MINUTES OF THE MEETING
BUSINESS AND LABOR COMMITTEE
50TH LEGISLATIVE SESSION

February 12, 1987

The meeting of the Business and Labor Committee was called to order by Chairman Les Kitselman on February 12, 1987 at 8:00 a.m. in Room 312-F of the State Capitol.

ROLL CALL: All members were present.

HOUSE BILL NO. 640 - Require Worker to Notify of Injury Within 24 Hours to Claim Workers' Compensation, sponsored by Rep. Bernie Swift, House District No. 64, Hamilton. Rep. Swift stated this bill requires that an injured worker give notice to the employer or employer's insurer within 24 hours of an injury to recover workers' compensation benefits. He commented the reason for the bill is that at present the 60-day time interval in the workers' compensation law is causing problems, and this should help alleviate some of the backlog buildup that the Division experiences.

PROPONENTS

None.

OPPONENTS

Tom Boland, attorney representing injured workers in workers' compensation system, Great Falls. Mr. Boland stated it would be outrageous to give an injured worker 24 hours notice within which to file a claim either personally or through a designee. He said the bill does not address the problem of the backlog at the Division, because the backlog starts only after a claim is filed, and the backlog has not been caused by the 60 day notice provision.

Gary Overfelt, attorney representing workers' compensation claimants, Billings. Mr. Overfelt stated that often times the most serious injuries are back injuries, and it is difficult to distinguish between a disk problem and a pulled muscle or sprain. He said this bill would prevent a lot of seriously injured people from filing a valid claim, because they did not know they were seriously injured and did not go to a doctor right away.

Jim Murry, Executive Secretary, Montana State AFL-CIO. Mr. Murry submitted written testimony. Exhibit No. 1.

QUESTIONS

None.

CLOSING

Rep. Swift stated there is no prohibition in the bill restricting anyone from filing a report, but allows for flexibilities needed in the event that there is a communications problem. He said as far as the delay in determining whether it is a real injury, this would help in that respect by beginning the process and notifying the employer of the situation. His objective, he said, is to involve both parties in the action in a timely manner and so that some prevention safety measures could be provided.

HOUSE BILL NO. 585 - Remove Area Restrictions on Telephone Cooperatives, sponsored by Rep. Dorothy Bradley, House District No. 79, Bozeman. Rep. Bradley stated that this bill removes the restrictions on areas where small telephone cooperatives may serve, because at present they can't serve an area if the population is over 1,500 individuals. She said the problem is that Mountain Bell can move into the cooperative area, but the coops can't reciprocate and compete in the Mountain Bell territory. She added that this bill would provide for equal treatment and equal amount of competition.

PROPONENTS

Jay Downen, General Manager and Executive Vice President, Montana Telephone Association. Mr. Downen stated that the bill is a compromise between the small telephone systems which serve the majority of the land mass of the state and the Mountain Bell Company. He said the bill is a means to give the small telephone systems a measure of equal footing and equity. He commented that the families or individual consumers are the motivation for introducing this bill.

Dennis Lopach, Mountain Bell. Mr. Lopach stated they are involved in a dispute involving the Public Service Commission authority to regulate the areas in which telephone companies serve, and it was decided in their favor. He said they support the concept described and embodied in the bill, the freedom of telephone companies to compete wherever they choose. He commented that given the significant changes in the industry, they feel that competition is the way the industry is headed, and they are not interested in protecting themselves from it.

OPPONENTS

Gene Phillips, Northwestern Telephone Company, Kalispell. Mr. Phillips stated the bill was of great concern to them.

He commented that the original concept of the cooperative law and the advantages given to rural telephone cooperatives was to provide low cost telephone service to people in rural areas who otherwise could not obtain it. He said this bill would take away the right that protects them to serve in certain areas without the coops moving into the area and being able to set a predatory price. He commented that their rates are regulated by the Public Service Commission and the coops' rates are not, and under this bill they wouldn't be assured that they were going to have a certain amount of growth in an area, and it wouldn't be prudent to install equipment not knowing whether they could continue to serve in that area.

Lester Loble II, representing General Telephone Company, Northwest. Mr. Loble stated they oppose this bill for the same reasons as Mr. Phillips cited. He said the coops have a substantial competitive advantage in the amount of taxes they pay.

QUESTIONS

None.

CLOSING

Rep. Bradley stated a cooperative does pay property tax and doesn't pay income tax because it it nonprofit. She said she is not interested in prohibiting competition or setting up a territorial system that would be diametrically opposed from the extensive changes made two years ago, but this is a compromise and fair.

HOUSE JOINT RESOLUTION NO. 15 - Audit of Workers' Compensation Claims Database and Related Areas, sponsored by Rep. Timothy Whalen, House District No. 93, Billings. Rep. Whalen stated that this resolution was introduced for the purpose of having an audit done on some of the practices in the state fund, and on some of the underlying data base that had not been previously audited. He said the audit is no longer necessary because the audit committee met and decided on their own to request the Legislative Auditor's Office to expand the audit, so he is requested that the bill be tabled.

EXECUTIVE ACTION ON HOUSE JOINT RESOLUTION NO. 15

Rep. Simon moved that House Joint Resolution No. 15 be TABLED. The motion carried unanimously.

HOUSE BILL NO. 626 - Limit Causes for Landlords' Recovery of Treble Damages, sponsored by Rep. Harry Fritz, House

District No. 56, Missoula. Rep. Fritz stated that this bill makes a change in the regulations governing the landlord/tenant situation. He commented at present if a tenant destroys or damages property in a rental unit, the landlord can sue for damages, and if the damages are purposeful, the landlord can sue for treble damages. However, he said, some landlords are using this to sue for treble damages in the events of a vacancy of a rental unit before the lease is up, and in some cases the rent has been paid. He added the landlord has the right to hold rent from the deposit, or sue for the rent, but the abandonment of a rental unit is not equivalent to purposeful damage or theft, and should not be subject to treble damage recovery.

PROPONENTS

Bruce Barrett, attorney, University of Montana Student Body, Missoula. Mr. Barrett stated he was a landlord and had the perspective from both sides. He submitted written testimony. Exhibit No. 2.

Matthew Thiel, representing Associated Students, University of Montana. Mr. Thiel presented an affidavit from a student at the University and read it to the committee. Exhibit No. 3.

Mr. Thiel stated this bill seeks to make a change in the landlord/tenant law but does not take away the rights of the landlord. He said it protects the tenants from unfair and exorbitant punitive damages when they move from a rental unit without the 30 day notice.

OPPONENTS

None.

QUESTIONS

Rep. Swysgood asked for clarification from the testimony of Mr. Thiel that the tenant was responsible for the rent until the place was rented; he said, he thought it was for the 30 days. Mr. Barrett responded that 80 percent of the landlord/tenant relationships are on a month to month basis which requires a 30 day notice, but there are one-year leases, and the law provides that in either situation the relationship ends when the landlord rents the place again.

Rep. Swysgood stated that on a one-year lease, there would be no incentive to rerent because the landlord is assured that he will get his money for the whole year from whoever was there. Mr. Barrett replied that there was a little

protection because the law provides that the landlord must try to rent it.

CLOSING

Rep. Fritz stated it was never the intent of the law to allow landlords to recover triple-damages merely for abandonment of a premises and the law was not used that way for the first eight or ten years of existence, but a loophole has been discovered that should be corrected.

HOUSE BILL NO. 420 - Insurance Reporting Requirements, sponsored by Rep. Timothy Whalen, House District No. 93, Billings. Rep. Whalen stated the bill provides to repeal section 33-16-202, which is recording and reporting loss and expense experience statute for insurance companies and sets some new criteria to follow in reporting to the Insurance Commissioner's office.

Rep. Whalen presented amendments to the bill and stated that the reason for the amendments were because of the attached fiscal note and the amendments were designed to address it. He also presented a letter from the Legislative Fiscal Analyst's office which explains the fiscal impact of the amendments. Exhibits Nos. 4 and 5.

PROPONENTS

Tom Boland, attorney, Great Falls. Mr. Boland submitted written testimony. Exhibit No. 6.

Gary Overfelt, attorney, Billings. Mr. Overfelt stated this bill presents an opportunity for the legislature and the people of Montana to make a decision based on facts to determine whether tort reform is warranted or justified. Exhibit No. 7.

Jackie Amsden, Women's Lobbyist Fund. Ms. Amsden stated that the liability insurance crisis has hit Montana hard, but small businesses are the ones that have found it almost impossible to continue doing business because of the high price of insurance. She said some providers are going underground and not registering with the state to avoid being held to the requirement of having to have liability insurance and to avoid paying the outrageous expense of liability insurance. She commented that in Montana there just hasn't been the claims experience to warrant such huge increases that these businesses have had to pay, and the time has come for the people of Montana to see some proof of the reason behind the skyrocketing insurance rates.

Rep. Ben Cohen, House District No. 3, Whitefish, and President of the Montana Solid Waste Contractors Association. Rep. Cohen stated that in the last three years the association's liability insurance rates have tripled, and surveying their membership they can see no justification for the increase in the rates. He said he supports the bill, and would like to see the data explaining why the rates have increased.

OPPONENTS

Bonnie Tippy, representing Alliance of American Insurers. Ms. Tippy stated that the tort reform issue and how it relates to the insurance industry has been debated at length over the last several months.

Larry Soular, Alliance of American Insurers. Mr. Soular stated the data reporting requirements of the bill would be very costly for insurance companies as well as the Insurance Department to analyze. He suggested that the Insurance Department and the legislators work closely with the industry to gather the existing data bases to see how the existing data bases could be analyzed to provide the types of information needed to analyze the coverages rather than going through a new and costly data reporting system.

Mr. Soular presented a written statement that provided considerable detail about the availability of insurance data, and insurance data that summarizes the types of data that are currently being provided on a uniform basis. Exhibit Nos. 8 and 9.

Randy Gray, representing State Farm Insurance Companies and the National Association of Independent Insurers. Mr. Gray stated that the basic problem with the bill is that it is expensive for companies to compile this type of data. He said it is particularly burdensome to the smaller companies, and this type of bill would give the message to the small companies that Montana is not a good place to do business because of the cost of complying with this type of legislation.

QUESTIONS

Rep. Swysgood asked if there was a fiscal impact with the bill. Rep. Whalen responded that there will be a fiscal impact on the bill for the first year, at least of probably hiring a half-time employee. He said the Auditor's Office feel that if the bill were to pass they would need a full time employee and possibly more to answer questions from the insurance companies calling regarding the new form.

Rep. Swysgood asked Ms. Irigoin if she believed there would be a fiscal impact with the bill. Ms. Irigoin stated the bill would have the fiscal impact of at least one employee, at a grade 7, to address telephone and written inquiries from the companies.

Rep. Cohen commented that Mr. Soular had stated that there was sufficient reporting of the National Association of Insurance Commissioners to get the data needed, and he asked if the data for Montana was available from them, so that someone could go into the data base and get the data for Montana. Mr. Soular responded that this usually comes through the Insurance Services Office, a statistical reporting agent, that provides the commissioners and others with the data. He said for most of the coverages available, they can usually provide separate state data.

Rep. Cohen asked what expenses are involved that the company would incur in reporting of the data. Mr. Soular replied that every time a state passes a data reporting law that is not the same as other states, it does require additional programming of the automated systems, if the data can be pulled. He said in other cases there are certain data elements that can only be obtained through a manual review of close claim files, requires additional data processing costs, and is difficult for companies that operate on a nationwide basis.

CLOSING

Rep. Whalen stated that pages 3 and 4 of the bill addresses some of the questions of the committee as to the type of information required by the bill. He commented that as far as income tax reporting purposes there is strong encouragement for insurance companies to set their reserves at an inflated level because it will be a downward pressure on the income they report and the income tax they will pay. He said regarding the question on what the fiscal impact will be, this is difficult to determine because it will depend upon the number of phone calls and questions directed at the Insurance Commissioner's Office.

HOUSE BILL NO. 622 - Generally Revise Financial Regulation of Insurance Companies, sponsored by Rep. Brandewie, House District No. 49, Bigfork. Rep. Brandewie stated this bill was at the request of the State Auditor's Office, and he explained what each section of the bill provided.

PROPONENTS

None.

OPPONENTS

None.

QUESTIONS

None.

CLOSING

Rep. Brandewie made no further comments.

EXECUTIVE ACTION - February 12, 1987 - 10:30 a.m.

ACTION ON HOUSE BILL NO. 622

Rep. Brandewie moved that House Bill No. 622 DO PASS. The motion carried unanimously.

ACTION ON HOUSE BILL NO. 420

Rep. Cohen moved that House Bill No. 420 DO PASS.

Rep. Glaser moved a substitute motion that House Bill No. 420 be TABLED. The motion carried with Reps. Brown, Cohen, Driscoll, Grinde, Hansen, McCormick, Nisbet, and Pavlovich opposed.

ACTION ON HOUSE BILL NO. 626

Rep. Driscoll moved that House Bill No. 626 be TABLED. The motion failed.

Rep. Thomas moved that House Bill No. 626 DO PASS. The motion carried unanimously.

ACTION ON HOUSE BILL NO. 640

Rep. Driscoll moved that House Bill No. 640 DO NOT PASS.

Rep. Thomas moved a substitute motion that House Bill No. 640 be TABLED. The motion failed.

Rep. Simon moved an amendment to strike "24 hours" and insert "14 days".

Rep. Brandewie commented that the 24 hours is just notification of an injury so at least the employer knows it happened on the job. He said if 14 days is allowed, there are going to be cases where the injuries are not happening on the job, and a reasonable time period should be found.

