

**A Report to the Legislature
of the State of Hawaii**

Study of a State
Motor Vehicle Insurance Fund
and Selected Insurance Issues

January 1988

Coopers
& Lybrand

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PART ONE
STATE FUND
FOR MOTOR VEHICLE INSURANCE

CHAPTER I

INTRODUCTION

This introductory chapter describes the origin of the current study as it was authorized by the 1987 Hawaii State Legislature, outlines the objectives of the study, and provides a guide to the organization of the report. Certain qualifications regarding the nature of data presented in the study are also discussed.

Origin and Authorization of Study

Various legislative bills (S.B. No. 1335, H.B. No. 1928 and S.B. No. 808) were introduced in the 1987 legislative session to establish the Hawaii Drivers' Insurance Fund (HDIF) as the exclusive source for purchasing motor vehicle insurance in Hawaii. Further consideration of all bills was deferred until the 1988 session pending a study of the issues by the Legislative Auditor. That study was authorized in Act 258, SLH 1987, and Coopers & Lybrand was selected by the Legislative Auditor to perform the study.

Objectives and Scope of Study

Act 258 established four major study objectives:

- . Outline the experiences of other states and jurisdictions which have operated funds for providing automobile insurance.
- . Analyze the legislation which was proposed during the 1987 session to establish a fund in Hawaii.
- . Develop an implementation plan which could be used by the Legislature for establishing such a fund.
- . Analyze a series of four selected insurance issues:
 - Uninsured motorists
 - Nondiscrimination
 - Take-all-comers
 - Motorcycles

Organization of Report

The report is divided into two major parts. The first part deals with the immediate issues surrounding the possible development of the Hawaii Drivers' Insurance Fund while the second phase takes up the four special topic issues within the context of the current insurance marketing system.

Part One. The chapter organization and major coverage objectives for this part are:

CHAPTER II: Introduces relevant concepts.

CHAPTER III: Reviews other relevant funds and mechanisms:

- Saskatchewan, Canada
- Manitoba, Canada
- British Columbia, Canada
- Quebec, Canada
- New Zealand
- Maryland
- Puerto Rico

CHAPTER IV: Reviews the three basic fund objectives:

- Reduce cost of insurance
- Simplify payment process
- Reduce uninsured motorists

CHAPTER V: Analyzes implementation issues and analyzes the proposed enabling legislation.

CHAPTER VI: Presents a proposed implementation plan.

Part Two. This portion of the study is oriented toward an examination of four specific issues as they apply to the current private insurer environment. These topics are also addressed throughout several discussions in Part One, but have greater relevance in terms of their impact on the current private insurer environment.

CHAPTER VII: Presents an introduction to the four issue areas in order to provide a perspective on how public policy impacts the private market in these areas.

CHAPTER VIII: Examines two of the four selected issues together:

- Nondiscrimination
- Take-all-comers

CHAPTER IX: Examines uninsured motorists issues.

- . CHAPTER X: Discusses possible no-fault coverages for motorcycles.
- . CHAPTER XI: Consolidates a number of ideas for resolving problems discussed in this phase and presents some possibilities for problem resolutions.

Qualifications Regarding Report Findings

Chapter VI of this report contains illustrative financial data for a hypothetical automobile insurance fund. The example was created to illustrate the levels of premium, expense, and loss data that might be associated with a future fund. As stated several times in the text of the report, the actual premium, expenses, and loss data that would be associated with a fund would vary significantly with the form of the fund, the insurance coverages provided by the fund, the coverage rules applied to the general coverage categories, and the legal systems which are devised to operate the fund.

The financial data presented in Chapter VI (and referenced elsewhere in the report) was based on actuarial extensions of current insurance loss characteristics to the time frame to be covered under the hypothetical fund. The insurance losses under current coverage plans were used to build this data in that no other data could justifiably be substituted, but it is also clearly stated in the report that the basic nature of the fund would require changes to the coverage plans currently in effect. The actual changes would depend on future planning studies recommended within this report. As such, we emphasize that the data refers to a hypothetical situation which would not be engineered in that exact form under any circumstance, and we cannot realistically comment on what changes might be made. In total, we offer no opinion on the actual achievability of any of the actuarial illustrations.

The illustrative financial data was presented only to acquaint members of the Hawaii State Legislature with the overall magnitude of a hypothetical fund in order to facilitate further planning. The data is not intended for any other use.

Even though changing future conditions may alter the reasonableness of underlying assumptions, Coopers & Lybrand assumes no responsibility for the further update of such information or for its unauthorized uses.

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CHAPTER II

REVIEW OF THE STATE FUND CONCEPT

This chapter serves as an introduction to relevant concepts and reviews certain aspects of Hawaii no-fault legislation which serves as the backdrop for a possible state fund. Also presented is a short review of the origin of state fund concepts as they apply to Hawaii.

BACKGROUND

The Introduction of No-Fault Insurance in Hawaii

The State's first no-fault auto insurance laws were enacted in 1973 and implemented in 1974 with only modest revisions since that time. The statutes have their origins in a 1972 report to the Legislature (Office of the Auditor, Report 72-1, written by Haldi Associates, Inc.) which laid the initial groundwork for no-fault legislation as applied to automobile insurance. Haldi's contributions included:

- . Articulation of no-fault concepts.
- . Rationale for nondiscrimination.
- . Rationale for take-all-comers.
- . Rationale for uninsured motorists coverage.

The 1973 Legislature enacted legislation which contained many of Haldi's recommendations. Some of the important provisions of the 1973 act are listed below, although it must also be stated that not all of the provisions were derived from Haldi's report. Further, Haldi had recommended a total no-fault system while the actual implementation of the no-fault legislation set a threshold for tort action.

- . No-fault minimum coverage of \$15,000 per person plus bodily injury liability of \$25,000 per person and property damage liability of \$10,000 per accident were established as compulsory for all vehicles.
- . The threshold for tort action was set at \$1,500 for bodily injury (except death, permanent loss of use, or permanent disfigurement) or claims above the no-fault coverages of \$15,000 per person inclusive of \$800 per month wage loss and \$1,500 funeral expenses.
- . Welfare recipients were covered at no cost to them under provisions of the Joint Underwriting Plan (JUP).

- . Commercial lines were placed automatically in JUP.
- . Nondiscrimination was established as a significant pricing principle. Rating factors were not allowed to include race, creed, ethnic extraction, age, sex, length of driving experience, credit bureau rating, or marital status.
- . Take-all-comers was established as a mandatory requirement for selling auto insurance in the State. Insurers were not allowed to refuse insurance to licensed motor vehicle owners who paid premiums.

Major Changes Since the Introduction of the No-Fault Law

Relatively few changes have been made in the basic no-fault law since its introduction in the early 1970s. Refinements have included:

- . Commercial vehicles are no longer required to purchase insurance through the JUP.
- . Motorcycles are now exempt from mandatory no-fault coverage.
- . Nondiscrimination was expanded to include restrictions against ratings based on physical handicaps.
- . The tort threshold was placed on an index plan in 1979 which was set to cover 90% of medical claims and has reached a level of \$6,000 as of September 1987.
- . The required minimum bodily injury liability coverage was increased for 1986 to \$35,000 per person and the maximum no-fault coverage for loss of wages was increased to \$900 per month.

THE CONCEPT OF A STATE FUND

Introduction of the Concept

The concept of a State fund has been around since 1972 and debated intermittently since that time. Haldi explored the possibility for a State fund in his 1972 report on no-fault. His analysis suggested that a fund could:

- . Lower cost of insurance through elimination of acquisition costs (sales commission and support).
- . Simplify the process for obtaining insurance.

Establish better systems for monitoring lack of coverage, license suspensions, and vehicle inspections.

Haldi did not, however, recommend implementation of a State fund at that time. He indicated that there were too many other prerequisite issues to resolve regarding the introduction of no-fault insurance. Further, he suggested that the State did not have the administrative personnel and skills to administer a fund and that private industry should get first chance at servicing the market. He stated that if the private insurance carriers failed in providing adequate service under the new no-fault laws, then the fund approach should be given consideration.

Consideration of a State Fund in the 1987 Legislature

The reasons for introducing State fund bills in the 1987 legislative session were to:

- . Reduce the cost of insurance.
- . Simplify the payment process.
- . Reduce the number of uninsured motorists.

Reduce the cost of insurance. The cost of insurance through private carriers has been perceived over time to be high. The fund concept attempts to address this area by reducing sales costs, reducing duplication of efforts, and eliminating potential profits.

Simplify the payment process. Shopping to find reasonable insurance values and the subsequent large outlays of cash for premium payments are seen as prohibitive for many individuals (although some premium financing plans are available). The fund bills attempt to simplify this process by implementing a single rate-making body and collecting a large portion of the payments through a more gradual pay-as-you-go system based on a fuel tax.

Reduce the number of uninsured motorists. Concerns have continued to exist over the years that a considerable number of drivers may be driving without insurance. The fund bills attempt to address this area by increasing the control of the State to obtain insurance payment at time of vehicle registration, drivers' license renewals, and through continual pay-as-you-go taxation at the gas pump.

Versions of Fund Defined

Two basic options for forming the Hawaii Drivers' Insurance Fund (HDIF) were defined in the bills which were proposed. They involved a publicly administered fund to be operated entirely by the State of Hawaii and a privately administered fund to be operated on a shared cost basis by existing insurance carriers.

The intention underlying both fund versions is that the fund would provide motor vehicle insurance coverage for each registered vehicle in the State essentially equivalent to the basic coverages now required by Chapter 294, HRS (\$15,000

personal injury protection per person, \$35,000 bodily injury liability protection per person, and \$10,000 property damage liability protection per occurrence).

Coverage would be automatic and the fund would be the required exclusive source of such coverages. Premium amounts would be collected on an automatic basis through the registration and licensing fees as well as a motor vehicle fuel tax. While the fund would be allowed to sell extended coverages above the basics provided automatically by the fund, the private insurance carriers would be allowed to compete for the sale of these extended coverage protections.

Publicly administered fund. S.B. No. 1335 and H.B. No. 1928 were oriented toward establishing a publicly administered fund involving:

- . A board of directors appointed by the Governor.
- . Establishment of automatic minimum coverages (no-fault plus basic liability) for all motor vehicles registered in the State.
- . Collection of premiums through:
 - Fuel tax
 - Vehicle registration fees
 - Driver's License renewals
- . Competition of the fund with private industry for marketing extended coverages.
- . Creation of a work force hired under the fund to administer claims and other support operations.

Privately administered fund. S.B. No. 808 provided for the creation of a privately administered plan with public oversight. Important provisions included:

- . Similar board structure, funding provisions, and coverages as the publicly administered plan.
- . The major difference is that operations are to be provided by private industry whereby existing insurers may submit bids in order to participate in a joint underwriting plan whose membership would market and operate the fund for 5-year periods. The number of bid openings in the plan would be determined by the Insurance Commissioner based on a commission staff estimate of the number of companies necessary to carry the plan.
- . While the publicly administered fund could operate without an agency force to sell the basic coverages (as they would be provided automatically), the privately administered fund version would probably require that state residents establish specific policy relationships with particular insurance companies. The fund would essentially pay the basic premiums (bid by the companies) on behalf of the resident.

CHAPTER III

REVIEW OF OTHER RELEVANT FUNDS AND MECHANISMS

This chapter reviews the experience of other relevant funds and mechanisms. Government sponsored or operated motor vehicle insurance programs in Canada, New Zealand, Maryland, and Puerto Rico are discussed. The implications of these various programs for the proposed Hawaii Drivers' Insurance Fund (HDIF) are examined.

THE CANADIAN PLANS—GENERAL

Three reasonably similar Crown Corporations of Canada provide compulsory automobile insurance in the Canadian provinces of British Columbia, Manitoba, and Saskatchewan. These corporations are the Insurance Corporation of British Columbia (ICBC), the Manitoba Public Insurance Corporation (MPIC), and Saskatchewan Government Insurance (SGI). Much of the following information is based on a visit by Coopers & Lybrand to the Insurance Corporation of British Columbia, which, in our opinion, is demographically the most similar to Hawaii of the three. The systems in the three provinces are very similar in form, differing only in some details. A fourth Canadian fund is operated in Quebec but represents a substantially different system which is more comparable in operation to the country of New Zealand. The Quebec and New Zealand operations are discussed separately in a later section.

In all three of the other provinces, Crown Corporations have been established to be the sole provider of compulsory automobile insurance coverages to the residents of each respective province. All vehicles registered in the province are required to have insurance. Private insurers are allowed to compete with the government companies for the optional coverages but have not captured a significant share of this business due to the difficulties that policyholders face when they attempt to split their coverage between insurers. The provincial corporations are all authorized to write all lines of general property and casualty business. MPIC and SGI do write other lines of insurance while ICBC did so until 1985, at which time they sold their general business and exited this market.

Compulsory coverages in all three provinces consist of third party liability coverage, first party (no-fault) accident benefits, and uninsured and hit-and-run motorists coverage. In Manitoba and Saskatchewan, physical damage (comprehensive and collision) coverages are also required.

Optional coverages which are available from both the government insurer and private companies include increased limits of third party liability coverage, underinsured motorists coverage, physical damage coverages in British Columbia, and physical damage deductible buy-back in Manitoba and Saskatchewan.

No-fault benefits are coordinated with the provincial health insurance systems with the health insurance being primary. In British Columbia, ICBC reimburses the health insurance system for medical care provided to an automobile accident victim, plus a surcharge of 30%. It should be noted that the existence of government operated health care systems is a significant advantage to the operation of auto insurance funds in all provinces of Canada.

In all three provinces, the purchase of insurance is accomplished simultaneously with the registration of a vehicle. In British Columbia and Saskatchewan, the entire insurance premium and vehicle registration fee must be paid in one payment. Therefore, a valid registration sticker indicates valid insurance of at least the amounts required by law. In Manitoba, a two-payment plan is available. The first payment consists of all of the vehicle registration fee and half of the annual insurance premium. The second payment, for the remainder of the insurance premium, is due within ninety days. If the second payment is not made, both the registration and the insurance are canceled. In this situation, however, the registration decal is still on the vehicle license plate so the absence of valid insurance is not immediately apparent to an enforcement officer. If cancellation is made by the insured, both the license plate and sticker must be returned for a refund.

As mentioned above, in British Columbia and Saskatchewan, the insurance premium is paid in full in one payment and revenue to the insurance company is received in no other manner. In Manitoba, a \$15 insurance charge is included in the driver's license fee and becomes revenue to MPIC. In Manitoba and Saskatchewan, gas taxes have in the past been levied for the benefit of the insurance corporation. At the current time, however, this method is not being used in any province.

Independent agents process both the registration and insurance transactions in British Columbia and Manitoba. In Saskatchewan, the transactions are performed by SGI employees and by independent service contractors, some of whom are also independent insurance agents. The SGI employees and the service contractors who are not agents do not sell or service optional coverages. This is done only by independent insurance agents.

In all three provinces, age, sex, and marital status are prohibited by law as rating factors. Territory rate differences are used in British Columbia and Manitoba but not in Saskatchewan. All three provinces rate on the basis of driver traffic violations and accident involvement.

British Columbia

The corporate mission published by ICBC reads: "The mission of the Insurance Corporation of British Columbia is to make quality automobile insurance available and affordable to the people of British Columbia."

The private automobile insurance system in British Columbia during the 1960's was similar to that of many jurisdictions. The public was becoming increasingly

concerned with market problems such as the growing number of drivers who could not obtain insurance in the private market at an "affordable" price, the slowness with which claims were settled, and the general rise in insurance prices. These led to the companion problems of a rapidly growing assigned risk plan population and an increase in the number of uninsured and underinsured drivers.

In British Columbia, the Traffic Victims Indemnity Fund was established to compensate the victims of uninsured and hit-and-run drivers and the Assigned Risk Plan was created to provide insurance to those drivers who were unable to obtain coverage in the private market. Even so, pressure from certain political sectors to change the basic system continued.

The Wooten Commission, a Royal commission appointed by the provincial government in 1966, recommended additional changes to the victim compensation and automobile insurance system. Among those eventually adopted were mandatory liability insurance for all drivers and a limited no-fault benefit system.

Pressure continued, however, as expectations of faster settlement and price reductions did not materialize from the no-fault system and certain drivers continued to have difficulty obtaining coverage at affordable prices.

A New Democratic Party (NDP) government, elected in 1972, passed two pieces of legislation in an attempt to remedy the situation. The Insurance Act (Motor Vehicle) called for a system of universal, compulsory automobile insurance known as "Autoplan." The Insurance Corporation Act created the Insurance Corporation of British Columbia as a Crown corporation to carry out the provisions of the Insurance Act (Motor Vehicle) and to be the sole automobile insurer in the province.

Available insurance coverage. Given the compulsory nature of automobile insurance in British Columbia and the monopoly on such basic insurance granted to ICBC, the objective of making insurance available was accomplished ostensibly on ICBC's first day of operation. At the time of ICBC's start-up, all vehicle registrations in the province were renewed on the same date. Therefore, virtually overnight, ICBC wrote every vehicle registered in the province. The change was not without problems, however. In anticipation of the change, some private insurers had stopped selling, leaving the market short of coverage; and the claim processing activities of ICBC were delayed after the start-up. Some have also characterized the settlements at time as somewhat arbitrary.

A key feature of the British Columbia system is the relationship between the vehicle registration and the insurance purchase. Both of these functions are accomplished with a single transaction and with a single document. The independent insurance agent who represents ICBC handles the renewal of both the registration and the insurance.

The annual vehicle license fee and the annual insurance premium must be paid in full at the time of renewal. Upon payment, a combined registration and proof-of-insurance certificate is validated and a registration decal is issued for the vehicle's license plate. Thus, a valid license tag also indicates valid insurance of at least the statutory minimums.

Uninsured motorist coverage is available because there remain conditions under which an automobile may not be insured. For example, a car may be unregistered, stolen, or from another province or state and uninsured. There appears to be no unusual effort to search for unregistered, uninsured vehicles beyond checking the registration papers if a driver is stopped for other reasons by a policeman or casual observation. Still, it would seem that a tie-in between registration and insurance such as exists in British Columbia would almost always significantly reduce, although not eliminate, the uninsured population.

Affordable insurance coverage. The objective of affordable insurance is more difficult to accomplish than that of making insurance available. "Affordability" depends on who is paying the full cost of the premium. The objective of reducing the cost of insurance is also difficult because an insurance provider has little or no control over many of the factors which influence the costs of insurance. These are determined by the underlying loss costs of coverages driven by claim frequency and severity. These, in turn, are primarily affected by hospital and medical costs, repair costs, claim consciousness, traffic, and driving factors, including law enforcement, inflation, and other factors.

In the case of ICBC, the affordable insurance objective translates, for practical purposes, into an objective of keeping insurance prices "as low as possible". While ICBC does attempt to influence loss costs in several ways, its most direct effort is in the control of its own operating expenses. It is also in this area that ICBC has advantages which have been granted by statute and which are not available to private insurers.

A direct expense advantage accrues to ICBC because it is not required to pay the provincial or federal income taxes levied on private insurers. While also not subject to local property taxes, ICBC does voluntarily pay such taxes in the form of grants to the locality in which the company owns property. In the past, ICBC was also not required to pay provincial premium taxes. However, beginning in 1987, ICBC will be subject to the premium tax.

ICBC has been able to compensate its agents at a lower percentage of premium generally seen in the private insurance sector. Those agents representing ICBC are compensated under a service and percentage commission expense of about 7% of premium. The fees paid to agents currently are \$10.00 for a new business transaction, \$8.50 for a mid-term endorsement, and \$7.20 for a renewal. No fee is paid for a cancellation transaction. The agent also receives a commission of 11.5% of any premium for optional coverages.

As the only provider of compulsory automobile insurance, ICBC obviously writes all of the mandatory insurance and almost all of the optional automobile insurance in the province. This allows ICBC to take full advantage of the economies of scale associated with writing an entire market. In addition, the writing of the entire market and the absence of competitive pressures enables ICBC to more accurately predict financial results than can an individual insurer in a private market system.

Because it is a Crown corporation, ICBC is mandated to break even, on a total income basis, each year. Profits to pay stockholder dividends or to increase net worth are, therefore, not required. Being backed by the government, ICBC is able to maintain less surplus as a margin of safety than would be required of a private insurer. Thus, ICBC may have a somewhat modest expense advantage to the extent that profit and surplus accumulation is unnecessary.

Although ICBC is backed by the government, it is expected to be self-sufficient, and to be fully funded from its own operations. The government provided a loan of \$18,000,000 for start-up and was repaid somewhat prematurely within eighteen months. Further, rates were set optimistically low during the initial two years eventually requiring a government contribution of \$175,000,000 to return the corporation to a fully funded level. Since that time the corporation has received no other government funding.

It is impossible, of course, to demonstrate whether or not ICBC insurance prices are "as low as possible," or if ICBC's prices are lower than they would be in a private insurance system.

Easier premium payment. One objective of the Hawaii Drivers' Insurance Fund is to provide an "easier" method of premium payment. The single annual premium payment required in British Columbia is not designed to be "easier" and may be quite difficult for some drivers. Because there is no theoretical limit to the surcharge which is applied under the provisions of the "Claims-Rated Scale," those drivers with a number of chargeable accidents are required to pay a sizable premium in one lump sum.

ICBC did, at one time, offer a premium financing plan. This, however, was discontinued because of cost and pressure from private finance companies. ICBC estimates that in 1983 about 14% of their policyholders used the plan and that its cost was approximately \$4,000,000. In addition, the relationship between the insurance premium and license fee created significant procedural problems when financed premiums were unpaid.

As an alternative to premium financing, an optional six-month registration and insurance term will soon be available from ICBC. Under this plan 50% of the annual registration fee and annual insurance premium will be payable. An additional service charge, equal to 5% of the full annual premium, will be imposed to defray the additional processing expense.

A gasoline tax surcharge to provide a portion of ICBC revenue was considered during the early stages of the corporation's existence. This method of premium payment appeals to some because the amount of gasoline purchased correlates to a certain extent with the vehicle's exposure to accidents. Procedural and fairness issues were seen as difficult and ICBC rejected this system in favor of rating on the basis of accident record. This, in its opinion, is a more equitable method of distributing the total required insurance premiums among policyholders.

Claims rated scale. Because ICBC must provide insurance to all drivers in the province regardless of driving record, underwriting resources are shifted from risk

selection to "equitable" allocation of the required total premium pool to individual policyholders. Because the use of age, sex, and marital status as rating factors is prohibited by law, ICBC has developed a rating system which depends primarily on the claims history of the vehicle and secondarily on the violation record of the owner. The "Claims Rated Scale" provides for discounts and surcharges from a base rate depending on claims history.

The base rate for each vehicle is determined by its value and age, the territory in which it is principally operated, and its use. It should be noted here that although age is not a permissible rating factor, pleasure use by a senior citizen (age 65 or over) is a required use category. The other use categories are "pleasure," "to and from work or school," and "business."

Because ICBC cannot cancel an insured, the Insurance Act (Motor Vehicle) provides that physical damage coverage may be denied and payments made under liability coverage may be recovered from a vehicle owner who uses his vehicle for a purpose which would require a higher rated use definition.

The Claims Rated Scale provides a series of discount and surcharge adjustments to be applied to the base rate. Each accident charged to the vehicle moves the premium up three levels on the scale. Each claim-free year moves the premium down the level. There is no upper limit to the surcharge levels, while there is a four level lower limit to the discount.

Accidents are chargeable to the vehicle regardless of who was driving. Accidents which are non-chargeable include those in which a third party was 75% or more at fault, those for which only no-fault benefits are paid, and those which involve only windshield damage, theft, or comprehensive coverage.

The policyholder is given the opportunity to pay the costs of a claim himself. This may be to the policyholder's benefit if the resulting premium surcharge to be collected over the three years is greater than the claim amount itself.

In addition, ICBC receives "Driver Point Premiums" which are assessed based on the number of points recorded on the driving record for traffic violations. These premiums are separate from any vehicle insurance premium or claim surcharge. The record of driving points is maintained by the Motor Vehicle Department.

While age or years of driving experience are not directly used as rating factors, a new owner driver starts in the Claims Rated Scale at the base rate level and moves down with each year of claim-free experience. Thus, at least implicitly, credit is given for the driver's years of experience.

Compulsory coverages. The mandatory coverages provided by Autoplan are:

First-party benefits, regardless of fault, which include medical and rehabilitation expense, income replacement, and death and funeral expense benefits. Benefit maximums are increased periodically for

inflation and currently are \$183,000 for medical and rehabilitation expense and \$145 per week for 104 weeks for income replacement coverage.

- . Third-party liability coverage for bodily injury and property damage with a basic combined limit of \$200,000.

- . Uninsured and unidentified motorist protection up to a limit of \$100,000.

These coverages are compulsory for every motor vehicle required to be licensed in the province. The annual insurance premium and the vehicle license fee are required to be paid at the same time so that valid license tag also indicates valid insurance of at least the statutory minimum. The mandatory coverages can be written only by ICBC.

Optional Coverages. Increased liability limits, increased no-fault benefits, underinsured motorist protection, comprehensive, and collision are among the optional coverages which may be purchased. Although ICBC has monopoly on the compulsory coverages, private insurers are allowed to write the optional coverages. The practical aspects of competing with a fund that already establishes the base coverages are, however, somewhat difficult, and the private insurers provide only a minority of extended coverages.

Distribution system. Early in its history, ICBC wrote its insurance through company employees in branch offices and through independent insurance agents. Currently, only independent agents are used. The distribution method was changed because ICBC decided not to be in competition with its own agents and because it did not want to present to the public the image of a "government license department."

Claims adjustment. In the lower Mainland and Victoria areas, in which most of the province's population lives, ICBC has established a phone claim reporting system and drive-in claims centers for the adjustment of claims. In less populous areas, the "Dial-a-Claim" Center is not utilized, but permanent claims centers have been established where justified by claim volume. Claims representatives visit the areas not serviced by a permanent facility on a regular basis to provide claims estimate and adjustment services.

First reports of a claim are made by telephone to operators at the "Dial-a-Claim" facility. The operator records identifying information, verifies coverage, takes a short description of the accident and damage, and schedules an appointment for the claimant at one of the claim centers. Appointments are usually available no later than the next day after first report.

The claimant's car is either driven or towed to the claims center at the appointed time and examined by an estimator. Complete details of the accident and claim are taken at this time. The car is then driven or towed to a body shop for repairs. Each body shop submits bills for completed work to ICBC two times per month.

At the present time, some adjusters in the more populous areas operate from offices other than the claim center, but ICBC is in the process of eliminating this practice. Eventually, all adjustment in the areas serviced by claim centers will be headquartered in those centers.

Manitoba

Manitoba differs from British Columbia in the mechanics of their two rating systems which are both based on accidents and driving violations. As explained previously, the British Columbia Claims Rated Scale is used to determine the premium for a vehicle based on accidents involving the vehicle regardless of who was driving. The surcharge system for traffic violations is separately applied, driver by driver, to the base license fee when applying for or renewing a driver's license.

In Manitoba, however, a standard rate is determined for the vehicle, and surcharges for accidents and/or convictions for traffic violations are assessed against the driver based upon his driving record. A basic driver's license costs \$24.00 with \$15.00 representing the insurance premium and \$9.00 being applied to the actual licensing fee. Attached Exhibit III-1 sets forth the table containing the charges which are dependent upon:

- . The number of violation points the driver has accumulated.
- . The number of points which will be subtracted for each year of driving without a violation or an accident for which the driver was at least 50% responsible.

The accident record of the driver is also an additional source of penalty surcharges. It is based on the latest 12 months of driving experience when the registration is renewed on March 1 each year. The driver is allowed one accident within the past twelve months without any penalty being applied. If there are two accidents in that interval, there is a surcharge of \$150. If there are three or more, the surcharge is \$250. Again, the definition of accident is one in which the driver is more than 50% or more at fault.

Again, due to population differences, coverage differences, and the lack of shared statistical information between the funds and privately-served provinces, a direct comparison of insurance costs could not be compiled for this study.

EXHIBIT III-1

MANITOBA PUBLIC INSURANCE CORPORATION
 SURCHARGE SYSTEM FOR TRAFFIC VIOLATION CONVICTIONS

<u>Number of Violation Points</u>	<u>Surcharge</u>	<u>Reduction in Points For One Year Without Violation</u>
1	none	0
2	none	0
3	none	0
4	none	1
5	none	2
6	\$150	3
7	162	4
8	175	4
9	187	5
10	212	6
11	237	7
12	262	7
13	287	8
14	312	9
15	337	10
16	362	10
17	387	11
18	412	12
19	437	12
20	462	13
21	490	14
22	490	14
23	490	15
24	490	16
25	490	16
26	490	17
27	490	17
28	490	18
29	490	18
30	490	18
31 or more	490	Reduce by 18 points

Note: Violation surcharges are assessed in addition to surcharge for accidents and in addition to a standard fee determined for each vehicle.

Saskatchewan

Provisions of the Auto Insurance Fund in Saskatchewan are quite similar to those in Manitoba in that the registration (insurance premium) for the vehicle is determined independently of the driving records of the owner or any of the operators. Surcharges for each driver are determined by accident involvement and/or record of traffic violations. Surcharges are collected at the time of automobile registration and applied to the standard rate applicable to the vehicle.

Surcharges for traffic violations are based on the latest three-year period. Exhibit III-2 sets forth the applicable dollar surcharges.

It should be noted that the surcharges can accumulate quickly. For example, 3 points are assigned for a speeding violation, 4 for a stop sign violation, 5 for driving without due care, and higher penalty points for more serious traffic violations. However, for the driver to avoid a surcharge, the driver must not have more than one speeding violation in that three-year period and no other violations as well. For each year of no conviction, the accumulated points in the three-year period under review are reduced by one-third.

