 | 89.8 | 100.0 |
| Physical damage | 6.9 | 4.5 | 11.4 | 88.6 | 100.0 |
| Total all coverages | | | | | |

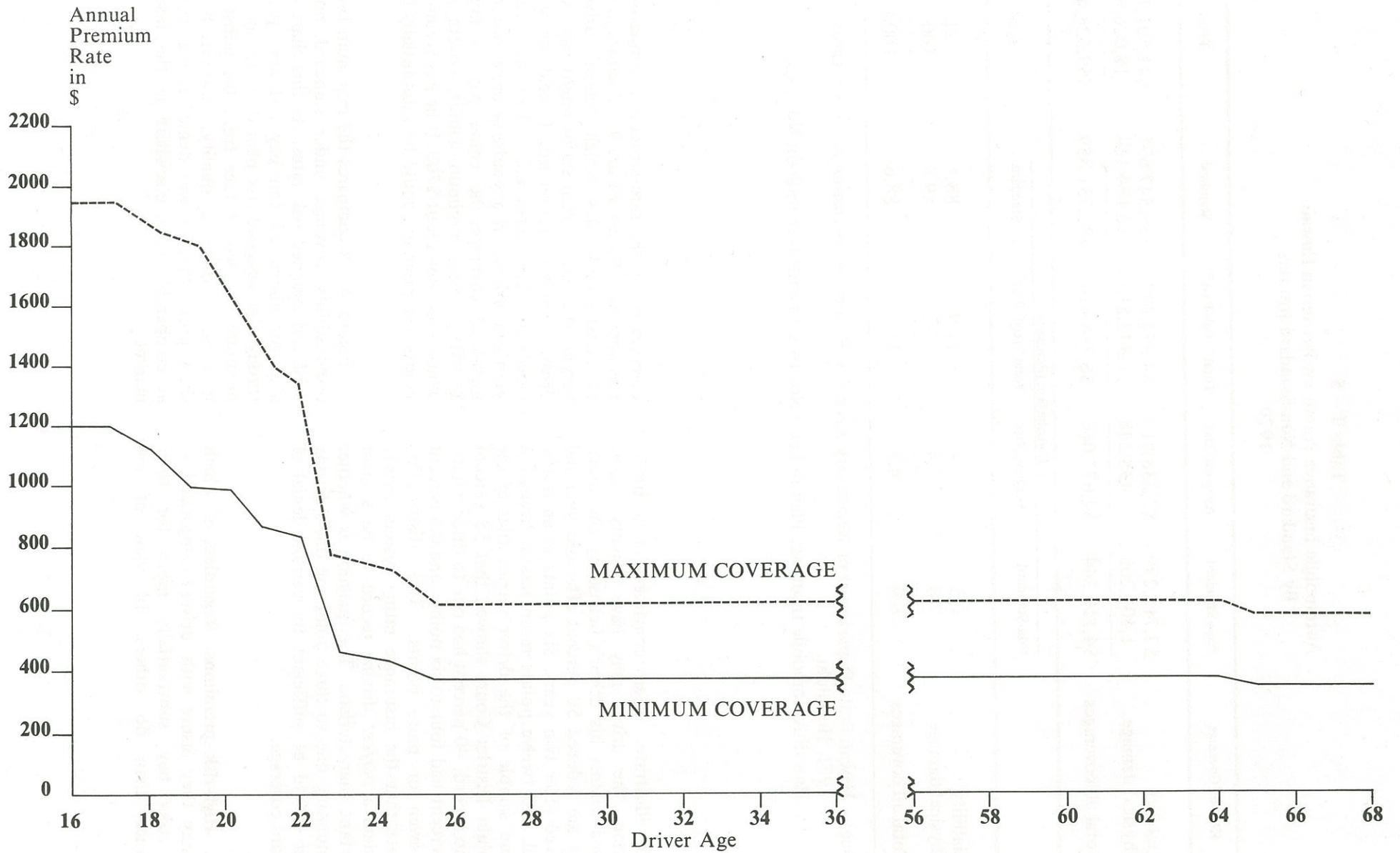
Source: Hawaii State Department of Regulatory Agencies, *Report of the Insurance Commissioner, 1971*, Honolulu.
Hawaii Automobile Insurance Plan Bulletin No. 140, amended by Bulletin No. 142.

To illustrate, when convicted of a traffic violation, the driver may have penalty points assessed against his driver's license by the court. Points are reduced 50 percent after one year and removed after two years. Six points mean traffic school, and twelve points mean loss of license. A random sample of the driver record files of the Honolulu District Court showed that 58 percent had no record, 40 percent had one to three points, 1.5 percent had four to six points, and 0.5 percent had seven or more points. This distribution indicates that the insurance rating system clearly considers a *perfect* driving record to be a most important characteristic. The question is whether accumulating one to three points on one's driving record should be sufficient to warrant denial of standard coverage.

1. **High-risk premiums.** Regardless of which company they insure with, drivers categorized as high risks pay substantially more for their insurance than do others. In view of the

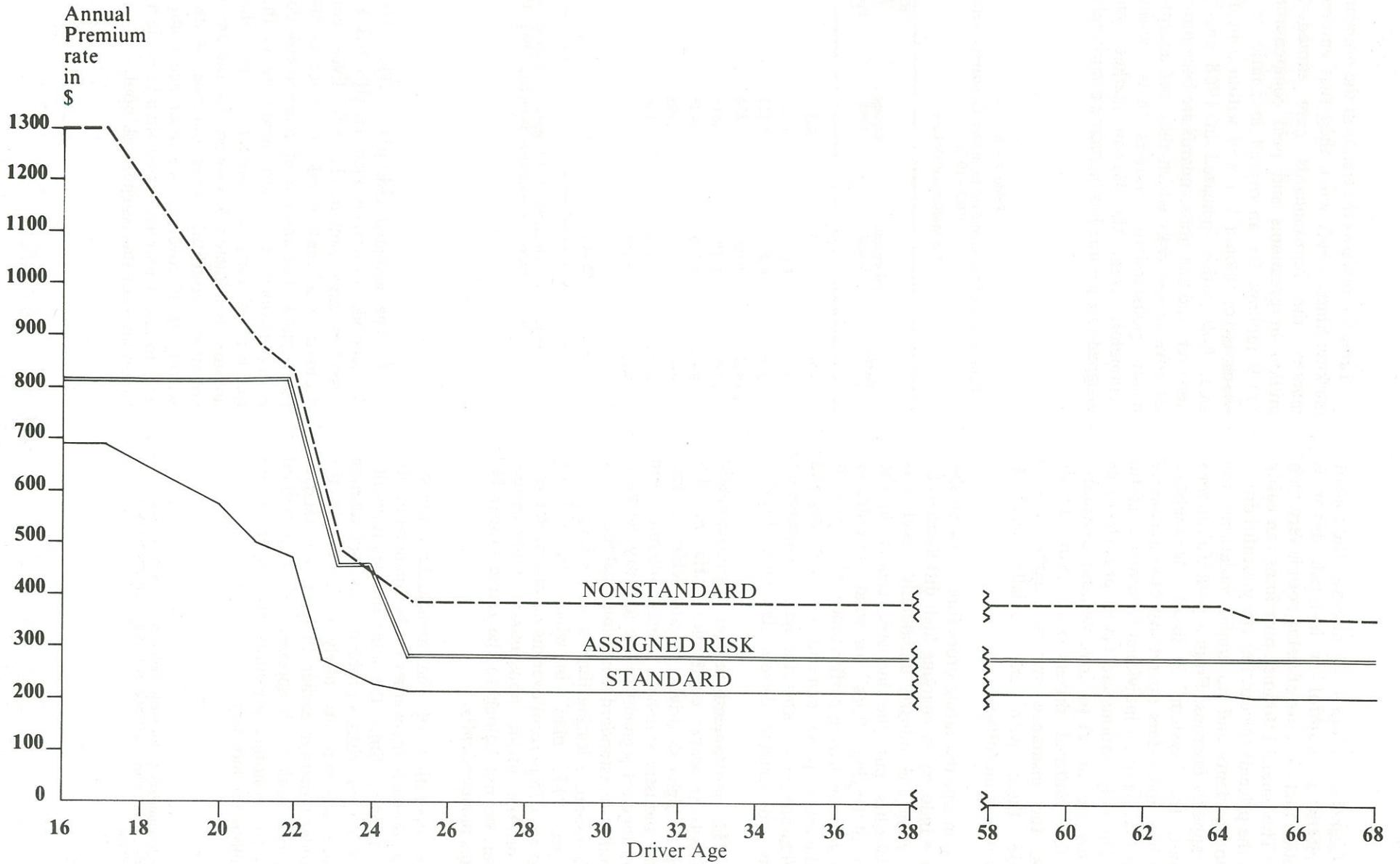
complexity of the rate structure, comparisons in this area are difficult. Figure 9 - 2 shows the range of nonstandard rates which "clean" drivers of varying age and marital status might pay. A clean driver is one with no record of accidents or traffic violations. The rates are particularly high for youthful drivers. If a youthful driver wants full, high-level coverage, he could pay as much as \$1,950 per year; minimum liability coverage alone would cost him about \$700. If he has accumulated points, the premium could be substantially higher.

Figure 9 - 3 compares the minimum financial responsibility coverage under standard, nonstandard and assigned risk rates. As this chart shows, a driver above 25 can pay a lower premium through the assigned risk plan than the minimum premiums he would face from the nonstandard insurers. In order to qualify, however, he must show proof that he was denied similar coverage at comparable rates elsewhere in the insurance market.



RANGE OF NONSTANDARD RATES FOR "CLEAN" DRIVER

Figure 9-2



COMPARISON OF PREMIUMS FOR MINIMUM COVERAGE

Figure 9-3

As figures 9 – 1 and 9 – 2 indicate, the cost of being either a youthful or high-risk driver is substantial, and the cost of being both is very high indeed. The annual insurance premiums can easily exceed the price of the car. For the youthful driver with no accidents and no traffic violations, the system appears onerous. From a youthful driver's viewpoint, the "system" is totally presumptive against him and offers no retrospective means of proving that he as an individual is in fact a careful driver. His only options are (a) to pay, (b) to lie about his age, or (c) to drive without insurance. Thus, for youthful drivers with clean driving records, the insurance system clearly fails to provide them with any socially desirable alternatives or incentives.

To sum up, the rating procedure used by the insurance industry in charging high differentials to drivers whom the industry unilaterally classifies as high risks has put the industry clearly in the position of levying "fines" for what the industry defines as poor driving performance. In essence, it plays the role of policeman and court, or judge and jury. Figuratively speaking, the system apprehends, convicts and penalizes drivers—its own customers.

2. The nonstandard market. Approximately 10–15 auto insurance companies in Hawaii offer policies to high-risk drivers at rates which deviate from the industry standard. These companies form the nonstandard segment of the industry. Some of the smaller nonstandard companies belong to the Hawaii Insurance Rating Bureau and write policies under the "175 plan" in which the high-risk insured pays 75 percent over his normal premium.⁷ Most of the major nonstandard underwriters, however, do not belong to the rating bureau but file rates independently.

The operation of the nonstandard market serves as an early bellwether to the financial health of the industry. Since the nonstandards normally write marginal risks, problems in maintaining insurance coverage are likely to appear in the nonstandard market earlier than in the standard voluntary market. Responses of nonstandard writers to economic pressures have repercussions throughout the industry.

⁷ Large companies also write under the "175 Plan"; e.g., if the applicant cannot show evidence of having been insured within the last 30 days.

Table 9 – 6 shows the trends in the nonstandard market. Since 1962, when they first entered the market, the nonstandards have earned \$22.7 million in premiums and paid compensation of \$11.9 million, for an overall loss ratio of 0.52, which is (or should be) well within a profitable area. Loss ratios increased in 1968 and 1969, however, and the nonstandards are becoming more selective in the risks which they will accept. Two major nonstandard insurers have withdrawn completely from the Hawaii market, and the assigned risk volume has increased accordingly.

Table 9 – 6
Performance of Non-Standard Insurance Companies in Hawaii
1962–1970
(In Millions of Dollars)

| Year | Premiums Earned | Losses Paid | Ratio of Losses Paid to Premiums Earned |
|-------|-----------------|-------------|---|
| 1970 | 5,222 | 3,025 | .58 |
| 1969 | 5,086 | 3,624 | .71 |
| 1968 | 4,414 | 2,221 | .50 |
| 1967 | 3,109 | 1,254 | .40 |
| 1966 | 1,979 | .814 | .41 |
| 1965 | 1,300 | .429 | .33 |
| 1964 | .734 | .298 | .41 |
| 1963 | .547 | .156 | .29 |
| 1962 | .353 | .112 | .32 |
| Total | 22,744 | 11,933 | .52 |

Source: Hawaii State Department of Regulatory Agencies, *Report of the Insurance Commissioner*, Honolulu, 1963–1971.

3. The assigned risk plan. The Hawaiian Automobile Insurance Plan (HAIP) has been in operation since January 1, 1950. Every company licensed to sell automobile insurance in the State participates. The amount of assigned risk coverage is apportioned to carriers according to the total number of car-years written, except that this amount is adjusted downward by the amount of voluntary youthful driver coverage written. By writing such coverage, an insurance company is able to select its risks rather than be subject to the randomness of the assigned risk pool.

The experience of the assigned risk plan is an interesting example of the manner in which the risk avoiding behavior of the insurance carriers affects those wishing to purchase insurance. Underwriters refuse to write standard coverages for a variety of reasons, chief among them being traffic conviction records or other indications of probable loss payout.

Table 9 – 7 shows data for the plan. In the ten years preceding 1970, an average of 2,400 assigned risk policies per year was written; in 1970 the number increased to 11,725 policies, or about 3 percent of all policies written. Since the average premium is higher, assigned risks represent approximately 4.5 percent of total earned premiums.

Table 9 – 7
Assigned Risk Plan Policies Written
1957–1970

| Date | Assigned Risk Policies Written | Total Car-Years Written |
|------|--------------------------------|-------------------------|
| 1970 | 11,725 | 251,270 |
| 1969 | 2,404 | 244,182 |
| 1968 | 1,960 | 216,519 |
| 1967 | 2,258 | 214,348 |
| 1966 | 2,613 | 203,624 |
| 1965 | 3,266 | 187,902 |
| 1964 | 2,295 | - |
| 1963 | 1,780 | - |
| 1962 | 2,813 | - |
| 1961 | 2,716 | - |
| 1960 | 1,860 | - |
| 1959 | 1,068 | - |
| 1958 | 661 | - |
| 1957 | 488 | - |

Source: Hawaii Automobile Insurance Plan, *Annual Reports of Operations*, 1961–1970.

In February of 1970, HAIP adopted uniform plan "C" which expanded the coverage to a point where assigned risk coverage was similar to that available in the voluntary market. Medical payments coverage of \$500 and \$1,000 was added, and physical damage coverage can now be purchased on the basis of \$100 deductible, comprehensive and collision combined. Prior to plan "C," coverage conformed only to the minimum 10/20/5 financial responsibility limits.

Table 9 – 8 indicates that the assigned risk plan has supported loss ratios significantly higher than those experienced by the nonstandard insurers. However, assigned risk loss is spread throughout the market, whereas any large nonstandard loss falls mainly on 10 – 15 carriers. Assignment to the plan involves not only a higher base premium but also surcharges based on HAIP's own system of penalty points, which in turn are based on traffic accidents and convictions. The surcharges range up to 150 percent for seven or more penalty points. In a random sample of recent assignments, shown in table 9 – 9, about half the assignees had no penalty points, meaning that they had no violations record or accident record for the last three years but, despite that fact, could not obtain insurance from standard sources. About half of the no-penalty assignees were under 25 years of age.

Table 9–8
Assigned Risk Plan Experience

| Year | Earned Premiums | Incurred Loss ¹ | Ratio of Incurred Losses Earned Premiums |
|------------------------|-----------------|----------------------------|--|
| <i>Bodily Injury</i> | | | |
| 1969 | 293,217 | 339,241 | 115.6 |
| 1968 | 278,878 | 346,062 | 124.0 |
| 1967 | 215,762 | 248,729 | 115.2 |
| 1966 | 209,419 | 168,455 | 80.4 |
| 1965 | 211,900 | 251,782 | 118.8 |
| 1964 | 174,199 | 160,430 | 92.1 |
| 1963 | 132,667 | 95,085 | 71.7 |
| Total | 1,516,042 | 1,609,784 | 106.1 |
| <i>Property Damage</i> | | | |
| 1969 | 134,266 | 113,931 | 84.8 |
| 1968 | 140,757 | 110,560 | 78.5 |
| 1967 | 116,311 | 114,082 | 103.4 |
| 1966 | 121,279 | 96,880 | 79.8 |
| 1965 | 126,658 | 87,205 | 68.8 |
| 1964 | 108,870 | 51,869 | 47.6 |
| 1963 | 88,763 | 39,614 | 44.6 |
| Total | 836,904 | 614,141 | 73.3 |

Source: Hawaii Automobile Insurance Plan, *Annual Reports of Operations*, 1961–1970.

¹Data on losses paid were not available. Since losses paid are less than losses incurred, the ratio of actual losses to premiums would be less.

Table 9 – 9

**Hawaii Automobile Insurance Plan
Records of Drivers to Whom New Policies Were Issued
Between October 28 to November 2, 1971**

| HAIP points | 0 | 1 | 2 | 3 | 4 | 5 | 6 | 7 and over |
|-------------|-----------------|----|-----|-----|-----|-----|------|------------|
| Risks (158) | 71 ^a | 4 | 20 | 18 | 4 | 10 | 8 | 23 |
| Surcharge | 0 | 5% | 10% | 15% | 50% | 75% | 100% | 150% |

^aThe 71 risks with zero points were reviewed to determine their character. It was found that 34 were youthful operators (under 25). Five risks were elderly (over 65) and remainder were adult risks, some of which were probably placed in the plan due to their occupations.

4. **The uninsured motorist.** For a variety of reasons, many motorists do not or cannot buy liability insurance. A victim of such a driver obviously has no insurance protection whatsoever, and the tort system is usually of no benefit to such a victim.

Many applicants are denied insurance because of the “underwriting” criteria used by insurance companies. These criteria discriminate between individuals on the basis of such characteristics as their occupation, race, personal associates, personal appearance, location and condition of residence, command of English, and general social standing. Information regarding many of these characteristics is not, of course, reflected in the application for insurance. Rather such information is obtained through instructions issued to agents as to what is not acceptable business, or it is acquired by private investigation conducted by commercial organizations as a service to insurance companies. Most, if not all, of the criteria mentioned here are grossly inequitable and are not socially defensible. For this reason, insurance companies do not advertise their grounds for accepting or retaining risks. When known, the exercise of these criteria is usually met with a degree of bitter resentment at least equalling any sense of injustice over rating classifications themselves.⁸

Since no official figures were available, the estimate of the number of uninsured motorists shown in table 9 – 10 was prepared. Despite the rapid increase in rates since 1966, it appears that the number of uninsured owners as a percent of total passenger cars registered has dropped slightly in recent years (see the last column of table 9–10). Since prior to 1969 the assigned risk plan never wrote more than 3,266 policies (1965, see table 9 – 7), it is apparent that the assigned risk plan has not operated in such a way as to keep the number of uninsured motorists from rising.

C. Conclusions

The existing insurance system clearly fails to achieve any of the three objectives stated at the beginning of this chapter. With almost 30 percent of the population either paying very high premiums or driving without insurance, protection is not universally available at reasonable cost. In addition, many of the criteria used for accepting, classifying or retaining policyholders are highly discriminatory and inequitable. The subjectiveness of the criteria used is apparent from the fact that many drivers who are forced to pay high-cost, assigned risk premiums have no record of accident involvement or traffic violation. Finally, the complete rate structure, which now contains 217 basic classifications plus various surcharges, is totally presumptive against youthful drivers and it is not simple.

To a substantial degree, these problems and the concurrent failure to attain reasonable objectives

⁸C. A. Kulp and John W. Hall, *Casualty Insurance*, Fourth Edition, Ronald Press, 1968, pp. 377 – 378 and 428.

Table 9 – 10
Uninsured Motorist Group

| Year | No. of Registered Passenger Cars ¹ | Total Car-Years Written ² | No. of New Car Sales ³ | Size of Uninsured Motorist Group ⁴ | |
|------|---|--------------------------------------|-----------------------------------|---|---------|
| | | | | Number | Percent |
| 1969 | 332,213 | 251,270 | 33,360 | 64,263 | 19 |
| 1968 | 315,024 | 244,182 | 29,044 | 56,320 | 18 |
| 1967 | 297,766 | 216,519 | 24,331 | 69,082 | 23 |
| 1966 | 286,836 | 214,348 | 23,518 | 60,729 | 21 |
| 1965 | 273,559 | 203,624 | 22,603 | 58,634 | 22 |
| 1964 | 254,249 | 187,902 | 20,880 | 55,907 | 22 |
| 1963 | 237,422 | 177,860 | 16,791 | 51,167 | 22 |

¹Hawaii State Department of Planning and Economic Development, *State of Hawaii Data Book 1970*.

²Hawaii Automobile Insurance Plan, *Annual Reports of Operations, 1961–1970*.

³Honolulu Chamber of Commerce, *Hawaii Facts and Figures*.

⁴Uninsured cars = registered passenger cars – (car-years written + 1/2 new car sales).

arise from the fact that the industry itself is a “victim” of the system of negligence law within which insurance must be sold and administered. Negligence law provides very strong incentives to avoid selling liability insurance to anyone who might make a poor defendant in a jury trial or anyone with a higher-than-average probability of being involved in an accident. The incentive to avoid underwriting certain risks leads the industry to find and legitimize any method that will screen out such risks or sort them into different categories of exposure and premium cost, regardless of whether the criteria used also discriminate in a larger and socially onerous sense.

The liability coverages which must be offered under a negligence system, and the inevitable relationships which these coverages subsequently create, are also far from ideal. When a policyholder is involved in a collision with another car, the insurance company is almost invariably forced to assume an adversary-antagonist position to the victims in the other car.⁹ And in those instances in

which a policyholder tries to collect on his uninsured motorist coverage, *which is based on proof of fault*, the insurance company *automatically becomes an adversary to its own policyholder*. Such a coverage, which automatically creates antagonism and litigation between a company and its own policyholder, would be positively absurd were it not for the seriousness of the uninsured motorist problem.

In view of the burden which the negligence system imposes, the logical conclusion is that any indictment of the way the insurance system works must also be interpreted as an indictment of the legal framework. It would probably be naive, however, to believe that simply reforming the legal system will automatically guarantee an end to industry abuses or guarantee achievement of the previously specified objectives. Any reform proposal should explicitly address itself to the problems discussed in this chapter.

⁹From an insurance industry viewpoint, the negligence system also has the undesirable characteristic of forcing what is customarily a service industry into a highly unfavorable public regulations posture, because of its adversary-antagonist role and its

lack of enthusiasm for insuring many members of society. It seems not unlikely that in some instances other insurance business of salesmen may be affected because of an insured's unhappy experience with his automobile insurance.

CHAPTER 10

TRAFFIC SAFETY SYSTEM: EVALUATION

Another objective of the insurance system is to complement related programs directed at reduction of both precrash and postcrash traffic accidents and losses. The purpose of this chapter is to explore the role of both public and private agencies and the insurance system in achieving this objective.

At the national level, the industry through the Insurance Institute for Highway Safety for some time has encouraged states and localities to establish effective programs of driver training and education. It has instituted limited rate reductions for graduates of such courses. More recently, it has begun to take an active role in rectifying both vehicle and roadway safety problems.

The motor vehicle insurance system has extensive interactions with traffic law enforcement. It also relates to medical services for traffic accident victims by paying for such services, and it interacts with the vehicle repair industry by paying a major portion of the State's auto repair expenses. The extent of this interaction provides a basis for examining the performance of Hawaii's traffic safety activities and suggesting possible areas for improvement. This discussion includes the following topics:

- . Traffic law enforcement
- . Highway, vehicle and driver safety
- . Emergency medical care services
- . Vehicle repair
- . Prospects for the future.

A. Traffic Law Enforcement

This section reviews traffic law enforcement system in the City and County of Honolulu in 1970. During 1970, more than 15,000 traffic accidents were reported (see table 10-1). Underreporting probably increases the number of actual accidents by an additional 25-30 percent.¹ Underreporting results from: (1) the \$100 exemption provided by law for reporting of property damage accidents; (2) the disincentive to report accidents above that threshold because of "safe driver" penalties for accident involvement; and (3) nonreporting for single car accidents.

Table 10-1
Disposition of Traffic Accidents
City and County of Honolulu
1970

| | Number | Percent Distribution |
|--------------------|--------|-------------------------|
| Accidents reported | 15,137 | 100.0 |
| Charges made | 11,185 | 73.9 |
| No charges made | 1,091 | 7.2 |
| Cases pending | 2,861 | 18.9 |

Source: City and County of Honolulu Police Department Traffic Violations Bureau.

¹For an informative analysis of the underreporting of traffic accidents in this country, see National Highway Traffic Safety Administration, Office of Accident Investigation and Data Analysis Research Institute, U. S. Department of Transportation, *Annual Report to the Secretary on Accident Investigations and Reporting Activities*, Washington, D. C.: U. S. Government Printing Office, April 1971.

Of all accidents reported in 1970, approximately 74 percent resulted in formal charges (see table 10-1). Despite this high rate of charges being lodged, in general, drivers in Honolulu do not appear to face a real threat of license suspension or revocation. More than three-fourths of all licensed drivers in the State have three traffic violation points or less, and license suspensions and revocations in Hawaii appear to fall far below national averages. The data below indicate the pattern for Oahu in 1969 and 1970. While the total number of license suspensions and revocations more than doubled between 1969 and 1970, such suspensions and revocations amounted to less than three-tenths of one percent of all licensed drivers (approximately 420,000). Applying the national average of 3 percent would have resulted in more than 12,000 license suspensions and revocations in 1970.

| Year | Total Suspensions and Revocations | Percent of All Licensed Drivers |
|------|-----------------------------------|---------------------------------|
| 1970 | 1,125 | 0.27 |
| 1969 | 545 | 0.13 |

Although driver license revocation and suspension rates are low in contrast to national values, traffic accident rates are virtually the same: 16 injuries per 1,000 persons.

Citations for drunken drivers on Oahu are similarly below national averages. In 1970, the police in Honolulu wrote 307 citations for driving while intoxicated, one-tenth of one percent of the 307,000 citations written during the period. This was one-tenth of the national value.

Although Hawaii's rate of license suspensions and revocations is low compared to national values, in those other jurisdictions which have adopted stricter enforcement policies resulting in higher driver license suspension rates, it does not appear that such stricter enforcement policies have had desired deterrent effects. One jurisdiction, California, estimates that more than two-thirds of all drivers with suspended licenses continue to drive despite severe penalties if apprehended. Thus, stricter enforcement alone cannot achieve desired reductions in the accident rate without being integrated with other accident prevention activities.

One of the most constructive aspects of traffic code enforcement in Hawaii is the fact that the court sentences guilty drivers to take mandatory defensive driving courses. The district court in Honolulu, for example, through the traffic violations bureau, has control over assessment of so-called conviction record points and the administration of defensive driving courses for offenders. It appears to be the general policy of the Honolulu district court that drivers with conviction records aggregating six points or more are required to take such courses of instruction.

B. Vehicle and Driver Safety

The density of motor vehicles in Hawaii is high by national standards. It has an average of over one vehicle for every two persons. Further, the level of injuries in the State has risen to a point which now equals the national frequency rate average—16 per 1,000 persons. The value of resulting insurance awards for bodily injury and property damage now averages well over 25 percent above prevailing national values. Of related importance is that the young among Hawaii's population bear the brunt of this accident profile. As indicated below, 16 percent of all automobile accident injuries sustained by the Hawaii population falls on youngsters between the ages of 15 and 19.

| Age | Percent of Total Injured in Traffic Accidents |
|-------|---|
| 15-19 | 16.0 |
| 20-64 | 67.4 |

Thus, the active highway and driver safety programs in these problem areas could make important contributions to the problem of reducing the level of damage sustained.

1. Highway safety. In 1966, the U. S. Congress passed the Federal Highway Safety Act. The purpose of the act is to establish a special grant-in-aid program to states and major localities for rationalization and improvement of the nation's roadway system. In order to qualify for federal support under this legislation, the governor of a state appoints a statewide highway safety coordinator. The coordinator in turn must work closely with traffic law enforcement and city and county government traffic engineering agencies to develop master programs and plans. The State of

Hawaii has appointed a highway safety coordinator.

Viewed in the aggregate, the State currently spends approximately \$12 million on highway safety as distinct from highway improvements. The federal contribution is less than 2 percent. The bulk of the funds are allocated toward crash prevention. Approximately 70 percent is directed toward related human factor aspects of traffic accident prevention and less than 13 percent toward vehicle related factors. The residual, 17 percent, is applied to postcrash services such as emergency medical care.

To date, there has been little experience with evaluation of the program's effectiveness and contributions to loss reduction and prevention. However, the program might address itself to two problem areas. First, it might attempt to achieve more integration of traffic accident reporting systems to make possible better diagnosis of road conditions and hazards. Second, the State might initiate some form of follow-up reporting for manufacturer vehicle recall programs to ascertain whether motorists have availed themselves of the opportunity to correct vehicle structural faults.

2. **Vehicle safety programs.** The State of Hawaii currently maintains a periodic inspection program for all registered vehicles. As in many other jurisdictions, this program is conducted by licensed, commercially-operated garages and repair facilities. A more rigorous vehicle inspection program is conducted by the public utilities commission for common carrier vehicles. This program requires semi-annual inspection of such vehicles licensed by the State.

Every motor vehicle in Hawaii must be inspected at least once a year and display an official certificate of inspection.² The inspection requirement is once every six months for trucks, tractor-trailers, buses and ambulances, or passenger cars ten years old and older, and once a year for other vehicles. The law is administered by local (county) police departments, except for vehicles

²Standards for passenger car inspection are set out in Hawaii Highway Safety Coordinator, *Standards and Regulations Governing the Periodic Safety Inspection of Vehicles under 10,000 Pounds of Gross Weight*, Honolulu: October, 1968.

under the public utilities commission's jurisdiction.³ Inspection findings are sent to both the police department and the vehicle owner for use in applying for new tags.

Local police departments publish a monthly "Motor Vehicle Safety Inspection Report," which summarizes data on the number of vehicles found to be defective and the types of defect found. Tabulation of 1969 data from monthly vehicle inspection reports in Honolulu revealed an average of at least one defect per vehicle inspected.⁴ The four most frequent types of defect per 100 vehicles inspected were:

| | |
|----------------|------|
| Headlight aim | 39.3 |
| Exhaust system | 12.6 |
| Tires and rims | 10.6 |
| Service brakes | 10.4 |

Of increasing concern is the rising number of "recalls" for defects and other unsafe conditions by auto producers. The recalls affect both Hawaii and mainland drivers alike. However, neither the State of Hawaii nor other jurisdictions are able to check on responses by vehicle owners. This creates considerable uncertainty as to whether these defects are, in fact, corrected.

The periodic inspection program in most jurisdictions does not seem an effective means of insuring high levels of preventive maintenance to avoid parts failure and creation of potentially unsafe conditions. The combination of a periodic inspection system with a random roadblock system seems to have more effective results. Random roadblock inspections of vehicles are used by both the U. S. Department of Transportation and the New York State police with some success. In the case of the U. S. DOT, random vehicle inspections have been conducted on ICC licensed carriers, with results indicating extensive defects and poor vehicle maintenance.

³The public utilities commission has responsibility for inspection of vehicles of over 10,000 pounds, buses, taxicabs and ambulances. Approximately 14,844 vehicles fell within its jurisdiction in 1970. Inspections are made every six months. More than 134 stations are licensed by the public utilities commission to conduct such inspections.

⁴Data were gathered from 26 stations which inspected over 28,535 vehicles. These generated 41,329 defects for an average of 1.4 per vehicle.

The New York State random inspection program has been applied to both commercial and private passenger vehicles. The results in general corroborate the DOT findings that periodic inspections alone are insufficient to detect important vehicle malfunctions and low levels of maintenance. To upgrade vehicle safety capabilities, it is suggested that the State of Hawaii consider adding a random inspection program.

3. **Driver safety.** An unfortunate aspect of a highly mechanized society is that the young pay a high price for entry into it. Both in the industrial and motoring environments, the accident profile by age indicates that the young, inexperienced driver or worker bears the brunt of serious injuries and even death.⁵ This fact of our technological society can be partially mitigated through provision of fail-safe devices and appropriate training.

a. **Driver education and training.** Driver education programs are provided through three means other than commercial schools:

- The department of education program for youths of high school age
- The mandatory program for drivers cited for traffic violations, under the auspices of the district courts
- Defensive driving courses given by the local police department.

The department of education program is offered after school hours in 32 high schools and provides 30 hours of classroom instruction and six hours of instruction behind the wheel. In fiscal year 1970, it reached 5,700 youths. Since the course has more applicants than openings, the prime limitation is money.

⁵See National Transportation Safety Board, *Special Study on Youth and Traffic Safety Education* (Report Number NTSB-ST-71-3), Washington, D. C.: U. S. Government Printing Office; and Jerome B. Gordon, Allan Akman and Michael Brooks, *Industrial Safety Statistics: A Re-Examination*, New York: Praeger Publishers, 1971, pp. 210-212.

✓ The court program is a joint effort by the traffic violations bureau of the Honolulu district court and the department of traffic of the City and County of Honolulu. Drivers cited for traffic violations are assigned to the program pending final disposition of the court case. The course consists of six two-hour sessions of classroom instruction, movies and manual instruction. About 1,000 persons go through the program every year. Data on the program indicate that within the first year after completion of the course only 37 out of the 1,000 plus who participated were cited for a traffic violation, and only four of these were involved in accidents.

Defensive driving classes of four two-hour sessions held in successive weeks are given by the Honolulu police department. Participation is voluntary. Attendance is limited by the size of the staff assigned to the program, three in the summer of 1971.⁶

b. **Possible directions for change in driver safety.** What is required is the provision of driver training in stages. The first stage may be a pre-entry preparatory course to acclimate youngsters. Later, courses could provide a combination of classroom and on-the-road experience. Accident avoidance techniques of driving can and have been taught through practices on so-called "skid pads." The skid pads are closed courses which simulate the actual occurrence of such conditions and teach driver trainees how to correct them. A graduated and comprehensive driver training program could provide some increase in the quality of driver behavior. By itself, however, it will be of only marginal help in reducing the frequency or severity of accidents.

✗⁶The interest of the state legislature is indicated in a joint resolution (H. R. No. 274) passed during the 1971 session, calling upon the State highway safety coordinator to make an annual evaluation of driver education programs in the State. The coordinator was requested:

- To develop measures of the performance records of graduates of driver education programs;
- To compare the performance records of graduates with those of other drivers and with those of graduates of programs in other states; and
- To analyze the effects of programs on differentials in insurance premiums charged graduates and nongraduates.

C. Emergency Medical Care Services

The State of Hawaii has taken a lead in the organization and delivery of emergency medical care services. While the level of adequacy for the State and its relative performance is high, there are nevertheless some gaps. Closure of these gaps could help reduce postcrash losses. A properly organized and integrated system of ground and air evacuation and telecommunications can perform for traffic accident victims the same life-saving functions that have kept the level of battle fatalities in Vietnam relatively low.

1. Current status of emergency care services.

Ambulance service in Hawaii is provided through the direct services of the state and county governments or through commercial ambulance firms under contract with the State department of health. The injury control branch of the department of health has responsibility for coordination and planning of emergency medical services for the State. Some augmentation of the system is provided through the resources of military installations on Oahu, such as U. S. Army Tripler General Hospital which provides emergency care to traffic accident victims regardless of whether they are military dependents.

Limited air evacuation services are provided on a request basis in some of the rural areas of the neighbor islands. For example, Hana Medical Center on Maui will furnish air or helicopter service to transport emergency cases to the Maui Memorial Hospital at Wailuku. All 31 hospitals in the State are equipped with helicopter pads for such a contingency.

A fairly pervasive telecommunications network exists to allocate emergency medical care services on Oahu. Based at the State Maluhia Hospital, a 24-hour dispatcher monitors fire, police and disaster two-way radio networks. Honolulu's private ambulance services have their own dedicated network and are not part of this government system.

Performance of the system appears to be adequate. For the major population centers on Oahu, ambulance services are situated so as to reach the scene of an accident within 12 minutes and deliver an emergency case within a maximum of one hour. These standards appear to be well met within the metropolitan area of Honolulu, but they

are frequently unattained in rural districts of both Oahu and the neighbor islands.

2. **Prospects for improvement.** Emergency care services in Hawaii will need several changes to overcome present deficiencies and to cope with considerable demands in the future (see section E).

The following improvements are suggested for further consideration in this area:

a. The integration of county/state and commercial ambulance communications networks should be investigated, with the view towards making capacity available on call from all sources, particularly in the case of major accidents and disasters.

b. Both present hardware and training of emergency care technicians can be upgraded to increase life-saving potential. An example would be the equipping of ambulance units with devices to communicate with emergency room physicians for immediate diagnosis and corrective procedures.⁷

c. Air evacuation techniques seem the most feasible answer for emergency care in rural areas. This could be possibly achieved at no cost to Hawaii taxpayers by transforming present Army and Air National Guard units into helicopter medical evacuation units. The Vietnam war has demonstrated the high life-saving capabilities of the air evacuation techniques. There is little reason why this could not be put to good use for the benefit of civilian traffic accident victims.

D. Vehicle Repair

In 1970, the insurance industry paid more than \$16 million for repair of property damages in accident involvements. The average size of claims for property damage increased by over 27 percent from \$220 to nearly \$280 in less than six months from the end of 1970 to mid-1971.

Motor vehicle repair is a difficult problem both in Hawaii and on the mainland. As a result of extensive hearings on the subject in 1969 and 1970, the Senate has recently passed a bill

⁷A necessary concomitant would be the training of driver/technicians in the use of such electronic devices.

sponsored by Senators Hart and Magnuson which will require the U. S. Department of Transportation to develop, by 1975, repair standards for all automobiles sold in this country.⁸ However, neither the complaints of owners nor the promise of future legislation will correct current deficiencies in the State of Hawaii.

1. Nature of repair industry in Hawaii. In 1970, more than 220 establishments employing 1,419 workers received over \$20 million for repair of motor vehicles. Growth in employment has been rapid, but not fast enough to keep pace with the level of physical damage. Over the period 1966 to 1970, employment in the repair industry rose by 32 percent. During the same period, major vehicle accidents in Hawaii rose by more than double that rate—78 percent. Thus, the ratio of the number of workers per 1,000 accidents actually dropped by more than 25 percent from 104 in 1966 to less than 78 per 1,000 in 1970.

2. Repair cost problems. Changes in the wage rates are only one factor behind the upward surge in claims costs. Over the period 1966 to 1970, wages for repair establishment employees rose by 34 percent, less than the 92 percent increase in the average claim cost for property damage liability. The real problem is replacement parts. Most dealers keep limited supplies of parts in stock, relying heavily on expensive air freight shipments from the mainland. The typical transportation cost ranges from 15 to 17 percent of the part's value. The more significant problem is that most vehicle replacement parts are sold by virtual monopolies—the auto producers themselves. Thus, prices for replacement parts are subject to few competitive pressures and are priced at whatever the market will bear.

3. Possible solutions. Because Hawaii lacks sufficient economic market power, the current pattern of vehicle repair is not likely to change much. Hope rests primarily on how fast and effectively the federal government can develop repair parts utilization standards and control collision repair prices.

⁸S. 976; see also U. S. Congress, Senate Subcommittee on Monopoly and Antitrust, 91st Congress, *Hearings on the Motor Vehicle Repair Industry* (Committee Print), Washington, D. C.: U. S. Government Printing Office.

E. Prospects for the Future

The traffic safety system in Hawaii will face greater difficulties during the next decade. Table 10-2 shows that by 1980, the number of vehicles is expected to increase by over 80 percent, and damaged vehicles will more than double the current level of 44,000. The number of injured victims will be more than double the present level to over 30,000. Together, the combined effects of heightened physical damage and injuries will result in over 22,000 claims for traffic accident compensation. The by-products of this scenario are equally appalling: over 25,000 traffic violations and 12,000 convictions, and filing of more than 2,000 tort actions for recovery of accident losses if the current insurance system continues. Health care costs will rise as a result of increased utilization of emergency and restorative care facilities. Vehicle repair costs may run as high as \$700 per claim, given current growth trends. In view of these projections, the question is what courses of action can contribute to effective accident loss reduction objectives.

Table 10-2
Projections of Motor Vehicles and
Accident Involvements
State of Hawaii

| | 1970 | 1980 |
|---|-----------|-----------|
| Motor vehicle registration ¹ | 400,000 | 720,000 |
| Motor vehicle miles of travel (in millions) ¹ | 3,500,000 | 6,500,000 |
| Damaged cars ² | 44,000 | 95,000 |
| Injured persons ² | 12,000 | 30,000 |
| (serious) | (3,100) | (7,500) |
| (visible) | (3,600) | (9,000) |
| Claims arising from injuries ³ . . . | 9,000 | 22,500 |

¹Based on a 10 percent annual compound growth rate, derived from 1960 to 1970 data series.

²Based on a 12 percent annual compound growth rate, derived from 1960 to 1970 data series.

³Based on a 14 percent annual compound growth rate, derived from 1960 to 1970 data series.

Undoubtedly, mass transportation in Honolulu could alleviate some of the problems. Further, rationalization of the traffic system to mitigate the

possibility of crash involvement would also help. Safer car structures and vehicle design could reduce both the extensive amount of physical damage and bodily injury. Air evacuation techniques borrowed from the military could enhance the life-saving properties of the State's emergency care system. Similarly, ground-based systems with remote telecommunications could work in concert with such a means. Lastly, driver training of a more refined and graded nature tied into the licensing

system might also affect reductions in the severity and occurrence of vehicle accidents and losses.

At present, these elements in the traffic safety system do not operate in concert with one another, nor are they managed as part of an integrated system. The best way to control insurance costs is to prevent accident losses from occurring. The year 1980 is not far away, and plans for avoidance of serious difficulties must be developed quickly.

PART IV
DESIGN AND ANALYSIS OF REFORM ALTERNATIVES

CHAPTER 11

OVERVIEW AND SUMMARY OF ANALYSIS

The principal objective of Part IV is to formulate the essentials of major motor vehicle insurance reform plans and analyze their comparative advantages, costs and social impacts.

A. Scope and Content of Part IV

Design of specific reform plans is the subject of chapters 12 and 13. Important reform proposals by scholars, trade associations and others, as well as operating reform programs, are reviewed in chapter 12. Specific provisions of these alternate approaches are examined. Candidate reform plans which together cover all major directions of reform that have been advocated are delineated in chapter 13. A quantitative analysis of the impacts of these alternatives is presented in chapters 14 and 15. The effect of reforms on the cost of insurance is analyzed in chapter 14. Impacts on the insurance industry, attorneys, and state government program costs are analyzed in chapter 15.

B. Summary of Analysis

1. **Cost of insurance.** The effect of various reforms on insurance cost is stated as *reductions* from current 1971 premiums charged by stock carriers, who account for 65 – 70 percent of all automobile insurance sold in Hawaii. Individual effects of five major reform proposals are summarized here. Combined effects are, of course, greater.¹

¹The effects are not additive; see chapter 14 and appendix D for details.

- a. *Complete no-fault:* Conversion to a complete no-fault program should produce premium savings of 20 to 23 percent after deduction for statutory social insurance and voluntary private accident and health insurance.
- b. *Modified tort liability:* This system could produce savings estimated at about 10 percent, achieved through greater efficiencies and the deduction of other sources of compensation.
- c. *Partial no-fault:* A partial no-fault plan with a \$10,000 tort liability exemption would probably produce almost the same savings as a complete no-fault plan.
- d. *Exclusive state fund:* Creation of a monopolistic state fund as the sole provider of motor vehicle loss protection is estimated to reduce insurance costs by 29 percent.
- e. *Mass merchandising:* Group sales of auto insurance will save the average consumer close to 15 percent for the existing tort liability system and all reform proposals.

Table 11–1 summarizes the effect of these reductions on three reform proposals for a range of premiums paid by the majority of Hawaii motorists. Premiums for individual policies are shown in columns 2 – 4, and group premiums are shown in columns 5 – 7.

Table 11-1
Effect of Selected Reform Alternatives on
Premiums for Motor Vehicle Insurance Coverage

| Premium Level | Present Tort Liability System | Individual Sales | | | Group Sales | | |
|------------------------------|-------------------------------|--------------------------------|--------------------------|------------|--------------------------------|--------------------------|------------|
| | | Modified Tort Liability System | Complete No-Fault System | | Modified Tort Liability System | Complete No-Fault System | |
| | | | Private Insurers | State Fund | | Private Insurers | State Fund |
| (1) | (2) | (3) | (4) | (5) | (6) | (7) | |
| High premium | \$270 | \$243 | \$216 | \$154 | \$207 | \$184 | \$131 |
| Average premium ¹ | 204 | 184 | 163 | 116 | 156 | 139 | 99 |
| Low premium | 150 | 135 | 120 | 86 | 115 | 102 | 73 |

¹Total premiums collected in 1970 divided by number of car-years of insurance in force.

2. **Impacts of reform plans.** The analysis of chapter 15 revealed the following with regard to the insurance industry, agents, attorneys and others.

- a. *Insurance industry:* The combined effect of reducing rates, adopting compulsory insurance, and introducing group merchandising would reduce aggregate 1970 premium income by \$3.2 million, or 5.8 percent.
- b. *Insurance agents:* Reductions in rates reduce the commission income of agents proportionately. Compulsory insurance increases commission income by increasing the volume of business. Mass marketing has by far the greatest and most disproportionate impact. The most severe effect on agents would come from a compulsory no-fault plan with group sales: on an average, agents would lose about \$2,100 each, or 16 percent of their gross income.
- c. *Legal profession:* Under a complete no-fault plan, the aggregate income of attorneys from motor tort cases could fall by as much as \$1.6 million per year, or \$21,000 – \$32,000 for the estimated 50 – 75 firms specializing in auto tort cases. This is a loss of 90 percent of the estimated

\$24,000 – \$36,000 per year that these firms currently receive from settlements of such cases.