Rep. Simon commented there can be injuries that do not manifest very quickly, sometimes it takes three or four days or a week, and this is a middle ground between the 60 days that is presently in effect, and the 24 hours which is too short a time.

Rep. Simon's motion on the amendment was voted on and carried with Reps. Bachini, Brown, Driscoll, Grinde, Hansen, McCormick and Nisbet opposed.

Rep. Brandewie moved that House Bill No. 640 DO PASS AS AMENDED. The motion carried with Reps. Bachini, Brown, Cohen, Driscoll, Hansen, Nisbet, and Pavlovich opposed.

ACTION ON HOUSE BILL NO. 313

Rep. Pavlovich moved that House Bill No. 313 DO PASS.

Rep. Pavlovich moved amendments Nos. 1 through 10 which inserts language regarding table wines. See Exhibit No. 10 for each of the amendments. The motion carried with Rep. Simon and Rep. Nisbet opposed.

Rep. Pavlovich moved amendments Nos. 11, 12, and 13. See Exhibit No. 11. The motion carried with Reps. Bachini, Driscoll, Kitselman, Nisbet and
Wallin opposed.

Rep. Pavlovich moved amendment No. 14. See Exhibit No. 11. The motion carried with Rep. Bachini and Rep. Kitselman opposed.

Rep. Pavlovich moved amendments Nos. 15 and 16. The motion carried with Reps. Kitselman, Swysgood, and Thomas opposed.

Rep. Pavlovich moved amendments Nos. 17, 18, and 19. Exhibit No. 11. The motion carried unanimously.

Rep. Pavlovich moved amendment No. 20. The motion carried with Reps. Brown, Bachini, and Kitselman opposed.

Rep. Pavlovich stated he wanted both bills, House Bill Nos. 562 and 313, Rep. Simon's and his proposal, to be considered on the House floor. He said then they could decide what to do with the state liquor system, or they could wait until Rep. Harrington's bill, House Bill No. 623, is heard, which provides that the system remains the same.

Rep. Kitselman commented the difference in House Bill 313, Rep. Pavlovich's bill, the liquor is exclusively controlled by the tavern owners.

Rep. Simon commented a second major difference was that in Rep. Pavlovich's bill, the freight is paid by the state.

Rep. Brandewie pointed out that the bills can't be heard at the same time or voted on at the same time.

Rep. Driscoll stated that if both bills were to pass to the Governor's desk, he couldn't sign both.

Rep. Brandewie gave an example of a person in Bigfork who has been providing service in an agency store, and under Rep. Pavlovich's bill, that person does not have a chance of his store staying open. He felt that House Bill No. 313 was unfair to the people who have the agency stores, and for that reason was not in favor of the bill.

Rep. Pavlovich moved that House Bill No. 313 DO PASS AS AMENDED. The motion carried with a roll call vote of 13 to 5. Roll Call Vote No. 1.

ADJOURNMENT

The meeting adjourned at 11:10 a.m.

Les Kitselman

REP. LES KITSELMAN, Chairman

DAILY ROLL CALL

BUSINESS & LABOR COMMITTEE

55th LEGISLATIVE SESSION -- 1987

Date FEBRUARY 12, 1987

NAME	PRESENT	ABSENT	EXCUSED
REP. LES KITSELMAN, CHAIRMAN	✓		
REP. FRED THOMAS, VICE-CHAIRMAN	✓		
REP. BOB BACHINI	✓		
REP. RAY BRANDEWIE	✓		
REP. JAN BROWN	✓		
REP. BEN COHEN	✓		
REP. JERRY DRISCOLL	✓		
REP. WILLIAM GLASER	✓		
REP. LARRY GRINDE	✓		
REP. STELLA JEAN HANSEN	✓		
REP. TOM JONES	✓		
REP. LLOYD MCCORMICK	✓		
REP. GERALD NISBET	✓		
REP. BOB PAVLOVICH	✓		
REP. BRUCE SIMON	✓		
REP. CLYDE SMITH	✓		
REP. CHARLES SWYSGOOD	✓		
REP. NORM WALLIN	✓		

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STANDING COMMITTEE REPORT

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STANDING COMMITTEE REPORT

February 12 19 87

Mr. Speaker: We, the committee on BUSINESS AND LABOR

report HOUSE BILL NO. 622

☒ do pass
☐ do not pass

☐ be concurred in
☐ be not concurred in

☐ as amended
☐ statement of intent attached

REP. LEE KITSELMAN Chairman

FIRST reading copy (WHITE color)

STANDING COMMITTEE REPORT

February 12 19 87

Mr. Speaker: We, the committee on BUSINESS AND LABOR

report HOUSE BILL NO. 626

☒ do pass
☐ do not pass

☐ be concurred in
☐ be not concurred in

☐ as amended
☐ statement of intent attached

REP. LEO KITSELMAN Chairman

FIRST reading copy (WHITE color)

ROLL CALL VOTE

BUSINESS & LABOR COMMITTEE

DATE Feb. 12, 1987 BILL NO. HB 313 NUMBER 1

NAME	AYE	NAY
REP. LES KITSELMAN, CHAIRMAN		✓
REP. FRED THOMAS, VICE-CHAIRMAN	✓	
REP. BOB BACHINI	✓	
REP. RAY BRANDEWIE		✓
REP. JAN BROWN	✓	
REP. BEN COHEN	✓	
REP. JERRY DRISCOLL	✓	
REP. WILLIAM GLASER		✓
REP. LARRY GRINDE		✓
REP. STELLA JEAN HANSEN	✓	
REP. TOM JONES	✓	
REP. LLOYD MCCORMICK	✓	
REP. GERALD NISBET	✓	
REP. BOB PAVLOVICH	✓	
REP. BRUCE SIMON	✓	
REP. CLYDE SMITH	✓	
REP. CHARLES SWYSGOOD	✓	
REP. NORM WALLIN		✓
TALLY	13	5

Elsie Armstrong
Secretary

Les Kitselman
Chairman

MOTION: Rep. Pavlovich moved HB 313 DO PASS AS AMENDED.

Motion carried - 13 to 5.

Form CS-31
Rev. 1985

EXHIBIT 1
DATE 2/12/87
HB 640

MONTANA STATE AFL-CIO
APRIL 29 1956

Box 1176, Helena, Montana

JAMES W. MURRY
EXECUTIVE SECRETARY

ZIP CODE 59624
406/442-1708

TESTIMONY OF JIM MURRY ON HOUSE BILL 640 BEFORE THE HOUSE BUSINESS AND LABOR COMMITTEE, FEBRUARY 13, 1987

Good morning. My name is Jim Murry and I am testifying on behalf of the Montana State AFL-CIO in opposition to House Bill 640.

Mr. Chairman, requiring workers to give notice of their injuries within 24 hours to their employer or employer's insurer is capricious and unfair. It will severely restrict access to the workers' compensation system for many workers with legitimate claims.

Twenty-four hour notice is simply unacceptable. In certain cases injured workers may be physically unable to give notice within 24 hours. It does not take much imagination to envision just such a case.

For example, an over-the-road trucker could be involved in a serious accident thousands of miles away from home. The injury may result in an inability for this trucker to contact his or her employer. Or, the trucker may be so far away that he or she is unable to have family or friends make contact within the required 24-hour period.

This bill is designed to reduce the number of workers' compensation claims filed. However, it is our contention that 24-hours notice may, in fact, actually increase the number of claims filed.

Currently, under the 60-day filing period, a worker may postpone filing a claim until he or she determines that medical attention is necessary. We are all aware of instances where where an on-the-job injury could be just "shook off" after a few days and the employee returns to work.

However, a 24-hour deadline threatens workers and will force all injured workers to file immediate claims, no matter how trivial the injury. More claims will be filed and more paperwork will be forced onto the Workers' Compensation Division with additional costs in processing new claims.

Finally, there are numerous "soft tissue" injuries, particularly back injuries that often take more than 24 hours to detect. The full extent of a back injury may take days or even weeks to ascertain. By arbitrarily restricting the filing period to 24 hours, many workers with legitimate claims will be denied workers' compensation coverage.

Members of the committee, it may very well be that our workers' compensation system needs certain reforms. But proposals such as House Bill 640 are certainly not the proper answers to reform.

House Bill 640 severely restricts access to workers' compensation coverage for hundreds or perhaps thousands of workers with legitimate job related injuries.

For these very important reasons, we urge you to oppose House Bill 640.

TESTIMONY SUPPORTING HB 626

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626

At times tenants move out before a long-term lease has expired, or by giving less than 30 days notice to a Landlord. A Landlord is entitled to his full lease term or 30 days notice. Under present law if a Tenant moves out early, the Landlord is entitled to rent for the remainder of the period, or until the premises is re-rented, whichever comes first.

70-24-422 MCA provides remedies for Landlords against their Tenants in certain situations. A reading will show the statute was drafted to cover Tenants who were intentionally destroying or defacing the property, keeping it in an unhealthy or unsafe condition, or if the Tenant fails to pay rent. None of this is a problem, it gives Landlords the same types of rights Tenants have for similar violations. The problem arises under subsection (4) of 70-24-422.

This subsection allows "triple damages" when the Tenant's noncompliance is purposeful. Certainly if a Tenant purposely destroys the premises, or keeps it purposely in an unhealthy or unsafe condition, this remedy is fair. However, Landlords are beginning to use the provision to sue for triple damages solely based upon the Tenant's moving out.

Let us take an example. If a Tenant is supposed to give 30 days notice, and for financial or compelling personal reasons, only gives 15 days notice. Even though the Landlord tries to rent it, the place stays vacant for 2 full weeks before it is rented. It is clear the Landlord may retain 2 weeks rent from the Security Deposit, or sue for two weeks rent. However, some Landlords are using subsection (4) to sue for triple the amount (eg six weeks rent).

I would hold that the subsection was intended to cover the sort of intentional, irresponsible, and destructive conduct by Tenants that Landlords occasionally encounter.

The problem is not limited to Landlords choosing to sue for triple when Tenants move out early. In certain cases where the Landlord is facing a legitimate suit for wrongfully withholding a deposit, or charging for questionable damages, the Landlord can "up the ante" by countersuing for triple the amount. This makes it very risky for Tenants to sue to contest unfair damage charges. The possible consequences get too high for Tenants to try.

Nothing in this bill would keep Landlords from withholding deposits, or suing for unpaid rent or damages. Additionally, when Tenants engage in purposefully destructive conduct, the Landlord's can still seek triple damages. It will only eliminate triple damages when the sole wrong committed by the Tenant is moving out. Even then, of course, the Landlord is entitled to rent, he just may not sue for triple.

Bruce B. Barrett 2/11/87 (406)243-6213

EXHIBIT 3
DATE 2/12/87
HB 626

Affidavit

I am writing to support a change in 70-24-422. I think the proposed ammendment would help to remedy a serious problem in the landlord temant law.

In September of 1985 I moved into an apartment in Missoula, Montana. My roommate and I signed a one year lease. Because of money problems, my roommate had to move away. I did not have enough money to pay the whole rent by myself so I had to move out of the apartment.

I knew that under the law I would have to pay the landlord rent until he could rerent the apartment. I also knew that if I left the apartment dirty or damaged I would be responsible and have to pay. I knew these damages could be taken out of my deposit. However, the landlord felt he could sue me for three times the damages because of 70-24-423(4).

A landlord is entitled to his unpaid rent and his damages, of course. However under the present law the landlord, if he feels, the tenant moved on purpose, can sue for triple.

This is unfair because the landlord is already guaranteed his rent under the law. Allowing him to get triple the rent when a tenant moves out early is unfair and gives the landlord money he did not really earn. Just moving out of an apartment early should not be the kind of conduct that can cost you triple damages.

Angela Fuhrmann

Angela Fuhrmann

subscribed before me on
2-10, 1987.

Louise Boteau

My commission expires
7-29-89

EXHIBIT 4
DATE 2/12/87
HB 420

37

Amendments to HB 420 (Introduced Copy)

1. Page 1, line
Strike: "For Purposes of Determining the Appropriateness of Rates Charged by such Insurers"

2. Page 4, line 22.
Strike: "compile and review"
Insert: "file"

3. Page 4, lines 23 through 25.
Strike: "to determine the appropriateness of premium rates for property and casualty insurance in this state"

4. Page 4, line 25 through line 1, page 5.
Strike: "commissioner's findings and the"

5. Page 5, lines 1 and 2.
Strike: "provided to the appropriate committees of the legislature and"

6. Page 5, lines 3 through 11.
Strike: "If the commissioner finds at any time that any rate is no longer fair and appropriate."

7. Page 5, line 13.
Following: "shall"
Insert: "annually"

8. Page 5, lines 15 through 17.
Strike: "write coverage, to continue to do business, or to increase or decrease rates charged for insurance coverage"
Insert: "transact insurance in this state"

9. Page 5, line 24.
Strike: Section 6 in its entirety

10. Page 4, line 22.
Strike: "compile"
Insert in its place: "store"

11. Page 5, line 1.
Strike: "7"
Insert: "6"

12. Page 6, line 5.
Strike: "8"
Insert: "7"

5
Date 2/12/87
HB 420

STATE OF MONTANA
Office of the Legislative Fiscal Analyst
STATE CAPITOL
HELENA, MONTANA 59620
406/444-2986

JUDY RIPPINGALE
LEGISLATIVE FISCAL ANALYST

February 11, 1987

Representative Timothy Whalen
Seat #48
Montana House of Representatives

Dear Representative Whalen:

In response to your letter requesting information on the cost of implementation of House Bill 420 with your proposed amendments, I have made an analysis of the bill requirements and the fiscal note.