At-fault accidents carry particularly severe penalties which are cumulative. For the first accident, the driver is surcharged \$100. For the second accident there is an additional penalty of \$200; for the third accident the additional penalty is \$300; and for the fourth accident the additional penalty is \$400. Thus, a driver involved in four at-fault accidents in the three-year period would have a cumulative surcharge for all accidents or an annual total of \$1,000 added to his premium. The monies collected from the traffic violation and accident surcharges are payable to the auto insurance fund and used as a source of additional revenue to offset required premium income for its losses and operating expenses.

EXHIBIT III-2

SASKATCHEWAN AUTO SURCHARGE FUND TRAFFIC VIOLATION SURCHARGES

<u>Number of Points in Latest 3-Year Period</u>	<u>Surcharge Amount</u>
3 or less	\$ 0
4-5	25
6-7	35
8-9	55
10-11	75
12-13	95
14-15	115
16-17	135
18-19	155
20-21	175
22 or more	30 additional per point

Quebec (Canada) and New Zealand

The Quebec and New Zealand plans, although established in different nations, are quite similar in operation and are reviewed jointly.

These plans provide only first party medical coverages. Physical damage coverages are provided by private carriers and liability coverages are not applicable as both governments have implemented complete no-fault systems which totally eliminate tort procedures as they would apply to personal injury.

The New Zealand plan is administered by the Accident Compensation Corporation which has responsibility (medical only) for:

- . Workers compensation
- . Motor vehicle accidents
- . Supplementary fund to cover injuries not covered under workers compensation or motor vehicle fund

The funding for these three divisions of the corporation is based on the following sources for the three divisions respectively:

- . Tax levy on employers based on payroll levels
- . Flat vehicle registration fee
- . General revenues

New Zealand is considering a fuel tax to replace the flat vehicle registration fee, but is still examining the ramifications.

The Quebec system is operated by the Re'gie de l'assurance automobile du Quebec and has the same essential divisions and funding sources.

Again, the most noteworthy consideration for both systems is that they have eliminated tort actions for damages due to accidental injury. They provide payment schedules for types of injuries and pay the cost of treatment in government operated health care centers. It is this combination of a no-fault program with various forms of nationalized medicine that make the system workable. The finer points of each case are assessed through case review with possible additional payments for private services if required.

The concept of pain and suffering is replaced with a program of long term disability payments for those who are seriously injured. Payments in New Zealand are intended to provide 80% of pre-accident wages (adjusted for inflation) until age 65 when the national retirement program provides benefits. A cap of total dollars per month is placed on disability payments but that cap would accommodate a very high percentage of persons before payments would no longer meet the 80% mark.

Tort provisions may apply to visitors who can be compensated from the systems in varying degrees based on their degree of fault in an accident.

Conclusions Relative to Canadian Systems

In total, it is fairly difficult to say how the Canadian plans have fared. Certainly, they are working reasonably well, but whether they are appreciably different or better than the private systems is unclear. Of the eight Canadian provinces, four operate automobile insurance funds. There have been deliberations in the other Canadian provinces (especially Ontario) about moving to government based funds for the last 20 years. The issues have been debated and there are followings on each side. To a large extent, the divisions have coincided with political followings. The four funds which exist were each established with the introductions of new governments elected from more socialist oriented parties.

In British Columbia, where the Conservative party regained the government, an attempt was made to dismantle the fund, but the logistics of attracting private insurers back into the market are more difficult than forcing their exit; and the automobile fund was retained, although the insurance programs in other lines were sold back to the private market.

The various government based health care programs which are operated in each of the provinces have a significant impact on the operations of the funds. Claims processing for medical injuries are relatively straight forward in that there is only one major provider of health care in each province. Further, the government based health care programs have a vested interest in holding down medical care costs. As such, the basic determinations as to the need for continued medical care are more often made by the medical care providers. This relegates the claims handling functions on the government based insurers part to a more administrative role than would be the case in a private system.

Through a centralization of functions into government sponsored organizations, the programs have come under government unionization, and the benefits for workers have fallen in line with other government operated systems. This has also provided for significant leverage on the part of the work force. Strikes in the British Columbia system have been extensive (three since its inception). The most recent strike was in 1985 with the strike in 1981 lasting for five months. Services to insureds were curtailed extensively, and large backlogs of claims and motor vehicle repairs developed. There are rumors in the press that the Saskatchewan system is now attempting to sell its general insurance lines but that the system's labor union represents a deterrent to such a sale. The fund representatives are not discussing these issues publicly.

With regard to the three objectives of the proposed Hawaii Drivers' Insurance Fund, we have these general observations:

Cost of insurance. It is very unclear whether the funds have lowered the costs of insurance. Conditions in the various provinces differ and the levels of mandatory coverage differ making comparisons between the publicly run funds and the private systems difficult. It is evident that the public funds pay a smaller portion of their costs to expenses, but even here difficulty of interpretation exists. The public funds use some shared facilities and services with other government entities, especially relative to computer costs. A 1979 study for Manitoba performed by the

Finance Ministry suggested that those costs were at least \$13.5 million (Canadian) for that year. The public funds have decreased agency costs through leverage as a monopoly. They have set rates such as a 7% standard for payments to agents while the private firms compete for independent agent services at levels of 10% to 12%. Other expense categories are reduced due to tax considerations and the fact that underwriting activities are minimized.

While outward expenses appear lower, the private trade associations have claimed that certain expenses are hidden or in some other way made up by tax dollars. Materials prepared for public debate in Manitoba by the insurance trade organizations illustrate examples of higher costs in the public systems, but these examples are probably not representative. It is our general belief that real expenses are somewhat lower in the public programs but possibly not by sizable amounts.

Simplified payment programs. The Canadian plans do not currently offer any form of monthly or "easy" payment method, and actually seem to offer less options regarding convenient premium financing than do many companies operating in Hawaii. The payment programs which require a full year of payment in advance are intended to minimize the number of uninsured motorists.

Uninsured motorists. Due to the fact that the premiums can be quite high depending on driving record (or vehicle experience) there is a fair incentive for drivers with poor records to evade premium payments, and the Canadian systems have not avoided the problems of uninsured motorists altogether. However, the systems are fairly tight in that license plates with the stickers attached have to be turned in to cancel insurance. This connection of the insurance program with the registration system has significantly impacted this area and while the Canadian systems have not gathered specific data on the number of uninsured motorists, they report them to be very low.

Nondiscrimination and take-all-comers. While the programs are established to take-all-comers, the premium rating programs can quickly make insurance difficult to afford for high risk drivers. Thus, as a practical matter some drivers are priced out of the market. Ratings begin with a base rate from which drivers can receive discounts for claim free years of driving. While age or length of driving experience are not explicitly included in the rating system, length of driving experience is implicitly included, since a discount is given based on the number of claim free years. Most drivers, about 80%, qualify for the maximum discount of 40%. This means that many new drivers pay a surcharge of about 67% over the amount paid by most drivers. Some new drivers continue to receive a discount based on the fact that the discount can follow the car.

U.S. FUNDS

To our knowledge, there are only two government sponsored motor vehicle funds operating in the United States or its territories. These are in Maryland and Puerto Rico. Both, however, are very different in form and purpose from the proposed HDIF.

Maryland

The Maryland Automobile Insurance Fund (MAIF) is a specialty fund designed to service the residual (high risk) market and to provide compensation for uninsured motorists. The origin and purpose is best stated in summary fashion by the introduction to the 1986 Annual Report to the Governor by the Executive Director of the fund. That introduction reads as follows:

"The Maryland Automobile Insurance Fund (MAIF) was created by the Legislature of the State of Maryland (Chapter 73, Acts of 1972) to replace the Maryland Automobile Insurance Plan and the Unsatisfied Claim and Judgment Fund (UCJF). The MAIF is not part of any department of the state government, but is an independent body, reporting directly to the Governor's Office and responsive to the Legislature.

"The purpose of this legislation was *not* to place the State of Maryland into direct competition with the private insurance industry, but to provide remedial relief for high loss drivers who were being priced out of other coverage. A recent amendment restated the Fund's purpose as, to provide automobile insurance to those eligible persons who are unable to obtain it in the private market.

"Actually, MAIF has two primary responsibilities and in most respects, these functions are separate and distinct. The first is the writing of insurance policies for those Maryland residents whose application has been declined by private insurers in the State. The second function is the administration and payment of claims to Maryland residents who are involved in Maryland accidents with uninsured motorists or with hit-and-run incidents where no responsible party can be found. This second function is a continuation of the preexisting Unsatisfied Claim and Judgment Fund, which has been statutory law in Maryland since 1959."

Thus, while Maryland is sometimes cited as operating a state fund for automobile insurance, creation was authorized to provide a substitute for the assigned risk plan and hopefully avoid some of the service difficulties of the plan which created a degree of customer dissatisfaction. As indicated, however, the fund operates only as a residual market mechanism.

It does operate, however, as a fully staffed and fully independent insurance company, reporting directly to the governor's office. Although it offers only those coverages which are compulsory under the financial responsibility laws of the State of Maryland, it has all of the features of an auto insurance company.

Puerto Rico

The Automobile Accident Social Protection Act for Puerto Rico became effective July 1, 1969. It establishes a fund which provides secondary coverage only after all other private insurance has been exhausted. As such it provides only a safety net program for residents of Puerto Rico. The program applies to all types of

vehicles except farm vehicles, highway maintenance and construction vehicles and those used solely on private property. Coverage is specifically excluded when the driver of the vehicle intentionally causes an accident, engages in racing, drives under the influence of drugs or alcohol, drives without consent or uses the vehicle in connection with a criminal act. A flat premium is collected for each vehicle registration and was initially determined as a percent of current auto insurance premium. The coverage is automatic and provides benefits for medical and hospital services, disability payments, dismemberment, and death and funeral expenses.

These coverages are secondary to other protection except for social security. In Puerto Rico, private insurance provides the primary forms of protection, although a large portion of the population may depend solely on the safety net coverage for which benefits are basically quite minimal.

The economy and standard of living in Puerto Rico are substantially different from those in the 50 states. This fact and the nature of these minimal safety coverages does not provide a realistic or practical basis for comparison of the Puerto Rico plan with the HDIF.

CHAPTER IV

REVIEW OF BASIC FUND OBJECTIVES AND IMPLICATIONS

This chapter reviews the three formally stated objectives of the state fund plan:

- . Reduce the cost of insurance
- . Simplify the payment process
- . Reduce the level of uninsured motorists

Formally Stated Fund Objectives

The three objectives specifically identified in the proposed fund legislation suggest that the HDIF should:

- . *Reduce the cost of insurance.* Because coverage by the fund would be automatic, there would be no reason to employ agents for the fund to sell its coverages. Thus, acquisition costs due to commissions could be eliminated. Secondly, as private companies are in business to pursue a profit, the nonprofit nature of the proposed fund has been offered as a method to pass lower costs to consumers. Further, the duplication of efforts among private carriers to service the same market was seen as a less efficient use of personnel and effort. It was reasoned by the HDIF proponents that a central system which performed all of these services on a single integrated basis could save portions of the organizational costs involved in maintaining the 20 separate private carriers now servicing the market.
- . *Simplify the payment process.* The fairly significant costs of insurance, especially the accumulation of premium payments into a single six month bill are perceived as marginally affordable for many individuals. One objective of the proposed fund legislation is to make the payment process more conducive to family budgeting. In particular, the collection of premium payments by the State through a tax on vehicle fuel is seen as spreading this cost fairly evenly over time based on actual vehicle use. It would be a cost for which families could budget, but one which would also be difficult to avoid.

Similarly, the collection of remaining premium portions through the registration of the vehicle and the renewal of drivers licenses would also make the payments difficult to avoid unless individuals opted to drive without licenses or proper registrations. This was seen as an additional mechanism for reducing the number of uninsured motorists. The collection of portions of the insurance premium amounts through licensing

CHAPTER V

ANALYSIS OF IMPLEMENTATION ISSUES AND FEASIBILITY OF LEGISLATION

This chapter begins by offering several observations regarding issues which should be addressed prior to the consideration of a fund. If these issues are resolved and a decision reached to pursue fund implementation, the chapter provides an analysis of various implementation strategies available and describes certain pros and cons associated with these strategies. These assessments include a comparison of public versus private administration. A number of assumptions are made about the manner in which a fund might be implemented and implications for legislation are described.

PRE-IMPLEMENTATION CONSIDERATIONS

The fund, if implemented, must be regarded as a permanent change which cannot reasonably be reversed. This is because:

- . A publicly operated State fund, as proposed, is likely to cause the exit from the State of all or most automobile insurance carriers (or the automobile services of multi-line carriers).
- . Once firms have exited, it is unlikely that they could be easily attracted to return, especially en masse at a specific time should the State decide to discontinue fund operations.
- . Even a privately run fund operated on a joint underwriting basis by a limited number of firms would probably result in the exit of all carriers not operating in the plan, and the State would be left with only those joint underwriting firms to continue the plan in the future.

Given the magnitude and permanency of change involved, there should be no lack of effort devoted to the process of deciding whether a fund is reasonably justified. We note that the current efforts to establish a fund have been initiated with only limited consideration allotted to an analysis of the current system in order to define the specific problems, problem sources, and alternative remedies. Further, the basic philosophical options outlining fund directions and objectives can vary tremendously even under the type of structure outlined in SB 1335. Many overall policy directions should be examined by the Legislature and certain assessments made prior to the establishment of specific fund mechanisms or for that matter any other form of remedy. Thus, we suggest that prior to any serious consideration of a fund, three specific areas be addressed:

- . A comprehensive assessment should be made of the current system to document actual problems and validate or dismiss various assumptions regarding the nature of those problems.
- . Specific remedy alternatives should be defined based on the definition of specific problem issues.
- . Underlying objectives and philosophies that are to be met by various alternatives should be articulated and a verification established that such directions are intended by the Legislature prior to any authorization action.

In this fashion, technical formulators will have more specific social policies and objectives to use in devising various options. Some of the foundation and guidance issues which should be addressed are outlined in this first segment of the chapter.

Comprehensive Study of Current System

We urge that prior to any adoption of a fund development strategy, a comprehensive study be initiated of the current private carrier based system in order to more adequately define what problems, if any, exist with the system. For instance, there appear to be general concerns regarding issues such as price, but specific problems should be identified. For instance, is the concern for safe drivers who pay base prices but still feel that these prices are too high? Are the concerns related to the surcharge system? Is it being applied fairly? Are high risk drivers being priced into foregoing insurance? Would they forego insurance at half the price? Do they have options for significantly reducing their insurance by purchasing lower risk vehicles? Since price is a function of losses paid plus insurance expenses and possible profits, is the concern that profits are too high, that they are hidden? Are price concerns more a reflection of the manner in which the Hawaii system spreads its costs over the policy group as a whole rather than focus on specific risks due to lack of risk information?

Our point is that any solution, including a fund, should be chosen as based on its specific ability to address specific problems.

Definition of Viable Alternatives

Even when seriously considered, a potential solution such as the fund should be one of several options tailored to fit the issues. Each solution should also be compared to see if it provides many of the same essential benefits for considerably less cost and disruption. Assuming a comprehensive study is to be made of current system ailments, we would expect any number of different remedies to be compared against features of the fund. Several of the following actions may represent candidate actions:

- . Require mandatory purchase of uninsured motorist coverage.
- . Raise or eliminate tort thresholds.

- . Increase the membership and revise eligibility requirements for the Joint Underwriting Program (JUP).
- . Improve driver record information systems within the Traffic Violations Bureau.
- . Improve accident information collection procedures.
- . Establish an uninsured victim accident compensation fund.

Resolve Questions of Coverage Philosophy

While certain recommendations can be made by consultants and other observers, the Legislature must ultimately decide at the beginning of any system solution or fund formation process what overall coverage philosophies are intended. For instance, the New Zealand and Quebec systems are oriented toward covering the medical expenses of all residents almost regardless of circumstances and are specifically oriented toward what they refer to as the development of "community responsibility." That is, they place the coverage of all individuals and the reduction of community strife regarding responsibility for injuries above issues of individual responsibility and accountability. This is in line with their elimination of the tort system and the implementation of total no-fault systems which collect reasonable equal premiums from all persons rather than assess premiums based on exposure to loss.

While the Hawaii system to date has established clear principles of nondiscrimination based on demographic and other class variables, the system is designed to focus specifically on issues of individual accountability and responsibility. This is seen in the rating systems which have been used by private carriers to determine premium contributions and this focus accounts for the continued reliance on the tort system to decide awards of any significance.

The proposed HDIF appears to foster this system of individual accountability through the provisions to assess premiums based in part on driving record, but the basic fund structure appears oriented toward providing the widest coverages possible. More than anything, there is no formal guidance offered as part of the current legislation which would establish the major thrust of such a plan. This absence of guidance does several things:

- . It allows fund implementers to create radically different types of plans when dealing with the various trade-off decisions to be made in the coverage and rate making process. As a result, questions of feasibility are often very tied to the philosophical orientation taken by the plan implementers.
- . It makes the comparison of probable outcomes with alternative systems very difficult in that the purposes of various systems are likely to be different.

There are a number of philosophical trade-offs that must be dealt with in establishing guidance by the Legislature, but the issues essentially reduce to the ultimate intent of corrective action authorized by the Legislature. Is that action intended to:

- . Assure that basic first party medical coverages are available to all accident victims regardless of situation?
- . Assure that all wrongfully hurt individuals have access to a sufficiently sized liability fund to provide adequate pain and suffering damages (even if funds provided for this purpose are not based on premium payments made by the wrong doer)?
- . More evenly spread the costs of insurance over the resident population so that no one identifiable group or individual has to pay a proportionately large cost for coverage but that everyone should pay some amount (even equally)?
- . Assure that all persons pay a proportionate share of insurance costs based on their probability for causing loss (e.g., the individual persons who drive irresponsibly or cause the greatest losses should pay the greatest amounts for coverages)?

These represent very major social policy issues which are probably beyond the levels of administrative latitude which should be left even to a Board of Directors. Certainly confirmation of any major directions suggested by a Board should be addressed by the Legislature. The following discussion attempts to outline the major directional issues which must be resolved by presenting trade off questions in three areas.

Chapter IV identified three implicit objectives that would appear to be underlying the current legislation. Those objectives are:

- . *Provide inclusive protection.* The automatic coverage features of the HDIF plan suggests that *all* persons involved in motor vehicle accidents are to be covered by the plan.
- . *Require compulsory payment.* The automatic payment features of the HDIF plan suggest that *all* persons covered by the plan are obliged to contribute at least some amount toward plan costs.
- . *Vary payment by level of risk.* The allocation of premium collection features among the funding sources, especially drivers license renewals, suggests that persons participating in the plan pay a *proportionate* share of plan expenses based on the expected costs of their participation in the plan.

Defining more closely the objectives of the plan along these dimensions raises several important questions:

Inclusiveness. Is the fund intended to provide a safety net of blanket coverages for all individuals injured in motor vehicle accidents regardless of circumstances? For instance, is the fund to exclude payments to those persons driving without licenses, operating unregistered vehicles, driving under the influence of drugs/alcohol, committing criminal acts, or apply as well to the otherwise uninsured victims of these individuals?

- If no, are individuals to be excluded from fund coverages due to the simple nonregistration of vehicles or failure to obtain a valid operator's license? If significant payments for insurance are to be associated with obtaining these certificates, would this not cause many people to avoid proper licensing or registrations, and would this not substantially redefine the problem of "uninsured motorists" to mean those individuals who do not pay for and obtain these certificates?

- If yes, and the State embarks upon a policy of inclusiveness, what implications does this have for undercutting principles of individual responsibility and accountability?

Further issues of inclusiveness: Even if the uninsured are excluded from first party medical coverage, but if victims or passengers of the uninsured are covered (aside from any coverage they may have due to their own license or registration), is that coverage to include the equivalent of full liability benefits?

- If no, how would a State fund plan differ from simply requiring all drivers operating under the current system to purchase uninsured motorist coverage?

- If yes, and all victims are to be covered by full liability benefits, who would serve as the defendant, how would the benefits be awarded (tort action?), and what further implications would this have for reducing the social responsibility and accountability of (uninsured) drivers.

Compulsory payment. Are the premium collection procedures intended to form a system whereby it is virtually guaranteed that everyone will pay into the system and thereby guarantee their coverages under the system?

- If the answer is a simple yes, and the goal of guaranteeing that everyone pays something into the system in order to further guarantee coverage is the primary goal, then would a fuel tax alone suffice to accomplish this goal?

- If the answer is more involved and if the inclusion of "rated premiums" based on drivers license renewals and vehicle registrations also implies that the rates should reflect some elements of risk assessment, then the following additional questions regarding fairness are implied.

Risk/payment association. Is the State fund system intended to spread cost among those covered by the plan so that persons participating in the plan pay a cost roughly proportionate to the risk that they pose (as defined by driving record)?

- If yes, would this not result in significant surcharges being placed on drivers license renewals for poor drivers, and as such bring the issue back around to creating a new class of uninsured due to the avoidance by poor drivers of the license renewal process?
- If costs are not to be shared proportionally or at least by some scheme that imposes significantly higher costs on poor drivers, what principles of social fairness and individual accountability are involved?

Trade off relationships among implicit objectives. The issues raised in these questions are really just variations of the classic dilemmas faced by any overall system of insurance. The issue of fairness balanced against the desire to cover all injured parties and avoid creating a class of "uninsureds" tends to generate a number of natural trade-offs. The process of balancing the trade-offs and maintaining each objective at a high level of priority requires that tremendous amounts of energy be devoted to managing the system. Ultimately, much of this energy must be applied as enforcement.

Based on our overall observation of attempts by various legislative and industry bodies to establish insurance programs in and out of the United States which meet these objectives, the trade-off relationships among the three implicit objectives can be stated as follows.

To the extent that a plan seeks to have all persons who should be covered actually pay toward those coverages (compulsory payment) *and* pay in a manner roughly proportionate to risk, the plan is also likely to create a class of persons who avoid payment and become (illegally) uninsured motorists. The manner of avoidance is discussed later.

To the extent that a plan seeks to be inclusive (cover all risks, eliminate uninsured motorists) *and* seeks to have all persons participating in the plan pay some amount toward their coverage (compulsory payment), then the plan is less likely to base its compulsive payment on a proportionate assessment of risk.

Implications for Hawaii State fund. These relationships appeared to hold true across the various scenarios that we saw operating in other areas. Their meaning may be better understood in the context of the proposed State fund.

To the extent that the fund attempts to include all drivers in the State *and* attempts to have them pay a proportionate share based on risk, the fund would have to impose a significant charge for poor risks based on drivers license renewals (and possibly to a lesser extent based on vehicle renewals). We suspect that this is likely

to place great pressure on poor drivers to illegally avoid license renewals and drive without valid permits. In effect, the fund would produce its own version of the uninsured motorist unless the bounds of inclusiveness were expanded to include these individuals as well. These relationships imply certain types operational alternatives.

- . The fund could refuse to pay for injuries to the unlicensed driver and to his passengers but cover injuries to persons in other vehicles with licensed drivers under PIP coverages attributed to those drivers. If additional benefits were provided under some form of liability coverages to these persons, the fund would essentially be providing medical liability and possibly property damage liability coverages for the unlicensed driver. This might be possible if the fund also sought to recover any payments from the driver, but the practical aspects of such recovery may be difficult.

- . Fund could pay for injuries to passengers in unlicensed driver's car. Would test of "knowingly" be applied? That is, would passengers be penalized for "knowingly" riding with an unlicensed driver? Would they also receive liability protections? Under any circumstance, personal injury protection (PIP) coverages would not have been properly paid.

- . If fund also paid for injuries to unlicensed driver, it would do so without PIP coverages having been properly paid.

To the extent that the State fund attempts to cover all risks (cover all injured persons in motor vehicle accidents) *and* attempts to require some form of compulsory payment by all vehicle operators, the fund is *not* likely to base this form of compulsive payment on a proportionate share of the risk. For the State fund, to guarantee that all persons were paying some amount toward coverages, this would most likely mean a substantially reduced emphasis being placed on driver's license renewals and a heavy reliance being placed on the motor fuel tax (and to a lesser extent vehicle registrations). This implies the following alternatives.

- . Motor fuel tax would represent a more "compulsory" form of payment in that it could less easily be avoided, but it would not represent a proportionate sharing of risk. Total miles driven is moderately related to risk, but not nearly as related as individual driving record or other risk characteristics.

- . Relative to safe drivers, the dangerous driver would be paying essentially the same rates for personal injury protection (PIP) and required liability.

To the extent that the State fund attempts to achieve objectives of covering all injured persons in motor vehicle accidents (by having all vehicle operators pay a compulsory premium amount) *and* that amount be appropriate to the risk, the level of control and enforcement would have to be very substantial.

- . Operating a vehicle without a valid operator's permit would be relatively easy until the point where the unlicensed driver was caught. At this point the system would have to impose severe penalties. Further, the penalties

would have to be far more punitive than paying the back operator license surcharges designated for insurance premiums. Otherwise, driving without a license would still represent too attractive an option. If the surcharges decline for succeeding years after accidents or infractions which caused them, then there would be a temptation to not renew a license at the time that the surcharges were due and to come in two to three years later and apply for a new license on the basis that the person had not been driving during that period because the surcharges had been too high. It would be difficult to determine whether the individual had or had not been driving.

Even if a valid operator's permit is required to register a vehicle, owners who are not licensed may convey title to another family member or friend who is licensed and willing to register the vehicle. There is no financial insurance penalty to be suffered by the volunteer registered owner of the vehicle even if that vehicle is involved in any number of accidents as long as the owner is not involved and gets a citation on his driving record. Further, accidents involving the vehicle would not impact owner's ability to gain extended insurance on his actual use vehicle as the files are unrelated. Thus, there is no incentive against registering a vehicle for another individual. Even if a system is used such as in British Columbia where accidents are charged to the vehicle while violations are charged to the driver, simply finding a new surrogate owner with the presumption that the vehicle had been sold would wipe clean the accident file. This process could be common among family members and eliminating this practice would be difficult.

The only method by which we were able to identify a potential approach to this problem would be to tie all accidents to vehicles and to tie all vehicles registered by the same owner to a common accident surcharge. That is, any vehicle registered by that owner would be subject to the collective accident surcharge of all vehicles registered to that owner. This provides a number of technical difficulties.

Priorities Associated With Implicit Objectives

The reason that all of these mechanics were described is that the resolution of these issue areas involves some basic assessments of fund philosophy.

Inclusiveness. Maintaining inclusiveness as an objective (covering injuries to all people) would have to be given high priority as it addresses one of the more noteworthy need areas in the current system. Further, the elimination of uninsured motorists has been offered as one of the main objectives in moving to a State fund. Inclusiveness is really of two varieties:

Providing full first party benefits and possibly making available liability benefits for innocent victims who have obeyed all aspects of the law but are injured by uninsured motorists.

Providing first party medical coverages to all persons including the uninsured and those participating in criminal acts.

Full benefits to innocent victims. The fund provides this protection only if it provides liability protection for uninsured motorists who have not properly paid for the protection, or if it imposes a compulsory payment program which virtually insures payment (e.g., fuel tax only), in which case it is difficult to collect premiums in proportion to loss potential or risk posed.

If these were the only issues to be addressed, the State need only establish a limited State fund operating within the current system as the surrogate liability protection provider for cases involving uninsured motorists. The fund could be based on the same concept as the Maryland uninsured victim compensation fund with the additional provision that injured parties could be allowed to sue the fund as if it were the insurance provider for the uninsured. The fund could provide the same level of defense as an insurance carrier in order that claims be proved. The fund should, however, be allowed subrogation rights against the uninsured and be allowed to attach assets. The program should also be accompanied by a vigorous enforcement program against uninsured drivers which would call for placing penalty proceeds into the fund to pay for claims. We note that the fund operating in Maryland generates funds beyond what are required to pay their claims. They do not, however, allow suit against their fund.

First party claims from the uninsured. This area was unspecified in the proposed State fund legislation but any decision to authorize first party benefits for the uninsured should be determined explicitly prior to implementation.

The reasons for possibly including first party benefits to the uninsured (unlicensed or unregistered, etc.) is that someone or some entity must eventually pay anyway and that such funding would alleviate many unpaid doctor/hospital bills and would take some tension off the problems currently associated with doctors and hospitals accepting such patients (especially in a quasi-emergency situation).

Another alternative is to include them under a limited State fund plan as described for other uninsured victims. These persons would not have benefit of suing the plan for additional liability and would be subject to subrogation by the fund to attach assets if assets were available or more simply to deny claims if assets were available for injured persons to pay their own claims. They would, of course, still be subject to independent criminal penalties and actions which should be severe.

An alternative even under the current system may be to include coverage of such individuals under the Joint Underwriting Plan as described for other uninsured victims.

Compulsory payment and differentiation of payment according to risk. Beyond the questions of inclusiveness are the other questions of whether all persons should pay at least some amount toward their insurance and whether that amount should be prorated according to risk. The priorities given to these items are likely to be based on social philosophy as much as on practical mechanics.

The first consideration is likely to focus on the degree to which the overall system is established on a no-fault basis. While it may be fairly reasonable to minimize the association between a person's potential to create loss and their payments into the system under a no-fault system, the extensive use of a tort system would seem incompatible with a system that tended to ignore risk differences in the payment collection system. This assumption reflects a value system more than a mechanical issue in that a system which is premised on finding fault but then does not penalize (relative to insurance costs) the persons chargeable seems somewhat incongruous.

