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OVERVIEW

THE AUDITOR
STATE OF HAWAII

Study of the Impact of the 1986 Reforms on Liability Insurance in Hawaii

Summary

Act 2 of the 1986 Special Session made reforms to both the tort system and the insurance regulatory system in order to alleviate a "crisis" in the availability and affordability of liability insurance in Hawaii.

The *tort-related reforms* included modifying the law of "joint and several liability," setting a cap on damages for pain and suffering, requiring increased arbitration of tort claims, and other changes. The *insurance reforms* included rate reductions in 1986, 1987, and 1988 for commercial liability insurance to reflect anticipated savings from the tort provisions.

Certain provisions of Act 2 are scheduled for repeal on October 1, 1995. Act 238 of 1993 directed the State Auditor to submit findings and recommendations relating to Act 2 to the 1995 legislative session. The Office of the Auditor and the firm of Ernst & Young LLP conducted the study. The study sought to determine the effects of Act 2 on the availability and affordability of liability insurance in Hawaii and to identify factors that contribute to availability and affordability.

We focused on commercial liability insurance, which Act 2 defined as coverage to protect businesses against losses from injuries or property damage sustained by other persons. This includes general liability and professional liability insurance. Our study did *not* include automobile no-fault reform, automobile insurance, or homeowners' personal liability insurance.

We found that the rate reductions imposed by Act 2 were among many factors that have improved availability and affordability of commercial liability insurance since 1986. Many forces affect availability and affordability. Foremost is the property and casualty insurance cycle, a historical pattern of fluctuations in pricing and profitability. The liability insurance "crisis" of 1984-1986 is believed to have been caused by highly competitive pricing resulting in rate inadequacies and underwriting losses, an increasingly litigious society resulting in larger jury awards and greater liability claims losses, and a decrease in previously high interest rates that resulted in decreased investment income for insurers. Many other factors can affect availability and affordability including inflation, stock market fluctuations, catastrophes, and insurer insolvencies.

The "crisis" of 1984-1986 was already beginning to abate prior to Act 2 because of improving financial performance in the insurance industry. Although only the 1986 rate reduction was implemented, we believe the reduction of 10 percent, coupled with very favorable financial results through 1988, contributed to increased availability and affordability in the liability insurance marketplace in Hawaii.

We also found that some of the tort provisions in Act 2 may have had a slight impact on reducing insurers' loss costs. Loss costs are the cost of insurance claims and include both indemnity payments to injured plaintiffs and payments to defense attorneys. Tort provisions that may have helped restrain costs include those on arbitration, joint and several liability, damages for pain and suffering, and loss of earning capacity.

However, we emphasize that we can only estimate the impact of the tort provisions. Any reductions in the cost of insurance are uncertain. Furthermore, any savings are small relative to the benefits desired from tort reform. The link to insurance availability, affordability, and rates, while it exists in theory, is not easily demonstrated in practice because of the many factors and variables that affect avauilability, affordability, and rates.

Recommendation

We recommend that the Legislature consider deleting the October 1, 1995 repeal date for various sections of Act 2, thereby making the entire act permanent.

Marion M. Higa
State Auditor
State of Hawaii

Office of the Auditor
465 South King Street, Room 500
Honolulu, Hawaii 96813
(808) 587-0800
FAX (808) 587-0830