- d. *Health insurance:* Hawaii motorists now have extensive coverage for health care, far exceeding the national average. Direct, annual medical costs arising from automobile accidents are almost \$2 million. If these costs were paid only by health insurance plans, the result would be a substantial savings to auto insurance purchasers.
- e. *Disability income:* Most automobile insurance reform plans eliminate duplicate payments from workmen's compensation and temporary disability insurance by relying on auto insurance only for excess payments. Eliminating duplicate payments from these sources would result in a combined annual savings of almost \$1 million.
- f. *State insurance taxes:* Under a private no-fault plan, state revenues from the 3.8 percent gross premium tax would decline about \$200,000. Under a state fund, they would decline by over \$550,000.
- g. *State expenditures:* (1) Court costs related to motor vehicle cases are already minimal;

hence, reduction or elimination of those few cases that do go to court will not appreciably affect state expenditures in the courts. (2) In the event the legislature creates an exclusive state insurance fund, only an initial appropriation for startup

expense would be required. An initial appropriation for reserve requirements would not be necessary because premium payments by consumers would provide more than ample loss reserves and operating revenues.

CHAPTER 12

ISSUES AND ALTERNATIVE SOLUTIONS

To provide a proper foundation for selection of an optimal motor vehicle insurance program, this chapter reviews solutions developed by many experts in government and private industry. They furnish a pertinent source for the design of alternative programs most likely to achieve an improvement in the current system for compensating auto accident losses in Hawaii.

A. Reform Solutions – A Summary

The evaluation of Hawaii's motor vehicle insurance system raises issues which are neither new nor isolated. The evaluation reflects the difficulties which a traditional tort liability system encounters in attempting to provide efficient and effective loss protection to accident victims. Forty years ago, the pioneer Columbia Report displayed similar evidence and developed a proposal to guarantee compensation through establishment of a system of direct reimbursement of auto accident losses. Within the past decade, reform of motor vehicle insurance has had an active renaissance as the traffic accident problem has become more acute and the consumer movement more vocal.

Probably no study has generated so much activity as the work of Professors Robert Keeton and Jeffrey O'Connell, *Basic Protection for the Traffic Victim*.¹ The product of a lengthy and scholarly research effort sponsored by the Harvard

Law School, it has forced the insurance industry, government officials and lawyers to debate the problems which confront motor vehicle accident victims. This has led to the generation of more than three dozen specific proposals and over 1000 individual pieces of proposed state and federal legislation.

Virtually all reform proposals include some form of direct reimbursement for many of the tangible losses from traffic accidents; e.g., medical and hospitalization expenses, wage loss or replacement services. They differ in terms of the extent to which they bar recovery of losses through tort action. A number of plans establish a dollar level for accident losses below which a victim is precluded from seeking redress through tort action. Others eliminate tort recovery for motor vehicle accident losses entirely. Certain kinds of losses recovered under existing tort law, such as general damages, are limited or replaced in part by formulas.

In terms of a motor vehicle owner's pocketbook, most reform plans are designed to lower the cost of insurance significantly. In addition to changing the traditional form of recovery, other proposals seek to introduce more efficient marketing arrangements such as group merchandising or expanded use of other efficient sources of compensation such as accident and health insurance.

Two operating programs limit the private sale of automobile insurance. Programs in the Commonwealth of Puerto Rico and the Province of Saskatchewan sell coverages and manage claims

¹ Published by Cambridge: Harvard University Press, 1965.

through government-owned corporations or authorities. Lastly, some proposals would make the present system of voluntary liability insurance more effective by establishing a fund from which victims of hit-and-run or uninsured drivers can recover losses. Seven states have already created such funds.

B. A Comparative Analysis of Reform Plans

This section outlines the distinguishing aspects of major reform proposals generated by experts in the insurance industry, by Professors Keeton and O'Connell, and by leaders in government. Two other widely discussed proposals, those of the Insurance Company of North America and the National Association of Independent Insurers are included in section C in connection with reforms enacted by the states of Delaware and Illinois in 1971. Six plans are reviewed in this section:

Modified Tort Liability

- Cotter Plan²
- American Mutual Insurance Alliance (AMIA) Plan

Partial No-Fault

- Keeton-O'Connell – Basic Protection Plan

Complete No-Fault

- U. S. Senate Bill 945 – Uniform Motor Vehicle Insurance Act
- American Insurance Association (AIA) Plan
- Plan of the New York Insurance Department.

1. **Modified tort liability.** The Cotter plan and the AMIA proposal are typical of reforms that would preserve the structure of a tort recovery system for auto accident losses but would improve its efficiency by superimposing direct limited

²Named after William Cotter, who was Commissioner of Insurance in Connecticut when he advanced his plan (now a member of the U. S. House of Representatives).

compensation of certain losses without waiting for a determination of fault. Essentially these plans expand the use of ordinary medical payments insurance to include compensation for wage losses and other expenses arising from an auto accident. After making a payment, the insurer is given a right to seek reimbursement from any party responsible for the loss, either through court action or through settlement with the negligent party's liability insurer.

Both plans would operate within the usual financial responsibility system which requires proof of insurance only after a driver has been involved in an accident, has not paid a judgment arising out of an accident, or has been convicted of a serious traffic offense.³ All policies would be required to provide limited medical and income loss coverage.

To improve the efficiency of the tort liability system, both plans recommend adoption of a rule of comparative negligence, a limitation on recovery for pain and suffering, and strict regulation of contingent fees. The plans differ only in minor details and have been introduced in most states holding legislative sessions during 1971.⁴ The AMIA proposal contains a number of provisions not found in the original Cotter plan: encouragement of advance payment procedures by insurers prior to trial or settlement, limitations on the cancellability of auto insurance, and arbitration for claims below a certain dollar value.⁵

Neither plan addresses the problems of the uninsured motorist or the driver who cannot purchase insurance except at high cost. In fact, the only advantage to be gained from enactment of this form of auto insurance coverage is the guarantee of limited payment for those who choose to purchase insurance at all. Uninsured motorist coverage would continue to be offered to policyholders, and an assigned risk plan would be maintained to insure those who are unable to obtain standard policies.

³Financial responsibility laws are discussed in appendix F.

⁴Variations of these plans were adopted in Minnesota and Oregon in 1971.

⁵47 *Journal of American Insurance* 2 (March 1971) pp. 1-6.

In all respects, the Cotter plan and the AMIA proposal represent a minimum reform of the tort liability system. The most significant changes would be regulation of contingent fees and a statutory formula for claims involving pain and suffering. Although these proposals might result in a more equitable distribution of compensation among some victims, they would not significantly improve conditions in any state facing a serious auto insurance problem.

The AMIA has conducted much research on the cost of operating either a modified tort liability system or a no-fault program. As a result of its study, the association feels that cost savings predicted by supporters of no-fault reform are somewhat optimistic. Arguing that the bulk of the premium dollar is allocated to repair of damaged vehicles, the association recommends greater effort in developing automobile crash absorbing capability rather than abandoning a fault system of recovery. Significant savings will not be possible, according to AMIA, until vehicle damage costs are reduced.⁶

Because of sizable discrepancies in savings estimates arising from the AMIA studies and from research generated by the American Insurance Association, both reports have been taken into account in developing relevant data on the cost of reforming the current system in Hawaii.

2. Partial no-fault. The most discussed partial no-fault plan is the Keeton-O'Connell Basic Protection Plan.⁷ This plan would require all vehicle owners to purchase no-fault accident insurance from a private carrier covering net economic losses up to \$10,000. The plan exempts all insured owners and drivers from tort liability up to a limit of \$10,000 actual loss and \$5,000 pain and suffering loss. Above these limits the insured is subject to civil suit. Claims which for one or more reasons are not compensable under the plan (e.g., hit-and-run accidents, unregistered vehicles) are assigned to insurers under a mutually acceptable, inter-insurer arrangement.

⁶In Hawaii, the cost of automobile repair accounts for approximately half of all insurance company payments. For details, see appendix C, tables 1 - 3.

⁷Keeton and O'Connell, *op. cit.* pp. 189-219.

The victim's net economic loss is computed by deducting other available insurance sources such as workmen's compensation or health insurance. In addition, the insured is required to purchase ordinary liability insurance with limits of \$15,000 per person up to \$30,000 per accident, applicable to personal injury only.⁸ Pain and suffering coverage must be offered by the insurer but may be rejected.

With respect to vehicle damage, three options are offered. First, the owner may choose not to purchase any insurance. The second is a "non-fault option" similar to ordinary collision coverage which pays the insured for damages to his own car regardless of fault but allows no subrogation rights in the event damage is caused by collision with a similarly insured vehicle. The third option, called the "liability option," pays the insured for vehicle damage only if he can show that another driver was at fault. Again, no subrogation is allowed against a similarly insured driver.

Although the Keeton-O'Connell plan would meet some problems left unsolved by proposals based on a modification of the tort liability system, it is open to criticism on grounds of its complexity. The "triple option" vehicle damage provision, for example, might be difficult to explain to an average motorist and will place the vehicle owner in an adversary position with his own insurance company every time the fault of another driver is made a prerequisite to recovery.⁹ Recently, its authors have expanded the "triple option" concept to bodily injury coverage above the minimum no-fault limit. The latest version would allow a motorist to purchase excess protection payable either directly (no-fault) or on establishing that another driver was responsible for the excess losses (liability option). Still another

⁸Other variations of the plan would make this added liability insurance optional, or would offer excess no-fault benefits.

⁹Recent versions of the basic protection plan appear to preserve more of the fault system than they abolish. The authors claim that the "fault option" is nothing more than an adaptation of ordinary uninsured motorist coverage, which reimburses an owner only when he shows that the damage was caused through negligence of an uninsured driver. This form of insurance automatically places the victim in a position of conflict with his own insurance company. In order to recover his losses, he is required to conduct a mock trial for negligence. This principle is inconsistent with the framework of a compulsory no-fault program.

version would make the *entire* no-fault program voluntary, conferring tort immunity on insured drivers and compensating all others on a liability basis through an intermediate public insurance fund.

3. **Complete no-fault proposals.** The last group of proposals recommend a complete system of direct compensation and discontinuation of tort recovery in the area of automobile accident law. U. S. Senate Bill 945 establishing a Uniform Motor Vehicle Insurance Act, the plan of the American Insurance Association, including the Minnesota variation developed by State Senator Jack Davies, and the plan of the New York Insurance Department are the major proposals in this category.

a. **U. S. Senate Bill 945, Uniform Motor Vehicle Insurance Act.** The federal proposal introduced by Senators Philip Hart and Warren Magnuson early in 1971 calls for compulsory first-party compensation of all auto accident victims regardless of fault. Once a partial no-fault plan, this measure has been amended by the Senate Commerce Committee to eliminate any possibility of recovery through negligence suits.¹⁰ The act, if adopted, would require every owner of a motor vehicle in the United States to purchase direct, first-party insurance as a prerequisite to registration of the vehicle in any state or territory.

Payments are made secondary to recovery from any public or private health insurance unless such insurance expressly provides that its benefits are not payable for automobile accidents. The policy is required to pay for all property damage except damage to a "motor vehicle in use."¹¹ Collision coverage for damage to a person's own vehicle would be optional. There is no requirement for additional compensation in cases of permanent injuries, but insurers would be required to offer

¹⁰Committee Print No. 1 (July 1971) of S. 945 incorporates changes designed to provide maximum first-party no-fault compensation to accident victims. The owner and operator of an insured vehicle are exempt from liability in tort for damages of any nature arising out of a motor vehicle accident, except that a person engaging in criminal conduct at the time of the accident will be strictly liable for noneconomic losses if his conduct caused the accident.

¹¹Damage to a parked vehicle would be compensated.

excess coverages, including compensation for pain and suffering.

An assigned claims plan to process uninsured claims, financed by an assessment against premium volume for each insurer, is provided. An insurer making payments under the assigned claims plan is subrogated to any rights the victim may have against the owner or operator of an uninsured motor vehicle. Other provisions restrict attorney contingent fees to 25 percent in any suit against an insurer, require adoption of a uniform statistical plan for maintaining loss records, restrict the number of risk categories and rating territories, and prohibit the pooling of loss experience by insurers.

The Hart-Magnuson proposal is generally opposed by those who believe that reform of the automobile insurance system should be instituted gradually on a state-by-state basis. In addition, some believe that control of the auto insurance industry at the federal level would obstruct the ability of state governments to initiate modifications of reform measures to conform with the accumulation of experience within a state. This position was taken by the Department of Transportation in its report to Congress on the status of motor vehicle crash loss compensation in the United States, with the proviso that a failure of the states to act within a reasonable time would justify federal intervention.¹²

b. **AIA plan.** The plan of the American Insurance Association,¹³ which contemplates state-by-state enactment, proposes a compulsory program of compensation for all economic losses suffered as a result of an automobile accident. This insurance constitutes the primary source of recovery for victims of automobile accidents and therefore other insurance payments are not taken into account in determining the claimant's net economic losses.

Coverage is unlimited; however, work loss benefits would be subject to a maximum payment of \$750 per month. There is no recovery for pain

¹²U. S. Department of Transportation, *Motor Vehicle Crash Losses and Their Compensation*, Washington, D. C.: U. S. Government Printing Office, March 1971.

¹³American Insurance Association, "Report of the Committee to Evaluate the Keeton-O'Connell Plan," New York: 1968.

and suffering. Regarding property damage, the AIA plan includes protection for loss or damage to property other than automobiles and their contents. Since tort liability is abolished, drivers assume the risk of damage to their own vehicles, but standard collision coverage is made available.

Complete tort immunity for injuries arising out of automobile use is conferred on persons covered by the plan. Uninsured drivers or drivers who do not maintain the required protection forfeit their immunity. Other characteristics of the plan are:

- (1) Strict liability for reimbursement on commercial vehicles for injury suffered in smaller passenger vehicles.
- (2) Residual liability insurance to protect the driver against tort claims occurring outside the state enacting the plan.
- (3) Coverage also pays losses suffered by the insured, his family, passengers and pedestrians in an accident occurring while the insured or a member of his family is driving out of state.
- (4) Uninsured losses are paid by an assigned claims plan.

One variation of the AIA plan receiving considerable attention is the Minnesota-Davies proposal introduced in Hawaii in the 1971 legislative session. This plan duplicates all basic elements of the AIA model except (1) tort liability for gross negligence is retained and made uninsurable and (2) a schedule of benefits is provided in cases involving serious impairment or disfigurement.

c. Plan of the New York Insurance Department. In 1970 the New York Insurance Department published its recommendations following an intensive research effort.¹⁴ This report, embodying what is generally termed the "Rockefeller-Stewart Plan," calls for New York to adopt a complete no-fault insurance system.

¹⁴State of New York Insurance Department, *Automobile Insurance - For Whose Benefit?* 1970.

The plan would require purchase of first-party, no-fault insurance by all persons registering a motor vehicle in the state. Basic personal injury benefits under the plan are unlimited. All medical expenses would be paid along with lost wages (subject to a reduction based on federal income tax scales), cost of replacement services, rehabilitation costs and miscellaneous out-of-pocket expenses. No additional compensation for permanent injuries is provided. The plan recommends a modification of the state's unsatisfied claim and judgment fund to accommodate payment of first-party benefits to victims of uninsured drivers and unregistered or stolen vehicles.

Compensation for property damage is divided into two classes: (1) automobile damage—ordinary collision coverage would be optional; and (2) other property—all other property damage would be compensated, with no limit on the amount recoverable. Other features of the New York plan are:

Strict liability is imposed on owners of commercial vehicles for all losses sustained by victims of an accident involving such vehicles, regardless of fault and regardless of the existence of first-party insurance covering the victim. In such cases the victim claims from his own carrier, but losses are then shifted to the insurance carrier of the commercial vehicle.

Special cost burdens are imposed on some categories of drivers such as drunk or drugged drivers, drivers in the course of committing a felony and drivers who intentionally cause accidents. These drivers would be strictly liable for damages and injuries. In an accident involving a driver in any of these categories, the victims would be able to recover compensation from a vehicle owner's insurer. The paying insurer could then claim reimbursement from the strictly liable driver or his insurer.

Except for cases involving death, the plan abolishes liability for negligence arising out of the operation of a motor vehicle for all owners carrying the required first-party insurance. The

Table 12 - 1

Summary Features of Reform Jurisdiction Plans

| | Modified Tort Liability | | Partial No-Fault | | Exclusive Fund | |
|--|-----------------------------------|------------------------------------|-----------------------------------|---|----------------------------|------------------------------------|
| | Illinois | Delaware | Massachusetts | Florida | Puerto Rico | Saskatchewan |
| <i>First-Party Benefits Features</i> | | | | | | |
| Medical expenses and rehabilitation | \$2000 per person | \$10,000 per person | \$2000 per person | \$5000 maximum | Unlimited | \$2000 per person |
| Income loss of wage earners | 85 percent up to \$150/week | \$20,000 per accident | 75 percent | 85 percent | 50 percent \$3900 maximum | \$25/week plus disability benefits |
| Payments to others | \$12/day | | \$12/day | | Scheduled death benefits | |
| Other | Optional catastrophic loss | \$2000 funeral expenses | | \$1000 funeral expenses | \$500 funeral expenses | \$300 funeral expenses |
| Collateral insurance deducted | Workmen's compensation | No | Workmen's compensation | Workmen's compensation | All | No |
| <i>Other Features</i> | | | | | | |
| Tort liability abolished | No ¹ | No ¹ | Up to \$2000 bodily injury | Up to \$5000 bodily injury | Up to \$2000 bodily injury | No |
| Compulsory liability insurance | No | \$25,000 | \$20,000 | No | No | \$30,000 |
| Pain and suffering tort recovery | Limited | Unlimited | Limited | Limited | Excess over \$1000 | Unlimited |
| Damage to owner's vehicle ² | Tort recovery, collision optional | Tort recovery, mandatory collision | Tort recovery, collision optional | Triple option tort recovery over \$550 loss | Not covered | Tort recovery, collision optional |

¹First-party insurance coverage subrogated to rights of victim.

²Tort recovery under all plans for non-vehicular property damage.

exception for death cases is required by the New York constitution which prohibits impairment of the right to recover for wrongful death. However, the report recommends that the state constitution be appropriately amended so that a total abolition of negligence might be achieved. Until that time, of course, insurance against liability for wrongful death would be available as an option under the existing plan.

C. Reform Jurisdictions

This section describes the reform plans actually operating in several jurisdictions.¹⁵ Table 12 - 1

¹⁵In 1969, Oregon created a special state fund to provide compensation for indigent victims of automobile accidents. In 1971, Oregon also adopted a law requiring certain medical payments insurance in every motor vehicle liability policy issued in the state.

summarizes their basic provisions. The jurisdictions reviewed in this section are:

Modified Tort Liability

Illinois
Delaware

Partial No-Fault

Massachusetts
Florida

Exclusive Government Funds

Puerto Rico
Saskatchewan

1. **Modified tort liability.** Illinois and Delaware enacted motor vehicle insurance reform measures during 1971. These reforms are based primarily on the expansion of first-party automobile accident insurance and retention of the framework of a tort liability recovery system. To prevent double recovery by accident victims, each plan requires any tort claim to be reduced by the amount received under first-party insurance with first-party insurers retaining the right of subrogation to recover amounts which they have advanced. The Delaware plan draws on a proposal developed by the Insurance Company of North America while the Illinois statute is based on the Dual Protection Plan of the National Association of Independent Insurers.

Despite its formidable length, the Illinois statute represents a moderate reform of the prevailing tort liability system and largely duplicates proposals similar in scope to the Cotter plan discussed above. Property damage is not covered, and to the extent that the system remains under the control of a financial responsibility law, it does not resolve problems connected with high-risk or uninsured drivers. The principal cost saving potential of the plan lies in the statutory formula for recovery of intangible or pain and suffering losses.

The Delaware program, on the other hand, is compulsory and on that basis will help alleviate the uninsured motorist problem. In addition, both vehicle collision and property damage liability insurance is required in every policy issued in the state. The Insurance Company of North America,

originator of the plan, candidly admits that savings under such a program cannot be precisely determined, but since the plan requires victims to exhaust the required first-party insurance benefits before resorting to court action, some reduction in insurance and legal costs can be anticipated.

a. **Illinois.** Beginning January 1, 1972, in addition to regular liability insurance, every automobile insurance policy issued in Illinois must provide direct medical compensation up to \$2,000 and income loss up to \$6,000. In addition, every insurer must offer catastrophic injury protection in the amount of \$50,000 per person up to \$100,000 per accident, for payment of any expenses in excess of the minimum mandatory protection.¹⁶

The new law requires uninsured motorist protection in every automobile insurance policy except where the insured has purchased the excess catastrophic harm coverage. Duplicate recovery under other applicable automobile insurance policies is prevented, but benefits must be paid regardless of all collateral sources, except workmen's compensation.¹⁷ Periodic payments are required as loss accrues. Any insurer of a potentially liable party is authorized to offer advance payments to a plaintiff or claimant, and such payment is not to be construed as an admission of liability. This applies to property damage as well as bodily injury liability.

In any tort action arising from an automobile accident, recovery for pain and suffering may not exceed 50 percent of medical expenses if such expenses are less than \$500, or 100 percent of such expenses if they are over \$500.¹⁸ Other provisions

¹⁶In the event of death, a survivor's benefit equal to 85 percent of the average weekly income of the deceased during the 52-week period immediately preceding the accident, subject to a limit of \$150 per week for a term of 260 weeks, must be offered to a surviving spouse or, if none, then to the surviving children until age 21 or until marriage.

¹⁷In any tort action or arbitration proceeding, injured victims must disclose amounts received under the first-party coverage. This amount is then deducted from any award or paid to any first-party payer, who retains a right of action for damages against the responsible party.

¹⁸This limitation does not apply in cases of death, dismemberment, permanent or partial disability or permanent serious disfigurement.

of the new law require arbitration of claims under \$3,000.¹⁹

b. Delaware. Effective January 1, 1972, Delaware will initiate a plan of compulsory motor vehicle liability insurance with mandatory first-party coverage for certain accident losses.²⁰ The new program will prohibit operation of a motor vehicle unless the owner procures insurance with the following minimum coverage:

- (1) Insurance against tort liability for bodily injury, death or property damage arising out of operation of a vehicle in the amount of at least \$25,000 for any one accident.
- (2) First-party compensation for all medical expenses, lost wages, costs of replacement services and funeral expenses. Compensation is limited to \$10,000 per person, up to \$20,000 per accident.
- (3) First-party compensation for property damage other than damage to vehicles of at least \$5,000.
- (4) Collision insurance on the owner's motor vehicle not to exceed the actual cash value, including a maximum of \$300 for loss of the vehicle's use, with allowable deductibles.

Insurers paying losses under this coverage are subrogated to the rights of the claimant to the extent of amounts actually paid, and may recover those amounts from the negligent party or his insurer. Any claimant may bring an action against the responsible party to recover all damages not compensated by the plan, including intangible losses.

No exemption from civil liability is provided, and no limitation on the amount recoverable for pain and suffering is established. However, compensation that is available from the victim's

¹⁹An insurer may exclude payment of benefits in any case of (1) self-inflicted injury, (2) drunk or drugged driving, (3) driving after a license suspension or revocation, (4) driving in a race, (5) commission of a felony or eluding a police officer and (6) riding in a vehicle known to be stolen.

²⁰H. B. 270 (1971).

own insurance cannot be introduced into evidence as part of his losses.

2. Partial no-fault programs. Reforms enacted by Massachusetts in 1970 and Florida in 1971 establish a partial no-fault automobile accident compensation program in those states.

a. Massachusetts. In 1970, the Massachusetts legislature enacted a partial first-party automobile accident reparations plan called Personal Injury Protection (PIP) as an adjunct to its long standing compulsory liability insurance requirements.²¹ This plan requires every liability policy issued to a motor vehicle registered in Massachusetts to include PIP benefits. These first-party benefits protect the insured from loss incurred as a result of an automobile accident, subject to a maximum payment of \$2,000 per person.²²

All persons covered by PIP benefits are declared exempt from tort liability up to \$2,000 for death or injury to any other person similarly protected under the program. However, the paying company may claim reimbursement from the insurer of an otherwise negligent driver pursuant to the inter-insurer arbitration provisions of the General Laws. Benefits are also payable for accidents occurring outside the state, but in any suit against a negligent nonresident driver, the judgment will be reduced to the extent of recovery under the plan. An insurance company paying PIP benefits is subrogated to the rights of the claimant against an uninsured driver and may sue a negligent driver for recovery of amounts paid to the claimant.

Recovery for pain and suffering in an action arising out of a motor vehicle accident is allowed only if actual losses exceed \$500, or in cases of death, complete or partial loss of a body member, permanent and serious disfigurement, loss of sight or hearing, or any fracture.²³

²¹G. L. chapter 670, sections 1-11, approved August 13, 1970. Constitutionality upheld in *Pinnick v. Cleary*, 271 N.E. 2d 592 (1971).

²²Massachusetts has recently amended the plan to extend tort exemption for property damage to automobiles.

²³No benefits are payable to drunk or drugged drivers, drivers committing a felony or evading a police officer, or for intentionally inflicted injuries.

Other features of the Massachusetts plan include:

- . An assigned claims plan
- . A merit rating plan with premium surcharges for certain traffic convictions and discounts for accident-free driving
- . Automatic renewal of automobile insurance policies for persons over age 65, except for fraud, nonpayment of premium, or conviction for drunk or drugged driving.

In the first several months of the plan's operation, experience in Massachusetts has revealed a substantial decline in claims frequency for bodily injury (estimates range from 50 to 70 percent) and a 10 percent increase in property damage claims. No precise determination as to the causes of these rather unusual frequency variations has yet been made. The best opinion is that previously inflated bodily injury claims made for the sole purpose of recovering property damage are now prevented as a result of the mandatory first-party medical coverage. This is entirely reasonable, since the compulsory insurance law did not require property damage liability coverage. Insurance premiums for the coverages affected by the new law have been reduced by an estimated 15 percent.

b. **Florida.** On January 1, 1972, Florida will begin implementation of the Automobile Reparations Reform Act approved in 1971.²⁴ This law mandates a minimum 15 percent reduction over 1971 premium charges. The plan requires all owners of motor vehicles registered in Florida to maintain a policy of insurance which provides first-party coverages up to \$5,000, payable regardless of recovery from other sources.²⁵

All persons covered by such insurance are declared exempt from tort liability up to the first \$5,000 of economic losses suffered by the victim. No person may recover damages for pain and suffering unless medical expenses exceed \$1,000 or

²⁴Session Laws 1971, chapter 71-252 (H. B. 1821).

²⁵An exception is that workmen's compensation payments must be credited against amounts claimed from the insurer. An insurer may exclude benefits in cases of unauthorized use of the insured vehicle, conviction for drunk or drugged driving or driving while committing a felony, and intentional, self-inflicted injury.

unless the injury consists of permanent disfigurement, certain fractures, loss of a body member, permanent injury within reasonable medical probability, permanent loss of a bodily function, or death.

Like the Keeton-O'Connell plan discussed earlier, the vehicle owner is given three choices as to vehicle damage insurance: (1) he can omit insurance entirely; (2) he can purchase "full coverage" providing compensation without regard to fault, as in the case of ordinary collision insurance; or (3) he can purchase "basic coverage" which limits payment for vehicle damage to cases where the damage was caused by the fault of another driver.

However, if an owner has elected not to purchase any vehicle damage insurance, he may, notwithstanding any exemption from liability, sue a negligent driver, but only if his damage exceeds \$550. In addition, the insurer of an owner who has purchased vehicle damage insurance of either type is given the right, if damages are in excess of \$550, to recover the amounts paid to its insured from the insurer of any negligent driver.²⁶ Disputes between insurers are to be resolved by arbitration.

3. **Exclusive government funds.** Puerto Rico and Saskatchewan currently provide motor vehicle insurance protection through government funds. The Puerto Rican system went into effect in 1968; the Saskatchewan program has been in existence over 25 years.

a. **Puerto Rico.** In January 1970, Puerto Rico began operation of a plan of compulsory first-party, government-administered compensation for automobile accident victims.²⁷ The Automobile Accident Compensation Administration (ACAA) administers the program. Benefits payable to accident victims are:²⁸

²⁶Non-vehicle property damage is compensable through liability based on negligence and is not affected by the new law.

²⁷Law 138 (1969).

²⁸Benefits provided by the plan are not payable in cases of (1) self-inflicted injury, (2) unauthorized use of the motor vehicle, (3) participation in an automobile race, (4) commission of a felony and (5) drunk or drugged driving. Payments will be made to victims of such drivers wherever applicable, but the ACAA will be entitled to indemnification from the driver for any expenses incurred in connection with the accident and is given a lien on any judgment obtained against him.

Medical payments and cost of rehabilitation, without limit

Death benefit — limited funeral expenses and a survivor's benefit of \$5,000 for each primary dependent (surviving spouse), \$1,000 for each secondary dependent (parents) and a maximum of \$2,500 to each child of the victim under age 21

Disfigurement — a schedule of payments is provided for cases involving permanent disfigurement ranging from \$2,500 to \$5,000

Lost wages — 50 percent of lost wages subject to a maximum of \$50 weekly for the first 52 weeks and \$25 weekly for one year thereafter. This benefit is payable if the victim was employed at the time of the accident or if the disability is of such a nature as to prevent him from engaging in any employment for which he might otherwise be qualified.

Payment by the ACAA is made after deducting the amount of available compensation from other sources except for bequests, life insurance, gifts or social security payments.

Tort immunity is conferred only for the first \$1,000 of pain and suffering and the first \$2,000 of economic loss. Above these levels, the ACAA is entitled to reimbursement in specified cases from a negligent driver for payments made to a victim or his family, or from the victim himself if his tort suit is successful. In any death case, the amount awarded must be reduced by a sum equal to the amount a victim and his beneficiaries have received from the administration.

Insurance is issued at the time of registration upon payment of a \$35 fee for most vehicles. Approximately 10 percent of the annual administrative expenses of ACAA (\$250,000) is allocated to traffic safety programs. One million dollars was appropriated to implement the system but was returned to the treasury after the first year of operation since the accumulated capital was in excess of estimated reserve requirements. ACAA anticipates that in the near future premiums will be reduced or benefits will be increased.

Incoming vehicles remaining on the island for more than 90 days must be registered (and insured) in Puerto Rico; those staying less than 90 days must be adequately insured elsewhere. Excess benefits and property damage coverage are available from private carriers.

b. **Saskatchewan.** For 26 years the Canadian province of Saskatchewan has administered its Automobile Accident Insurance Law through the Government Insurance Office (SGIO).²⁹ This plan combines compulsory first-party with ordinary liability insurance, the latter being offered by SGIO in competition with private insurers.

Premiums for SGIO insurance are paid when a vehicle is registered or upon application for a driver's license. The office maintains approximately 600 agents who are responsible for issuing policies and performing the work of insurance adjusters. SGIO is authorized to transact the business of a liability and casualty insurer without limitation. Thus, in addition to motor vehicles, the office insures hospitals, schools and many other public facilities.

The insurance provides direct, first-party compensation for dismemberment, disfigurement or loss of a bodily function up to \$4,000, payment being determined on the basis of degree of disability expressed as a percent of loss of function, similar to a workmen's compensation program. Additional benefits pay all hospital, medical, laboratory and ambulance charges up to \$2,000. In this connection, the province also maintains a general medical coverage plan providing somewhat similar benefits, but applicable to any illness or accident. Persons suffering work loss as a result of an automobile accident are paid \$25 weekly for a maximum of 104 consecutive weeks. In the event of death, the plan pays benefits to family dependents subject to a maximum of \$10,000 in accordance with priorities and qualifications similar to those included in the Puerto Rico plan. The death benefit also pays \$300 for burial expenses.

²⁹R.S.S. 1965, chapter 41.

With respect to tort liability coverage, the plan establishes a liability insurance requirement of \$35,000 out of which claims for bodily injury have priority up to \$30,000, while the remainder is available for property damage liability, comprehensive and collision insurance (subject to a \$200 deductible). Supplementary coverage and increased liability coverage are offered in competition with private insurers.

Insurance premiums under the Saskatchewan program are derived from surcharges on both driver licenses and vehicle registrations. The system takes into account driver performance and vehicle size,

weight and age. In general, the cost of insurance is greatest for drivers with poor accident and driving records and the owners of new large vehicles.

The Saskatchewan plan does not create any immunity from tort liability, but a judgment awarding damages to an accident victim would be reduced by any amounts payable under the first-party recovery provisions of the law. Saskatchewan does not employ the traditional civil jury trial system in litigation involving automobile accidents. Such cases are heard by a judge only. In addition, the contingent fee system has been abolished.

CHAPTER 13

REFORM PROPOSALS FOR ANALYSIS

This chapter combines the proposals described in chapter 12 into broad reform alternatives that encompass all major proposals. They range from modifications of the existing tort liability system to a complete or "pure" no-fault plan administered by a monopolistic state insurance fund. The major thrust of these reform plans is in the direction of *simplifying* rather than complicating the choices confronting the motorist in Hawaii. Major no-fault reforms are outlined in section A. Section B presents two other alternatives: (1) a modified tort liability plan and (2) a partial no-fault plan. Section C presents alternatives for insurance administration. Mass merchandising of insurance is discussed in section D.

A. Major Reform: Complete No-Fault

This section first outlines a complete no-fault reform measure for analysis. Three major no-fault options having significant cost implications are then discussed.

1. Complete no-fault insurance plan. Two variants of a complete no-fault plan are prime candidates for analysis and review. They differ only with respect to treatment of other forms of insurance. In one instance automobile insurance is primarily responsible for all losses except those paid by statutory coverages such as workmen's compensation, temporary disability insurance, or Medicare.

Under the second plan, compensation by auto insurance would, in addition, be secondary to the victim's recovery under health and accident insurance policies or wage continuation plans. This

variant of no-fault takes into account the extent to which Hawaii's population is covered by some form of private accident and health insurance, such as HMSA or the Kaiser plan. Approximately 86 percent of the population is protected under such programs, all of which appear to be considerably more efficient than motor vehicle insurance. Another reason for considering this second alternative is the prospect of a state or national health insurance plan in the near future. Should a universal system of prepaid insurance be enacted by the state legislature or the Congress, the need to revise the motor vehicle accident compensation program would be eliminated if it were already secondary to all health insurance.

The complete no-fault plan exempts every motorist from all tort liability resulting from an automobile accident. Since no motorist can be sued under this plan, personal injury insurance coverage will be compulsory for all motor vehicles. Under the plan analyzed in chapter 14, the tort exemption also extends to vehicular damage, but collision coverage is optional.

a. Eligibility criteria. First-party personal injury benefits are assumed to accrue to everyone injured in a motor vehicle accident. Benefits extend to owners of registered motor vehicles, their families, passengers and those authorized to use an owner's car. Any person injured by a motor vehicle, regardless of whether the accident occurs on private or public property, is entitled to the same mandatory personal injury benefits. This broad eligibility ensures that all accident victims will have access to personal injury benefits. This means that pedestrians, bicyclists, hit-run victims,

or out-of-state visitors will all be compensated in the event of a motor vehicle accident on the same basis as policyholders and their families. Basic accident loss protection is further enhanced by eliminating restrictions on the receipt of first-party benefits because of citizenship, residence or driver license validity.

Sources of compensation are, in order of priority, public or private accident and health insurance, the vehicle owner's automobile insurance policy, or an assigned claims plan for anyone not covered by the first two.

b. Personal injury losses. Under the complete no-fault plan, all health care and related costs are paid virtually without limit for all victims. The major coverages are:

- . Payment of all medical and hospitalization expenses without limit
- . Payment of all rehabilitation expenses without limit
- . Payment for replacement services otherwise performed gratuitously by the victim
- . Funeral expenses up to X dollars
- . Other out-of-pocket expenses up to X dollars.

c. Wage losses. When determining the extent to which lost wages should be replaced, it should be recognized that the higher the limit, the more will hardship be avoided but the greater will be the cost. A low limit will give full income protection to relatively few wage earners. On the other hand, a compulsory high limit, while it avoids economic hardship for virtually everyone, presents another problem since it cannot be known in advance how rates for this coverage will be determined. If a uniform premium is charged to all motorists, then the poor would be paying premiums to support those well-to-do who become involved in accidents.

Based on income data compiled by the department of planning and economic development, the number of families covered by different income levels is as follows:

| Monthly Income | Percent of Families with Monthly Earnings Less than Amount Shown |
|----------------|--|
| \$ 500 | 53 |
| \$ 750 | 68 |
| \$1,000 | 88 |

At \$500 a month, 53 percent of the families in Hawaii would have their income fully protected, and an additional 15 percent would have at least two-thirds protection. At \$750 a month, 68 percent are fully protected, and an additional 20 percent would be fully protected, and an additional 20 percent would have at least three-fourths of their income replaced. In order to provide a conservative cost estimate, the no-fault plan in chapter 14 assumes a \$750 monthly income restriction.¹

d. Property damage. Under complete no-fault, all property damage is exempt from tort liability. The plan analyzed in chapter 14 assumes that all vehicular property damage will be insured on a strictly first-party (optional) basis with deductible collision coverage.

2. Options for complete no-fault. The no-fault protection plan described above omits three options which have significant implications regarding both equity and cost. They are:

- . Compensation for permanent disability and disfigurement
- . Unlimited wage loss compensation
- . Strict liability on commercial vehicles.

a. Disfigurement and disability losses. All permanent injuries are labeled here as *disfigurement losses*, which include loss of limbs or permanent scarring. A common criticism of most complete no-fault plans is that they do not include payment for any such losses.² Under the existing tort system, a few seriously injured victims now receive substantial awards for such losses.

¹Subject to a 15 percent reduction for federal and state income taxes because replacement income is tax-exempt; i.e., it is not "reportable income."

²This feature is included, however, in the Minnesota-Davies proposal discussed in chapter 12.

It is entirely feasible to list disfigurement losses in a schedule and compensate victims according to amounts listed in the schedule. This is suggested here as a possible inclusion in a complete no-fault program for Hawaii. Although some reparation for such losses is necessary to achieve the objective of adequate compensation, to compensate all cases at the munificent levels now paid to a few could be prohibitively expensive. For this reason, compensation of disability and disfigurement under a schedule comparable to benefits provided in the Minnesota-Davies plan has been included in the actuarial analysis in chapter 14.

b. Wage loss limits. As noted previously, the objective of reducing hardship requires that wage losses be compensated to the fullest possible extent. To restrict cost of the basic no-fault plan, however, the analysis in chapter 14 assumes wage loss coverage limited to \$750 a month, and the cost of providing complete wage loss protection is analyzed separately in chapter 14.

c. Treatment of commercial vehicles. From a cost standpoint, a complete no-fault plan strongly favors large or heavy commercial vehicles. When commercial vehicles are involved in accidents with private passenger cars, they are relatively invulnerable to significant damage while they inflict heavy losses. Accident data indicate the seriousness of this situation for Hawaii. Commercial vehicles comprise less than 11 percent of the total number of registered vehicles in the State, but they accounted for almost one-fifth of the automobile fatalities during 1970. Clearly, to require large trucks to pay only their own collision losses under a complete no-fault plan would violate the objective of equitable cost distribution among all motor vehicles.

Within a complete no-fault approach, there exist two other legal alternatives for preventing an inequitable shifting of accident costs to private passenger vehicles. First, commercial vehicles may be held strictly liable for all personal injury suffered in an accident. Strict liability of commercial vehicles is a feature of the reform plan developed by the New York State Insurance Department. Second, damages in accidents involving passenger cars and commercial vehicles may be apportioned among the parties involved by

a formula which arbitrarily allocates the total losses between the parties' insurers.³ The first option, strict liability for commercial vehicles, will be analyzed in chapter 14.

B. Other Important Reform Alternatives

Two other alternatives are formulated here for analysis. The first preserves the basic concept of tort liability but makes significant changes in the operation of the liability system. The second is a partial no-fault plan similar in major outline—but not in details—to the Keeton-O'Connell plan discussed in chapter 12.

1. Modified tort liability system. Five suggested reforms of the tort liability system are:

- a. Inclusion of high-level, first-party benefits in every policy
- b. Abolition of the collateral source rule
- c. Arbitration between insurers for bodily injury claims below specified dollar thresholds
- d. Enactment of a statutory schedule or formula for settlement of all general damages
- e. Regulation of contingent fees.

The cost impact of these changes vary, but they are all directed at making the system more efficient. The effect of such changes is to provide greater compensation to accident victims, while preserving the right of access to the law of torts for recovery of losses. None of these reforms would affect property damage.

a. First-party benefits. Consistent with the proposals discussed in the previous chapter, this reform would require every automobile insurance policy issued in Hawaii to provide direct payment of medical and income losses up to a high dollar limit. Like the Delaware plan, victims would first apply for compensation from their auto insurance before pursuing their right of recovery in tort

³Guido Calabresi, *The Cost of Accidents*, New Haven: Yale University Press, 1970, pp. 314-315.

against a negligent driver. Insurers paying first-party benefits are given the right to seek reimbursement from the negligent driver or from his insurer. In any tort action arising out of the accident, a plaintiff would not be permitted to recover any amount already compensated by his auto insurance.

b. Abolish collateral source rule. Under the collateral source rule, a defendant in a civil action who is found to have been negligent may not benefit from knowledge that the plaintiff received compensation from other sources for losses he has suffered. In an automobile injury case, evidence that accident and health insurance paid for a victim's medical expense is therefore not admissible for the purpose of reducing damages for which a negligent driver is liable. In many cases, this policy produces a "windfall" for the plaintiff, who recovers more than once for his actual losses.

As discussed in chapter 5, double recovery and overpayment for losses are clearly not objectives of any insurance system, nor should they be the objectives of any legal system. Furthermore, the greater the extent of double recovery, the greater the amount of premiums required to be paid collectively into the insurance pool.⁴ Thus, despite the widespread use of accident and health insurance, workmen's compensation and other benefit sources, the collateral source rule prevents any reduction in the cost of auto liability insurance.⁵ Therefore, any reform which seeks to preserve the tort system should include legislative abolition of this rule.

c. Arbitration of smaller bodily injury claims. Arbitration procedures for settling smaller claims out of court have been promoted and upheld in many areas of law. In the field of tort law, the Philadelphia plan instituted in the early 1950's is a

⁴See National Association of Insurance Commissioners, *Committee Report of the Special Committee on Automobile Insurance Problems*, Philadelphia, Pennsylvania, June 16, 1969, p. 106.

⁵Expert opinion is not in agreement on the amount by which the cost of auto liability insurance could be reduced if collateral first-party insurance benefits were taken into account. Estimates range from 4 to 20 percent reduction in cost; the estimate for Hawaii in chapter 14 is 10 percent. See E. Scott Maynes and C. Arthur Williams, Jr. (eds.) *Fault or No-Fault?* (Proceedings of a National Conference on Automobile Insurance Reform), Minneapolis: University of Minnesota, 1970, pp. 90-92.

model which has been adopted, with variations, by many other jurisdictions.⁶ In Hawaii, arbitration of controversies arising out of auto accidents is suggested for inter-insurer disputes only, rather than disputes between the original parties. This judgment is based chiefly on the relative efficiency of the Hawaii judicial system but also because arbitration of inter-insurer disputes concerning property damage is already an established procedure in Hawaii. This particular reform would expand existing arbitration agreements to include bodily injury claims up to amounts in the \$2,000 - \$4,000 range (exclusive of interest, fees and costs), with an aggrieved party retaining the right to court appeal.

d. Statutory formula for general damages. A significant proposal for reducing insurance costs is to establish a statutory schedule or formula for third-party recovery of losses involving pain and suffering, disfigurement, loss of limb, serious impairment or disability.⁷ In these cases there is theoretically no limit to the amount a victim can recover from a negligent defendant under the present tort system. For example, a jury may be persuaded to award \$10,000 to a person even though his medical expenses amounted to less than \$1,000 simply because he has suffered pain and may have to endure it for some time. Court rulings in Hawaii now effectively preclude the use of pain and suffering or disability formulas by plaintiff's attorneys on grounds that a jury should not be influenced by artificial or contrived mathematical equations but should judge each case in accordance with its most enlightened guess as to how much a plaintiff deserves to recover for his general damages.⁸ Courts in other states have ruled similarly.

Evidence shows that general damage awards account for a substantial portion of amounts recovered by plaintiffs whose economic or actual losses range from low to medium. On the other hand, plaintiffs suffering large economic loss

⁶Rosenberg and Schubin, "Trial by Lawyer: Compulsory Arbitration of Small Claims in Pennsylvania," *Harvard Law Review*, 1961 (Reproduced in American Bar Association, Negligence Section, *Dollars, Delay and the Automobile Victim*, 1969).

⁷This is similar to the no-fault proposal (see section A-2(a) above) except that recovery would be from negligent drivers only, via tort action.

⁸*Franco v. Fujimoto*, 47 Haw. 408 (1964); 309 P.2d 740; *Young v. Price*, 48 Haw. 22, 395 P.2d 365 (1964).

generally recover only a portion under liability insurance.⁹ To counteract this trend, a formula for recovery for general damages would distribute funds available for this type of loss more equitably and would help reduce the cost of liability insurance.¹⁰

e. Regulation of contingent fees. Another complaint against present tort recovery procedures is the widespread use of contingent fee agreements by plaintiffs' attorneys.¹¹ In suits for negligence, a significant portion of judgment or settlement awards is paid to the attorney in amounts ranging from 25 to 33 percent. Contingent fees in excess of these amounts are common. Fees of this magnitude clearly diminish the amount of funds available for compensation of victims' actual losses or significantly raise system costs and insurance premiums. Most current proposals for reform of the liability system would either abolish the use of contingent fees¹² or would regulate them through legislation or strict court supervision.

The reform proposed here is to limit contingent fees to no more than 25 percent of a victim's total recovery, a provision which is included in the Hart-Magnuson bill now pending in the U. S. Senate.