Even under a no-fault system, the failure to charge those who are higher risks may meet with social resistance. The Quebec and New Zealand systems are formulated on concepts of "community responsibility" that are not particularly widespread in the United States which tends to emphasize individual accountability and responsibility. Even with the current take-all-comers and nondiscrimination laws in Hawaii, the current system is still based (at least theoretically) on these individual accountability principles, and we suspect that the HDIF would ultimately face many demands that it prorate costs according to risk.

In terms of the ultimate mechanics involved in addressing issues of compulsory but yet prorated payments, the first underlying assumption is that the data bases necessary to produce the ratings are adequate. This is certainly not the case in Hawaii at present, and a significant amount of work would have to be done in the counties, the Department of Transportation, and in the Traffic Violations Bureau to improve information systems aside from any other issues of forming an insurance fund. Other mechanical issues related to the ability to make fair rating charges are taken up in the next segment and under the segment dealing with the funding sources.

All of these issues have tremendous importance relative to costs. They would determine the actual completion of claim activity which is the most important element of fund expense. Actuarial studies cannot realistically be pursued until these coverage areas were fully addressed.

KEY IMPLEMENTATION ISSUES

Assuming that a study of the current system is in fact conducted and the specific analysis of problems points to solutions that could be provided by a State fund, some of the more significant implementation issues are likely to revolve around these major themes.

- . Forming a workable organization in the time available to initiate operations.
- . Managing impacts on local business and on Hawaii's business climate image.

- . Establishing coverage philosophies and limits as well as specific provisions relative to no-fault and tort issues.
- . Establishing a proper operating posture once the fund is initiated.

Forming a Workable Organization

The prospects of actually forming an organization which would be capable of handling the claim volume expected under the fund are difficult at best. It must be remembered that this fund will handle 100% of all automobile insurance claims involving injury to one or more persons (with the possible exception of drivers licensed outside of the State). Further, the HDIF would probably be involved with most claims involving property damage. This is due to the \$10,000 property damage liability coverage required under the no-fault law benefits.

In terms of volume, there are a number of ways to express this magnitude. The 1986 State of Hawaii data book lists 19,577 traffic accidents in 1985 for which each caused more than \$300 in damage or personal injury. Further, 12,613 injuries were reported. Based on insurance claim data obtained from the Office of the Insurance Commissioner, we feel these estimates are probably low. One accident can generate multiple claims due to multiple coverages available under a single policy, but one claim under a single coverage can also involve more than one person or more than one vehicle. The number of claims by basic required coverage handled by private insurers for Hawaii in 1986 was more than 60,000. This number does not include an additional estimated 6,000 claims that were covered by self-insured entities (which the proposed legislation does not exclude).

We estimate that it would take an organization of about 500-600 personnel operating in nine divisions to service this number of claims adequately. Further, services would have to be readily available on all islands. As pointed out in the next chapter, the size of the organization would need to be significantly larger if the fund offers excess coverages. This, of course, is equivalent to forming a fully operating insurance company. Segments of the next chapter describe the specific divisions and operational tasks to be addressed. However, the point should be made at the onset that an organization of this size and complexity cannot be formed easily, and in the provinces of Canada where similar undertakings were accomplished, it was done with difficulty.

One of the major issues to be faced in the Hawaii environment deals with the basic organizational form that might be established for a fund. Most specifically whether the fund should be operated as a public entity or whether private industry should operate the fund on behalf of the State. Senate Bill 1335 of the 1987 Legislature provided the basic authorization for establishment of the HDIF as a public entity, but it offered no implementation guidance. Senate Bill 808 of the same session outlined a plan for operating the fund through contract with the private sector. The decision to pursue public versus private administration is in some sense complex, but as our analysis reveals, we do not see any truly workable form for private administration unless the concept of the fund is altered significantly.

Publicly Administered Fund

A publicly administered fund (of the type proposed) might be formed through a number of different strategies:

- . Stop private carriers, initiate massive hires and contracts.
- . Buy an existing auto insurance company.
- . Start with the creation of a competitive residual market fund or uninsured victim compensation fund and experience with the insurance market was developed to consider an independent assessment as to whether to move toward a fund such as the HDIF.

Stop private carriers, initiate massive hires and contracts. This is the method used by the Canadian provinces. Their general approach was to announce that as of a certain date, licenses or certificates to sell certain types of insurance by private carriers in the jurisdiction would no longer be honored. At that point, private carriers began closing down operations, laying off staff, and terminating service contracts. Using this approach, the government entity must be prepared to begin a massive hiring and contracting process to recruit, organize and place the staff released by the private firms. A compounding problem in this type of scenario is that the time clock begins ticking as soon as the legislation is passed (or even sooner if there is a strong feeling that the legislation is imminent). That is, the private carriers are likely to begin disbanding fairly quickly and the State must be prepared immediately with an operational system.

In the cases of Manitoba and British Columbia, the shutdown of private operations (in terms on new sales) began much more quickly than was anticipated by the government operations and there was a period where insurance was difficult to obtain. Further, the government operations had to be brought on line more quickly than planned, and the volume of business was much greater than planned.

It should also be noted that the action in British Columbia was challenged in the courts by one of the insurance trade associations and was taken all the way to the Canadian Supreme Court. One should expect no less in Hawaii, as this would be the first state in the United States to attempt such an action, and the issue of precedence would be an important part of the national insurance industry's attention to the process.

Buy the auto division of a local company. One of the ramifications of establishing a State fund is that it would severely impact the financial stability of certain local companies, and if those companies are grounded primarily in their automobile insurance businesses, there may be serious questions as to whether those companies would continue operations even if they could trim their operations to include only non-auto lines. As such, the State may be able to provide a bail-out

service as well as acquire an organization infrastructure for operating the fund if the State were to acquire one or more of the local companies or if it were to acquire the Auto Division of one of the companies.

Such a possibility is purely speculative as we know of no company wishing or willing at this point to sell such an operation. We also note that, depending on the circumstances, simply purchasing the auto division of a company may not provide much in the way of an infrastructure. The operations may be tied in a complex fashion to all of the other company support services such as data processing, personnel, accounting, agent services, legal, and otherwise so that the Division alone would be of marginal value. Further, there are currently no local operations of the size necessary to support the entire fund.

Start small. A later segment on the options for operating a public fund illustrate how the fund concept could begin with a specialty fund (such as one developed to service the high risk market or uninsured victims) and as the State developed expertise in these areas, further considerations for expanding the fund could be examined.

Private Administration of the Fund

There may be certain options for having a fund administered by the private sector, but the method proposed in SB 808 is not a viable option. Other options that we considered for private administration do not fully embrace all concepts of the proposed fund.

Bid for joint underwriting participation. Senate Bill 808 of the 1987 Legislative Session provided for a plan whereby private insurers would bid for the opportunity to participate in a joint underwriting program which would serve as the administering organization for the fund. Very few of the mechanics were offered with the legislation, but we have assumed that companies would bid a fixed amount on a per policy basis for each year of a five-year period and that this fixed amount would be returned to the insurance companies from the fund on a quarterly basis depending on the number of policies that each insurer serviced. The number of companies participating in the plan would be somewhat less than the total number of companies currently offering coverage at the time of bid. This would be done in order to insure that companies were competitive in their bids to be a part of the fund.

This type of bid process is not likely to produce a workable solution for regulating insurance operations. Its problems are basically these:

- . Only those insurance companies allowed into the joint underwriting program would be allowed to offer basic coverages (to be paid for automatically by fund proceeds).
- . Only the companies offering basic coverages could reasonably expect to sell extended coverages. The inconvenience to the policyholder of going to one insurer in order to receive prepaid basic coverages and then going to another insurer to purchase extended coverages would be too great,

especially if the consumer had a significant choice among companies to select for basic coverages. Further, once the companies offering basic coverages incurred the expense of underwriting the risk, establishing the file, and paying agent costs, they could offer the extended coverages at a discount.

- . In effect, this plan would exclude all non-plan insurers from the market and would mean that those insurers would, in fact, exit the auto market.
- . After exiting the market for five years and disbanding personnel as well as other operations such as computer support, it is extremely doubtful that any of those insurers would bid for the next period. The plan would be left to the original bidders, and if the State reduced the number of plan participants again for the next period to make the bids meaningful, the pool would again drop. The implications are obvious.

Other difficulties with the SB 808 concept include:

- . It is unclear as to whether plan participants would be able to rate individual risks and impose appropriate surcharges. Either the bid would have to presuppose a particular mix of risks and attempt to develop an average rate, or the bid would be based on the amount to be charged for different classes of risks with the insurer to submit subsequent requests for payment to the fund for the particular risks that an insurer encountered. In the first instance, the chances for difficulty for each carrier would be significant based on the mix of business that carrier happened to receive. In the second instance, the bid and charge back system would be complicated and the fund would not be faced with a specific fixed amount that it must cover.
- . There is the potential that firms would subsidize auto lines with revenues from other insurance lines in order to make the bid cut. This is because the auto business is considered by some companies to be a necessary service that must be provided to policyholders in order to attract customers to the firms' other lines or more importantly to keep existing customers from moving to other companies where they can consolidate coverages and agents. Subsidization would raise questions of unfair competition and would promote a distorted market in which non auto policyholders would likely complain if they were to become aware of the subsidization.
- . The invitation for collusion and other disruptive bid strategies would be great. Depending on the cost sharing provisions of the system, especially given bid procedures which might allow for bids by type of risk, the evaluation of bids and their ultimate impact on expected cost sharing provisions could get complicated and allow for bid strategies that were unexpected and based on underlying expectations of cost sharing that were not evident in the bid amounts. For instance, a firm might bid fairly low for accepting the normal types of risks and bid significantly higher for high risk coverages. The firm might be accepted into the plan based on

the overall computation of bid amounts, but then go after only the high risk business (having higher premiums) knowing that the claim costs for this business would be shared under the joint underwriting features. The company would receive very high revenues while suffering no relative penalties on cost.

Inadequate information at the time of the bid about costs of other companies and the revenue sharing procedures would make the bid process very speculative. It would be necessary on the part of the State to develop full bid procedures and cost sharing procedures in exact detail prior to bid. Any detail left to chance or to later resolution by plan members would be cause for a company claiming that it was not given a fair and even chance in the bid process. It might also represent an opening for plan members to demand that additional costs be charged to the fund. There is an extremely good chance that the bid procedures would be subject to lengthy litigation.

Even if bids are made in all earnestness, the effects of a misjudged and low bid amount could be highly disruptive to the carriers involved and ultimately to the joint underwriting fund.

Automatic premium payments from fund collections. It would be possible theoretically to collect premium payments through use of a fund but to contract the administration of each policy separately to a private carrier. From the State's side, the largest difficulty would be determining what form and level of payments made from the fund to the insurers on behalf of each insured would be fair. If all carriers were included in the plan and carriers did not compete for the right to participate, there would be no bid price by which the State might establish a fixed payment level for each basic policy for each insurer. The State could, however, establish an amount computed by the Insurance Commissioner that it would credit each insurer from the fund for each policy serviced.

If the insurer had to charge more, it could do so by charging the policyholder directly for the additional cost. Companies that could afford to provide the insurance at the basic State fee could advertise that they would service policyholders at no additional cost. Other firms could require a modest surcharge. Policyholders could make their own decision as to whether the service of the surcharge firms was worth the cost.

A true joint underwriting program would allow carriers to pool their costs. There would be no reason to do that in this case. Each carrier would carry its own costs and the fund would simply serve as a mechanism to collect premiums through an automatic process such as fuel taxes. Residents to be insured would go to the company of their choice and request that a prepaid policy be issued. The insurer would issue the policy and then charge the fund on behalf of the policyholder. The singular benefit of this type of approach is that premiums would be collected in a mandatory and more certain process. Since insureds would have already paid for the coverage through taxes, licenses, and registrations, there is very little reason why each resident should not go to an agent and collect coverage authorization in the form of a policy. They could, at the same time, purchase additional coverages if desired.

A significant issue with this type of approach centers on whether the participating companies would have the option to rate risks above the base premium to be paid by the fund. If poor drivers were rated as such by the individual firms and charged a surcharge, there would still be some incentive to go without insurance rather than accept the prepaid base coverage. Insureds might still have to pay the driving record surcharges, especially if the record were bad and the surcharges were significant. The State could collect surcharge amounts based on driving record at the time of license renewals and make such additional premium levels available to the carriers based on their coverage of the drivers for whom the surcharges were collected. This would have the effect of creating a standard surcharge process. Insurers might still have the option of charging additional amounts if the State supplied surcharges were inadequate. Still, this would mean that for almost all drivers, the major part of their premiums would be paid by the fund.

Of the three major objectives established for the proposed HDIF, this concept would appear to make positive impacts in two of the areas:

- . reducing uninsured motorists.
- . establishing an easier payment system for the insureds.

While it should decrease the level of uninsured motorists, it would not eliminate them as there would always be those who would avoid licensing to avoid the surcharge system or would not pay even the additional amounts that might be required from the private carriers. Further, there would be those few who for some reason just did not bother to get an authorization of insurance from a private carrier.

Establishment of the State supported rate might be accomplished by computing some portion of the rate levels for which insurers have filed and been awarded. As the market consistently over time began to charge more than the State supported rate, that rate could be increased. The same process could be used to compute surcharge rates. It might be tempting on the part of the State to disallow surcharges under such a system and force companies to set rates which took into account the bad drivers. This would be a serious mistake. Our discussions in Chapters VII and VIII should make this point clear.

We indicated that there would be no reasons for carriers to pool all of their costs under this system. An exception might involve the placement of high risk policies into a pool. This would be especially important if the system did not allow a proper surcharge system and the cost from coverage of high risk policies must be spread among all policyholders. This pool might also be subsidized by the fuel tax.

Current system with expansion of joint underwriting program. The simple expansion of the Joint Underwriting Plan (JUP) along with improvements to the methods for assigning risks to the pool could also be conceived as a privately administered fund, especially if deficits from the operations were funded through some form of fuel tax collections or other surcharges placed on licenses or registrations.

Further Options for a Publicly Administered Fund

Given that we did not see the competitive bid concept for a joint underwriting plan as set forth in Senate Bill 808 as feasible in principle, our analyses relative to further implementation issues have focused on publicly administered funds. We do see some potential for the concept of having a fund serve as a collection system to automatically pay premiums, but as this option was a departure from fund concepts proposed by the 1987 Legislature, we did not pursue full concept development.

If a publicly administered fund is pursued, some of the immediate options for making the fund more manageable are:

- . Limit coverages to mandatory levels. Do not sell extended coverages.
- . Limit coverages to medical. Do not include property liability.
- . Limit policies to certain risks. Sell only to the residual market that has trouble purchasing through the private system.
- . Establish the fund to meet only the high priority social goals of the proposed legislation. This might involve creating an Uninsured Motorist Compensation Fund (UMCF).

In each of the above cases, the personnel and the operations necessary to establish the corresponding type of fund would be significantly less than the personnel required to operate the full fund as described somewhat later. Further, these actions are not as likely to drive the private insurers completely out of the market.

Limit coverages to mandatory levels. One of our observations of the Canadian plans which sell extended coverages is that the private market eventually gave up in its effort to compete in those situations. The convenience to the policyholder of purchasing all coverages from the same insurer and the claim difficulties of coordinating two insurers are strong motivators for the insureds to stay with the government plan exclusively. If the HDIF is not prepared to assume all extended coverage motor vehicle risk in the State, it ought not to attempt to secure part of it.

In Canada, the government programs are sold through authorized agents, but it would appear that the Hawaii plan would not require agents for the basic coverages. If the HDIF were to sell extended coverages as well, the plan would have to add an entire sales system with administrative support and have that system ready to operate as the fund was established in order to service this additional market. Further, the claims and other administrative support required to service the additional lines such as collision, comprehensive, uninsured motorists, road service, and rental car conveniences would increase the operation from 500-600 persons to 800-900 persons and would increase overall premium collections in 1989 from \$300 million to \$480 million. The large personnel increases would be due to the fact that the type of organization and types of functions such as accounting would change significantly.

If the HDIF legislation specifically limited the fund to the basic coverages, and if insurers could be assured that the fund would not compete with them in the sale of these coverages, then the approach may be successful in keeping some number of the private insurers in the market, and the State may be able to avoid forming such an extensive bureaucracy in such a short period of time. The Catch 22 of this approach is that if the private insurers feel that this is just an attempt to phase in the full fund concept and that the fund may offer extended coverages in a year or two, they may begin the process of retreating from the market anyway. In such a case, the fund would be specifically prohibited by legislation from offering these coverages and an availability crunch may develop.

Limit coverages to medical. Using a very similar logic, the State may be able to limit the grandness of the fund plan by limiting the coverages to medical payments but extending limits to include more than the current first party coverages. The HDIF plan as proposed in SB 1335 would cover basic no-fault personal injury protection and bodily injury liability protection as well as \$10,000 worth of property damage liability protection. Providing the property damage protection would require an entirely different type of claims and operating staff.

Both the Quebec and New Zealand plans are limited to medical payments, and physical damages are left to the private insurers. It must be stated in all fairness that both Quebec and New Zealand totally eliminated the tort system as it applies to accidental injury. This process alone accounts for much of the manageability of these systems.

The implications for a medical claims only system are numerous:

- . There are likely to be significant attempts to eliminate tort considerations from the system once all payments are consolidated into the same payment program. See our discussion later on the tort system.
- . Due to the long tail on claim settlements, (many claims take as long as 10 years to settle), the State would need to establish significant reserves for future payments. The apparent positive cash flows of the first few years will disappear quickly after a few years as the accumulated settlement agreements begin to hit the system.

Limit State fund coverage to only certain risks. The concept of limiting the fund to only certain risks such as the coverage of high risk drivers offers a number of advantages that may not be readily apparent. The Maryland Automobile Insurance Fund (MAIF) represents an excellent example of such an endeavor. Such a fund could be established as if it were a separate insurance company servicing a particular segment of the market. The fund would not involve collections of premium through tax, registration, or license collections and thus might not seem to accomplish many of the goals of the HDIF, but what it does do is get the State into the insurance business. Further, it helps to resolve a legitimate problem with the current system which involves the disposition of high risk drivers. From this position the State can:

Establish an effective insurance organization complete with management, claims personnel, computer support systems, contracts for independent adjustment services, fund investment personnel, and all of the remaining component pieces which are required to function as a full insurance company.

Because this form of fund would be operating in a residual market, it could define the size of the market that it was capable of handling at any one time. For instance, the fund could begin by simply servicing all welfare recipients and expand its operations to 2% of the remaining market in the first year.

Because the fund would be addressing a specific problem area of the current system, it could be implemented on a non-threatening basis with the private insurers. This would be under the assumption that the fund could continue indefinitely in this form and there would be no reason to necessarily expand the fund to include the principles of the HDIF.

After growing and servicing a significant portion of the market, an independent decision could be made as to whether or not to establish the HDIF in Hawaii. If the decision were positive, the high risk fund would represent an excellent core organization around which to establish the remaining features of the HDIF.

Because the decision of whether or not to eventually form the HDIF should be made independent of the justification for forming the high risk fund at present, experience with the insurance market from an insurer point of view would be important to that ultimate decision, and the professional staff of the high risk fund would represent an excellent source of study personnel to work on the assessment areas described in the pre-implementation section of this chapter and develop recommendations relative to the full range of future options.

Equally important as the other reasons listed in favor of this approach is the fact that one such residual market fund has been formed in the United States has been formed and has operated since 1972. There is excellent model legislation available for creation of this form of fund, and there is available a cadre of expertise regarding fund operations. The Maryland fund (MAIF) is regarded even by the private market as being reasonably well run and it would serve as a very credible model.

Create an uninsured victim compensation fund. The logic behind forming an uninsured victim compensation fund is very similar to the logic presented for the creation of the high risk fund presented in the previous segment. In fact, the Maryland model also includes such a fund. The fund would help the immediate cause of reducing the negative impacts of uninsured motorists and would allow the State further opportunity to develop experience in adjusting medical claims. The Maryland compensation fund is supported from the fines imposed on uninsured motorists which more than offset the fund costs each year.

MANAGING IMPACTS

Although we have given this issue area a significant heading and regard it to be crucial to fund development, it was not part of our charge and we have not given it substantial coverage in the report. However, it should be noted that much of what must be dealt with is the reaction from the insurance industry and from insurance consumers, both individuals and organizations. Further, once the system is ongoing, the process of establishing and maintaining public support may be difficult and will at least require substantial resources. Some of the topics and issues are likely to be:

- . Concerns over displaced workers and agents.
- . Income losses by other private insurers who continue to maintain some form of operations.
- . Unexpected exits from the market of insurers who were expected to service portions of the market.
- . Opposition from businesses impacted by the fund but not directly related to the insurance industry. This would include rental car companies and others particularly concerned over the fuel tax.
- . Unfavorable characterizations of the business climate in Hawaii by certain members of the press and other national business organizations.
- . Probable legal action by industry groups, trade associations, or possibly consumer advocates.
- . Start-up errors and misjudgments which will impact the perceived quality and competence of the HDIF.
- . Maintaining perceived sense of fairness in claims handling.
- . Avoiding "monopolistic mentality" relative to ultimate questions of service and innovation.

The fact that the HDIF would be the only such fund in the U.S. and for that matter, the only one of this particular variety in the world will invite critiques and critical reviews on both a national and international level. The degree of examination placed on the HDIF will be intense.

Residents of Hawaii will be aware that they live in the only state that operates such a fund and would probably hold the fund to a fairly small tolerance level in terms of adequate performance. That is, if the service and claims handling are not on par with their expectations of private carriers, they will quickly point to the monopolistic nature of the HDIF and their dissatisfaction with having no choice. If on the other hand, the claim payments and service levels are generous, the rates will be impacted and substantial public concern may be generated over the cost of the fund.

Visitors to Hawaii may find the fuel tax to be an annoyance, especially if their benefits under the fund are minimal. Even if benefits are provided, visitors may find the HDIF confusing and express apprehension about driving in Hawaii or becoming injured.

These are all concepts and issues that must be given considerable thought and various forms of public debate may be useful.

ESTABLISHING COVERAGE PROVISIONS AND DEFINING LEGAL OBLIGATIONS

Establishing the Finer Points of Coverages

The earlier section of this Chapter dealing with pre-implementation issues offered some observations about the need to identify the intended coverage philosophy of the HDIF in any proposed legislation. Even with that philosophy identified, some of the major implementation issues concern the manner in which coverages would actually be implemented. Even with considerable detail established prior to implementation, it is likely that the finer points of coverage would be worked out over time with much of that coming from legal actions and court decisions.

Still, a significant effort would be required to work out most of the logistics ahead of time. Some of the sample issues include:

- . If a person with a valid Hawaii drivers license driving a vehicle registered to that individual in a different state has an accident with that vehicle out of state, is that driver covered? What if the car were borrowed, but uninsured? Can the injured sue the HDIF? Would a positive decision encourage persons to maintain Hawaii drivers licenses once they leave the State? If coverage is not offered, how does the fund protect a legitimate Hawaii resident on vacation? in college?
- . Who should be considered to be on the State's "master policy?" Can a college student claim coverage out of State because his parents own a registered car in Hawaii?

Some coverage document or master policy must be devised and made known to all residents through newspapers, direct mail, and other forms of publication. Legal opinions regarding coverages must be developed in many areas including whether the master policy would have to be established as part of the State statutes.

Fund Exclusivity and Plaintiff/Defendant Representation

Fund exclusivity and questions of legal recourse are central to a number of overall feasibility and fund design issues. On the one hand, the technical and legal

problems are known and can be addressed. Large private insurers have been dealing with these issues for some time. The practical implications, however, are substantial and could ultimately create pressures for a restructuring of the fund.

The insurers consistently deal with the problems of representing both the plaintiff and defendant in major liability cases although this type of arrangement usually occurs in fewer than 15% of all such cases due to the fact that no one insurer has more than that market share. The general process is to approach the case by:

- . Allowing insureds to choose attorneys.
- . Maintaining an arms length relationship with the case and the attorneys.

The process of the fund suing itself on all occasions brings the difficulty of this process to a higher level of visibility. Legal costs would be under constant attack as they would probably represent a single cost center and the benefits of moving to a \$35,000 PIP with no tort action allowed, until reaching the upper limit and consolidating legal action with the second insurer, would become evident.

The real problem for the HDIF in the legal area would be in splitting a single insured's legal representation between fund and private carrier who may handle extended coverages especially excess limits on bodily injury liability. This is apt to result in:

- . Frustrating claims coordination for the insured
- . Disagreements between fund and private insurer on legal counsel and defense strategies
- . Potential for fund settled on lower portions of claim without a rigorous finding of fault. This may have serious implications for the private insurer who may, in turn, offer arguments of bad faith representation on the part of the fund attorneys.
- . Increased liability on the part of the fund to protect the interests of the excess insurer or more pressure to tender the defense to the excess insurer along with funds from the underlying coverage to pay both liability costs and legal costs.

The area of splitting legal defenses is a complicated one although there are a number of specific mechanisms in place to regulate this area. The net effect, however, is to give the insurer covering excess amounts significant leverage over the actions of the insurer covering base amounts. In these cases, the insurer providing base coverages may assume significant liabilities for the entire amount plus penalties if the defense is not conducted in a flawless fashion. The fact that the fund is an agency of the State and may be construed to have a vested interest in judgments where the State would also be liable as a defendant complicates this matter and may provide an automatic basis for attorneys on the plaintiff side as well as attorneys for the insurers of excess coverages to claim bad faith.

There are a number of reasons why such challenges would be made even when the defenses are competent, and those challenges could create additional liabilities for the fund. Attorneys for the private carriers will either demand tender of the defense to them along with proceeds from the fund for the underlying liability coverages or else they will demand high excellence of the fiduciary responsibility of the fund to carry the defense. In either case, there is apt to be substantial jockeying for position relative to both the plaintiff and defense positions and the fund will always be regarded as the target for increased payments.

In addition, the fund may find itself in an awkward position as a type of State agency when injured persons sue the State as part of their claims of negligence. This is often the case regarding road conditions, etc. Further, existing insurance laws place many requirements on the insurance companies to pay legal defenses in odd situations and pay for additional counsel when there are questions about the loyalties of fund legal representatives. These issues might be raised more often under a fund concept given the potentially conflicting position of the State government. A thorough study is needed just on the legal implications.

An additional practical problem for the HDIF is that it attempts to combine two fairly different insurance concepts into the same payment package. These involve no-fault first party medical coverages for the plan participants and fault based liability protection against lawsuits by other plan participants.

The concept of a pool is most easily associated with no-fault concepts. The reasons for associating a pool with no-fault principles stem primarily from considerations of efficiency. If the pooled resources of a large group are to be most efficiently applied to providing benefits for plan members, and if those benefits are to be provided based on actual injury, it is often reasoned that the pool should not waste resources on the determination of fault; and the fact that fault could not be proved against another plan member should not keep a second plan member from receiving benefits available to other plan members who could prove fault.

Alternatively, the concept of liability protection against lawsuits can be viewed primarily as a value to the negligent defendant who would otherwise have his/her assets attached in order to pay for acts of negligence. This is especially true in a closed system pool or fund where:

- . payments into the system are relatively uniform among plan participants, and
- . lawsuits are effectively limited to the protection levels provided by the fund.

In such cases, the injured parties would always receive less relative value from the fund in terms of benefits than the negligent party would receive in terms of asset protection (discounting the fact that many participants may have few assets to protect). This is because the legal costs would always decrease the money available from fund resources for injury payment while no assets would be attached to pay for legal defenses. This would represent full protection value to the negligent fund participants and a decreased value to the unjustly injured fund participants.

The only way to increase the relative value to the unjustly injured fund participants is to:

- . eliminate or reduce the legal costs,
- . have the negligent parties pay a substantially larger amount into the fund as a premium assessment (higher assessments for high risk drivers/groups), or
- . secure judgements against the negligent parties in excess of the protection levels provided by the fund.

Given the fixed resources of a pooled fund, one method for raising the overall benefits of the unjustly injured to the protection levels of the negligent is to implement a no-fault system which sets the tort threshold for lawsuits equal to the no-fault benefit payment ceiling. As such, the first and third of these points are covered relative to the finances of the fund. Legal costs are eliminated and any legal judgments assessed through the tort system would be for amounts not covered and not protected by the legal defense obligations of the fund. Further, there is no reason, even in a no-fault system, why premiums cannot be adjusted according to loss exposure or probability of causing a loss.

This logic holds that in a closed fund system where virtually all lawsuits transpire between fund participants, setting the tort threshold below the no-fault benefits always diverts money from potential medical payments to less productive legal fees. The one impact potentially consistent with some overall sense of fairness that might be achieved by setting the tort threshold below the no-fault benefit is that injured drivers who were at fault in accidents might not have the opportunity to collect as much in medical and general damages as not-at-fault injured persons. Even this relationship however, would be mediated by the fact that many not-at-fault injured persons who simply could not prove fault of another driver would have access to these benefits as well, and if benefits paid by the fund are to be determined primarily on the basis of injury and need, such a distinction may not be considered meaningful anyway.

The HDIF does have the positive feature of attempting to charge the potentially negligent driver a higher premium amount (through ratings based on driver's license renewals), but the apparent inclusion of the same Act 294 coverage limits combined with the same tort threshold level which is lower than both the first person medical and the liability limits has the effect of diminishing overall fund effectiveness for providing benefits given its fixed resources.

The relationships described above are more or less true for the overall private market as well, but the impacts are more diffuse when spread over the 20 or so private carriers servicing the Hawaii market. However, the financial impacts of servicing litigation activities out of the fund would be far more visible under an inclusive fund approach. As such questions regarding the inherent lack of compatibility between a fault finding system and a no-fault system working from the same funding source may come more to the forefront.