With the amendments you have proposed, I conclude that the added workload to the State Auditor's Office would be reduced to 1) indexing and filing annual loss and expense experience reports from approximately 800 insurance companies, 2) responding to requests to make the information available to interested insured parties or citizens, and 3) a monitoring function to ensure that each insurance company has filed the required information as a prerequisite to transacting insurance in Montana. The reports are an addition to annual reports already required from each company, so the added report filing workload would be minimal. There would also be minor operating expenses for storage, communications, and postage.

The Insurance Department staff size has not changed significantly in recent years, even though the crisis in insurance rates has increased workload. If the existing staff had a difficult time absorbing the added workload, I would estimate that costs of the added workload would be no more than $10,000 in fiscal 1988 and $10,000 in fiscal 1989, which would allow an additional 0.5 FTE filing clerk and related operating costs.

Please contact me if you have any questions or if I can be of further assistance.

Sincerely,

Clayton Schenck
Senior Fiscal Analyst

CLS1:bn:rw2-11.

6
2/12/87
420

NATIONAL INSURANCE
CONSUMER ORGANIZATION

October 22, 1986

Dear Editor:

Will "tort reform" -- limiting compensation to injured people -- reduce insurance rates? Legislators have been asking this question for months.

The enclosed documents answer that question for the first time. Prepared by the Aetna, one of the nation's largest commercial liability insurers, and the St. Paul, the nation's largest medical malpractice insurer, both documents carefully analyze the tort reforms that were recently enacted in Florida and conclude that they will not reduce insurance rates.

For example, the Aetna document analyzes the following limitations, which it has been lobbying for throughout the nation:

(1) reducing compensation to injury victims by the amount of compensation from collateral sources;

(2) restricting the doctrine of joint and several liability;

(3) limiting compensation for paralysis, disfigurement and other types of non-economic damages to $450,000;

(4) limiting punitive damages; and

(5) requiring periodic payment of future economic damages of more than $250,000.

The Aetna document, a rate filing proposed to take effect January 1, 1987, explains why each of these provisions will have little or no effect on insurance rates. Eliminating the collateral source rule, for example, will have a negligible effect on insurance rates because "current Aetna claim settlement practices recognize, in part, the existence of collateral sources as part of the negotiating process used in arriving at a mutually satisfactory damage value with the plaintiff." Restricting joint and several liability will not reduce insurance rates "due to the interaction of economic damages sustained by the

121 N. Payne Street
Alexandria, Virginia 22314
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plaintiff, the percentage of liability assigned to Aetna's insured, and the policy limits purchased." And limiting compensation for "non-economic" damages will not lower insurance costs, according to Aetna, "due to the impact of degree of disability on future losses, the impact of policy limits, and the actual settlement reached with the plaintiff."

Finally, Aetna concludes, limiting punitive damages will have "no impact" on Aetna's claim values, and requiring periodic payments of future economic damages over $250,000 will yield "no net savings" because of the "interaction of policy limits, past economic losses, and future economic losses," the "settlement value of the case," and the "apparent implicit recognition of the periodic nature of future damages."

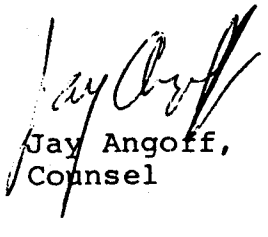
The St. Paul conducted an analysis similar to Aetna's and reached similar conclusions. The St. Paul found that 4 of the 313 closed claims it analyzed would have been affected by the "tort reforms" enacted in Florida, "for a total effect of about 1% savings." The St. Paul further explains that the 1% savings estimate probably overstates the effect of tort reform.

We also call your attention to the form contained in the Aetna filing that Aetna had its branch managers fill out. This form asks for, and has yielded, data on the effect of joint and several liability, non-economic damages, punitive damages, the collateral source rule, and other legal doctrines on Aetna's payouts. Ironically, Aetna and many other insurance companies have consistently refused to disclose this type of information to the public or legislators.

If you have any questions about the enclosed documents, or if we can be of further assistance, please let us know.

Sincerely,

J. Robert Hunter,
President



Jay Angoff,
Counsel

/ljb

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ITT Graphic

Reading between the lines of profit policy

By Rebecca Lightsey and Margarita Fournier

DURING THE FIVE YEARS ELAINE Brightwater was a midwife, not a single malpractice claim was filed against her. Yet her liability insurance was cancelled recently. The only policy she can now obtain will cost her $3,500 a year, a 9,0000 percent increase from five years ago, when her annual premium was $38.

Brightwater's experience exemplifies recent actions by the insurance industry. Mass cancellations of policies and rate hikes are reaching critical proportions. This crisis of availability and affordability of insurance directly affects many Americans.

To solve this crisis, the insurance industry advocates tort reform (see story below), a proposal that puzzles Brightwater: "We have never been sued. Only 6 percent of midwives have ever been brought to court nationwide. I see no relationship between lawsuits and insurance premiums—at least not for midwives."

New worlds to conquer

In the fall of 1985 the national campaign for tort reform started with a bang, fueled by a $6.5 million budget raised by the property and casualty insurance industry. Insurance companies coalesced various business interests in the effort to alleviate "the grave crisis" in liability insurance that they insisted was caused by an excessive American penchant for lawsuits.

Initially the strategy succeeded. Several states amended their tort laws to suit the industry's proposals. But the changes expected in return—rate reductions and increased availability of insurance—have not materialized. Policy makers and insurance consumers have begun looking beyond the aggressive but poorly documented tort reform campaign and are seeking changes in the insurance industry as well as legal restraints (see story on right).

The insurance industry has tracked a path between boom and bust for the past 50 years. In "crisis" periods, when profitability is relatively low, the industry has challenged and even modified the law. For instance, the last bust cycle in the mid-'70s brought attention to medical malpractice insurance costs; the industry achieved success in many states, making claims against doctors procedurally more difficult to pursue and in some cases capping recovery of damages. But even in the "bust" year of 1984, when the insurance industry registered its lowest profits in 10 years, combined industry profits amounted to $2 billion, according to the Insurance Information Institute.

This paved the way for an all-out assault on the civil justice system. As Mechlin D. Moore, president of the Insurance Information Institute, a large public relations firm, wrote in the *National Underwriter*: "An effort to market the idea that there is something wrong with the civil justice system...is, in effect, the national pilot effort.... We believe there is a very real opportunity now—probably for the first time—to gain significant legislative change."

Media accounts of outrageously excessive awards in ridiculously frivolous suits have created the impression that filing suit is *the* response to any wrongdoing. Citing these factors, insurers cease writing types of insurance or virtually price consumers out of the markets. Hidden behind the veil of the legal process, one senses that the insurers are threatened most by profit concerns. Therefore, if they reduce liability, their payouts will decrease.

In calling for "tort reform," insurance companies propose to shrink their liability, restricting the recovery of damages for injury, by limiting awards for pain and suffering; abolishing joint and several liability, which forces solvent defendants to pick up the tabs for insolvent defendants out of line with their shares of responsibility; and total abrogation of punitive damages, commonly cited as a corporate deterrent.

The root of the crisis

Insurers make money in two ways: first, through the difference between the price of

Continued on following page

Tort reform: what is it?

Technical phrases that mean little to those outside the legal profession are an integral part of the current tort reform debate. These terms represent legal doctrines that play a critical role in the U.S. civil justice system. Below are brief descriptions of those legal theories and their practical applications, which the insurance industry is attempting to change or abolish:

• **Abolish the doctrine of joint and several liability.** This doctrine holds that when more than one defendant is responsible for an injury, any one of those defendants has a responsibility to compensate the innocent party. Without this doctrine, for example, the victims of a toxic waste dump would not be able to recover fully for the harm. The victim would have the burden of proving what share of their injuries was caused by each dump user.

• **Caps on pain and suffering.** Juries award money to injured individuals for both economic damages, such as medical bills, and non-economic damages, such as the pain some victims suffer after a tragedy. The industry proposes a limit on how much juries in any state can award for pain and suffering, so that, for instance, the daily anguish and aggravation a paraplegic endures would be "worth" only $100,000. Caps enacted during the malpractice crisis of the '70s were held by some state courts to be unconstitutional.

• **Abolish punitive damages.** Punitive or exemplary damages are the "punishment fines" levied against wrongdoers, usually corporations, for *intentional* wrongs. As admitted by many companies, punitive damages is the one social pressure that has most influenced companies' willingness to redesign products according to higher safety standards.

• **Limits on contingency fees.** Most injured people cannot afford the attorneys' hourly rates, so to obtain legal representation they hire lawyers on contingency fee arrangements. The lawyer gets a percentage of an award, sometimes 33 1/3 or 40 percent, but receives no payment if the suit is lost. The system assures that everyone, regardless of their financial resources, has access to the courts. Restricting contingent arrangements would make it more difficult for those without money to hire lawyers. ■

Reform proposals

The complexity of insurance business requires permanent solutions aimed at its fundamental structure. Thus consumer organizations in several states have proposed various insurance reforms designed to make the industry more accountable and equitable, and thus less likely to engage in irresponsible behavior. These proposals include the following:

• **Sunshine laws.** Companies must provide detailed financial data to the state insurance commissions, and data that would also be accessible to the public. Today only industry insiders know the actual losses and reserves, and their actuaries massage the numbers. What else could explain the 10-year combined profits of $75 billion without any federal tax payments? The rates should be reviewed periodically by commissions to determine their validity.

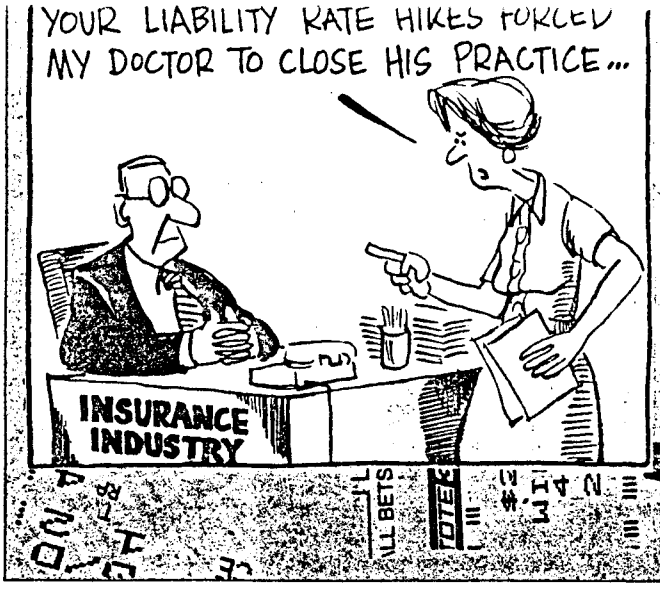
• **Public counsel offices.** In New Jersey, an active Office of Public Counsel guarantees that insurance buyers are represented at the rate hearings. Regardless of states' different rate-approval mechanisms, establishment of such an office would bring more balance into the rate regulation system.

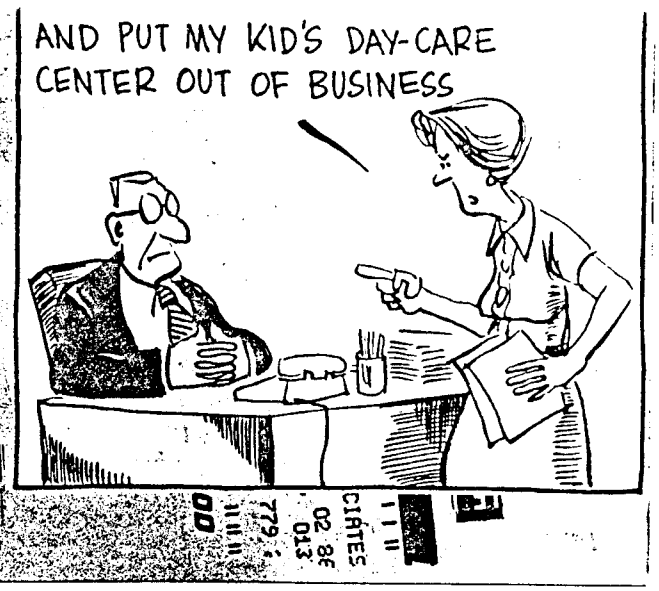
• **A limit on mid-term cancellation.** Consumers should also demand readable and, if possible, standardized policy forms. Information, such as claims procedures, and a company's record of claim settlements should be readily available.

• **Experience rating.** As illustrated by Florida's malpractice figures, often only a small number of offenders are responsible for most claims there. In a more egalitarian system of rate classification, premiums would be based on the individual's experience. An experience rating system would provide an additional incentive for the policyholders to maintain their good records.

• **Risk management.** Considering that the best cure is prevention, companies would be required to develop and maintain strict "risk management" programs that concentrate on safety.

• **Flex-rating.** Flex-rating, introduced in New York, would limit rate increases and decreases to a plus-or-minus 3 percent range. ■





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the product (premiums charged) and the cost of the product (underwriting), the way most businesses earn profits; and second, "investment income," the interest earned by investing the unearned (or unspent) premium dollars, which accounts for the largest part of the profits.

Beyond the primary level of insurance, which provides insurance for the buying public, there are reinsurers, who insure the insurance companies, thereby permitting primary insurers to spread their underwriting risk. Lloyd's of London presides over the reinsurers, most of which are located in foreign countries.

Reinsurers sell shares of policies, a practice called retroceding. Reinsurance, and to a larger degree, retroceding markets attract investors with large capital. When interest rates begin to drop, opportunities to make a quick profit decrease. Many reinsurers opt for a hasty withdrawal, limiting the ability of the primary insurers to reinsure.