2. Partial no-fault plan. The partial no-fault plan considered here provides a limited exemption from tort liability and establishes compulsory first-party insurance for recovery up to that limit. For damages above the no-fault limit, recovery is allowed through tort action and liability insurance. The following discussion examines the rationale for alternative tort exemption limits within a partial no-fault plan.

a. Personal injury exemption. The general formula for conferring tort immunity on drivers

and owners covered by the necessary first-party insurance is to exempt them from tort liability in an amount equivalent to the value of recovery from first-party insurance.¹³ If first-party benefits for personal injury are provided up to \$10,000, then the corresponding immunity from civil liability would exempt drivers from claims resulting in losses up to that amount.¹⁴

The derivation of a specific tort exemption level must consider (1) the extent to which claimants in Hawaii are prone to litigate, (2) possible cost savings in terms of the bodily injury premium component of motor vehicle insurance rates, and (3) the extent to which the seriously injured will not receive compensation for tangible losses. Limited actuarial studies are available on the extent of savings effected by raising or lowering the tort exemption levels. On the basis of published AIA studies, the findings in table 13-1 were developed. Generally, the bulk of savings in

Table 13-1
Partial No-Fault
Premium Savings and Claims Reduction

| Tort Exemption | Percent Premium Savings by Tort Exemption Threshold ¹ | Percent Reduction in Hawaii Motor Vehicle Tort Claims ² | Percent Serious Injury Cases Compensated ¹ |
|----------------|--|--|---|
| \$ 2,000 | 32 | 56 | 50 |
| \$10,000 | 45 | 83 | 90 |

¹Unpublished data from American Insurance Association.

²Motor Vehicle Tort Cases by Settlement Awards, Hawaii Circuit, and U. S. District Courts.

⁹See U. S. Department of Transportation, *Economic Consequences of Automobile Accident Injuries*, Volume I, Washington, D. C.: U. S. Government Printing Office, April 1970, pp. 50-51.

¹⁰See discussion of insurance industry proposals in chapter 11.

¹¹See O'Connell, *op. cit.*, pp. 37-53.

¹²In most countries, contingent fees are prohibited, and in suits under federal statutes, such as the Federal Tort Claims Act, contingent fees above 25 percent are not permitted.

¹³The limits on exemption from tort liability and compulsory first-party coverage need not coincide, although most partial no-fault plans so specify. It is also possible to (1) allow tort action below the point where no-fault coverage applies, or (2) prohibit tort action above some point but require a lesser amount of compulsory insurance. The first implicitly gives rise to double coverage, and the latter creates a potential gap. For these reasons, these possibilities are not considered here.

¹⁴A slightly different approach is used in Puerto Rico; see chapter 12 for details.

premiums under a partial no-fault plan is accomplished at a tort exemption threshold of \$2,000. Beyond that level, the marginal change in premium savings decreases gradually up to a maximum of 45 percent at or about \$10,000. Using Hawaii claims experience, tort actions would decrease by more than 56 percent at \$2,000 and by more than 83 percent at \$10,000.

While the minimal tort exemption limit may yield the most important relative change in premium savings and significant reductions in the volume of tort claims, it does not significantly alleviate the inadequate compensation of serious injuries. Further, it does not achieve the maximum amount of possible premium savings. For these reasons the Keeton-O'Connell \$10,000 tort exemption level was selected for the actuarial analysis which follows in chapter 14.

b. Property damage exemption. Accidents involving property damage can be treated in two ways under a partial no-fault plan:

- (1) No tort exemption for any property damage
- (2) Exemption for vehicle damage only: complete exemption, or exemption up to X dollars.

The first alternative leaves all property damage losses to the tort liability system and provides no exemption from negligence, consistent with the programs originally enacted in Massachusetts and Puerto Rico. The second choice establishes either a complete exemption from any liability for automobile damage or limits such an exemption to a stated dollar amount with losses in excess of the amount recoverable in tort (the Florida plan). The partial no-fault plan analyzed in chapter 14 adopts the original Massachusetts and Puerto Rico approach and gives no exemption for property damage.

C. Administrative Reform

Broadly the alternatives are to have insurance sold by:

1. Private carriers exclusively
2. Private carriers and a complementary or competitive state fund

3. An exclusive state fund.

1. Private carriers exclusively. At present, motor vehicle insurance in Hawaii is sold only through private commercial carriers. The State regulates basic premium rates, adopts financial responsibility limits, and establishes prerequisites for licensing of new insurance carriers. Special categories of risk, particularly assigned risks, are handled by the carriers in accordance with the privately administered Hawaii Automobile Insurance Plan (HAIP). Details of performance are within the discretion of the carriers.

2. Complementary or competitive state fund. This alternative expands the role of the state to provide motor vehicle insurance coverage either for special categories or for all risks in competition with other carriers. The objective is to increase the availability of coverage at reasonable cost.¹⁵ Under this alternative, the motorist simply determines whether he finds it more efficient to purchase his coverage from the state or from private sources. Policies could be purchased either with the vehicle registration, at other times during the year at regular offices, or by direct mail. The state carrier would be subject to the same regulatory procedures as private carriers with a view toward maintaining a reasonable competitive balance.

3. Exclusive state fund. Sale of motor vehicle insurance by private carriers would be prohibited, and the state would assume this role exclusively. The motorist would purchase his coverage when paying his license or registration fees, as in the programs operated by Saskatchewan and Puerto Rico. Prohibition against the sale of motor insurance by private carriers could be either partial or complete. In Saskatchewan, the motorist purchases his basic minimum coverage from the government insurance office and can purchase excess coverage from private carriers or the SGIO itself. In Puerto Rico, liability insurance or excess coverage beyond the system's mandatory first-party coverages can be procured from private carriers.

The primary advantage of an exclusive state fund lies in the virtual elimination of acquisition

¹⁵The state carrier would provide consumers with a low cost alternative, as some states do with workmen's compensation insurance.

costs and the simplicity of purchasing coverage along with payment of other fees connected with vehicle ownership and operation. Another advantage is the potential ability of the state insurance corporation to coordinate effectively with other driver licensing and vehicle registration facilities to produce a system of strict supervision over license suspension, vehicle inspection and traffic safety programs. Of the two state fund reform alternatives, the exclusive state fund has by far the greatest cost-reducing potential and is therefore the plan analyzed in chapter 14.

D. Basic Reform: Mass Merchandising

Group policies are common in such areas as life, accident and health or major medical insurance. In those instances where group auto insurance plans exist, experience demonstrates that they are also a more efficient means of marketing.

Advantages of group merchandising accrue to both policyholders and insurers alike. Policyholders obtain considerable premium reductions, and insurers can reduce the costs associated with marketing programs. In addition, group policies and mass underwriting promise to make insurance more accessible to many "high-risk" segments of the population and, because of payroll deduction, assure continuity of coverage. For these reasons, it is proposed as a major reform alternative. Chapter 14 analyzes the effects of mass merchandising on the premium costs of other reform alternatives. Employment and income effects of mass merchandising on the state's insurance industry and its retail outlets are examined in chapter 15.

E. Summary

Three alternative reforms of the system by which automobile accident victims recover their losses have been developed:

- . Complete no-fault
- . Partial no-fault
- . Modified tort liability.

The most important distinguishing features of these three reform proposals are summarized in table 13 - 2.

Within the complete no-fault system, three additional options have been considered: (1) development of additional compensation for permanent injuries, (2) removal of limits on wage loss compensation, and (3) imposition of strict liability on commercial vehicles.

Accompanying each of these major system reforms are other alternatives designed to improve efficiency and provide equitable recovery regardless of the system ultimately selected for implementation in Hawaii. They are:

- . Establishing an exclusive state fund for the purchase of automobile insurance
- . Encouraging use of more efficient sources of compensation
- . Mass merchandising of automobile insurance.

These alternative reforms are drawn from the many separate proposals advanced by others and include every significant recommendation designed to improve delivery of motor vehicle accident compensation. The alternatives range from relatively small adjustments in the prevailing system to sweeping overhaul of the methods by which accident losses are presently recovered. The next task is to evaluate the implications each alternative has on the purchase of automobile insurance in Hawaii.

Table 13 – 2
Summary of Features in
Major Legal Reform Proposals

| Insurance Provisions | Legal System | | |
|--|--|---|--|
| | Complete No-Fault | Partial No-Fault | Modified Tort Liability |
| Financial responsibility limits | | | |
| 1. B.I./P.D. minimums (\$ in 000) | Not necessary | 20/50/10 or higher | 20/50/10 or higher |
| 2. Personal injury benefits | | | |
| a. Medical and income loss | a. First-party payment, no limit | First-party payment, up to specified limits; third-party tort recovery thereafter | First- and third-party payment, with inter-insurer arbitration of claims below specified amounts |
| b. Out-of-pocket, including funeral expenses | b. First-party payment up to specified limit | | |
| c. Disfigurement losses | No recovery or scheduled benefits with first-party payment | Tort recovery according to schedule | Third-party tort recovery according to schedule |
| d. Pain and suffering | Optional first-party coverage | Tort recovery over specified limits | Tort recovery – any amount |
| 3. Property damage | | | |
| a. Vehicular – own car | Optional collision | Optional collision | Optional collision |
| b. Vehicular – other car | No liability | Tort recovery or no liability | Tort recovery |
| c. Non-vehicular | Strict liability | Tort recovery | Tort recovery |
| 4. Uninsured motorists coverage | Not necessary | Mandatory | Mandatory |
| 5. Basic coverage | Compulsory | Compulsory | Semi-compulsory under financial responsibility law |
| 6. Legal fees | Virtually eliminated | Eliminated in 50–85 percent of all injury cases | Reduced, limited to 25 percent maximum |

CHAPTER 14

CONSUMER COSTS UNDER REFORM PLANS

This chapter estimates the extent of premium savings that the average Hawaii motorist insuring a private passenger vehicle could realize by converting from the present tort liability insurance system to a reform alternative. Five major reform alternatives are analyzed in this chapter:

1. Tort liability/private insurance companies, group insurance
2. Tort liability/exclusive state fund
3. Complete no-fault/private insurance companies, individual insurance
4. Complete no-fault/private insurance companies, group insurance
5. Complete no-fault/exclusive state fund.

These major reform proposals span the range of probable premium savings and also reflect prevailing federal and state reform trends in motor vehicle insurance.

This chapter also examines the cost implications of either a modified tort liability system or a partial no-fault plan. Further, the cost of three options which could accompany no-fault alternatives are discussed: (1) the addition of permanent disfigurement and disability loss coverage to basic reform packages; (2) elimination of all ceilings on wage-loss compensation; and (3) imposition of strict liability on commercial vehicles.

Because of some actuarial uncertainty concerning two important no-fault assumptions,

the analysis includes the sensitivity of consumer premium savings to (1) *relative claims frequency* and (2) *loss severity*. Further, the effect of two separate assumptions regarding collateral source deductions is also noted.

Appendix D discusses in detail the methods, procedures and data sources used for this analysis.

A. Summary of Findings

1. Premium savings. Potential savings under the five major reform alternatives are displayed in table 14 – 1. The savings figures shown represent

Table 14 – 1
Summary of Premium Savings¹
for Five Major Reform Proposals¹

| | | Range of Savings ² (Percent) |
|----|--|--|
| 1. | Existing tort liability/ private, group insurance | 15 |
| 2. | Existing tort liability/ exclusive state fund | 29 |
| 3. | Complete no-fault/ private, individual insurance | 8 – 28 |
| 4. | Complete no-fault/ private, group insurance | 22 – 40 |
| 5. | Complete no-fault/ exclusive state fund | 35 – 50 |

¹ Assumes that other sources of existing insurance coverage are consumed before automobile coverage applies. See table 14 – 2 for details.

² For the no-fault plans, low saving figures reflect high frequency/high severity experience and high savings reflect low frequency/low severity experience.

deductions from the price of a policy consisting of existing liability and physical damage coverages and are based on rates deemed *adequate* by the insurance rating organization servicing Hawaii bureau carriers.¹ The ranges shown for the no-fault plans in table 14 – 1 reflect variations in claims frequency and severity of loss, after deduction for all collateral social and accident and health insurance.

Modified tort liability: Abolition of the collateral source rule could produce savings of approximately 10 percent *provided* that awards are not increased to offset the deduction of collateral sources. However, enactment of the modified tort liability plan will not result in any material savings and may actually increase rates. This is due chiefly to the large component of mandatory first-party benefits coupled with a continued resort to action for recovery of general damages.

Partial no-fault: A partial no-fault plan like the Keeton-O’Connell Basic Protection Plan (\$10,000 no-fault limit; tort liability thereafter) would produce about the same savings as a complete no-fault plan. General damage awards would increase the cost, but the \$10,000 limit would substantially reduce no-fault payments in serious cases.

2. No-fault options. The impact on insurance premiums of three no-fault options is as follows:

- . *Disfigurement losses:* Limited compensation for disfigurement losses as part of a complete no-fault scheme would *reduce* expected premium savings by about 4 percent.
- . *Wage loss limitations:* Paying all wage losses without limit under no-fault would *reduce* expected savings by 3 percent.
- . *Strict liability for commercial vehicles:* Making commercial vehicles strictly liable for all damages in the event of an accident with a private passenger vehicle would *increase* no-fault premium savings for *automobiles* by approximately 4 percent.

¹That is, savings estimates are *not* based on present rates, which are deemed “inadequate” by approximately 3 percent. See section D-3 of this chapter for further explanation.

B. Premium Savings

In order to estimate the savings from reform proposals, the analysis assumed the existence of certain coverages; these assumptions are reviewed first. The impact of administrative reforms on the existing tort liability system is then reviewed, after which conversion to a complete or “pure” no-fault, first-party recovery plan is discussed. Following this, the premium savings open to an optimal tort liability plan and to a partial no-fault reform option are examined. Finally, the findings regarding premium savings in terms of the Hawaii driving environment are interpreted.

1. Assumptions for analysis. For any individual, the potential saving to be derived from an alternative system depends upon the total premium which he is currently paying (assuming, of course, that he is insured in the first place). A person’s total premium depends upon (a) coverages currently purchased by the insured, (b) the insurer issuing the current policy, (c) adequacy of the premium (from the insurer’s point of view) at the time when a reform alternative is adopted, and (d) underwriting characteristics of the insured and his family. The following assumptions were made:

- a. The insured currently has the following policy:
 - . \$25,000/\$50,000 liability insurance
 - . \$10,000/\$20,000 uninsured motorists coverage
 - . \$5,000 property damage liability insurance
 - . \$1,000 medical payments insurance
 - . Average of \$50 and \$100 deductible collision insurance
 - . Comprehensive insurance.
- b. Insurance was purchased from a stock agency insurer whose loss and expense experience equals the average for all such companies reporting to the national rating organization of stock companies, the Insurance Services Office (ISO).
- c. Premiums are adequate.

Table 14 - 2

Savings from Adequate Rate: Estimated Percentage
Premium Savings on a Common Package of Existing Coverages*
By Conversion to Five Alternative Insurance-Legal Systems

(Adequate Present Premium Assumed)

| Insurance System | Legal System | | | | | | | Loss** Severity |
|----------------------|----------------|-------------------------------|--------|------|--|--------|------|-----------------|
| | Tort Liability | Complete No-Fault | | | | | | |
| | | All social insurance deducted | | | All social insurance and private health insurance deducted | | | |
| Private, individual | --- | 25 | 22 | 19 | 28 | 26 | 23 | Low |
| | | 22 | 19 | 16 | 26 | 23 | 20 | Low-Medium |
| | | 20 | 16 | 12 | 23 | 20 | 16 | Medium-High |
| | | 17 | 13 | 8 | 21 | 17 | 12 | High |
| Private, group | 15 | 37 | 34 | 31 | 40 | 37 | 35 | Low |
| | | 34 | 32 | 28 | 37 | 35 | 32 | Low-Medium |
| | | 32 | 29 | 25 | 35 | 32 | 29 | Medium-High |
| | | 30 | 26 | 22 | 32 | 29 | 26 | High |
| Exclusive state fund | 29 | 47 | 45 | 43 | 50 | 48 | 46 | Low |
| | | 45 | 43 | 40 | 48 | 46 | 43 | Low-Medium |
| | | 43 | 41 | 37 | 46 | 43 | 41 | Medium-High |
| | | 41 | 38 | 35 | 44 | 41 | 38 | High |
| Loss frequency** | | Low | Medium | High | Low | Medium | High | |

*\$25,000/\$50,000 Bodily injury liability insurance
\$10,000/\$20,000 Uninsured motorists coverage
\$ 1,000 Medical payments insurance
\$ 5,000 Property damage liability insurance
Average of \$50 and \$100 deductible collision insurance
Comprehensive insurance

**Loss frequency and severity under no-fault system expressed as a percent of loss frequency and severity under present system (see text).

d. The insured is an average or typical driver.

Table 14 - 2 shows savings estimated for all five alternatives. These are discussed below in more detail. The impact of the first three assumptions is analyzed in section D of this chapter.

2. Tort liability administrative reform. Private group insurance should reduce rates by 15 percent, primarily by reducing agents' commissions. Premiums paid for mass-merchandised automobile insurance currently tend to be about this much less

than ISO rates. An exclusive state fund should be able to reduce premiums by a total of 29 percent because, assuming a compulsory system, it would incur minimal selling and administrative expenses and reduce or eliminate underwriting profits.

3. Complete no-fault. Two no-fault systems are considered. Under both systems, injured victims would have all medical expenses paid and lost income replaced subject to a 15 percent tax reduction and a \$750 monthly limitation. Under the first system, all *social insurance* recoveries

would be deducted from the auto insurer's obligation—i.e., workmen's compensation, Old Age Survivors and Disability Insurance, Medicare and statutory temporary disability insurance. Under the second system, *private health insurance benefits* would also be subtracted, i.e., income from individual or group medical insurance, individual or group disability income insurance, and wage continuation plan.² No payments would be made for disfigurement losses under either system. Disfigurement losses are considered separately in section D of this chapter.

Table 14 – 2 shows a total of six alternative no-fault legal systems. Under each of these six systems, table 14 – 2 shows 12 savings estimates; these depict the range of potential savings which can be expected for whatever plan the legislature adopts. The 12 estimates for each no-fault plan are based on differing assumptions with respect to the following variables:

- a. Bodily injury loss *frequency* under the no-fault plan relative to frequency under the present system (three assumptions shown in the bottom row of table 14 – 2).
- b. Bodily injury loss *severity*, or average claim size, under the no-fault plan relative to severity under the present system (four assumptions shown in the right-hand column of table 14 – 2).
- c. Property damage payments are reduced by converting all property damage liability insurance to collision insurance with a *deductible*. Three different assumptions used (explained below in the text) are implicit in the estimates shown in table 14 – 2.

The different savings estimates shown for each plan in table 14 – 2 basically reflect differing viewpoints between the American Insurance Association (AIA), a strong proponent of complete no-fault legislation, and the American Mutual Insurance Alliance (AMIA), an opponent of complete no-fault insurance.

²If these private insurance benefits are not deducted from the no-fault benefits, the no-fault benefits can be deducted from the health insurance benefits and the cost of the health insurance correspondingly reduced.

For each of the six no-fault plans shown in table 14 – 2, the high savings estimate (i.e., low frequency and low severity) is based with some modifications on the sample data and methodology developed by the AIA. These modifications recognize the insular characteristics of Hawaii, differences between the AIA proposal and the one under investigation, and additional disability and death losses noted below. The low savings estimate (i.e., high frequency and high severity) was obtained by adjusting the low cost estimate in the manner in which the AMIA modified the original AIA estimates but with an even more conservative estimate of the additional cost of death and permanent disability cases.

In early 1968, the AIA compiled comprehensive data on the bodily injury and property damage losses in a sample of accidents. The sample included the entire experience over a three week period for 12 participating insurers in seven states.³ Results of this study form the basis for the AIA assumptions. The AIA assumptions in table 14 – 2 (i.e., the low cost estimate) were adopted unchanged except that people in Hawaii are assumed to be involved in fewer out-of-state accidents.

a. Bodily injury frequency assumptions. The AIA estimated that under a no-fault system, the number of claims increase by 27.9 percent. This increase occurs for a number of reasons—e.g., currently uninsured motorists are covered or claims are made by people with minor injuries who now avoid reporting to their insurance company (for fear of having their premium increased, perhaps). This 27.9 percent increase represents the *low* frequency assumption used in table 14 – 2.

The AMIA argues that the number of no-fault bodily injury claims will be at least 30 percent higher than the AIA estimates, or 66.3 percent higher than the current frequency. This is the *high* frequency assumption used for table 14 – 2. The *medium* frequency assumption is midway between the AIA and AMIA positions—namely, it assumes a 47 percent higher than current frequency. In sum, three assumptions for bodily injury frequency are:

³California, Connecticut, Illinois, Massachusetts, New York, Rhode Island and Wisconsin.

| | Current Frequency | AIA Base |
|------------------|----------------------|-------------|
| Low | 1.279 | 1.00 |
| Medium | 1.471 | 1.15 |
| High | 1.663 | 1.30 |

b. Bodily injury severity assumptions. The AIA assumes that the average claim for bodily injury loss will be substantially less under no-fault than at present because of elimination of awards for pain and suffering. The low severity assumption used here is slightly more conservative than the AIA's original methodology in that disability and survivorship cases are assumed to cost more than the AIA sample indicated.⁴

The AMIA's position is that permanent disability and death claims will increase present system costs by 29 percent more than the AIA estimate. This AMIA figure forms the basis for the *medium-high* severity estimate shown in table 14-2. The *low-medium* assumption again splits the difference between the AIA and AMIA positions. The high severity assumption is even more conservative than the AMIA position, and hence represents the "worst" possible case for the premium cost analysis. The four assumptions for bodily injury severity are:

| | Additional Costs of Permanent Disability and Death Benefits as a Percent of Present System Costs | Loss Adjustment Expenses Relative to Losses |
|-----------------------|--|---|
| Low | 12 | .135 |
| Low-medium | 20 | .145 |
| Medium-high | 29 | .154 |
| High | 37 | .161 |

The loss adjustment expenses increase as the additional costs of permanent disability and death benefits rise because serious cases are more difficult to adjust.

⁴The AIA later revised its estimate to include higher costs for permanent disability and death cases but it has not published its revised methodology. Scattered evidence suggests that the adjustment is slightly less than that used here.

c. Property damage payments. As noted, premium savings are expected to materialize because under no-fault, all automobile property damage would be subject to a deductible allowance (damage now paid for under liability insurance is fully compensated). The AMIA accepted the AIA property damage savings estimates. Under each no-fault plan in table 14-2, the lowest estimate (i.e., low frequency-low severity) is based on the AIA assumption of an 8.1 percent saving on loss payments. This is the most "optimistic" case shown for each alternative system. For the highest estimate (i.e., high frequency-high severity), a savings of only 6.8 percent was assumed, based on a New York State Insurance Department study of AIA data which indicated that 6.8 percent would be the probable savings on property damage premiums under no-fault in New York. The other 10 savings estimates shown for each no-fault plan use the midpoint between the AIA and New York State Insurance Department values, i.e., a 7.5 percent savings.

4. Modified tort liability. Deduction of all social insurance and private health insurance benefits from tort recoveries could reduce costs about 10 percent, provided that general damage awards are not increased to offset the effect of these deductions. However, premiums under the modified tort liability system would tend to increase because (a) persons with no legal rights under the present system could recover some losses and (b) victims collecting benefits under the present system could continue to do so, although prompt payment of economic losses to victims with tort possibilities might cause some of these persons not to pursue their tort claims. Arbitration agreements among insurers should result in some savings in the cost of handling inter-insurer claims. On balance, no credible estimate of the dollar savings resulting from these conflicting forces is possible.

5. Partial no-fault plan. Savings associated with a partial no-fault plan depend largely upon the extent of the tort liability exemption. Because the effect of no-fault benefits upon the residual tort liability system cannot be predicted with much confidence, cost estimates for any partial system may be subject to more error than are those for a complete no-fault system.

If the no-fault limit is set reasonably high, then savings might be about the same as for a complete

no-fault plan. For example, if personal injury losses are covered on a no-fault basis up to \$10,000 per person and anyone whose losses exceed this amount can sue under the present tort system, savings under the medium frequency and severity estimate (assuming \$25,000/\$50,000 limits under the residual liability coverage) would appear to be about the same as for the complete no-fault plan. General damage awards to those who sue under the tort system would increase costs. On the other hand, the \$10,000 no-fault limit would substantially reduce first-party payments in serious cases. The net result of these two offsetting factors could be about equal. This estimate assumes that the tort liability system continues to operate as it does at present with respect to persons with large losses. If these persons are treated more liberally, savings under a partial no-fault plan will of course be less.

6. Interpretation for Hawaii. Because of the actuarial uncertainties discussed above, it is impossible to predict precisely what the savings will be under a new insurance system. However, for reasons given in appendix D, they most likely will fall between the low to medium frequency and low-medium to medium-high severity estimates. For an individual no-fault plan, operated by private insurance companies, this means savings in the range of 16–22 percent if only social insurance is deducted as a collateral source of compensation, and savings in the range of 20–26 percent if accident and health insurance is also made primary. For a private, group no-fault plan, savings could range between 29–37 percent.

C. No-Fault Options

Three no-fault options were analyzed. One expands the scope of first-party recovery to include payment for serious injuries resulting in disfigurement, including partial or permanent disability, or loss of limb. The second option provides *unlimited* wage loss awards to an average insured risk. The third option would make commercial vehicles responsible for all damages in accidents between such commercial vehicles and ordinary automobiles. The estimated costs (or savings) of adding these three provisions to a no-fault, first-party recovery scheme follow.

1. Compensation for disfigurement losses. According to the AIA, 10 percent of all

automobile accident injuries results in scarring, disfigurement, loss of limb or sight, or permanent impairment of bodily functions. Under the no-fault proposal analyzed in section B above, automobile accident victims receive compensation only for economic losses and would not receive any compensation for the social losses associated with disfigurement.⁵ Thus, adding reparations for disfigurement losses would overcome a basic deficiency of the complete no-fault proposal.

Adding compensation for permanent disfigurement losses to the no-fault plan would obviously decrease the premium savings, but omitting such benefits would continue to undercompensate those with serious losses and would thus perpetuate one of the most serious social problems which exists under the present tort liability system. If 110 victims received an average scheduled award for disfigurement of \$5,000, savings under the individual no-fault system, operated by private insurance companies, would decrease by about 4 percent. The cost of adding such injury reparations to the basic personal injury protection benefits is thus relatively small.

2. Elimination of limitation on monthly income losses. The wage loss protection described earlier assumed a \$750 monthly limit on compensation for net income losses experienced by motor vehicle accident victims. This level of wage loss protection is applied after deducting other sources of statutory income protection available under both state and federal social insurance; e.g., temporary disability insurance, workmen's compensation, or federal social security long term disability. This means that after taking account of other insurance sources, the victim would obtain up to \$750 a month, net of 15 percent allowance for federal, state and local taxes. Under this provision, well over 67 percent of Hawaii workers and their families would have all of their basic monthly earnings covered.⁶

⁵Wage losses resulting from disability are paid under the basic no-fault proposal, but no payments are made for other obvious losses. See chapter 5, section B-1 for definitions and related discussion.

⁶The arbitrary 15 percent deduction for income taxes means that gross income up to \$882 a month is covered. A monthly income of \$750 would fully cover an estimated 101,000 of an estimated 150,000 families with earnings (estimated from table 59 of Hawaii State department of planning and economic development, *Data Book 1971*).

The change considered here would eliminate this monthly limit on wage loss protection. This would simplify subsequent legislative adjustment of basic protection benefits and extend the full range of income loss protection to virtually all Hawaii families. This analysis indicated that eliminating the \$750 per month limit would, for the comprehensive policy of motor vehicle insurance protection displayed in table 14-2, decrease the premium savings by 3 percentage points.

3. Strict liability on commercial vehicles. As discussed earlier, commercial vehicles have extensive damage-generating properties when they are involved in accidents with private passenger vehicles. There is thus some necessity to apportion costs of accidents involving commercial vehicles more equitably than would a pure no-fault scheme. Suggested solutions to this problem include (a) holding owners of commercial vehicles strictly liable for damages in the event of an accident involving a private passenger car or (b) apportioning the total cost of the accident between the two parties involved by an arbitrary formula—e.g., 90-10, 80-20 or 70-30.

From the viewpoint of commercial operators, the most onerous of these alternatives is obviously the strict liability option.⁷ Depending on the formula adopted, the second option might involve little if any change in either the existing premiums paid by commercial operators or the relative premium savings for the comprehensive policy in table 14-2. Calculations based on the strict liability of commercial vehicles indicate a savings to automobile owners on the policy of comprehensive coverages of approximately 4 percent.⁸

The cost to commercial operators is more difficult to estimate. The New York State Insurance Department estimated that in New York, strict liability under its no-fault proposal would cost the same as present tort liability insurance. Increased claims frequency would be offset by

⁷This is the current position in the Hart-Magnuson bill pending before the U. S. Senate.

⁸The assumptions and conditions for this estimate are based on AIA methods and procedures.

lower costs per case (commercial vehicles in New York are frequently the target of substantial court awards). The AIA has made, but not published, calculations showing that strict liability under their plan would actually save money.

D. Impact of Major Assumptions

Three major assumptions underlie the savings calculations given in section B-1 of this chapter. This section examines the reasonableness and the effect of varying these assumptions: (1) the differential impact which no-fault insurance would have on different coverages purchased by most Hawaii motorists; (2) the relevance of savings estimates to premiums charged by non-stock carriers; and (3) differences which arise if premium savings are calculated on a "prevailing" rather than an "adequate" rate basis.

1. Savings on component coverages. The savings analyzed in table 14-2 are for a typical policy containing all six coverages. Savings have also been calculated on four more limited packages of coverages, as follows:

Bodily injury coverages only

a. Limited

- . \$10,000/\$20,000 bodily injury liability insurance, including uninsured motorists coverage of a like amount

b. Extended

- . \$25,000/\$50,000 bodily injury liability insurance
- . \$10,000/\$20,000 uninsured motorists coverage
- . \$1,000 medical payments insurance.

Property damage coverages only

c. Limited

- . \$5,000 property damage liability insurance

Table 14-3

**Estimated Percentage Premium Savings on a
Limited Policy of Bodily Injury Coverages
By Conversion to Five Alternative Insurance-Legal Systems**

**\$10,000/\$20,000 Bodily Injury Liability Insurance
Uninsured Motorists Coverage**

(Adequate Present Premiums Assumed)

| Insurance System | Legal System | | | | | | | Loss* Severity |
|----------------------|----------------|-------------------------------|--------|------|--|--------|------|----------------|
| | Tort Liability | Complete No-Fault | | | | | | |
| | | All social insurance deducted | | | All social insurance and private health insurance deducted | | | |
| Private, individual | --- | 25 | 16 | 6 | 35 | 27 | 19 | Low |
| | | 18 | 7 | -4 | 28 | 19 | 9 | Low-Medium |
| | | 9 | -3 | -15 | 19 | 9 | -2 | Medium-High |
| | | 2 | -12 | -25 | 12 | 0 | -12 | High |
| Private, group | 15 | 37 | 28 | 20 | 46 | 38 | 31 | Low |
| | | 30 | 21 | 12 | 39 | 31 | 23 | Low-Medium |
| | | 23 | 12 | 2 | 32 | 23 | 14 | Medium-High |
| | | 16 | 5 | -6 | 25 | 15 | 5 | High |
| Exclusive state fund | 29 | 47 | 40 | 34 | 54 | 49 | 43 | Low |
| | | 42 | 34 | 26 | 49 | 42 | 36 | Low-Medium |
| | | 36 | 27 | 19 | 43 | 36 | 28 | Medium-High |
| | | 30 | 21 | 11 | 37 | 29 | 21 | High |
| Loss frequency* | | Low | Medium | High | Low | Medium | High | |

*See table 14 - 2.

- . average of \$50 and \$100 deductible collision coverage

d. Extended

- . \$5,000 property damage liability insurance
- . average of \$50 and \$100 deductible collision coverage

- . comprehensive insurance.

The savings on bodily injury coverages (a) and (b) are presented in tables 14 - 3 and 14 - 4, respectively. Table 14 - 5 shows the savings on property damage coverages (c) and (d). Assumptions and definitions are the same for these tables as for table 14 - 2. Major conclusions from these three tables are:

Table 14 – 4

Estimated Percentage Premium Savings on an
Extended Policy of Bodily Injury Coverages
By Conversion to Five Alternative Insurance-Legal Systems

\$25,000/\$50,000 Bodily Injury Liability Insurance,
\$10,000/\$20,000 Uninsured Motorists Coverage
and \$1,000 Medical Payments Insurance

(Adequate Present Premiums Assumed)

| Insurance System | Tort Liability | Legal System | | | | | | Loss* Severity |
|----------------------|----------------|-------------------------------|--------|------|--|--------|------|----------------|
| | | Complete No-Fault | | | | | | |
| | | All social insurance deducted | | | All social insurance and private health insurance deducted | | | |
| Private, individual | --- | 45 | 38 | 31 | 52 | 47 | 41 | Low |
| | | 40 | 32 | 24 | 47 | 40 | 33 | Low-Medium |
| | | 33 | 25 | 15 | 41 | 33 | 25 | Medium-High |
| | | 28 | 18 | 8 | 35 | 27 | 18 | High |
| Private, group | 15 | 54 | 48 | 41 | 60 | 55 | 50 | Low |
| | | 49 | 42 | 35 | 55 | 50 | 44 | Low-Medium |
| | | 43 | 36 | 28 | 50 | 44 | 37 | Medium-High |
| | | 39 | 31 | 22 | 45 | 38 | 31 | High |
| Exclusive state fund | 29 | 61 | 56 | 51 | 66 | 62 | 58 | Low |
| | | 57 | 52 | 46 | 63 | 58 | 53 | Low-Medium |
| | | 53 | 47 | 40 | 58 | 53 | 47 | Medium-High |
| | | 49 | 42 | 35 | 54 | 48 | 42 | High |
| Loss frequency* | | Low | Medium | High | Low | Medium | High | |

*See table 14 – 2.

(1) Anyone with policy (a) could under adverse conditions experience a premium increase, but his premium is more likely to be below present adequate premiums (table 14 – 3).

(2) Anyone currently purchasing policy (b) would receive the greatest percentage savings by shifting to a no-fault system (table 14 – 4).

Table 14 – 5

Limited Percentage Premium Savings on
 Limited and Extended Policies of Property Damage Coverages
 By Conversion to Five Alternative Insurance-Legal Systems

(Adequate Present Premiums Assumed)

| Insurance System | Legal System | | | | | | |
|-----------------------|----------------|-------------------|--------|-----|--------------------|--------|-----|
| | Tort Liability | Complete No-Fault | | | | | |
| | | Limited Package* | | | Extended Package** | | |
| Private, individual | -- | 11 | 11 | 9 | 9 | 9 | 8 |
| Private, group | 15 | 25 | 25 | 24 | 24 | 23 | 22 |
| Exclusive state fund | 29 | 37 | 37 | 36 | 36 | 35 | 35 |
| Conversion Savings*** | | High | Medium | Low | High | Medium | Low |

*\$5,000 property damage liability insurance
 Average of \$50 and \$100 deductible collision insurance

**\$5,000 property damage liability insurance
 Average of \$50 and \$100 deductible collision insurance
 Comprehensive insurance

***Reduction in claims under present property damage liability and collision coverages
 resulting from paying all damage to cars under deductible collision coverages

High – 8.1% Medium – 7.5% Low – 6.8%

(3) Premium savings for property insurance are more predictable than for bodily injury coverage and are expected to be a smaller percentage of present adequate premiums (table 14 – 5).

Including compensation for disfigurement losses and eliminating monthly income loss limits would have a greater percentage impact on the cost of policies (a) or (b) than upon the cost of the more complete policy used as a base for comparison in table 14 – 2. Compensation for disfigurement losses would reduce the savings on policy (a) by about 13 percent, and on policy (b) by about 10 percent. Removing the monthly income loss limitations would reduce the savings

by about 3 percent on policy (a) and by 2 percent on policy (b).

2. **Savings on insurance purchased from other (non-ISO) insurers.** Previous savings estimates were stated as a percentage of ISO rates. Because large independent insurers generally charge lower rates than ISO companies,⁹ the saving to an individual consumer will be different if he currently purchases his insurance from an independent, non-ISO insurer. To illustrate this point, assume

⁹The independent insurer, it will be assumed, is more selective than the ISO insurer. It also pays lower commissions and incurs less expense in other areas, thus producing lower rates under the present system.

that an independent insurer's premiums are 20 percent less than ISO rates. For the no-fault system (social insurance deductions only) the medium frequency-severity saving for policies (a) and (b) are shown in table 14 - 6.

3. **Prevailing vs. adequate rates.** According to the Insurance Services Office, the motor vehicle insurance premiums that went into effect in Hawaii on April 1, 1971 failed to reach adequate levels by about 3 - 4 percent. For an average driver, the comparison between adequate and actual rates is shown in table 14 - 7. Because of this difference,

Table 14 - 6

Percentage Savings from Independent Insurer Rates
(Social Insurance Deductions Only)

| | Bodily Injury Coverages | | | |
|----------------------|-------------------------|----------|------------|----------|
| | Policy (a) | | Policy (b) | |
| | Tort | No-Fault | Tort | No-Fault |
| Private, individual | - | -10 | - | 19 |
| Private, group | 7 | -2 | 7 | 25 |
| Exclusive state fund | 21 | 13 | 21 | 36 |

Table 14 - 7
Hawaii Motor Vehicle Insurance Premiums, Adequate and Actual
Effective April 1, 1971

| Coverage | Considered Adequate | Actual, as Approved | Adequate/Actual |
|--|---------------------|---------------------|-----------------|
| \$25,000/\$50,000 bodily injury liability insurance | \$101.96 | \$ 99.21 | 1.03 |
| \$10,000/\$20,000 uninsured motorists coverage | 3.75 | 3.75 | 1.00 |
| \$1,000 medical payments coverage | 12.59 | 12.59 | 1.00 |
| \$5,000 property damage liability insurance | 46.90 | 44.39 | 1.06 |
| Average of \$50 and \$100 deductible collision insurance | 78.29 | 76.85 | 1.02 |
| Comprehensive insurance | 23.21 | 21.14 | 1.10 |
| Total | \$266.70 | \$257.93 | 1.034 |

Source: Data obtained from Insurance Services Office, New York, Hawaii Rate Filing, Oahu District, 1971.

Table 14 - 8

**Savings from Actual Rates: Estimated Percentage
Premium Savings on a Common Policy of Existing Coverages*
By Conversion to Five Alternative Insurance-Legal Systems
(Present Premiums Equal to 97% of Adequate Premiums Assumed)**

| Insurance System | Legal System | | | | | | | Loss** Severity |
|----------------------|----------------|-------------------------------|--------|------|--|--------|------|--------------------|
| | Tort Liability | Complete No-Fault | | | | | | |
| | | All social insurance deducted | | | All social insurance and private health insurance deducted | | | |
| Private, individual | --- | 23 | 19 | 16 | 26 | 23 | 20 | Low |
| | | 20 | 16 | 13 | 23 | 20 | 17 | Low-Medium |
| | | 17 | 13 | 9 | 20 | 17 | 13 | Medium-High |
| | | 14 | 10 | 5 | 18 | 14 | 9 | High |
| Private, group | 15 | 35 | 32 | 29 | 38 | 35 | 33 | Low |
| | | 32 | 29 | 26 | 35 | 33 | 30 | Low-Medium |
| | | 30 | 26 | 23 | 33 | 30 | 27 | Medium-High |
| | | 27 | 23 | 19 | 30 | 27 | 23 | High |
| Exclusive state fund | 29 | 45 | 43 | 41 | 48 | 46 | 44 | Low |
| | | 43 | 41 | 38 | 46 | 44 | 42 | Low-Medium |
| | | 42 | 39 | 36 | 44 | 41 | 39 | Medium-High |
| | | 39 | 36 | 33 | 42 | 39 | 36 | High |
| Loss frequency** | | Low | Medium | High | Low | Medium | High | |

*\$25,000/\$50,000 Bodily injury liability insurance
 \$10,000/\$20,000 Uninsured motorists coverage
 \$ 1,000 Medical payments insurance
 \$ 5,000 Property damage liability insurance
 Average of \$50 and \$100 deductible collision insurance
 Comprehensive insurance

**See table 14 - 2.

percentage savings from adequate rates previously analyzed in table 14 - 2 will be slightly more than savings from the actual rates in effect on April 1, 1971. Table 14 - 8 shows estimated percentage savings from actual rates for all insurance-legal systems which were previously analyzed in table 14 - 2.

It should be noted that if past trends continue, further increases in medical expenses, repair costs

and accident rates can be expected. Any insurance system which covers such costs will be faced with a rising trend. Under the present system, loss and operating costs have been increasing about 12 percent annually. Consequently, the adequacy of the rates now in existence will decline with the passage of time, and the savings which can be achieved by switching from one system with inadequate rates to another system with adequate rates will also decline.

CHAPTER 15

IMPACTS OF REFORM PLANS

In addition to the effect on premiums discussed in the preceding chapter, reform of the motor vehicle insurance system will have effects on insurance carriers and their agents, lawyers and others. The effects are discussed in this chapter. Estimates of the impacts are presented for the basic reforms of the insurance system discussed earlier—modified tort liability, partial no-fault and complete no-fault.

For the purposes of consolidating the ensuing insurance industry income analysis, a partial no-fault plan with a \$10,000 tort exemption and complete no-fault will be treated as virtually the same system. The rationale for this approach is predicated on the fact that premium savings derived for the two no-fault plans in chapter 14 were almost identical. The partial and complete no-fault plans do differ markedly in terms of their treatment of compensation for the seriously injured and related legal fees and court costs for such cases. Effects on both income from professional practice and court costs from adopting various forms of partial no-fault are therefore treated separately in sections C and G of this chapter.

The most pervasive administrative reform, selling motor vehicle insurance through a state fund, would virtually eliminate all forms of industry income and produce significant changes in general revenue tax yields for the State. The effects of a state fund on general revenues are addressed both here and in chapter 16.

A. Insurance Industry Revenue Changes

The analysis in chapter 14 indicated the extent to which reforms would change insurance rates. Changes in total premiums now earned by the insurance industry will result from three sources: lower rates will reduce premium income; compulsory insurance for all motorists will increase premium income; mass merchandising will reduce income. The effect of these three factors is analyzed on the basis of 1970 data, the last year for which complete data were available. Results of this analysis are summarized in table 15-1 and explained in the following paragraphs.

1. Changes in rates. For the modified tort liability plan, efficiencies from the four reforms are assumed to reduce premiums by 10 percent. For individual no-fault insurance run by private carriers, average rates are assumed to decline by 20 percent, which represents the savings realized from the medium frequency and medium-high severity assumptions in table 14-2.¹ The extent to which these two assumptions reduce average premiums for different risk categories is shown in row 2 of table 15-2.

2. Compulsory insurance. Estimates of the effect of any major reform plan should presume that insurance will be compulsory, since this is the principal method of closing existing coverage gaps. Adoption of a compulsory insurance law raises the industry's gross revenues and helps offset the drop in income due to rate reductions.

¹Assumes all collateral sources deducted.

Table 15-1
Effect of Two Proposed Reform Measures
Insurance Industry Revenues
(\$ in thousands)

| | Modified Tort Liability | No-Fault |
|---|----------------------------|------------------|
| 1. 1970 premiums earned (motor vehicle insurance only) from present tort liability system | \$ 54,750 | \$ 54,750 |
| 2. LESS: changes in basic rates | <u>-5,460</u> | <u>-10,950</u> |
| 3. Subtotal | 49,290 | 43,800 |
| 4. ADD: increase from compulsory insurance | <u>+14,115</u> | <u>+13,000</u> |
| 5. Subtotal | 63,405 | 56,340 |
| 6. LESS: 15% reduction for group merchandising | <u>-5,393</u> | <u>-4,792</u> |
| 7. Total | <u>\$ 58,012</u> | <u>\$ 51,548</u> |
| 8. Net impact (7 - 1) | +\$ 3,262 | -\$ 3,202 |
| 9. Percent change, net of all adjustments | +6.0 | -5.8 |

Table 15-2
Auto Insurance Commission Income
Impacts of Proposed Reform Measures
(\$ in thousands)

| | Modified Tort Liability | No-Fault |
|--|----------------------------|----------------|
| 1. 1970 Commission income motor vehicle insurance only | \$ 4,380 | \$ 4,380 |
| 2. Less: Effect of changes in rates | <u>- 438</u> | <u>- 876</u> |
| 3. Subtotal | 3,942 | 3,504 |
| 4. Add: Increase in commission income from compulsory insurance | <u>+ 1,127</u> | <u>+ 1,037</u> |
| 5. Subtotal | 5,069 | 4,541 |
| 6. Less: Reduction in commission income from group merchandising | <u>- 4,106</u> | <u>- 3,678</u> |
| 7. Total commission income | \$ 963 | 863 |

The change in aggregate premium income which would accompany a shift to compulsory insurance is shown in row 4 of table 15-1. Derivation of this estimate will be found in appendix E.

3. Mass merchandising. All major reforms include mass merchandising as a more efficient means of marketing. It was assumed that 70 percent of all insurance sold would be subject to reductions from mass merchandising. Of this, it was further assumed that 81 percent would in fact take advantage of group rates. Finally, based on the actuarial methodology of chapter 14, a 15 percent reduction in premiums was assumed to apply. Row 6 of table 15-1 displays the results of calculations based on these assumptions. The impact of group merchandising ranges from a \$4.8 million reduction for a no-fault plan to a \$5.4 million reduction under the modified tort liability system.

B. Insurance Agent's Income

All stock carriers in Hawaii use the agent system exclusively as do many non-stock companies. Most insurance agents sell both life and casualty insurance. Of all automobile insurance sold in Hawaii, agents sell approximately 75 - 80 percent.

Table 15-1 displayed the impact of two reform plans on premiums earned by insurance carriers. The impact on agents' income is displayed in similar fashion in table 15-2. As with gross premiums earned, agents' commissions are also affected by changes in rates, adoption of compulsory insurance and mass merchandising. Agents' commissions are a straight 10 - 15 percent of the premium. Hence, the first two items, which only affect the total dollar volume of insurance sold, change an agent's income proportionately. The impact of mass marketing, however, is dramatically different. Consumer savings from group merchandising are achieved chiefly at the expense of the agent, by a substantial reduction in his commission.