Finally, the definitions of certain terms of the legislation such as "motor vehicle" should be tightened. Even "registered" motor vehicles could possibly include certain trailers and would definitely include motorcycles. At the point that the coverages, were being decided, these definitions could be corrected as well depending on the particular coverages to be allowed.

ESTABLISHING AN OPERATING POSTURE

The major issues to be dealt with in terms of actual operations is whether the fund would be operated on an accrual (reserve) basis or attempt to pay expenses as they actually require payment. Especially given the question of whether the fund would have power to directly levy additional taxation on fuels or other fees should the fund require additional money, we see no real alternative other than to operate on an accrual system.

The political pressures against establishing substantial reserves are apt to be immense. There will be a great desire on the part of all involved to hold down rates. However, the nature of insurance, especially bodily injury claims is that the first few years of experience will look unusually good due to the immediate settlement of easy claims and the deferral of more difficult claims pending litigation. In later years as the deferred claim payment obligations are added to regular claims, the demands on the fund will rise dramatically. In fact, our financial analyses suggest that with normal inflation, the premium required to service the fund would have to increase by a factor of four during the first four years of operation if the fund were operated on a pay-as-you-go basis.

The use of reserves would also provide a greater insulation against inadequate revenues that are quite likely even on an accrual (reserve) based system simply due to the fact that many issues of coverage will be worked out during the first few years. Human nature being what it is, the fund is more likely to increase its obligations as these issues are worked out rather than decrease its obligations.

The Saskatchewan plan involves a Rate Adjustment Reserve account which is specifically available to pay shortages when the current rates are not adequate. Any future rate adjustment is supposed to replenish the rate adjustment account as well as make up for needed operating revenues.

COMPONENTS OF PROPOSED LEGISLATION

Efficiency and Appropriateness of Method of Payment

The intended goals of the fund relative to simplified payment are that everyone be included automatically in the premium collection process, that the costs be spread over time such that drastic impingements on family budget are reduced, and that some degree of control be available to the insured regarding the actual out of pocket money paid at any one time.

Several assumptions have been implied regarding the various impacts on the insureds of premiums collected through the fund mechanisms. One of the first issues to be resolved centers on the relative amounts of premium to be derived from each revenue source:

- . Fuel Taxes
- . Vehicle Registrations
- . Drivers License Renewals

Based on 1986 dollars, we estimate according to the financial plan presented in Chapter VI that if the entire system of basic coverages were operated from the premiums collected for fuel taxes, it would increase the cost of gasoline some 59 cents per gallon above the otherwise existing sales prices based on 1986 insurance costs. This represents a probable increase in fuel prices of over 50%.

A more realistic computation for a per gallon fuel increase amount should be based on projected 1989 fuel consumptions and insurance costs. Again, based on the model presented in Chapter VI, implementation at that time would suggest a fuel tax of some 82 cents per gallon. This is due both to projected increases in insurance costs and to the continuation of historical trends toward greater fuel efficiency. Some earlier informal estimates by other persons had suggested the fuel tax increases might be limited to only 25 cents. A smaller levy such as this could be imposed but the remaining revenues would have to be made up through very high auto registrations and license renewals.

If half of the premiums were collected through fuel taxes (41 cents in 1989) and the other half were split between registrations and license renewals such that registrations accounted for 40% and license renewals accounted for the other 10%, this would result in the distribution of revenues illustrated as follows. Another option of collecting 70% of premiums through the fuel tax is also shown.

EXHIBIT V-1

Possible HDIF Revenues by Source Based on 1989 Cost Levels

<u>Revenue</u>	<u>Fuel Tax</u>	<u>Vehicle Registrations</u>	<u>License Renewals</u>
Share	50%	40%	10%
Per Unit	\$.41/gal.	\$134/vehicle	\$47/driver
Total	\$150 mil.	\$120 mil.	\$30 mil.
Share	70%	20%	10%
Per Unit	\$.57/gal.	\$67/vehicle	\$47/driver
Total	\$210 mil.	\$60 mil.	\$30 mil.

While these distributions of premium would not represent the only options, they do provide a feel for relative costs.

Any number of rationales might be developed for how to split costs among the sources, but one which is illustrated by the 70/20/10 split attempts to place the greatest burden on the fuel tax in order to address the pay-as-you-go philosophy of the HDIF concept. Vehicle registrations and license renewals are kept low under this scheme in order to reduce the pressure on drivers to avoid these registrations. The 10% allocated to the drivers license renewal could be misleading however, in that the \$47 average is intended to reflect a negligible annual registration fee for most individuals with significant surcharges of \$150 to \$300 per moving violation in order to assess a significantly larger premium for drivers with violation records. Moving more of the burden to the registration fees, however, would significantly reduce the level of the fuel tax.

As discussed in Chapter VI focussing on the implementation plan, all of the financial information provided is highly speculative and is based on a number of assumptions and future events which may not eventuate. We offer no opinion on the actual achievability of these results.

The specific issues associated with these revenue sources are discussed in the following segments.

Fuel tax. There are a number of issues which would have to be addressed in detail before a fuel tax might reasonably be imposed. These include:

- . *Definition of tax versus premium surcharge.* While we are not qualified to offer a legal opinion in this area, we do raise the issue as to whether any distinction would ever be necessary to assure that the fuel tax was regarded as a true tax and not some form of premium payment made on behalf of any particular motor vehicle operator using taxed fuels. The greatest opportunity for such interpretation might be under a situation in which such taxes were earmarked for a specific fund such as the HDIF which might be further incorporated as an insurance company. Special emphasis in the legislation or even passing the revenues through the general fund might help protect against future claims made by persons arguing that they had paid premiums to the fund and now expected coverage, even if operating a non-registered vehicle including motorcycles, recreational vehicles, or construction equipment.

- . *Rebates for self-insureds.* It is unclear from the legislation proposed as to whether other provisions of Act 294 allowing self insureds are to be maintained. If such self insureds are allowed to exist, some self insureds such as the City and County of Honolulu may be able to purchase fuel at the wholesale level on a special arrangement which allows the premium tax to be forgiven. Other self insureds would have to purchase the fuel on the commercial market and would probably have to depend on a State income tax refund procedure to recapture fuel tax expenses. Nonprofit self insureds would have to be handled in some other manner such as an application for refund directly to HDIF.

Rebates to non-vehicular users. Large users of gasoline and diesel fuel purchased in the commercial market place for uses such as farming, construction, and equipment operation may seek rebates as well. The current fuel tax system provides for some amount of fuel to be sold on a lower tax basis for these uses, but many of these users continue to purchase some or all of their fuel at a retail level due to convenience or availability. The significant price hike would probably cause most of these users to seek relief in some fashion.

Fuel Tax Avoidance. At present, it is known that some amount of fuel such as that sold for farm uses winds up in highway vehicles. The pressure to divert fuels in order to avoid the taxation would be multiplied several times over. There would no doubt exist a small but active black market for farm and equipment fuels unless all fuels were taxed and an extensive rebate system established.

Rental cars and visitor impacts. The issue of what to do about fuel taxes paid by visitors is related to the question of what coverages are provided visitors. If they are not covered by the fund and some form of rebate were attempted, we can see no easy way for visitors to obtain refunds, even through the rental car agencies. As an alternative, the fuel tax paid by visitors might provide automatic liability protection for the visitor against any injury to a Hawaii resident or passenger of a Hawaii resident.

New technology transportation. While not a current problem, 10 to 15 years of technology advancement could bring new forms of vehicle propulsion such as electric or solar based systems. Vehicle registration fees for these exotic types of vehicles would have to be increased substantially to make up for lack of fuel purchases.

Inherent fairness. The fuel tax approach has certain features of inherent fairness in the sense that the greater exposure a vehicle has in terms of miles driven, the greater the potential for loss. Still, the tax has no way of increasing or decreasing in its impact based on individual circumstances. Thus, there will be those particular individuals who drive very long distances each day but have a long history of accident free driving. The fuel tax system has the potential to significantly penalize cases such as those who would otherwise be eligible for various safe driver discounts under a policy based system. Still in total, the miles driven to loss relationship is likely to be fairly significant and applicable to the population as a whole.

The revenue stability for a fuel tax could also pose problems. This is because:

Rate increases. Automobiles are becoming more fuel efficient, and this is particularly true on the average as older cars are removed from service. Gallons used per vehicle have been decreasing at rates averaging about 3% per year while overall miles driven has remained fairly constant. Thus, fuel taxes would have to be increased by this much each year just to

keep pace. As medical claim costs have been increasing at rates upwards of 10%, the projections for 13% annual increases in fuel taxes would make such increases notable and a cause for public concern.

Self created impacts. All of the price per gallon estimates offered for fuel tax premiums are based on the assumption that fuel consumptions would continue according to current patterns. The very act of imposing an 82 cent per gallon tax amount (or even half that amount) is likely to cause a decrease in consumption with a subsequent requirement that the tax be further increased in order to make up for the lower levels of consumption. The impact of lower consumption on the total number of accidents (and therefore lower need for revenues) would be very difficult to estimate in advance.

Susceptibility of revenues to economic factors. In the event of an oil crisis, a severe drop in visitor counts, or some other form of overall economic impact, the sale of vehicle fuels could be significantly impacted. Although it is unclear as to whether these drops would also be associated with fewer losses, it is very unlikely that any such relationship would hold true in the short term, and an unexpected revenue drop could cause significant revenue shortages at a point when the State may not be in the best position to provide funds from other areas.

Motor vehicle registrations. If registration premiums were based on the association of vehicle types with medical and liability costs, we would not, however, expect to see large variations based on the make, year, and model of vehicle so much as on their overall type and their use. For instance, it would be at the registration point that commercial use vehicles would be rated higher, especially rental cars, taxis, busses, different types of trucks, and even ambulances, police cars and hearses. Motorcycles would also receive special ratings (Chapter X) as would other types of specialty vehicles such as antique cars, etc. The proper placement of these vehicles into their proper categories would be automatic in some cases based on the type of license. In many cases, classification would depend on the accurate self reporting of use by the insured accompanied by a check for reasonableness by the county licensing clerk.

This process would involve development of guidelines and policies in several areas:

County support. The rating process would require the generation of a rating code and renewal price by the county's computer based on the Vehicle Identification Number (VIN) and the owner's responses to a registration questionnaire. The rating scheme and logic would have to be provided by HDIF, and the level of complexity of the licensing clerk position would be increased.

Ratings by vehicle make and model. Since automatic premium payments would not cover collision and comprehensive claims which are most related to the type and value of vehicle, the actual distinctions between private passenger vehicles would be relatively unimportant for rating

purposes. The exceptions might include categorizations of vehicle make and model related to muscle car or sports car distinctions as those model types were shown to be associated with high accident rates.

. *Motorcycles.* Because fuel taxes would be especially inadequate to cover the costs of motorcycle injuries, a fairly expensive registration fee would be required to cover this form of licensing (also making stolen motorcycle plates and validation stickers worth significant amounts).

. *Commercial use vehicles.* Many types of commercial uses would be difficult to verify and rate. As such, the system would have to rely on the expectation that vehicles used commercially would pay significantly more fuel taxes if used more often and that this mechanism would have to suffice for rate making in this area. Exceptions include taxis, other public hire automobiles, busses and various sizes of trucks which can be distinguished from their license types.

. *Police cars.* The HDIF would be particularly well suited to covering Hawaii's fairly unique situation involving privately owned police cars. Private insurers tend to rate these risks fairly high and charge accordingly. The HDIF system could simply ignore this use and make it a matter of policy to insure police officers and their vehicles at regular prices or possibly modestly increased prices.

. *Rental cars.* A system change at the county level would have to be established to identify rental cars other than by the current check of the owner's name. Depending on the coverage decisions made regarding visitors, the rental car owners would be charged proportionally higher premiums to correspond with the levels of risk covered.

. *Garage liability.* One type of risk which would have to be dealt with at the point of registration would be coverages for what is commonly called "garage liability." This coverage applies to multiple cars owned temporarily by a new or used car dealer or repair shop. There is really no convenient method within the HDIF concept to cover accidents involving the various unregistered cars of a dealership. The only apparent method is to charge for each set of dealer license plates issued. The catch, however, is that each set of dealer plates may cost in the tens of thousands of dollars. Further, the system does not allow for an assessment of the differences in risk associated with each dealership. Thus, the costs would be blended, and the small used car lot dealer would pay just as much for dealer plates as the proportionally higher risk large lot operator who may be loaning the cars to any number of employees. This approach would also make the physical license plates worth a significant amount of money and potentially subject to theft.

The role of vehicle registration in determining premium charges and coverage eligibility could also create a number of social pressures that could work contrary to the system. These include:

Incentives to own/register more vehicles. There are questions about actual incentives to purchase and register additional automobiles. This thought comes from several perspectives:

- *Hiding unlicensed drivers.* Because an owner would suffer no insurance rating consequence of registering a vehicle for a family member or a friend who avoided licensing because of high surcharges, it would be difficult to control surrogate registrations. While penalties could be imposed for knowingly loaning a car to an unlicensed driver, proof of such violations would be difficult and would only come up after major losses or violations where an investigation were conducted. This would be an even more difficult problem where registrations were done in company names to avoid having to show a valid license at the time of registration.
- *Sharing car ownerships.* The temptation for youthful drivers to purchase a car on some sort of a joint basis outside of any family control would also be significant. Accidents with the vehicle would impact none of the group members other than the person who might have had the accident and then only if the accident involved a moving violation. Even if the HDIF were to implement a system whereby chargeable accidents would be added to drivers records (currently not a part of the Traffic Violations Bureau system), the deterrent from an insurance rating standpoint would be small.
- *Incentives for purchasing and registering additional cars.* Due to the fact that families would experience very little marginal cost for registering additional vehicles, the system would actually encourage parents to purchase inexpensive cars for their children rather than allow them to drive the family cars. This is because the family car is apt to be covered under some form of extended coverage involving collision and comprehensive protections which, if rated according to traditional approaches, would cost additional amounts for additional household members. If these members had poor records, the surcharges could be expensive. Alternatively, the youths could each be provided with an inexpensive car which did not require physical damage coverage, and the only additional insurance cost is the registration fee. If registration fees are kept to a lower level, as suggested by the logic presented earlier in the chapter, the additional value for this type of insurance could be worth the cost of the car. The net effect could be more automobiles and may especially involve more automobiles being driven by adolescent drivers.
- *Impacts of stacking.* The Hawaii Supreme Court ruling in the case of *Walton v. State Farm Automobile Ins.*, 55 Haw. 326 (1974) allows liability coverages for multiple cars owned by the same individual to be combined when determining overall liability protection. If this interpretation is maintained under the HDIF system, it could make the additional registration of vehicles quite worthwhile. Each

additional registration could provide a head of household with an additional \$35,000 of protection at a potentially bargain rate. This would be even another incentive for families to buy cars for their children.

As indicated earlier, even if the British Columbia system of attaching surcharges for accidents to the vehicles instead of the driver is used, the simple process of establishing a new owner for each cheap car prior to the registration (switching among family members) would bypass this form of surcharge. Secondly, if inexpensive cars are likely to be the greatest source of the problem, they are likely to be totaled in anything other than a minor accident and sold anyway. Thus, even the B.C. system would not seem to help in this problem. Further, the use of this form of accident surcharge would preclude the imperfect but probably better form of surcharge where both accidents and violations are charged to the driver.

Driver's license renewals. There are basically two methods of satisfying the HDIF orientations toward assessing drivers according to their driving record. These methods involve either:

- . Collecting premium amounts annually and issuing a new license or validation sticker, or
- . Directly surcharging each moving traffic violation and chargeable offense.

In both cases, our approach would be to require very little in the way of a drivers license renewal for those drivers having good records but to assess significant surcharges for those drivers with problem records.

- . ***Annual renewal.*** The annual renewal of drivers licenses would represent a multi-million dollar expenditure for the State and for the counties each year. The cost could be reduced somewhat by implementing a mail-in program to update existing plastic cards with annual validation stickers. This approach has associated issues to resolve:
 - Validation stickers for license cards stolen or reported lost would be worth some value to drivers who were attempting to avoid the surcharge system, but appear to police as if they were current. Further, the actual enforcement process to check validation sticker numbers as well as all drivers license numbers is apt to be fairly lax.
 - While such an annual collection could be fairly expensive for problem drivers (and therefore discourage some from renewing) it would at least allow for a more integrated surcharge process that could take into account driving history over a three-year period including chargeable accidents (if a data collection system is implemented) whereas a simple surcharge system would depend on a series of one shot payments that may not accurately reflect overall driving record.

- Implementation of this process would require substantial upgrading of the Traffic Violations Bureau data system as well as significant upgrades to licensing systems within county operations. Licensing clerk jobs would be more complex and require more time per transaction.

. *Direct violation surcharges.* The alternative to an annual review process would be to charge drivers immediately upon being cited for moving violations. Issues relating to this approach include:

- The plan would not easily provide for charges based on "at fault" accidents (even when person was cited).
- On one hand, the approach fits with current judiciary movement to remove traffic violations from courts, but on the other hand, the plan may result in more cases going back into court due to an increased motivation to dispute the citation as a result of the high cost of the accompanying surcharges.
- There may be questions as to whether surcharges would be viewed as premium collections or excessive fines. There are potential legal challenges either way.

Constitutionality of Tax Method (Article VII, Section I)

Questions are apt to exist as to whether the HDIF through its Board of Directors could reasonably set the rates for the fuel tax to cover fund expenses without action by the State Legislature. We conclude that:

. Based on a separately provided legal opinion researched by the law firm of Kessner Duca & Maki, the answer is somewhat unclear but that in any event it would appear difficult to bypass the Legislature in the setting of a new rate. Some latitude may exist relative to the delegation of rates within a specified range. See Appendix B for the full opinion.

. Alternatives to a direct taxation levy by the HDIF Board of Directors are probably more reasonable anyway. These include:

- Operate the fund using a rate adjustment account that was sufficient to cover year-to-year variations in any event. Allow the Legislature to adjust the rate for the following year to maintain the fund and to replenish the buffer in the rate adjustment account. The Saskatchewan system uses such an account.
- Authorize pre-approved loans that could be called on a short fall basis.

If the deficits were larger and more unexpected than what these mechanisms would provide, an emergency call of the Legislature would probably be required or at least prudent in any event.

Powers and Duties of Board of Directors

The legislation provides very broad powers to the Board of Directors and this is probably necessary. However, because the legislation provides relatively little guidance regarding the actual formation of the HDIF, it is unclear who would make the decisions regarding its actual organization and the initial Board would assume almost inordinate power.

- . The board would have to rule on any unresolved coverage policies which may require further interpretation after establishment of authorizing legislation.
- . The board would appear to have full control over the creation of the initial organization and its basic forms of operation.

Further, there are a number of responsibility areas for which the legislation offers no guidance at all. While the Maryland plan does not correspond in operation to the HDIF, the content areas of the authorizing and controlling state legislation for MAIF appear to have applicability to the establishment of any type of insurance fund that Hawaii might want to consider. Some of the important content areas not only for the Board of Directors but for definition of other operational responsibilities include:

- . Guidance and definitions regarding proper reserve levels.
- . Guidance regarding investment policies.
- . Authority relating to fiscal areas such as indebtedness, limitations on payable amounts from the fund.
- . Basic guidance on form of organization.
- . Relationship to Insurance Commission.
- . Ultimate control by the Governor and Legislature.

We suggest that the lengthy statutes established for the Maryland Automobile Insurance Fund (MAIF) be used as a model for any fund in Hawaii. Although a Hawaii fund may be structured quite differently, the basic authorization components of the Maryland legislation provides a good illustration of the detail and issues to be addressed. Some of the specific features of a Hawaii statute must await the resolution of particular study efforts as suggested in the next chapter.

CHAPTER VI

ESTABLISHMENT OF IMPLEMENTATION PLAN

This chapter presents an implementation plan for proceeding with considerations relative to the establishment of the HDIF. The information development steps which are still to be performed are reviewed and the type of organization which is likely to be required is discussed. Finally, a hypothetical financial scenario is examined. As stated later, the financial plan is based on a fairly straightforward transposition of the current private market system to one supported by a fund. As indicated in other sections, however, we expect that the actual form of any fund would be somewhat different from the model once all of the planning steps had been accomplished.

INFORMATION DEVELOPMENT STEPS

Current System Assessments

As suggested in Chapter V, we recommend that the current private market system be examined to determine what problems and issues currently impact the motor vehicle insurance carriers as well as the motor vehicle insurance consumers of Hawaii. While we understand the reluctance of action-oriented persons to return to a basic research mode, we also suggest that the proposed HDIF plan represents a very significant and basic set of changes impacting a number of business and social systems in Hawaii. Consideration of an HDIF plan must not be taken lightly nor based solely on intuitive conceptualizations as to what problems and challenges exist. Just as there have existed many varying assumptions as to the probable numbers of uninsured motorists in the State (which may not have been accurate according to the data that we presented), there appear to be many more assumptions which have been made about several other impact areas and possible cause and effect relationships. In turn, there is relatively little data or accumulated documentation on the actual state of affairs regarding automobile insurance in Hawaii and accordingly, few well-reasoned assessments regarding possible alternative actions which could be taken. Prior studies, while useful, have been directed toward basic updates rather than overall problem definitions.

We recommend that a comprehensive review be performed to define market problems and to outline options both at a specific tactical level and at a more strategic level which might be taken to address these problems.

Administrative Review of Study Findings

Upon completion of the Study, the Governor should appoint a major study review group to examine the study findings and the options presented. The review group should issue its own recommendation report confirming its interpretation of the major problems and the major strategies to be pursued in the resolution of those problems if any. The review group should be composed of legislators, insurance industry leaders, the Insurance Commissioner, consumer advocates, county government representatives and persons knowledgeable regarding Hawaii's business and social fabric. The report(s) issued by the review group would be sent to the Governor and to the Legislature. The Governor could endorse or not endorse any recommendations of the review group (results should be available for the 1989 session).

If the Recommendation is to Investigate a Fund Option

While we presuppose no particular outcome from this study review group, for purposes of this discussion we will consider that the review group recommends further pursuit of a fund. Under that circumstance, the Governor should reconstitute the group to serve as a basic policy development group. Membership is apt to change from the original review group, but many members of the former may be retained. The group would be supported administratively from the Insurance Commissioner's Office while the Commissioner would maintain active membership in the group. The policy group would have the responsibility to begin defining the specific philosophies and coverage postures anticipated for the fund.

Simultaneously, several specific planning studies should be authorized for consideration during the 1990 Legislative Session. At the point that consultants for the planning studies are selected by the Insurance Commissioner (with input by the policy group), the consultants should begin to work interactively with the policy group in order to derive guidance from the group regarding philosophical directions and to offer perspectives which may, in turn, influence the stated directions set forth by the policy group.

We project that the following specific studies would have to be authorized by the 1989 Legislature in order to provide a reasonable basis for fund consideration during the 1990 session.

- . Legal issues, coverage limits, tort implications, master policy development, and model legislation development.
- . Organizational conversion and government systems requirements including migration plan, organizational structure and staffing requirements, county licensing and registration interfaces, as well as State based information systems support.
- . Actuarial/rate and comprehensive pricing, taxation procedures, fiscal model, and reserve procedures.

Fund Consideration and Possible Legislation

At the completion of the three major studies, the policy group should reexamine the issues surrounding the possible development of a fund and examine the study results to determine if the fund, as ultimately configured by the consultants in the planning phase, continues to meet the specific problem needs which were originally identified. If so, the policy group should offer to the Legislature the package of legislation developed from the three studies.

Fund Creation

At the point that the legislation is passed, the Governor should appoint an implementation task force which may or may not include all of the Directors forming the initial Board of the HDIF. The task force should also include representatives of the insurance industry (as their cooperation in a phase-out or joint marketing program would be essential) and other representatives from government and business. Especially important would be representatives from the county government who would be responsible to see that basic information systems could be put in place.

Fairly large contracts would have to be awarded and administered by the task force during this period to cover such items as:

- . The creation of State and county data processing procedures to support the fund.
- . The initial hiring and contracting of fund personnel to begin set-up operations prior to the time that the fund was initiated.
- . Purchases of equipment and supplies as well as rentals of office space.
- . Retaining legal and other professional services.
- . Coordinating public relations and public education activities.

Concurrent Actions for Systems Improvements

We have also noted in this report that one of the major technical difficulties facing the current market is the lack of good driver record information on which premiums can be based. The HDIF, if established would face many of the same problems and would be dependent on actions in other government areas to improve information processing systems. We offer some observations in Chapter XI about how those systems might be improved in the private sector, but there would still be a need to make internal assessments within the State and county jurisdictions regarding the improvement of driver records and vehicle registration information. We would suggest that a systems study of information processing within the Traffic Violations Bureau be conducted and that additional assessments be conducted at the

county level. These assessments should examine possibilities for more cooperative information consolidation based on these drivers records and information in the county motor vehicle files as well as traffic accident information collection procedures in general.

THE FINANCIAL BASE OF AN HDIF

Coverages under a fund such as the HDIF would not align exactly with coverages under the private system even if significant efforts were taken to make coverages comparable to current plans. Further, there are significant reasons why coverages should be modified under a fund plan in any event. Thus, the straightforward transposition of current loss data to generate premium and expense data for a fund system is not entirely realistic. Still, in order to provide a sense of the magnitude and financial dynamics of such a fund, we have cast current loss information (trended for a fund beginning 1989) into a fund format for illustrative purposes.

Two financial plans are presented, one assuming that the HDIF provides coverage for only the minimum amount required by the current financial responsibility laws, and one assuming the HDIF writes all coverages, including physical damage coverages, and the optional excess liability coverages.

Each plan is based on the historical claims information for companies writing in Hawaii. The plans assume a 4% growth per year in the number of vehicles registered in Hawaii. We have assumed no essential changes in the vehicles covered vis-a-vis the military, and other possible vehicles registered out of state. We have assumed that entities currently self-insured would be brought into the plan, and that all vehicles, including those now estimated as being uninsured would be covered under the HDIF. Specifically, the following assumptions were made in developing these plans.

The plans are based on loss information provided by the Insurance Division for the years 1982 to 1986. This loss information was adjusted to current cost levels using trend factors from the latest filing approved for the HIRB by the Insurance Division. An average expected amount of loss was therefore developed for 1986, based on these five years of loss history. These losses were increased by roughly 10% to include the losses for currently uninsured vehicles in Hawaii. This assumes approximately 9% of vehicles in Hawaii are uninsured. Chapter VIII gives the basis for this assumption. Losses have also been increased by \$15,000,000 for the effect of bringing currently self-insured vehicles into the program for the required coverages. In order to estimate losses for self-insured entities, we used a summary of "imputed" premiums reported to the Insurance Division by the self-insureds. These imputed premiums are estimates of the premiums for basic coverages for the self-insureds, and total approximately \$30,000,000 for 1986. We have assumed that losses would correspond to 50% of this amount.

- . Since the data supplied by the Insurance Division did not separate losses for the required coverages from losses for optional coverages, data from the Insurance Services Office was used for this purpose.
- . The plans are established on an accrual accounting basis. This is necessary so that costs in a given period are matched by the revenue in that period. If the plans are operated on a "cash-flow" basis, then less funding would be needed for the first 3 or 4 years. During the first four years of the "cash-flow" plan, the taxes needed to support the plan would have to grow by a factor of 4.
- . We have assumed taxes would be set at a level such that incurred losses and operating expenses would be covered, that a loan from the state for start-up costs and initial capitalization would be paid back over a 10-year period, and an unassigned reserve of 40% of annual taxes could be maintained. This corresponds roughly to a 2.5 to 1 premium-to-surplus ratio, generally considered to be prudent for private companies writing this insurance. This unassigned reserve is needed to protect the HDIF against fluctuations in operating results, due either to variations in the amount of losses incurred, or due to variations in the revenue stream. Without such an unassigned reserve, there is a significant chance that the HDIF would eventually need to borrow additional funds from the state to cover unexpected operating losses.
- . Loss expenses incurred are derived based on the ratio of loss expenses incurred to losses incurred for companies currently writing automobile coverages in Hawaii.
- . Other expenses incurred are the sum of half the acquisition costs (commission, brokerage, and other acquisition), the general expenses, and charges made by bureaus which are assessed to insurance companies writing in Hawaii. Half of the acquisition costs are included as an estimate of the services currently provided by agents and brokers, such as some claims handling and explanation of coverages and options to insureds, which will have to be provided by the HDIF.
- . It is assumed that a loan from the State will be used for initial capitalization of the plan. We have assumed that this loan would be paid back over a 10-year period at a 7% interest rate. This rate is based on current one-year federal Treasury Bill yields.
- . Investment income generated by this plan is assumed to accrue to the benefit of the plan. Average investable funds are derived assuming a loss and loss expense payout pattern based on Hawaii insurance results, and assuming that other expenses incurred are paid informally throughout the year. A yield rate of 7% on invested assets is assumed.
- . Plan estimates assume the state would have expenses in line with those of insurance companies, reduced for commission savings.

It is assumed that the HDIF would not pay premium taxes.

There are many uncertainties in this plan. Since it is assumed that many vehicles not now covered by insurance would be covered by the plan, a provision for their losses must be included. Since there are no loss statistics available on vehicles now uninsured, it is difficult to say with certainty what the effect of these vehicles would be. We have assumed that loss costs per vehicle for the currently uninsured vehicles would be similar to those for insured vehicles. This seems more likely to underestimate losses than to overestimate them, since uninsured vehicles are more likely to be operated by higher risk drivers, and hence have higher loss costs.

Another uncertainty is whether claims costs would generally be in line with those seen under the current insurance system. When people have claims, it is difficult to tell what their attitude regarding filing a claim against the state fund would be relative to filing a claim with a private insurer. To the extent insureds currently feel some need to maintain good relations with their private insurer and not feel this concern relative to the state fund, it is possible that claims costs could escalate beyond the levels contemplated herein.