"The property/casualty insurance industry will always by cyclical," said U.S. Fidelity and Guaranty President Paul J. Scheel. The last cycle was an extreme one, with investment returns reaching 25 percent in the late '70s and early '80s, when interest rates were high, and then dropping precipitously to 3-4 percent by 1984.

As investment income peaked, large policy holders saw premiums fall to unprecedented lows as insurers cut rates substantially in a wild clamor to attract more dollars. Some companies went beyond premium cutting and insured risks after the loss had occurred. For example, the MGM Grand Hotel, devastated by fire in 1980, was able to buy insurance in 1981 to cover the damage. While suits over the fire dragged out in court, insurers gambled on investment of premium dollars. But the hotel settled instead, and then had to sue the underwriters, who resisted paying settlements.

The "brutal price war," as it was characterized in a report published by the National Association of Independent Insurers, ended on a sour note when interest rates started to drop rapidly in the '80s. Claims came due for collection and the insurance companies found themselves with severely diminished cash reserves.

In September of 1984, people attending the National Convention of the Independent Insurance Agents of America were warned "to brace themselves for sharp premium hikes." Suddenly premiums shot up 100, 200, even 1,000 percent. Many policies were cancelled in mid-term, and several lines of liability coverage were no longer available.

The industry searched for a culprit to blame for what Thomas Kellogg, senior vice president of General Re, one of the larger reinsurers, called "corrections necessary for a return to underwriting profit."

The mantle of guilt was conveniently draped on a "permissive" court system and "greedy" trial lawyers. A litigation explosion manifested by excessive awards in frivolous suits—decided by sentimental juries and presided over by irresponsible judges—gave the industry pause to tell the public that the nature of the system forced them to increase rates and, in many cases, withdraw from particular lines of coverage.

Clearly, the industry's reluctance to cover certain risks such as toxic waste dumps, likely to generate increasing numbers of claims in coming years, were not unfounded. But the denial of coverage to day-care centers, midwives and cities, however, appeared unwarranted.

It turned out that the mass cancellations was in large part a publicity stunt. The Insurance Service Organization, another insurance trade association, could find no justification for denying liability to day-care centers, for example. Nevertheless, the publicity served to portray a worsening crisis and thus forced lawmakers to respond.

John J. MacKowski, chairman of the board of the Atlantic Companies, in a *Business Insurance* article, expressed the hope that the capacity shortage would never end, or at least the perception that there is one.

It would seem that this capacity shortage would end with the industry's recent performance. After all, the leap in premiums in recent years has led to high profits currently. "It was acres and acres of diamonds for owners of insurance and financial services issues as our favorites sparkled in 1985 as they seldom have before, if ever," wrote Thomas Meakin in *The National Underwriter*.

For the first quarter of 1986, "the rebound in profits is astonishing," wrote the National Underwriter, with company income up as high as the 814 percent registered by St. Paul Insurance Company. Because of the insurance industry's normal profitability cycle, it is pulling out of its slump, although the tort law changes that were enacted have not yet had an effect.

While tort laws have not affected the insurance cycle, the cycle has affected tort law. The insurance industry's aggressive tactics took most legislatures by surprise. In 1985 and early 1986, the states of Washington, Utah, South Dakota and Wyoming passed tort law restraints, with little or no

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Big firms buy way out

By Allen Hornblum

CAUGHT IN THE LIABILITY INSURance squeeze, many of the nation's railroads and mass transit companies have turned to what has become a growing favorite of private industries—the "captive" insurance company.

Captives are insurance companies, usually headquartered in Bermuda or another Caribbean country for tax advantages and regulatory permissiveness, that insure only member corporations who form it to provide their own insurance.

Railroad Association Insurance, Ltd.; or RAIL, is the latest of 1,200 captives established in Bermuda, 75 percent of which are U.S. owned. Some of the largest U.S. industrial companies, such as IBM, Ford and SmithKline Beckman, have joined captives.

Railroads and transit authorities have been squeezed by declining federal support combined with a terribly unstable property and casualty insurance market. Managers have tried escape routes such as fare hikes, service cutbacks, self-insurance pools, bonding and group purchase of excess coverage. RAIL, formed by 11 private and public rail firms, will provide its members with $50 million of liability coverage on any catastrophe with claims of more than $50 million.

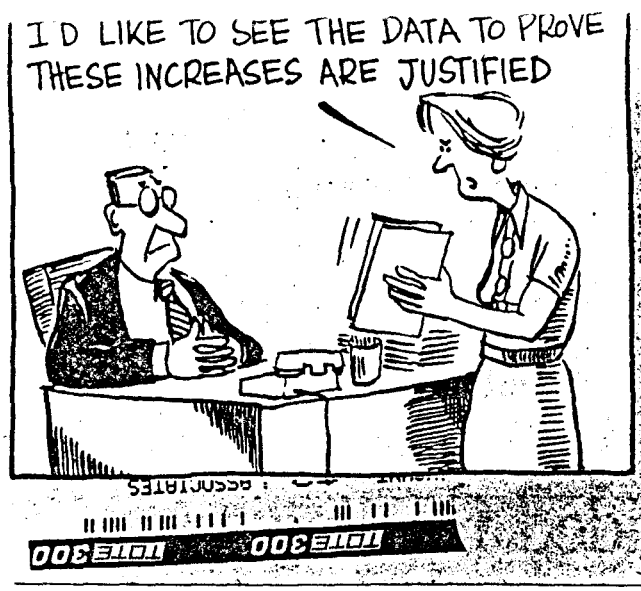
"The big problem for all of us is that the marketplace lacks reinsurance for the higher excess [liability] layers," says Bill Boone, director of risk management for the Southeastern Pennsylvania Transportation Authority (SEPTA). In two years SEPTA's coverage has plummeted from $149 million to less than a tenth of that for triple the price.

Many railroad managers were tempted but considered the venture risky and fraught with problems. "Few companies wanted to share losses with other railroads," observed Gene Gibson, director of casualty insurance for CSX Transportation, the parent company of the Chessie system. Each believed that their own operation was far better run and safer than that of others. There was also a debate over who was at greater risk, freight carriers that hauled explosives and toxic chemicals or commuter lines that had trains filled with people.

Since its founding by Union Pacific, Amtrak, CSX, Chicago and Northwestern, Kansas City Southern, Conrail, Illinois Central Gulf, Norfolk Southern, Santa Fe and Southern Pacific, the Soo Lines and SEPTA, RAIL has voted to accept two new members, Canadian Pacific and Chicago's METRA system. RAIL also voted to open board membership to transit authorities, some of whom have been contemplating their own captive.

Standard risk management strategies are proving useless for rail and transit systems in the current insurance crunch. Within the next year and a half it should be clear whether a captive insurance company is a workable answer. ■

Allen Hornblum is chief government information officer for SEPTA.



study of the necessity or their consequences, as a response to industry pressure.

As part of its public-relations campaign, the insurance industry publicized awards that it considered excessive, often using numbers that had been reduced by further court action. It counted on public opinion to promote their legislative agenda for tort reform. For a while, this PR campaign overshadowed any legislative need for hard facts.

Not until April of this year did a definitive study of the actual numbers of lawsuits filed and the average size of awards become available. And when the National Center for State Courts published its survey of the court filings, its statistics conflicted so sharply with general assumptions that they went unrecognized.

The Center, funded in part by state governments, found no lawsuit explosion. The total number of court filings for personal injury claims rose only slightly during the past four years; from 1978 through 1984, tort filings increased 9 percent, while the

Continued on page 22

Urban poor 'redlined' out

By Gregory D. Squires & William Velez

THE INSURANCE CRISIS FACING many cities, professionals and businesses with the cancellation of their liability insurance has recently grabbed the headlines. But for at least 20 years black residents in central cities have confronted a similar crisis in availability and affordability of homeowners insurance. That crisis will only worsen as the current liability crunch squeezes consumers and companies tighten underwriting practices, exacerbating the redlining and concomitant disinvestment of urban neighborhoods.

Our recent study of Milwaukee is not untypical. Voluntary market homeowners policies sold by the traditional, well-known insurance companies are concentrated in predominantly white and suburban neighborhoods. The FAIR Plan also known as the Wisconsin Insurance Plan, or WIP), a publicly administered but privately financed "insurer of last resort" that provides an inferior quality product for those unable to obtain coverage through the voluntary market, is for the black community.

From data on 18 of the state's largest insurers, we found that in 1985 the number of homeowners policies in force for every 100 owner-occupied dwellings ranged from seven in a nearly all-black inner-city neighborhood to 48 in a nearly all-white suburban community. WIP was concentrated in virtually all-black communities and often did not even exist in white neighborhoods.

Does that pattern simply reflect greater risk in older, poorer, less stable parts of town? Excluding age of housing, income and residential turnover—factors that the industry claims are associated with risk—there was still a statistically significant relationship between race and the absence of voluntary market policies or presence of WIP policies.

Even profitability cannot explain the pattern. We found no relationship between insurer profitability and market penetration of minority communities. That is, the companies that redlined most did not make more money. Clearly, racial discrimination is an important factor, in violation of state laws.

Besides passing new legislation such as state variants on the federal Community Reinvestment Act that would require insurers to be sensitive to the insurance needs of particular areas, states and cities could develop alternatives. Several cities are now considering municipal insurance programs. Funds that traditional insurers pay out as dividends to stockholders would be reinvested into the community to finance programs to reduce losses, such as smoke alarms, block-watch programs or better building inspection and fire-fighting services. Loss reserves could be deposited in local financial institutions that are committed to neighborhood investment.

Private insurance cooperatives could be established along the same principles. All these institutions could emphasize employment of local residents, purchases from local businesses and use of local offices to become a vehicle for reinvestment. Although greatly restricted in its operations by the insurance lobby, the long-profitable Wisconsin state life insurance fund has proven what a publicly-owned insurance plan can do. It offers a model that might be followed to combat the long-term but worsening problem of homeowner insurance redlining. ■

Gregory D. Squires and William Velez teach sociology at the University of Wisconsin-Milwaukee.

Individualized law fails in our 'risk-infested' world

By Stephanie Wildman

THE PICTURE MOST OF US HAVE OF the law focuses on individuals—individuals clashing in court, individuals paying other individuals for harming them, individuals charged with violating a law.

That is particularly true regarding accidents, even though, as California Justice Mathew Tobriner said of today's "risk-infested society," "our current crowded and computerized society compels the interdependence of its members."

Underlying modern personal injury law are 19th-century principles that continue to emphasize individual responsibility, using notions such as fault and causation. But in the 20th century, technology has magnified the kind of harm victims may suffer, and the use of insurance and other devices to spread losses have implicitly collectivized responsibility for accidents. Thus legal principles and social reality have diverged.

In the 19th century a growing body of negligence cases firmly established the principle that an injured person must prove that someone responsible for an accident was at fault in order to recover damages. But "fault" is now so ingrained in our thinking it is hard to imagine theoretical alternatives. Yet the law could instead require someone to prove that he or she was not at fault or could require someone involved in an accident to pay regardless of right or wrong. These alternatives penalize activity broadly and seem particularly inappropriate when two individuals are involved.

When two contesting corporations or an individual and a corporation are involved, however, there may be preferable alternatives. Already we have seen how workers' compensation laws and doctrines of strict liability concerning defective products have reduced the emphasis on fault. But "fault" remains central in personal injury law.

With regard to "causation," there is also a conflict of individual and collective responsibility. Nineteenth-century legal writers tried to maintain a doctrine of objective causation to ensure that liability would not be automatically assigned to a rich capitalist defendant with "deep pockets," according to Harvard Law School professor Morton Horwitz. He argues that the doctrine on causation limits legal liability and denies the interdependence of people by focusing on individual responsibility for injuries. Some courts have modified the harshest application of causation doctrine by looking, for example, at a company's market share of a defective drug to assess the likelihood that the company caused an injury.

While some legal doctrines of personal injury law rest on notions of individualism, others spread responsibility more broadly, much as financial responsibility is collectivized by insurance or losses are spread by tax and price policies. The battle over personal injury law reform, like Proposition 51 in California, occurs in this gray area of conflict between older legal doctrines of individual responsibility and a sense of social responsibility for compensation of accident victims.

Proposition 51, approved in a June 3 referendum, eroded the notion of joint and several liability. This doctrine, which had early roots in common law, evolved from cases where wrongdoers acted in concert to harm the victim. Joint and several liability evolved from these cases to be applied in instances where wrongdoers had not acted in concert and might have been held liable independently. Under this interpretation, independent actors could be joined in one legal action for the sake of efficiency; one harm from multiple causes could be settled in one lawsuit.

Thus a victim could bring one suit against a wrongdoer who drove negligently and broke his or her leg and the doctor who mended it negligently. If one defendant was insolvent, then the victim could still be compensated in full by the other. Joint and several liability shared responsibility and thus conflicted with much of the philosophical basis of personal injury law.

If individual responsibility is stressed, victims may never recover enough to pay for their medical care or rehabilitation. In some instances we already socially share responsibility for risks, such as sharing nuclear power risks through pricing and insurance. More generally, we should acknowledge directly that society will take care of accident victims and not leave them victims of the law as well as their accident. ■

Stephanie Wildman is a law professor at the University of San Francisco.

Insurance

Continued from page 7

population increased 8 percent. The oft-cited litigation explosion thus appears to have been exaggerated.

During the period 1981-84, wrote the Center's Robert Roper, "the source of the perception that there is a litigation explosion may be based on a changing mix of civil cases, increased complexity of cases being filed and widespread media reports of enormous awards in relatively few cases."