The income estimates shown in rows 1, 3 and 5 of table 15-2 assume that agents receive 8 per-

cent of all premiums earned from the sale of automobile insurance.² After introduction of mass merchandising, it is assumed that in time the proportion of owner/drivers purchasing group plans will be equivalent to the current proportion of the general population covered under group accident and health plans, i.e., 81 percent. Thus, the substantial reduction of income shown in row 6 is achieved largely through reduction of solicitor commissions.

In 1970, the insurance commissioner's files indicated that over 4,100 active agent and solicitor licenses were outstanding. However, a number of these work less than full-time as insurance agents. It is estimated that Hawaii has the equivalent of about 2,000 full-time salesmen. On this basis, the estimated loss in commissions from automobile insurance ranges from approximately \$1,839 per agent under the no-fault plan to \$2,053 per agent for the modified tort liability system. Based on an estimated annual income of \$13,000 per agent, this amounts to a reduction in expected annual income of 14.1 and 15.7 percent under the no-fault and modified tort liability plans, respectively.

C. Legal Profession

All major reform plans aim at some reduction in attorneys' fees for motor vehicle accident cases. Their effects range from minimal reductions through regulation of contingent fees to major reductions through the abolition of motor vehicle tort cases under the complete no-fault plan.

Direct data concerning the income of attorneys engaged in accident liability cases are not available. It is possible, however, to make some rough estimates of both present income and the effect of reform plans. These are shown in table 15-3 and are based on the following assumptions. First, attorneys' fees are estimated to be 7 percent of all liability claims paid by insurers—that is, bodily injury and property damage liability combined, which totaled \$25.8 million in 1970. Estimated income is shown in the first row of table 15-3.

²That is, a 10 percent commission times 80 percent (the estimated proportion of insurance premiums sold through the general agent system) of gross premiums shown in rows 1, 3 and 5 of table 15-1.

Table 15-3

Impact of the Reform Plans on Attorneys' Fees

| Plan | Amount in Millions | Average Fees per Firm ¹ |
|--|-----------------------|---------------------------------------|
| 1. Tort liability | \$1.8 | \$24,000 - 36,000 |
| 2. Modified tort liability | 1.4 | 19,000 - 28,000 |
| 3. Partial no-fault ² \$10,000 exemption level | .7 | 9,000 - 14,000 |
| 4. Complete no-fault ³ | .2 | 3,000 - 4,000 |

¹Assumes 50-75 firms engaged in practice of motor vehicle tort liability cases.

²Assumes a 56 percent reduction in case loads from the dockets of the Hawaii circuit courts.

³Assumes that complete no-fault system will remove 90 percent of prevailing motor vehicle tort liability case loads.

A modified tort liability plan is assumed to decrease legal fees by only 20 percent. The partial no-fault plan with a \$10,000 exemption from tort liability is assumed to reduce attorneys' fees by approximately 60 percent. Finally, the complete no-fault plan is assumed to reduce attorneys' fees by approximately 90 percent, with the remaining 10 percent representing fees from policy disputes in the course of claims settlements.

The estimated loss in income to the legal profession thus ranges from \$400,000 to \$1,600,000, depending on the reform plan adopted. It was assumed that motor vehicle accident cases comprise a significant portion of the practice of 50 - 75 Hawaii law firms. This loss in income could amount to as much as \$32,000 per firm.

Clearly, a major no-fault reform of motor vehicle insurance will have a significant impact on the income of those attorneys engaged heavily in automobile tort negligence work. However, the effect of any drop in fees should be mitigated by the fact that Hawaii has a lawyer shortage.³

³"As against the national average of one lawyer for every 621 people in 1966, Hawaii's 1 to 1,083 was the fourth lowest ratio in the nation . . . Hawaii ranked 45th among the states, followed by Delaware, Nevada, Vermont, Wyoming and Alaska." Norman Meller, *Hawaii Law School Study*, Honolulu: University of Hawaii Legislative Reference Bureau, 1971, pp. 53-54.

D. Health Insurance Costs

A significant feature of all proposed reform plans is the primary use of other sources of recovery, with auto insurance playing a secondary role. The net impact on motorists is an initial reduction of the cost of automobile insurance coverage. In a broader context, making these other sources primary and auto insurance secondary results in eliminating or substantially reducing the duplication in payments which now occurs. While it is impossible to determine the exact extent of this duplication, it is possible to make estimates in three critical areas: health care insurance coverage, workmen's compensation, and temporary disability insurance. This section estimates the extent of the health care costs borne by private sources; payout for disability income protection is estimated in the following section.

In 1970, over \$60,000,000 in health care benefits was delivered to Hawaii residents by private accident and health plans.⁴ As indicated in table 15-4, over 81 percent was provided through such plans as Hawaii Medical Service Association, Kaiser Foundation Health Plan, and other medical services programs. Less than 19 percent was provided by insurance carriers.

Table 15-4

Estimated Health Insurance Benefits
Delivered to Hawaii Residents in 1969
By Private Health Plans

| Source of Compensation | Amount | Percent |
|---|--------------|---------|
| Commercial insurers ¹ | \$11,518,000 | 19 |
| Noncommercial health plans ² | 49,311,000 | 81 |
| Total | \$60,829,000 | 100.0 |

Sources: ¹Hawaii State department of regulatory agencies, *Report of Insurance Commissioner, 1970*, Honolulu.

²Health Insurance Association of America, *Annual Survey of Health Plans, 1970*, New York.

⁴Total health insurance benefits paid out in 1970 would rise by more than a fifth to \$73.6 million if federal medicare payments for Hawaii beneficiaries (\$13,639,000 for parts A and B) are included.

Duplication of medical coverage in Hawaii is substantial. More than 70 percent of automobile insurance purchasers have duplicate coverages under some other health plan.⁵ In contrast, the Health Insurance Association of America estimated in 1970 that, on a nationwide basis, duplication between health insurance coverages amounted to 36 percent.⁶ Thus, Hawaii far exceeds the national average in terms of the proportion of car owners with extensive overlap of medical coverages from different sources. Passage of mandatory prepaid health care legislation would further increase this overlap.

The result of reducing duplicate medical payments by relying on other sources is shown in table 15-5. The first column shows the effect under existing conditions, and the second column shows what will happen under mandatory prepaid health care. The estimates in table 15-5 assume (1) in the absence of a mandatory prepaid health insurance plan, the proportion of total bodily injury losses paid by auto insurers will drop from the current estimated level of 12 percent to less than 4 percent; (2) imposition of prepaid health insurance will eliminate medical payments by automobile insurers entirely;⁷ and (3) the proportion of health benefits paid by the two major health plan sources in the State will be (in percent):⁸

| | Without Mandatory Health Insurance | With Mandatory Health Insurance |
|---|---|--|
| Commercial insurers . . . | 16 | 15 |
| Noncommercial health plans | 84 | 85 |
| Total | 100 | 100 |

⁵For estimated duplication between automobile medical payments coverages and health plan coverages, see appendix E.

⁶For national estimates of duplication between health insurance coverages, see appendix E.

⁷See Legislative Reference Bureau, University of Hawaii, *Prepaid Health Care in Hawaii*, Report No. 2, Honolulu: 1971; and Hawaii State Legislature, S. B. No. 25, S. D. 1, "A Bill for an Act Relating to the Hawaii Health Prepayment Act," Honolulu: April 5, 1971.

⁸For details, see appendix E.

Table 15-5
Reduction in Duplicate Payments for
Health Care from Auto Insurance, 1970¹
(\$ in thousands)

| Paid by | Without Mandatory Prepaid Health Plan ¹ | With Mandatory Prepaid Health Plan ² |
|---|---|--|
| Commercial insurers | \$ 260.0 | \$ 348.0 |
| Noncommercial health plans | 1,362.0 | 1,969.0 |
| Total reduction in auto insurance medical payments (including bodily injury coverage) | \$1,622.0 | \$2,317.0 |

¹Assumes 70 percent of all current medical payments are duplicated; see section E of appendix E for details.

²All 1970 payments for health care.

In effect, the burden of current medical payments will be eliminated from the cost of automobile insurance and will continue to be paid chiefly by noncommercial health plans.

E. Disability Income Sources

All reform plans considered in this study specify statutory disability income maintenance programs as the primary source of wage loss benefits. For those employed in the labor force, disability income maintenance in Hawaii is provided through three sources. The major federal source is the long term disability income program of the Social Security Administration, which in 1969 paid over \$5,700,000 to more than 5,700 chronic disabled in Hawaii. The State of Hawaii has two disability income systems: workmen's compensation and temporary disability insurance (TDI). Workmen's compensation provides indemnity benefits for those injured in work-related accidents. TDI, which gives more limited coverage for non-work-related accidents, is provided for a period of up to 26 weeks. Making automobile insurance secondary to these sources will also reduce duplicate benefit payments.

The estimated expenditures by these two state systems is summarized in table 15-6. In 1970, an estimated 1,656 persons injured in auto accidents

(out of a total of approximately 9,000) qualified for compensation from these two sources. At current rates they received approximately \$924,000. Derivation of these estimates is discussed below.

1. **Workmen's compensation.** Estimates are based on the 1965 to 1969 aggregate workmen's compensation experiences which revealed a consistent rate of two on-the-job motor vehicle accidents out of every hundred which occurred. The average income award per case was \$735. Since it was not known whether the severity of these auto-related accidents differed from other accidents, this average figure was used. For 1970, the estimated 1,016 vehicle-related accidents thus resulted in awards totaling \$745,000.

2. **Temporary disability income.** In general, the estimated payment for motor vehicle accidents from TDI is less than one-third of the effect on the workmen's compensation system. TDI benefits do not pay for the first week of disability. The estimate in table 15-6 assumes that (a) 10 percent of all TDI covered injuries are automobile related, (b) the average claimant is compensated for four weeks, and (c) average TDI compensation is \$69 per week. On this basis, 640 claims result in estimated total cash awards of \$179,000.

F. State Taxes

Assuming that auto insurance is left to private carriers, adoption of a modified tort liability or a no-fault plan will, at most, make only a minor change in the revenues collected by the State through its 3.8 percent gross insurance premium tax. As indicated in table 15-1, the maximum decrease in premiums occurs under a complete no-fault plan, and is about \$5,000,000. Thus, the State stands to lose no more than \$200,000 in revenues from the most complete reform of the legal and insurance system. This is equivalent to less than a 10 percent drop from current collections under the present tort liability system.

Adoption of an exclusive state fund similar to those in Puerto Rico and Saskatchewan would have a larger impact because of the greater reduction in rates. Under a state fund no-fault plan, rates would fall by 43 percent,⁹ and aggregate premiums would fall by 27 percent. Assuming that a state fund would continue to collect the 3.8 percent tax, the net result would be a loss in revenues of \$563,000.¹⁰

⁹Using the same medium frequency and medium-high severity assumption as was used previously.

¹⁰See appendix G.

Table 15-6
Estimated Disability Income Paid to
Automobile Accident Victims, 1970

| | Number of Covered Injuries | Vehicle- Related Accidents | Total Compensation |
|----------------------------------|-------------------------------|----------------------------------|-----------------------|
| Workmen's compensation | 50,800 | 1,016 | \$745,000 |
| Temporary disability insurance . | 6,400 | 640 | 179,000 |
| Total | 57,200 | 1,656 | \$924,000 |

G. State Expenditures

Two areas of expenditures by the State need to be examined: (1) court costs and (2) costs for an exclusive state insurance fund.

1. **Court costs.** The four circuit courts in Hawaii handle the major portion of motor vehicle cases. In fiscal year 1970, 966 of approximately 28,000 cases filed dealt with motor vehicles. Based on budget data, the average court cost per case filed was \$75. At present, therefore, court costs for motor vehicle cases are approximately \$73,000, which represents less than 4 percent of the total \$2,000,000 court budget.

Table 15-7 shows the distribution by size of award of all motor vehicle tort cases which were settled in the circuit court over a period of four and one-half years. Using these data, the impact of alternative tort exemption limits under a partial no-fault plan would be as follows:

| Partial No-Fault Tort Exemption Limits | Percent Reduction in Cases |
|--|----------------------------|
| \$ 2,500 | 23 |
| \$ 5,000 | 35 |
| \$10,000 | 56 |

At a tort exemption limit of \$2,500, anticipated savings equal 23 percent of \$73,000, or \$17,000. By extending the tort exemption limit to \$10,000, cost savings would increase to about \$40,000. Thus, elimination of motor vehicle tort cases would not significantly affect the total costs of the court system in Hawaii. Initially, in fact, a number of actions might ensue from policy disputes over issues such as benefit entitlements, thus precluding any savings in court costs for some time.

Table 15-7

Average Number of Motor Vehicle Tort Cases Settled by Verdict, Hawaii Circuit Courts, By Value of Award
January 1967 - June 1971

| Value Award Class | Number | Percent Distribution |
|-------------------|--------|----------------------|
| \$ 1 - 1,000 | 29 | 12.4 |
| 1,001 - 2,500 | 26 | 11.1 |
| 2,501 - 5,000 | 28 | 11.9 |
| 5,001 - 10,000 | 52 | 22.1 |
| 10,001 - 25,000 | 52 | 22.1 |
| 25,000+ | 48 | 20.4 |
| | 235 | 100.0 |

2. **State insurance fund.** Establishment of an exclusive state insurance fund would probably require an appropriation for initial startup and operating expense of \$1,000,000. This would be a one-time appropriation, and the legislature could mandate that it be repaid. In no event should more than this amount be necessary.

Reserves necessary for a state fund would not need any appropriation by the legislature, assuming that the fund adhered to the same requirements now applied to private carriers, and assuming that, upon initiation, all premiums are collected for one year in advance.

PART V
CONCLUSIONS AND RECOMMENDATIONS

CHAPTER 16

CONCLUSIONS

This chapter gives the rationale for the following three major conclusions and recommendations which emerge from this study:

(1) The State of Hawaii should adopt a complete no-fault motor vehicle insurance system. The specific plan recommended for adoption is contained in appendix A-1 and its contents are explained in the next chapter.

(2) The legislature should enact a bill enabling mass merchandising of motor vehicle insurance *regardless of whether it enacts any other insurance reform legislation*. Appendix A-2 contains a recommended mass merchandising bill.

(3) The State should not adopt an exclusive state fund at this time.

A. Selection of Optimum Insurance System

To determine the best insurance reforms for Hawaii, the analysis in Part IV was used to evaluate the major reform alternatives against the objectives specified in Part II. A summary of the extent to which each reform plan meets the insurance subobjectives is given in table 16-1. This table shows the four major policy objectives applicable to accidents, the primary insurance objective, and the eight insurance subobjectives.

The accident victim should be given the overriding consideration and should, therefore, probably be the controlling factor in determining the most desirable insurance system. As table 16-1 indicates, a complete no-fault plan is the only system which completely satisfies the postcrash

objective of guaranteeing adequate care for all victims. It is also the only system which satisfies insurance subobjectives 1, 2 and 3, which specify that victims should receive adequate, prompt and guaranteed payment for their losses. This result is consistent with the fact that a no-fault insurance system is expressly designed to take care of accident victims, whereas a principal purpose of liability insurance is to protect the assets of those motorists accused of negligence. If a widespread or universal insurance system is to be the principal source from which accident victims are compensated for their losses, a no-fault insurance system is clearly superior.

Further, no-fault is potentially the most efficient and least costly system, thereby fulfilling a prime insurance objective. In view of the large sums of money which the public spends each year for insurance, the efficiency criterion is extremely important. Potential increases in system efficiency represent the most important source of cost reduction and premium savings. In addition to being more efficient, a complete no-fault plan is also more equitable concerning the availability and pricing of insurance. Thus, no-fault fulfills subobjectives 4, 5 and 6.

The following sections elaborate on the rationale for recommending a complete no-fault system over either modified tort liability or partial no-fault.

1. Modified tort liability. All improvements over the existing tort liability system are achieved by moving in the direction of a no-fault system. For example, abolition of the collateral source rule

Table 16-1
Insurance Reform Plans Compared with Objectives

| Objectives | Insurance System | | |
|---|--|---|--|
| | Modified Tort Liability | Partial No-Fault | Complete No-Fault |
| Accident objectives: precrash 1. Prevent accidents | No significant differences between alternatives. Differences slight or negligible; widespread no-fault has desirable <i>potential</i> of rating cars on safety factors, but not feasible for Hawaii to undertake alone. | | |
| 2. Reduce severity and minimize losses | | | |
| Accident objectives: postcrash 1. Treat injured victims | Third party prepayments resembling first party system is strongest point | The lower the tort exemption limit, the larger the potential gap | Guarantees all necessary treatment for every one |
| 2. Reduce hardships | Has most gaps and most uneven treatment of victims | The lower the tort exemption the more uneven the treatment | Gives most even treatment to all victims |
| Primary insurance objective: To be efficient and effective | Least efficient system; all reform efficiencies obtained by moving in direction of first party recovery | Potential efficiencies increase with higher tort exemption limits | Potentially the most efficient system |
| Insurance subobjectives: 1. Compensate personal injury losses adequately | Has the greatest number of potential gaps, which are best closed by residual first party recovery | The higher the first-party coverage, the fewer the gaps | Pays medical expenses and wage losses of all victims |
| 2. Pay promptly | Inherently slowest system | A mixture of fast and slow elements | Inherently fastest system |
| 3. Guarantee payments | Inherently has greatest amount of uncertainty | In between | Inherently has least uncertainty |
| 4. Universal availability at reasonable cost | Avoids insuring anyone who might be a poor defendant in a negligence lawsuit or else arbitrarily classifies him into a high cost category | In between | Best system; guarantees basic personal injury coverage for all |
| 5. Assess cost equitably | Discriminates on factors other than driving ability; potential liability is major cost factor | In between | Potentially least discriminatory |
| 6. Operate simply | Complicated and not easily understood by average citizen | May be the most complicated and least understood system of all | Has potential of being simplest system which will be most easily understood by the average citizen |
| 7. Complement related activities | "Secrecy" desired for negligence suits complicates reporting and investigation | In between | Has greatest potential |
| 8. Account for performance | Equally feasible for each alternative | | |

essentially eliminates duplication of coverage by deducting other first-party insurance benefits whenever they exist. But in any accident where a victim does not have such other first-party insurance and cannot prove negligence on the part of some other driver, there obviously exists a serious gap in coverage. That is, this system gives such victims no protection against losses. Clearly, it is the widespread existence of other first-party insurance which makes abolition of the collateral source rule a tenable reform. Thus, if a person has no such insurance, the abolition of the collateral source rule would be a meaningless reform. The implication is that the more widespread is first-party insurance, the less will be the gaps and other problems associated with a tort liability system. This reasoning merely needs to be extended to its logical conclusion.

The other reforms in the modified tort liability system—inter-insurer arbitration for bodily injury claims, a formula or schedule for general damages and regulation of contingent fees—are intended to speed up the compensation process, distribute insurance benefits more equitably, and reduce attorneys' fees. These reforms can succeed to a limited degree, but not nearly so well as does a complete no-fault plan.

Consider the arbitration proposal, for instance. Depending on one's interpretation of this proposal, inter-insurer arbitration of bodily injury claims either gives end-results similar to a no-fault approach or it leaves a serious compensation gap. To illustrate, assume there is a collision where two injured drivers both have liability insurance but no other coverage. The fact that arbitration takes place between insurers would seem to imply that medical costs for each victim will somehow be compensated by the insurance system, with the principal unresolved question being the share to be paid by each victim's insurer. If this does occur, the net result is similar to the no-fault system (i.e., the insurance system pays), except that the no-fault plan determines in advance which company pays rather than relying on expensive and time-consuming, case-by-case investigation and arbitration. If, on the other hand, it is possible for an arbitrator to decide that one driver was "negligent" and is not entitled to have his losses compensated, then the system contains a serious gap—unless, of course, everyone also buys extensive no-fault medical expense coverage in addition to *liability insurance* to pay for the

expenses of others if found negligent. The inescapable conclusion is that the modified tort liability system moves in the direction of achieving the desired objectives, but does not go as far or succeed as well as a no-fault system.

2. Partial no-fault. Every partial no-fault plan is, by definition, a combination of tort liability and pure no-fault. The higher the tort exemption, the more the system resembles complete no-fault. A \$10,000 tort exemption, for example, covers the losses of over 95 percent of all personal injury cases. Conversely, the lower the exemption, the greater will be the number of injured victims who will have to establish negligence in order to receive adequate compensation.

Between partial and complete no-fault, some of the differences disappear or become somewhat obscure at high tort exemption levels. For example, cost differences between partial and complete no-fault become negligible as the tort exemption level approaches \$10,000. However, even with an exemption level of \$10,000, under partial no-fault, the 5 percent who suffer the most serious injuries (their losses can exceed \$10,000 by a wide margin) would have to depend upon the vagaries of the tort system (e.g., delays, uncertainty of payment, limited compensation, etc.) for recovery of most of their losses and thus suffer the greatest hardship of all victims. Further, the retention of the liability system would require purchase of liability insurance if one desires to protect oneself from liability over the partial no-fault exemption level and thus would retain many of the problems associated with buying liability insurance (unwillingness of the insurer to sell or renew policies, assigned risk plans, very high premiums for a few, etc.). Also, if partial no-fault is accompanied by compulsory, high liability limit, the cost of purchasing such insurance would be expensive.

Fortunately for society, serious injuries comprise a small percentage of all personal injury cases. However, since hardship increases disproportionately with the seriousness of the injury, in these few cases partial no-fault is clearly less equitable. In other words, the farther a partial no-fault plan departs from tort liability in the direction of complete no-fault, the closer it would come to fulfilling major social objectives for the insurance system.

Finally, in terms of *simplicity*, the partial no-fault plan is perhaps the worst of all. Under this system a driver will have to have two fundamentally different types of insurance and he will have to understand two distinctly different sets of rules.

3. Complete no-fault. Some complete no-fault plans achieve the basic objectives better than do others. For instance, some proposals provide benefits only for basic personal injury losses. At least one plan (the Minnesota-Davies plan) goes beyond this by including both long term disability and disfigurement compensation, thereby providing more effective compensation for traffic accident victims. Inclusion of these important serious injury benefits in the plan recommended in chapter 17 is a distinct and beneficial difference from many existing state and national proposals.

It should also be noted that the summary in table 16-1 indicates the several instances where the no-fault system has the *potential* of being the best system; e.g., it is potentially the most efficient, the least discriminatory and the simplest. The extent to which this potential will in fact be realized depends critically upon the design and implementation of the system. The plan recommended in chapter 17 attempts to realize these potential benefits to the maximum extent possible.

B. Mass Merchandising

In the 1971 legislative session, a group marketing bill passed both houses of the Hawaii State legislature but was subsequently vetoed by the governor.¹ The analysis in part IV confirms the original opinion of the legislature that group merchandising is more efficient and has significant cost-savings potential. Hawaii vehicle owners as a group could obtain in excess of a \$5 million savings from this feature.

Mass merchandising is not limited to any particular system of automobile insurance. It can be applied to tort liability or to partial or complete no-fault plans. Because mass merchandising is not tied to any particular insurance reform, enactment of a separate bill applicable to any insurance

¹See S. B. 541.

system in the form contained in appendix A-2, is recommended. Passage of such bill will remove the existing artificial restriction on competition and permit the competitive enterprise system to benefit the consumer by offering meaningful alternatives.

C. Exclusive State Fund: Advantages and Disadvantages

An exclusive state fund would be the sole issuer of any mandatory personal injury coverages. Beyond this point, such a fund could (1) be the sole provider of all automobile coverages; (2) permit private insurers to compete in the sale of certain optional coverages, such as excess wage loss protection or insurance against collision damage; or (3) permit private carriers to be the sole providers of all optional coverages.

From a purely financial viewpoint, a state fund provides a more efficient use of the vehicle owner's insurance premium money. Chapter 14 showed that a state fund would result in an additional 14 percent cost savings for either a tort liability or complete no-fault system (see table 14-2). Therefore, although establishment of an exclusive state fund is not recommended at this time, it must be recognized as a viable administrative alternative. It is instructive to consider briefly the rationale for a state fund under all three insurance reforms, even though a complete no-fault system has been indicated as the best plan in terms of fulfilling public policy objectives.

1. Modified tort liability. An adversary process lies at the foundation of the tort liability system. Victims injured in an automobile accident attempt to recover losses by retaining an attorney and suing the driver and his insurance company. If the injured victim was himself a driver of another motor vehicle and his insurance company advanced money against first-party coverages and has subrogation rights, then that insurance company may also be a party to the suit. The adversary system is clearly preserved when the victim's insurer and the other driver's insurer are different companies. However, occasionally, a policyholder of a company collides with another policy holder of the same company. In such instances, it is clear that the insurer cannot fairly serve both the plaintiff and the defendant. Thus, to adhere to the requirements of the adversary system, the injured victim hires an attorney to bring suit against the other driver and his own company. Attorneys

retained by the company then defend its other policyholder and attempt to minimize the claim of the injured victim, although the victim is one of the company's own "valued" customers.

If insurance must operate under a tort liability system, this may be the only procedure possible. However, the result is that if payment is made, it is from an insurance fund contributed to by both the plaintiff and the defendant. It is clearly an expensive and inefficient means of accomplishing society's desired end-result: taking care of accident victims. Were the State to establish an exclusive insurance fund under a tort liability system, the state fund would be the insurer of the defendant and plaintiff most of the time. If liability insurance were made compulsory, the state fund would be cast in an undesirable plaintiff-defendant role in virtually every suit.² For this reason, it is recommended that *in no event should an exclusive state fund be established in conjunction with a tort liability system.*

2. Partial no-fault. The more a partial no-fault system relies on tort liability for recovery, the more the preceding presumption against a state fund applies. Thus, with low tort liability exemptions, a state fund would appear to be highly undesirable because the fund would be the insurer of plaintiff and defendant in too many instances. However, this objection to a state fund diminishes with higher tort liability exemptions and as more cases are settled on a first-party basis. With a \$10,000 exemption, a state fund would probably be cast in the defendant-plaintiff conflict-of-interest situation no more often than occurs with some very large insurance companies today. For this reason, a state fund must at least be considered tenable under partial no-fault with high tort exemption.

3. Complete no-fault. As indicated in chapter 12, both Saskatchewan and Puerto Rico have successfully established government insurance funds to provide basic loss protection for automobile accidents. In Hawaii, however, enactment of a state fund to monopolize the sale

²A similar situation arises today when someone tries to collect under the uninsured motorist coverage in his insurance policy. Under this first-party tort liability creation, the victim must claim against his own insurance company and prove that he was struck by a negligent motorist. If the insurance company "wins" the suit, its policyholder loses.

and administration of motor vehicle insurance would mark a complete break with present traditions. Nevertheless, the fact that such a change has received some form of serious consideration in both Hawaii and Maryland indicates that public antipathy to such a change may be waning. The advantages and disadvantages are considered separately in the following paragraphs.

a. Advantages. An exclusive state fund for basic compulsory insurance has several appealing advantages. These include:

- . Administrative efficiency
- . Low cost to the public
- . Little money needed for initiation; self-perpetuating thereafter.

A state fund can make the purchase of automobile coverage an integral part of the vehicle registration process. Further, premiums can reflect a driver's traffic safety record by integrating rating with existing or anticipated improvements in the traffic conviction reporting system. This would be a distinct improvement over the present system where rate increases can result from mere accident involvement or from being found "negligent" without any proof of inadequate driving ability, bad driving judgment, or other socially undesirable characteristics.

In terms of cost, the motor vehicle owner clearly obtains a substantial out-of-pocket savings in terms of reduced premiums under the state fund alternative. The actuarial analysis of chapter 14 indicated that under complete no-fault, current premiums could be adjusted downwards by 43 percent.³ In 1970, the average premium paid by a motorist in Hawaii was approximately \$204.⁴ Thus, a 43 percent reduction would, on the average, save each motorist about \$88. In terms of aggregate figures, Hawaii's private insurance carriers earned premiums of \$54.5 million in 1970. A 43 percent savings from this figure would amount to an annual \$23.4 million dividend for

³Based on the medium frequency and medium-high severity assumption with all other insurance sources used first; see table 14-2.

⁴Total earned premiums divided by number of car-years of insurance written.

Hawaii motorists. At current rates (which were raised 19 percent in April 1971), the annual savings would be \$27.9 million.⁵

An efficient operation under a state fund should not require any continuing general revenue appropriation or tax subsidy. As indicated in chapter 15, the initial purchase of insurance by all motorists should provide more than adequate reserves from the outset. Thereafter, a state fund should have no difficulty operating on a self-sustaining basis. The Puerto Rico Automobile Accident Compensation Commission operates on a self-sustaining basis and has also fully repaid the first appropriation for initial start-up expenses. The Saskatchewan Government Insurance Office, which markets all lines of insurance coverage, actually returns a net operating surplus.⁶

b. Disadvantages. Offsetting the advantages of a state fund are a number of problems and issues which must be considered. None of these are insuperable, but on net balance they outweigh the advantages *at this time*.

The first problem confronting the State is the fact that it now has no capability for running a large motor vehicle insurance operation. The methods, procedures and forms which would be required are all lacking and would have to be developed. Moreover, the State does not have managers, administrators, claims adjustors, or other skills necessary to run a state fund. Such talents exist within Hawaii, but they would have to be recruited and melded into a smooth-running organization before consumers could reap the benefits of a more efficient operation.

The second reason for not recommending a state fund at this time is the fact that no decision has been made to adopt a no-fault insurance system. As indicated above, this move should at least accompany and should probably precede any change to an exclusive state fund. Changing from a tort liability system to a no-fault system entails a substantial number of unique problems and

⁵See appendix G for a more complete financial analysis of a state fund.

⁶For a detailed analysis of the revenue impacts of a state fund based on the performance of the Saskatchewan exclusive fund, see appendix G.

difficulties in terms of explaining the new system both to insurance agents and to the average motorist. In order for any insurance system to deliver benefits effectively, it is important that everyone understands his rights, where and how he makes a claim, etc. With its thousands of trained agents, private industry is well-situated for this task; the state government is not.

A third disadvantage of a monopolistic state role is that this would preclude the healthy and creative effect which competition can have when directed in the right channels. Government monopolies are generally more defensible in situations which are relatively stagnant and routine. A state monopoly is at a distinct disadvantage when innovation is desired. A switch to no-fault is in itself a major innovation, and a great deal of further work, experimentation and innovation will be necessary before no-fault can deliver its fullest potential. A dynamic, competitive enterprise situation is therefore indicated.

It should be noted that efficient and effective delivery of insurance benefits entails considerably more than just lower premiums. *The quality of delivery* involves many dimensions, including (1) the speed with which the system reacts, (2) whether an adjustor comes to the victim or the victim is required to apply for benefits at a central office, (3) whether the victim's case is treated impersonally or in an individual and considerate manner, and (4) whether the victim is made to feel that he is treated fairly, etc. The utility of a state fund for Hawaii rests upon whether the competitive enterprise system can deliver compensation benefits more efficiently and more effectively. In other words, the crucial test is whether high quality service along with lower costs can best be achieved through an exclusive state fund or a competitive system.

The fourth and final reason for not adopting an exclusive state fund now is that one must assume that it will be a one-way, one-time move. Once private carriers are preempted from the field, it is not likely that the state fund will be disestablished or the field later opened to competition. At a minimum, Hawaii's private insurance carriers deserve an opportunity to prove that under a no-fault system they and the competitive enterprise system can reduce overhead, increase efficiency, treat *all* drivers equitably and otherwise deliver the substantial benefits which the no-fault

system promises. If they cannot, there is time enough later to institute an exclusive state fund.

In sum, a state fund is not recommended for immediate adoption, but this view is contingent upon the insurance industry's response and performance. If the insurance industry indicates an unwillingness to implement the no-fault system

proposed by this study and suggests some other system not in the complete interests of the citizens of Hawaii, establishment of a state fund should seriously be considered. In addition, a state fund should be considered as a distinctly viable alternative if experience with the basic reforms proposed in this study indicates that the private insurance system is either inefficient or ineffective.

CHAPTER 17

RECOMMENDED MOTOR VEHICLE INSURANCE REFORMS

The recommendations that Hawaii adopt a complete no-fault automobile insurance system plus mass merchandising are predicated on the ability of these reforms to assure maximum efficiency as well as adequate and affordable protection for all. Should experience with no-fault under private carriers prove unsatisfactory, an exclusive state fund should be considered.

Appendix A contains three legislative bills: (1) a no-fault reform bill recommended for adoption at this time, (2) a mass merchandising bill also recommended for adoption at this time, and (3) a bill for a state motor vehicle insurance fund, which is not recommended for enactment at this time. Discussion in this chapter centers on a description of and commentary on basic reform provisions of all three bills. Topics addressed in the following sections include:

- . Effects of basic changes on the consumer
- . Basic plan benefits
- . Guarantee of loss protection and compensation
- . Mass merchandising
- . Hawaii motor vehicle insurance fund.

Chapter 18 contains a recommended implementation plan for the reforms discussed here.

A. Effects of Basic Changes on the Average Consumer

Adoption of the proposed no-fault plan will have several major effects, including (1) providing protection to the total population; (2) broadening the coverages purchased by a vehicle owner while exempting him from personal liability; and (3) making coverages available with likely cost savings to the consumer and under conditions which preclude discrimination in the acceptance of risks.

1. Compulsory insurance. To make protection applicable to the total population, the bill requires every motor vehicle owner in Hawaii to buy basic insurance coverage for personal injury losses to himself and anyone else in his car, plus pedestrians and any non-vehicle property damage which his car might inflict.¹ Thus, approximately 60,000 vehicle owners who currently do not insure will be required to purchase insurance.² Those individuals who now buy liability coverage (80 percent of all motorists in Hawaii) to pay for losses of *other* drivers will instead buy guaranteed protection for themselves, their families and guest passengers.

¹Under the proposed legislation, self-insurance is permitted for those who have 25 or more vehicles and are financially capable of paying all traffic accident losses in accordance with required benefit provisions.

²The reforms brought about by the proposed legislation include complete abolishment of the current financial responsibility law recently made less effective by U. S. Supreme Court rulings. For an analysis of financial responsibility laws, see appendix F.

At the time of registration, the owner will have to submit proof from his insurance company that coverage has been in effect during the past registration period and will be in effect during the forthcoming period.³ It is anticipated that proof of insurance coverage for the forthcoming year will consist of a "binder" which companies customarily issue to anyone who requires evidence of insurance in force. This practice is now followed in other states where insurance is compulsory; thus, although new to Hawaii, it is not a new procedure for the industry.

Failure to insure will subject the owner to penalties which exceed the cost of insurance. It will also mean that the owner will not be covered for his own personal losses in the event of an accident. Moreover, an uninsured car owner will also be personally liable to any insurer who provides compensation to other victims under the assigned claims plan, such as passengers in the uninsured owner's car or pedestrians.

In order to require every car owner to have insurance, it is clearly necessary that insurance coverage be readily accessible. For this reason, every insurance company will be required to sell the mandatory minimum package to any car owner. Every policy for the minimum required insurance will be noncancellable and guaranteed renewable as long as premiums are paid and provided that there is no fraud in the application. This guaranteed availability of insurance is discussed further in section C.

2. What the vehicle owner will buy under the new system. Upon introduction of complete no-fault insurance, the six coverages now contained in a standard insurance policy will change markedly. Table 17-1 illustrates the changes in basic policy coverages as a result of introducing no-fault. Bodily injury liability coverage is eliminated and replaced by a vastly expanded,

required bodily injury loss coverage. The required coverage under the proposed plan includes benefits for medical services and hospitalization, income loss to wage earners or their dependents, lump sum death payments to dependents of non-wage earners, replacement services, disfigurement, funeral expenses and other out-of-pocket expenses.

Table 17-1
How Motor Vehicle Insurance Would Change
Under the Complete No-Fault Plan

| Existing Coverages | How Changed | Complete No-Fault Policy |
|---------------------------|-----------------------------------|---|
| | | <u>Required Benefits</u> |
| Medical Payments | Expanded | Payments for bodily injury losses: Medical and hospital Income maintenance Replacement services Disfigurement Funeral expenses Other out-of-pocket expenses |
| Property damage liability | | |
| Vehicles | Eliminated | |
| Non-vehicular property | Retained on different legal basis | Strict liability: payments for all non-vehicular property damage |
| Bodily injury liability | Eliminated | |
| Uninsured motorists | Eliminated | |
| | | <u>Optional Coverages</u> |
| Collision | Retained | Collision |
| Comprehensive | Retained | Comprehensive |
| | | Excess wage loss |
| | | Excess replacement of personal services |
| | | Pain and suffering |
| | | Out-of-state liability |

Under the proposed plan, liability for damage to vehicles is eliminated, but payment for non-vehicular property damage is required. This means that in the event of a collision between two cars, neither owner can sue the other for damage to or loss of his vehicle. Damage to cars, however, may be covered under some form of optional collision coverage.

³The combination of retrospective and prospective checking of insurance coverage at the time of registration is intended to provide a more efficient means of enforcement. In an island state like Hawaii it should be particularly effective. It is anticipated that in December of each year, the insurance companies will issue to each customer a notice of insurance in force during the past year, much as all employers now give a W-2 withholding statement to all employees.

In addition to optional insurance for collision damage, the proposed no-fault plan also contemplates that automobile insurers will offer several other optional coverages which are not now offered. Four specifically mentioned in the bill are (a) recovery of income lost in excess of \$600 per month, (b) replacement of personal services in excess of one year, (c) pain and suffering reparations for those who suffer disfigurement or whose medical expenses exceed \$5,000, and (d) liability coverage for those who drive out-of-state. Nothing in the bill is intended to preclude insurance companies from offering still other optional coverages.

Uninsured motorist coverage is completely eliminated. Such coverage is made unnecessary by the requirement that all car owners carry insurance and by the establishment of an assigned claims plan.

In summary, the net result of the bill will be two basic mandatory coverages, bodily injury losses and payments for damage to property other than automobiles, and several optional coverages.

3. What the vehicle owner will pay under the new system. Average savings under the no-fault proposal have been estimated for three possible cases. In brief, this analysis indicates that (a) a person now buying complete coverage can expect to save between 15 and 21 percent per year; (b) a person now buying complete coverage less property damage liability and physical damage coverages can expect to save 23 to 36 percent; and (c) a person now buying only minimum bodily injury liability and uninsured motorists coverage can expect to pay up to 5 percent more or save as much as 13 percent, depending on the loss frequency and loss severity experience.⁴ It should be noted that this last hypothetical motorist who now buys only minimal coverage would receive far more insurance coverage for his money than the coverage he is now getting.

The premium cost experience of some individual motorists under the no-fault plan will probably lie outside the range given. Thus, those who now pay very high premiums but who have no record of traffic violations and no accident record will probably save even more than the highest

⁴The methodology is the same as that used in chapter 14. See appendix H for details.

percentage figure given. On the other hand, motorcyclists and those who drive very unsafe cars may save less than the lowest amount shown and they may even pay more than they do today.

B. Scope of Basic Plan Benefits under Proposed No-Fault

Questions of eligibility, how to obtain benefits, and the scope of the required benefits under the recommended no-fault bill are discussed in this section. In the discussion which follows, it is important to remember that no-fault insurance provides direct reimbursement for accident losses from one's own insurer.

1. Who is eligible. Eligibility for basic no-fault benefits extends to any member of the insured vehicle owner's family. To preclude as many problems as possible, the bill provides for the insured to specifically denote any "marginal" member of his household⁵ whom he wishes to have included under his policy. This basic concept of household protection also extends to those driving with the consent of the owner as well as to any guest passenger in the policyholder's vehicle.

Also covered is anyone injured by a motor vehicle and who is not an occupant of another motor vehicle (e.g., a pedestrian or a bicyclist). Should any such person be injured by a hit-and-run or uninsured motorist, he will receive full benefits through an assigned claims plan. Thus everyone (except an uninsured motorist) who is injured in an automobile accident will receive the same benefits as though he were directly covered by a policy.

2. How benefits are obtained. All occupants of a car will be paid the required benefits directly from the insurer of the car in which they are riding. If a person has optional coverage for excess benefits under another policy (for instance, a guest passenger with excess wage loss coverage under his own policy), he will receive all such excess benefits from that policy. A pedestrian or bicyclist who is hit by a car will be paid by the insurer of the car.⁶

⁵For example, a son or daughter over 21 who is a student at a college or university outside of Hawaii and who is normally elsewhere for 8-10 months of the year.

⁶In the event of a multicar accident where it is not clear which car struck the pedestrian, he can claim against the insurer of any involved car; the insurers of the cars then apportion the loss among themselves.

Under the assigned claims plan which the proposed bill requires, a victim of a hit-and-run or uninsured motorist should be able to submit his claim by filing an official accident report at the office of any insurance carrier in the State of Hawaii. The carrier to whom such a claim is subsequently assigned will then honor such claim as if the claimant were covered by that company.

Under the proposed legislation, benefits must be paid within 30 days after a valid claim is filed. If any benefit is not paid within 30 days, the insurer is charged interest on the benefit at the rate of 1½ percent per month, or 18 percent per annum. This is to discourage late or overdue payments by insurance carriers. The interest rate is the same as those typically charged by department stores, bank credit cards and others for overdue payments. It is to be hoped, of course, that all insurance companies will pay promptly.

In general, benefits are to be paid on a periodic basis. Lump sum settlements above \$1,000 will require the issuance of a court order upon showing of proof of necessity. The basic purpose of periodic payments is to avoid having seriously injured victims or survivors imprudently exhaust a lump sum award and then become wards of the state. At the same time, however, the general requirement of periodic payments is not intended to perpetrate small, periodic, nuisance payments which unnecessarily increase insurance company costs. For this reason, an insurer may settle all claims totaling \$1,000 or less and pay the same in a lump sum with the approval of the claimant.

3. Basic bodily injury benefits. Bodily injury benefits mandated under the proposed bill and described here include:

- (a) Full payment of all medical and rehabilitative services required to restore victims as nearly as possible to their state of physical and mental health prior to injury
- (b) Full payment for necessary replacement services up to one year
- (c) Up to \$500 for miscellaneous out-of-pocket expenses
- (d) Funeral expenses up to \$2,000

- (e) Periodic income maintenance payments to victims or to dependents of victims for losses of income from work
- (f) Lump sum disfigurement awards
- (g) Lump sum death payments.

a. Medical expenses. The insurance covers all necessary medical and rehabilitative services provided to injured victims. Payments may be made directly to the providers of such services. In order to promote overall efficiency, automobile insurance benefits are made secondary to all other sources of compensation available to the victim: i.e., health plan coverages such as the Hawaii Medical Service Association (HMSA) or Kaiser Foundation Health Plan.

It was shown in chapter 8 that these other plans now operate with substantially lower overhead (7 to 25 percent) than do automobile insurers (whose "target" in rate filings is a 46 percent overhead). They are far more efficient than automobile insurers. For this reason, health plans such as HMSA and Kaiser, as well as commercial health insurers, should be relied on for primary coverage for medical expenses to the maximum extent possible.

For purposes of convenience and accountability, however, automobile insurance companies should arrange for accident victims to submit copies of all claims to them, and they in turn should then make an accounting with the insured person's health plan. All medical expenses not paid for by health plans are to be paid by the automobile insurance carrier.

b. Replacement services. Payment for replacement services is also covered. Such services include all ordinary and necessary household activities which the injured would have ordinarily performed himself but for the injury. Examples of such services include child care, as well as normal housecleaning, laundry and meal preparation in the event someone such as a housewife is hospitalized, totally bedridden or otherwise incapacitated as a result of an accident. Replacement services are payable *in full* for a period not to exceed 12 months.

c. Out-of-pocket expenses. Reasonable out-of-pocket expenses up to \$500 per victim will

be paid. Such items may include taxi and baby sitter expenses when visiting a doctor or replacement of miscellaneous personal property, such as damaged clothing.

d. Funeral expenses. Funeral and associated expenses up to \$2,000 will be provided for each fatally injured victim.

e. Work income losses. Payments for work income losses up to \$600 per month are included in the plan in order to protect all households (including single persons) from economic hardship. Entitlement is based on each wage earner. Thus, households with more than one wage earner will have a substantial portion of their income protected in the event more than one is injured in the same accident. Income maintenance payments under the proposed plan continue for as long as the loss of income due to disability continues. In the case of permanent disability, income maintenance payments continue indefinitely.

The \$600 per month is *net* of a flat 15 percent allowance for federal and state income taxes, since income replacement payments are not reportable as income and are not subject to income taxes. This means that gross income of approximately \$706 per month or \$8,400 per year is *fully* covered by the bill. This is approximately twice the poverty level and will fully cover approximately 50 percent of all Hawaii wage earners.⁷ Those with incomes substantially in excess of \$700 per month may buy optional excess wage loss coverage.

In order to minimize any inequities which might arise out of fluctuations in earnings and employment status of persons in a changing economy, an injured person may calculate his income by any one of three straightforward options and select the one which is most favorable to him. Income from work is defined simply as that which a person has reported for income tax purposes. The three options are a monthly average of (1) a person's earnings during the current year up to the date of accident, (2) last year's reported

⁷ In chapter 14, an income replacement level of \$750 (equivalent to a gross income of \$882 per month, or \$10,584 per year) was analyzed. In order to avoid requiring excessive coverage which many may consider to be an unnecessary expense, a lower limit of \$600 per month was selected for the mandatory coverage in this bill.

income, or (3) income from the last two years. For persons normally employed on a regular basis, these options will make little difference. But for anyone whose income is (or may be) subject to seasonal or cyclical fluctuations, such as construction workers, salesmen, writers, artists, et al., the availability of these options may make an important difference, and it is for this reason that they are provided.

Basic income loss benefits will be paid periodically and are net of deductions for collateral sources of compensation. This means that when a claim is submitted, the insurance carrier should also receive an accounting of payments made (or to be made) by the eligible victim's social and wage continuation plan insurers. Thus, the victim is assured of receiving his entire range of benefits.