The data outlining the two versions of the hypothetical fund are presented in Exhibits VI-1 (Mandatory Coverages Only) and VI-2 (All Coverages). The assumptions and actuarial methodology are the same in both analyses other than for the differences in coverage levels.

Based on the assumptions presented in the hypothetical cases, the results suggest that, if the fund were to provide only mandatory coverages it would require premiums (or taxes) for a first year of operation in 1989 estimated at \$300,000,000 with an initial capitalization of \$120,000,000 required from the Legislature to support the operation at a prudent 2.5 to 1.0 ratio of premium to surplus.

If all extended automobile coverages were to be provided exclusively by the hypothetical fund, the needed revenues for 1989 are estimated at \$480,000,000 with a required initial capitalization of \$190,000,000.

These numbers are in addition to any costs of conversion, systems development, or purchases of operating organizations. They also do not include expenses for defending the constitutionality of the fund or for resolving other legal issues.

While the size of the capitalization loans are a matter of some speculation, they provide a level of capitalization consistent with the minimal standards for operating private firms in the State. Even if the HDIF were ultimately backed by the State, these loans would serve several important purposes.

Because there would be no historical data on the levels of claims to be expected from the establishment of coverage provisions under the "automatic master policy" provisions of the HDIF payment/coverage system, actual claim activity could vary significantly from expected claims. The loans would help prepare for downside outcomes.

EXHIBIT VI-1
 Actuarial Analysis of a
 Hypothetical Fund Performance Based on
 Historical Loss and Expense Data

Mandatory Coverages Only

(in \$1,000's)

	1989	1990	1991	1992	1993
Revenue and Expense Items					
Taxes - Premium	300,000	339,000	383,000	433,000	489,000
Investment Income	14,000	24,000	33,000	41,000	49,000
Total Receipts	314,000	363,000	416,000	474,000	538,000
Net Losses Incurred	213,000	241,000	273,000	309,000	351,000
Net Loss Expenses Incurred	37,000	42,000	48,000	54,000	61,000
Expenses Incurred	38,000	43,000	49,000	56,000	63,000
Repayment of State Loan	17,000	17,000	17,000	17,000	17,000
Total Losses and Expenses	305,000	343,000	387,000	436,000	492,000
Net Income	9,000	20,000	29,000	38,000	46,000
Balance Sheet Items					
Investable Assets	292,000	429,000	546,000	663,000	782,000
Total Assets	292,000	429,000	546,000	663,000	782,000
Loss and Loss Expense Reserves	163,000	280,000	368,000	447,000	520,000
Surplus	129,000	149,000	178,000	216,000	262,000
Total Liabilities and Surplus	292,000	429,000	546,000	663,000	782,000
Cash Flow Items					
Start Balance	120,000	292,000	429,000	546,000	663,000
Taxes - Premium	300,000	339,000	383,000	433,000	489,000
Losses and Loss Expenses Paid	87,000	166,000	233,000	284,000	339,000
Expenses Paid	38,000	43,000	49,000	56,000	63,000
Loan Repayment	17,000	17,000	17,000	17,000	17,000
Ending Balance, Before					
Investment Income	278,000	405,000	513,000	622,000	733,000
Investment Income	14,000	24,000	33,000	41,000	49,000
Ending Balance	292,000	429,000	546,000	663,000	782,000

EXHIBIT VI-2
Actuarial Analysis of a
Hypothetical Fund Performance Based on
Historical Loss and Expense Data

All Coverages

(in \$1,000's)

	1989	1990	1991	1992	1993
Revenue and Expense Items					
Taxes - Premium	480,000	552,000	635,000	730,000	840,000
Investment Income	20,000	33,000	44,000	55,000	67,000
Total Receipts	500,000	585,000	679,000	785,000	907,000
Net Losses Incurred	342,000	386,000	437,000	495,000	560,000
Net Loss Expenses Incurred	56,000	64,000	72,000	82,000	92,000
Expenses Incurred	74,000	83,000	94,000	106,000	120,000
Repayment of State Loan	27,000	27,000	27,000	27,000	27,000
Total Losses and Expenses	499,000	560,000	630,000	710,000	799,000
Net Income	1,000	25,000	49,000	75,000	108,000
Balance Sheet Items					
Investable Assets	398,000	568,000	724,000	895,000	1,091,000
Total Assets	398,000	568,000	724,000	895,000	1,091,000
Loss and Loss Expense Reserves	207,000	352,000	459,000	555,000	643,000
Surplus	191,000	216,000	265,000	340,000	448,000
Total Liabilities and Surplus	398,000	568,000	724,000	895,000	1,091,000
Cash Flow Items					
Start Balance	190,000	398,000	568,000	724,000	895,000
Taxes - Premium	480,000	552,000	635,000	730,000	840,000
Losses and Loss Expenses Paid	191,000	305,000	402,000	481,000	564,000
Expenses Paid	74,000	83,000	94,000	106,000	120,000
Loan Repayment	27,000	27,000	27,000	27,000	27,000
Ending Balance, Before					
Investment Income	378,000	535,000	680,000	840,000	1,024,000
Investment Income	20,000	33,000	44,000	55,000	67,000
Ending Balance	398,000	568,000	724,000	895,000	1,091,000

- . The loans would better allow HDIF to work out its initial fiscal problems with fewer abrupt changes in fuel taxes, registration fees, and licensing fees. It would also not have to submit immediate subsequent requests to the Legislature for subsidies in a piecemeal fashion.
- . Substantial reserves must be established as soon as possible to help accommodate the large increases in claim payments which would build as a natural process during the first three to five years. Even though the British Columbia system appeared to start operations on only \$18,000,000 in reserve loans, it had to request \$175,000,000 in subsidies shortly thereafter.
- . Investment interest from the money should provide the approximate level of return necessary to pay a loan finance rate to the State. As such, while the money is tied up, the interest would eventually accrue to the State and would therefore represent a productive use of the funds.

Development of Actuarial Experience Projections

While a number of the assumptions were discussed in the preceding segments, the following segments discuss some of the methodology used to derive these numbers. A more complete description of methodology is contained in Appendix A.

Projection of ultimate losses. Ultimate losses incurred by each coverage were obtained from data provided by the Hawaii Insurance Commissioner's Office. Since the total incurred losses include IBNR estimates made by the various carriers, these losses are at ultimate.

The historical rate of losses per vehicle, by year, by type of coverage was developed for NF, RBI, and PD. UM was treated in another manner as explained later.

These loss rates by year were trended at the amounts given in HIRB Circular 1985-14, the basis for the last rate change approved for the Bureau. The BI trend has been used for NF and BI, and the PD trend has been used for PD. The rates are trended to 1986 cost levels. An average of the trended rates was computed.

The average rate was multiplied by the number of vehicles to obtain loss costs at 1986 cost levels and vehicle levels.

Losses were multiplied by a factor to reduce them from the total coverage level to the Basic Limits (required coverages) level. This factor was derived from ISO supplied material for ISO companies showing basic limits and total limits losses reported. An average of the ratios for the several accident years was used. As these losses are not at ultimate, and since there might be some reason to expect different development on total limits losses than on basic limits losses, loss development factors for total limits losses were derived, and compared to the basic limits loss development factors computed by the ISO. Based on a comparison of these factors, we decided that the possible difference on loss development would not have a significant effect on the ratios computed above.

A factor of 1.05 was developed to reflect the fact that the Insurance Division data only covers a 95% share of the market.

It is estimated that 9% of the vehicles in Hawaii are uninsured, so losses were divided by 0.91 (based on 1-.09) to increase the reported losses to cover all vehicles. This assumes all vehicles would be insured under the new plan, and it assumes their loss experience would be close to the average of insured vehicles.

\$15,000,000 was added for self-insured vehicles. This is based on an "imputed premium" of \$31,000,000 for 1985-86 attributed to the 11 self-insured entities in Hawaii, assuming their losses would be about 50% of this premium. This \$15,000,000 was distributed by coverage in proportion to the insured losses by coverage.

Insured losses described above were multiplied by the 1.05 (market share adjustment) and divided by 0.91 (UM adjustment), and the self-insured effect was added.

This provides ultimate losses at 1986 cost levels by coverage, including additions for self-insured vehicles and uninsured motorists. These losses were trended forward, by coverage, at the above trend rates.

Additional trending of losses was done at 4% per year to reflect expected growth in the number of vehicles. The 4% is derived by taking the number of registered vehicles, excluding trailers, for the period 1980 to 1985 and fitting an exponential curve.

Other elements of the financial model. Some of the computational parameters include these assessments.

Taxes (that will replace premiums) were set so as to cover the several expense items (losses, loss expenses, other expenses, repayment of the loan from the state) and to maintain an approximate 2.5:1 premium to surplus ratio.

Investment income was set at 7% of the average investable asset balances over the course of the year.

The net losses incurred were estimated from the methodology described earlier while net loss expenses incurred were based on the ratio of loss expenses incurred to losses incurred as reported in the Insurance Expenses Exhibits (Insurance Commissioner) for Hawaii for all companies writing in Hawaii. For the required coverages only, these expenses were reported as 17.5% of losses.

Other expenses are estimated to be 18.0% of losses. This is half the commission and other acquisition costs reported, plus the general expenses, and .5% for boards, bureaus, and associations, mainly designed as the fee to the HIRB.

The state loan was set to provide an initial capital so that there would be about a 2.5 to 1 ratio of taxes (premiums) to surplus at each point in time. For the required coverages, this was estimated at \$120,000,000. For all coverages, the loan was estimated at \$190,000,000.

To compute cash flows, loss and loss expense payout patterns were developed from the state data. At each stage of maturity, the proportion of losses paid to total losses incurred (including IBNR) was developed. This was turned into a payout pattern, and was applied to loss and loss expense. Other expenses are assumed to be paid uniformly throughout the year.

The only reserves needed are for loss and loss expense. This is computed from the payout pattern above. The reserve amounts were established such that a separate adjustment account (such as used in Canada) would probably not be necessary, although the reserves could be redefined to include a specific account of this type. The total dollars are not estimated to change.

FUND ORGANIZATION AND COMPONENTS

While it would be premature in our estimate to discuss the final operational organization of a fund prior to the specific planning studies that we recommend, we do offer an illustrative example of some of the operational components to be developed in the formation of a fund.

We have estimated the total number of personnel required to operate the fund to be some number around 500-600 for providing basic coverages and some number around 800-900 to provide all coverages. These numbers should be granted a substantial latitude for differences in how the fund would be organized and to what extent functions were performed by county and other personnel in support of the fund. The estimates are based on the numbers of personnel required to staff local companies, the size of the Canadian operations (adjusted for differences in the government operated medical system and the coverages with which they deal), and the expense dollars that are typically allocated to insurance operations. These personnel estimates do not include the agents which would be required if the fund also provided all coverages.

We did not allocate personnel to operations that might be performed on contract for the fund. For instance, independent claims adjusters are available in Honolulu to provide claims handling for firms who do not maintain in-house claims staffs or for other firms which are temporarily overextended on claim servicing. We could not determine the proportion of the market that these operations were servicing but through discussions with one of the larger of such operations roughly estimated it to be around 20% of claims. These operations would be available to remove some of the load from a fund, but they would not relieve the fund of the necessity to establish an overall claims handling system into which these claims could be reported and finalized. Certainly, there is not sufficient capacity in the independent claims handling firms to carry the operations of the fund.

Some general thoughts regarding organizational structure are presented in the following segments.

Staff Function for the Board of Directors

- . Policy Development Function:
 - Address unresolved issues dealing with posture of the fund relative to coverage of medical costs and liabilities associated with a wide variety of hard to interpret situations (which may arise on a continual bases after legislation has been developed and passed).
 - Coordinate legal programs to establish actual coverage limits as a result of court actions brought against the fund.
- . Internal Audit function:
 - Review and verify experience reports and other data produced by the fund administration.
 - Perform special studies for the Board.

Administration and Government Liaison

- . Establish central administrative core of organization to be headed by a fund Executive Director.
- . Coordinate an Operations Advisory Group of outside specialists (non-board members) who are invited by the Executive Director to provide input on operations issues. Likely to be composed of Finance Directors from all counties, representatives from independent insurance adjusters, etc.
- . Coordinate management in the staff and operating areas:
 - Claims
 - Agency
 - Information systems
 - Finance and accounting
 - Statistical and actuarial
 - Legal
 - Administrative Support Services

Claims

- . Develop way to keep track of claimants, claim histories, driving records and other information without having that information collected according to policy number. That is a bigger task than first appears. Most likely prospect is social security number (drivers license number), but a system of cross checks against vehicle records would also be beneficial.

- Service personal injury claims
- Service bodily injury liability claims
- Service property damage liability claims

Agency

- . Authorize all licensed agents in State to sell fund extended coverages. We would not advise fund to have its own agency system.
- . Establish agency support operations which could be operated as a section in the Finance and Accounting area.

Information Systems

- . Provide mainframe and computer communications support for:
 - Claims
 - Licensing Divisions
 - Accounting
 - Statistical and Actuarial (management information)
- . This would be one of the most difficult groups to put together because of the large up-front start-up costs.
- . HDIF would not be able to perform modern claims handling and tracking without a sophisticated system.
- . HDIF might be able to engage an existing computer service company on a large contract which would support the entire fund organization.

Finance and Accounting

- . System would have to be developed as a one-of-a-kind and would be time-consuming to build.
- . If extended coverages are sold, a whole new form of accounting would have to be added.
- . One of the most basic questions is whether fund should be operated on a accrual (reserve) or on a cash flow basis.
- . Accrual (Reserve):
 - Would ultimately protect against huge increases in fund revenue needs in any one year and would minimize the need to adjust fuel taxes or other fees on a variable basis.

- Would be very expensive to establish reserve funds initially as a two-to-one ratio for premium written as is currently the case for private insurers entering the Hawaii market.
- Would build reserves based on claim activity from day one. The costs would be relatively high during initial periods but would provide greater stability at a later date.
- Would require an investment committee. Might invest heavily in State and County bonds. This would be a convenient market for bonds as well.

Cash Flow

- Would require some form of emergency source of funds.
- Would require constant monitoring to project cash flow needs. Expenses may be predictable but revenues may be hard to predict due to variations in fuel sales and competition from the private market for extended coverages.
- Makes the constitutionality of tax collections and powers to levy a more significant question because fund may not be able to wait each year on legislative action.
- Even if the first years of the fund would appear to work under a cash flow basis, medical claims which make up the bulk of what would be covered under the fund would have an extremely long tail on payments and final judgments due to court actions. The fund would inevitably require huge increases in capital after the first few years of operation.

Statistical

- . Responsible for forecasting revenues and expenses
- . Compute fuel tax adjustment requirements (or adjustments to other revenue sources)
- . Compile of reports for management, the Board and for the Commissioner

Actuarial

- . Responsible for developing rating schemes for:
 - Drivers license renewals or violation surcharges
 - Vehicle registration

- . Perform special studies on rating alternatives.
- . Develop data collection procedures in conjunction with the counties and State Department of Transportation to produce adequate data files on which to base rate information.

Legal

- . Would be split between two types
 - State Fund Legislation Support Group devoted to the task of addressing constitutional and other challenges to aspects of the State fund legislation.
 - Claims support
- . Legal resources may represent a potentially decreasing long-term cost as legal questions of fund were resolved.

Administrative Support Services

- . This area would involve a variety of services including personnel, government liaison, purchasing, general services, etc.
- . Liaison with counties:
 - Make payments to counties for the costs of their implementation and operating expenses
 - Help create ordinances and support other county actions (especially police enforcement) which are complementary to the operations of the fund
- . Private industry personnel practices would be most appropriate to operations of the fund.

PART TWO
STUDY OF
SELECTED INSURANCE ISSUES

CHAPTER VII

INSURANCE AND PUBLIC POLICY – AN INTRODUCTION TO THE STUDY OF FOUR SELECTED TOPICS

This chapter offers a number of perspectives important to the understanding of the four selected insurance topics which are addressed in subsequent chapters:

- . Nondiscrimination
- . Take-all-comers
- . No-fault coverage for motorcycles
- . Uninsured motorists

Basic operating principles of the current private system are described and are related to the social policy objectives which have been established by the Hawaii Legislature as a framework for this system. The points at which stress are produced and some of their underlying causes are described. The following issues and questions introduce some of the issues relevant to this chapter and to the chapters which follow.

Nondiscrimination. Current State statutes prohibit insurance pricing or rating based on race, creed, ethnic extraction, age, sex, length of driving experience, credit bureau rating, marital status, or physical handicap. What impacts might result from allowing insurers to rate based on age or length of driving experience?

Take-all-comers. Current State statutes require all insurers to provide insurance to any licensed driver who pays the premium (drivers with exceptionally poor driving records may be assigned to the Joint Underwriting Program). What impact does this requirement have and are any changes suggested?

Uninsured motorists. Estimates of the number of uninsured motorists suggest that some 11% of Hawaii drivers may be uninsured. Several attempts have been made to develop programs to reduce this number, but none have been embraced and adopted. What other steps might be taken?

Motorcycles. Motorcycles are currently exempt from provisions of the no-fault law. How should motorcycles be treated relative to State insurance statutes (including the HDIF proposal)?

Other than a portion of the segment regarding motorcycles the following discussion assumes a private insurer market (not a State fund). The reason is that the issues are being discussed with an emphasis on impacts and corrective measures for the current environment.

SOCIAL POLICY AND ISSUES OF NONDISCRIMINATION/TAKE-ALL-COMERS

Current Hawaii statutes are based on an underlying presumption that insurance is a social necessity and that although some groups may represent significantly higher risks than others, society as a whole may be better off to spread the cost to the larger society of covering some of these higher risk groups rather than set insurance prices for these risk groups at such levels that insurance becomes prohibitively expensive and a large portion of those risk groups go uncovered. This is presumed to be especially true if the rest of society is at risk from the actions of those groups.

The legislation also implies that if risk groups were to be defined by social classifications outside the control of individual members of those groups (e.g., race), various individual members of the groups may be unfairly treated regarding insurance pricing or availability relative to their risks as individuals. It is therefore more reasonable and socially justifiable to increase the cost of insurance for society as a whole by some modest amount than to:

- . Raise prices for specific groups to the point of driving them out of the market.
- . Penalize individuals based on a social classification over which they have no control and one that may not be reflective of their individual risk or may be a violation of their civil rights.

This logic would also suggest that the most socially preferred method of pricing risk should be based on the actual loss experience of *individual policy holders* or their participation in activities which involve specific risks rather than some larger demographic class rating system over which an individual has no control.

Alternatively, to understand why there is an issue with such legislation whereby insurance companies may wish to use demographic class rating factors such as age, length of driving experience, sex and marital status, one must understand how an insurance company achieves profits in a competitive environment.

Companies charging the same premiums for the same product can compete in three ways. They may be able to achieve:

- . Lower operating costs.
- . Better investment of premium dollars being held.
- . Better risk selection.

An examination of these factors illustrates where the major potential for increasing profits exist.

- . The lowering of operating costs means increasing efficiency or cutting back on services. There are points after which further increases in

efficiency are very difficult to achieve. Salaries must be kept competitive to retain good personnel and cutting costs too deep can impact operating effectiveness.

The quality of investment of premium dollars can make a significant difference in offsetting losses or in creating profits. Still, the return on investment for firms investing money on a large national market tends to be determined as much by the general state of the economy as by investment strategies. Most companies over a certain size find themselves facing very similar prospects for returns on investments, and the competitive distinctions among companies are diminished.

Risk selection (and pricing) has traditionally provided insurers with the most direct method to control loss exposures relative to the premiums charged. The company which selects its policyholders more carefully than the others will perform better financially.

Factors such as age, sex, and marital status have been shown consistently to correlate with the likelihood of future accidents and claims.

Social policy decisions made at a legislative level to prohibit insurers from rejecting or pricing risks even partially on these variables removes a proven and economically significant mechanism from the strategy options that insurers might otherwise use to more closely predict losses and price risks accordingly.

The pressures of economic survival and competition among insurance companies make it unlikely that insurers will completely ignore these known loss indicators even given the existence of legal prohibitions against discrimination. All things being equal, the companies that can attract good risks (e.g., married and over age 26) will do better than those who take bad risks (e.g., youthful male singles). This can lead to the use of much more subtle techniques such as:

- . Advertising focused at specific markets
- . Location and style of offices
- . Channeling (the informal process of directing a high risk to a product line which does not offer the lowest price available or discouraging the risk from choosing the company)
- . Abandonment of a market area (e.g., stop writing auto insurance in Hawaii)

Alternatively, those companies which adhere most closely to the spirit of the nondiscrimination and take-all-comers statutes are, unfortunately, often subject to the greatest financial penalties in the open market.

ALTERNATIVE RATING FACTORS

One of the central reasons why insurance companies tend to focus on factors such as age, length of driving experience, sex, marital status, and certain other demographic variables is that these factors are most readily available in terms of:

- . Ease of collection and verification at time of application.
- . Existence of previously developed actuarial information based on these rating factors (also developed because information was readily at hand) which provide verifiable indices of potential loss.

Alternative rating factors which are oriented toward assessing risk on a more individualized basis are generally more difficult to obtain and/or verify.

- . Many theoretical rating factors exist but cannot reasonably be established.
 - Attentiveness or even conscientiousness
 - Propensity to challenge danger
 - Social consciousness
 - Physical reaction time
 - Driving habits in general
- . Other more practical indices based on experience often require the continual development and maintenance of specific data bases identified by individual.
 - Driving record
 - * Traffic violations
 - * Previous accidents (especially if at fault)
 - Possession of a valid operators license for the type of vehicle to be operated.
 - Prior misrepresentations relative to insurance.

Some quasi-theoretical/practical indicators are available and used (mostly in the past) in some jurisdictions, but they often require the acceptance of significant inferential leaps and the sources of data are often troublesome.

- . Conscientiousness and social responsibility were sometimes inferred from credit bureau reports.
- . Propensity toward substance abuse and antisocial behavior were occasionally inferred from police reports other than driving records.
- . Personal fitness or ability to maintain control of vehicle were sometimes inferred from medical records with special attention given to treatment of mental disorders.

At a social policy level, it can be argued, as in the case of Hawaii legislation, that reasonable attention to individual rights and the desire to make insurance available across the board generally favor restricting rating/acceptance factors to those such as:

- . Driving record
 - Traffic violations
 - Previous accidents (especially if at fault)
- . Possession of a valid operators license for the type of vehicle to be operated.

We add that the judicious allowance of certain other factors may not seriously impair this rationale. These include:

- . Prior misrepresentations relative to insurance.
- . Limited class rating factor such as length of driving experience (especially if the full rating impact is not imposed).

Reconciliation of Social Needs and the Pressure to Quantify and Rate Risks

It must be recognized that the competitive nature of the private insurance market will always push companies to try and select better risks than the other firms competing in the same portion of the market.

If demographic factors or other known rating factors are to be prohibited, then good substitute or other better rating factors based on complete and reliable information should be available to promote an efficient market whereby insurers have strategic mechanisms to guide their pricing and marketing efforts.

In situations where industry pricing policies are fairly clear and based upon quantifiable risk, the market will tend to be covered in all areas. It is true that insurance companies are in the business of insuring risks and if they can price adequately for even a high exposure risk, they are inclined to cover it. Some firms will go after higher risks based on higher premiums in order to establish their niche in the market. They can do this because other insurers in the market will use similar rating mechanisms and will not be inclined to insure the risk at a lower premium unless the company is simply better run and can operate at lower costs. This helps to further promote efficiency of operation.

With exceptions for age and sex, individual experience factors such as driving record tend to be better predictors of loss than demographic factors anyway, thus driving records make good pricing mechanisms for the market if they can be obtained and are accurate.

The greatest exception relates to age or length of driving experience. The problem with youthful drivers is that they have very little in the way of individual

driving records on which to base assessments of individual risk. Further, as a whole, they are a known and very significantly high loss group, involving twice the accident rate and three times the claim payout. Thus, unless they can be rated or some other mechanism put in place to account for their losses, they tend to be avoided as a group. Insurers attempting to limit the number of youthful drivers that each covers may cause position jockeying among insurers (avoiding being the lowest priced in coverage options that would attract higher risks such as youths) and may lead to other forms of market disruptions.

Still, if driving records are to be the main source of rating information used instead of known demographic factors, then accurate records must be available to the market. There are often difficulties with this data.

- . Traffic violations data (maintained by government) are usually fairly accurate but depending on court and other administrative action, may be subject to purging at fairly short intervals as well as delayed or incomplete reporting by various participating agencies. Coding schemes and meanings are subject to change over time as well as between jurisdictions. In Hawaii, however, availability is a major issue.
- . Accident histories (maintained by government) are generally less accurate, incomplete, and not well structured for rating purposes. In Hawaii, they are almost nonexistent.
- . Insurance company records on accidents and claims by policyholder or driver are more suited to rating purposes, but unless a specific program is established and further mandated by industry regulators, this type of data is not often shared among insurers.

Despite the significant and real value of defining a free market rating system around socially acceptable variables such as driving record, it must be realized that information as a whole is cumulative in its value. More is generally better. Thus,

- . Demographic information will usually represent some potentially useful information for marginal risk selection by insurers even beyond what information they obtain regarding individual driving records.
- . While individual driving records may be by far and away most useful in risk selection, some insurers may find that fine tuning their underwriting/actuarial process through subtle application of prohibited demographic factors may prove to be an attractive temptation.

The ultimate regulatory environment and legal provisions for conducting an insurance business must take into account this pressure and should promote a system whereby the process established to rate on a reasonably broad concept of socially acceptable factors is well conceived and the perceived need on the part of the industry to use other factors is minimized. Many adjustments such as the use of a well functioning assigned risk plan can help promote this end. Chapter XI attempts to describe such an environment in reasonable detail.

CHAPTER VIII

ISSUES OF NONDISCRIMINATION AND TAKE-ALL-COMERS

Nondiscrimination and the "Take-All-Comers" provisions are discussed together because both issues involve restrictions regarding the ability of insurance companies to price individual risks. They have related impacts on the insurance marketplace in Hawaii.

NONDISCRIMINATION

In most states, the insurance law prohibits "unfair" discrimination in insurance rates. "Unfair" discrimination refers to discrimination which is not based on reasonable expectations regarding differences in loss costs among insureds. Rating on the basis of race, creed, and ethnic extraction is generally regarded as unfair as a matter of principle and is prohibited. "Fair" discrimination, however, is generally permitted. While some states bar rating differences based on one or some of age, length of driving experience, sex, marital status, or credit bureau rating, Hawaii is unique in prohibiting *all* of these.

Presumed Benefits of Nondiscrimination

The presumed benefits of the nondiscrimination are:

- . To promote social equity and civil rights protections. This applies especially to the restrictions on rating due to race, creed, and ethnic extraction.
- . To spread the burden of risk for several groups who could ill afford to pay their full proportionate share. This would especially apply to youths and to handicapped.
- . To emphasize individual responsibility, individual driving records, and other factors presumed to be controllable by the individual.
- . To avoid creation of certain uninsured classes (due to full difference pricing) especially if many individual members of that class may not represent the poor risks of the class.

Age as a Rating Factor

The problem as it applies in particular to age (or length of driving experience) is that there is an overwhelmingly larger chance that youthful drivers will be involved in chargeable accidents. In Hawaii, drivers under the age of 25 are twice as likely to be involved in an accident as drivers over this age, and the chances of a driver under 25 being at fault in an accident are even greater. In dollar losses, they generate three times the losses of individuals over 25.

The implied philosophy of the current law is:

- . Even considering this group loss difference, rates should be based only on individual driving record. This is intended to maintain the emphasis on individual responsibility and avoid ratings based on class distinctions over which the individual has no control.
- . Further, if a class rating orientation were to be taken regarding inexperienced drivers (essentially youths), this would cause families with adolescent operators to pay large amounts for insurance. A question could be raised as to whether this is responsible social policy compared to the view that having children is a necessary social activity and that it should be a joint responsibility of society to help in the process of getting the youths through adolescence and into adulthood. This is essentially the same philosophy that underlies free public education and the requirement that all taxpayers participate in the funding process regardless of whether any individual tax payers had children in school.

The problem with this social approach as it applies to auto insurance is basically this:

- . Since new drivers have no records, they are, by definition, placed in the lowest rating group.
- . Since they can not be surcharged any faster than adults (nondiscrimination), it can take several violations and chargeable accidents before they are assessed a premium which even partially reflects their actual risk category.
- . A youthful driver who has been claim free for 3 years is still more likely to cause an accident during the next year than an older driver with a similar record. Thus, even the claim free youthful drivers with a number of years of experience will generate greater loss costs than older drivers.
- . Although individual differences exist among youthful operators (and among older drivers), there are such high probabilities of adolescents causing some form of claim activity that this class of business is extremely unprofitable for the various insurers at any rate levels comparable to more experienced drivers.

No way has been found to distinguish the "better" youthful drivers from the other youthful drivers. The total amount of claims paid for a group of insureds is based on the average characteristics of those insureds. The fact that there is an overlap between the loss experience of youthful drivers and the loss experience of older drivers does not mean that insurers can safely ignore the differences between these two groups. In fact, most youthful drivers will not have a claim in any given year, and most older drivers will not have a claim either. This does not mean the expected loss costs for a youthful driver are not significantly more than for an older driver. An analogous situation is life insurance costs for smokers. Many smokers outlive many non-smokers. The mortality curves for these groups overlap substantially. But it is still true that smokers die at higher rates than non-smokers. While no insurer can say which of its policyholders who are smokers will die in any given year, it does know that the rate of claims from smokers will be higher than from non-smokers.