A study by the Rand Corporation, partially funded by the insurance industry, also concluded that "the per capita filings have remained stable in the past several years."

Some areas do, in fact, experience high concentrations of suits, specifically medical malpractice and products liability. But these are areas where public confidence is low, in many cases deservedly so. In Florida and Texas, some malpracticing doctors continue to treat patients without reprisals. Three percent of Florida's doctors accounted for 48 percent of the money paid, to malpractice victims from 1975 through 1984; one Miami dermatologist settled 34 claims totaling $1.5 million. And in Texas in 1985, out of 669 complaints filed against doctors that year with the state medical board, only 32 led to serious disciplinary measures..

Product liability cases, in which manufacturers are sued for defective products, often grab headlines. The infamous Ford Pinto with its exploding gas tank, the Dalkon Shield that caused 60,000 women to miscarry, and asbestos manufacturing, predicted to cause 20,000 deaths annually until the year 2012, have eroded public confidence in corporate concern for health and safety. The Rand Corporation found that "of all the various external social pressures, product liability has the greatest influence on product design decisions." Thus it appears that it is the constant threat of lawsuits that holds manufacturers accountable.

The absence of an actual lawsuit explosion explains why tort reform has not measurably affected insurance rates. In the state of Washington, for example, strict tort laws were enacted this past spring, only to be followed by additional industry requests for rate hikes. One company's representative informed the Washington insurance commissioner that the 50 percent increase requested would have been 80 percent were it not for the new tort changes.

Iowa abolished joint and several liability during 1983, but today the state faces the same problems of availability found in other states.

In Florida, the state legislature enacted most of the tort restrictions the insurance industry demanded, but coupled them with a rollback in premiums. Several of the largest carriers responded by withdrawing their coverage from the market. Although the tort legislation satisfied them, they did not lower insurance rates.

The predictability of losses that some tort alterations may bring to the insurance industry will likely have only a fleeting impact on the built-in cycle of the insurance industry, which is largely tied to larger economic trends. It will, however, have long-term implications for society. Although tort law changes may affect how many people go to court, they do not address the real issues, mainly those of preventing injuries and fair compensation for injuries incurred. On the contrary, restricting tort law will preclude victims of others' negligence from obtaining adequate compensation, leaving open the question of who is responsible for their care.

Recent insurance industry reports indicate that it is recovering from its latest profit slump, with or without tort reform. Although the liability crisis has abated—at least until the next profit slump—questions remain about the role of the American tort system. In a less hysterical atmosphere, fundamental questions about societal responsibility for injured persons need to be addressed.

Originally, insurance was a way to help diffuse risk by spreading cost among a large number of people. Implicit in this role was a sense of responsibility toward society. But now, in the age of complex technological advances--which can cause unexpected, adverse consequences—spreading risk is increasingly complicated. Recent disasters such as the Bhopal chemical explosion led to large numbers of injuries or deaths. But if insurance companies refuse to underwrite, for example, chemical operations, who will assume the responsibility for potential damage?

It's difficult to imagine any resolution of this question without government intervention. Unfortunately, to date government involvement has focused more on protecting the insurance industry than the public. ■

***Rebecca Lightsey** is a representative of a coalition of public-interest groups in Texas working on the insurance and tort issues. **Margarita Fournier** works with her and is a graduate student at the Lyndon B. Johnson School of Public Affairs in Austin, Texas.*

Mao

Continued from page 13

began his cruel "purges" 10 years before his death, whereas Stalin's "Great Terror" started more than 15 years before he died. Therefore many of the Chinese party workers incarcerated and imprisoned during the years of the "Cultural Revolution" were not only rehabilitated but returned to responsible posts in the '70s.

I don't mean to downplay the contribution of Deng Xiaoping in the renewal of the Chinese economy, society and party. Deng clearly achieved better results in overcoming the Chinese "cult of personality" than Khrushchev was able to achieve with the 20th Party Congress and after it. But who could Khrushchev rely on? The doors of the prisons and camps were open, but most of the people returning home were broken physically, if not in spirit. Among them was not one former member of the Central Committee; they were shot immediately after their arrest or only a little bit later. The only ones still left to the leadership of the country and the party were Molotov, Voroshilov and Kaganovich—and Khrushchev found them much harder to remove from power than the Chinese Gang of Four was for Deng Xiaoping.

History is not a realization of something predestined on high. It is held in the hands of human beings. The responsibility of those who lead great powers is especially heavy. China has not achieved the level of economic and cultural development it might have attained without the "Great Leap Forward" and the "Cultural Revolution," which blocked the development of China and pushed it back into its past. But after Mao's death, China achieved much more than it would have been possible to predict 10 years ago. Changes in the USSR and the People's Republic of China are aiding improvement of relations between them.

It's possible to say with certainty that the memorial to Chairman Mao in Tiananmen Square in Peking will be just as enduring as the mausoleum to V.I. Lenin in Moscow's Red Square. It would be a mistake to enshrine the past or to create new myths around the name of Mao, but it would also be a mistake for us to talk only about the shortcomings and crimes of this person.

I hope that the new Soviet leaders can meet with the new Chinese leaders more than once before this century is over, both in Moscow and Peking. The Chinese leaders will truly consider it an honor to visit the Lenin mausoleum. But likewise a visit to the memorial to Chairman Mao Tse-tung should not be seen as a humiliating procedure to the Soviet leaders. ■

***Roy Medvedev**, author of **Let History Judge** and **On Socialist Democracy** among other works, is the leading public democratic socialist dissident living in the Soviet Union.*

Translated by Alexander Amerisov and Anne Schmitt.

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The Anti-Apartheid Campaign You Can Dance To.

Critics hailed "Sun City" as a powerful musical statement against apartheid. The all-star collaboration features 54 artists, including Little Steven, Bruce Springsteen, Jimmy Cliff, Miles Davis, Bob Dylan and Run-DMC. Together they created a song, an album, a music video, a book and now a 51-minute video cassette.

Now, you can obtain all of these items to inform yourself and others about the struggle for freedom in South Africa. The non-profit Africa Fund, the agency that is distributing the monies raised by "Sun City," offers the records, book and video at a substantial educational discount: 20% off. There's even a teacher's guide to help stimulate discussions in classrooms and communities. It's an ideal way to turn people on to learning more and acting against apartheid.

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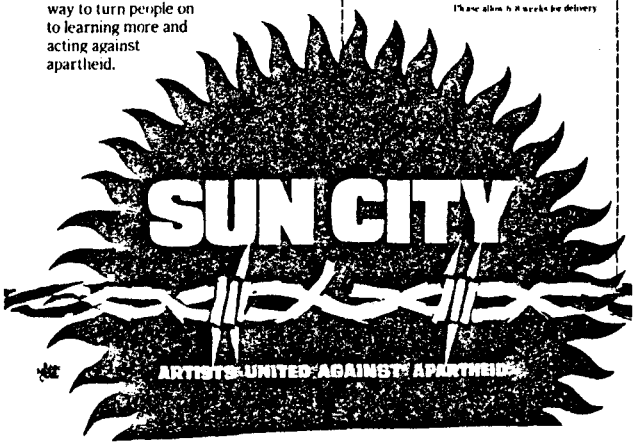

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HEARINGS

BEFORE THE

SUBCOMMITTEE ON ECONOMIC STABILIZATION

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS HOUSE OF REPRESENTATIVES

NINETY-NINTH CONGRESS

SECOND SESSION

PART 1

JULY 23 AND 30; AUGUST 6, 1986

Serial No. 99–98

Printed for the use of the Committee on Banking, Finance and Urban Affairs

U.S. GOVERNMENT PRINTING OFFICE

63-754 O WASHINGTON : 1987

being [illegible]en to certain risks, then American businesses, municipalities, and individuals do not have the necessary financial protection and security that is necessary in order for them to carry out their jobs.

The insurance industry, consumer advocates, and others have offered differing explanations for this liability crisis. The property/casualty insurance industry, which claims it sustained its worst underwriting losses ever at the end of 1984 and 1985, blames the tort system for its recent financial downturn. It argues that its losses are due to a civil justice system that encourages litigation and permits juries to return excessive judgments. Therefore, the industry argues that it needed to raise its premiums to cover these unanticipated losses, and also that it had to reduce its risks by no longer writing certain lines of coverage.

There are also those who dispute the basic contention that the property/casualty industry is suffering genuine financial difficulties. These critics note that the term "underwriting loss" is not synonymous with actual payouts, and contains highly subjective judgments regarding the likelihood of future unreported claims.

Serious differences of opinion also exist regarding the accounting terminology used by the industry, which, some would argue, creates a false picture of the industry's financial well-being. Furthermore, Wall Street's bullish appraisal of the industry's prospects seems starkly at odds with the picture being painted before legislatures across the country in an effort to secure tort reform.

There is also considerable evidence that the insurance industry's cyclical nature and its own cash-flow underwriting practices have caused its recent economic problems. During the "soft market," the industry may have priced its premiums below cost in order to maximize revenues for its investments. Then, when interest rates fell, investment income was no longer sufficient to offset its underwriting losses. Thus, the industry had to raise its prices in order to make up for years of underpricing.

The insurance industry has shown profits on underwriting operations alone in only 8 of the last 25 years. Thus, it seems quite probable that the industry's current financial difficulties are inextricably related to its cyclical nature and pricing policies.

It is imperative that we examine the reasons for this current liability crisis before we endorse a Federal bailout or propose Draconian tort law changes that may have little to do with this crisis.

Therefore, today's hearing will examine the following issues: extent of the liability crisis with respect to availability, affordability, and solvency, and the reasons for it; profitability of the industry over the past 10 years, projections of future profitability, and explanations for these results availability of data and adequacy of the various measures that are used to explain the crisis and the overall financial health of the industry; examination of whether there is any empirically demonstrated correlation between the financial health of the industry and suggested tort changes; and any proposed solutions to the cyclical nature of the industry.

We are fortunate today to have four distinguished witnesses who can speak with authority on these issues: William J. Anderson, Director, General Government Division of the General Accounting Office, who will speak on the results of GAO's indepth studies on the liability insurance industry and its financial and accounting practices; J. Robert Hunter, former head of the Federal Insurance Administration, and president of the National Insurance Consumer Organization, who will speak on the current profitability of the liability insurance industry and the reasons for this liability crisis; A. Michael Frinquelli, managing director of Salomon Bros., Inc., who will present Wall Street's perspective on the industry, including an assessment of its profitability, structure and future prospects; and Thomas Bloom representing National Association of Professional Surplus Lines Offices, Ltd., who will speak on the profitability of the excess surplus insurance industry and its cycles.

I also understand Mr. Frinquelli and Mr. Bloom are accompanied by assistants, whom I did not mention, as is Mr. Anderson. I would ask that their assistants also identify themselves, whom they represent.

Mr. BOUHAN. I am Rick Bouhan with NAPSLO.

Ms. MOYNES. Katherine Moynes, insurance analyst at Salomon Bros.

Mr. GANDHI. I am Nat Gandhi, Group Director for Tax Policy, for the General Accounting Office.

Chairman LAFALCE. We will proceed. We will hear first from the General Accounting Office.

STATEMENT OF WILLIAM J. ANDERSON, DIRECTOR, GENERAL GOVERNMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY NATWAR M. GANDHI, GROUP DIRECTOR/TAX POLICY

Mr. ANDERSON. Good morning, Mr. Chairman.

Chairman LAFALCE. I would advise the witnesses we will put the entire text of your remarks in the record, and you may feel free to summarize those remarks, if that is your desire.

Mr. ANDERSON. Thank you, Mr. Chairman.

I would like to take just a second, if I could, and lay out the credentials of Dr. Gandhi, to my left. I think it is important in assessing what we are talking about today.

Dr. Gandhi is a recognized expert on the taxation of the insurance industry. In fact, he frequently addresses industry groups, such as the Hartford Institute, on insurance. He has been on the faculty of a couple of American universities. He is now on the faculty of the University of Maryland. In fact, he is assisting the conferees on tax reform with those issues that pertain to insurance taxation.

In response to your offer, I would like to have my full statement entered into the record. I have an abbreviated one that I would like to go through and, at the same time, refer to certain exhibits that we will leave here for the committee.

We are pleased for the opportunity to assist the committee in its deliberations on the subject of the property/casualty insurance industry. We will address our remarks to the industry's pricing strategies, industry profitability, the cyclical nature of that profitability, the financial outlook for the industry, and the current difficulties in the industry.

In addressing these issues, we will make the following points: property/casualty companies have used a pricing strategy which sacrificed underwriting profit margins in order to generate cash for investment purposes. As a result of this strategy, the industry has made, depending upon whose estimates are used, between $52 billion and $80 billion in pretax net gains over the last 10 years.

Furthermore, like many other businesses, property/casualty underwriting is subject to profitability cycles. While underwriting losses have mounted since 1980, estimated data for 1985 and the first quarter of 1986 indicate that the underwriting cycle has turned and is now moving in a positive direction. Indeed, the industry itself is projecting substantial net gains over the next 5 years.

The current affordability and availability difficulties in liability insurance are found principally in certain liability insurance lines. The medical malpractice and general liability insurance lines are two lines frequently mentioned by the media within a crisis context. These lines represented less than 9 percent of the total property/casualty business, but more than a quarter of all underwriting losses, over the last 10 years.

I will now discuss these points in greater detail; first, pricing strategies.

A property/casualty company derives its income from two principal areas: underwriting gains, which are the excess of premiums over claims and expenses; and investment gains. Because of investment gains, a property/casualty company can have net income even though its premium revenues alone are not large enough to cover claims and expenses, which are the components of underwriting losses.