As regards permanent disability, it should be clearly understood that this bill differs to some extent from the approach taken by workmen's compensation. In the case of workmen's compensation, disability payments tend to be chiefly a medical-legal determination. That is, expert medical witnesses testify on the effect, for example, of losing a finger, and a disability award is then made *regardless of what the victim is in fact earning*. In the proposed bill, income work loss is essentially an economic determination and is measured by a person's actual reduction in earnings. Thus, if a person loses an arm in an accident but suffers no permanent loss of income, he would not be entitled to receive income maintenance benefits under this bill. He will, however, be entitled to a disfigurement award, discussed in the next section. In the event a person with a permanent injury does suffer a reduction in income attributable to an automobile accident, he will receive income benefits up to \$600 a month.

One result of basing income work loss benefits on an economic determination is to direct insurance resources to those who in fact suffer a loss of income. A second result should be to avoid most or all of the expensive and time-consuming hearings procedures with which the workmen's compensation process is encumbered. As indicated in chapter 8, experience under workmen's compensation indicates that this system is even less efficient than the present automobile liability insurance system. Hence, the establishment of another procedural system similar to workmen's compensation should be avoided at all costs.

f. **Disfigurement awards.** Benefits for income work loss, described in the preceding section, are based solely on economic loss. However, economic loss needs to be distinguished from the psychic or dignitary loss which accompanies permanent disfigurement. A person who suffers loss of a limb or permanent scarring may be forced to change his life-style, even if he suffers no loss of income whatsoever. Thus, in the proposed bill, payments are provided for scarring and permanent loss of a limb or other part of the body.

These payments are over and above payments for wage losses resulting from disability. Anyone who suffers loss of a limb (or other scheduled injury) will receive a disfigurement award, regardless of whether the person is a minor, housewife, or wage earner. These awards are essentially arbitrary in amount and have nothing to do with the "extent of (economic) disability" so frequently at issue in workmen's compensation cases. Issues concerning economic wage loss or reduction in earning capacity may appropriately be raised in connection with wage loss payments, not with disfigurement awards. Thus, a specific amount to be paid for each type of disfigurement, except scarring, is set forth in the bill. In the case of scarring, the insurance commissioner is mandated to establish suitable guidelines for reparations payments up to a maximum of \$12,000.⁸

g. **Death benefits.** In the event a wage earner dies as a result of an automobile accident, his surviving spouse or children below the age of 18 are entitled to receive income loss support up to \$600 a month. In case of a surviving spouse, she (or he) receives these payments until she dies or remarries. In the event she dies, these payments continue to the children until they reach age 18. If she remarries, the payments terminate, but if at the time of her remarriage, the monthly income payments she received prior to her remarriage total less than \$10,000, she gets paid the difference in lump sum. In the event a single wage earner dies, or in the event of the death of a non-wage earner

⁸The medical payments provision of the required benefits will pay for cosmetic surgery as part of rehabilitation and medical expense necessary to restore a person as nearly as possible to his previous condition.

(e.g., a housewife or child), a lump sum \$10,000 payment will be made to the estate of the deceased or to the non-wage earner's surviving spouse or children. Thus, a minimum of \$10,000 will be paid on behalf of anyone who dies as a result of an automobile accident.

4. **Property damage provisions.** The bill makes a motor vehicle owner strictly or absolutely liable for any damage which his car does to non-vehicular property. That is, there is no need to establish negligence. To protect both the driver and property owner, the proposed plan requires unlimited liability coverage for such property damage. Losses sustained by property owners will be paid directly by the insured's carrier. In the event any such non-vehicular damage is caused by a hit-and-run or uninsured motorist, the property owner can recover his loss through the assigned claims plan.

Property damage to automobiles will either be covered under some form of optional first-party collision insurance or else will be uninsured. Ordinary collision coverage should be available with a variety of deductibles, as it is now.⁹ However, no motorist should consider a deduction of less than \$250.¹⁰ For an insurance company, the processing of small claims is time-consuming, costly and generally uneconomic. The \$100 deductible became "standard" in the 1940's when \$100 represented approximately 8-12 percent of the cost of a new car, and when \$100 bought a substantial amount of automobile repairs. This clearly is no longer the case. A \$250-\$300 deductible would thus restore what was at one time a sensible threshold for insurance to begin.

⁹It is hoped that insurance companies will offer new forms of collision coverage. Keeton and O'Connell's "triple option plan," discussed in chapter 12, demonstrates that there can be substantial innovation in this area. Another possibility in collision insurance would be for companies to offer a "vanishing deductible." Under this concept, insurers would pay the entire claim if damage exceeds a certain amount. The "vanishing deductible" would screen out the small, expensive-to-process claims but would give the insured owner maximum protection in the event of extensive damage.

¹⁰Typically, banks and other consumer lending institutions require collision coverage with a \$100 deductible or less. It is suggested that the legislature consider restricting this practice and prevent such institutions from requiring optional collision insurance lower than \$250 deductible.

C. Guaranteed Affordable Protection

The preceding discussion has focused on benefits under the proposed no-fault plan. Of equal importance are several reforms which will guarantee the availability of insurance coverage at reasonable rates by changing basic methods of underwriting. To complement these reforms, a reinsurance provision has been authorized for spreading certain risks among all commercial insurance carriers writing motor vehicle insurance in Hawaii.

1. **Underwriting changes.** The proposed bill proscribes certain methods of developing insurance premium rates and of assessing driving risks.

a. **Rate making criteria.** The proposed bill is designed to correct pervasive inequities in current methods of underwriting and rate making. Any inequity is undesirable, but it is especially important that such inequities be eliminated when determining rates for the basic compulsory coverages. To accomplish this, the proposed bill specifies that rates may no longer be based on personal characteristics such as age, sex, or marital status.

Specific rules which insurance carriers will use in developing new rating systems are not specified as such. It is hoped, however, that rates will become more equitable by focusing any major rate differential on safety-related factors over which drivers have some control. One anticipated result is increased rates for relatively unsafe vehicles, with reduced rates for vehicles of safer design. Rates may also reflect, in some sensible fashion, a driver's traffic violation record as reflected in the points assigned against his driver's license, and thereby provide some incentive for appropriate road behavior. Still other possibilities were suggested in chapter 5.

Rates may be based upon involvement in past accidents provided that insurers can establish that such involvement has a probable effect upon future losses. It is hoped, however, that insurers will completely abandon the capricious \$100 accident standard embodied in the safe-driver plan.¹¹ This

¹¹See chapter 9, *supra*.

standard, which severely penalizes a driver for using his \$100 deductible collision coverage, is a serious abuse which needs to be eliminated as soon as possible. Instead of using accident involvement, it would be preferable for insurers to rely on traffic convictions obtained under the criminal justice system. If the traffic enforcement system is felt to be inadequate, insurers should work within the system and use their influence to attempt to improve it rather than construct other standards. If accident involvement is to be used under a no-fault plan, it is hoped that insurers will first develop a more refined method of distinguishing the various types of accidents which occur; that is, a method which is somewhat more sophisticated than a simple \$100 threshold.

Investment income will henceforth be considered in rate applications. Further, rates will be based on Hawaii loss experience, not on the basis of experience outside of the State. Moreover, rates will be based on a firm's individual overhead expense experience, not on pooled experience. It is intended that these changes will enable the more efficient carriers to charge lower rates. This in turn will channel competition in directions and areas which are beneficial to consumers. The competitive enterprise system does not function in the consumers' best interests under the widespread pooling of experience and rate-fixing which now exist. The direct importance of increased pressure on less efficient companies will be to reduce operating costs and translate resulting savings into lower premiums.

To assure full compliance and understanding of what the new system will accomplish, all proposed rating systems and any subsequent change in a rating system will be subject to public hearings.

Under existing statutes, the office of consumer protection has the function of appearing before governmental commissions, departments and agencies to represent and be heard on behalf of consumers' interests. The intent of the insurance reform plan is that the office of consumer protection shall play an active role in representing consumer interests at all rating system hearings and, together with the insurance commissioner, protect and promote the interests of the consumer public in all matters dealing with motor vehicle insurance.

b. **High-risk and "assigned risk" drivers.** Under the proposed bill, every carrier must sell the required insurance to any motorist. Drivers classified by the industry as "high-risk" will no longer face the inconvenience and embarrassment of having to be denied coverage by several carriers in order to "qualify" for assigned risk insurance.¹² Nor will the insurance industry any longer be allowed to impose inequitable rates on a driver without cause or evidence that such driver is truly a high-risk.

To ease the burden on individual insurers who feel that they are forced to sell to a disproportionately large number of high-risk drivers, an assigned risk reinsurance pool will be introduced and established by the insurance industry. The operation of this reinsurance pool is described in the next section. To an individual vehicle owner who would otherwise be discriminated against, the net effect of the existence of this pool is that henceforth he will experience little or no change in his basic rates if his insurance company merely "feels" or has a "hunch" that he should be an assigned risk.

2. **High-risk reinsurance pool.** The no-fault bill provides for the establishment of a high-risk reinsurance pool for a broader and more equitable distribution of risks. This assigned risk reinsurance plan is intended to be patterned after the Canadian Facility concept. Under this plan, a carrier may classify a driver as high-risk and assign him to the pool if he so desires. However, the driver's insurance policy remains in effect through his carrier and, in all likelihood, drivers reinsured as high-risks will not even be aware of the fact.¹³

Under the present system, an insurer who is uncertain about a particular individual simply turns down the applicant. The undesirable results, of course, are (a) a substantial number of uninsured

¹² Many insurance companies now employ, *sub rosa*, an occupational classification in determining the acceptability of a particular risk. Henceforth, all risks must be accepted regardless of occupation. If occupation is an important factor, it must be made part of the published rate structure. As such, any proposed occupational classification will be subject to public hearings and approval by the insurance commissioner.

¹³ A high-risk driver would be defined as one whose premium is felt to be disproportionately low compared to the exposure or risk of loss.

motorists and (b) substantial uncompensated losses for those involved in collisions with uninsured motorists. The new system recognizes that, collectively, society cannot afford to have motorists denied basic personal injury protection. Further, it does not allow poor or uncertain underwriting skills to shift losses to society at large. Instead, insurance costs will be stabilized under this proposal through administrative transfer of the assigned risk drivers to the reinsurance pool while keeping the policy in force with his present carrier. Costs of reinsurance will be borne through an assessment of subscribing members based on the proportion of total automobile insurance written in Hawaii. Subscribing members will sign agreements with the reinsurance pool for participation in the plan. The chief limitation on the extent of reinsurance is that companies cannot transfer to the pool more than one-third of their gross dollar volume of direct written automobile insurance in any calendar year without board approval.

D. Other No-Fault Reform Provisions

The proposed reform bill imposes strict liability on commercial vehicles for personal injury, enables the establishment of a second reinsurance pool to share high losses, and requires the insurance commissioner to submit an evaluation of the industry's performance each year.

1. **Strict liability for commercial vehicles.** Under complete no-fault, trucks and other large commercial vehicles will be exempt from tort action for any property damage which they may do to automobiles.¹⁴ In return for this exemption, however, the proposed bill makes owners of commercial vehicles strictly liable for required benefits as a result of collisions with automobiles. This provision recognizes the significant potential for losses generated by large commercial vehicles because of their size and weight.

2. **High-loss reinsurance pool.** A second reinsurance pool which may be established under the proposed legislation is intended to allow carriers to share the risk of high losses from serious

¹⁴ A commercial vehicle is defined as any motor vehicle with a gross weight of 8,000 pounds or more.

injury cases whose effects extend over a long term and can run into high figures. The ability to reinsure against large individual losses will be of particular assistance to smaller carriers, whose reserve requirements could be disproportionately affected by a single accident.

The net effect of such a plan on motor vehicle insurance carriers will be to shorten their risk horizon by simply allowing them to reinsure in advance against abnormally high losses: e.g., those arising from long-term disability cases. Such a reinsurance plan may be unavoidable for any insurer writing mandatory coverages proposed in this legislation. If the insurance commissioner determines that adequate reinsurance is not available in the private marketplace, he may require insurers to establish a reinsurance plan.

3. Performance evaluation. A major change will be the periodic reporting of compensation performance by motor vehicle insurance carriers to the insurance commissioner. The commissioner in turn will submit an annual evaluation report to the legislature and the public portraying the relative standing of carriers in meeting statutory waiting period requirements for loss compensation. The direct reimbursement approach under no-fault facilitates such reporting. Other jurisdictions in this country require workmen's compensation carriers to submit similar reports concerning promptness of payment and the extent and nature of so-called contested awards. The state of Wisconsin publishes an annual ranking showing individual carriers deficient in these dimensions. A similar approach is intended under the proposed no-fault measure to assist in giving visibility to performance in the competition for the delivery of the benefit dollar.

The proposed performance evaluation system will require the insurance commissioner to design both performance measures and reporting and recording standards for Hawaii motor vehicle insurance carriers. Sample performance indicators are displayed in appendix B.

E. Reforms Compared to Objectives

The method and extent to which the reform proposal achieves the eight insurance subobjectives is summarized in table 17-2. As this table shows, various features of the recommended plan have been designed specifically to address each of the eight subobjectives.

Table 17-2
Achievements of Proposed No-Fault Insurance Plan
in Terms of Objectives

| Insurance Subobjective | No-Fault Reform Plan Proposal |
|---|--|
| 1. Compensate personal injury losses adequately | Pays all medical expenses, income losses up to \$600 per month, plus disfigurement losses |
| 2. Pay promptly | Payment within 30 days after claim is filed; insurance carriers pay interest at 1 1/2 percent per month for late payments |
| 3. Guarantee payments | Everyone except an uninsured motorist assured of coverage; assigned claims plan takes care of anyone not otherwise protected |
| 4. Make protection universally available at reasonable cost | Every insurance carrier required to sell to any motorist; a reinsurance pool established for those deemed to be high risks |
| 5. Assess cost equitably | Discrimination in rate making by age, sex, marital status, length of driving experience prohibited |
| 6. Operate simply | Simplified coverages; minimal number of law suits and disputes; auto carriers handle all claims problems for victims |
| 7. Complement related activities | Focus in rate-making should be on controllable variables |
| 8. Account for performance | Public hearings on rating system; insurance commissioner required to submit annual evaluation to the legislature |

The proposed plan attempts to make the industry more efficient by increasing competition and channeling competition into the most beneficial direction for consumers. With existing artificial barriers removed, the competitive enterprise system is relied upon for innovation to reduce costs. Mass merchandising, discussed in the next section, is also recommended as a significant cost-cutting device.

F. Mass Merchandising

In order to reduce insurance costs quickly without reducing benefits, the early introduction of group selling of automobile insurance is strongly urged. Because mass marketing is a specific and separable reform proposal not unique to the basic no-fault plan, it is presented as a separate legislative proposal in appendix A-2.

The basic purpose of the bill is to enable any insurance carrier to offer (and any bona fide group to obtain) motor vehicle insurance under a group policy. It is intended to enable the selling of group insurance with as few restrictions as possible. This will have the desirable effect of reducing consumers' insurance cost and enhancing competition in ways which will definitely be beneficial to consumers. Coercion of members of any group to join a group plan is repugnant to the spirit of this bill and is prohibited.

To protect motorists who change jobs, this bill provides that upon termination of employment, any insured has the right to maintain his policy for one year provided that premiums are paid and that he exercises the option within 30 days of his termination. Lastly, in the event an employer or group does not remit premiums, the policies of the members will remain in force until 20 days after (1) written notification of lapse of payment has been submitted by the carrier to each member or employee, or (2) the due date of the premium, whichever is later.

G. Hawaii Motor Vehicle Insurance Fund

From the analysis contained in part IV, the adoption of a state fund for automobile insurance coverage was deemed feasible. However, based on the problems and priorities expressed in chapter 16, a Hawaii motor vehicle insurance fund was not recommended for immediate adoption pending an evaluation of the performance of the basic no-fault plan under a privately operated system.

Because a state fund is clearly a viable and feasible alternative to the current system and because of the legislature's expressed desire to consider this alternative, a plan for such a fund in the form of proposed legislation is included among the prospective reform recommendations (see appendix A-3). The remaining portions of this section will address the more salient features of the proposed Hawaii motor vehicle insurance fund:

- . Purpose of the fund
- . Board of trustees
- . General manager
- . Fiscal and funding limitation
- . Implementation steps.

1. Purposes of the fund. It is assumed that a no-fault reform bill will be adopted prior to the establishment of such a fund. Based on this assumption, the purposes of the Hawaii motor vehicle insurance fund (HMVIF) are to manage and operate a public motor vehicle insurance fund for (a) selling bodily injury and property damage coverages and (b) providing effective means of compensation for all traffic accident victims. In addition, the fund is permitted to sell all optional coverages, without restriction.

2. Board of directors. a. Term and conditions of office. It is suggested that the governor appoint, with the advice and consent of the Senate, a five member board of directors for the HMVIF. At least one board member must be selected from each county. The board elects its own chairman who serves for a one-year term.

No one may serve on the board if he has a potential conflict of interest or does business directly or indirectly with the fund (except as an insured), including but not limited to persons engaged in the business of providing legal, medical, motor vehicle repair or insurance services, or motor vehicle sales. The governor may remove directors for good cause and the governor shall remove directors who are absent for two consecutive meetings. Directors shall serve until a successor is appointed; however, directors may not serve for more than two consecutive five-year terms. Terms of the directors are staggered. Frequency of meetings, quorum requirements, voting procedures and compensation for the directors are indicated in appendix A-3.

b. Powers of the board. The board of directors is responsible for and directly accountable to the governor and the legislature for operation of the fund. The board's functions pertain chiefly to policy, planning and control. Basic powers of the board include, but are not restricted to the following:

- . Determining coverages and premium rates
- . Establishing programs for the sale of motor vehicle insurance covering personal injury and property damage losses
- . Providing compensation for all personal injury and property damage losses arising out of traffic accidents

- . Overseeing the proper investment of reserve funds
- . Establishing short term financial lines of credit and borrowing working capital
- . Hiring fund management personnel and contracting for outside professional services.

The total responsibility of the board for operating the HMVIF demands the appointment of highly qualified individuals who are interested in and dedicated to the task.

c. **Duties of the board.** The duties of the board are commensurate with its far-ranging powers. Among its principal duties are:

- . Hiring an administrator to function as general manager of the fund
- . Reviewing and approving all budgets
- . Determining rates to be filed for basic motor vehicle insurance coverages.

A major limitation on the board is that it shall not have the authority to issue long term bonds or other forms of indebtedness, without the authorization of the legislature and approval of the director of finance. As indicated later, the fund is to be placed on a self-financing basis.

3. **General manager.** The general manager is hired by the board of directors. He is responsible for overseeing the entire operation of the fund. It is suggested that the general manager:

- . Work with the board of trustees to establish operating policies
- . Actively participate in all planning
- . Develop those central staff functions which the fund needs
- . Develop overall financial controls which will insure the solvency, liquidity and sound financial operation of the fund

- . Engage in such other activities as the board of trustees may desire.

4. **Funding status.** Financing of the fund's operations will come primarily from the premiums and fees charged for the purchase of basic motor vehicle insurance coverage by registered owners. Whenever the annual budget of the fund calls for appropriations from the general fund of the State, the fund will be classified as a special fund and will be subject to review by the director of finance. When no appropriations are required, the fund shall be classified as a revolving fund, subject to the review, but not control, of the department of budget and finance.

The intent of this provision is to provide every incentive for the board and fund management to achieve revolving fund status as quickly and as expeditiously as possible.

5. **Implementation changes.** The fund may either be competitive with private insurance companies, or it may be an exclusive state fund. Presuming a changeover to an exclusive state fund and given adoption of the basic no-fault plan explained previously, the following implementation steps would ensue.

First, the State would acquire control over the operating features of the assigned claims plan, assigned risk reinsurance pool and the long term disability reinsurance pool. Indemnities will be made by the State to the carriers for losses sustained in the transfer of these programs operated by them as a group on the basis of actual cost or market value, whichever is lower. No claims for loss of business by individual carriers resulting from the changeover will be honored.

Second, given the desirability of unifying payment of fees with vehicle registration, the fund would be authorized to enter into agreements with the counties to act as financial intermediaries for the collection of basic insurance fees at the time of vehicle registration.

CHAPTER 18

IMPLEMENTATION PLAN

This chapter provides a program and implementation plan designed to assure successful initiation of the no-fault insurance system proposed in chapter 17. The program identifies the activities and resource requirements which the government will need to introduce and regulate the new insurance system. State government activities fall into four major areas:

- . Implementation of the new insurance program
- . Administration of compulsory provisions
- . Public information concerning the new system
- . Better regulation of the insurance industry.

The implementation plan itemizes and schedules the specific tasks which will be necessary for government agencies immediately following enactment of the proposal. These primarily involve the county governments and the insurance commissioner and will temporarily place a heavy workload on their respective staffs. The primary implementation tasks facing the insurance commissioner involve:

- . Promulgation of underwriting and compensation guidelines for the new act
- . Public review of key system features
- . Conduct of active public information programs to introduce the change
- . Upgrading insurance regulatory capabilities.

A. Government Costs

Adoption of the proposed reforms will necessitate State expenditures for introduction of the new no-fault program. In addition, public investment is recommended in two other areas: (1) public information services to apprise Hawaii citizens of their rights, responsibilities and benefits under the reform plan, and (2) upgrading of existing insurance regulatory functions.

1. Implement new insurance program. As indicated in the introduction to this chapter, passage of a complete no-fault reform act will require the insurance commissioner to perform a great number of one-time, nonrecurring activities in addition to his usual workload. The currently understaffed office would be hard-pressed to perform these extra tasks. At the same time, their nonrecurring nature does not require any permanent increase in staffing. It is therefore recommended that, upon approval of the no-fault plan, the insurance commissioner receive \$45,000 for extra assistance during the implementation phase.¹

2. Administer compulsory insurance program. The requirement for compulsory motor vehicle insurance will create an additional burden for county governments which handle licensing and vehicle registration functions. Table 18-1 summarizes the estimated incremental costs

¹This \$45,000 could be financed through a permanent revolving fund scheme discussed in the next section.

associated with implementing and operating a compulsory insurance system. Internal systems will first have to be modified in order to establish the appropriate files and data which will allow control of the compulsory program. Existing motor vehicle registration procedures will also need to be modified to pick up the appropriate data. To initiate the system and work out any flaws will require an anticipated estimated development cost of \$232,000.

Table 18 - 1
Cost of Administering Compulsory Insurance System

| Year | Projected Motor ¹ Vehicle Registrations | Development ² | Annual ³ Operating Costs |
|------|--|--------------------------|-------------------------------------|
| 1973 | 456,000 | \$114,000 | \$228,000 |
| 1974 | 473,000 | 118,000 | 236,000 |
| 1975 | 490,000 | | 245,000 |
| 1976 | 503,000 | | 252,000 |
| 1977 | 517,000 | | 258,000 |
| 1978 | 530,000 | | 265,000 |

¹ State of Hawaii, Department of Transportation.

² Motor vehicle registrations x \$.25 (based on experience of New York State Department of Motor Vehicles, Division of Research and Statistics).

³ Motor vehicle registrations x \$.50 (same source).

Annual operating expenditures will be the second source of costs. Experience with compulsory programs in other jurisdictions has shown operating cost to be approximately 50 cents per motor vehicle. Based on projections of motor vehicle registrations for the period 1973 to 1978, the operating costs will range from \$228,000 to \$265,000. Major expenditures will be for additional personnel to handle the increased number of transactions: verifying proof of insurance at registration time, establishing records for new registrations during the year, and issuing registration revocations upon notification by insurance companies of cancellation for nonpayment of premiums.

One way to finance these expenditures would be through the motor vehicle weight tax. Alternatively, the legislature may wish to consider financing these expenditures by establishing a new revolving fund. Under such a scheme, the counties would periodically bill the revolving fund for their

costs of operating the regulatory program. The fund would be replenished by assessing insurance carriers in accordance with their relative share of the motor vehicle insurance market. Such a scheme is now used by a number of states (notably New York) to underwrite the financial burden of their compulsory insurance administration and regulatory activities.

3. Provide public information. Introduction of a new and different motor vehicle insurance system will require communication of the changes to the public. Any fundamental change in the manner in which automobile insurance is obtained or accident losses compensated will be of direct interest to virtually every motorist. Therefore, a short but intensive public information campaign to explain the reform plan to all Hawaii motorists is recommended.

Motor vehicle insurance reform will be a lively topic for discussion in both the press and on radio and television. It is recommended that the responsibility for disseminating information concerning a new motor vehicle insurance system be coordinated through the office of consumer protection. Since this is a vital topic to consumer interest groups, and since the insurance commissioner will be occupied with many other aspects of instituting the new reform, the office of consumer protection is the logical focal point for preparation and release of basic information.

An initial effort, in the form of formal television and radio forums with state and private officials, may be coordinated with a direct mail campaign prior to the effective date of the legislation. This can be accomplished expeditiously by inserting a brief informative brochure into the vehicle owner's registration form at the time of its annual mailing. Such a campaign was successfully carried out by the Province of British Columbia in 1969, when it adopted its reform of motor vehicle insurance. The approximate costs of a public information campaign is estimated to be \$30,000. This program is strictly a nonrecurring cost item but nevertheless an important one if Hawaii's people are to be apprised of their rights under the new system.²

²This could be financed by a general revenue appropriation or, if the legislature establishes the revolving fund suggested above, this item could appropriately be charged to the fund.

4. **Upgrade insurance regulation.** The ability of the department of regulatory agencies to effectively monitor and regulate the insurance industry is hampered by lack of personnel and insufficient information. The proposals outlined here are designed to eliminate these deficiencies.

a. Establish a performance tracking system.

The reform measure requires the insurance commissioner to report to the legislature on the effectiveness and efficiency with which each motor vehicle insurance firm in Hawaii assesses damages and delivers benefits. A specific effort will have to be undertaken by the insurance division if it is to capture data and generate the basic information required for regulating the industry. While this recommendation generally applies to all lines of insurance, the focus here is solely on the regulation of motor vehicle insurance. Figure 18-1 illustrates the general structure of an insurance information and performance tracking system. The system should be designed to produce four basic types of information:

- (1) *Analysis of rate change requests.* Based on data from previous years, the system should be able to project loss and premium experience, thereby providing a basis for independent analysis of rate requests.
- (2) *Compensation performance reports.* The new evaluation reports to the legislature should aim at pinpointing problems in effecting compensation and the reasons for them. The reports will generally indicate the amount of compensation provided, timeliness of compensation, and number of claims disputed or contested. The system requires development of standards for measurement, reporting and recording. Appendix B depicts an array of suggested performance indicators for use in conjunction with the bill's basic evaluation provisions.
- (3) *Insurance industry financial performance analysis.* To analyze rate change requests and regulate the insurance industry in general, performance reports of the financial operations of the insurance companies should be readily available. These reports will track both underwriting experience and investment operations of the insurance companies.

- (4) *Special problems.* The system should provide information on special problem areas. Special studies should be conducted on high-risk drivers and on how the insurance system can more effectively improve traffic safety information systems.

In view of the many other activities and problems which the insurance commissioner will have with the initiation of a new system, the implementation of this component is probably best delayed until fiscal 1974. At that time it is estimated to require an initial, nonrecurring cost of \$125,000, of which \$120,000 would be for a three man-year system development and implementation effort, and the remaining \$5,000 would be for recruiting personnel to operate the system thereafter.

In terms of operating expenses, it is projected that a three-man staff would require \$60,000 annually, including overhead. In addition, some type of information processing capability must be provided (from SWIS or a similar source), estimated at \$12,000. Initial effort should focus on developing a capability to use information derived from existing sources.

b. Expand rate and policy analysis section.

Rate and policy analysis is currently done by only four persons. In fiscal year 1970, they processed 3,286 rate filings. In order to process rate requests more effectively and to conduct more independent analysis, the addition of three professionals to the present staff is recommended. The additional personnel should include persons with expertise in actuarial analysis, statistical analysis, insurance, or economics. The cost estimates include appropriate support personnel. Staff expansion is programmed to take place incrementally so as not to create operational problems through too rapid expansion.

The investment cost for this proposal is \$3,000, primarily for recruiting new personnel. Annual operating costs will eventually reach the rate of \$60,000.

Table 18-2 shows the development, investment, and six-year operating costs for these two components. No expenditures are required until fiscal year 1974. At that time estimated expenditures are an initial nonrecurring cost of \$127,000 and first year operating cost of \$40,000. Operating cost will reach a high of \$132,000 in

Figure 18-1
INSURANCE INFORMATION AND PERFORMANCE TRACKING SYSTEM

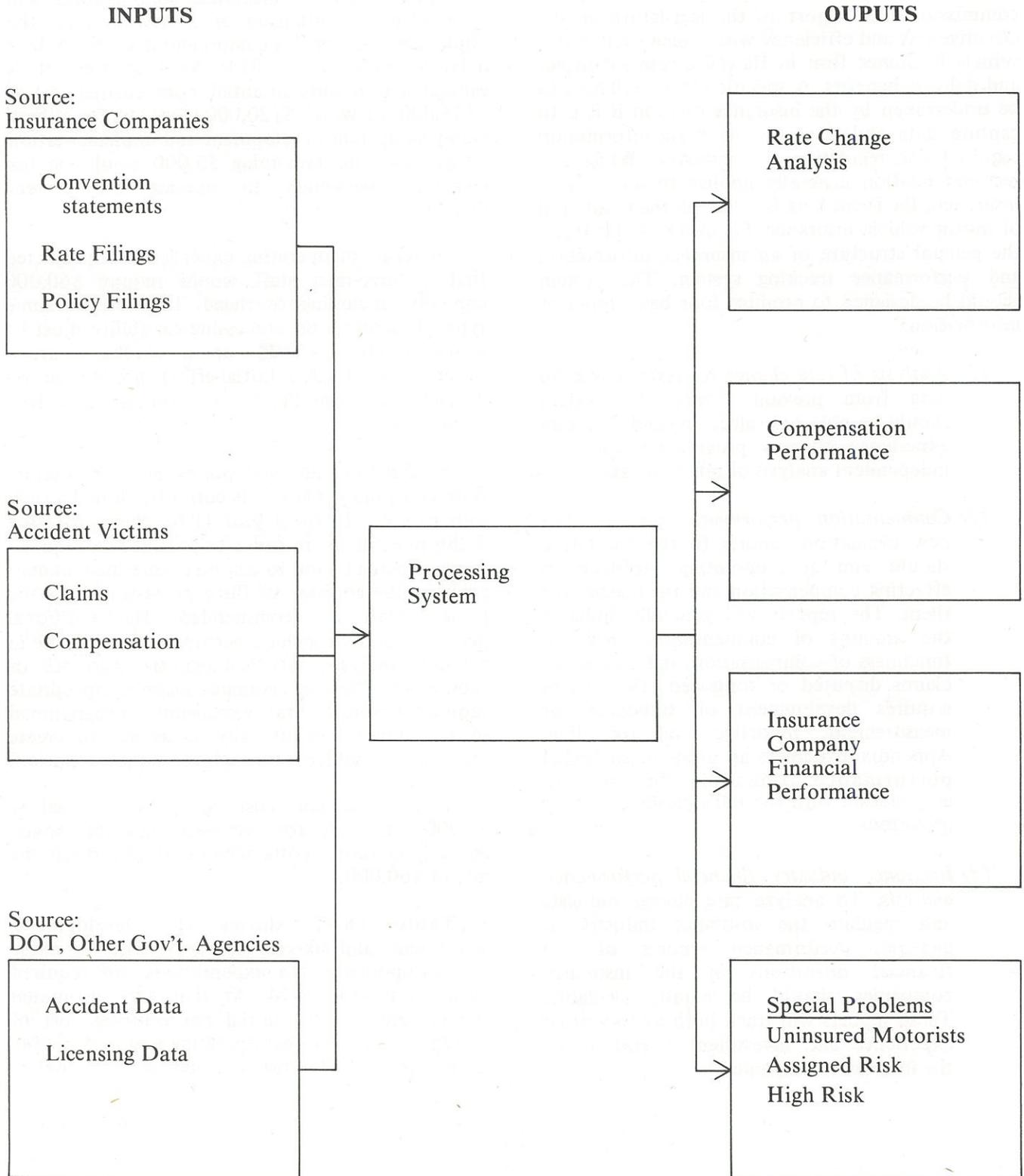


Table 18-2
Cost to Upgrade Insurance Regulation Administration
(\$ in thousands)

| Program Element | Fiscal Year | | | | | |
|---|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| | 1974 | 1975 | 1976 | 1977 | 1978 | 1979 |
| 1. Design and establish an insurance investment system: | | | | | | |
| Development | \$125 | | | | | |
| Operating: | | | | | | |
| Equipment | | \$ 12 | \$ 12 | \$ 12 | \$ 12 | \$ 12 |
| Personnel | | (2) \$ 40 | (2) \$ 40 | (3) \$ 60 | (3) \$ 60 | (3) \$ 60 |
| 2. Expand rate and policy analysis section: | | | | | | |
| Investment | \$ 2 | \$ 1 | | | | |
| Operating: | | | | | | |
| Personnel | (2) \$ 40 | (3) \$ 60 |
| Total | (2) \$167 | (5) \$113 | (5) \$112 | (6) \$132 | (6) \$132 | (6) \$132 |

FY 1977 when it is anticipated that the upgraded insurance regulation and administration program will be fully operative.

5. Summary and conclusions. The cost to the government of adopting the reform proposals arises from the establishment and operation of a compulsory no-fault insurance system, an initial public affairs program to explain the benefits and workings of the preferred reform measure, and upgrading the State's capabilities to regulate and administer insurance programs more effectively.

In view of the fact that the people in Hawaii are currently paying motor vehicle insurance premiums of over \$60 million a year, plus another \$2.3 million in gross premium taxes, the proposed expenditures are not an excessive sum for a vastly improved motor vehicle insurance system and more effective regulation of the industry.

B. Proposed Implementation Plan

Full implementation of the no-fault bill is recommended no later than seven months following enactment of the proposed measure. Four major tasks will be required involving 15 specific subtasks. They are:

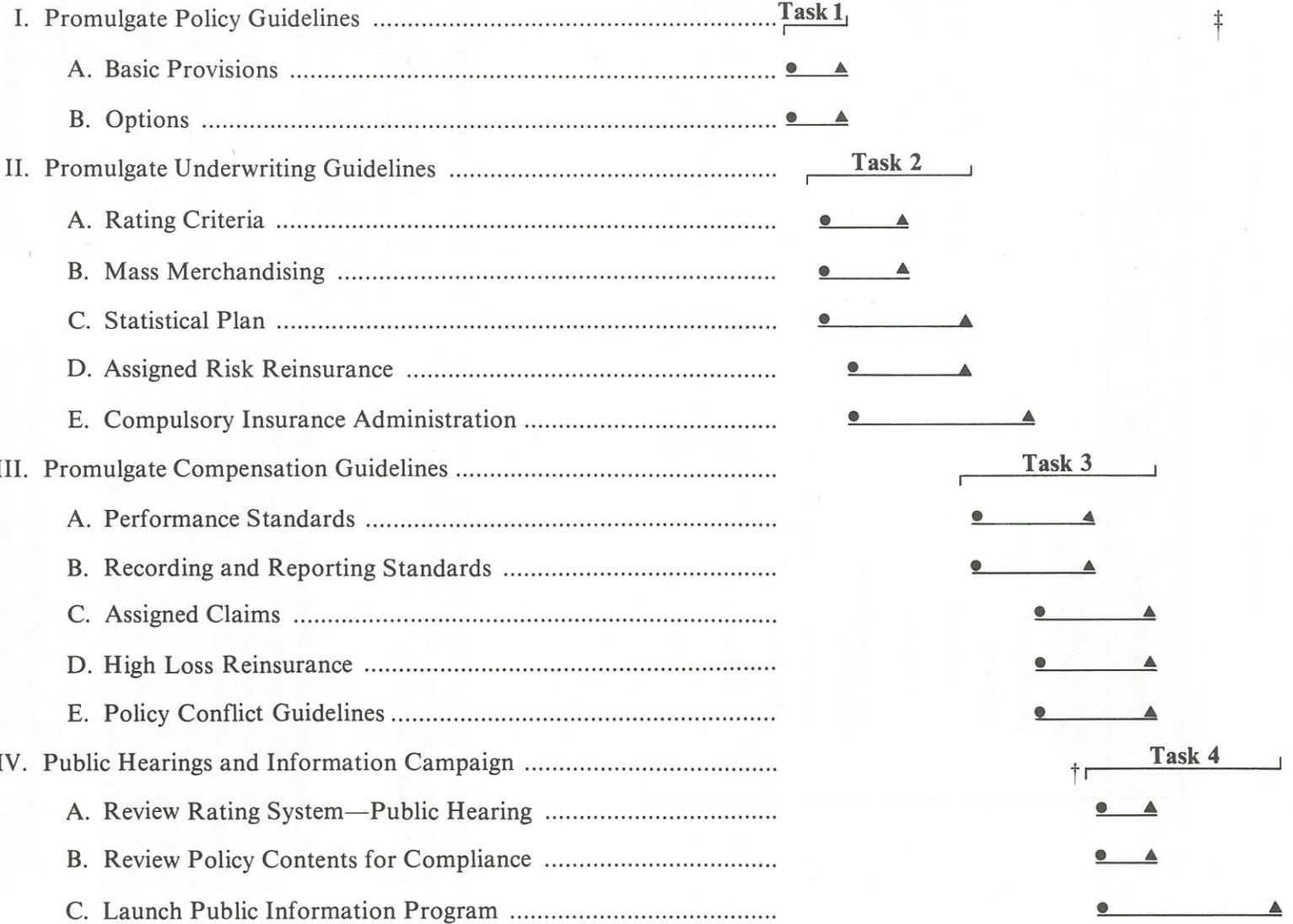
- (1) Promulgate policy guidelines
- (2) Promulgate guidelines for underwriting
- (3) Promulgate guidelines for compensation
- (4) Hold public hearings and initiate information campaign.

The purpose and scope of each of these will be discussed in order. Figure 18-2 contains a seven month implementation schedule showing estimated initiation and completion dates for each task and subtask. Major milestones in the initial post-enactment period are:

**Figure 18-2
IMPLEMENTATION SCHEDULE FOR INSTITUTION OF MOTOR VEHICLE INSURANCE REFORM**

MONTHS AFTER ENACTMENT
Begin 0 1 2 3 4 5 6 7 8 9

LEGEND
 ● Beginning of Task
 ▲ End of Task
 -- Continuation
 † Public Hearing
 ‡ Effective Date of Act



- . Completion of public hearings on new rating system (sixth month)
- . Completion of policy contents review (sixth month)
- . Effective date of the bill (seventh month)

1. Promulgate policy guidelines. This first task involves development of basic guidelines for insurance carriers to follow in the composition of new policy content and development of optional coverages enabled by the bill.

a. Basic plan provisions. This first subtask requires interpretation by the insurance commissioner of mandatory coverage provisions established by the bill and the release of formal standards of compliance to insurance carriers. This is required to facilitate a subsequent informal review of carrier policy content by the commissioner's office six months following enactment. In figure 18-2, this subtask is to be completed within one month of enactment.

b. Options. This second subtask involves establishing criteria for the development of optional coverages enabled by the bill. Except for optional coverages which the insurance commissioner may mandate to be sold, this action is primarily meant to provide carriers with sufficient information to formulate additional coverages which they may wish to offer. No subsequent compliance action is intended, other than for the mandatory items. As shown in figure 18-2, this information will be released simultaneously with the policy guidelines within one month of the bill's passage.

2. Promulgate underwriting guidelines. This task develops compliance ground rules for the major reform of basic motor vehicle insurance underwriting mandated by the proposed legislation.

a. Rating criteria. As indicated in the previous chapter, certain classifications now used for rating drivers have been proscribed. To assure full compliance with this provision, the insurance commissioner will have to formally notify all insurance companies of these provisions and instruct them to develop appropriate rating mechanisms. At the beginning of the sixth month following enactment, the proposed rating systems

for different classes of risks will be aired at a series of public hearings. To facilitate compliance with this regulatory provision, formal notice of the new regulations concerning composition of rating systems should be released by the insurance commissioner at the end of the second month following enactment.

b. Mass merchandising. Eligibility rules for group policies under basic required insurance optional coverages will be reviewed by the insurance commissioner and his staff. This review will assure compliance with the prohibitions against discriminatory practices in the sale of group plans. During the second month following enactment, the insurance commissioner will formally notify all companies to be prepared to submit group policies for review and approval during the sixth month following enactment, if they propose to offer such policies.

c. Statistical plan. The proposed reform measure restricts the pooling of Hawaii loss experience with aggregate national data sources. Therefore, loss exposure will have to be specifically developed for Hawaii. To achieve this, the commissioner, in conjunction with the department of transportation, will develop and issue guidelines to motor vehicle insurance carriers for the acquisition and utilization of publicly available sources of traffic accident experience for the State of Hawaii. Motor vehicle insurance carriers will be required to base both individual and group rates on these data. A total of three months is programmed for execution of this subtask. Formal guidelines for operation and compliance with the proposed Hawaii statistical plan on motor vehicle loss experience will be issued at the end of the third month following enactment.

d. Assigned risk reinsurance. A significant reform contained in the legislation is authorization of a reinsurance "facility" for assigned risks. This facility will be operated by the insurance carriers as a group. The insurance commissioner will promulgate informational guidelines as to the form and nature of inter-insurer agreements to be completed by members of the proposed pool. Methods of allocation and the limitations on assignment of policies to the facility will be detailed in the proposed guidelines. These will be issued by the insurance commissioner at the conclusion of the third month following passage of the bill.

e. **Compulsory insurance administration.** The institution of compulsory insurance in Hawaii represents a major change. An administrative program will be operated by the county governments in conjunction with motor vehicle registration. The suggested system provides simply for annual submission of a form indicating whether the insured had coverage during the preceding period and will have it in force during the ensuing policy year. Insurance carriers will supply this information to their policyholders who will submit it with their automobile registration. An appropriate form must be prescribed by the insurance commissioner. It is visualized that this activity will entail a period of three months, ending with the development of an approved form and associated processing procedures for review by all participating parties.

3. **Promulgate compensation guidelines.** A companion task to development of underwriting guidelines is the matter of developing standards for ensuring adequate compensation for all traffic accident victims. Some of the information developed here will be used in the continuing assessment of the reform plan's effectiveness when it goes into full operation.

a. **Standards of performance.** A critical aspect of the overall reform is assuring that benefits are delivered on a timely basis. Therefore the insurance commissioner, as indicated in section A, will be responsible for the design and development of a management information system. A key input to this system will be the reporting of basic information on system performance. Some standards have been discussed in chapter 17, and an array of proposed measures is displayed in appendix B. The insurance commissioner must establish both the basic set of indicators to be reported periodically by carriers and the form on which they will be transmitted. These standards and reporting procedures should be promulgated at the end of the fifth month following enactment.

b. **Recording and reporting standards.** Compensation performance data will require reporting standards. The insurance commissioner will develop and submit these for review and comment to the insurance industry. These standards will be issued simultaneously with performance reporting guidelines at the close of the fifth month.

c. **Assigned claims.** The proposed reform measure mandates establishment of an assigned claims fund to be operated by private carriers. The insurance commissioner will coordinate design of the proposed system with the private insurance carriers to assure that efficient claims settlement procedures and equitable cost apportionment formulas are developed. This subtask will be completed in the sixth month.

d. **High loss reinsurance.** Very serious accidents involve potentially high losses for an individual insurer. Smaller companies may wish or may need to share the burden of such losses through reinsurance. If reinsurance for this type of loss is not available in the private marketplace, the insurance commissioner may mandate the formation of a reinsurance pool. In this event, he will issue guidelines to motor vehicle insurance carriers with suggested apportionment formulas and other operating rules for the reinsurance plan. The subtask which provides for this eventuality will conclude in the sixth month.

4. **Policy dispute guidelines.** Disputes may arise between claimants and insurance companies over issues such as entitlement to benefits, onset of disability, or application of auto insurance coverage. To forestall problems in this area, the insurance commissioner will determine the optimum administrative procedures for resolving such questions. Proposed guidelines for initial use will be promulgated by the end of the sixth month.

5. **Public hearings and information campaign.** Prior to the effective date of the bill, the insurance commissioner will undertake a review aimed at effective compliance with the reform plan. Further, the office of consumer protection will implement a campaign to inform the public about the new law. These actions will entail both formal and informal public hearings as well as information leaflets and radio and television coverage.

a. **Review new rating system.** Beginning in the fifth month following enactment and ending in the sixth, the insurance commissioner will hold a number of public hearings directed at approval of candidate ratings systems proposed by motor vehicle insurance carriers. The purpose of these hearings is to provide an open forum for disclosure of the new methods of underwriting and the potential savings that will be effected through

adoption of no-fault. Both public and industry witnesses will be called to offer testimony on the new rating systems.

b. Review policy contents for compliance.

Paralleling the public hearings on the new rating systems, a series of informal hearings will be held by the insurance commissioner on a scheduled basis with the insurance carriers. The basic purpose is to review proposed policy content to be offered to the public to assure full compliance with the bill's loss compensation provisions.

c. Launch public information program. As described earlier, the office of consumer protection

will develop and distribute brochures to motor vehicle owners apprising them of basic changes brought about by the new motor vehicle insurance system and how it affects them. It will also coordinate information programs through the mass media. Information will be provided on the nature of benefits provided, and how underwriting and claims satisfaction will be handled. Attention will also be directed at explaining how complaints with the system's operation will be channelled to appropriate governmental agencies for response and disposition. The information campaign will begin five months following enactment, and the entire operation will be completed one month following the bill's effective date.

APPENDICES

A BILL FOR AN ACT

RELATING TO MOTOR VEHICLE INSURANCE

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

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PART I

GENERAL PROVISIONS

SECTION 1. Short title. This act shall be known as the "Hawaii Motor Vehicle Insurance Act."

SECTION 2. Purpose. The purposes of this act are to establish a system for prompt and fair compensation to all victims of motor vehicle accidents and to provide for equitable and reasonable rates for motor vehicle insurance.