The implications of this for the insurance market in Hawaii are:

- . Insurers naturally avoid the youthful driver market when at all possible.
- . At a minimum, each insurer attempts to make sure that it does not take on a disproportionate share of the younger market.
- . If an insurer does get out of balance with regard to its share of the youthful market, it will experience higher loss ratios, and because they cannot rate this portion of their business differently as a class, they will have to apply for across the board increases. Across the board rate increases tend to drive out established policyholders. Established policyholders tend to have better loss ratios because the poor drivers who would have been among them are surcharged into seeking new insurers. More often than not, the established policyholders are replaced with new policyholders having a higher loss potential who are escaping bad driving record surcharges imposed by a prior insurer. With the new rounds of higher losses that this new business would produce in addition to the losses of the youthful drivers, the insurer must raise rates again, and a vicious business cycle can be started.
- . This same phenomenon applies to all types of demographic variables having statistical relationship to loss ratios. These include sex, marital status, and possibly certain other variables such as impairments or handicapped status. In all cases, the insurers would prefer to target rate increases to specific loss groups in order to avoid across the board increases that hinder their competitiveness in the overall market.

While the insurers operating in Hawaii have by and large accepted the social policy decisions which prohibit them from rating on demographic variables, they have on a fairly consistent basis made a valid argument for rating based on age or the length of driving experience. The proposed remedy offered by insurers is to be

able to price their business separately for nonexperienced drivers so that losses in this area can be corrected through a direct repricing which will not affect established customers in other rate categories. The rationale is supported by:

- . This is the only group for which no driving record is available on which some other form of individualized rating could be devised.
- . A fair pricing program (from the perspective of the insurers) would allow them to pursue the nonexperienced market (or at least stop avoiding it) and provide quality services in a competitive environment.
- . The loss differences associated with age are much more significant than loss differences associated with other demographic factors.
- . Rates for experienced drivers could be readjusted downward and the system would reflect a more efficient and directly proportional sharing of premium obligations according to estimates of probable future risks.
- . More direct family control is likely to be placed on the driving activities of youthful drivers by parents who have greater incentive to restrict driving activities in order to avoid significant insurance payments for those youth.
- . Special rates for inexperienced drivers would also allow those rates to further differ according to whether the operator attended a certified drivers education program. Research has shown that students graduating from such programs are better risks than students not graduating from such programs.

Observations

The issues essentially reduce to:

- . The question of whether society wishes to share the costs of allowing inexperienced (generally youthful) operators to mature through the early years of their driving experience on a collective cost basis.
- . Whether there really is a volatility of insurance pricing or other demonstrable negative market impact which can reasonably be traced back to subsidies of this inexperienced operator group.

We find that there are differences in loss ratios between nonexperienced drivers and other drivers which are significant enough to cause financial distress among the Hawaii operations of most companies should they find themselves holding a disproportionate share of the youthful market (ages 16-25).

By being allowed to segment their markets according to rating factors, the companies gain the ability to become competitive in certain segments and experiment with rating changes while at the same time isolating these limited rate changes from their policyholder group as a whole. This affords a certain degree of protection in that they need not worry about losing their client base as a whole should they fall out of competition in certain areas.

Options

We see several options available to deal with these issues. The choices, however, continue to revolve around a question of social priority versus market efficiency.

Option #1. The industry could be allowed a compromise surcharge percentage limit which could be established for inexperienced drivers. The rationale is that if the additional charge is based on a maximum percentage increase (e.g., 50%) of whatever rate the company would have charged if it were not for the length of driving experience factor being considered, there would exist an upper limit protection of parents and independent young adults from being charged huge increases in insurance based solely on the fact that they were paying for inexperienced operators.

For instance, if one were to assume that the demographically accurate rate for a 16-year old represented a 200% increase over the rate appropriate for a mature adult, then establishing a maximum allowable surcharge for inexperienced drivers of 50% would allow insurance companies to attribute one fourth of their expected additional losses directly to the youthful drivers while spreading the other three fourths of those additional costs over the remainder of the policyholder group.

Alternatively, setting the surcharge allowance at 100%, 150% or at 200% would provide less price subsidies to the parents (or the payer of the premiums) and would allow the companies to charge more demographically accurate prices. Charging more demographically accurate prices would promote the following objectives of the insurance industry:

- Reduce the probable feeling of many policyholders that they are unfairly being penalized for the losses of others.

- Allow insurers to take on more inexperienced drivers and suffer less penalty. To the extent the surcharges were accurate (e.g., at levels of 200% or more), the insurers could even actively pursue this market and surcharges would eventually settle in at competitive but fairly accurate rates. Even if they are set at levels below demographic accuracy, they would still lessen the financial burden companies (and insureds with more driving experience) would be subject to as they took on more youthful drivers (especially if such shifts were unplanned and involuntary). This would have the effect of easing some of the potential volatility of subsequent rate adjustments. That, in turn, should promote a healthier sense of competition.

Option #2. Surcharges might also be varied according to the length of driving experience in order to phase out as the driver approached higher levels of mature experience. For instance, the following schedule might be considered.

<u>Years of Experience</u>	<u>Surcharge Maximum</u>
0-2	50%
3-4	35%
5-6	15%

It should be realized that setting factors in this manner is not an actuarially based exercise, but represents the degree to which the Legislature chooses to strike a balance between promoting a social policy of spreading inexperienced driver costs across the whole of all policyholders versus promoting an environment of free business competition where insurance companies attempt to align their services to the market.

In the same vein, surcharge maximums could be dropped to a somewhat lower level (e.g., 45%) for those inexperienced drivers completing a high school or otherwise certified drivers education program.

Option #3. Recast the problem into a system for granting discounts based on numbers of years of claim free experience. Youthful drivers would not be able to show claim free status and would be charged a base premium amount that would be higher than the premium generally available to long term policyholders. The Canadian fund plans use this system. This system does, however, have certain drawbacks for bringing other new customers into a company.

TAKE-ALL-COMERS

Impact on Market

The impact on the market is very much a function of how well the insurers are able to develop credible rating information to categorize each risk as it is accepted. In Hawaii, information available regarding driving record and chargeable accidents is very poor at the time that the risk must be accepted by the company. This lack of credible rating information, when combined with the Hawaii take-all-comers provision, creates a volatile market with potentially dramatic swings among different insurers in terms of market share and rates. Once, however, an equilibrium is established among insurers, there is little incentive for attempting to compete aggressively. In fact, there are strong incentives for insurers to concentrate on maintaining existing books of business and to raise rates in fairly consistent levels of unity among insurers. This is because:

- . Each insurer avoids large increases in business at any one time.
- . Each insurer avoids being the lowest priced insurer in the market (especially in commercial).

Avoiding large increases in business. In Hawaii, many insurers limit the number of new risks they will accept in one day. In this manner they control the volume of business they add in any period. There are not very many states where insurers limit the number of new accounts this directly. This posture can be understood given the following perspectives.

Policyholders with bad driving records who have been rated into high payment groups are usually the most likely to look for new insurers. Since they know that they must be accepted by any insurer, they will (all other things being equal) go to the insurer with the lowest price. They are seldom likely to fully disclose their entire driving history at the time of application unless the insurer requires that the applicant go to the Traffic Violations Bureau to obtain a copy (which may still be altered) of his traffic abstracts. The insurer who orders abstracts for the applicant may wait two to four weeks for mail processing of requests. In the meantime, the new policyholder is likely to be placed in an unrealistically low rating group by the new insurer. The insurer may ultimately gain some information regarding moving violations as recorded by the State Violations Bureau some weeks later. At that point, the insurer will require that additional premium be paid, and under law must wait for a response. If no response is made within a reasonable time, the insurer may issue a notice of cancellation to be effective in another 30 days. In any event, the driver will have received approximately 3 months of coverage at the lowest rate. The driver can repeat this process each quarter with another insurance company and given the number of companies writing in Honolulu, can go more than three years before having to come back around to the same company which is obliged under the law to go through the same process again.

If during this process, the driver has a space between moving violations where the points on his driving record are relatively low, he may decide to take up the company on payment of the additional premium due at the time the insurer orders the motor vehicle record and completes the rating process. At that point, he has secured a rating category that is uncharacteristically low for the actual risk that the driver poses.

The system is further complicated by the fact that chargeable accident information is not consistently maintained in any central file. While accident information is supposed to be maintained on the Motor Vehicle Record, only those accidents which are reported to the police actually make it to the file and then only those accidents for which a chargeable offense has been cited can be used in computing a rating category. This essentially limits ratings to citations and removes accident information from being considered. Thus, the insurer may very well wish to place the risk in a higher risk category but is unable to. Eventually, the risk will cause claim activity and will eventually be rated into a higher class. At that point, the risk will voluntarily leave the company and begin the process again.

In actual fact, most problem purchasers of insurance are not so systematic as to move to a new insured regularly on a quarterly basis, but the essential elements of this practice go on in a more haphazard fashion, usually associated with the need to obtain a no-fault card in order to register a vehicle.

Most insurers in Hawaii attempt to take on new business only at a rate sufficient to replace lost business with some possible growth factor, but they are hesitant to take on too much of this business under a take-all-comers rule where they are allowed virtually no latitude to refuse any of this business. In other states, without take-all-comers provisions, insurers tend to find that new insureds have worse loss experience than renewal insureds. The main reason for this seems to be that the underwriting process continues for some time after an insured is accepted for coverage. Certain insureds are not renewed at the end of the original policy term, due to information that has come to the attention of the company during the course of the policy term.

Avoidance of lowest price. Avoidance of being the lowest priced insurer applies primarily to the commercial lines. This is because:

- . Commercial customers tend to come in waves based primarily on price considerations (e.g., taxi drivers communicate quite rapidly through their associations as to which companies are covering commercial lines at reasonable rates and they sometimes migrate in mass to that insurer).
- . Companies may be offering certain commercial lines without doing much business in that line and may not have very accurate loss projection data. As long as the level of business is fairly low, this poses no real problem. Should, however, other companies carrying commercial lines stop offering that insurance or should they be granted rate filings that raise their premiums, a company with only a small portion of the commercial business may suddenly find itself receiving a large portion of the business without adequate rates to pay for losses in this area (especially given that it would be primarily new business).
- . This fear of being the lowest rate applies particularly to specialty areas such as the insurance of motorcycles. In this case, the motorcycle vendors and shop owners may steer large numbers of insureds toward a particular insurer.
- . While insurers attempt to keep their regular lines of insurance at lower prices in order to service and maintain their existing customer base, they are still concerned about being lower than the rest of the market in their regular prices. They want to be near a competitive price, but not necessarily the lowest (especially if it is a significant difference). Under the take-all-comers provision, and especially with prices published publicly by the Insurance Commissioner, they fear receiving far more business than they were prepared to accept. The reasons are as we discussed earlier.
- . Frequently insurers find themselves offering insurance at rates below what they feel is adequate because they are unable to obtain approval from the Insurance Division to implement the rates they want. This applies especially to the specialty classes of business where the company's own volume may be insufficient for rate making purposes, and what little volume they write may be unrepresentative of the business they could be required to write.

The Implications for the Market

Uneasy equilibrium. The net effect on the market is the creation of a somewhat uneasy equilibrium which has settled in during the past few years but is likely to be subject to:

- . Potential volatility given any major changes:
 - Exit from market by other insurers, especially writers of specialty classes of business.
 - Changes in the law.
 - Upward rate filings by other insurers.
- . Conservative approach to competition. As soon as competitor prices go up, insurers are inclined to request a rate change for their own in order to avoid being too low.
- . General uniformity among industry in rates and requests for rate changes (during times of equilibrium).
- . Subtle actions of insurers to avoid market segments.

Major contributing factor. Related pressures contribute to the general uneasiness of the market.

- . Lack of good/timely driving record information for rating purposes.
- . Lack of complete and accurate accident records.
- . Combined effects of nondiscrimination and take all comers.

Options

We see several options for improvement of the situation including:

Improvement of driving record rating information. This is discussed in more detail in Chapter XI. Essentially, providing insurers more complete and more timely information, (it takes two to four weeks to obtain a driver's record from the Violations Bureau currently) would allow more accurate rating.

Expansion of JUP. Currently only a limited group of specifically defined risks are allowed into the JUP. In most states, insurance companies are permitted to have their own criteria for accepting or rejecting risks. If an insured cannot find a company that will write him voluntarily, he is eligible for the involuntary market. The exact rules for such placement vary by state. In Hawaii, it might make the most sense to tighten the point system levels which define entrance and allow

insurers to reject such individuals for regular placement. JUP placement could then be offered to anyone who has been rejected by some number of companies, perhaps two companies. As long as the JUP rates are kept at realistic levels, in the sense that there is some subsidy by the voluntary market but that the JUP rates remain well above the voluntary rates, there should remain substantial room for the voluntary market to write all but the most hazardous risks. In many states there are companies which write the so-called "sub-standard" market, and many do so quite willingly. While the risks they write are higher hazard than the average risks, they charge sufficient premium that there is the potential for profit. Also, risks will sometimes seek out a sub-standard carrier because they can obtain coverages and services (monthly payment plans, etc.) not available through the involuntary market.

Expansion of the JUP would eliminate many of the current methods companies use in order to avoid writing certain risks.

Cancellations for misrepresentation. Currently an insurer has to accept or reject a risk, and set a premium for the risks it is accepting, before a copy of the driving record can be made available from the Violations Bureau. This means that the insurer has to rely heavily on the accuracy of the information provided by the applicant at the time of policy issuance. As a practical matter under the current law, an insurer cannot cancel a risk who has misstated his driving record. If insurers could cancel risks, within some reasonable time period, for significant misstatements at the time of application for insurance, there would be much greater pressure on insurance applicants to provide complete information. This would lead to more accurate rating, and reduce the reluctance of insurers to accept new business.

CHAPTER IX

AN EXAMINATION OF UNINSURED MOTORIST ISSUES

This chapter examines certain issues related to the problem of uninsured motorists. Various problems associated with estimating the actual proportion of the driving population who are uninsured are covered. There is some general discussion of the major issues surrounding the uninsured motorist problem, and the options for Hawaii are discussed.

Estimating the Size of the Uninsured Population

There are a number of methods which have been used to estimate the proportion of drivers who are uninsured in various states, including Hawaii. None of the methods which have been applied provide a completely reliable estimate of the uninsured population.

Haldi, in his 1972 report, estimated the proportion of vehicles which are uninsured by comparing the number of vehicle registrations to the number of car-years of insurance written by the insurance industry, with a correction due to the effect of new car sales. Haldi concluded that approximately 20% of all vehicles in Hawaii were uninsured over the period 1963 to 1969. (Motor vehicle insurance was not mandatory during this period.)

Tillinghast (1985) compared vehicle registrations to vehicles insured over the period 1979 to 1983 and concluded that the uninsured population is about 14% of all vehicles.

The method of comparing vehicle registrations with the number of vehicles insured, as used by Haldi and by Tillinghast, is subject to some problems. The two populations of vehicles do not coincide. The number of vehicles registered also includes vehicles used by businesses. Many of these will not appear in the count of the number of vehicles insured because they may be self-insured, or because the number of vehicles covered as a "fleet" on a "commercial lines" insurance policy is not reported. Rental cars which are self-insured would contribute significantly to the difference between the count of vehicles registered and vehicles insured. Also, if an owner registers a vehicle in April, and sells the vehicle in August at which time a new owner registers it, then two car years of registration will be counted for the year even though there is only one vehicle involved. Conversely, certain types of specialty vehicles, such as antiques, may be included in the count of the vehicles insured, but not in the registration figures.

Other approaches have included making estimates based on accident reports, registration samples, or other government agency information, and making estimates based on comparisons of the number of uninsured motorist claims with liability claims. The report "Uninsured Motorist Facts & Figures" prepared by the All-Industry Research Advisory Council (AIRAC-1984) discusses the strengths and weaknesses of these various methods.

On the use of accident reports, AIRAC noted:

"Accident reports collected by law enforcement agencies and state motor vehicle departments contain insurance information so that state agencies can enforce various state financial responsibility laws . . . There are wide variations among the states . . . in the methods of recording and reporting accident data . . . (A)ccident reports do not yield direct information on the number of uninsured vehicles. Instead, they provide information on the proportion of vehicles found to be uninsured at the time of accident. Such figures may overstate or understate the actual percentage of vehicles without insurance. Uninsured vehicles may not have the same probability of being involved in accidents as insured vehicles. Also, accidents involving uninsured vehicles may not be reported to the same extent as accidents involving insured vehicles. These problems indicate a need for caution in using accident reports alone as a measure of the uninsured motorist population." (page 3)

On the use of registration samples to estimate the uninsured population, the AIRAC report notes that such studies have been done for only a handful of states. To our knowledge, no such study has been performed for Hawaii. AIRAC lists potential problems with such studies, including the fact that they do not account for unregistered vehicles, and in the studies performed, there were difficulties in locating a portion of the sample and verifying the presence or absence of insurance.

AIRAC also notes, "In states with Unsatisfied Judgement Funds, uninsured motorists are required to pay additional registration fees that can be used to reimburse victims of uninsured and hit-and-run vehicles. The percentage of motorists paying such fees is sometimes used as a rough indicator of the number of uninsured vehicles in those states. Such estimates have the same deficiencies as studies based on registration samples. In addition, the extra fees required of uninsured motorists give them an incentive to evade payment"

In discussing the method of comparing the number of vehicle registrations with the number of insured cars reported by insurance companies, AIRAC notes that the method gives a negative number of uninsured vehicles for certain states for certain years. This may be due to pickup trucks, or other type of vehicle, which are insured as a passenger type vehicle while being registered as a truck, or some other type of vehicle.

AIRAC has commissioned surveys of households on a nationwide basis. These surveys are useful in determining some aspects of the uninsured population, but do not include a large enough sample to draw conclusions by state. The surveys suffer

the drawback of respondents under-reporting the uninsured vehicles in their possession.

The AIRAC report gives the results of comparing the frequencies of uninsured motorists claims to liability claims. The uninsured motorist claim frequency is the number of claims paid under the uninsured motorist coverage of an automobile insurance policy per 100 vehicles carrying uninsured motorists coverage for a year. The uninsured motorist claim frequency can be compared to the bodily injury claim frequency (number of bodily injury claims per 100 vehicles per year) to indicate the proportion of overall claims that are due to uninsured motorists.

There are two drawbacks to this method. First, it is not possible to separate hit-and-run accidents from accidents caused by uninsured motorists. Second, this method really measures the relative number of claims due to uninsured motorists, as opposed to the relative proportion of uninsured motorists. To the extent uninsured motorists have higher accident rates than insured motorists, the ratio of the frequency of uninsured motorists' claims to insured claims will be greater than the ratio of the number of uninsured motorists to insured motorists. Since the AIRAC surveys (on a nationwide basis) have shown that uninsured motorists are younger than insured drivers, on the average, there is reason to believe the uninsured population does, in fact, have a higher accident rate than the insured population.

Probable Levels of Uninsured Motorists in Hawaii

The method of comparing uninsured motorist coverage claim frequency to bodily injury claim frequency appears to be the most reliable method which has been performed for Hawaii. Exhibit IX-1 shows the result of this method for Hawaii for the years 1976 to 1985. The 1976 to 1980 figures are from the AIRAC report cited above. The 1981 to 1985 figures were supplied to us in advance of an update of the study which is anticipated within the next year.

EXHIBIT IX-1

Estimated Percentage of Vehicles Uninsured
in the State of Hawaii
According to U.M./B.I. Claim Frequency Ratio

Year	U.M.* Claim Frequency	B.I.** Claim Frequency	Ratio of U.M. to B.I. Claim Frequency
1976	.026	.410	.063
1977	.022	.273	.081
1978	.018	.289	.062
1979	.023	.287	.080
1980	.018	.253	.071
1981	.026	.264	.098
1982	.026	.257	.102
1983	.032	.248	.130
1984	.031	.260	.120
1985	.024	.257	.094
Average	.025	.280	.090

Source: 1976-1980--All-Industry Research Advisory Council,
"Uninsured Motorist Facts & Figures," 1984.

1981-1985--Data comparable to the above was supplied
by the National Association of Independent Insurers
and Insurance Services Office, the data sources for
the 1984 AIRAC study.

- * Uninsured Motorist
- ** Bodily Injury

It appears, from the table, that the overall average of uninsured motorists for the past 10 years is approximately 9%. However, in the last five years the percentages have moved to the 10-12% range with a return to 9% in 1985. Since this includes hit-and-run, and since the accident rate for uninsured motorists may be higher than for insured motorists, the proportion of uninsured vehicles is probably notably less than this amount.

Some additional support for this estimate of the proportion of uninsured drivers in Hawaii is given by some figures provided informally by the Traffic Violations Bureau. Of about 140,000 moving violations in Hawaii in 1986, approximately 9,000 were for driving without a license, and 14,000 were for not being able to produce a no-fault card. At face value, this would tend to indicate that approximately 6% of the drivers in Hawaii are driving without a license, and 10% of all drivers do not have insurance on their vehicle. One factor that tends to make these estimates too high is that a certain number of these citations will have been dismissed because the defendant will in fact have had a license or a no-fault card. A factor that would tend to make these estimates too low is that some people are given more than one citation when they are stopped by the police. Thus, less than 140,000 drivers were stopped by the police to yield the 140,000 citations. Figures are not available to make better estimates on this basis.

Comparison to Other States

The AIRAC report gives the results of this analysis by state for the period 1976 to 1980. This chart is reproduced as Exhibit IX-2. In 1980, Hawaii ranked 38 among the states, meaning that 37 states had higher ratios of uninsured motorists coverage claims frequencies to bodily injury coverage claims frequencies, and 12 states had lower ratios. Thus 37 states appear to have a worse uninsured motorist problem, and 12 states seem to not have as bad an uninsured motorist problem. Only two states, North Carolina and Massachusetts, seem to have tremendously lower ratios of uninsured motorists populations. There is some evidence that stricter enforcement of the financial responsibility laws is the reason for the better performance. There is also evidence that the situation has deteriorated in these two states since 1980.

The uninsured motorist problem in Hawaii does not appear to be as large as previously estimated.

The Nature of the Problem

Under the current insurance system in Hawaii and most other states, the fact of the existence of uninsured motorists means that certain victims of automobile accidents are not compensated for their injuries or losses.

The usual objective of eliminating the uninsured motorist problem is to assure that persons not at fault in automobile accidents are able to recover for their losses from the person at fault in the accident. A different objective would be to assure that persons who are the victims of automobile accidents are able to recover their medical costs and wages lost due to bodily injury on a first party basis.

EXHIBIT IX-2

State Rankings as of 1980
based on
U.M.* and B.I.** Claim Frequencies and Ratios

State	Rank Based on Ratio of U.M. to B.I. Claim Frequencies	Rank Based on U.M. Claim Frequency	Rank Based on B.I. Claim Frequency
New Mexico	1	4	22
Mississippi	2	7	22
Florida	3	17	39
California	4	6	9
Colorado	5	32	47
Alabama	6	15	33
Arizona	7	2	4
Rhode Island	8	1	2
District of Columbia	9	3	3
Georgia	10	29	43
Nevada	11	8	8
Michigan	12	41	48
Oklahoma	13	11	21
Washington	14	9	12
Louisiana	15	5	1
Tennessee	16	12	20
Minnesota	17	37	46
Ohio	18	14	19
Alaska	19	18	29
Illinois	20	10	7
Virginia	20	12	15
Arkansas	22	20	27
West Virginia	23	22	33
Missouri	24	16	18
Pennsylvania	24	33	42
Kentucky	26	43	45
Oregon	27	19	14
Indiana	28	24	26
Wyoming	29	39	40
Kansas	29	45	44
Wisconsin	31	21	11
Nebraska	32	34	37
Texas	33	23	17
Idaho	34	27	24
Delaware	35	31	30
New Hampshire	36	24	13
Maine	37	30	25
Hawaii	38	49	49
Iowa	39	37	35
North Dakota	40	50	50
New Jersey	41	23	6
South Dakota	42	47	41
Montana	42	36	32
Connecticut	42	35	31
New York	45	40	36
Maryland	46	28	5
Utah	47	46	37
Vermont	48	42	28
North Carolina	49	44	10
Massachusetts	50	48	18

* Uninsured Motorist

** Bodily Injury

Under a tort system of automobile insurance, an individual might be unable to recover damages because another driver is at fault in an accident and has neither insurance coverage nor any other means of compensating the victim. Thus, a given driver might purchase coverage, and meet all the requirements of the law, and yet find himself uncompensated for losses due to an automobile accident. Under a no-fault system, the only uncompensated victims are those who do not purchase coverage for themselves. Under a partial no-fault, such as in Hawaii, for small losses, a victim goes uncompensated only if the victim has not purchased no-fault insurance, but for larger losses a victim's recovery of losses depends on whether the person at fault in the accident has purchased insurance.

The differing objectives of the two systems are that under the no-fault system a person pays for the chance that the person will be in an accident. Under the tort system the person pays for the chance that the person will be the cause of an accident. There is a wider spread of costs under the latter than the former.

Current System Loopholes

There are many ways vehicle operators avoid the system, and many reasons for this avoidance. The major reason for avoidance is that insurance is seen as costing more than the person is able to pay, or is willing to pay. For many vehicle owners, insurance is the largest single expense of operating the vehicle, larger than the drivers license fee, the vehicle registration cost, the gasoline, the maintenance, or even the price of the vehicle itself. There are vehicle owners for whom insurance provides no real protection. If the person does not own other property, insurance affords no real protection, since in the event of being sued by another party, there is nothing to be lost. If a person has a low income, owns no significant amount of property, and has a car with a very low market value, that person has no reason to buy insurance other than that the law requires it. Given a choice between not driving at all, or taking the chance on either getting caught driving without insurance, or having an accident, many such people will choose to take the chance.

One way to become uninsured is to purchase insurance on an installment plan just before registering, or re-registering a vehicle. This generally allows one to show that coverage will be in force for the coming six months. When the next premium payment is due, the person chooses not to pay it, and eventually, the insurance is cancelled due to nonpayment of premium. It is even possible to pay the first insurance premium installment with a check, receive the proof of coverage, register the vehicle, and then have the check not clear. This results in the insurance being cancelled very shortly after the issuance of the proof of coverage. While no statistics are available, we suspect that this is the manner in which most vehicles become uninsured.

Another way to avoid being insured is to not register the vehicle. Some such vehicles will be operated without the proper license plates and stickers being affixed. Some will have a license plate without a current sticker. Some will use stolen license plates or stickers.

A final category of uninsured vehicles is those used without permission. This includes vehicles that are in running condition that the owner intends to not use, but which are "borrowed" without permission, perhaps by a family member or possibly used "just this once."

Actions by Other States

Other states have developed a variety of methods for dealing with the uninsured motorist problem.

One method, used from 1978 to 1985 in Kentucky, involved the use of stickers that showed insurance was in effect. This method was found to be not very effective, due to improperly applied stickers, difficulty in seeing stickers under certain lighting conditions, and the fact that most apparent violations turned out to be due to the incorrect display of the stickers, as opposed to being due to insurance not being in-force.

Sticker plans to prove that insurance is in-force seem to be no more effective than checking for insurance at the time of registering a vehicle, and add a significant administrative burden to vehicle owners, police departments, and insurance companies.

Many states require proof of insurance at the time of registering a vehicle. California, like Hawaii, requires that a card showing proof of insurance be carried in the vehicle and produced when stopped for an alleged traffic violation. The California vehicle owner, however, need not present proof of insurance at the time the vehicle is registered.

A few states require uninsured motorists to pay into a fund to be used to compensate otherwise uncompensated victims of automobile accidents (Michigan, New Jersey, Maryland, New York and North Dakota). Ultimately, most jurisdictions opt for more enforcement and higher fines. Options being discussed more these days include computer checks of registrations against insurance company records.

Options for Hawaii

Two main options seem to present themselves. One is to increase the enforcement of existing laws and regulations. If the various police entities increase the attention they give to checking that vehicles are displaying proper registration plates and stickers, and if police check the insurance status of each vehicle every time it is stopped for any reason, then the number of uninsured vehicles operated on the streets would likely decline. Increasing the fines and other penalties for operating an uninsured vehicle would also make the risk of operating an uninsured vehicle less attractive to many drivers.

The other option is to develop an automatic cross checking of registrations with insurance company information, essentially checking in a periodic manner (monthly

or quarterly) that each registered vehicle is insured, and that each insured vehicle is registered. This method is discussed in greater detail in Chapter XI.

A very strong argument can be made that driving without insurance should be treated in much the same way that "driving under the influence" is handled. When caught, the uninsured operator's license should be suspended immediately and the vehicle license plates should be removed and the car impounded. The practical difficulty of this procedure in Hawaii is that there are often marginally acceptable reasons why an operator may not be able to produce a no-fault card. Improvements to the information system such as outlined in Chapter IX would allow such enforcement activity to be more realistically carried out. In any event, operators who later fail to show proof of insurance in court should be fined heavily.

CHAPTER X

MOTORCYCLES

This chapter discusses some of the particular insurance coverage problems which exist relative to motorcycles as motorcycles are now exempt from mandatory no-fault coverages. Some background history is presented as well as a synopsis of current conditions. The relative merits of including motorcycles under the provisions of a State fund are outlined. Also included are thoughts on the inclusion of motorcycles within the requirements of the current no-fault laws.

The Exclusion of Motorcycles from No-Fault Insurance Provisions

Although it was initially intended that motorcycles would be included under the provisions of the no-fault law, lobbying efforts were led by vendors to exclude motorcycles from no-fault laws based primarily on removing price obstacles from the sale of motorcycles. Including motorcycles under the no-fault law meant that operators had to carry PIP (first party personal injury protection) as well as bodily injury liability and physical damage liability.