Thus, the ability to offset underwriting losses with investment income plays an important role in a company's pricing strategy; that is, the amount it charges for the insurance that it offers. For a number of years, many companies have employed a pricing strategy known as cash-flow underwriting. Basically, companies have been willing to accept lower premiums for certain insurance lines in order to encourage sales and obtain funds for investment.

In essence, the strategy has been to sacrifice underwriting gains to attract more business and thereby enhance investment gains.

From 1976 to 1983, investment gains, in the aggregate, exceeded underwriting losses by a fairly wide margin. However, this situation changed in 1984, when underwriting losses for the industry were $19.4 billion, while investment gains were $17.9 billion. Subsequently, some companies sharply raised premiums. In 1985, underwriting losses increased further to $22.6 billion; however, investment gains increased to $30.2 billion, resulting in total pretax gains of $7.6 billion.

Let me speak to the profitability of the industry. We developed a financial overview of the property/casualty insurance industry using financial data for the 10-year period 1976 through 1985. In the table before you, we show sources of property/casualty income broken out by underwriting gains, investment gains, and total gains, both pretax and aftertax.

This table clearly illustrates the results of the industry's pricing strategy to obtain investment income at the expense of underwriting income. While property/casualty companies had about $65 billion in underwriting losses, they also earned about $144 billion from their investments during this 10-year period. Overall, the industry had a net pretax gain of about $80 billion and an aftertax gain of about $81 billion.

We would like to make two points about our figures which differentiate them from figures developed by others. First, the investment gains include net investment income, and both realized and unrealized capital gains. The chart shows that for the property/casualty industry and for industry generally, as well as certain selected businesses.

Rate of return on net worth is a common measure used by investors in making investment decisions. The rate of return investors expect to earn in order to commit their funds to the property/casualty insurance industry will depend on how they assess the risk of the industry compared to other potential investment opportunities.

Attachment I to my statement shows rate of return data published by the Insurance Information Institute for the 10-year period 1975 to 1984. The attachment shows that the average rate of return for the property/casualty industry was 10.9 percent. Furthermore, the attachment shows how the property/casualty industry's rate of return compared to other industry groups, such as banks, 12.6 percent—transportation, 10.6 percent—and utilities, 11.9 percent, as well as all industry groups combined, 13.2 percent. Return on equity was 1.8 percent in 1984; it was 3.8 percent for 1985.

Perhaps more importantly, it is projected to significantly increase in the next couple of years by certain industry analysts. Salomon Bros. is one that projects that return on equity increasing sharply. But I will get back to that later.

Let me speak to the cyclical nature of the industry. While it is important to look at the figures for the most recent years, it should be noted that over the longer period the property/casualty industry has demonstrated profit and loss cycles. We believe that data covering longer periods give a more complete picture of the industry's profitability.

Attachment II illustrates the cyclical nature of industry profitability. It shows the year-by-year underwriting and investment results for the 12-year period 1974 through 1985. Column 2, "Underwriting Gains and Losses," illustrates the cyclical nature of the industry. The earlier cycle bottomed out in 1975 with a $3.65 billion loss, and peaked in 1978 with a $2.55 billion gain. Since 1980, underwriting losses have mounted again. However, available estimates by the industry and others indicate that the loss cycle bottomed out in 1985, and that the cycle has now turned upward.

I would like to give you a couple of numbers that are not on the chart, Mr. Chairman. They kind of explain what happened over that period of time. I had the staff pull out a couple of numbers for me.

In 1977, the return on municipal bonds was 5.56 percent—5.56 percent. By 1981, that rate of return had gone up to 11.23 percent. A large—about 40 percent of the industry's investments are in municipal bonds. Another 30 percent are in U.S. Treasury paper.

In 1977, the average of 10-year bonds was 7.42 percent. By 1981, that figure was 13.91 percent. So there was a tremendous increase on the returns to be had by nontaxable municipal bonds and on

Treasury bonds. That fed the desire to get cash and take advantage of the high interest rates that were available in these absolutely totally safe tax advantageous papers.

Attachment III illustrates the cyclical nature of the industry over the past 40 years. It is in the statement. I think the important thing is it does show, as indeed everybody observes, that the industry is subject to cyclical fluctuations that result from periods of extreme competitiveness, and then periods where rates are comparably reduced, and then recovery from that stage.

From all indications, it appears that the trend towards larger underwriting ratios has peaked. Available industry estimates show that over the next 5 years, the industry expects substantial net gains. Our calculations, made from industry estimates, indicate an expected net gain before taxes of more than $90 billion over the years 1986 to 1990.

Getting back to that return on equity, which we said was only 1.8 percent in 1984, and only 3.8 percent in 1985, Salomon Bros. projects that that is going to be up around 15 percent, which would equal some of the high, excellent years the industry had back in the seventies, by 1998 or so.

In any event, right now all the industry analysts see a real turnaround.

Chairman LAFALCE. Just so I understand we are talking about apples and apples as opposed to apples and oranges, when you cited the rate on return figures before, you recited figures presented by the Insurance Financial Institute.

Did they not use the statutory returns as opposed to——

Mr. ANDERSON. No, sir; those are GAAP numbers.

Chairman LAFALCE. Reflected in the insurance information?

Mr. ANDERSON. That is correct.

Financial results for the first quarter of 1986 provide evidence of the industry's improved financial condition. During the first quarter of 1986, net premiums written increased 26.5 percent over the first quarter of 1985. A similar comparison shows underwriting losses down 22.7 percent over this same period. For all lines, the combined ratio after dividends was 109.5 percent in the first quarter of 1986, compared to 117.2 percent in the first quarter of 1985.

In other words, the industry indeed has significantly reduced its combined ratio, meaning it has cut its losses, its underwriting losses, quite a bit. We make the point that there has been even a more significant drop in the combined ratios of the malpractice and general liability lines.

It should also be noted that policyholder surplus increased by a record $6.5 billion in the first quarter of 1986. A large part of that represented an influx of new capital, about 5 billion dollars' worth, which indicates that investors see this industry as a place to put their money, as contrasted to other alternatives.

Let me speak briefly to the problems in the medical malpractice and general liability lines. Although the financial outlook for the property/casualty industry as a whole appears favorable, two insurance lines often mentioned as having difficulties in terms of high premiums and lack of availability are medical malpractice and general liability.

The medical malpractice and general liability lines do not represent a major portion of the total property/casualty insurance underwriting business. Attachment IV shows the relationship of these two lines to other property/casualty lines for the 10-year period 1976 to 1985. Medical malpractice premiums accounted for less than 2 percent of all property/casualty premiums written during this 10-year period, and general liability premiums accounted for less than 7 percent.

The figures in this attachment show, however, that as a proportion of all lines, the medical malpractice and general liability lines' losses accounted for over a quarter of all underwriting losses: medical malpractice accounted for 8 percent of total underwriting losses, and general liability, 19.4 percent.

It should be noted, Mr. Chairman, that for those companies specializing in these liability lines, the proportion of the underwriting losses will likely be higher. It should also be noted that this analysis did not include the investment gains applicable to these individual lines.

In conclusion, Mr. Chairman, available financial information shows that, over the long term, the profitability of the property/casualty industry has been cyclical in nature. The data further indicate that over the last 10 years, the industry has been generally profitable. There was an overall loss in 1984; however, the industry projects increasing premiums and more favorable prospects for the next few years. Indeed, the industry returned to profitability in 1985.

That concludes my statement, Mr. Chairman. We would be pleased to respond to questions.

I am sorry I took so long, sir.

[The prepared statement of Mr. Anderson and attachments can be found in the appendix.]

Chairman LAFALCE. That is quite all right. It was a very comprehensive statement. Thank you.

Our next witness will be Mr. Robert Hunter, former head of the Federal Insurance Administration under President Ford, and now president of the National Insurance Consumers Organization.

STATEMENT OF J. ROBERT HUNTER, PRESIDENT, NATIONAL INSURANCE CONSUMER ORGANIZATION

Mr. HUNTER. Thank you, Mr. Chairman, Mr. Shumway. I appreciate the leadership of both of you gentlemen in calling these hearings. I know that the chairman has had a long interest in this subject. I was reading the 1977 hearings in which you asked some of the same questions that are being raised today. If you remember the hearings on product liability.

Chairman LAFALCE. We didn't have as much data as we would like. Everybody said there was a paucity of data. It was interesting to see the underwriting profits the insurance industry made in attachment 3 in 1977 and 1978 at the time they were claiming the worst time of underwriting losses.

According to your figures, those were years of great underwriting profits, much less additional type of profit.

Chairman LAFALCE. Dr. Gandhi, I am rather amazed that the in-urance industry over the past 10 years has made approximately 80 billion and not paid one penny in taxes. How do you account or that? What ought we to do about that?

Mr. GANDHI. Well——

Chairman LAFALCE. It seemed scandalous to me.

Mr. GANDHI. We at GAO have studied the subject and made spe-ific recommendations about what Congress should do about the axation of the insurance casualty industry. Among our recommen-ations, the important recommendation is that they should dis-ount the reserves, which is a very important deduction reducing ne taxable income. The Senate version of the tax bill incorporates ne GAO recommendation.

We also recommended that the acquisition expenses, the ex-enses that they incur, the commission expenses to get new poli-es, those expenses should be pro rated over the life of the con-act and not be allowed to be written off in the year in which nose expenses are incurred.

Most of these accounting practices that are adopted by industry re based upon the NAIC accounting, which is generally highly onservative as an accounting system. In addition to this, the bulk the investment income that the companies earn is coming from ne so-called tax-exempt securities. They are not taxed there either. Then you put all these things——

Chairman LAFALCE. What about dividends? Aren't they able to unt dividends they pay out as losses?

Mr. GANDHI. Yes, they are. But they are considered to be a legiti-ate business expense by the NAIC accounting system.

Chairman LAFALCE. Are other companies able to do that other an the insurance industry?

Mr. GANDHI. No; these are the policyholder dividends. While the vidends that are declared by, say, General Motors are declared to nd paid to the stockholders and are not deductible.

When you add all these practices and also the insurance indus-y's ability to get in and get out of the tax-exempt market, when ou put all these things together, that is why they have not paid xes over the last 10 years.

Chairman LAFALCE. While they have made approximately $80 llion in property casualty alone.

Mr. GANDHI. Yes, sir.

Chairman LAFALCE. Well, the subcommittee has to recess be-use of a call of the House for a vote.

Unfortunately, we will not be able to return. This has been an tremely informative, revealing, enlightening 2-hour period. I ank you very, very much.

[Whereupon, at 12:05 p.m., the subcommittee adjourned, subject the call of the Chair.]

APPENDIX

UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY

Expected about 10:00 a.m.

Wednesday, July 30, 1986

STATEMENT OF

WILLIAM J. ANDERSON, DIRECTOR

GENERAL GOVERNMENT DIVISION

BEFORE THE

SUBCOMMITTEE ON ECONOMIC STABILIZATION

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

HOUSE OF REPRESENTATIVES

ON

PROFITABILITY OF THE PROPERTY/CASUALTY

INSURANCE INDUSTRY

Mr. Chairman Members of the Subcommittee:

We are pleased for the opportunity to assist the Subcommittee in its deliberations on the subject of the property/casualty insurance industry. We will address our remarks today to: (1) the industry's pricing strategies; (2) industry profitability; (3) the cyclical nature of that profitability; (4) the financial outlook for the industry; and (5) the current difficulties in the industry.

In addressing these issues, we will make the following points. Property/casualty companies have used a pricing strategy which sacrificed underwriting profit margins in order to generate cash for investment purposes. As a result of this strategy, the property/casualty industry has made, depending upon whose estimates are used, between $52 and $80 billion in pre-tax net gains over the last 10 years. Furthermore, like many other businesses, property/casualty underwriting is subject to profitability cycles. While underwriting losses have mounted since 1980, estimated data for 1985 and the first quarter of 1986 indicate that the underwriting cycle has turned and is now moving in a positive direction. Indeed, the industry itself is projecting substantial net gains over the next 5 years.

The current affordability and availability difficulties in liability insurance are found principally in certain liability insurance lines. The medical malpractice and general liability insurance lines are two lines frequently mentioned by the media

within a crisis context. These lines represented less than 9 percent of the total property/casualty business, but more than a quarter of all underwriting losses, over the last 10 years.

I will now discuss these points in greater detail. In doing so, I will explain the sources of our data and the scope of our work.

PROPERTY/CASUALTY COMPANY PRICING STRATEGIES

A property/casualty company derives its income from two principal areas: underwriting gains, which are the excess of premiums over claims and expenses, and investment gains. Because of investment gains, a property/casualty company can have net income even though its premium revenues alone are not large enough to cover claims and expenses (underwriting losses).

Thus, the ability to offset underwriting losses with investment income plays an important role in a company's pricing strategy--that is, the amount it charges for the insurance that it offers. For a number of years, many companies have employed a pricing strategy known as "cash flow underwriting". Basically, companies have been willing to accept lower premiums for certain insurance lines in order to encourage sales and obtain funds for investment. In essence, the strategy has been to sacrifice underwriting gains to attract more business and

thereby enhance investment gains. For example, in 1985, claims, expenses, and policyholder dividends exceeded premium revenues by almost 19 percent industry-wide.

Through the increased volume of premiums resulting from this pricing approach, companies were able to generate a larger amount of net cash flow which they could then invest to earn additional investment income. For instance, over the 5-year period 1981-1985, when the industry's claims and expenses exceeded premiums by about 12 percent, its underwriting loss was about $66 billion. Even so, the industry had $97 billion in investment gain which, when offset against its underwriting losses, resulted in a net gain of about $31 billion. The investment gain was made possible, at least in part, by the industry's pricing strategy which generated about $85 billion in net cash flow. The industry was then able to invest these funds at favorable rates.