SECTION 3. Definitions. As used in this act:

- (1) "Bodily injury" means physical harm, sickness, or disease, including death resulting therefrom, arising out of a motor vehicle accident.
- (2) "Claimant" means a victim or any other person entitled to any benefit under motor vehicle insurance.
- (3) "Commercial vehicle" means a motor vehicle having a gross weight of eight thousand pounds or more.
- (4) "Commissioner" means the insurance commissioner.
- (5) "Insured" means a motor vehicle owner designated as such in a policy of motor vehicle insurance issued in compliance with this act.
- (6) "Insured vehicle" means a motor vehicle covered by insurance as provided in this act.
- (7) "Insurer" means a person who undertakes or is required to pay the benefits under motor vehicle insurance.

1 (8) "Member of the insured's household" means an insured's relative of any degree by blood,
2 adoption, or marriage, or any other person designated by the insured in his policy of motor
3 vehicle insurance, who usually makes his home in the same family unit with the insured, includ-
4 ing any such relative or person temporarily living elsewhere by reason of study, work or otherwise.

5 (9) "Motor vehicle" and "vehicle" mean a vehicle, operated or used on land, which is self-propelled
6 but not operated upon rails and includes trailers and semi-trailers attached to the vehicle.

7 (10) "Motor vehicle accident" means an accident arising out of the operation, maintenance, or use
8 of a motor vehicle.

9 (11) "Occupant" means a person in or upon or entering into or alighting from a motor vehicle.

10 (12) "Owner" means a person having property in or title to a vehicle, other than a holder of a
11 security interest therein. It includes a person entitled to the use and possession of a vehicle sub-
12 ject to a security interest in another person, but excludes a lessee under a lease not intended as
13 security, unless under the terms of the lease, the lessee is required to purchase and maintain an
14 insurance on the leased vehicle.

15 (13) "Property" means any real or personal property other than a motor vehicle and its contents.

16 (14) "Required benefits" means the minimum benefits required in section 8 of this act.

17 (15) "Victim" means any person sustaining bodily injury or damage to or loss of property as a result
18 of a motor vehicle accident.

19 (16) "Vehicle insurance" means an insurance against loss or expense, or liability for loss or expense,
20 resulting from injury to persons or loss of or damage to property arising from the ownership,
operation, maintenance, or use of a vehicle.

22 SECTION 4. Tort liability abolished. Tort liability arising from a motor vehicle accident within the
23 State is abolished, and no person shall be subject to any civil action for damages for losses sustained in a
24 motor vehicle accident.

25 SECTION 5. Motor vehicle insurance required. (a) The owner of every motor vehicle operated or

1 used in the State shall maintain at all times insurance on the vehicle which provides for payment by the
2 insurer of at least those required benefits specified in section 8.

3 (b) No motor vehicle shall be registered or its registration renewed under chapter 286, unless at the
4 time of submission of an application for registration or renewal, the owner submits proof that an
5 insurance on the vehicle as required by subsection (a) will be in effect during the period for which
6 registration or renewal is sought. At the time of submission of such application for registration or
7 renewal, the owner shall also submit proof that the required insurance was continuously in effect during
8 the period of his ownership of the vehicle in the State in the preceding registration period. Failure to
9 submit proof that the required insurance was continuously in effect during the preceding registration
10 period shall not be a bar to registration or renewal of the owner's vehicle, but shall constitute prima facie
11 evidence, in any criminal proceeding brought against the owner, of violation by the owner during the
12 preceding registration period of subsection (a). Proof shall be submitted on forms prescribed by the
13 commissioner and may consist of such statements of the insurer, as the commissioner may approve,
14 attesting to the existence of such insurance.

15 SECTION 6. Form of insurance. (a) The insurance required to be maintained by the owner of every
16 motor vehicle may be provided through a policy of insurance issued by an insurer authorized to transact
17 the business of vehicle insurance in the State or through a system of self-insurance.

18 (b) Any policy of insurance represented by the issuer as providing the required benefits shall be
19 read to comply with this act, and any later agreement, contract, covenant, or disclaimer inconsistent
20 therewith shall be void.

21 (c) An owner of twenty-five or more motor vehicles may self-insure his vehicles, provided that the
22 method of self-insurance is approved by the commissioner. No method of self-insurance shall be
23 approved by the commissioner unless the commissioner finds that the owner has the financial ability to
24 pay the required benefits and that the method of self-insurance affords security for the payment of the
25 required benefits equivalent to that afforded by a policy of vehicle insurance. All applications for

1 self-insurance shall be submitted to the commissioner on forms prescribed by the commissioner. Upon
2 approval of any application, the commissioner shall issue a certificate of self-insurance. A certificate of
3 self-insurance may be cancelled by the commissioner on reasonable grounds upon not less than five days'
4 written notice to the self-insurer. Failure to pay any of the required benefits within thirty days after it is
5 due constitutes a reasonable ground for cancellation. Every owner to whom a certificate of self-insurance
6 is issued shall have all the rights and obligations of an insurer enumerated in this act, except where
7 expressly exempt or the rights and obligations are stated to be those of insurers authorized to transact
8 the business of vehicle insurance in the State.

9 SECTION 7. Failure to maintain insurance. Any owner of a motor vehicle required to be insured
10 who fails to maintain the insurance shall be subject to the penalty provided in section 32(b) and, in the
11 event his motor vehicle is involved in an accident, be personally liable for the payment of the required
12 benefits which an insurer would have been required to pay had the vehicle been insured. If benefits are
13 paid by an insurer to whom a claim is assigned pursuant to section 25, the insurer shall be entitled to
14 reimbursement from such an owner.

15 PART II

16 BENEFITS

17 SECTION 8. Required benefits. Every policy of insurance required by this act to be maintained by
18 the owner of a motor vehicle shall provide for payment by the insurer, without regard to fault or
19 negligence, of the following minimum benefits:

20 (1) To each victim sustaining bodily injury, other than death, as a result of an accident involving
21 the insured motor vehicle:

22 (A) All reasonable and customary expenses for necessary medical, hospital, and dental
23 services furnished the victim, including ambulance, surgical, X-ray, professional nursing
24 and therapeutic services and prosthetic devices, and for any other services, products and
25 accommodations necessary for treatment, rehabilitation, and recovery.

- 1 (B) All losses of income, up to \$600 per month, sustained by the victim as a result of the
2 injury disabling or preventing him from fully performing work in which he was employed
3 when the disability commenced.
- 4 (C) All expenses reasonably incurred by the victim or members of his household within one
5 year from the date of the injury for ordinary and necessary household services which the
6 victim himself would have ordinarily performed but for the injury; provided such services
7 are obtained from persons not members of the victim's household.
- 8 (D) All other out-of-pocket expenses reasonably incurred as a result of the injury, not
9 exceeding \$500 in the aggregate.
- 10 (E) A sum for such disfigurement as the victim may sustain in accordance with the schedule
11 set forth in section 10.
- 12 (2) To each victim sustaining damage to or loss of property as a result of an accident involving the
13 insured vehicle, the repair or replacement cost thereof.
- 14 (3) If any victim dies as a result of bodily injury sustained in an accident involving the insured
15 vehicle:
- 16 (A) To the legal representative of the estate of each victim, all expenses, losses, and sums
17 enumerated in paragraph (1) incurred but remaining unpaid by the insurer on the date of
18 the death of the victim and all funeral and burial expenses not exceeding \$2,000.
- 19 (B) To the victim's surviving spouse or, if no surviving spouse, to the victim's surviving
20 children below the age of 18 years:
- 21 (i) All expenses reasonably incurred after the victim's death, but within one year from
22 the date of the victim's injury resulting in his death, for ordinary and necessary
23 household services which the victim himself would have ordinarily performed for the
24 benefit of the surviving spouse and children but for his death; provided that such
25 services are obtained from persons not members of the deceased victim's household.

1 (ii) The monthly income, up to \$600 per month, that the deceased victim was earning
2 from work he was performing at the time of his injury or at the time of his death,
3 whichever amount is greater.

4 The monthly sum shall be payable to the surviving spouse until he or she dies or
5 remarries. If the spouse remarries and the total of all monthly sums paid to the
6 spouse prior to his or her remarriage is less than \$10,000, then upon such
7 remarriage, the insurer shall pay to the spouse in lump sum as death benefit, the
8 difference between \$10,000 and the total of all monthly sums theretofore paid, and
9 the obligation of the insurer under this paragraph shall terminate.
10

11 If the spouse dies, or if at the time of the victim's death there is no surviving spouse,
12 the monthly sum shall be payable in equal shares to those of the victim's children
13 who are from time to time surviving and below the age of 18 years until the last of
14 them dies or attains the age of 18 years; provided that, considering the age of the
15 youngest of the children then surviving and below the age of 18 years, if the total of
16 all monthly sums to be paid to the children will not equal or exceed the sum of
17 \$10,000, less such total amount as the victim's spouse may have received during his
18 or her lifetime, the insurer shall pay in equal shares to such children then surviving
19 and below the age of 18 years, in lump sum as death benefit, the sum of \$10,000,
20 less such total amount as the victim's spouse may have received during his or her
21 lifetime, and the obligation of the insurer under this paragraph shall terminate.

22 (iii) If the benefit provided in paragraph (ii) above is not payable because the victim was
23 not earning income from work at the time of his injury or death, a lump sum death
24 benefit of \$10,000.

25 (C) If there is no surviving spouse and no surviving child below the age of 18 years, to the

1 victim's estate a lump sum death benefit of \$10,000. Any sum due under this paragraph
2 but not payable for want of beneficiaries shall not escheat but shall be applied to
3 payments required to be made under the assigned claims plan described in section 25.

4 SECTION 9. Income and income loss determination. (a) For purposes of section 8(1)(B) and
5 section 8(3)(B)(ii), the work in which the victim was employed when disability commenced or the work
6 he was performing when he sustained his injury or when he died shall be deemed to be:

7 (1) The work he was then actually performing; or

8 (2) If temporarily unemployed at the time, any work which he performed during the two years
9 immediately preceding his disability, injury, or death, provided that the victim performed work
10 from which he earned an income during a total of at least twenty weeks in the twelve month
11 period or a total of at least thirty-six weeks in the twenty-four month period immediately
12 preceding the date of his disability, injury, or death. Work performed during any portion of a
13 week shall constitute a week of work.

14 (b) The amount of income a victim was earning from work shall be determined on a monthly basis
15 and shall be the monthly amount that he was actually earning or, if the earnings consisted in whole or in
16 part of commissions and gratuities or if the victim was self-employed or temporarily unemployed or if
17 the job he was performing was of a temporary nature pending permanent employment, then the greater
18 of:

19 (1) The average monthly income reportable as earned from work for State or federal income tax
20 purposes for the current taxable year; or

21 (2) The average monthly income reported as earned from work for State or federal income tax
22 purposes for the last completed taxable year; or

23 (3) The average monthly income reported as earned from work for State or federal income tax
24 purposes for the last two completed taxable years.

25 To determine the average monthly income, the total income reportable or reported as earned from work

1 for the taxable year shall be divided by the total number of months in which income was actually earned
2 from five or more days of work. Work performed during any portion of a day shall constitute a day of
3 work.

4 (c) Except as otherwise provided in subsection (d), income loss shall be determined by deducting
5 from the monthly income the victim was earning eighty percent of all monthly income which the victim
6 earns from any work he performs after sustaining injury; provided that, the amount paid as income loss
7 shall not, when added to the full amount the victim earns from any work he performs after sustaining
8 injury, exceed the amount the victim was earning at the time of the injury as defined in sections 9(a) and
9 9(b).

10 (d) In case of a victim who suffers any of the following conditions, income loss shall be deemed to
11 be the greater of the monthly income the victim was earning, without deduction of any amount he earns
12 from any work he performs after sustaining injury, or the sum of \$360 per month:

13 (1) Loss of sight in both eyes; or

14 (2) Loss of both feet at or above the ankle; or

15 (3) Loss of both hands at or above the wrist; or

16 (4) Loss of one hand and one foot; or

17 (5) Permanent and complete paralysis of both legs or both arms or one leg and one arm as a result
18 of injury to the spine; or

19 (6) Incurable imbecility or insanity as a result of an injury to the skull; or

20 (7) Any other condition or combination of conditions similar to or of equal severity as those
21 enumerated above, which permanently and completely disables the victim from performing
22 any work.

23 (e) "Monthly salary" and "monthly income" shall be the gross monthly salary or gross monthly
24 income, less fifteen percent for State and federal income taxes.

1 SECTION 10. Disfigurement schedule. (a) Payment by the insurer for disfigurement provided in
 2 section 8 shall be made in accordance with the following schedule:

| | | |
|----|--|-------------------------|
| 3 | (1) Loss of a thumb | \$ 2,100 |
| 4 | (2) Loss of first finger, commonly called index finger | 1,290 |
| 5 | (3) Loss of second finger | 840 |
| 6 | (4) Loss of third finger | 700 |
| 7 | (5) Loss of fourth finger | 420 |
| 8 | (6) Loss of phalanx of thumb or finger: | |
| 9 | First phalanx of thumb | 1,575 |
| 10 | First phalanx of finger: | |
| 11 | First finger | 645 |
| 12 | Second finger | 420 |
| 13 | Third finger | 350 |
| 14 | Fourth finger | 210 |
| 15 | More than one phalanx of the thumb or any finger | Full amount payable for |
| 16 | | loss of that thumb or |
| 17 | (7) Loss of great toe | 1,065 |
| 18 | (8) Loss of other toes | 450 |
| 19 | (9) Loss of phalanx of toe | |
| 20 | First phalanx of toe | |
| 21 | Great toe | 530 |
| 22 | Other toes | 225 |
| 23 | More than one phalanx of any toe | Full amount payable for |
| 24 | | loss of the entire toe |
| 25 | (10) Loss of hand | 6,830 |

| | | |
|----|---|------------------------|
| 1 | (11) Loss of arm | \$ 8,735 |
| 2 | (12) Loss of foot | 5,740 |
| 3 | (13) Loss of leg | 8,065 |
| 4 | (14) Loss of eye | |
| 5 | Loss of eye by enucleation | 4,480 |
| 6 | Loss of vision | 3,920 |
| 7 | Loss of binocular vision | 3,920 |
| 8 | (15) Loss of ear or hearing | |
| 9 | Loss of hearing—both ears | 5,600 |
| 10 | Loss of hearing—one ear | 1,455 |
| 11 | Loss of both ears | 2,240 |
| 12 | Loss of one ear | 1,120 |
| 13 | (16) Scarring | Not to exceed \$12,000 |
| 14 | | under standards |
| 15 | | established by the |
| 16 | | commissioner |
| 17 | (17) For those conditions enumerated in section 9(d). | \$20,000 |

17 A victim shall be compensated for each disfigurement enumerated in this subsection; provided that the
18 aggregate amount of the benefits payable by the insurer under this subsection shall not exceed \$20,000.

19 (b) For those conditions enumerated in section 9(d), in addition to the lump sum provided in
20 paragraph (17) of subsection (a) above, the insurer shall pay to a victim who is not otherwise
21 compensable for income loss under sections 8(1)(B) and 9(d), the sum of \$360 per month.

22 (c) Loss of a hand means amputation between the elbow and the wrist. Loss of an arm means
23 amputation at or above the elbow. Loss of a foot means amputation between the knee and the ankle.
24 Loss of a leg means amputation at or above the knee.

25

1 SECTION 11. Adjustments in amounts of benefits. If the commissioner at any time finds that the
2 consumer price index has risen by seven percent or more since the required benefits payable under this
3 act were last adjusted, the commissioner may increase any or all benefits by five percent.

4 SECTION 12. Required territorial coverage. Every policy of insurance required by this act to be
5 maintained by the owner of a motor vehicle shall provide for the payment of the required benefits to the
6 insured and the members of his household for bodily injury and death sustained by him or any member
7 of his household as a result of any motor vehicle accident occurring outside the State but within the
8 United States, its territories and possession, or Canada; provided that the insurer may seek
9 reimbursement of the amounts of benefits paid from any recovery had by the insured or any member of
10 his household under the laws of the locality in which the accident occurs and, for the purposes of such
11 reimbursement, it may bring suit in behalf of or in the name of the insured or any member of his
12 household in the locality in which the accident occurs.

13 SECTION 13. Collateral sources of indemnity. All required benefits, except payments for damage
14 to or loss of property, the lump sum death benefit, and the lump sum benefits for
15 disfigurement, shall be paid net of the amount of any benefit payable by reason of bodily injury resulting
16 from the occurrence which gives rise to the benefit under the United States Social Security Act (except
17 the disability insurance cash benefits payable under the Social Security Act to victims who suffer any of
18 those conditions enumerated in section 9(d) of this act), the Hawaii Workmen's Compensation Law, the
19 Hawaii Temporary Disability Insurance Law, any other state or federal income disability or workmen's
20 compensation law, any accident, health, sickness, or disability insurance, and any contract or agreement
21 of any group, association, organization, partnership, or corporation to provide or to pay for or reimburse
22 the cost of medical, hospital, dental, or other services included in the required benefits under this act.
23 Nothing in this section shall prevent any person from expressly insuring against, and receiving payment
24 for, damages in excess of those included in the required benefits under this act.

1 SECTION 14. Optional insurance coverage. Every insurer authorized to transact the business of
2 motor vehicle insurance in the State may offer to the owner of any motor vehicle it insures, which offer
3 may be rejected, coverages in excess of or in addition to the required benefits. If the commissioner finds
4 that any or all of the following are not being offered as optional coverages, he may require them to be
5 offered by any or all insurers:

6 (1) Payment for loss of income resulting from bodily injury to or death of the insured or any
7 member of his household in excess of the maximum amount required to be paid under section
8 8.

9 (2) Payment of all reasonable expenses incurred for ordinary household services which the victim
10 would have ordinarily performed but for his injury or death for a period in excess of one year
11 from the date of the victim's injury.

12 (3) Payment for damage to or loss of the insured motor vehicle and its contents resulting from
13 collision and from theft, fire, and other causes, without regard to fault or negligence. The
14 coverage with respect to damage or loss resulting from causes other than collision may be
15 offered on a comprehensive basis. The coverage with respect to damage to or loss of a motor
16 vehicle shall be offered with option in the owner to accept it subject to a deductible amount
17 selected from varying deductible amounts offered by the insurer, including \$250. The insurer
18 may include within the terms and conditions applicable to these coverages such other
19 provisions as it customarily applies to such coverages in other states.

20 (4) If the expenses for medical, hospital, and dental services incurred as a result of bodily injuries
21 sustained by the insured or a member of his household exceed \$5,000, payment for physical
22 pain and suffering at a stipulated percentage of the medical, hospital, and dental expenses or at
23 a stipulated percentage of the amount recoverable for disfigurement.

24 (5) Payment of claims for bodily injury, death, and property damage made against the insured or
25 any member of his household as a result of a motor vehicle accident occurring outside the
State.

1 PART III

2 BENEFIT PAYMENTS; ENFORCEMENT OF PAYMENTS

3 SECTION 15. Benefits payable when. Unless otherwise expressly provided, all benefits, both
4 required and optional, shall be paid as loss accrues; provided that income benefits shall be paid not less
5 often than semi-monthly as loss accrues. All benefits shall be payable within thirty days after the insurer
6 receives notice of the fact and of the amount of loss sustained. Payment shall be deemed to have been
7 made when delivered or when a draft or other valid instrument of payment is placed in the United States
8 mail, properly addressed and postage prepaid. All payments not made within thirty days shall bear simple
9 interest at the rate of eighteen percent per year, which shall accrue to the claimant. All claims for
10 benefits shall be made on forms approved by the commissioner.

11 SECTION 16. Lump sum settlement. Where benefits accrue periodically and the total sum payable
12 to a claimant is not likely to exceed \$1,000, the insurer may, with the approval of the claimant, pay all
13 of such amounts that are likely to accrue in a lump sum; provided that such lump sum payment shall not
14 preclude further claim for payment if the recoverable losses accruing after such settlement exceed
15 \$2,000. No lump sum settlement shall be made in cases where the total amount of the benefits is likely
16 to exceed \$1,000, except upon approval by a court of competent jurisdiction. The court may approve
17 any such lump sum settlement if it is satisfied, after a hearing upon due notice at which all interested
18 parties have had an opportunity to be heard, that the settlement is in the best interest of the claimant.
19 All lump sum settlements shall disclose the complete basis of computation.

20 SECTION 17. Payment from which insurance. (a) Except as provided in the subsections following,
21 the insurer of a motor vehicle involved in an accident shall pay the required benefits accruing as a result
22 of bodily injury and property damage sustained by all victims of the accident.

23 (b) If two or more motor vehicles are involved in an accident, the insurer of each vehicle shall pay
24 the required benefits accruing as a result of bodily injury sustained by all victims who are occupants of
25 the vehicle insured by it; and the insurer of any of the vehicles shall be subject to claim for payment of

1 the required benefits accruing as a result of bodily injury and property damage sustained by victims, not
2 occupants of any of the involved vehicles, subject to apportionment of all payments made by any insurer
3 among insurers of all involved vehicles as provided in section 25.

4 (c) If the identity of any motor vehicle involved in an accident is not known or if any motor
5 vehicle involved in an accident is not insured, a claimant who would otherwise have been paid by the
6 insurer of such vehicle shall be paid the required benefits from the insurer to whom his claim is assigned
7 under the assigned claims plan provided in section 25; provided that no claim arising from bodily injury
8 or property damage sustained by the owner of the uninsured vehicle shall be subject to assignment under
9 the assigned claims plan.

10 (d) The provisions of this section shall apply, notwithstanding that any victim is an insured of
11 another motor vehicle or the owner of another insured motor vehicle, except that a claimant, to the
12 extent that he is so entitled, may claim against the insurer of such other vehicle for benefits in excess of
13 the required benefits.

14 SECTION 18. Benefits not assignable. An agreement assigning the right of a claimant to any benefit
15 payable by the insurer shall be void, except that the claimant may assign to the provider of services such
16 amounts receivable from the insurer to pay for the cost of the services actually provided.

17 SECTION 19. Claims for benefits excluded when. (a) No claimant shall be paid any of the benefits
18 provided in this act if his claim arises from bodily injury or property damage sustained by a victim which
19 the victim intentionally causes or in an accident occurring during the course of commission by the victim
20 of a felony, other than negligent homicide, of which he is convicted. Nothing in this section shall be
21 construed to preclude payment to other claimants.

22 (b) In case of a claim arising from injury or damage sustained by a victim in an accident occurring
23 during the course of commission by the victim of a felony, other than negligent homicide, upon the
24 indictment of the victim for such felony, the insurer shall place in escrow all funds required to be paid on
25 the claim under this act until such indictment is dismissed or a conviction obtained. The funds in escrow

1 shall be paid to the claimant upon dismissal of the indictment or returned to the insurer upon conviction
2 of the victim.

3 (c) Any insurer paying any benefit for bodily injury or property damage intentionally caused or
4 resulting from an accident occurring during the course of commission of a felony, other than negligent
5 homicide, shall be entitled to reimbursement from the person intentionally causing the injury or damages
6 or the person convicted of committing the felony.

7 SECTION 20. Statute of limitations. Actions against an insurer for the recovery of any benefit shall
8 be brought within two years from the date an injury or loss is sustained or one year from the date of the
9 last payment of benefit, whichever is later.

10 SECTION 21. Insurer's right to information. (a) Whenever the mental or physical condition of an
11 injured victim is material to any claim, the insurer may request the victim to submit to a mental or
12 physical examination by a physician or physicians. Any examination conducted at the request of the
13 insurer shall be at the expense of the insurer.

14 (b) An employer of a victim, if requested by an insurer against whom a claim has been made for
15 payment of income or income loss, shall forthwith furnish on a form approved by the commissioner, a
16 statement under oath or affirmation of the amount that the victim was earning at the time and during a
17 reasonable period before the victim sustained his injury, disability, or death and the amount the victim
18 earned or is earning after he sustained his injury or disability.

19 (c) Every provider of medical, hospital, and dental services, products, and accommodations, if
20 requested by an insurer against whom a claim has been made for expenses incurred by a victim for such
21 services, products, or accommodations, shall forthwith furnish such information as requested or permit
22 an examination of its records pertaining to the services, products, and accommodations furnished,
23 rendered to, or performed for the victim and the nature of the condition for which such services,
24 products, and accommodations were furnished, rendered, or performed.

25 (d) No insurer shall seek to enforce its right to information provided in this section for the

1 purpose of annoying, harrassing, embarrassing, or oppressing any claimant. Upon the petition of a
2 claimant, a court of competent jurisdiction may enjoin an insurer from requiring any examination or
3 disclosure of information or permit such examination or disclosure upon prescribed conditions and in
4 any such proceeding may order payment by the insurer of all costs and expenses of the proceeding,
5 including reasonable attorney's fees.

6 (e) Interest on any payment of benefits delayed as a result of the insurer's request for examination
7 or disclosure of information shall continue to accrue during such examination or disclosure and shall be
8 payable by the insurer if such examination or disclosure results in no change in the insurer's liability to
9 pay the benefits.

10 SECTION 22. Rehabilitation. (a) The insurer shall cause to be evaluated for rehabilitation every
11 victim who sustains permanent bodily injury as a result of a motor vehicle accident and shall offer such a
12 victim a rehabilitation program whenever such evaluation indicates that such a program will be
13 potentially beneficial to the victim.

14 (b) Every victim who sustains permanent bodily injury as a result of a motor vehicle accident
15 which results in total or partial loss of income shall make reasonable efforts to obtain rehabilitative
16 treatment or occupational training, provided such treatment or training is reasonably accessible, and
17 every such victim entitled to compensation for income loss shall make reasonable efforts to work to the
18 extent permitted by his physician. If such victim refuses to make such reasonable efforts or to submit to
19 reasonable rehabilitative treatment or occupational training, an insurer may petition any court of
20 competent jurisdiction for an order that benefits be reduced or terminated so as to limit recovery of
21 benefits to an amount equal to the benefits that in reasonable probability would be due if the victim
22 submitted to such rehabilitative treatment or occupational training or made reasonable efforts to work,
23 or for such other order as may be reasonable. The court in determining whether the victim has reasonable
24 grounds for refusing to submit to rehabilitative treatment or occupational training or has made
25 reasonable efforts to work shall take into account all relevant factors, including the extent of the

1 probable benefit, the attendant risks, the extent to which the procedure, treatment, training, or work is
2 accessible and is or is not recognized as standard and customary, and whether the imposition of sanctions
3 because of the victim's refusal would abridge his right to the free exercise of his religion.

4 SECTION 23. Right to purchase insurance. No insurer authorized to transact the business of motor
5 vehicle insurance in the State shall refuse to issue a policy of insurance providing for the payment of the
6 required benefits to any person, except on grounds of fraud in an application for insurance or
7 nonpayment of a premium or any installment thereof. No policy of insurance issued on any motor
8 vehicle shall be cancellable and every such policy shall be automatically renewed, except on grounds of
9 fraud or nonpayment of any premium or any installment thereof within thirty days after it becomes due.

10 PART IV

11 RIGHTS AND OBLIGATIONS BETWEEN AND AMONG INSURANCE COMPANIES

12 SECTION 24. Reinsurance. (a) Insurers authorized to transact the business of motor vehicle
13 insurance in the State shall establish, maintain, and participate in a plan of reinsurance approved by the
14 commissioner for the purpose of distributing among themselves the costs of insuring risks which an
15 insurer does not wish to bear alone. Each insurer shall be limited in its participation to an amount equal
16 to not more than one-third of its gross dollar volume of motor vehicle insurance issued in the State in
17 any calendar year, unless otherwise approved by the governing board or committee of the plan, and shall
18 be assessed the costs of reinsurance in proportion to the gross dollar volume of motor vehicle insurance it
19 issues in the State. Any insurer may appeal to the commissioner from any ruling or decision of the
20 manager, governing board, or committee designated to operate the plan.

21 (b) Insurers authorized to transact the business of motor vehicle insurance in the State may enter
22 into any plan of reinsurance approved by the commissioner for the purpose of equitably distributing
23 among themselves losses which may result to any insurer as a result of benefit payments in excess of
24 those which may reasonably be borne by an insurer in consideration of its total exposure to loss and its
25 statutory capital and surplus positions. If no such plan is established by the insurers and the

1 commissioner deems the establishment of such plan advisable for the protection of the public interest, he
2 may require the insurers to establish such plan. Any such plan, once established, shall be open to
3 participation by all insurers authorized to transact the business of motor vehicle insurance in the State.
4 Any insurer may appeal to the commissioner from any ruling or decision of the manager, governing
5 board, or committee designated to operate the plan.

6 SECTION 25. Establishment of assigned claims plan. All insurers authorized to transact the
7 business of motor vehicle insurance in the State shall establish, maintain, and participate in a plan for the
8 equitable assignment among themselves of claims for the required benefits arising out of accidents
9 involving vehicles not insured as required by this act. The plan, the rules and regulations for the
10 operation of the plan, and the method of assignment of claims shall be subject to the approval of the
11 commissioner. If the insurers default in the establishment and continued maintenance of such plan, the
12 commissioner shall organize and maintain such a plan. The insurer to whom a claim is assigned shall
13 thereafter have all the rights and obligations with respect to such claim as it would have if the insurer had
14 issued a policy on the vehicle.

15 SECTION 26. Apportionment of obligations. (a) If a motor vehicle accident involves a commercial
16 vehicle and one or more non-commercial vehicles, the insurer of the commercial vehicle shall reimburse
17 the insurers of the non-commercial vehicles for all required benefit payments made by them.

18 (b) If a motor vehicle accident involves two or more vehicles, the insurers of all involved vehicles
19 shall apportion equally among themselves the costs of paying the required benefits accruing as a result of
20 bodily injury and property damage sustained by victims, not occupants of any of the involved vehicles;
21 and if an accident involves two or more commercial vehicles, the insurers of all involved commercial
22 vehicles shall also apportion equally among themselves the costs of reimbursing the insurers of all
23 involved non-commercial vehicles.

1 PART V

2 MOTOR VEHICLE INSURANCE RATES

3 SECTION 27. Rates generally. With the exception of section 431–693 and except as otherwise
4 provided in this act, all premium rates for motor vehicle insurance shall comply with the provisions of
5 the casualty rating law contained in chapter 431.

6 SECTION 28. Making of rates. (a) All premium rates for motor vehicle insurance shall be made in
7 accordance with the following provisions:

8 (1) Consideration shall be given to the individual insurer's: past and prospective loss experience
9 within the State; reasonable margin for underwriting profit from and contingencies in the
10 administration of motor vehicle insurance sold within the State; past and prospective expenses
11 in the sale and administration of motor vehicle insurance within the State; income from
12 investments of premiums and other proceeds received on account of motor vehicle insurance
13 sold within the State; and all other relevant factors.

14 (2) No insurer shall pool or in any manner combine its past or prospective expenses of adjusting
15 losses, sale, and underwriting, or its past or prospective administrative expenses of any other
16 kind for any class of risk in any rating territory with those of any other insurer. An insurer
17 may pool its loss experience in the State with the loss experience in the state of any other
18 insurer, subject, however, to the provisions of subsection (c) of this section.

19 (3) The systems of expense provisions included in the rates for use by an insurer may differ from
20 those of other insurers to reflect the requirements of the operating methods of any such
21 insurer with respect to motor vehicle insurance or with respect to any classification for which
22 separate expense provisions are applicable.

23 (4) Rating territories may be established and risks may be grouped by classifications for the
24 establishing of rates and minimum premiums. The commissioner may by rule or regulation
25 provide for a uniform classification of risks and rating territories for the various coverages.

1 Classification rates may be modified to produce rates in accordance with rating plans which
2 establish standards for measuring variations in hazards or expense provisions, or both. Such
3 standards may measure any differences among risks, including vehicles, occupations, and
4 involvement in past accidents, provided they are established to have a probable effect upon
5 losses or expense. For the required benefits, no standard or rating plan shall be based, in
6 whole or in part, directly or indirectly, upon frequency of accident involvement associated
7 with age, sex, length of driving experience, or marital status.

8 (5) Rates shall not be excessive, inadequate or unfairly discriminatory. Differentials reflecting
9 differences in administration, overhead, or selling expenses shall not be deemed to be unfairly
10 discriminatory.

11 (b) No manual of classification, rule, rate, rating plan, designation of rating territories, or standard
12 for motor vehicle insurance shall be effective unless approved by the commissioner. No such approval
13 shall be given to any classification, rating plan, rating territory, or standard without a public hearing at
14 which all affected and interested parties have a full opportunity to examine and comment on the impact
15 and application of the proposed classification, rating plan, rating territory, or standard. The
16 commissioner shall publish a notice of the date, time, and place of the public hearing at least once in
17 each of three successive weeks in a newspaper of general circulation.

18 (c) Motor vehicle insurance rates shall be made separately for each insurer and no insurer shall
19 agree, combine, or conspire with any other insurer or enter into, become a member of, or participate in
20 any understanding, pool, or trust, to directly or indirectly fix, control, or maintain motor vehicle
21 insurance rates. The provisions of sections 431-696, 431-697, and 431-698, relating to rating
22 organizations, shall not apply to motor vehicle insurance rates. Any violation of this subsection shall
23 be subject to all civil and criminal penalties provided in chapter 480.

24 SECTION 29. Review of rates. Any person aggrieved by the application as to him of any
25 classification, rule, standard, rate, or rating plan made, followed, or adopted by an insurer may make

1 written request to the insurer to review such application and grant the relief requested. If the review is
2 not granted within thirty days thereafter, the person may treat it as refused. Any person aggrieved by the
3 action of an insurer in refusing to review the matter or grant the relief requested may file a written
4 complaint with the insurance commissioner, specifying the grounds relied on. If the commissioner finds
5 that probable cause for the complaint exists or that the complaint charges a violation of this act or any
6 applicable provisions of the casualty rating law, he shall conduct a hearing on the complaint. The hearing
7 shall be subject to the procedure provided in section 431-705(a).

8 SECTION 30. Noncompliance of rates. (a) If the insurance commissioner has good cause to believe
9 that a classification, rule, standard, rate, rating territory, or rating plan made, followed, or adopted by an
10 insurer does not comply with any of the requirements of this act or any applicable provisions of the
11 casualty rating law, he shall, unless he has good cause to believe that such noncompliance is willful, give
12 notice, in writing, to such insurer stating therein in what manner and to what extent such noncompliance
13 is alleged to exist and specifying therein a reasonable time, not less than ten days thereafter, within
14 which such noncompliance may be corrected. Notices under this subsection shall be confidential as
15 between the commissioner and the parties unless a hearing is held as provided in subsection (b).

16 (b) If the insurance commissioner has good cause to believe such noncompliance to be willful, or if,
17 within the period prescribed by the commissioner in the notice, the insurer does not make such changes
18 as may be necessary to correct the noncompliance specified by the commissioner or establish to the
19 satisfaction of the commissioner that such specified noncompliance does not exist, then the
20 commissioner may proceed with a hearing which shall be subject to the hearing procedure provided in
21 section 431-705(a).

22 SECTION 31. Orders on hearing. If, after a hearing conducted pursuant to section 29 or 30, the
23 insurance commissioner finds that the complainant is entitled to relief or that any classification, rule,
24 standard, rate, rating territory, or rating plan violates this act or any applicable provisions of the casualty
25 rating law, he shall issue an order granting the complainant's claim for relief or prohibiting the insurer

1 from using such classification, rule, standard, rate, rating territory, or rating plan. The order shall contain the
2 commissioner's finding of facts and conclusions of law, including, as appropriate, a specification of the re-
3 spects in which a violation of this act or any applicable provision of the casualty rating law exists and shall
4 specify a reasonable time period within which the insurer shall comply with the terms of the order. Any
5 such order shall be subject to judicial review in accordance with the provisions of section 431-705(b).

6 PART VI

7 PENALTIES; EVALUATION; RULES AND REGULATIONS

8 SECTION 32. Penalties. (a) In addition to any other penalty prescribed in this act, the penalties pro-
9 vided in section 431-707 shall be applicable to an insurer who violates any provision of this act or fails to
10 comply with any order of the commissioner.

11 (b) Any owner of a motor vehicle who fails to maintain the insurance required by this act or who
12 gives information in an application for motor vehicle insurance, knowing or having reason to believe that
13 the information is false, or who forges or, without authority, signs any evidence of proof of insurance,
14 or who files or offers for filing any evidence of proof of insurance, knowing or having reason to believe
15 that it is forged or signed without authority, shall be fined not more than \$1,000 or imprisoned not more
16 than one year, or both.

17 SECTION 33. Evaluation and report. (a) The commissioner shall periodically review and evaluate
18 the motor vehicle insurance program described in this act, including an annual review of the premium
19 rates, benefit payments, and insurers' loss experience.

20 (b) The commissioner may require insurers to report periodically any loss experience and other
21 statistical information necessary for an evaluation of the insurance program. Any insurer failing to report
22 information in the manner and within the time required by the commissioner shall be subject to the
23 penalty provided in section 431-707.

24 (c) The commissioner shall prepare and submit to the legislature annually a report containing his
25 evaluation of the insurance program, with respect to both required and optional coverages. The report

1 shall include a summary of abuses and deficiencies in benefit payments, the complaints made to the
2 commissioner and their disposition, and the extent of compliance and noncompliance by each insurer
3 with the provisions of this act and any applicable provision of the Hawaii insurance law.

4 SECTION 34. Rules and regulations. The commissioner shall promulgate rules and regulations,
5 pursuant to chapter 91, to effectuate the purposes of this act.

6
7 **PART VII**

8 **TRANSITIONAL REQUIREMENT; REPEALER;
SEVERABILITY; APPROPRIATION; EFFECTIVE DATE**

9 SECTION 35. Transitional requirement. (a) During the period between the approval of this act and
10 December 31, 1972, policies of motor vehicle insurance insuring the insured against liability in tort for
11 bodily injury and property damages arising out of motor vehicle accidents may continue to be issued.
12 Any such policy may be issued for a term expiring beyond December 31, 1972, or for a term expiring
13 on December 31, 1972, provided that:

14 (1) If a policy of liability insurance is issued for a term expiring beyond December 31, 1972, on
15 January 1, 1973, such policy of insurance shall automatically be converted to a policy
16 complying with the provisions of this act, and the premium for the liability insurance shall be
17 adjusted so that the total premium for the policy of liability insurance and the new policy
18 complying with this act shall not exceed the sum of the following:

19 (A) The annual premium for the liability insurance policy divided by twelve and the quotient
20 resulting therefrom multiplied by the number of months the liability insurance policy was
21 in effect; and

22 (B) The annual premium for the new policy complying with this act divided by twelve and
23 the quotient resulting therefrom multiplied by the number of months the new policy will
24 be in effect.

25 (2) If a policy of liability insurance is issued for a term expiring on December 31, 1972, the

1 premium for such liability insurance shall not exceed a sum equal to the annual premium for
2 the liability insurance divided by twelve and the quotient resulting therefrom multiplied by the
3 number of months the liability insurance will be in effect.

4 (b) During the period between the approval of this act and January 1, 1973, the commissioner
5 shall do all things necessary, for the full implementation of the provisions of this act on January 1, 1973,
6 including promulgating rules and regulations, approving manuals of classifications, rules, standards,
7 rates, rating territories, and rating plans, and prescribing forms, all in the manner provided in this act; and
8 the office of consumer protection shall organize and conduct a public information program explaining
9 the provisions of this act.

10 (c) After approval of this act and before January 1, 1973, insurers authorized to transact the
11 business of vehicle insurance in the State may sell motor vehicle insurance complying with the provisions
12 of this act to be effective January 1, 1973, provided that the commissioner has approved all such matters
13 pertaining to such insurance which require his approval under this act and, for the purpose of securing
14 such approval and effectuating such sale, may take such actions as necessary to formulate plans and
15 determine rates complying with the provisions of this act.

16 SECTION 36. Laws repealed. The following chapters and sections of the Hawaii Revised Statutes
17 are repealed: chapter 287, chapter 288, section 286-92, section 286-112(c), section 431-448, and
18 section 431-448.1. All other laws relating to motor vehicle insurance which are inconsistent with this
19 act are repealed.

20 SECTION 37. Severability. If any provision of this act or the application thereof to any person or
21 circumstance is held unconstitutional, the remainder of this act and the application of such provision to
22 other persons or circumstances shall not be affected thereby, and it shall be conclusively presumed that
23 the legislature would have enacted the remainder of this act without such invalid or unconstitutional
24 provision.

25 SECTION 38. Appropriation. There is appropriated out of the general revenues of the State the

1 sum of \$45,000, or so much thereof as may be necessary, to the department of regulatory agencies and
2 the sum of \$30,000, or so much thereof as may be necessary, to the office of consumer protection for
3 the purposes of this act.

4 SECTION 39. Effective date. Sections 35, 37, and 38 shall take effect upon approval, and the
5 remainder of the act shall take effect on January 1, 1973.

A BILL FOR AN ACT

RELATING TO MASS MERCHANDISING OF MOTOR VEHICLE INSURANCE

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. Purpose. The purpose of this act is to authorize the sale of motor vehicle insurance in
2 the State by mass merchandising.

3 SECTION 2. Chapter 431, Hawaii Revised Statutes, is amended by adding a new part, reading as
4 follows:

5 "MASS MERCHANDISING OF MOTOR VEHICLE INSURANCE

6 Sec. 431- . Definitions. As used in this part:

- 7 (1) 'Employees' includes compensated officers, managers, and employees of a firm,
8 corporation, partnership, sole proprietor, trust, estate, or unincorporated association
9 or organization. A mass merchandising agreement may provide that the term
10 'employees' shall include retired employees and the individual proprietor, partners, or
11 trustees, if the employer is an individual proprietor, partnership, trust, or estate.
- 12 (2) 'Employer' includes any firm, corporation, partnership, sole proprietor, trust, estate,
13 and unincorporated association or organization; it also includes the State, any county,
14 and any municipal corporation, and any governmental unit, agency, or department
15 thereof.
- 16 (3) 'Insurer' means an insurer authorized to transact the business of motor vehicle
17 insurance in the State.
- 18 (4) 'Mass merchandise' means to sell and 'mass merchandising' means a sale of insurance
19 (A) to a group, all participating members of which become insureds under a single

1 group policy, or (B) on a mass basis to members of a group, each member becoming
2 an insured under an individual policy.

3 (5) 'Mass merchandising plan' or 'plan' means a program, design, or scheme of the
4 insurance to be mass merchandised, including terms, coverages, and premiums.

5 (6) 'Mass merchandising agreement' means an agreement between an insurer and an
6 employer, association, or organization for the sale of insurance to the employees of
7 the employer or to the members of the association or organization on a mass
8 merchandising basis.

9 (7) 'Motor vehicle' or 'vehicle' means every vehicle, operated or used on land, which is
10 self-propelled but not operated upon rails and includes trailers and semi-trailers
11 attached to the vehicle.

12 (8) 'Motor vehicle insurance' or 'insurance' means insurance against loss or expense, or
13 liability for loss or expense resulting from injury to persons or loss of or damage to
14 property arising from the ownership, operation, maintenance, or use of a motor
15 vehicle.

16 Sec. 431— . Applicability. This part shall apply only to motor vehicle insurance and to
17 policies which become effective on or after January 1, 1973. The provisions of this part are in
18 addition to, and not in substitution for, other applicable requirements of law relating to motor
19 vehicle insurance and the rules and regulations of the insurance commissioner adopted pursuant
20 thereto. The requirements of this part do not apply to methods of merchandising other than mass
21 merchandising as defined in section 431— .

22 Sec. 431— . Mass merchandising authorized. An insurer may mass merchandise motor
23 vehicle insurance to the employees of any employer or to the members of any association or
24 organization under a mass merchandising plan approved by the insurance commissioner; provided
25 that such mass merchandising is agreed to by the employer, association, or organization. An

1 employer, association, or organization may contract with one or more insurers for mass
2 merchandising of motor vehicle insurance to its employees or members.

3 Sec. 431— . Mass merchandising prohibited when. (a) No insurer shall mass merchandise
4 motor vehicle insurance to members of any association or organization formed principally for the
5 purpose of obtaining the benefits of mass merchandising.

6 (b) No insurer shall mass merchandise motor vehicle insurance to employees of any employer
7 or to members of any association or organization which requires the purchase of or participation
8 in insurance sold on a mass merchandising basis as a condition of employment or membership, or
9 which subjects any employee or member to any penalty for failure to purchase or participate in
10 insurance sold on a mass merchandising basis.

11 Sec. 431— . Mass merchandising requirements. Mass merchandising of motor vehicle
12 insurance and every mass merchandising plan shall be subject to the following conditions:

13 (1) The insurance offered shall be open to participation by or be available to every
14 employee of the employer or to every member of the association or organization
15 without discrimination.

16 (2) The insurance shall be offered without discrimination against any employee or
17 member as to rates, forms, or coverages. Nothing herein shall preclude the
18 establishment of different classes of risks, provided that no employee or member
19 within a class shall be discriminated against as to the rates established for such class.

20 (3) Upon the termination of employment or membership or upon the termination of the
21 mass merchandising agreement, an insured employee or member shall have the option
22 of continuing his participation in a group policy or his individual policy then in force
23 for a period of one year upon payment of the applicable premium; provided that the
24 employee or member shall exercise his option within thirty days following the date of
25 such termination.

1 (4) The insurer shall issue a certificate or other evidence of participation to every member
2 covered under a group policy and a policy of insurance to every member insured
3 under an individual policy.

4 (5) The insurance offered shall not be contingent upon the purchase of any other
5 insurance, product, or service; nor shall the purchase of any other insurance, product,
6 or service be contingent upon the purchase of the motor vehicle insurance offered.

7 Sec. 431— . Disclosure. Every insurer selling motor vehicle insurance on a mass
8 merchandising basis shall, prior to sale, make full and fair disclosure to prospective insureds of all
9 features of the plan, including but not limited to premium rates, claims procedure, benefits,
10 duration of coverage, and policyholder services.

11 Sec. 431— . Payroll deductions and premium collections. A mass merchandising agreement
12 may provide for the collection of premiums from employees or members by payroll deductions,
13 assessments, or otherwise, and the remittance of the same to the insurer by the employer,
14 association, or organization. No such collection and remittance of premiums by the employer,
15 association, or organization shall constitute collection of premium within the meaning of this
16 chapter; no act of furnishing information about such collection method by the employer,
17 association, or organization to its employees or members shall constitute solicitation of
18 applications for insurance; and neither the collection and remittance of premiums nor the
19 furnishing of information about such collection method shall constitute the employer,
20 association, or organization an agent, subagent, or solicitor of insurance.