The rates charged by most insurers were quite high for all three coverages. Since an operator would have to have a no-fault card in order register the cycle, this severely depressed the sale of cycles. Annual insurance payments could easily be more than the cost of the motorcycle.

Vendors/owners suggested that all of this coverage was unnecessary because:

- . PIP coverage should be a matter of personal choice. If a person knowingly took a risk but endangered no one other than him/herself, the person should be allowed to accept that risk (logic similar to repeal of helmet law).
- . Other forms of standard medical insurance would often cover first party injuries anyway.
- . Further, motorcycle accidents were statistically much more likely to be the fault of the other vehicle and most medical coverages could be derived from the liability coverage of the other vehicle.
- . Liability insurance for injuries to parties of other vehicles was almost never used. Occupants of cars hit by motorcycles were almost never hurt, and even if they were, the injuries would be even less likely to exceed the no-fault limits provided under the vehicle owners policy.

- . Property damage to automobiles hit by motorcycles was seldom extensive and the \$10,000 liability requirement at the time appeared excessively high.

Insurance companies tacitly supported the exclusion of motorcycles from the no-fault requirements because their inclusion under the law would have placed motorcycles within the take-all-comers provisions. Companies were very wary of the PIP losses that were characteristic of motorcycle losses. Further, this would have been a specialty market very sensitive to price differences and insurers were afraid that they would unknowingly find themselves to be the lowest priced insurer in the market at some point and suddenly be presented with a large number of insureds moving to the company, and the company would be obliged to take them all.

There also existed at the time of the exclusion, a couple of specialty companies that serviced only the motorcycle market in Hawaii. Including motorcycles under no-fault would have also meant (unless special legislation were developed) that these companies could have been subject to the take-all-comers provision requiring the insurance of automobiles. This would probably have caused these specialty carriers to withdraw from the market.

Potential Problems With Exclusion Rationale

Although this logic was generally true, certain flaws exist:

- . Motorcycle accidents often involve injuries to passengers and occasionally pedestrians.
- . Although unusual, motorcycles can cause other vehicles to swerve and hit other objects causing injury to the vehicle occupants. This could even include busses overturning down embankments, etc.
- . New varieties of "bullet motorcycles" have caused serious damage to larger vehicles including inflicting serious injury or death to vehicle occupants.

Treatment of Motorcycles Under the Current Law

Under the current law, proof of insurance is required for registration of a motorcycle although insurance need only consist of:

- . Bodily injury liability coverages for passengers and pedestrians
- . Property damage liability

No-fault automobile insurers are not required to provide coverages. Thus, there is no take-all-comers provision which applies to motorcycles.

Market Conditions

Specialty insurers withdrew from the market during the insurance crunch of the previous two years. A few regular auto insurers are providing motorcycle package insurance, but generally at fairly high rates. Rates for full coverage PIP are very high.

Although not foreseen at the present time, there is a possibility that without the requirement that motorcycles be included within the take-all-comers portion of the no-fault law, there could exist a requirement that motorcycles be covered by insurance in order to register them but no carrier offering insurance in the market.

Options for Hawaii

Option #1. Leave the situation as it is. The most recent law change requiring only pedestrian and passenger liability coverages was implemented in September of 1987, and the market must still work out adjustments before it is known which carriers will eventually enter the market at what rates.

Option #2. In view of the potential liability (although rare) for occupants of other vehicles, the law could further be expanded to include more general bodily injury liability requirements.

Option #3. Although it would make motorcycle insurance quite expensive, first party PIP could also be required (and required for passengers as well). This is essentially a value judgement relative to the societal costs of dealing with injured persons who have no means to pay for the medical support which is ultimately provided to them, especially in emergencies. It is similar to situations such as hang gliding, scuba diving, and other activities for which no insurance is required (although these activities are not regulated by the state).

Option #4. Include motorcycles under the no-fault provisions of Chapter 294. If PIP coverages are to be required, this is essentially paramount to including motorcycles within the no-fault law. The major difference would have to do with whether motorcycles should be included within the take-all-comers provision. Many insurers indicate that they are not prepared to offer motorcycle coverage, and it is doubtful that these companies would ever attempt to be competitive in this area even if they were forced to offer the coverage. Unless a good reason (of which we are unaware) can be shown to force companies into offering this coverage, we cannot recommend a forced application of the take-all-comers provision to motorcycles.

Similarly, if motorcycles were made subject to the other provisions of the no-fault law (maintaining all required coverages), specialty firms which might sell only motorcycle insurance should be exempt from having to sell automobile insurance (exempt from the full definition of take-all-comers). Further, because motorcycle travel does not represent any form of social necessity, there is no particular reason why even those firms selling motorcycle insurance should be compelled to abide by a take-all-comers provision applied only to motorcycles.

Private market risk underwriting including the right to refuse coverage and rate based on length of driving experience (motorcycle operation) may represent meaningful and valid considerations for this marginal portion of the market.

Implications for the State Fund

Most assessments made above would apply to the state fund as well. However, coverage of motorcycles under the state fund would involve a number of additional considerations.

The state fund would allow a greater range of overall policy decisions to be made regarding motorcycle coverages and would allow the cost of coverages to be shared across all automobile policyholders without ultimate concern for profitability of the individual line. This, of course, represents a social policy decision.

If motorcycles were to be included in the state fund, the fuel tax method of premium payment would not suffice to cover their losses. The miles per gallon obtained from motorcycles and the level of exposure would not at all be consistent with other vehicles.

The opportunity to have motorcycles pay their fair share for the exposures that they create would be most appropriate for the operator license renewals or registration payments. This would represent a highly increased cost of registration over other types of vehicles but could be adjusted to compensate for the lack of funds to be received through gasoline assessment. A special actuarial study would be required to determine these exact costs, but license renewals/registrations would likely run several hundred dollars.

The high cost of registrations would make motorcycle license plates a valuable commodity and would no doubt create a significant market for stolen plates having valid stickers. For this reason, we would recommend shifting the major costs to the operators permit for cycles. The temptation here, of course, would be to avoid acquiring a valid Class 2 permit. Many operators may choose to use their regular operators license until caught. Enforcement would be difficult and spotty. Significant fines would also be necessary. Further, even if the operators license were required to obtain the registration, many of the problems discussed earlier about using other persons to register the vehicle (motorcycle) would hold true.

CHAPTER XI

POSSIBLE ACTIONS RELATIVE TO FOUR ISSUE AREAS

This chapter outlines a number of steps that might be taken within the current insurance environment in order to ameliorate some of the issues raised as part of the four selected topic reviews of Part Two. The activities which are identified focus on the improvement of driver record information in order to provide adequate rating alternatives given the take-all-comers and nondiscrimination features of the local market. The improvements also allow for a fairly extensive cross check process to be implemented in order to identify and control levels of uninsured motorists. While motorcycles are not dealt with directly as part of the possible actions, the information systems resulting from these actions would be helpful in defining the actual problem levels associated with motorcycle accidents.

Establish System for Improvement of Driver Records

The process of establishing better driver records must involve both the private carriers and the government agencies responsible for maintaining component pieces of the information. While the information could be consolidated on government automated processing systems, it might very well be done on a cooperative basis using a contracted private system and paid for based on a pro rata contribution by the insurers using the system.

As such, interest within the industry could be assessed relative to forming an organization to handle these activities. For purposes of discussion, we have conjectured that a not-for-profit organization possibly called the Hawaii Insurance Service Corporation (HISC) could be formed for this purpose. The Insurance Commissioner might even require membership in the corporation by all motor vehicle insurance companies operating in the State. In such case, all companies writing more than 2% of total premium should have a representative on the Board of Directors. Membership fees should be sufficient to carry on the duties of the corporation and could be prorated among member firms in proportion to the amount of premium written for the preceding year.

Duties of the HISC

The HISC might obtain (or more reasonably contract for) a significantly sized computer system to:

- Receive and consolidate information provided to it monthly by member companies. That information would consist roughly of:

- Identification of vehicles insured (under no-fault provisions) by the company during the preceding month (manufacturers' Vehicle Identification Number (VIN)).
- Policy inception date for that vehicle.
- Policy renewal date for that vehicle.
- Final policy expiration date for that vehicle.
- Premium payment status.
- Drivers authorized as primary and secondary drivers for the vehicle (Drivers license number).
- Claim activity for the policy:
 - * Date of claim and company claim number
 - * Driver involved
 - * Chargeable/nonchargeable code
 - * Severity code
 - * Other vehicles/drivers involved in the accident

Receive and consolidate information received from the county motor vehicle divisions. That information would consist roughly of:

- Identification of vehicles with active registration in the county during the preceding month (manufacturers' Vehicle Identification Number (VIN)).
- Initial registration date by current owner.
- Registration renewal date.
- Registered owners (drivers license numbers when applicable).

Receive and consolidate information received from the State of Hawaii Traffic Violations Bureau. This information would roughly consist of:

- Drivers actively licensed within the State.
- Violation information for each driver:
 - * Date of offense
 - * Offense code
 - * Current points
- Accident information reported to system:
 - * Accident date
 - * Chargeable offenses related to the accident
 - * Fault finding by the police
 - * Other vehicles/drivers involved in the accident

- . Perform a monthly matching of records from these sources in order to create:
 - Updated driver history file which can be used by all member companies to rate new and existing business. The driver history record would consist of three parts:
 - * Violations History
 - * Chargeable Accident History
 - * Non-payment Cancellations
 - Vehicle coverage history file which can be used to determine:
 - * How many months if any, during the previous year was any vehicle registered but did not show insurance coverage.
- . Receive and consolidate other information from member companies in order to operate other services described in later segments. Information to be processed involves:
 - Collection of experience data to be supplied to the Insurance Commissioner.
 - Development of information and support systems to operate a premium financing plan.
 - Development of information and support systems for:
 - * Across the counter verification of records for insureds.
 - * Update and error correction by member companies.

Using these data bases, the HISC could provide services to the member companies of the corporation, to government, and to insurance consumers. These could include:

- . Provide on-line inquiry capabilities to member companies for the purpose of accurately rating new business as that business is initially reviewed. Information in this system would be more accurate, far more complete, and more useful than information which is currently available. This service would also minimize problems of new insureds being underrated at the time of the application and then being charged additional amounts later when the driver records were obtained from the state. This would further reduce the number of subsequent cancellations due to non-payment.
- . Provide on-line inquiry capability to the counties to be used for screening the registration of vehicles. If a vehicle showed that it was currently uninsured or if it had been uninsured for any period during the previous registration year, then the vehicle owner would be shifted to a special registration process described in a later segment. Most vehicle owners who were participating in a regular insurance program would not be affected by the program, and would, in fact, find registration easier as it

would not require that they possess a no-fault card. As a practical matter, the information could be provided to the counties in the form of a tape which could be used by their own systems. This would allow checks to be done automatically for mail-in renewals which are the most common.

Provide information to the Insurance Commissioner regarding the experience of member companies. Currently, the Commissioner's office expends considerable energy collecting various forms of information that could be consolidated and provided to the Insurance Commissioner without need on the Commissioner's part to re-enter or further compile the information using sometimes slow interactions with the State's EDP system. Such information could be audited if such reassurance were felt prudent.

Provide insurance customer services which would include a premium financing program and other record verification services which may be helpful in dealing with uninsured motorists issues as described later.

Potential Roles of the HISC

Facilitate accurate rating of insureds. The corporation would further serve as a central information base to facilitate the accurate rating of insureds.

If Hawaii is to maintain its emphasis on take-all-comers and nondiscrimination, the companies serving the market place need reliable driver record information on which to base their rating programs. Our earlier discussions have dealt with the reasons for this and the the implications for promoting a more efficient and competitive market. The ultimate benefit for the consumer is that those individuals who operate their vehicles in a safe and responsible fashion can depend on receiving a significant discount over those individuals who pose a more serious exposure to loss.

The current system of developing driver information does not provide for the transfer of driving record information from one insurer to another, and as a result, operators can under the take-all-comers provision move from one insurer to another with relative immunity, leaving a prior chargeable claim history to go unassessed by the new insurer. Accident information in the State's Traffic Violations Bureau files is very incomplete and difficult to assess. Traffic violation information is available only after a risk has been rated and placed on the insurers books. As a result, rates must necessarily involve a greater blending of risks between good and poor drivers. This has the effect of raising prices for the majority of good drivers.

Accurate driver record information provided on a central on-line system or a system that insurers could use to update their own files would allow effective rating of insureds as they applied for coverages. The HISC would be capable of maintaining such files on a monthly update basis as outlined in an earlier segment of this chapter.

While such a system would not be feasible for a large state, the modest size of both the registered vehicle files and the Driver License File in the State of Hawaii make computer comparisons and updates of these files very accomplishable.

Address issues of uninsured motorists. The corporation could serve as the central foundation for a program to address the issues of uninsured motorists. Under this assumption, however, specific sanctioning of HISC roles would have to be addressed by the Legislature and incorporated into Chapter 294 of the HRS. Such a program might feature these elements.

Cooperation from the counties would have to be developed in establishing a significant control point at the vehicle registration level. Involvement by the counties, however, would be fairly straightforward and potentially less involved than the premium collection activities associated with a state fund. For the majority of vehicle owners, the program would be invisible. The county would check, prior to issuing a registration sticker that the vehicle was covered under a self-insurance program (as is currently done) or check that the data base provided by the HISC indicated that the vehicle was insured as of the last file update (possible one month lag) *and* that the vehicle was insured for each month of the prior registration year (unless the vehicle was new during the year). This check could be done automatically by computer and an automatic clearance generated for most registrations. For those vehicles uninsured at that time or at some time during the previous year, the vehicle would move into a remedial program which is described further.

For those vehicles uninsured at the time or uninsured at some point during the previous year, the owner would be required to obtain from an insurance agent, a Certificate of Insurance Purchased which would indicate the period for which the insurance had been purchased. The owner could then take this certificate to the county but would receive a registration sticker only for the period of insurance purchased (3 month minimum). This would represent a variance from the County's current system of issuing stickers, but as the current sticker system uses stickers with monthly expiration dates, it would appear to be a change which could be accommodated. The following provisions might also apply.

- . The insurance company could require a cashiers check or cash payment to issue a Certificate of Insurance Purchased. Refunds due to cancellations by the insured would have special requirements.
- . If the owner did not have sufficient funds to pay the required insurance amount, the owner could apply and would have to be accepted by the HISC Premium Financing Division, which could, in turn, require a lien on property of the insured, including but not limited to the vehicle to be insured.

Once an owner/vehicle had been identified for special documentation, (Note: the owner may have purchased insurance for as short a period as 3 months, and thus received only a registration sticker valid for only 3 months) the owner would remain automatically on the program until the computer showed continuous purchase of insurance for the past 12 months. If desired by the Legislature, this period of probation could be extended with a minor adjustment to the program.

Persons with no uninsured indicators for the past 12 months would be allowed to register their vehicle for the next 12 months under the assumption that coverage would be provided. This process would eliminate the need for a no-fault card in this context, and if the card could be eliminated altogether (we feel other uses are fairly marginal especially if on-line checks are available), this would represent an even more streamlined process for the majority of responsible owners.

New registrations would require that the insured obtain a Certificate of Insurance Purchased. The computer, for new registrations, could also check to see whether the owner was on (or had been on) a probation program for some other vehicle. If so, that program could also be extended to the new vehicle registration.

Programs to identify persons requiring repeat probations could also be implemented. For repeaters, it may be prudent to extend probations for two years or more. These individuals would be required to show a Certificate of Insurance Purchased each time they registered and would receive a registration sticker only for the period they had purchased insurance. While such a program would be highly cumbersome for the population as a whole, its application to the marginal 5-10% or so who posed a problem would be far more justifiable.

Customer service. The corporation could provide customer services for insureds of the HISC member companies. The major service could take the form of a premium financing program. This program would be oriented toward making insurance payments more convenient and consistent with monthly budgets. It would also form the organizational basis for handling many unusual payment programs including assistance provided to welfare recipients. The Premium Financing Division of the HISC would be subject to several considerations.

All insureds applying to the program would have to be accepted although the Premium Financing Division would be allowed to require liens on the property of insureds including but not limited to the vehicle to be insured.

The Premium Financing Division could offer a number of plans including the financing of six months or even a year of insurance to allow operators to in turn obtain a Certificate of Insurance Purchased for the entire vehicle registration period. Collateral would, of course, be provided under most circumstances. Insureds who simply wished to pay on a monthly basis could also take advantage of the Division's Services and as long as prepayments to the carriers by the HISC were not made in excess of three months, there would probably be no need for security in most cases. Even insureds on monthly pay plans offered directly with their companies might opt for plans under the Premium Financing Division in order to assure that payments were credited in the most timely fashion to the records of the HISC and thus avoid possible indications of "uninsured" on the HISC records due to late payments.

Finance rates (when applicable) would be limited to market levels, and the HISC would be limited to the recovery of reasonable costs in the exercise of any liens. The HISC would offer a monthly pay plan. Payments to the insurance companies would be made directly by HISC. Insureds would receive no cash with which to make payments on their own.

Welfare recipients or other persons designated by the State to receive insurance at no or reduced costs could be serviced by the Premium Financing Division of HISC. In effect, HISC would make payments to the companies chosen by these individuals in order to cover basic no-fault provisions or the coverages allowed them. Payments might be set at a fixed rate or at rated levels depending on policies set by the HISC board. Further, there should be no restrictions against placing any of these insureds, when appropriate, in the Joint Underwriting Plan. The companies would be assessed quarterly for funds to cover the deficits of the Premium Financing Division in proportion to the total amount of premium written. Deficits could include welfare payments plus other costs due to bad debts, etc.

The use of the HISC Premium Financing Division for welfare and any other subsidized insureds would allow for a centralized record keeping of coverages provided and the companies providing the coverages. The PFD would also be able to better manage continual updates and checks on status with appropriate State agencies to verify eligibility. These are currently problem areas.

Services to Insurance Commissioner. The corporation would also provide services provided to the Insurance Commissioner. These services might include:

- . Compile experience statistics and other mandatory reporting data (not including rate filings). In simple terms, the corporation could take over much of the data collection and compilation activities of the Commissioner's Office.
- . Provide the data analysis and operational support for programs such as the Joint Underwriting Program (JUP). The HISC could actually perform the allocation analyses and other assessments necessary to operate the JUP. New programs such as an uninsured victims compensation fund could also receive statistical and allocation support through the HISC.
- . Provide special statistical reports and analyses of vehicle insurance topics, especially relating to emergency issues such as the availability of insurance for the rental car market and taxis.
- . Procedures and support provided the Commissioner could be subject to audit at HISC's expense on order of the Commissioner when deemed reasonable.

Major Issues to be Dealt With in the Formation of the HISC

Aggregating and combining data. Although the size of the data files are manageable, a number of operational issues would have to be resolved.

Insurers would have to agree on data protocols and codes for accident severity, etc. Much of this data is fairly standard and such data is reported at present to statistical service organizations such as ISO or NAII which have developed standard codes.

Responsibility for maintenance of rights to privacy and appropriate use of data would have to be established and agreed upon. Such issues are worthy of significant discussion, but it should also be recognized that current practice already makes such information available to insurance companies although not on such an organized basis.

Costs incurred by the counties in the preparation for and maintenance of such a system would have to be addressed.

Procedures to identify and correct data errors as well as establish file update procedures when prior data is altered or a status may be forgiven would have to be developed. The most significant data error to be overcome is likely to be the erroneous entry of Vehicle Identification Numbers (VINs) by either the counties or the insurers.

Since the system would represent an enhancement of current operations rather than a replacement, there would be time for an extensive development and data error correction phase to be completed before the system were made operational. Later updates and corrections would appear to be manageable if planned in the system resource allocations and operating procedures.

Acquiring a computer system. A computer system adequate to the task would have to be obtained or contracted.

There appear to be companies in Honolulu which would be appropriate for taking on the task. File aggregation and combinations are not particularly difficult. The key difficulty would be in providing sufficient on-line access for inquiry. Providing data tapes to the counties and to certain large insurers would appear to solve this problem.

Direct transmission of data from insurance companies and government bodies to the HISC and back again appears to be a very reasonable prospect.

Generating sufficient initiative. As this represents a significant cooperative effort on the part of the insurance industry, it would be relatively difficult to legislate this process into existence. Much--if not most--of the initiative must come from the industry itself.

Further, the counties as well as State agencies and offices must be willing to exert efforts to make the system work properly. A weak link in the data chain can disrupt the entire system.

Funding. Funding for the HISC would appear to be a fairly accomplishable effort. Allocating even 1% of premium revenues to the HISC would allow for a budget approaching \$3 million. We have not performed analyses to determine a proper budget, but we expect that the operation could be established for less than this amount. We further would expect that efficiency gains would allow that 1% to be recaptured.

Developing legislation. Legislation needs would appear to be minimal in that the funding and operations could be provided most generally from the private sector. Important changes would include, however:

- . Legislation authorizing release of data sources to the HISC.
- . Alterations to Chapter 294 to eliminate the requirements for providing no-fault cards if such cards were not required. Additional legislation would be required to establish requirements regarding the Certificate of Insurance Purchased.
- . Establishment of registration requirements for the counties. County ordinances requiring compliance with County rules and regulations would probably be sufficient to implement the system, but further legislation at the State level to increase enforcement provisions and provide for criminal penalties of violators would seem advisable. In fact, strict enforcement would appear important to any system aimed at reducing uninsured motorists.
- . While the program could be set up voluntarily by the insurance industry, there could, of course, be legislation introduced to require the system. In any event, legislation should be established to require membership of any company writing automobile insurance in the State. Legislation might also provide for appointment of public officials to the board, regulation of the Premium Financing Division, and authorization of the HISC to perform other duties such as administer the JUP or administer an uninsured victim accident compensation fund if one were established.

Relationship of the HISC Concept to Legislative Goals

The HISC would accomplish many of the current legislative goals:

Reduce uninsured motorists. Compared to the current system the HISC could more specifically identify those vehicles and individuals who are uninsured. Further, implementation of the program would establish a registration system which is more difficult to thwart than the current no-fault card system.

Reduce the cost of insurance. The HISC would facilitate efforts to make the market more efficient. It would promote:

- . Reduction of costs for many drivers by allocating appropriate costs to those who are problem drivers
- . Reduction of costs for stable insureds which are associated with inefficient and inappropriate coverage of new risks during the initial application period prior to the time that the new insured can be adequately rated.

- Improving the overall orientation of the market toward a more competitive posture where companies can more realistically pursue new business and have some faith that they can rate that business appropriately. This would reduce the reluctance of companies to accept new business and might generate greater competitive pricing.

- Maintaining the administration of the system in the private sector which is most motivated to reducing costs.

Simplify the payment process. The HISC would serve as an intermediate agent to smooth the effects of bulk premium payments.

Through the Premium Financing Division, the HISC would offer a guaranteed way to put premium payment programs on a monthly basis program while still controlling for the subsequent cancellation of coverage after the vehicle is registered.

The entire payment and registration process for most drivers would be streamlined due to the elimination of the no-fault card for registration purposes.

Eliminate the problem of insureds obtaining insurance at one price and then finding that they had a large surcharge to pay within the first month due to their re-rating after the insurance company received driving records from the State.

Minimize disruptions to business. The HISC could be implemented with little disruption to the business community and to the State's business environment image.

Manageable start-up costs. The HISC would avoid substantial organizational start up issues. This is because the system could be established as an enhancement to current activities and could be phased in as system development activities allowed.

Problems With the HISC Concept

Like any overall insurance system, it can not totally eliminate uninsureds who avoid legal registration and licensing systems to avoid payment. It does have the benefit of most closely identifying who those persons are likely to be.

It is not oriented toward more fully subsidizing persons with high potential for loss in order to keep their insurance costs down and to keep them from avoiding coverage (becoming uninsured). The HISC concept is highly compatible with an expansion of the JUP, however, which could more effectively be used to accomplish this goal.

APPENDICES

APPENDIX A

NOTES ON METHODOLOGY OF FINANCIAL PLAN

The purpose of this appendix is to show the derivation of the elements of the hypothetical fund performance discussed in Chapter VI.

It is not possible to forecast any exact result for the HDIF at this time because there are many elements of the design of the HDIF which are uncertain currently. Additionally, it is not possible to say with certainty what the exact population of drivers and vehicles claiming coverage under the HDIF would be.

Summaries of the results are given in Exhibit A-1 for the mandatory coverages, and in Exhibit A-2 for all coverages.

The starting point is ultimate losses incurred by coverage for the period 1982 to 1986. These are taken from reports provided by the Insurance Division. These consist of amounts reported by the various carriers regarding their Hawaii business. Reports were provided covering the companies writing a 95% market share of voluntary Private Passenger Types and Motorcycles, 95% market share of voluntary Commercial and Other Vehicles, the Hawaii Joint Underwriting Plan - Certified Public Assistance Insureds (HJUP-CPAI), and other HJUP risks.

For the "Mandatory Coverages Only" illustration, losses for the No-Fault, Residual Bodily Injury, and Property Damage coverages were summed. Uninsured Motorists losses are discussed below. For the "Full Coverages" illustration, Physical Damage coverages are also included. This summary is shown as Exhibit A-3.

As the goal is to use several years of experience in order to forecast the losses that would be incurred under this program, the losses for each year were divided by the earned number of vehicles for the year, to obtain a rate of loss per vehicle. The number of earned vehicles for the no-fault coverage was used, as the number of earned vehicles for the no-fault coverage, residual bodily injury coverage, property damage coverage, and physical damage coverage were all approximately equal.

To adjust to current and future cost levels, trend factors have been applied to these rates. The trend factors are from the Hawaii Insurance Rating Bureau Circular 1985-14, the latest approved bureau filing for the state. For no-fault the factor is 5.4% per year, for residual bodily injury the factor is 11.6% per year, and for property damage and physical damage, the factor is 7.0% per year. The average trended rate is multiplied by the 1986 earned vehicle count to convert back to loss dollars. These loss dollars represent expected losses for a year at 1986 cost levels, based on experience for the five-year period 1982 to 1986. These are total limits losses incurred. The rates before and after trending are shown in Exhibit A-4.

Exhibits A-5 and A-6 apply certain adjustments to the result of Exhibit A-4, for the two illustrations. The Insurance Division does not maintain records of losses for just the mandatory coverages required by statute. In order to convert the total limits losses, above, to the mandatory coverages, the ratios of basic limits losses to excess limits losses for these coverages were applied to the total limits losses. The ratios of basic limits losses to excess limits losses were determined from material supplied by the Insurance Services Office, and is based solely on Hawaii loss experience. The derivation of these factors is shown in Exhibit A-7.

The trended mandatory limits losses are then adjusted for the fact that the above losses represent only a 95% market share, and for the effects of uninsured motorists and self-insureds. Losses have been increased 5% to reflect the fact that the initial data provided covered only a 95% market share.

We have assumed that the effect of uninsured motorists is equivalent to 9% of the population being uninsured. This estimate is based on the analysis presented in Chapter IX. This estimate also includes the effect of drivers causing hit-and-run accidents. This is appropriate because under the HDIF plan, losses caused by such drivers would be covered (either because a formerly uninsured driver is now insured, or because there may be a presumption that a true hit-and-run driver is, in fact, covered by the HDIF, even if the driver cannot be identified).

To account for the effect of self-insured vehicles coming under the coverage of the HDIF, \$15,000,000 has been added to the estimated losses. This amount is based on total reported "imputed premium", which is an estimate of the premium the self-insured would pay for coverage through the HJUP. This "imputed premium" is required to be reported to the Insurance Division by all entities in Hawaii which are self-insured. The total of the most recent imputed premiums reported to the Insurance Division is \$31,000,000. We have assumed that losses would be 50% of the imputed premium, and have rounded this down to \$15,000,000. This has been spread by coverage in proportion to losses for insured vehicles.

The result of these adjustments is a rough estimate of the losses that would be expected to be covered under this program at 1986 cost levels, subject to the general caveats given above. Losses for years subsequent to 1986 are estimated following the assumptions that there will be a 4% per year growth in the number of vehicles, and that losses by coverage will increase at the annual rates per vehicle given above. The 4% growth in the number of vehicles matches the average growth over the last five years.

Elements of the Hypothetical Fund Performance, Other Than Losses

Exhibits A-1 and A-2 give the hypothetical fund performance for the mandatory coverages, and for all coverages, respectively.

Taxes are set so as to provide sufficient funds, along with investment income, to cover the several loss and expense items, and to maintain a surplus fund. Additionally, they have been set so as to provide fairly uniform growth from one year to the next.

Initial surplus has been set so there will be a 2.5 to 1 tax to surplus ratio. This is considered a prudent level of surplus in order to provide a temporary source of funds in the event of variations in losses, expenses, or revenue. It is assumed that the initial surplus would be provided by a loan from the state, and that this surplus amount would be the most significant component of the initial loan from the state.

Investment income has been determined assuming that revenues and expenses are paid uniformly throughout each year. A 7% yield rate has been assumed, based on yield rates for one year federal Treasury Bills as of November 1987. A loss payout pattern has been developed from ISO paid loss information, and is shown in Exhibit A-10. It is assumed that expenses, other than losses and loss adjustment expenses, are paid in the year in which they are incurred.

The estimated loss expenses are based on loss expense information for all carriers writing in Hawaii. The Insurance Division provided a summary of all expense items reported to them for the several categories of automobile insurance, as reported by companies, in the format of the Insurance Expense Exhibit. This information is summarized in Exhibits A-8 and A-9. For the mandatory coverages, a ratio of loss expense to loss of 17.5% is used. For the combination of all coverages, a ratio of 16.8% is used.