From 1976 to 1983, investment gains, in the aggregate, exceeded underwriting losses by a fairly wide margin. However, this situation changed in 1984, when underwriting losses for the industry were $19.4 billion, while investment gains were $17.9 billion. Subsequently, some companies sharply raised premiums. In 1985, underwriting losses increased further to $22.6 billion, however, investment gains increased to $30.2 billion resulting in total pre-tax gains of $7.6 billion.

PROFITABILITY OF THE PROPERTY/CASUALTY INDUSTRY

We developed a financial overview of the property/casualty insurance industry using financial data for the 10-year period 1976 through 1985. We obtained the 1976-1985 data from Best's Aggregates and Averages published by the A.M. Best Company. In the table below, we show sources of property/casualty income broken out by underwriting gains, investment gains, and total gains (both pre-tax and after-tax). This table clearly illustrates the results of the industry's pricing strategy to obtain investment income at the expense of underwriting income. While property/casualty companies had about $65 billion in underwriting losses, they also earned about $144 billion from their investments during this 10-year period. Overall, the industry had a net pre-tax gain of about $80 billion and an after-tax gain of about $81 billion.

All Companies -- Consolidated Basis
1976 through 1985
($ in billions)

Underwriting gain	Investment gain	Net gain	Federal income tax	Total gain after-tax
($64.8)	$144.3	$79.5	($1.6)	$81.1

We would like to make two points about our figures which differentiate them from figures developed by others. First, the investment gains include net investment income and both realized and unrealized capital gains. We recognize that unrealized gains are just that, unrealized, and, therefore, are subject to investment risks which could result in lower or higher amounts. However, we have chosen to include unrealized gains in our figures because it is within a company's control to manage its investment portfolio so as to realize these gains while the investments are profitable.

Second, the underwriting losses do not reflect policyholder dividends. We consider these dividends to be voluntary, not mandatory, distributions by the companies. Since the companies are not required to make these distributions, we have chosen to exclude them from our underwriting loss figure.

If we adjusted our figures to exclude unrealized gains and to include policyholder dividends (the approach used by the industry in its calculations), the industry's net gain for this 10-year period would be about $52 billion. In either case, it is within management's discretion to realize investment gains or to not pay policyholders' dividends. This was also the opinion of the National Association of Insurance Commissioners' Investment Income Task Force in 1984.

Another factor that plays a role in assessing the industry's profitability is its "rate of return on net worth." Rate of return on net worth is a common measure used by investors in making investment decisions. The rate of return investors expect to earn in order to commit their funds to the property/casualty insurance industry will depend on how they assess the risk of the industry compared to other potential investment opportunities. Attachment I shows rate of return data publisned by the Insurance Information Institute for the 10-year period 1975-1984. The attachment shows that the average rate of return for the property/casualty industry was 10.9 percent. Furthermore, the attachment shows how the property/casualty industry's rate of return compared to other industry groups such as banks (12.6 percent), transportation (10.6 percent), and utilities (11.9 percent), as well as all industry groups combined (13.2 percent). It should be noted that, in recent years, the rate of return for the property/casualty industry, as compared to other industries, has declined.

CYCLICAL NATURE OF INDUSTRY PROFITABILITY

While it is important to look at the figures for the most recent years, it should be noted that over the longer period the property/casualty industry has demonstrated profit and loss cycles. We believe that data covering longer periods give a more complete picture of the industry's profitability.

Unlike most other industries, the property/casualty insurance industry is flexible with respect to capacity or supply. During profitable periods, insurance companies can increase their capacity, take varied and greater risks, and generally lower their premium rates to achieve a greater market share. Such actions result in price competition as other firms lower their prices to retain their market share. Price competition results in a change from favorable premium profit margins to unfavorable margins, resulting in the underwriting profit and loss cycles.

Attachments II and III illustrate the cyclical nature of property/casualty industry profitability. Attachment II shows the year-by-year underwriting and investment results for the 12-year period from 1974 through 1985. Column 2 in that attachment, underwriting gains and losses, illustrates the cyclical nature of the industry. The earlier cycle bottomed out in 1975 with a $3.65 billion loss and peaked in 1978 with a $2.55 billion gain. Since 1980, underwriting losses have mounted again. However, available estimates by the industry and others indicate that the loss cycle bottomed out in 1985 and that the cycle has now turned upward.

Attachment III illustrates the cyclical nature of property/casualty stock companies over the past 40 years. For purposes of illustration, we used the combined ratio concept, a ratio of claims and expenses to premium income. The attachment reflects the industry's underwriting results and premium pricing

strategy; it does not include investment results. As can be seen, stock companies have had several underwriting cycles since 1945.

FINANCIAL OUTLOOK FOR THE INDUSTRY APPEARS FAVORABLE

From all indications, it appears that the trend towards larger underwriting ratios has peaked. Available industry estimates show that over the next 5 years the industry expects substantial net gains. Our calculations, made from the industry estimates, indicate an expected net gain before taxes of more than $90 billion over the years 1986-1990.

Analysts of the industry also generally predict favorable industry prospects. For example, an August 1985 study by Salomon Brothers, Inc.,[1] forecasts that premiums written will grow at a 12-percent annual rate over the 1985-1989 period. The same study forecasts a 10-percent growth rate for incurred losses over the period. The study forecasts further that total industry profits will rise annually at a rate of 25 percent over the same period. More recently, the A.M. Best Company reported that net premiums written in 1985 had increased by about 22 percent over net premiums written in 1984.

[1]Salomon Brothers, Inc., Property/Casualty Insurance Organizations, Five-Year Review and Outlook, 1985 edition, August 1985.

Financial results for the first quarter of 1986 provide further evidence of the property/casualty industry's improved financial condition.[2] During the first quarter of 1986, net premiums written increased 26.5% over the first quarter of 1985. A similar comparison showed underwriting losses down 22.7% over this same period. For all lines, the combined ratio after dividends was 109.5% in the first quarter of 1986, compared to 117.2% in the first quarter of 1985. In both the medical malpractice and general liability lines, the combined ratios declined 17 points, compared to the 7.7 point decline for all lines. Furthermore, policyholder surplus increased by a record $6.5 billion in the first quarter of 1986.

PROBLEMS IN MEDICAL MALPRACTICE AND GENERAL LIABILITY LINES

Although the financial outlook for the property/casualty industry as a whole appears favorable, two insurance lines often mentioned as having difficulties in terms of high premiums and lack of availability are medical malpractice and general liability. General liability insurance includes coverage of items like day-care centers, asbestos removal, and municipalities.

The medical malpractice and general liability lines do not represent a major portion of the total property/casualty

[2] "First-Quarter Underwriting Results," Best's Review, Property/Casualty Insurance Edition 87 (July 1986): 10, 103.

insurance underwriting business. Attachment IV shows the relationship of these two lines to other property/casualty lines for the 10-year period 1976-1985. Medical malpractice premiums accounted for less than 2 percent of all property/casualty premiums written during this 10-year period and general liability premiums accounted for less than 7 percent. The data were provided by Best's which reports on 27 insurance line categories. For our purposes, we have shown 9 insurance lines separately and grouped the others into an "All other lines" category.

The figures in this attachment show, however, that as a proportion of all lines, the medical malpractice and general liability lines' losses accounted for over a quarter of all underwriting losses: medical malpractice accounted for 8 percent of total underwriting losses and general liability, 19.4 percent. It should be noted, Mr. Chairman, that for those companies specializing in these liability lines, the proportion of the underwriting losses will likely be higher. It should also be noted that this analysis did not include the investment gains applicable to these lines.

CONCLUSION

In conclusion, Mr. Chairman, available financial information shows that, over the long term, the profitability of the property/casualty industry has been cyclical in nature. The data further indicate that over the last 10 years the industry has been generally profitable. There was an overall loss in 1984; however, the industry projects increasing premiums and more favorable prospects for the next few years. Indeed, the industry returned to profitability in 1985.

That concludes my statement, Mr. Chairman. We would be pleased to respond to questions.

ATTACHMENT I

ATTACHMENT I

Average Annual Rates of Return—Net Income After Taxes as Percent of Net Worth for Selected Industries

Year	Property/Casualty Insurance	Banks	Transportation	Utilities	All Industries
1975	2.4%	12.1%	3.7%	9.9%	11.6
1976	10.0	11.5	8.8	10.6	13.3
1977	19.0	11.6	10.1	11.1	13.5
1978	18.1	12.9	13.3	11.3	14.3
1979	15.5	14.1	13.2	12.0	15.9
1980	13.1	13.4	11.3	11.7	14.4
1981	11.8	13.0	13.3	12.7	13.8
1982	8.8	12.0	7.9	12.5	10.9
1983	8.3	12.5	11.6	13.3	10.7
1984	1.8	12.8	12.9	13.4	13.6
Average: 1975–84	10.9%	12.6%	10.6%	11.9%	13.2%

Source: 1985-86 Property/Casualty Fact Book, Insurance Information Institute.

ATTACHMENT II

ATTACHMENT II

Underwriting Gains, Investment Gains, Combined Gains (Pre-tax and After Tax): All Companies — Consolidated Basis[a] Yearly 1974-1985 ($ in millions)

Year	Underwriting gains/losses[b]	Investment gains/losses[c]	Pre-tax total	Federal income tax	After-tax total
1974	($1,974)	($2,443)	($4,417)	($325)	($4,092)
1975	(3,653)	7,009	3,356	(555)	3,911
1976	(1,726)	7,173	5,447	148	5,299
1977	1,926	5,063	6,989	1,015	5,974
1978	2,548	7,758	10,306	1,389	8,917
1979	24	11,610	11,634	896	10,738
1980	(1,712)	15,870	14,158	593	13,565
1981	(4,464)	10,858	6,394	55	6,339
1982	(8,303)	18,387	10,084	(716)	10,800
1983	(11,086)	19,441	8,353	(1,218)	9,571
1984	(19,379)	17,875	(1,504)	(1,732)	228
1985	(22,597)	30,219	7,622	(2,030)	9,652
Totals: 1974-1985	($70,398)	$148,820	$78,422	($2,480)	$80,902
1976-1985	($64,771)	$144,254	$79,483	($1,600)	$81,083

[a]Consolidated totals eliminate double counting by excluding intercompany transactions between parent and subsidiary companies.

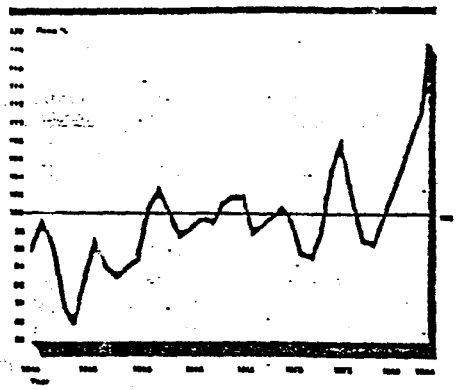
[b]Net earned premiums less losses and expenses.

[c]Net investment income plus realized and unrealized capital gains.

Source: A. M. Best Company

ATTACHMENT III

Combined Underwriting Ratios for Property/Casualty Stock Companies for the Years 1945-84[a]



Year	Ratio %	Year	Ratio %
1945	95.6	1965	101.9
1946	98.8	1966	98.1
1947	96.3	1967	98.9
1948	91.2	1968	100.0
1949	87.6	1969	100.6
1950	93.0	1970	99.3
1951	97.1	1971	95.8
1952	94.4	1972	95.4
1953	93.1	1973	98.2
1954	93.6	1974	105.0
1955	94.9	1975	107.5
1956	100.5	1976	102.0
1957	102.9	1977	97.0
1958	100.0	1978	96.6
1959	97.8	1979	99.6
1960	98.4	1980	102.4
1961	99.4	1981	104.9
1962	99.0	1982	108.7
1963	101.0	1983	111.8
1964	101.9	1984	119.0

[a]A combined ratio is a ratio of claims and expenses to premium income. Ratios below 100 represent underwriting gains and ratios above 100 represent losses.

ATTACHMENT IV

Net Premiums Earned and Underwriting Gains/(Losses) by Line for 1976-1985 ($ in millions)

Insurance lines	Net premiums earned	Premiums as a percent of all lines	Underwriting gains/losses[a]	Underwriting gains/losses as a percent of all lines
Auto liability (Private passenger)	$192,432	20.47%	($16,506)	25.48%
Auto physical damage (Private passenger)	134,515	14.31	809	(1.25)
Workers' compensation	128,099	13.63	(1,584)	2.45
Homeowners multiple peril	96,376	10.25	(3,833)	5.92
Commercial multiple peril	66,002	7.02	(7,015)	10.83
General liability	62,441	6.64	(12,557)	19.39
Auto liability (Commercial)	46,150	4.91	(8,739)	13.49
Auto physical damage (Commercial)	25,599	2.72	(94)	0.15
Medical malpractice	14,143	1.50	(5,176)	7.99
All other lines[b]	174,362	18.55	(10,076)	15.55
Total - all lines	$940,119	100.00%	($64,771)	100.00%
Total investment gains			144,254[c]	
Total gains before taxes			$ 79,483	
Federal income tax			(1,600)	
Total gains after taxes			$ 81,083	

[a]Net premiums earned less losses and expenses.

[b]Includes such lines as reinsurance, group accident and health, burglary and theft and aircraft.

[c]Net investment income plus realized and unrealized capital gains.