21 Sec. 431— . Employer's failure to remit premiums. If any employer, association, or
22 organization is required under a mass merchandising agreement to collect the premiums from its
23 employees or members and remit the same to the insurer, its failure to so collect and remit as to
24 any employee or member for any reason, including termination of the employee's employment
25 or the member's membership in the association or organization, shall not be regarded by the

1 insurer as nonpayment of premium by such employee or member, unless the insurer gives written
2 notice of such failure to remit to the employee or member and the employee or member fails to
3 pay the required premium by the later of (1) twenty days after the notice or (2) the due date of
4 the premium.

5 Sec. 431— . Cancellation and nonrenewal. No policy of an individual employee or member
6 or participation of an employee or member in a group policy shall be cancelled or its renewal
7 denied unless a written notice of cancellation or renewal is given the employee or member. All
8 such notices shall set forth the reasons for the cancellation or nonrenewal.

9 Sec. 431— . Premium rates. Premium rates for motor vehicle insurance sold on a mass
10 merchandising basis shall comply with all applicable provisions of law relating to rate-making for
11 motor vehicle insurance. Rates shall not be excessive, inadequate, or unfairly discriminatory.
12 Differentials reflecting differences in administration, overhead, or selling expenses shall not be
13 deemed to be unfairly discriminatory.

14 Sec. 431— . Underwriting standards. Every plan of mass merchandising and all rules and
15 standards applicable to mass merchandising of motor vehicle insurance shall be subject to the
16 approval of the insurance commissioner. No underwriting standard for risk selection or otherwise
17 under a mass merchandising plan shall be more restrictive than the standards used for insurance
18 sold by methods other than mass merchandising.

19 Sec. 431— . Statistics. Every insurer mass merchandising motor vehicle insurance shall
20 keep and maintain data on its experience under each plan, including data on premium income,
21 losses, and expenses. The data shall be kept and maintained separately from any experience data
22 on motor vehicle insurance sold by means other than mass merchandising.

23 Sec. 431— . Licenses. No person shall act as an insurance agent, subagent, or solicitor, in
24 connection with mass merchandising of motor vehicle insurance, unless he is licensed as such
25 under sections 431–361, 431–362, or 431–363.

1 Sec. 431— . Establishment and maintenance of office. Every insurer selling motor vehicle
2 insurance on a mass merchandising basis shall establish and maintain at all times an office in the
3 State to conduct the administration of its business and to handle claims.

4 Sec. 431— Rules and regulations. The insurance commissioner shall promulgate rules and
5 regulations necessary to effectuate the purposes of this part.”

6 SECTION 3. Effective date. This act shall take effect upon approval.

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Appendix A-3

[EXPLANATORY NOTE. As noted in chapter 16 of this report, this bill is not recommended for passage at this time, and, in any event, it should be considered only if a complete no-fault bill (appendix A-1) is enacted. This bill assumes the enactment of a complete no-fault bill, to be effective on January 1, 1973, and further assumes a complete take-over of the compulsory motor vehicle insurance business by the State. If the present tort liability system is retained, the words, "required to be carried by all owners of motor vehicles in the State," appearing in the first sentence and the entire last sentence in section 16 and all of section 18(a) should be deleted. If it is desired that the state fund be *competitive* in all respects, this can be accomplished by deleting the first and last sentences of section 16 and all of section 18(a).]

A B I L L F O R A N A C T

RELATING TO THE ESTABLISHMENT AND OPERATIONS OF A HAWAII MOTOR VEHICLE INSURANCE FUND

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF HAWAII:

1 SECTION 1. Purpose. The purposes of this act are to (1) establish a system of fair compensation
2 for persons sustaining bodily injury and property damage as a result of motor vehicle accidents and (2)
3 establish a system of reasonable cost for motor vehicle insurance.

4 SECTION 2. Definitions. As used in this act:

- 5 (1) "Board" means the board of directors of the fund, described in section 4.
6 (2) "Bodily injury" means physical or mental harm, sickness, or disease, including death resulting
7 therefrom, arising out of a motor vehicle accident.
8 (3) "Director" means a member of the board.
9 (4) "Fund" means the Hawaii Motor Vehicle Insurance Fund, described in section 3.
10 (5) "Motor vehicle" means every vehicle, operated or used on land, which is self-propelled but not
11 operated on rails and includes any trailer or semi-trailer attached to the vehicle.
12 (6) "Motor vehicle accident" means any accident arising out of the ownership, operation,
13 maintenance, or use of a motor vehicle.
14 (7) "Property damage" means physical injury to or destruction of tangible property arising out of
15 a motor vehicle accident.

1 SECTION 3. Fund established; purpose. There is established the “Hawaii Motor Vehicle Insurance
2 Fund.” The fund shall be under the control of the board described in section 4 and be placed within the
3 department of budget and finance for administrative purposes.

4 The purpose of the fund is to establish, manage, control, and operate the business of motor vehicle
5 insurance, including but not limited to:

- 6 (1) Selling motor vehicle insurance covering bodily injury and property damage, including damage
7 to motor vehicles;
- 8 (2) Determining premium rates for such insurance; and
- 9 (3) Providing compensation to victims of motor vehicle accidents entitled to benefits under
10 insurance issued by the fund.

11 The fund shall be a nonprofit fund and shall be exempt from taxation by the State.

12 SECTION 4. Board; composition; appointment; removal. There is established the Hawaii motor
13 vehicle insurance fund board of directors of five members. At least one member shall be from each
14 county. In addition, the director of finance shall be an ex-officio member of the board without vote.

15 All members shall be appointed by the governor with the advice and consent of the senate.

16 No one may serve on the board if he has any potential conflict of interest or does business with
17 directly or indirectly or receives payments from the fund, including but not limited to persons who are in
18 the business of providing legal, hospital, medical, motor vehicle repair, or insurance services, or
19 motor vehicle sales, except as an insured under the fund.

20 A director may be removed by the governor for good cause.

21 Any director who is absent for two consecutive meetings shall be removed by the governor.

22 SECTION 5. Term; vacancy. The normal term of each director is five years. Of the first five
23 directors appointed, one shall be appointed for a term of one year, one for two years, one for three
24 years, one for four years, and one for five years.

25 A vacancy on the board shall be filled by appointment of the governor with the advice and consent

1 of the senate. The person appointed to fill a vacancy shall serve for the remainder of the term of his
2 predecessor.

3 If by the end of his term, his successor is not appointed, the director shall serve until his successor is
4 appointed.

5 A director shall not serve for more than two consecutive terms.

6 SECTION 6. Compensation; expenses. Each director shall receive \$150 per official meeting
7 attended, but the total amount received by a director per year shall not exceed \$5,000.

8 Travel and other out-of-pocket disbursements necessary to the business of the fund shall be paid by
9 the fund.

10 A director may be reimbursed by the fund for any necessary expenses made by the director in
11 behalf of the fund and approved by the board.

12 SECTION 7. Chairman. The directors shall select one of their members to serve as chairman, who
13 shall serve no more than one consecutive term of one year.

14 SECTION 8. Meetings; notice; records and minutes. There shall be at least one meeting of the
15 board every month. The chairman may call a meeting of the board at any time by giving at least seven
16 days' written notice of the time and place of the meeting to all other directors. Any three of the directors
17 may call a meeting of the board by giving at least ten days' written notice of the time and place of
18 the meeting to all other directors. A meeting of the board may be called at any time without notice
19 if all directors agree.

20 The board shall keep records and minutes of all meetings of the board.

21 SECTION 9. Quorum; voting power; majority; deadlock. Three directors shall constitute a quorum
22 to transact business of the fund. Each director present at a meeting shall have one vote. Any action taken
23 shall be by a simple majority of the directors present at a meeting. If the vote on any matter is
24 deadlocked, every director present shall cast a vote.

25 SECTION 10. Powers. Except as otherwise provided in this act, the board may do all acts generally

1 performed by persons engaged in the business of motor vehicle insurance and other acts necessary to
2 carry out the purposes of the fund, including but not limited to:

- 3 (1) Hiring or contracting for the services of attorneys, insurance consultants, actuarial consultants,
4 medical consultants, auto repair consultants, certified public accountants, adjusting
5 consultants, investment consultants, and other personnel.
- 6 (2) Determining policies affecting the premium rates of motor vehicle insurance sold by the fund.
- 7 (3) Investing any of its funds in such assets authorized by law.
- 8 (4) Establishing short-term lines of credit not exceeding twelve months and borrowing short-term
9 money not exceeding twelve months for working capital needs.
- 10 (5) Entering into contracts for the guaranty of services or for a program of services and facilities
11 management.
- 12 (6) Determining all personnel policies, including but not limited to the establishment or
13 negotiation of wages, salaries, hours, and other conditions of employment for all personnel.
- 14 (7) Establishing programs providing for sale of motor vehicle insurance covering personal injury
15 and property damage losses, hospital, medical, surgical services, and other expenses arising out
16 of motor vehicle accidents.

17 SECTION 11. Duties. The board shall do all acts necessary to achieve the purposes of this act,
18 including but not limited to:

- 19 (1) Hiring an administrator to function as general manager of the fund.
- 20 (2) Reviewing and approving all budgets, including operating and capital improvement programs.
- 21 (3) Contracting for and receiving an annual audit by a certified public accounting firm covering all
22 financial operations of the fund.
- 23 (4) Determining premium rate schedules for insurance so that by July 1, 1975, the rate schedules
24 shall be at a level which will make all of the operations and programs of the fund
25 self-supporting.

1 (5) Determining reasonable fee schedules to compensate persons providing for motor vehicle
2 repair, hospital, and medical services.

3 SECTION 12. Fiscal limitation. The fund may not issue long-term bonds or other indentured
4 indebtedness or otherwise enter into long-term debt arrangements without the authorization of the legis-
5 lature and the approval of the director of finance.

6 SECTION 13. Administrative, technical, and professional employees. The administrative, technical,
7 and professional employees of the fund shall be appointed without regard to chapters 76 and 77, at such
8 salaries determined by the board. The board may waive the requirements of section 78-1, Hawaii
9 Revised Statutes, in hiring administrative, technical, and professional employees of the fund.

10 SECTION 14. Funds and status. Whenever the annual budget of the fund calls for appropriations
11 from the general fund of the State, the fund shall be classified as a special fund and shall be subject to
12 all other review and controls which the department of budget and finance imposes on all other special
13 funds.

14 Whenever the annual budget of the fund calls for no appropriation from the general fund of the
15 State, the fund shall be classified as a revolving fund. The department of budget and finance shall review,
16 but not exercise any controls over, the revolving fund.

17 SECTION 15. Audit and reporting requirements. The fund and all operations run by the fund shall
18 be audited by the office of the legislative auditor at least once every two years.

19 SECTION 16. Fund as exclusive seller of motor vehicle insurance. No motor vehicle insurance,
20 required to be carried by all owners of motor vehicles in the State, covering bodily injury and property
21 damage sustained in a motor vehicle accident occurring on or after January 1, 1974, shall be sold in the
22 State except by the fund. Except as otherwise provided in this act and except as to those provisions
23 which by their nature can have no application, all provisions of the casualty rating and any other law
24 regulating the sale of motor vehicle insurance shall be applicable to the fund. Nothing in this section shall
25 be deemed to preclude the sale by private insurance companies of motor vehicle insurance providing

1 benefits and coverages in excess of those required by law to be maintained by all owners of motor
2 vehicles in the State.

3 SECTION 17. Marketing insurance. The fund may coordinate its selling of motor vehicle insurance
4 with licensing and registration of motor vehicles by the various counties.

5 SECTION 18. Implementation. (a) On January 1, 1974, all right, title and interest in and to any
6 and all motor vehicle assigned claims funds and reinsurance pools existing in the State shall devolve upon
7 the fund, and the fund shall thereafter operate the same. The fund shall pay to each private insurance
8 carrier for the carrier's interest in any such assigned claims funds and reinsurance pools compensation
9 determined on the basis of the current market value of the carrier's interest or the actual cost incurred by
10 the carrier in the acquisition of its interest, whichever is lower. No payment shall be made by the fund
11 for any loss of business sustained by any private insurance carrier as a result of the transfer of the
12 assigned claims funds and reinsurance pools to the fund.

13 (b) The initial implementation of the provisions of this act shall be made under the direction of
14 the legislative auditor. The implementation may begin before the appointment of the board of directors.
15 Once the board of directors has been appointed with the advice and consent of the senate, the board of
16 directors shall be responsible for the implementation; provided that the legislative auditor may serve as
17 an advisor to the board on matters of implementation.

18 SECTION 19. Appropriation. There is appropriated out of the general revenues of the State the
19 sum of \$, or so much thereof as may be necessary, to the department of budget and finance
20 for the purpose of carrying out the provisions of this act by the legislative auditor and the board of
21 directors. The initial costs may be included in the premium rate determination and amortized over a
22 period of years so that such costs may be returned to the State by the end of five years.

23 SECTION 20. Severability and constitutionality. If any provisions of this act or the application
24 thereof to any person or circumstance is held unconstitutional, the remainder of this act and the
25 application of such provision to other persons or circumstances shall not be affected thereby, and it shall

1 be conclusively presumed that the legislature would have enacted the remainder of this act without such
2 invalid or unconstitutional provision.

3 SECTION 21. Effective date. This act shall take effect upon its approval.
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APPENDIX B

PERFORMANCE CRITERIA

Chapters 17 and 18 recommended adoption of an evaluation system to be developed by the insurance commissioner for purposes of monitoring insurance carrier performance under the proposed no-fault legislation. The commissioner is directed by the act to submit annual performance reports to the State legislature and to the public. The following selected indicators are proposed as initial candidates for the evaluation system:

1. Time to settlement by value of claims
2. Percent of all claims not paid within statutory waiting period:
 - . by number of claims
 - . by value of claims
3. Losses paid as percent of earned premiums
4. Contested claims as percent of claims paid out
5. Ranking by individual carrier for item 2, above
6. Ranking by individual carrier for item 3, above
7. Ranking by individual carrier for item 4, above.

Appendix C

SPECIAL EVALUATION ANALYSES

In chapter 8 certain data or special evaluation analyses were briefly alluded to or summarized. This appendix discusses the data and methodology used in the analyses of:

- . Loss payout
- . Delay in settlement
- . Validation of closed claims survey
- . Disposition of court cases

I. Basic Data for Comparative Loss Payout Analysis

Chapter 8 displayed a comparative analysis of loss experience for several lines of insurance, including automobile. Several indicators of relative efficiency were calculated and discussed. Basic information for that analysis was derived from the annual reports of the State of Hawaii insurance commissioner. The following tables display detailed data for the components of the loss payout indicators used in the analysis for the period 1960-1970. The information displayed on the various tables are:

| | |
|-----------|---|
| Table C-1 | Hawaii Loss Experience - Automobile - Bodily Injury 1960 - 1970 |
| Table C-2 | Hawaii Loss Experience - Automobile - Property Damage Liability 1960 - 1970 |
| Table C-3 | Hawaii Loss Experience - Automobile - Physical Damage 1960 - 1970 |
| Table C-4 | Hawaii Loss Experience - Hawaii Medical Services Association (HMSA) 1960 - 1970 |
| Table C-5 | Hawaii Loss Experience - Group Accident and Health 1960 - 1970 |
| Table C-6 | Hawaii Loss Experience - Workmen's Compensation 1960 - 1970 |

Table C-7 Hawaii Loss Experience - Liability Other than Auto-Bodily Injury 1960 - 1970

Table C-8 Hawaii Loss Experience - Liability, Other than Auto-Property Damage 1960 - 1970

II. Average Time to Settlement Based on Insurance Loss Payouts

In chapter 8 the average time to settlement was calculated on the basis of the closed claim survey. An alternate method of estimating the average time to settlement is presented here. This method uses aggregate financial data supplied by the insurance commissioner and presented in section I of this appendix. Using this method, the average delay in settlement is implicitly weighted by the value of the claim. On this basis, the average time to settlement is estimated to be one year and five months. Thus, this aggregate estimate not only reinforces but exceeds the delay estimated from the closed claims survey. The following sections show derivation of this estimate in a stepwise procedure.

A. Procedure for Determining Losses Incurred

Losses incurred are estimated by the insurance commissioner's office as follows:

$$\begin{array}{r}
 \text{losses paid during period} \quad (x) \\
 + \text{ loss reserves (end of period)} \quad + (y) \\
 \hline
 \quad \quad \quad \quad \quad \quad (x + y) \\
 - \text{ loss reserves (beginning of} \\
 \quad \quad \quad \quad \quad \quad \text{period)} \quad \quad \quad - (z) \\
 \hline
 = \text{ losses incurred} \quad \quad \quad (x + y - z)
 \end{array}$$

Table C-1
Hawaii Loss Experience
Automobile – Bodily Injury 1960–1970

| Year | Premiums | | Losses | |
|-------|-------------|-------------|-------------|------------|
| | Written | Earned | Incurred | Paid |
| | (1) | (2) | (3) | (4) |
| 1970 | 30,648,241 | 28,167,643 | 21,319,992 | 19,305,597 |
| 1969 | 24,058,409 | 22,208,508 | 18,356,661 | 15,541,751 |
| 1968 | 18,742,343 | 17,564,669 | 15,152,583 | 10,925,218 |
| 1967 | 15,647,313 | 14,704,896 | 11,280,590 | 8,872,016 |
| 1966 | 13,096,758 | 12,758,602 | 9,403,250 | 6,320,375 |
| 1965 | 11,940,335 | 11,043,885 | 7,579,496 | 5,571,695 |
| 1964 | 9,894,503 | 8,972,128 | 6,848,350 | 5,283,019 |
| 1963 | 8,927,282 | 8,213,651 | 5,687,896 | 4,388,807 |
| 1962 | 7,159,426 | 6,881,015 | 4,859,603 | 3,843,788 |
| 1961 | 6,854,429 | 6,755,648 | 4,492,916 | 3,299,965 |
| 1960 | 6,665,301 | 6,064,269 | 3,929,464 | 2,898,381 |
| Total | 153,634,340 | 143,334,914 | 108,910,801 | 86,250,612 |

Source: Hawaii State department of regulatory agencies, *Report of the Insurance Commissioner*, Honolulu: 1960–1970.

Table C-2
Hawaii Loss Experience
Automobile – Property Damage Liability 1960–1970

| Year | Premiums | | Losses | |
|-------|------------|------------|------------|------------|
| | Written | Earned | Incurred | Paid |
| | (1) | (2) | (3) | (4) |
| 1970 | 10,853,551 | 9,723,258 | 6,993,975 | 6,482,457 |
| 1969 | 8,059,085 | 7,549,207 | 5,814,753 | 5,607,877 |
| 1968 | 6,755,907 | 6,288,827 | 4,272,752 | 4,303,033 |
| 1967 | 5,670,858 | 5,439,733 | 3,582,347 | 3,423,573 |
| 1966 | 5,368,292 | 5,178,788 | 3,092,986 | 2,891,361 |
| 1965 | 4,967,862 | 4,766,608 | 2,954,689 | 2,636,355 |
| 1964 | 4,615,882 | 4,419,711 | 2,281,600 | 2,243,775 |
| 1963 | 4,456,146 | 4,333,228 | 2,192,404 | 2,218,813 |
| 1962 | 4,463,844 | 4,299,328 | 2,453,584 | 2,325,168 |
| 1961 | 3,986,403 | 3,937,478 | 2,404,113 | 2,254,978 |
| 1960 | 3,762,198 | 3,391,235 | 2,257,034 | 2,071,582 |
| Total | 62,960,028 | 59,327,401 | 38,300,237 | 36,458,972 |

Source: Hawaii State department of regulatory agencies, *Report of the Insurance Commissioner*, Honolulu: 1960–1970.

The first and last items in the above formula, losses paid and losses incurred, are available for the period 1960–1970 in table C-1. Loss reserves are

not readily available from the insurance commissioner's report, and must therefore be estimated.

Table C-3
Hawaii Loss Experience
Automobile – Physical Damage 1960–1970

| Year | Premiums | | Losses | |
|--------------|--------------------|-------------------|-------------------|-------------------|
| | Written | Earned | Incurred | Paid |
| | (1) | (2) | (3) | (4) |
| 1970 | 18,026,677 | 16,641,634 | 10,240,709 | 9,863,513 |
| 1969 | 14,223,125 | 13,407,073 | 8,808,609 | 8,635,490 |
| 1968 | 12,182,096 | 11,604,057 | 7,481,135 | 7,167,685 |
| 1967 | 10,724,200 | 10,225,225 | 5,910,757 | 5,716,429 |
| 1966 | 9,415,450 | 9,031,275 | 5,186,806 | 5,199,311 |
| 1965 | 8,385,634 | 7,949,230 | 4,837,086 | 4,398,965 |
| 1964 | 7,416,681 | 6,964,505 | 3,474,262 | 3,446,234 |
| 1963 | 6,676,010 | 6,283,304 | 3,278,854 | 3,339,010 |
| 1962 | 6,215,311 | 6,010,986 | 3,616,656 | 3,626,678 |
| 1961 | 5,928,969 | 5,838,612 | 3,389,479 | 3,319,698 |
| 1960 | 5,481,094 | 5,118,338 | 3,589,519 | 3,343,054 |
| Total | 104,675,247 | 99,074,239 | 59,813,872 | 58,056,067 |

Source: Hawaii State department of regulatory agencies, *Report of the Insurance Commissioner*, Honolulu: 1960–1970.

Table C-4
Hawaii Loss Experience
Hawaii Medical Service Association (HMSA) 1960–1970

| Year | Dues | Benefits Paid | Ratio of Benefits Paid to Dues Received |
|--------------|--------------------|--------------------|---|
| 1970 | 35,388,717 | 33,590,188 | 94.92% |
| 1969 | 30,577,328 | 28,107,331 | 91.92 |
| 1968 | 26,705,285 | 24,659,375 | 92.34 |
| 1967 | 22,137,941 | 20,889,864 | 94.36 |
| 1966 | 20,290,991 | 18,825,918 | 92.78 |
| 1965 | 19,216,631 | 17,445,389 | 90.78 |
| 1964 | 17,303,218 | 15,402,693 | 89.02 |
| 1963 | 15,003,180 | 13,641,472 | 90.92 |
| 1962 | 13,422,491 | 12,464,463 | 92.86 |
| 1961 | 10,822,345 | 9,521,449 | 87.98 |
| 1960 | 9,062,903 | 7,992,932 | 88.19 |
| Total | 219,931,030 | 202,541,074 | 92.02% |

Source: Hawaii State department of regulatory agencies, *Report of the Insurance Commissioner*, Honolulu: 1960–1970.

Table C-5
Hawaii Loss Experience
Group Accident and Health 1960-1970

| Year | Premiums | | Losses | |
|-------|------------|------------|------------|------------|
| | Written | Earned | Incurred | Paid |
| | (1) | (2) | (3) | (4) |
| 1970 | 14,876,077 | 15,189,532 | 10,571,607 | 9,214,435 |
| 1969 | 8,677,352 | 8,315,558 | 7,793,126 | 6,154,854 |
| 1968 | 8,088,410 | 8,173,665 | 7,011,993 | 6,534,101 |
| 1967 | 7,236,893 | 7,105,185 | 5,917,121 | 5,548,744 |
| 1966 | 6,086,846 | 6,002,674 | 4,763,860 | 4,565,735 |
| 1965 | 5,956,939 | 5,955,781 | 4,819,357 | 4,464,304 |
| 1964 | 5,246,427 | 5,186,864 | 4,295,942 | 4,151,989 |
| 1963 | 5,055,172 | 5,032,474 | 4,205,221 | 4,035,509 |
| 1962 | 4,636,010 | 4,659,643 | 3,853,958 | 3,891,798 |
| 1961 | 4,669,318 | 4,685,274 | 3,930,869 | 3,871,833 |
| 1960 | 4,433,298 | 4,342,445 | 3,778,529 | 3,627,735 |
| Total | 74,962,742 | 74,649,095 | 60,941,583 | 56,061,037 |

Source: Hawaii State department of regulatory agencies, *Report of the Insurance Commissioner*, Honolulu: 1960-1970.

Table C-6
Hawaii Loss Experience
Workmen's Compensation 1960-1970

| Year | Premiums | | Losses | |
|-------|-------------|-------------|------------|------------|
| | Written | Earned | Incurred | Paid |
| | (1) | (2) | (3) | (4) |
| 1970 | 23,667,364 | 22,334,005 | 12,772,044 | 10,025,801 |
| 1969 | 16,860,802 | 16,344,504 | 11,759,787 | 8,655,249 |
| 1968 | 13,153,763 | 13,149,735 | 10,154,982 | 7,526,350 |
| 1967 | 11,149,970 | 10,753,279 | 7,529,546 | 6,856,696 |
| 1966 | 10,741,306 | 10,486,265 | 8,514,580 | 5,614,820 |
| 1965 | 9,855,332 | 9,593,730 | 6,060,373 | 4,882,451 |
| 1964 | 9,039,679 | 8,654,000 | 5,215,875 | 4,400,159 |
| 1963 | 8,031,462 | 7,461,031 | 5,367,346 | 4,091,254 |
| 1962 | 7,367,444 | 7,188,677 | 4,372,245 | 3,928,123 |
| 1961 | 6,718,820 | 6,784,778 | 5,248,825 | 3,650,214 |
| 1960 | 6,797,239 | 6,290,833 | 4,010,883 | 3,046,446 |
| Total | 123,383,181 | 119,040,837 | 81,006,486 | 62,677,563 |

Source: Hawaii State department of regulatory agencies, *Report of the Insurance Commissioner*, Honolulu: 1960-1970.

Table C-7
Hawaii Loss Experience
Liability Other than Auto-Bodily Injury 1960-1970

| Year | Premiums | | Losses | |
|-------|------------|------------|------------|------------|
| | Written | Earned | Incurred | Paid |
| | (1) | (2) | (3) | (4) |
| 1970 | 8,554,111 | 7,766,157 | 3,714,459 | 2,389,940 |
| 1969 | 6,134,419 | 5,731,696 | 2,201,649 | 1,585,185 |
| 1968 | 4,756,987 | 4,576,859 | 1,667,897 | 1,722,119 |
| 1967 | 4,151,610 | 3,814,704 | 1,616,411 | 1,362,079 |
| 1966 | 3,433,802 | 3,400,320 | 1,526,122 | 1,012,589 |
| 1965 | 3,326,915 | 3,369,180 | 870,880 | 793,417 |
| 1964 | 3,210,027 | 2,969,782 | 1,248,230 | 857,988 |
| 1963 | 2,833,465 | 2,702,976 | 1,362,849 | 697,413 |
| 1962 | 2,772,257 | 2,649,643 | 982,429 | 500,128 |
| 1961 | 2,695,081 | 2,575,901 | 1,067,518 | 532,806 |
| 1960 | 2,289,437 | 2,030,449 | 744,648 | 382,427 |
| Total | 44,158,111 | 41,587,667 | 17,003,092 | 11,836,091 |

Source: Hawaii State department of regulatory agencies, *Report of the Insurance Commissioner*, Honolulu: 1960-1970.

Table C-8
Hawaii Loss Experience
Liability, Other than Auto-Property Damage 1960-1970

| Year | Premiums | | Losses | |
|-------|------------|------------|-----------|-----------|
| | Written | Earned | Incurred | Paid |
| | (1) | (2) | (3) | (4) |
| 1970 | 2,899,166 | 2,669,195 | 1,699,434 | 894,910 |
| 1969 | 1,973,124 | 1,924,584 | 811,232 | 747,081 |
| 1968 | 1,584,712 | 1,568,913 | 897,325 | 606,604 |
| 1967 | 1,493,198 | 1,427,354 | 551,644 | 406,173 |
| 1966 | 1,471,441 | 1,407,779 | 497,932 | 435,912 |
| 1965 | 1,219,710 | 1,151,784 | 222,642 | 331,129 |
| 1964 | 996,522 | 946,049 | 616,546 | 371,928 |
| 1963 | 856,782 | 812,352 | 349,344 | 315,636 |
| 1962 | 819,540 | 803,962 | 316,162 | 281,217 |
| 1961 | 877,517 | 842,605 | 370,133 | 227,977 |
| 1960 | 736,688 | 700,705 | 294,588 | 215,821 |
| Total | 14,928,400 | 14,255,282 | 6,626,982 | 4,834,388 |

Source: Hawaii State department of regulatory agencies, *Report of the Insurance Commissioner*, Honolulu: 1960-1970.

B. Estimation of Loss Reserves

Losses paid for 1960-1970 were \$86,250,612; losses incurred were \$108,910,801. Thus

$$(1) \quad x = \$ 86,250,612$$

$$(2) \quad x + y - z = 108,910,801$$

$$\text{and } (3) \quad y - z = 22,660,189$$

If ratio of loss reserves at end of any period is a constant percentage of losses incurred during the period, then

$$(4) \quad \frac{y}{21,319,922} = \frac{z}{3,929,464}$$

$$(5) \quad z = .1843y$$

and, substituting (5) into (3) gives

$$(6) \quad y - .1843y = .8157y = 22,660,189$$

$$(7) \quad y = 27,780,053$$

C. Calculation of Time to Settlement

The estimated loss reserves at the end of 1970 were \$27,780,053, and losses paid during 1970 amounted to \$19,305,597. It is assumed here that loss reserves represent a reasonably accurate indication of losses which will in fact have to be paid out by insurance carriers for accidents prior to January 1, 1971. If it is further assumed that the \$27.8 million in reserves will be paid out at an annual rate of \$19.3 million (the losses paid in 1970), then the reserves will be exhausted in approximately one year and 23 weeks (reserves divided by annual payout).

The *average* time to settlement from January 1, 1970 is obviously half this figure, or about 37 weeks (nine months). This calculation is from January 1st only. However, many of the accidents represented by the \$27 million in reserves have had settlement pending for some time; the average pending time would probably be almost nine months. Hence on the basis of these aggregate data, the average time to settlement is about one year and 23 weeks, or one year and five months.

III. Validation of Closed Claims Survey

Chapter 8 displayed results of a closed claim survey that was conducted using information extracted from the files of five major motor vehicle insurance carriers in Hawaii. A net of 512 claims closed during 1970 was used for the resulting tabulations and analysis. The following discussion deals with the methods and procedures used to conduct the survey, as well as a validation of basic survey composition and comparison with results of two major national automobile compensation studies: the U. S. Department of Transportation study of auto insurance and compensation completed in 1970, and a closed claims study of the automobile loss experience conducted in 1969 by the American Insurance Association.

A. Methods and Procedures

Sample survey data were extracted from the claim files of selected insurance carriers writing automobile lines in Hawaii. As indicated in table C-9, these firms had total premiums written in 1969 of over \$10.2 million, or about 18 percent of the total volume for the State. The original survey sample was allocated among the five carriers in proportion to their volume written; this distribution is shown in column 2 in table C-9. The resulting distribution, after data checking and validation, is shown in column 1. Thus, the resulting data base for tabulations has a slight over-representation for Pacific, First Insurance and Guaranty, and an equivalent under-representation for Island Insurance and State Farm Mutual.

Claims information is normally based on an accident involvement unit of reporting. Thus a claims file may have anywhere from one to perhaps as many as ten or more individual claimants, with varying degrees of losses and each settled differently at various points in time. A claim that is filed may involve bodily injury or property damage liability losses, or both. In some instances, claims initiated as a bodily injury claim may be settled as a property damage liability award. Further, a claim for estimated bodily injury losses may be filed at the date of loss and, as has been evidenced, may be closed without any award being made.

Table C-9

**Composition of Survey Sample of Closed Claims by Company and
Direct Automobile Insurance Premiums Written, 1969**

| Company | Percent Distribution | | Difference |
|------------------------------------|-------------------------------|----------|------------|
| | Survey Sample | Premiums | |
| | (1) | (2) | (1)-(2) |
| Pacific Insurance | 35.5 | 25.5 | +10.0 |
| First Insurance and Guaranty | 31.6 | 26.5 | +5.1 |
| Hawaiian Insurance and Guaranty .. | 17.9 | 20.7 | -2.8 |
| Island Insurance | 4.8 | 10.8 | -6.0 |
| State Farm Mutual | 10.2 | 16.5 | -6.3 |
| | 100.0 | 100.0 | |
| | (512 claims) (\$10.2 million) | | |

Sources: Haldi Associates, Inc., sample survey of closed claims, automobile insurance, Hawaii, 1970.

Hawaii State department of regulatory agencies, *Report of the Insurance Commissioner, 1970*, Honolulu.

The basic data array was extracted using the survey instrument and attached instructions shown at the conclusion of this section (see exhibit C-1). The study team prepared the instructions and forms and the basic information was coded onto the form by members of the firms which volunteered to participate in the survey.

B. Validity of Results

The validity or accuracy of such a sample survey can be checked by comparing the percent error of estimate for the average value of paid out bodily injury claims in the survey with data compiled for the same year, 1970, by the Hawaii Insurance Rating Bureau.

In 1970, the average paid out bodily injury claim for IRB members was \$1,818; the average value for the sample survey was \$1,760. Thus, there is less than a 3.2 percent error in the estimates derived from the sample survey. This is a fairly good indicator of both the accuracy of the results and the efficiency of the sampling technique.

C. Comparison with National Closed Claim Surveys

The subject of automobile insurance reform has generated several major studies of accident compensation conducted both by government and private industry. Foremost among these studies are two: the U. S. Department of Transportation (DOT) study of auto insurance and compensation, a two-year effort completed in 1970, and a survey of the closed claims experience of member carriers of the American Insurance Association.

The studies had slightly different objectives from the present one and, as a result, their data collection and analysis concentrated on separate problems of automobile insurance reparations. The DOT study conducted a number of nationwide surveys of victim loss experience in an attempt to derive estimates of the extent of under- and overcompensation for serious injuries and fatalities. The AIA study concentrated on the extent of less serious injuries paid for under bodily injury claims filed with member companies in seven states. The State of Hawaii was not included in the data base

for either study. The comparisons shown in tables C-10 and C-11 illustrate some of the divergence between the composition of the present study and the two prominent national surveys of traffic accident victim compensation.

In general, the following can be said about the present closed claim survey and the DOT results. The Hawaii closed claims have a greater preponderance of cases in the low value range below \$1,500 and slightly higher above \$10,000. In the mid-ranges, between \$1,500 and \$10,000, the DOT study has approximately 40 percent more cases. The result is that, in the aggregate, Hawaii closed claims are less than 50 percent of the average value of losses in the DOT study. Again, the DOT study concentrated very heavily on the analysis of serious injury cases and fatalities; the current study did not because of the limited number of such occurrences experienced in Hawaii and the across-the-board random sample which was taken.

Table C-11 compares the distribution of Hawaii sample cases with that for the 1969 AIA survey conducted in seven states. The AIA study included many less serious claims below \$500 in value; 38 percent more than in the Hawaii closed claims survey. In the value range of \$1501-\$5000, the Hawaii survey has 21 percent more cases than in the AIA survey. Again, the private industry study concentrated on a different spectrum of the auto accident compensation problem, the less serious cases.

Table C-10
Comparison of Survey Sample and
U. S. Department of Transportation Survey of
Economic Loss Experience Automobile Insurance and
Compensation Study

| Value Range | Average Value of Awards | | |
|---------------------|-------------------------|------------------------------------|---|
| | Survey Sample | Department of Transportation Study | Difference (1-2) as Percent of Column (2) |
| | (1) | (2) | (3) |
| \$ 1 - 500 | \$ 413 | \$ 396 | +4.3 |
| 501 - 1,500 | 1,176 | 1,281 | -8.2 |
| 1,501 - 5,000 | 3,124 | 3,264 | -4.3 |
| 5,001 - 10,000 | 5,753 | 8,619 | -33.2 |
| 10,000+ | 15,655 | 11,340 | +38.1 |
| Average claim award | \$ 1,760 | \$ 4,082 | -57.3 |

| Value Range | Distribution (Percent) | | |
|----------------|------------------------|------------------------------------|------------|
| | Survey Sample | Department of Transportation Study | Difference |
| | (1) | (2) | (3) |
| \$ 1 - 500 | 42 | 6 | +36 |
| 501 - 1,500 | 28 | 24 | +4 |
| 1,501 - 5,000 | 21 | 53 | -32 |
| 5,001 - 10,000 | 6 | 16 | -10 |
| 10,000+ | 3 | 1 | + 2 |
| Total | 100 | 100 | |
| N= | (455) | (267,851) | |

Source: Table 8-12, *supra*; Table 44 B, "Total Compensation to Families Not Receiving Tort Settlement for Economic Loss," in U. S. Department of Transportation, *Auto Insurance and Compensation Study, Vol. I, Economic Consequences of Automobile Accident Injuries*, Washington, D. C.: U. S. Government Printing Office, April 1970.

Table C-11
Comparison and Survey Sample and
American Insurance Association Closed Claim Survey of
Seven States 1969

| Value Range | Distribution (Percent) | | Difference |
|---------------|------------------------|------------|------------|
| | Survey Sample | AIA Sample | |
| \$ 1 - 500 | 46 | 84 | -38 |
| 501 - 1,500 | 30 | 13 | +17 |
| 1,501 - 5,000 | 24 | 3 | +21 |
| Total | 100 | 100 | |
| Claims | (414) | (5,153) | |

Thus the present Hawaii closed claim survey would appear to present a balanced picture of the overall performance of the current tort liability system in Hawaii, with reasonably accurate results.

IV. Disposition of Motor Vehicle Tort Cases in Hawaii

In chapter 8 a comparison was made between the relative performance of the insurance and court systems in settling cases involving motor vehicle traffic accidents. It was asserted that the actual number of such cases that reach the judiciary and are settled through court actions is a small fraction of the total number of claims generated annually.

This appendix presents an analysis of the flow of such cases through the judiciary and compares it with the pattern for all civil actions. The analysis is based on data compiled by the department of the judiciary and published in its annual report. Most cases involving significant amounts of losses are heard in the four State circuit courts.

A. Comparative Caseloads for Civil Actions

Table C-12 displays the changes in the comparative caseloads for all civil actions and those involving motor vehicle accidents for both personal injury and property damage. In general, motor vehicle accidents constitute 10 percent of the total civil action cases pending at the start of the court calendar. The number filed during the year increased the backlog of cases by more than 57 percent for all civil actions and by nearly 70 percent for motor vehicle actions. During the course of the judicial calendar, less than two-fifths of the caseloads for both categories were terminated either through trial or non-trial actions; e.g., withdrawing a case due to outside settlement or arbitration.

B. Disposition of Terminated Cases

The manner in which cases are terminated is further analyzed in table C-13. Of all civil actions

terminated during fiscal year 1969-70, more than four-fifths were disposed of through non-trial actions, hearings, arbitration, etc. However, in the instance of motor vehicle actions, over 93 percent were handled through non-trial actions and less than 7 percent were terminated through trial.

Table C-12
Analysis of Comparative Caseloads
Circuit Court of Hawaii
Fiscal Year 1969-70

| | Number | | Percent Distribution | |
|------------------|-------------------|-----------------------|----------------------|-----------------------|
| | All Civil Actions | Motor Vehicle Actions | All Civil Actions | Motor Vehicle Actions |
| Pending at start | 13,830 | 1,386* | 100 | 100 |
| Filed | +7,893 | +966 | 57 | 69 |
| Total caseload | 21,723 | 2,352 | 100 | 100 |
| Termination | -8,045 | -918 | 37 | 39 |
| Pending at end | 13,678 | 1,434 | 63 | 61 |

Source: Hawaii State Department of Judiciary, *Annual Report of the Department of Judiciary, Fiscal Year 1969-70*, Honolulu, 1970.

*Includes personal injury and property damage actions.

Table C-13
Disposition of Terminated Cases
Circuit Court of Hawaii
Fiscal Year 1969-70

| | Total Terminations | Jury Verdict | Non-Jury Verdict | Non-Trial Terminations |
|-----------------------------|--------------------|--------------|------------------|------------------------|
| Total civil actions | 8,045 | 153 | 1,475 | 6,417 |
| Motor vehicle actions .. | 918 | 40 | 23 | 855 |
| Distribution (Percent) | | | | |
| Total civil actions | 100.0 | 1.9 | 18.3 | 79.8 |
| Motor vehicle actions .. | 100.0 | 4.4 | 2.5 | 93.1 |

Source: Hawaii State department of judiciary, *Annual Report of the Department of Judiciary, Fiscal Year 1969-70*, Honolulu.

Using the total number of injury and property damage liability claims (approximately 9,000) in Hawaii for the same period, the following estimate shows that less than 10 percent of all personal injury loss claims reach court and less than 1 percent obtain compensation through trial.

| | Number | Percent of Total |
|----------------------------------|--------|------------------|
| Total bodily injury claims . . . | 9,000 | 100.0 |
| Filed | 966 | 10.7 |
| Terminated | 918 | 10.2 |
| Terminated through trial . . . | 63 | .7 |

Table C-11

| Disposition | Motor Vehicle Accidents | | All Other Accidents | |
|--------------------------------|-------------------------|------------------|---------------------|------------------|
| | Number | Percent of Total | Number | Percent of Total |
| Total filed | 966 | 10.7 | 1,000 | 11.1 |
| Total terminated | 918 | 10.2 | 1,000 | 11.1 |
| Total terminated through trial | 63 | .7 | 100 | 1.1 |

Source: Hawaii State Department of Judiciary, Annual Report of the Department of Judiciary, from Year 1988-89, Honolulu, 1989.

IV. Disposition of Motor Vehicle Tort Cases in Hawaii

In chapter 3 a comparison was made between the relative performance of the insurance and court systems in settling cases involving motor vehicle traffic accidents. It was asserted that the total number of such cases that reach the judiciary and are settled in the court system is a small fraction of the total number of claims reported annually.

This appendix presents an analysis of the flow of such cases through the judiciary and compares it with the pattern for all civil actions. The analysis is based on data compiled by the department of the judiciary and published in its annual report. Most cases involving significant amounts of losses are heard in the four State circuit courts.

A. Comparative Caseloads for Civil Actions

Table C-12 displays the changes in the comparative caseloads for all civil actions and those involving motor vehicle accidents for both personal injury and property damage. In general, motor vehicle accidents constitute 10 percent of the total civil action cases pending at the start of the year calendar. The number filed during the year increased the backlog of cases by more than 57 percent for all civil actions and by nearly 70 percent for motor vehicle actions. During the course of the judicial calendar less than two-fifths of the caseloads for both categories were terminated either through trial or non-trial actions, e.g. withdrawing a case due to outside settlement or arbitration.

B. Disposition of Forwarded Cases

The number in which cases are terminated is further analyzed in table C-13. Of all civil actions

Exhibit C-1

Haldi Associates, Inc.
Hawaii Motor Vehicle Insurance Study
Survey of Closed Claims for 1970

Instructions and Information

Background and Purpose of Survey

The consulting firm of Haldi Associates, Inc., of New York has been engaged by the Office of the Legislative Auditor at the request of the State Legislature of Hawaii to conduct a comprehensive study of motor vehicle insurance reform for the State of Hawaii. A major element in the firm's investigations is an assessment of the nature and adequacy of compensation for victims of automobile accidents in the State. To this end, a survey of closed claims maintained by motor vehicle insurance carriers doing business in the State has been designed. Your firm has voluntarily consented to participate in this survey. Your cooperation in assisting us in completing the survey is greatly appreciated.

Using the Survey Form

Attached is a completed sample copy of the survey form to be used to collect basic data. The form, as you will notice, has two parts: *Part A* which identifies the claim and describes some of its basic characteristics; *Part B* which is directed at acquiring information on the cost of the settlement.

In general, please use a blue or black ink ballpoint pen or dark lead pencil in filling out the survey form. Information for each item in the schedule will be derived from the claims file abstract, settlement drafts or summary sheets in the file itself. Data should be filled in from the extreme right to left as shown in the sample form. Dates, such as "Date of Loss", e.g., Oct. 10, 1971, should be filled in as follows, "10-10-71."

Items 8 and 10 should be left blank as indicated. They will be calculated by the study office staff. However, all other items including 8. A, B and C should be filled in.

When you have completed the form, sign your initials in the space provided in the lower left hand corner and indicate the date of completion in the lower right hand corner.

Thank you.

APPENDIX D

ACTUARIAL METHODS AND PROCEDURES

In chapter 14, savings estimates were presented for five alternative insurance-legal systems. Additional comments were made on the effect of changing to a modified tort-liability system or to a partial no-fault plan and on three possible policy options in a complete no-fault plan. This appendix explains how these savings were calculated.

I. Calculations for Five Alternative Insurance-Legal Systems

Savings calculations for each of the five alternative insurance-legal systems will be examined first.

A. Tort Liability/Private, Group Insurance

The first alternative involves only a shift to mass merchandising. Group insurance was assumed to cost about 15 percent less than private, individual insurance. Experience under existing "mass merchandising" plans in states other than Hawaii provides support for this estimate. The premium components for bodily injury insurance were assumed to be as follows:

| | Group Insurance | | |
|--------------------------------------|-------------------------|-----------------------|------------------|
| | Individual Insurance | Individual Premium | Group Premium |
| Pure losses | .541 | .541 | .636 |
| Loss adjustment expenses | .100 | .100 | .118 |
| General adminis- tration expenses | .065 | .055 | .065 |
| Other expenses | .294 | .154 | .181 |
| | <u>1.000</u> | <u>.850</u> | <u>1.000</u> |

Similar assumptions were made regarding the property damage coverages.

B. Complete No-Fault/Private, Individual Insurance

The second alternative involves a shift to a no-fault system. Bodily injury and property damage estimates will be explained separately.

1. Bodily injury coverages. Twelve estimates were presented for each of the two no-fault bodily injury systems. The two systems differed only with respect to whether social insurance benefits were deducted or whether all social insurance *and private health insurance benefits* were deducted. As explained in chapter 14, the twelve estimates differed depending upon assumptions regarding (a) claim frequency under the no-fault system relative to claim frequency under the present system and (b) relative claim severity (influenced greatly by the size of permanent disability and death cases under no-fault) under the two systems. The low-cost estimate is based, with certain modifications, on the sample data and methodology used by the American Insurance Association (AIA) to determine the cost of its own no-fault plan in seven states—California, Connecticut, Illinois, Massachusetts, New York, Rhode Island, and Wisconsin. The modifications were as follows:

- (i) *Out-of-state modification.* Because Hawaii is an island state located about 2,400 miles from the west coast of the mainland, Hawaii residents are less likely to be involved in out-of-state accidents than residents in the seven states sampled.