Expenses have been estimated based on current insurance company operating expenses. Of the current expenses for acquisition costs (Commission and Brokerage and Other Acquisition), it is estimated that half of these expenses are for functions which would need to be continued under the HDIF. This includes much of the direct contact with insureds, including explanations of policy coverages, options available to the insured, and claims handling and settlement.

The General Expenses are assumed to remain the same. Currently this covers the administrative expenses of operating an insurance company, including the substantial record keeping. The HDIF will need to track claim information in much the same way as is done currently by insurance companies. While the HDIF will not have policies to keep track of, except for the optional coverages, the HDIF will need to maintain some records of the characteristics of insureds. This will be needed for forecasting the tax requirements, if for no other reason.

We have assumed there would be no premium tax, or other state fees.

A fee for Boards and Bureaus has been set at the current rate. The HDIF will probably continue to need services from outside bureaus as a part of the tax determination process, and especially if the HDIF writes excess coverages. The volume of loss in Hawaii will not be sufficient for the reliable setting of rates for excess coverages.

The remaining portion of the acquisition costs, the general expenses, and the fee for boards and bureaus result in an expense charge of 18.0% of losses for the program covering just the mandatory coverages, and 21.5% of losses for the program offering all coverages.

The loan repayment amount has been determined assuming a 10-year payback, that the amount of the loan would be the initial surplus, and that the loan would be made at an interest rate of 7%.

Net Income is the Total Receipts less the Total Losses and Expenses.

A summary of cash flows is provided. Losses and loss expenses paid are derived from the losses and loss expenses incurred, above, and the payout pattern discussed above. Other items are assumed received or paid as they are incurred. Investment income is 7% of the average balance of cash and investable assets.

In the Balance Sheet summary, it is assumed that all assets are investable. The only significant reserve will be for losses and loss expenses, and this reserve is shown. Any reserves needed for premiums paid in advance of coverage, or for expenses incurred but not paid will be small relative to the loss and loss expense reserve. Surplus is the difference between the total assets and the loss and loss expense reserves.

Exhibit A-11 presents a summary of the taxes per gallon, assuming all taxes are raised through a fuel tax. It also shows the taxes per drivers license, and taxes per vehicle, assuming, in each case, that all taxes are raised in the indicated manner.

Exhibit A-12 presents a summary of fuel consumption data provided by the State of Hawaii Department of Taxation and the Department of Business and Economic Development Energy Division. These data were used in estimating the price per gallon of fuel required to provide adequate revenues.

EXHIBIT A-1
 Actuarial Analysis of a
 Hypothetical Fund Performance Based on
 Historical Loss and Expense Data

Mandatory Coverages Only

(in \$1,000's)

	1989	1990	1991	1992	1993
Revenue and Expense Items					
Taxes - Premium	300,000	339,000	383,000	433,000	489,000
Investment Income	14,000	24,000	33,000	41,000	49,000
Total Receipts	314,000	363,000	416,000	474,000	538,000
Net Losses Incurred	213,000	241,000	273,000	309,000	351,000
Net Loss Expenses Incurred	37,000	42,000	48,000	54,000	61,000
Expenses Incurred	38,000	43,000	49,000	56,000	63,000
Repayment of State Loan	17,000	17,000	17,000	17,000	17,000
Total Losses and Expenses	305,000	343,000	387,000	436,000	492,000
Net Income	9,000	20,000	29,000	38,000	46,000
Balance Sheet Items					
Investable Assets	292,000	429,000	546,000	663,000	782,000
Total Assets	292,000	429,000	546,000	663,000	782,000
Loss and Loss Expense Reserves	163,000	280,000	368,000	447,000	520,000
Surplus	129,000	149,000	178,000	216,000	262,000
Total Liabilities and Surplus	292,000	429,000	546,000	663,000	782,000
Cash Flow Items					
Start Balance	120,000	292,000	429,000	546,000	663,000
Taxes - Premium	300,000	339,000	383,000	433,000	489,000
Losses and Loss Expenses Paid	87,000	166,000	233,000	284,000	339,000
Expenses Paid	38,000	43,000	49,000	56,000	63,000
Loan Repayment	17,000	17,000	17,000	17,000	17,000
Ending Balance, Before					
Investment Income	278,000	405,000	513,000	622,000	733,000
Investment Income	14,000	24,000	33,000	41,000	49,000
Ending Balance	292,000	429,000	546,000	663,000	782,000

EXHIBIT A-2
 Actuarial Analysis of a
 Hypothetical Fund Performance Based on
 Historical Loss and Expense Data

All Coverages

(in \$1,000's)

	1989	1990	1991	1992	1993
Revenue and Expense Items					
Taxes - Premium	480,000	552,000	635,000	730,000	840,000
Investment Income	20,000	33,000	44,000	55,000	67,000
Total Receipts	500,000	585,000	679,000	785,000	907,000
Net Losses Incurred	342,000	386,000	437,000	495,000	560,000
Net Loss Expenses Incurred	56,000	64,000	72,000	82,000	92,000
Expenses Incurred	74,000	83,000	94,000	106,000	120,000
Repayment of State Loan	27,000	27,000	27,000	27,000	27,000
Total Losses and Expenses	499,000	560,000	630,000	710,000	799,000
Net Income	1,000	25,000	49,000	75,000	108,000
Balance Sheet Items					
Investable Assets	398,000	568,000	724,000	895,000	1,091,000
Total Assets	398,000	568,000	724,000	895,000	1,091,000
Loss and Loss Expense Reserves	207,000	352,000	459,000	555,000	643,000
Surplus	191,000	216,000	265,000	340,000	448,000
Total Liabilities and Surplus	398,000	568,000	724,000	895,000	1,091,000
Cash Flow Items					
Start Balance	190,000	398,000	568,000	724,000	895,000
Taxes - Premium	480,000	552,000	635,000	730,000	840,000
Losses and Loss Expenses Paid	191,000	305,000	402,000	481,000	564,000
Expenses Paid	74,000	83,000	94,000	106,000	120,000
Loan Repayment	27,000	27,000	27,000	27,000	27,000
Ending Balance, Before					
Investment Income	378,000	535,000	680,000	840,000	1,024,000
Investment Income	20,000	33,000	44,000	55,000	67,000
Ending Balance	398,000	568,000	724,000	895,000	1,091,000

EXHIBIT A-3
State of Hawaii
Losses by Coverage

Coverage	Year in Which Losses Occurred				
	1982	1983	1984	1985	1986
No-Fault	23,875	27,745	31,276	35,968	36,842
Residual Bodily In	46,006	51,268	52,404	57,475	50,194
Property Damage	19,061	19,870	22,743	27,099	30,691
Uninsured Motorist	3,774	5,091	5,576	4,397	7,020
Physical Damage	34,269	33,092	35,336	41,039	46,880
Total	126,985	137,066	147,335	165,978	171,627
Number of Vehicles	407,297	408,983	416,852	484,304	516,012

Notes:

Data is per the Experience Report provided by the Insurance Division.

Losses are in \$1,000's.

Losses are for 95% of the voluntary market, plus the HJUP.

Number of vehicles is the earned number of vehicles purchasing no-fault coverage.

EXHIBIT A-4
State of Hawaii
Losses per Insured Vehicle

	No-Fault	Residual Bodily Injury	Property Damage	Physical Damage
1982	58.62	112.95	46.80	84.14
1983	67.84	125.35	48.58	80.91
1984	75.03	125.71	54.56	84.77
1985	74.27	118.68	55.95	84.74
1986	71.40	97.27	59.48	90.85
Annual Trend Factor	1.054	1.116	1.070	1.070

Trended Losses per Insured Vehicle

	No-Fault	Residual Bodily Injury	Property Damage	Physical Damage
1982	72.34	175.20	61.35	110.29
1983	79.43	174.23	59.51	99.12
1984	83.35	156.57	62.47	97.05
1985	78.28	132.45	59.87	90.67
1986	71.40	97.27	59.48	90.85
Average	76.96	147.14	60.54	97.60

Average times

Number of Vehicles	39,712,284	75,926,006	31,239,366	50,362,771
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Notes:

Losses per insured vehicle are losses from Exhibit A-3 divided by number of vehicles from Exhibit A-3.

Trend factors are from HIRB Circular 1985-14.

Trended losses per vehicle are trended to 1986 cost levels.

EXHIBIT A-5
State of Hawaii
Mandatory Coverages
Estimate of Losses

	No-Fault	Residual Bodily Injury	Property Damage	Total
Trended Average Losses	39,712,284	75,926,006	31,239,366	
Mandatory Coverage Losses as a Percentage of Total Loss	90%	66%	94%	
Factor for Market Share Adjustment	1.05	1.05	1.05	
Effect of Uninsured Motorists	9%	9%	9%	
Effect of Self-Insureds	4,055,649	7,754,005	3,190,346	15,000,000

Estimated Future Losses

	No-Fault	Residual Bodily Injury	Property Damage	Total
1986	45,295,329	65,574,579	37,073,043	147,942,951
1989	59,658,904	102,524,607	51,086,904	213,270,415
1990	65,395,704	118,994,160	56,849,507	241,239,371
1991	71,684,155	138,109,382	63,262,131	273,055,668
1992	78,577,303	160,295,273	70,398,100	309,270,676
1993	86,133,297	186,045,105	78,339,005	350,517,407

Notes:

Trended average losses are from page Exhibit A-4

Source of other factors discussed in the text.

Estimated Future Losses for 1986 are Trended Average Losses estimated percentage of total loss due to mandatory coverages times 1.05 times $1/(1 - .09)$ plus the effect of self-insureds.

Estimated Future Losses for other years are the 1986 losses trended forward using the combined effects of the loss per vehicle trend, 5.4% per year for No-Fault, 11.6% per year for Residual Bodily Injury, and 7.0% for Property Damage, and the anticipated increase in the number of vehicles, 4% per year.

EXHIBIT A-6
State of Hawaii
All Coverages
Estimate of Losses

	No-Fault	Residual Bodily Injury	Property Damage	Physical Damage	Total
Average Trended Losses	39,712,284	75,926,006	31,239,366	50,362,771	
Factor for Market Share Adjustment	1.05	1.05	1.05	1.05	
Effect of Uninsured Motorists	9%	9%	9%	0%	
Effect of Self-Insureds	4,055,649	7,754,005	3,190,346		15,000,000

Estimated Future Losses

	No-Fault	Residual Bodily Injury	Property Damage	Physical Damage	Total
1986	49,877,515	95,360,935	39,235,768	52,880,910	237,355,128
1989	65,694,144	149,095,008	54,067,154	72,870,252	341,726,558
1990	72,011,293	173,045,630	60,165,929	81,090,016	386,312,868
1991	78,935,899	200,843,680	66,952,646	90,236,970	436,969,195
1992	86,526,375	233,107,209	74,504,904	100,415,700	494,554,188
1993	94,846,751	270,553,551	82,909,057	111,742,591	560,051,950

Notes:

Trended average losses are from Exhibit A-4.

Source of other factors discussed in the text.

Estimated Future Losses for 1986 are Trended Average Losses times 1.05 times $1/(1 - .09)$ (except for Physical Damage) plus the effect of self-insureds.

Estimated Future Losses for other years are the 1986 losses trended forward using the combined effects of the loss per vehicle trend, 5.4% per year for No-Fault, 11.6% per year for Residual Bodily Injury, and 7.0% for Property Damage and Physical Damage, and the anticipated increase in the number of vehicles, 4% per year.

Exhibit A-7
State of Hawaii
Basic vs. Excess Loss Experience

No-Fault Coverages

	Basic Limits Losses	Excess Limits Losses	Total Losses	Ratio of Basic Limits to Total Limits Losses	
1984	16,805,914	1,301,885	18,107,799	0.928	
1985	18,510,922	1,724,243	20,235,165	0.915	
1986	17,228,974	2,926,692	20,155,666	0.855	
Total	52,545,810	5,952,820	58,498,630	0.898	

Property Damage Coverages

	Basic Limits Losses	Excess Limits Losses	Total Losses	Ratio of Basic Limits to Total Limits Losses	
1984	11,998,209	784,497	12,782,706	0.939	
1985	14,573,036	980,806	15,553,842	0.937	
1986	14,990,173	998,150	15,988,323	0.938	
Total	41,561,418	2,763,453	44,324,871	0.938	

Residual Bodily Injury Coverage

	Basic Limits Losses	Excess Limits Losses	Total Losses	Ratio of Basic Limits to Total Limits Losses	
1984	19,208,186	8,829,958	28,038,144	0.685	
1985	17,413,519	9,494,534	26,908,053	0.647	
1986	12,052,080	6,540,711	18,592,791	0.648	
Total	48,673,785	24,865,203	73,538,988	0.662	

Notes:

Accident year reported loss and allocated loss expense as of February 1987 for companies reporting to the Hawaii Insurance Rating Bureau.

EXHIBIT A-8
State of Hawaii
Summary of Insurance Expense Exhibits

Automobile Coverages

Item	Total No-Fault and Other Liability		Total All Coverages	
1	Net Premium Written	215,313,011	310,259,646	
2	Net Premium Earned	208,886,021	303,273,419	100 %
3	Net Loss Incurred	153,848,419	200,576,443	66.1
4	Loss Adj. Exp. Paid	18,554,843	23,457,883	
5	Loss Adj. Exp. Incurred	26,897,806	33,003,773	10.9
6	Comm. & Brok. Incurred	23,370,833	32,616,978	10.8
7	Othr Acq, Fld Sup, Collet	13,880,703	20,374,757	6.7
8	Bds, Bureaus & Assoc Incrd	766,187	1,015,212	0.3
9	Other General Expenses	7,865,998	10,924,434	3.6
10a	General Expenses 1	10,125,515	14,052,309	4.6
10b	General Expenses 2	8,632,185	11,939,646	3.9
11	Taxes, Lic. & Fees Incrd	9,799,255	14,192,783	4.7
12	Total Expenses Incurred	84,072,007	114,238,495	37.7
13	Invst Gain/Loss & Othr	20,744,207	24,495,784	8.1
14	Dividends to Plcyhldrs	935,039	1,860,211	0.6
15	Net Income	(9,236,250)	11,083,041	3.7
16	Direct Prem. Writ.	178,485,981	258,664,068	
17	Adj. Drct. Prem. Writ.	178,457,369	258,633,780	100
18	Drct. Comsn. & Brokrge.	18,732,726	26,151,805	
19	Adj. Drct. Comsn. & Brokrge.	18,729,917	26,147,688	10.1
20	Other Acq. Exp. Incurred	10,371,011	15,257,599	5.9
21	Gen'l Expenses Incurred	8,420,287	11,665,916	4.5
22	Taxes, Lic. & Fees Incrd.	7,371,558	10,795,714	4.2
23	Adj. Drct. Prem. Earned	174,278,665	253,138,695	100
24	Gen'l Exp - ratio			5.8%

Source: Summary Provided by the Insurance Commission Motor Vehicle Branch

EXHIBIT A-9
State of Hawaii
Expense Ratios

Ratio	Mandatory Coverages	Full Coverages
A. Net Loss Incurred to Net Premiums Earned	73.7%	66.1%
B. Loss Adjustment Expense Incurred to Net Premiums Earned	12.9	10.9
C. Adjusted Direct Commission and Brokerage Incurred to Adjusted Direct Premiums Written	10.5	10.1
D. Other Acquisition Expenses Incurred to Adjusted Direct Premiums Written	5.8	5.9
E. General Expenses Incurred to Adjusted Direct Premiums	4.7	4.5
F. Boards, Bureaus, and Associates Expenses Incurred to Net Premiums Earned	0.4	0.3
 Ratios to Net Loss Incurred		
G. Loss Adjustment Expense Incurred (B/A)	17.5	16.5
H. Half of Commission, Brokerage, and Other Acquisition (((C + D)/A) x .5)	11.1	12.1
I. General Expense (E/A)	6.4	8.9
J. Boards, Bureaus, and Associations (F/A)	0.5	0.5
K. Total Administrative Expenses (H + I + J)	18.0%	21.5%

Notes:

- A. Insurance Expense Exhibit Summary - Line 3 / Line 2
- B. Insurance Expense Exhibit Summary - Line 5 / Line 2
- C. Insurance Expense Exhibit Summary - Line 19 / Line 17
- D. Insurance Expense Exhibit Summary - Line 20 / Line 17
- E. Insurance Expense Exhibit Summary - Line 21 / Line 17
- F. Insurance Expense Exhibit Summary - Line 8 / Line 2

EXHIBIT A-10
State of Hawaii
Automobile Loss Payout Pattern

Mandatory Coverages

	Paid Through 12/31/86	Incurred Through 12/31/86 (Incl IBNR)	Paid Percent.
1982	\$68,840	\$ 72,714	94.7%
1983	73,798	83,887	87.9
1984	73,001	91,600	79.7
1985	63,607	103,033	61.7
1986	35,841	103,633	34.6

All Coverages

	Paid Through 12/31/86	Incurred Through 12/31/86 (Incl IBNR)	Paid Percent.
1982	\$ 98,851	\$102,911	96.1%
1983	102,506	112,629	91.0
1984	104,106	122,289	84.8
1985	98,522	139,974	70.4
1986	70,102	145,877	48.1

Note:

Paid and incurred losses are from the Experience Report provided by the Insurance Division.

EXHIBIT A-11
State of Hawaii
Possible HDIF Revenue Sources

	Fuel	Number of Vehicles	Drivers Licenses	Taxes for Mandatory Coverages
1985		767,892	593,852	
1986	356,407	798,608	605,729	\$209,000
1989	367,206	898,325	642,805	\$300,000
1990	370,879	934,258	655,661	\$339,000
1991	374,587	971,628	668,774	\$383,000
1992	378,333	1,010,493	682,149	\$439,000
1993	382,117	1,050,913	695,792	\$489,000

	Taxes per Gallon	Taxes per Registration	Taxes per Drivers License
1986	\$0.586	\$262	\$345
1989	\$0.817	\$334	\$467
1990	\$0.914	\$363	\$517
1991	\$1.022	\$394	\$573
1992	\$1.160	\$434	\$644
1993	\$1.280	\$465	\$703

Fuel is in 1,000's of gallons and is the fuel distributed for highway use. It is trended forward at 1% per year.

Number of Vehicles is all registered vehicles, including trailers. This is trended forward at 4% per year.

Drivers licenses are trended forward at 2% per year.

EXHIBIT A-12
State of Hawaii
Fuel Distributed for Highway Use

(in thousands of gallons)

Type of Fuel	1886	1985
Gasoline	337,952	327,021
Diesel	19,354	19,636
Liquid Petroleum Gas	1,031	1,038
Subtotal	358,337	345,685
Less Agricultural Refunds	1,930	1,727
Total	356,407	343,958

Source: State of Hawaii, Department of Taxation

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APPENDIX B

LEGAL OPINION REGARDING

CONSTITUTIONALITY OF FUEL TAX

ASSESSMENTS BY FUND DIRECTORS

This letter is written in response to your request concerning an opinion on the constitutionality of a proposed legislative program funded by gasoline tax charges, drivers license fees and a vehicle tax. It is our understanding that the insurance fund would be supplemented by an apportioned board of directors responsible for determining tax revenues with the costs of this insurance program.

We have mainly nonincome questions with the question as to whether tax revenues should be used in the way which would require the most adjustment. It is quite conceivable that drivers license fees and vehicle tax fees could be set by the legislature without any need to delegate to that authority to the board of directors. The most fundamental issue is the proper need of the board to adjust gasoline tax rates, whether up or down, to balance the rest of the program. It is most likely that the board of directors would be required to adjust the tax rate in the intervals between legislative sessions to maintain proper fiscal balance in the fund.

Thus, the legal issue posed is whether the Hawaii State constitution would be violated by such a legislative delegation of power to adjust tax rates to an agency other than a political subdivision. We believe that such an unrestricted and unrestricted delegation would be unconstitutional. However, a delegation of power enabling the attainment of public tax revenues may be permissible if the legislature exercises particular authority to remove discretion as to tax policy from the board of directors.

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Re: Constitutionality of Legislative
Delegation of Gasoline Tax Rate
to a political subdivision

Dear Mr. Colbert:

This letter is written in response to your request concerning an opinion on the constitutionality of a proposed legislative action establishing a State-wide no-fault insurance program funded by: gasoline tax charges; drivers license fees; and a vehicle tax. It is our understanding that the insurance fund would be administered by an appointed board of directors responsible for balancing tax revenues with the costs of this insurance program.

We have mainly concerned ourselves with the question as to gasoline tax revenues since that is the area which would require the most adjustment. It is quite conceivable that drivers license fees and vehicle tax fees could be set by the Legislature without any need to delegate adjustment authority to the board of directors. The most troubling area is the probable need of the board to adjust gasoline tax rates, whether up or down, to balance the cost of the program. It is most likely that the board of directors would be required to adjust the tax rate in the intervals between legislative sessions to maintain proper fiscal balance in the fund.

Thus, the legal issue posed is whether the Hawaii state constitution would be violated by such a legislative delegation of power to adjust tax rates to an agency other than a political subdivision. We believe that such an unrestricted and unstructured delegation would be unconstitutional. However, a delegation of power enabling the adjustment of ultimate tax revenues may be permissible if the Legislature establishes guidelines sufficient to remove discretion as to tax policy from this board of directors.

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As a general rule, the Legislature holds the power of taxation exclusively and cannot delegate it. Unless otherwise provided for in the State Constitution, the taxing power cannot be delegated to either of the other branches of the government, or to any individual, officer, board, or commission. If the State's Constitution does so provide, the legislature may delegate the power of taxation for local purposes to political subdivisions of the State. Also, the legislature may create agencies to execute its tax laws. 84 C.J.S. Taxation Section 8.

The test of a valid delegation of administrative power is different:

In determining whether the delegation of power to an administrative body is an unconstitutional grant of legislative power or a proper grant of administrative power the distinction is between a delegation of power to make the law, which involves a discretion as to what the law shall be, which delegation is void; and the delegation of authority or discretion as to the execution of the law to be exercised under, and in pursuance of, the law, to which delegation no objection can be made.

73 C.J.S. Public Administrative Law and Procedure Section 27.

Thus, the nature of the power delegatable to an administrative agency is less expansive than that delegatable to a political subdivision. Indeed, it has been held that a legislature may not authorize a subordinate administrative agency to levy a tax without definitely fixing the rates of the levy or the amount to be collected. 84 C.J.S. Taxation Section 8.

Thus, the general rules are that if constitutionally provided for, a legislature may delegate its power of taxation as regards local matters to the appropriate political subdivision within the State. However, the legislature may delegate only advisory or administrative

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duties to an administrative agency. The law of the State of Hawaii, as far as it can be discerned, is in consonance with these general principles.

The Hawaii State Constitution at Article VII Section 3 provides "The power of taxation shall never be surrendered, suspended, or contracted away." This section is not absolute because Article VII Section 3 expressly provides for the delegation of taxing power to political subdivisions as follows:

The taxing power shall be reserved to the State, except so much thereof as may be delegated by the legislature to the political subdivisions, and except that all functions, powers and duties relating to the taxation of real property shall be exercised exclusively by the counties...

Article VIII Section 1 of the Constitution enables the legislature to create counties and other political subdivisions within the State. Article VIII Section 1 imposes the limit upon the legislature that "each political subdivision shall have and exercise such powers as shall be conferred under general laws."

The Hawaii State legislature, by HRS Section 248-2, delegated its taxing power to political subdivisions, when it authorized counties to set the real property tax rate. The Attorney General found that HRS Section 248-2 is not in violation of Article VI Section 1. Att. Gen. Op. 68-25.

Article VII Section 3 of the Constitution establishes a tax review commission that is to meet every five years and submit to the legislature an evaluation of the State's tax structure and recommend revenue and tax policy. Chapter 232E of the Hawaii Revised Statutes, recognizes that constitutional mandate by establishing the tax review commission and setting forth its duties. Nothing in this chapter appears to be in conflict with or prevent the establishment of a board of directors to monitor the no-fault insurance tax program.

Since there are no existing statutory limitations, the question arises whether the legislature may enact a statute

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directly delegating its taxing power to this proposed board of directors. The answer to that question appears to be no.

The legislature would be required to empower this board of directors under general laws. Bulgo v. County of Maui, 50 Haw. 51 (1967). "A 'general law' is one that operates equally, without discrimination as to particular localities, upon all the people or certain things of the territorial jurisdiction of the State of Hawaii..." Att. Gen. Op. 61-36, see also Att. Gen. Op. 65-9. Any law establishing this board of directors and their taxing authority, would appear to be a general law because it would operate statewide. The problem lies in the fact that this board of directors will most likely be considered merely a branch of the State government rather than a political subdivision. "The phrase 'political subdivisions' refers to counties and cities and counties as now constituted, and other local units of government including the municipal corporations." Thus, a political subdivision is apparently an entity similar in nature to a municipality.

The court in McCandless v. Campbell, 20 Haw. 411 (1911) considered a situation very similar to the one now in issue. The statute in question in McCandless provided that rates of charges for the use of sewers would be fixed from time to time by a superintendent of public works, subject to the Governor's approval, and "shall be fixed as nearly as reasonably may be so that the entire yearly receipts shall not exceed the total yearly cost of maintaining and repairing the sewers together with the yearly interest on the bonds representing the cost of the sewer system." Id. at 414.

The court in McCandless held that the legislature could delegate its power to tax only to a municipality itself and not to administrative or administrative officer. Id. at 417. The court explained that the power of taxation is essentially a legislative power and also that the power to tax must not be confused with the administrative duties which are necessarily involved in the assessment and collection of taxes. Id. at 420. The court continued:

"There is a difference in making the law and giving effect to the law; the one is legislation and the other administration. We can see that the legislature must, in

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every instance, prescribe the rule under which taxation may be laid..."

Id. at 421, citing Cooley on Taxation (2d edition) 62.

The problem that the court perceived was that the only rule that the legislature fixed with reference to that tax, was that the total amount of the revenue to be raised should approximate is nearly as possible the total yearly cost of maintaining the sewer system. The court found that the legislature had delegated to the superintendent more than just a mere matter of calculation. In fact, the legislature had failed to fix the principle upon which the charges were to be based. The key criticism made by the court, appears to be that the legislature prescribed no rule or method by which the superintendent should be guided in fixing the tax rate and that the matter of how to fix the tax rate itself was left entirely to the discretion of the superintendent. It is precisely this discretionary power that the Legislature is prohibited from delegating.

It is difficult to predict whether a court will be persuaded by this decision. This case is very old and is not based on the present Constitution of the State of Hawaii. Moreover, since the time this case was decided administrative agencies have gained much broader powers.

On the other hand, a court may be persuaded to follow this case because it is so factually similar to the present situation. The board of directors is being charged with the duty to maintain a tax system that would generate revenues to approximate the yearly budget of the insurance program. This case is illustrative because it explains that because the legislature cannot delegate its authority to tax to an administrative body, the legislature itself must develop a formula or guidelines for the board of directors to follow. This guidance is helpful because no recent Hawaiian cases squarely face this issue. The case is consistent with the policy objective that the authority to impose a tax should remain with the legislative branch or a political subdivision thereof. This case is also consistent with the current

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views on the delegation of the legislative taxing power, as outlined above.

The Legislature must be careful to delegate authority to this board of directors in such a way as to not delegate its own discretionary powers. The objective for the legislature would be to develop a formula to set the rate of the tax so that the tax rate could be adjusted to reflect changes in the costs of the insurance system, while at the same time limiting the role of the board of directors to computational matters. This has been explained as follows:

Under constitutional provisions restricting delegation of the taxing power, the legislative powers which may not be delegated include the selection of the property to be taxed, the determination of the basis for the measurement of the tax, and the definition of the purpose for which the tax will be levied; while, on the other hand, powers which are not legislative include the power to value property for taxation pursuant to fixed rules, the power to extend, assess, and collect the taxes, and the power to perform any of the innumerable details of computations, appraisal, and adjustment, and the delegation of such details has been held not constitutional.

84 CJS Taxation Section 8.

For example, the court in Burns v. Herberger, 498 P.2d 536 (Ariz. App. 1972) held that the taxing power was not unlawfully delegated. The statutes at issue in Burns granted the director power to develop property classifications for taxation purposes. The court was satisfied that this statute did not involve an unconstitutional delegation of legislative power because it contained reasonably definite standards by which to govern the exercise of that power. Id. at 542. For other examples of lawful delegation of the taxing power, see, 84 C.J.S. Taxation Section 8, pocket part.

The court held the taxing power to be unlawfully delegated in Bade v. Drachman, 417 P.2d 689 (Ariz. App. 1966). The

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court struck the statute at issue as unconstitutional, stating, "What the legislature cannot do is to delegate to an administrative body or official not only the power to fix a rate of taxation according to a standard but also the power to prescribe the standard." Id. at 694. For other cases where the taxing power was held unlawfully delegated, see, 84 CJS Taxation Section 8, pocket part.

The principle that connects these more modern cases concerning the delegation of legislative taxing power, is a requirement that the legislature maintain its control over the imposition of the tax. Ideally, the action of the administrative body should be viewed as merely implementing a rule or standard established by the legislature.

CONCLUSION

The board of directors the Hawaii State Legislature seeks to establish will most likely not be considered a political subdivision or municipal corporation. Thus, the Legislature may not directly delegate its taxing authority to that board.

The board should be characterized as an administrative agency. Accordingly, the Legislature must delegate its taxing authority by imposing upon the board of directors a standard that will limit the exercise of that board's discretion and that will avoid the delegation of the discretion of the Legislature itself. A carefully drafted standard may embody the flexibility needed to enable the board to adjust revenues to expenses of the insurance system.

Very truly yours,

KESSNER DUCA & MAKI



Elton John Bain

EJB:pab