Consequently, the loss cost of out-of-state liability coverage was reduced from 6.7 percent of present system loss costs to 1.0 percent. On the other hand, passengers and pedestrians noted as injured out of state in the AIA sample were considered to have been injured in Hawaii, thus raising the relative claim frequency under no-fault from 127.1 percent to 127.9 percent. Furthermore, no allowance was made for subrogation recoveries on out-of-state accidents when the other driver was at fault.

(ii) *Collateral source modification.* Reductions in loss costs because of collateral source recoveries were increased because both of the no-fault plans under investigation stipulate more sources of recovery than the AIA plan. The AIA methodology and supporting data were used to calculate these offsets.

(iii) *Permanent disability modification.* Permanent disability and survivorship cases plus deferred benefits for disabled children were expected to increase pure loss costs by 12 percentage points more than the AIA originally estimated. The American Mutual Insurance Alliance (AMIA) would have added 29 percentage points for permanent disability and survivorship cases. An independent estimate explained below indicated an additional cost of 24.5 percentage points. The four severity assumptions used in the analysis—12, 20, 29, and 37 percentage points—range from half of this independent estimate to 1.5 times its value. One of the points shown is the AMIA estimate.

The independent estimate was obtained by combining U. S. Department of Transportation (DOT) data on death cases with the AMIA estimate of the relationship between permanent disability case costs and the cost of fatalities. According to table 9B in volume I of the DOT study, *Economic Consequences of Automobile Injuries*, in 1967 families with fatalities suffered

about \$1.2 billion in economic losses, not counting property damage losses. Collateral source recoveries from social security and workmen's compensation reduced this loss to about \$1 billion. This estimate, however, assumed that the deceased person would have received a 3 percent annual increase in wages (imputed wages if a housewife) if he had lived. Removing the losses associated with this inflation factor and multiplying the remainder by a tax adjustment factor of .85 produced a net economic loss of about \$600 million, which was almost 4.2 times the gross tort settlements received by these families excluding payments in excess of \$10,000. According to the AIA sample, death cases accounted for about 3.8 percent of total tort settlements—excluding settlements in excess of \$10,000. DOT data suggest a similar percentage. Death cases, therefore, were assumed under the intermediate estimate to be about

$$(4.2) (3.8\%) = 15.9\%$$

of present system costs. According to the AMIA study, long-term disability cases cost about 55 percent of death cases. Hence, long-term disability and death cases combined were assumed to add about

$$(1.55) (15.9\%) = 24.6\%$$

of present system costs. The actual figure used was 24.5 percent.

(iv) *Loss adjustment modification.* Instead of the 55.0 percent of premiums allocated for losses in the AIA study, 54.1 percent, the current proportion in Hawaii, was used in this study. Because serious losses were expected to be relatively more important than the AIA study assumed and because the ratio of loss adjustment expenses to losses under the present system is different in Hawaii, loss adjustment expenses under the no-fault system were expected to be 13.5 percent of losses, not 11.0 percent.

Table D-1

Index Numbers of Claim Frequency, Average Economic Loss and Total Loss Costs under Bodily Injury Coverage – Low Cost Estimate

(Present System = 100)

| | Number of Claims | Average Amount | Total Loss Costs |
|--|------------------|----------------|------------------|
| <u>Present System Tort Claims:</u> | | | |
| Bodily injury liability insurance (\$10,000/\$20,000 limits) uninsured motorists coverage | | | |
| Total | 100.0 | 100.0 | 100.0 |
| <u>Complete No-Fault System:</u> | | | |
| Economic losses | 127.9 | 56.5 | 72.3 |
| Reductions: | | | |
| Medical expense collateral sources ... | | | -2.5 |
| Income loss reductions: | | | |
| \$750 per month limit | | | -11.7 |
| 15% tax deductible | | | -4.0 |
| Collateral sources | | | -1.8 |
| Additional costs for permanent disability and survivorship cases and deferred benefits for disabled children ... | | | 12.0 |
| Residual liability for out-of-state accidents | | | 1.0 |
| Total benefit payments under complete no-fault systems | | | 75.3 |

a. **Minimum-coverage, low-cost calculation.** The calculation of the 25 percent low-cost savings under the social-insurance-deductions-only plan for a person currently purchasing \$10,000/\$20,000 bodily injury liability insurance and uninsured motorists coverage is shown in tables D-1 and

D-2. To calculate the savings that would result if private health insurance benefits were also deducted, the reduction for medical expense collateral sources was increased to 11.0 percent of present system costs and the reduction for income loss collateral sources to 4.9 percent.

Table D-2

Conversion of Loss Saving to Premium Saving
Low Cost Estimate

| | Proportion of Present Premium under | |
|---|-------------------------------------|--------------------|
| | Existing System | No-Fault System |
| Pure losses | .541 | .541 x .753 = .407 |
| Loss adjustment expenses | .100 | .407 x .135 = .055 |
| General administration expenses | .065 | .065 |
| | <u>.706</u> | <u>.527</u> |
| Savings = $1 - \frac{.527}{.706} = 1 - .746 = 25.4\%$ | | |

b. Broad-coverage, low-cost calculation. For persons purchasing \$25,000/\$50,000 bodily injury liability insurance, \$10,000/\$20,000 uninsured motorists coverage, and \$1,000 medical payments insurance, the saving was calculated on the assumption that while under the present system the broader package would cost much more than the limited package, under a no-fault system only the very small cost of out-of-state tort liability coverage would be increased. The calculation was as follows:

$$1 - \frac{.746(86.65) + .09}{86.65 + 31.65} = 45.3\%$$

c. Minimum-coverage, high-cost calculation. To calculate the high-cost, low-savings estimate, the low-cost estimate was modified using the AMIA loss frequency assumption (1.30 times the AIA assumption) and 1.5 times the independent additional death and disability cost estimate. The net additional income loss associated with permanent disability and death cases was

assumed to be 37 percent of present system loss costs instead of 12 percent and the relative injury frequency under a no-fault system was increased 30 percent from 127.9 percent to 166.3 percent. The loss adjustment expense factor was also increased to 16.0 percent of losses. The calculation of the 25 percent increase in premiums under these assumptions for a person currently purchasing \$10,000/\$20,000 bodily injury liability insurance and uninsured motorists coverage under the present system is shown in tables D-3 and D-4.

d. Broad coverage, high-cost calculation. The 8 percent savings for the person currently purchasing the broader package of bodily injury coverage was calculated as explained in section (b) above.

$$1 - \frac{1.249(86.65) + .09}{86.65 + 31.65} = 8.4\%$$

e. Other calculations. Calculations for the other ten sets of assumptions were performed in the same manner.

Table D-3

Calculations of Loss Cost under Alternative Assumptions
 (37 Percent Additional Costs Instead of
 12 Percent; 30 Percent More Claims)

| | Percent |
|--|---------|
| Low-cost pure no-fault loss costs | 74.3 |
| Net additional income loss (37% - 12%) | 25.0 |
| Adjusted pure loss before compensable frequency adjustment | 99.3 |
| Compensable injury frequency adjustment factor | 1.3 |
| Total loss cost after compensable injury frequency adjustment (1.30 x 99.3) | 129.1 |
| Cost of residual liability | 1.0 |
| | 130.1 |

Table D-4

Conversion of Loss Savings under Alternative Assumption to
 Premium Saving
 (Loss Cost Developed in Table D-3; Loss Adjustment Expense
 16.1 Percent of Losses under No-Fault System)

| | Proportion of Present Premium under | |
|--|-------------------------------------|---------------------|
| | Existing System | No-Fault System |
| Pure losses | .541 | .541 x 1.301 = .704 |
| Loss adjustment expenses | .100 | .704 x .161 = .113 |
| General administration expenses ... | .065 | .065 |
| | .706 | .882 |
| $\text{Savings} = 1 - \frac{.882}{.706} = 1 - 1.249 = -24.9\%$ | | |

2. **Property damage coverages.** Three estimates were calculated for savings under each of two property damage insurance packages. The methodology used was that of the AIA. The AIA, however, assumed that property damage liability insurance losses and collision losses would be reduced 8.1 percent by paying all damage to cars under deductible collision insurance. The three estimates used in this study were 8.1 percent, 7.5 percent, and 6.8 percent, the last figure representing the proportion calculated by the New York State Insurance Department for that state. The assumed ratio of loss adjustment expenses to losses was the Hawaii collision ratio of 11 percent instead of the 10 percent used by the AIA.

For a person currently purchasing \$5,000 property damage liability insurance and deductible collision insurance, the low-cost 11 percent saving was calculated as follows:

| | Proportion of Present Premium under | | | |
|---------------------------------|-------------------------------------|-------------|---------------------------|---------------------------|
| | Existing System | | No-Fault System | |
| | P.D. Liability | Collision | P.D. Liability | Collision |
| Pure losses | .559 | .547 | $.559 \times .919 = .514$ | $.547 \times .919 = .503$ |
| Loss adjustment expenses | .082 | .064 | $.514 \times .11 = .057$ | $.503 \times .11 = .055$ |
| General administration expenses | .065 | .065 | .065 | .065 |
| | <u>.706</u> | <u>.676</u> | <u>.636</u> | <u>.623</u> |

P. D. liability saving: $1 - \frac{.636}{.706} = 9.9\%$

Collision saving: $1 - \frac{.623}{.706} = 11.8\%$

Combined saving: $1 - \frac{.901(46.90) + .882(78.29)}{46.90 + 78.29} = 11.1\%$

For the person purchasing comprehensive insurance (which would not be affected by the legal system change) in addition to the other two coverages, the 9 percent saving was calculated as follows:

$$1 - \frac{.901(46.90) + .882(78.29) + 23.21}{46.90 + 78.29 + 23.21} = 9.4\%$$

The calculations for the other two assumptions followed the same procedure.

3. **Package savings.** The package savings were calculated by comparing the sum of the reduced cost of the component coverages with their existing cost under the present system. For example, the low-cost saving of 25 percent was calculated as follows:

$$1 - \frac{(.746(86.65) + .09) + (.901(46.90) + .882(78.29) + 23.21)}{(86.65 + 31.65) + (46.90 + 78.29 + 23.21)} = 25.3\%$$

C. Complete No-Fault/Private, Group Insurance

The savings under a group insurance no-fault system were calculated in two steps:

1. The no-fault savings were calculated in the same manner as for the individual insurance system except that the premium components used were those relative to the group insurance premium; i.e., .636 for losses and .181 for other expenses. The savings are affected only slightly by this assumption.

2. The savings calculated in step 1 were increased to reflect the additional 15 percent savings associated with group insurance. For example, the low-cost saving of 37 percent on the limited package of bodily injury coverage was calculated as follows:

$$1 - .850(.746) = 36.6\%$$

For the broader package, the calculation was the following:

$$1 - \frac{.632(86.65) + .850(.09)}{86.65 + 31.65} = 53.6\%$$

Otherwise the procedure was the same as for private, individual insurance.

D. Exclusive State Fund/Tort Liability System

An exclusive state fund was assumed to incur no acquisition expenses, pay no taxes, and expect no profit, thus permitting a 29 percent reduction from ISO rates. The assumed premium components for bodily injury liability insurance were as follows:

| | Private Individual Insurance | Percent of Private Premium | Percent of Fund Premium |
|---|------------------------------|----------------------------|-------------------------|
| Pure losses | .541 | .541 | .766 |
| Loss adjustment expenses . . | .100 | .100 | .142 |
| General administration expenses | .065 | .065 | .092 |
| Other expenses | .294 | .000 | .000 |
| | 1.000 | .706 | 1.000 |

E. Complete No-Fault/Exclusive State Fund

Savings under an exclusive state fund no-fault system were calculated in two steps in a manner analogous to that explained for a private, group insurance no-fault system (section C above). However, because all of the expense reductions involved items that are expressed as a percent of the gross premium, step 1 produced the same results as the savings for the private, individual insurance no-fault system. To illustrate, the low-cost saving of 47 percent on the limited package of bodily injury coverages was calculated as follows:

$$1 - .706(.746) = 47.3\%$$

For the broader package, the calculation produced the following result:

$$1 - \frac{.527(86.65) + .706(.09)}{86.65 + 31.65} = 61.3\%$$

Similar reasoning was used to calculate the savings for the other assumptions and tables.

II. Independent Check on Validity of Loss Frequency and Severity Assumptions

The loss severity assumption was checked using an independent estimate derived from U. S. Department of Transportation data on fatal cases and AMIA death and permanent disability data. This yielded an additional cost over the AIA assumption of 24.5 percent, which is exactly half-way between the low-medium and medium-high severity estimates. Thus these two assumptions would appear to represent a "most likely" range.

It is also possible to make an independent check on the reasonableness of the loss frequency assumptions. According to data supplied by the insurance commissioner of Hawaii, insurers in 1969 paid 8,733 bodily injury claims under the present system. The police report that 133 persons died and 10,603 others were injured in automobile accidents during the same year. If injuries are increased 15 percent to reflect possible underreporting to police, the total injured and killed would be 12,326 or 1.41 times the number of insurance bodily injury liability payments. If injuries are increased 30 percent, the total injured and killed would be 13,916 or 1.59 times the number of insurance claims. However, only about 80 percent of all drivers in Hawaii are insured. If only 80 percent of all injuries in 1969 would have been compensable by insurers under a no-fault system, the two adjusted ratios of no-fault claims to tort claims become 1.17 and 1.27.¹ Hence the low and medium loss frequency assumptions, which are 1.279 and 1.471, respectively, appear to be reasonable estimates of the no-fault loss frequency in Hawaii.

III. Modified Tort Liability System

For the reasons presented in chapter 14, savings were not calculated for a modified tort liability system except with respect to collateral sources. Other savings would be small at best and might be negative. A rough estimate of the effect of collateral source deductions was calculated on the assumption that there would be no change in the level of present tort awards. It was further assumed that the AIA sample experience would be repeated in Hawaii, that injured parties with tort claims in the sample would have their recoveries reduced by these collateral source recoveries and that 20 percent of the additional death and permanent disability costs would be deducted. Since tort settlements in serious cases presently are less than the economic losses in these cases, recoveries of these losses might increase if the collateral source rule were abolished.

¹Some injuries not paid by insurers were probably compensable under the tort liability system and should have been paid by drivers without insurance. Other injuries which are not compensable under the tort system would, under a no-fault system, be the responsibility of persons not currently insured.

IV. Partial No-Fault System

The partial no-fault system detailed in chapter 14 would produce about the same savings as a complete no-fault plan under the medium severity assumption. Imposing a \$10,000 limitation on economic losses was assumed to reduce bodily injury no-fault benefit payments by about 20 percent of present system costs. Permanent disability and death cases would account for about 80 percent of this reduction. On the other hand, the residual in-state liability would cost about 20 percent of present system costs. This 20 percent was based on the amount insurers typically charge to increase bodily injury limits from \$10,000/\$20,000 to \$25,000/\$50,000. Property damage savings would not be affected.

V. No-Fault Plan Modifications

A. Disfigurement Losses

Compensation for disfigurement losses would enable 554 persons to collect \$1,000 each, thus

adding 12.6 percent of present system bodily injury loss costs to the pure loss cost. The effects of this increase were processed in the usual fashion.

B. Wage Loss Limitation

Eliminating the monthly limit on income losses would increase pure loss costs by about 3.2 percent of present system bodily injury loss costs.

C. Commercial Vehicle Liability

Imposing strict liability on commercial vehicles would reduce pure bodily injury loss costs by about 5-7 percent of present system loss costs. Present property damage loss costs would be reduced by about 4-6 percent. These estimates were based on the percentage of injuries in accidents involving a commercial vehicle.

APPENDIX E

PROCEDURES FOR ESTIMATING HEALTH CARE LOSS SHIFTING

Chapter 15 displayed estimates on the extent of duplicate payment from automobile insurance and other health plan coverages in Hawaii. This appendix displays basic data and procedures used to derive specific estimating factors used in that analysis.

A. Estimate of Revenue Impacts from Compulsory Insurance

Table 15-1 in chapter 15 displayed estimates of the revenue impacts on the insurance industry from the adoption of basic reform proposals. One such reform was the adoption of a compulsory motor vehicle insurance system for Hawaii. The estimate of revenues from this reform was derived in the following manner.

First, the present 15 percent of total motorists without insurance protection was allocated to assigned and non-standard risk categories on the basis of the inverse ratio of both categories to one another—that is, 1:3.¹ Thus, of the 60,000 vehicles presently uninsured, 15,000 were classified as non-standard risks and the remaining 45,000 as assigned risks. This allocation increased the number of vehicles classified as assigned risks to 13.8 percent and increased the number classified as non-standard risks to 11.2 percent (see table E-1).

¹This conforms generally to the distribution in other states with compulsory motor vehicle insurance.

Table E-1

Distribution of Insured Vehicles by Risk Classification under Noncompulsory and Compulsory System

| Risk Classification | Noncompulsory * | Compulsory |
|----------------------------------|-----------------|------------|
| Assigned | 3.0 | 13.8 |
| Nonstandard | 7.0 | 11.2 |
| Standard and preferred | 75.0 | 75.0 |
| Uninsured motorists | 15.0 | — |
| | 100.0 | 100.0 |

*Sources: From Hawaii Automobile Insurance Plan (HAIP); Hawaii Department of Transportation, *Motor Vehicle Reports*, Honolulu.

Table E-2

Average Premiums under Alternative Reform Plans

| Risk Classifications | Present Tort Liability | Modified Tort Liability | Complete No-Fault |
|------------------------|------------------------|-------------------------|-------------------|
| Assigned risks | \$270 | \$243 | \$216 |
| Nonstandard | 235 | 212 | 188 |
| Standard and preferred | 150 | 135 | 120 |

Second, the resulting distribution of risks displayed in table E-1 were then multiplied by the average premiums for each risk classification under the existing tort liability system shown in table E-2, to arrive at the value for increased insurance revenue income from adoption of compulsory insurance displayed in table 15-1. Existing average premiums were reduced by 10 and 20 percent for modified tort liability and no-fault, respectively, to estimate aggregate premium income under these two reform plans.

B. Extent of Duplication in Health Insurance Coverage

In chapter 15, a national estimate of duplication in health insurance coverages was used in a discussion of duplication of health coverages under auto insurance for Hawaii. This estimate was derived from unpublished data supplied by the Health Insurance Association of America from its annual survey of health plan coverages. Table E-3 displays basic data used to derive the national estimate.

Table E-3

Extent of Duplication in Health Insurance Coverage
- United States -
1970

| Health Insurance Coverage | Number of Persons in Civilian Non-Institutionalized Population (In Thousands) | | |
|---|---|--------------------|--------|
| | Total Population | Less than 65 Years | 65+ |
| Hospital | 29,514 | 28,376 | 1,138 |
| Surgical | 25,090 | 24,420 | 670 |
| Non-surgical | 15,560 | 15,133 | 427 |
| Weekly indemnity | 4,289 | 4,289 | — |
| (1) Total all coverages | 74,453 | 72,218 | 2,235 |
| (2) Total civilian non-institutionalized population, 1970 | 201,998 | 184,998 | 17,000 |
| (3) Total duplication = (1) ÷ (2) = in percent | 36 | 39 | 13 |

Source: Health Insurance Association of America, New York, unpublished estimates from annual survey of health insurance coverage.

The Health Insurance Association uses two concepts of measurements: (1) individuals having duplicate health insurance coverages and (2) duplication between insuring organizations for the same individuals. The values displayed in table E-3 cover the four basic forms of health insurance coverages arrayed by the number of persons in the civilian non-institutionalized population for the year 1970.

In general, the population below the age of 65 has greater duplication in health insurance coverage (39 percent) than do those over 65 (13 percent). This disparity is a reflection of the wide eligibility of the elderly for federal medicare hospitalization and medical insurance benefits.

C. Estimated Proportion of Medical Payments of Total Bodily Injury Losses

This estimate is based on the proportion of total bodily injury payouts represented by medical payments. As noted in chapter 8, medical and hospitalization awards in the closed claim survey constituted 54 percent of total special damages; total special damages in turn represented approximately one-quarter (22 percent) of bodily injury loss payouts (general plus special damages). Therefore, the proportion of the total bodily injury loss payout attributable to medical payments is the product of the two (54% x 22%), or approximately 12 percent. In 1970, the total bodily injury losses reported to the insurance commissioner were \$19,305,597. Applying the estimated proportion attributable to medical payments, gives \$2.3 million for 1970.

D. Estimated Extent of Duplication between Automobile Medical Payments Coverages and Health Plan Coverages

1. The proportion of auto insureds with medical payments coverage for each of the major insurance industry reporting services was calculated as a percent of insureds purchasing mandatory bodily injury coverage. These were then multiplied by the relative distribution among the three reporting services² of total medical payment losses.

²Insurance Services Office, New York; Mutual Insurance Rating Bureau, New York; National Association of Independent Insurers, Chicago.

The resulting value for Hawaii was 82 percent. That is, 82 percent of the average insureds purchasing bodily injury coverage also purchase medical payments coverages.

2. This value was then applied to an estimate of the total population having hospitalization and medical insurance coverages. This latter estimate was derived by taking the average population under the age of 65 and inflating by 5 percent to take account of those aged 65 and over. This value was calculated as follows:

Average Employed
Population in 1969
with Health Care
Coverages – Aged
65 or Less

$$540,946 \times 1.05 = 567,993$$

This value was then adjusted for those persons receiving medical assistance payments under the medicaid program in Hawaii in 1969, or 35,000. Thus, the final adjusted population with health coverages was 602,993. Dividing this by the estimated civilian resident population for 1969 (698,445) gave a final value of 86 percent. Thus, some 86 percent of Hawaii's residents are covered by some form of private, state or federal health care coverage.

3. Multiplying the estimated proportion of insured vehicle owners with medical payments coverages (82) by the proportion of all persons with health coverages (86) gave a final value of 70 percent. Therefore, at least 70 percent are covered under automobile insurance medical payments as well as under other forms of health care insurance.

E. Extent of Duplication Absorbed by Other Health Coverages

This estimate was derived by multiplying the weighted average proportion of medical payments

losses as a percent of total bodily injury loss payouts by the proportion of motor vehicle insurance owners having duplicate care coverages. The calculation was as follows:

| Average Percent of Medical Payments as Percent of Total Bodily Injury Losses | | Percent of Auto Insureds with Duplicate Coverage | | Percent of Total Medical Payments Duplication Absorbed by Other Health Insurers |
|--|---|--|---|---|
| 12% | x | 70% | = | 8.4% |

F. Extent of Reduction in Automobile Medical Payments Insurance Losses with Shifting to Collateral Sources

The extent of the reduction in commercial insurer proportions of automobile medical payments loss payouts was derived as follows:

| Proportion of Total Health Care Losses Paid out by Commercial Insurers | | Proportion of Automobile Medical Payments of Total Commercial Insurer Health Care Losses | | Extent of Reduction in Total Health Care Paid out by Commercial Insurers |
|--|---|--|---|--|
| 19% | x | 20% | = | 3.80% |

| Extent of Reduction in Total Health Care Paid Out by Commercial Insurers | | Proportion of Duplicate Health Care Coverage Held by Automobile Insureds | | Extent of Reduction of Total Health Care Payments Paid by Commercial Insurers without Mandatory Pre-Paid Health Care Law |
|--|---|--|---|--|
| 3.80% | x | 70% | = | 2.66% |

Therefore the operation of the collateral source rule without mandatory pre-paid health care legislation in Hawaii would reduce commercial insurers' share of total loss payouts by 3 percent. With mandatory pre-paid health care insurance, it would rise to 4 percent.

APPENDIX F

FINANCIAL RESPONSIBILITY LAWS

A. Origin

Recommendations on financial responsibility legislation applicable to drivers and owners of motor vehicles were promulgated nationally in 1938 by the National Conference on Street and Highway Safety, predecessor to the National Committee on Uniform Traffic Laws and Ordinances.¹ At that time concern of the National Conference leadership about problems of uncompensated automobile accident victims focused on the need for uniform state legislation designed to assure the compensation of persons suffering injury or damages *at the hands of careless drivers*. One state, Massachusetts, had already enacted legislation requiring insurance as a prerequisite to registration of a vehicle. To other states it appeared that a system less costly to motorists, and perhaps easier to supervise through the accident reporting and license suspension process, could be devised to accomplish essentially the same purpose as compulsory liability insurance. Largely through the efforts of the American Automobile Association, the National Conference was able to recommend to the states a "safety responsibility" system that, in effect, would postpone the requirement of insurance until (1) after an accident has occurred, (2) after a driver has failed to satisfy a judgment against him involving operation of a motor vehicle, or (3) after the driver has been convicted of a serious traffic

offense. In these cases the driver or owner would be required to post security or submit proof of financial responsibility for future accidents subject to a suspension of his license or registration in the event of noncompliance.²

B. State Laws

The Uniform Motor Vehicle Safety Responsibility Act, now Chapter 7 of the *Uniform Vehicle Code*, has been enacted with few variations by all states, except Massachusetts.³ Major changes in this legislation over the years have centered primarily on increases in the amounts of security required from drivers involved in accidents. The original Uniform Act called for security in the amounts of \$5,000 liability to persons injured, up to \$10,000 per accident, and \$1,000 property damage liability. Only a few states have retained these limits, while the substantial majority have raised them in attempts to meet the increased costs of medical care and property damage repair.

A standard automobile liability policy is most commonly used to satisfy the requirement of security from drivers involved in an accident.⁴

²The early proposals recommended adoption of "future proof" laws only. Proposals for requiring security after involvement in an accident were developed a few years later.

³Hawaii Revised Statutes ch. 287 (1968).

⁴Typically a driver involved in an accident must file an "SR 21" form with the department of motor vehicles indicating whether he, or the vehicle he was driving, was covered by liability insurance.

¹The National Committee was formed in 1947 and is responsible for the *Uniform Vehicle Code*.

However, such a policy does not qualify (absent a specific endorsement) as proof of future financial responsibility when security is required because a driver has not paid an accident judgment or has been convicted of a serious traffic offense.

Thus in cases where a driver is required to show responsibility for *future* accidents, all state laws have specified that only a "motor vehicle liability policy" or so-called "future proof" policy will be acceptable in order for the driver to escape a license or registration suspension.⁵ The essential differences between a standard policy and a future proof policy are: (1) the latter is far more costly; (2) a future proof policy binds the insurer absolutely once loss or damage occurs (that is, the insurer may not raise such defenses as non-payment of premium, fraud in the application, or other defenses ordinarily available under a standard policy); and (3) a future proof policy may not be cancelled until 10 days after notice of intended cancellation is submitted to the department of motor vehicles.

Another feature of the majority of state financial responsibility laws is the absence of any requirement that the driver's responsibility for causing the accident or "fault" be established before the department can suspend his license or his registration for failure to establish proof of financial responsibility. In other words, most laws require proof of financial responsibility from *all* drivers involved in a reportable accident, even if only one of them is clearly at fault. This procedure has been defended on grounds that the state is merely postponing the imposition of compulsory insurance until after a driver has been involved in an accident whether through fault or not.

Lastly, most state financial responsibility laws have a provision that specifically upholds a license or registration-suspension even though a person who has not paid a motor vehicle accident judgment has been declared bankrupt under the federal statute. In other words, the laws state that the non-paying driver cannot defeat the purpose of the financial responsibility law merely by filing a petition in bankruptcy.⁶

⁵In these cases the driver must file an "SR 22" form certifying that he has obtained insurance to cover damages occurring in any future accident he might have.

⁶See Hawaii Revised Statutes sec. 287-17. Forty-four other states have an identical law.

These last two features of state financial responsibility legislation generated considerable argument and were the subject of many state and federal court decisions. The controversy was finally resolved against validity of these provisions by the United States Supreme Court in 1971.

C. Constitutionality

Before 1971 the validity of financial responsibility legislation had been upheld by two cases decided by the United States Supreme Court. These cases, *Reitz v. Mealey*⁷ and *Kesler v. Department of Public Safety*,⁸ both upheld those provisions of the New York and Utah financial responsibility laws shared by the laws of 44 other states, including Hawaii, granting motor vehicle judgment creditor the power to cause the debtor's driver's license to be withheld and excluding the debtor from the protection of the Bankruptcy Act.⁹ These provisions in effect gave an unpaid judgment creditor an advantage by allowing him to invoke the license suspension provisions of the law at his pleasure notwithstanding the debtor's inability to pay. These laws were upheld on grounds that the purpose of the legislation was not to provide relief for a certain class of creditors but to promote highway safety by encouraging the financial responsibility of motor vehicle owners and drivers, a goal which was clearly within the purview of a state's police power. Against the argument that these laws were contrary to the intent and purpose of the federal Bankruptcy Act, and hence invalid under the Supremacy Clause of the Constitution, the Supreme Court stated (by a 5-4 vote) that in view of the legitimate purpose of the legislation the relatively slight intrusion against the spirit of the Bankruptcy Act could be overlooked because, after all, the intrusion occurred only in the form of a license suspension against the driver who didn't pay.

This rationale is no longer acceptable. On June 1, 1971 in the case of *Perez v. Campbell*¹⁰

⁷62 S. Ct. 24 (1941).

⁸82 S. Ct. 807 (1962).

⁹See Hawaii Revised Statutes sec. 287-15, *et seq.*

¹⁰91 S. Ct. 1704 (1971).

the high court reversed its position in the *Reitz* and *Kesler* cases, again by a 5-4 vote. Although the facts of this case differed slightly from those in the two previous cases, the issues were precisely the same and the Arizona statute struck down by this decision was identical to those of New York and Utah. In short, the reasoning behind the *Reitz* and *Kesler* cases was recognized as "aberrational," and it was decided that this law could not be allowed to stand in light of the clear design of the federal Bankruptcy Act. This means that HRS sec. 287-17 is unconstitutional because it is contrary to the purpose of a federal law. As a result, the driving privileges of any person whose license is suspended for failure to pay a motor vehicle accident judgment must now be reinstated once he obtains an adjudication of bankruptcy. It means, further, that any driver can escape the financial responsibility law by filing bankruptcy.

Also in 1971, the Supreme Court dealt another blow to the enforcement of financial responsibility legislation. As noted, most state laws provide for the license suspension of any driver involved in an accident regardless of fault, unless the driver submits evidence of financial responsibility. Despite the existence of a license suspension hearing procedure in most states, the evidence introduced in such a hearing is limited to two questions: Whether the driver was involved in the accident, and whether he can establish an exemption from suspension.¹¹ Any consideration of the driver's responsibility or negligence is specifically excluded. Thus a completely fault-free driver may be subject to license suspension simply because of his involvement in an accident, unless he submits evidence of insurance or other financial responsibility.

On May 24, 1971, the Supreme Court declared this practice unconstitutional because it deprives individuals of certain liberties without due process of law. In the case of *Bell v. Burson*¹² the Court stated that inasmuch as the scheme of Georgia's financial responsibility law is based on a theory of fault or negligence, some indication of a driver's carelessness must be made apparent before

his license can be suspended for lack of insurance. To apply the suspension provisions of such a law on a wholesale basis to all drivers involved in accidents without consideration of the possibility of a negligence suit amounts to an arbitrary, discriminatory procedure contrary to the 14th Amendment. The impact of this decision undoubtedly will be to require all states administering a financial responsibility law to conduct preliminary fault hearings prior to suspending an uninsured driver's license. The added cost of this requirement has already prompted a few states, according to the American Association of Motor Vehicle Administrators, to suspend enforcement of the law entirely. In states where fault hearings are provided, of course, the decision will have no great consequence.

D. Future Trends

In view of the interpretations placed on financial responsibility laws by these recent cases, the continued viability of such legislation is open to serious question. At this time the National Committee on Uniform Traffic Laws and Ordinances is engaged in a comprehensive review of the financial responsibility recommendations embodied in the Uniform Vehicle Code. It is very likely that within a short time the present structure of the Code in this area will be altered significantly and the National Committee will be asked to consider recommending to the states a scheme of compulsory insurance, the details of which are yet unspecified. In addition, one state, Maryland, has discontinued any requirement of "future proof" upon notice of a conviction or an unpaid motor vehicle accident judgment, after noting that not infrequently this procedure results in less financial protection for the motoring public.¹³

Research shows a continuing decline in the efficacy of license suspensions. In many states the number of persons driving after a suspension or revocation is increasing, with the majority of the suspensions taking place as a result of

¹¹Exemptions are listed in Hawaii Revised Statutes secs. 287-7, -8.

¹²91 S. Ct. 1586 (1971).

¹³For example, once a driver has been convicted of a serious offense he must obtain a future proof policy with minimum coverage at considerable expense and suffer cancellation of any previous insurance which might have provided high limits of liability protection, such as \$100,000 - \$300,000, and substantial first-party coverage.

non-compliance with the financial responsibility law.¹⁴ This seems to indicate a rather low level of

¹⁴National Committee on Uniform Traffic Laws and Ordinances, *Report of the Subcommittee on Drivers, 1971*.

public respect for such laws and the difficulties of enforcing a suspension order are multiplied accordingly. In sum, new remedies are needed. The financial responsibility system has not measured up to the expectations of its framers, who did not anticipate the extent and gravity which automobile accidents have attained in modern times.

APPENDIX G

STATE FUND REVENUE ANALYSIS

In chapter 16 it was concluded that a State fund dedicated to the sale of motor vehicle insurance was both a feasible and viable alternative means of administration. Further, it was recommended for adoption should the complete no-fault plan fail to function properly under private control. As noted, the extent of direct benefits that would accrue to Hawaii motorists by converting to a State fund could be as much as a \$23.4 million savings when calculated against 1970 premiums of \$54.5 million. The analysis which follows examines the revenue implications of a motor vehicle insurance fund for Hawaii.

This analysis assumes that an exclusive State fund will not be permitted to subsidize the cost of motor vehicle insurance protection by placing an additional claim on general revenue appropriations. Such an operational condition was proposed in a bill submitted to the State legislature of Hawaii in the 1970-71 session.¹ Within this constraint, calculations were based on the following assumptions:

First, using the actuarial analysis in chapter 14, current premium rates were adjusted by a 43 percent savings based on the medium-frequency and medium-severity assumption.²

Second, net revenues collected by the State fund were compared with the most favorable

reform alternative, no-fault/private insurance companies, group insurance.

Third, it was assumed that 6 percent of State fund premiums collected will be retained after provision for losses incurred and general and administrative costs of operations. Further, one-half of this net surplus will be set aside for working capital.

Based on these assumptions, the impact of conversion to a State fund is depicted in table G-1. Note that on a compulsory basis total

Table G-1
Estimates of No-Fault Premium Income
Net Revenues Collected for Private and State Funds
Hawaii, 1970

(\$ in Thousands)

| | <u>Compulsory</u> |
|--|-------------------|
| <i>Private group</i> | |
| (1) Net premium income | \$49,579 |
| (2) Revenue collections ¹ | 1,884 |
| <i>State fund</i> | |
| (3) Net premium income ² | 40,300 |
| (4) Net income returned to general revenues ³ | 1,209 |
| (5) Net revenue difference (2) - (4) | 675 |
| (6) Percent change (5) ÷ (2) | -36 |

Source: Tables 14-1 and 15-1.

¹3.8 percent of net premium income.

²Product of estimated State fund rates and distribution of risks (see chapter 15).

³Assumes 6 percent of premium income after provision for losses incurred and 50 percent reserve for revolving fund working capital.

¹See S. B. 1092.

²See table 14-1.

premium income of the fund rises by nearly a third to \$40.3 million. Based on the private, group, no-fault estimate of \$49.6 million, this amounts to a reduction of nearly one-fifth under the compulsory assumption.

Using the conservative reserve requirements of the third assumption, the State would stand to lose over one-third of its anticipated collections under private, group, no-fault (\$1.2 million versus \$1.9 million). If somewhat more realistic revolving fund

reserve requirements were made, the net loss in State revenues would disappear. For example, complete elimination of the reserve requirement would result in a net *surplus* returned to general revenues of more than \$536.5 thousand using 1970 estimates (\$2.4 million versus \$1.9 million). Thus, the adoption of a State fund, while generally more efficient, could result in significant revenue losses to the State, but nowhere near the weighty estimates prepared by some of the alternative's critics.

Appendix H

ESTIMATED PREMIUM SAVINGS UNDER NO-FAULT PROPOSAL TO STATE LEGISLATURE

I. Premium Savings

Appendix A-1 contains a motor vehicle insurance bill that will change the present tort liability system to a complete no-fault system. Using the methodology explained in appendix D, this appendix estimates the savings associated with this specific proposal.

Table H-1 shows the estimated average savings for Hawaii insureds currently purchasing three different policies with varying coverages from stock bureau companies charging rates they deem adequate under the present system. Twelve estimates are shown for each policy, based on three loss frequency assumptions and four loss severity assumptions. As was true for the estimates presented in chapter 14, the savings will most likely fall between the low to medium frequency and low-medium to medium-high severity estimates.

Policy 1 includes bodily injury liability, uninsured motorists, medical payments, property damage liability and physical damage insurance. For this policy, the estimated savings range from 8 to 23 percent. The most likely estimate is 15 to 21 percent.

Policy 2 is policy 1 less the property damage liability and physical damage coverages. The estimated savings on this package are 9 to 40 percent, the most likely range being 23 to 36 percent.

Table H-1
Estimated Percentage Premium Savings
Under No-Fault Proposal for Insureds
Purchasing under Present System
Three Different Policies of Insurance Coverages*

| Loss Severity Assumption | Loss Frequency Assumptions | | |
|--------------------------|----------------------------|--------|------|
| | Low | Medium | High |
| <i>Policy 1</i> | | | |
| Low | 23 | 19 | 16 |
| Low-Medium | 21 | 17 | 13 |
| Medium-High | 19 | 15 | 11 |
| High | 17 | 13 | 8 |
| <i>Policy 2</i> | | | |
| Low | 40 | 32 | 24 |
| Low-Medium | 36 | 28 | 19 |
| Medium-High | 32 | 23 | 14 |
| High | 28 | 18 | 9 |
| <i>Policy 3</i> | | | |
| Low | 18 | 7 | -3 |
| Low-Medium | 13 | 1 | -11 |
| Medium-High | 8 | -5 | -18 |
| High | 2 | -11 | -25 |

*Policy 1: \$25,000/\$50,000 bodily injury liability insurance
\$10,000/\$20,000 uninsured motorists coverage
\$ 1,000 medical payments insurance
\$ 5,000 property damage liability insurance
Average of \$50 and \$100 deductible collision insurance
Comprehensive insurance

Policy 2: First three coverages in Policy 1

Policy 3: \$10,000/\$20,000 bodily injury liability insurance
\$10,000/\$20,000 uninsured motorists coverage

Policy 3 is minimum bodily injury liability and uninsured motorists coverage. The average insured currently purchasing this package would under some conditions pay more under the proposed

no-fault program but he would also have considerably more protection except for the absence of out-of-state liability insurance. The estimated savings are -25 to +18 percent with -5 to +13 percent being the most likely result.

These savings estimates ignore any benefit increases that may be ordered because the cost of living increases more than 7 percent over current levels. If long-term benefits are assumed to increase about 3 percent a year because of inflation, the most likely savings for policy 1 would be reduced 4 to 5 percentage points. The savings for policy 2 would be 8 to 10 percentage points less, and for policy 3, 12 to 14 points less.

Individual Hawaii car owners purchasing insurance from stock bureau insurers may experience savings that are significantly different from those in table H-1. Conversion to a no-fault system will cause insurers to develop new ways of classifying insureds for pricing purposes. Many approaches are possible. Insureds will pay different premiums depending upon how likely they are to be involved in an accident, the probable severity of the losses that result from that accident, and the portion of those losses which the automobile insurer will be responsible for. Under a no-fault system, the factors that determine both the frequency and severity of accident claims will differ from the present rating factors. New factors will have to be considered and the old factors may have different effects. Insurers can be expected to experiment with different approaches and to revise them as they develop experience.

Under a no-fault system some insureds will improve their position relative to others and thus receive greater savings than those shown in table H-1. The reverse will be true for others, who will obtain smaller savings. New factors affecting the pricing of the bodily injury coverages will probably include the safety rating of the insured automobile, the income of the insured's family, and the public and private insurance benefits available to the family. For example, other things being equal, a motorcycle will probably cost much more to insure than a solidly built four-door sedan with safety features. Also, because of the higher income and survivor benefits, a family with an income of \$8,000 a year may pay more than a family earning \$4,000 or \$5,000 a year. A family with no private insurance may pay more than a family with a comprehensive health insurance program.

II. Actuarial Assumptions

The methodology used to derive these estimates is explained in appendix D. Some additional assumptions and steps were necessary, however, because certain details of the proposed plan differ from the system presented in chapter 14.

A. Bodily Injury Frequency Assumptions

The low, medium, and high bodily injury frequency assumptions are those used to cost the no-fault plan in chapter 14—namely, 127.9, 147.1, and 166.3 percent of present system frequency.

B. Bodily Injury Severity Assumptions

Several benefit features of the proposed bill are affected by the bodily injury severity assumptions. These features and the values assigned under the four assumptions are expressed as a percent of present system costs as follows:

| | Low | Low-Medium | Medium-High | High |
|---|------|------------|-------------|------|
| 1. \$360 monthly income to permanently and totally disabled non-wage earners plus \$360-\$600 monthly income to permanently and totally disabled wage earners | 11.2 | 11.9 | 12.6 | 13.4 |
| 2. \$20,000 payments to permanently and totally disabled persons and scheduled payments to persons with permanent partial disabilities | 8.9 | 9.7 | 10.5 | 11.2 |
| 3. \$10,000 payments to survivors or estate of deceased non-wage earners or wage earners with no dependents | 8.0 | 8.5 | 8.5 | 9.0 |
| 4. Loss of income less 15 percent tax savings subject to \$600 monthly maximum to survivors of wage earners | 12.0 | 16.0 | 20.0 | 24.0 |

1. Permanent disability income payments.

The four assumptions regarding the cost of permanent total disability income payments were developed by assuming 7.5 - 9.0 permanent and total disability cases in the American Insurance

Association sample, an average case cost of \$60,000 for the minimum \$360 per month, and an additional 20 percent average cost for wage earners who might receive up to \$600 a month. These factors were based on a synthesis of the AIA sample data, American Mutual Insurance Alliance methodology, and New York State Insurance Department reports.

2. **Scheduled disfigurement payments.** The estimated cost of the \$20,000 payments to permanently and totally disabled persons assumes payments to the 7.5 – 9.0 persons noted above. The permanent partial disability estimates were developed by applying the schedule in the bill to an AMIA sample of permanent partial disabilities and assuming that the number of permanent partial

disabilities in the AIA sample would vary between 270, the AMIA estimate, and 350, the number suggested in a U. S. Department of Transportation report on automobile personal injury claims.

3. **\$10,000 death benefits.** The \$10,000 payments to survivors of the estate of deceased non-wage earners or wage earners with no dependents were assumed to involve payments on behalf of 34–39 persons. This number is based on the proportion of wage earners in the AIA sample and the AMIA estimate of wage earners with no eligible dependents.

4. **Survivor income benefits.** The income replacement payments to survivors of deceased

Table H-2
Index Numbers of Total Loss Costs under
Bodily Injury Coverage—Low Cost Estimate
(Present System = 100)

| | Number of Claims | Average Amount | Total Loss Costs |
|--|---------------------|-------------------|---------------------|
| <i>Present System Tort Claims</i> | | | |
| \$10,000/\$20,000 bodily injury liability insurance and uninsured motorists coverages | 100.0 | 100.0 | 100.0 |
| <i>Proposed No-Fault System</i> | | | |
| AIA sample economic losses | 127.9 | 56.5 | 72.3 |
| AIA sample reductions: | | | |
| Medical expenses collateral sources | | | -11.8 |
| Income loss reductions: | | | |
| \$600 per month limit | | | -2.9 |
| 15% tax deductible | | | -4.0 |
| Collateral sources | | | -4.5 |
| | | | <hr/> 49.1 |
| \$360-\$600 monthly income to permanently and totally disabled | | | 11.2 |
| Disfigurement lump sum payments to permanently disabled | | | 8.9 |
| Lump sum payments on behalf of deceased non-wage earners and wage earners with no dependents | | | 8.0 |
| Income replacement to survivors of wage earners | | | <hr/> 12.0 |
| | | | 89.2 |
| Reduction for strict liability of commercial vehicles (-6.5% of losses) | | | <hr/> -5.8 |
| Total benefit payments under proposed system | | | <hr/> <hr/> 83.4 |

wage earners were estimated by relating the "personal and family" economic losses sustained by families with fatalities in the DOT report on *Economic Consequences of Automobile Accidents* to their tort recoveries. Adjustments were made for the 15 percent tax reduction, collateral source recoveries, and the \$600 monthly limit.

5. Other assumptions. Increasing the income payments to permanently and totally disabled persons and to the survivors of wage earners 3 percent a year would increase the first and fourth sets of assumptions about 50 percent.

Loss adjustment expenses were assumed to range from 13.5 percent of losses to 16.1 percent, depending upon the serious claim assumptions.

The effect of collateral source recoveries and the \$600 monthly limit were calculated using AIA sample data.

C. Calculation of Estimates

Tables H-2 and H-3 show how the low frequency, low severity estimate for policy 3 was

calculated. The other eleven estimates were calculated in the manner illustrated in tables D-3 and D-4.

Table H-3
Conversion of Loss Saving to Premium Saving
Low Cost Estimate

| | Proportion of Present Premium Under | |
|---|-------------------------------------|--------------------|
| | Existing System | No-fault System |
| Pure losses | .541 | .541 x .834 = .451 |
| Loss adjustment system . . | .100 | .451 x .135 = .061 |
| General administration expenses | .065 | .065 |
| Savings = $1 - \frac{.577}{.706} = 1 - .817 = 18.3\%$ | | |

The savings on policies 1 and 2 were calculated as described in appendix D. Because the property damage provisions under the proposed bill are the same as those in the chapter 14 no-fault proposal, the estimated savings on the property damage coverages did not have to be recalculated.

[Faint, illegible table content]

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