Source: A. M. Best Company

The Journal of Commerce
and Commercial
Second Class Postage Paid at N.Y., N.Y. and additional Mailing
★ ★ ★ ★ ★ TUESDAY, OCTOBER 21, 1986 160TH YEAR

No Florida Savings Seen From Tort Law Reform

By LEAH R. YOUNG
Journal of Commerce Staff

WASHINGTON — There will be no insurance savings due to tort law reform in Florida, according to documents filed by Aetna Casualty and Surety Co. and St. Paul Fire and Marine Insurance Co.

The documents, filed with the Florida insurance commissioner, were revealed here by J. Robert Hunter, president of the National Insurance Consumer Organization, a Ralph Nader-affiliated consumer group fighting tort reform.

"Aetna sold the state of Florida a false bill of goods," Mr. Nader told reporters Monday.

The company lobbied for tort law changes saying limitations on the right to sue would affect liability insurance rates, but then "it broke its promise and reported that these changes will not affect insurance rates," Mr. Nader said.

"They have to be lying one way or another," Mr. Hunter told a press conference. Either tort law reform will not save insurance dollars, he said, or it will. But Aetna is now arguing it both ways, he added.

Mr. Hunter suggested that the restrictions in the Florida law would, under his analysis, save about 7%.

Aetna told the Florida commission that limitation of non-economic damages to $450,000 would result in "no reduction of cost. This result is due to the impact of degree of disability on future losses, the impact of policy limits, and the actual settlement reached with the plaintiff.

"All seemed to reduce the expected non-economic component of damages to less than $450,000," Aetna added.

Peter Lefkin, counsel to the American Insurance Association, said in an interview that there are problems with the Florida example.

For starters, he said, the law has been challenged by both the trial bar and the insurance industry and is on appeal before the Florida Supreme Court.

SEE NO, PAGE 16A

No Florida Savings Seen From Tort Law Reform

CONTINUED FROM PAGE 1A

If companies reduce rates for 1987 and the law is overturned, Mr. Lefkin said, "we have to eat up that loss."

There also is fear among companies doing business in Florida that the four year time limit in the law combined with Florida's four year statute of limitations might result in attorneys delaying the filing of suits until the law expires.

But Aetna alluded to this problem in its presentation to the department, saying that if this law is allowed to expire, "the expected reductions will be lower than those indicated in this memorandum."

Aetna told the department that its estimates are based on "future cost reductions if the law as currently structured remains in effect."

Elizabeth Krupnick, a public relations spokesman for Aetna, said many of the tort law changes in Florida were "diluted."

For instance, she said, the collateral source law allows for subrogation, so pay-outs by health insurers and others may be recouped from the liability insurer.

Dale Hazlett, director of the Florida department's Division of Insurance Rating, said his office is reviewing filings received from "many, many" companies, and the task is not completed.

"There are areas where the department will have questions and will require further clarification," he said, adding that the effects of tort reform would be one area. The department, he added, can turn down the requests for increases if the justifications filed by the companies are found to be inadequate.

He also noted that other companies have filed for increases that did include a reductive effect from the tort reform elements of the law.

"The savings from tort reform are only as good as the law that is passed," she said.

Ms. Krupnick contrasted the Florida situation with Aetna's actions after tort law changes in New York and Connecticut.

In New York, she said, Aetna decreased liability rates by 7% while in Connecticut it pulled back expected increases in personal and commercial automobile lines.

She added, too, that another goal of tort reform is increasing availability of insurance, and availability problems are easing where tort reform has been enacted.

A chart produced by Aetna showed that collateral source offset in which other sources of compensation are taken into consideration would have zero effect in products liability bodily injury claims and 0.4% in all other general liability.

Limitations on joint and several liability in which one defendant can be saddled with total pay-out would gain 0% in either category, the chart showed.

Limitations on punitive damages and requiring periodic payment of future economic damage above $250,000 also have no monetary effect on the costs of either products bodily injury or all other general liability.

A similar chart showed no effect on automobile bodily injury claim costs from tort law changes in Florida, either.

In a similar analysis, St. Paul Fire and Marine Insurance Co. concluded that "the non-economic cap of $450,000, joint and several liability on the non-economic damages, and the mandatory structured settlements on losses above $250,000 will produce little or no savings to the tort system as it pertains to medical malpractice."

St. Paul went on to say that it is hopeful that the tort law changes which went into effect July 1 in Florida might have an impact on losses that occur after that date.

But, the company insisted, "to forecast the effect is highly speculative. Our evaluation of prior losses showed little or no savings under key provisions of the law and our analysis of other provisions show no expected savings. Our best estimate is no effect from the tort changes."

In its letter to the Florida Insurance Department, Aetna asked for selected premium increases of 17.2% with annual premium effect of $622,250 on policies written on or after Jan. 1, 1987.

In its presentation to the state insurance department, St. Paul suggested that it might have limited savings in malpractice claims resulting in death.

A 4.5% savings in this one category could result in dollar savings in the state of $420,196 on coverage of physicians and surgeons.

Mr. Hunter surmised that the insurance industry must believe that tort law changes will affect insurance costs since it is lobbying every state legislature and the federal government for changes.

"I think they want to pocket the money," he said of the Florida filings.

He noted, too, that to compile the data, Aetna analyzed claims information and projected the effects of specific tort law changes such as the effect of joint and several liability.

AUTOMOBILE BODILY INJURY CLAIM COST IMPACT OF FLORIDA TORT LAW CHANGE

Summary

The following table summarizes the expected impact of the new Florida law on automobile bodily injury claims costs (including Allocated Loss Adjustment Expenses). The impacts shown were developed from data gathered via a special claim study conducted by the AEtna. The claim study and the analysis are detailed in the succeeding sections of this memorandum.

Impact of Tort Law Changes

Tort Law Change	Automobile Bodily Injury
Collateral Source Offset	0
Joint & Several	0
Limitation of Noneconomic Damages to $450,000	0
Punitive Damages	0
Future Economic Damages over $250,000 Paid at Present Value	0

The analysis as shown is based solely on AEtna data and, therefore, is applicable only to AEtna's book of business.

Claim Study

The attached special claim analysis form, designed to gather data on the impact of the tort reforms, was completed by experienced Branch Office claim personnel. Claims eligible for analysis were selected according to the following criteria:

1. Commercial Casualty automobile bodily injury claims (excluding National Accounts business) for policy years 1981 through 1985
   a. reported prior to January 1, 1986
   b. open as of May, 1986
   c. closed during the last six months

2. All claims in category (1) with indemnity payments or reserves over $25,000 were analyzed (total of 39 claims).

3. Twenty closed claims with indemnity of less that $25,000 were randomly selected.

The completed forms were reviewed for internal consistency prior to coding and analysis.

Commercial Insurance Division
151 Farmington Avenue
Hartford, CT 06156
(203) 273-0123

August 8, 1986

FCC-86-2172

RECEIVED
AUG 13
FORMS AND CONTRACTS

Honorable Bill Gunter
INSURANCE COMMISSIONER
Florida Department of Insurance
Tallahassee, FL 32301

ATTN: Mr. Charlie Gray, Chief
Bureau of Policy and Contract Review

Dear Mr. Gray:

RATE REVISION
CONTRACTORS LIABILITY POLICY PROGRAM
THE AETNA CASUALTY AND SURETY COMPANY
THE STANDARD FIRE INSURANCE COMPANY
THE AUTOMOBILE INSURANCE COMPANY OF HARTFORD, CONNECTICUT

In accordance with your Insurance Laws, our Companies file a revised liability rate level which results in an overall selected premium increase of 17.2% with an annual premium effect of $622,250.

Our Companies' decision to revise rates results only after a thorough and comprehensive analysis. We evaluated our experience, market conditions, tort reform, and other relevant factors as they affect the establishment of adequate rate levels. The enclosed exhibits prepared by actuarial unit are submitted in support of our rate filing decision, and demonstrate that the resultant rates are neither excessive, inadequate, nor unfairly discriminatory.

We propose to implement this filing with respect to all policies written on or after January 1, 1987. So as to not delay the filing of our rate level decision, revised rate pages will be forwarded under separate cover when available.

A stamped, self-addressed envelope is enclosed for your convenience in responding.

Sincerely,

Thomas L. Rudd

Thomas L. Rudd, Superintendent
Insurance Department Affairs - Commercial Lines

BODILY INJURY CLAIM COST IMPACT OF FLORIDA TORT LAW CHANGE

Summary

The following table summarizes the expected impact of the new Florida law on bodily injury claims costs (including Allocated Loss Adjustment Expenses). The impacts shown were developed from data gathered via a special claim study conducted by the AEtna. The claim study and the analysis are detailed in the succeeding sections of this memorandum.

Impact of Tort Law Changes

Impact of Tort Law Changes

Tort Law Change	Line of Business: Products Bodily Injury	Line of Business: All Other General Liability
Collateral Source Offset	0	(0.4%)
Joint & Several	0	0
Limitation of Noneconomic Damages to $450,000	0	0
Punitive Damages	0	0
Future Economic Damages over $250,000 Paid at Present Value	0	0

All Other General Liability includes the bodily injury liability portion of package policies, SMP Section II, and monoline General Liability policies. The analysis as shown is based solely on AEtna data and, therefore, is applicable only to AEtna's book of business.

Claim Study

The attached special claim analysis form, designed to gather data on the impact of the tort reforms, was completed by experienced Branch Office claim personnel. Claims eligible for analysis were selected according to the following criteria:

1. Commercial Casualty claims (excluding National Accounts business) for policy years 1981 through 1985
   a. reported prior to January 1, 1986
   b. open as of May, 1986
   c. closed during the last six months

2. All claims in category (1) with indemnity payments or reserves over $25,000 were analyzed (total of 55 claims).

3. Fifty closed claims with indemnity of less that $25,000 were randomly selected.

The completed forms were reviewed for internal consistency prior to coding and analysis.

Collateral Source Analysis

Exhibits I and II detail the analysis of the revision in the collateral source rules. Exhibit I is for claims over $25,000 indemnity. Exhibit II is for claims under $25,000 indemnity.

Exhibit I shows that since the right of subrogation exists for many collateral sources available to the plaintiff, the economic losses incurred are not expected to be substantially reduced due to the law change. Furthermore, current AEtna claim settlement practices recognize, in part, the existence of collateral sources as part of the negotiating process used in arriving at a mutually satisfactory damage value with the plaintiff.

Exhibit II shows that for claims under $25,000, no additional savings are expected due to the change in Florida law.

Joint and Several Analysis

Exhibit III details the analysis of joint and several additional payments made by AEtna. Total joint and several payments were 4.5% of indemnity payments over $25,000. A review of each claim generating additional payments due to joint and several liability indicated no reduction in those payment due to the interaction of economic damages sustained by the plaintiff, the percentage of liability assigned to AEtna's insured, and the policy limits purchased.

Analysis of Limitation of Noneconomic Damages to $450,000

Nine claims had the potential for coming under the new limitation for noneconomic losses. The nine cases were identified on the basis of full liability value—not our insured's share of the liability. Data in the above format allowed for a review of whether total claim value could be reduced and whether such a reduction would impact on AEtna's incurred claim cost.

The review of the actual data submitted on these cases indicated no reduction of cost. This result is due to the impact of degree of disability on future losses, the impact of policy limits, and the actual settlement reached with the plaintiff; all seemed to reduce the expected noneconomic component of damages to less than $450,000.

Analysis of Punitive Damages

Only two cases were found where punitive damages had an impact on the claim settlement value. The total impact was estimated at less than $15,000 or less than 0.1% of total indemnity payments. Consequently, it appears that there will be no impact on AEtna's claim values due to changes in the allocation of the punitive damages awarded.

Analysis of Installment Payment of Future Economic Damages Over $250,000

Ten claims had the potential for coming under this section of the law. The review of individual cases indicated no net savings to AEtna for the following reasons:

1. interaction of policy limits, past economic losses, and future economic losses

2. settlement value of the case

3. apparent implicit recognition of the periodic nature of future damages

Overall Summary

The expected net reduction in claim costs is based on an analysis of AEtna claims. As such, the analysis is applicable only to AEtna's book of business.

Due to the level of detail of the historical claim data, informed claim judgement was required in some instances to ascertain some of the detail required for the analysis. The judgement, if any, was exercised by experienced claim adjustors and is implicit in the analysis.

The analysis shown represents the best estimate of future cost reductions if the law as currently structured remains in effect. However, the sunset provision of the law takes effect in four years. Furthermore, the law applies only to cases filed under the law, and the Florida statute of limitations is four years. Consequently, it is possible that any plaintiff who might be severely impacted by the provisions of the law would delay filing until after the law expires. If this situation arises, then the expected reductions will be lower than those indicated in this memorandum.

EXHIBIT I

FLORIDA

COLLATERAL SOURCES - CLAIMS OVER $25,000

	Products	All Other
Economic Paid	$ 206,000	$ 1,854,000
Future Economic	466,000	2,567,000
General	624,000	11,960,000
Total Indemnity	1,296,000	16,380,000
Claims with Collateral Sources	628,000	4,187,000
Claims with Collateral Sources and with Liens	255,000	1,987,000
Claims with Collateral Sources and without Liens	378,000	2,200,000
% of Claims with Collateral Sources Available	28.8%	13.4%
Estimated Reimbursement Rate	50%	50%
Economic as % of Total Indicated	51.9%	27.0%
% of Indicated which could be Reduced	7.5%	1.8%
Claims with Collateral Sources without Liens - subject to:		
Statutory Liens	378,000	1,132,000
Contractual Liens	0	100,000
Not Subject to Liens	0	949,000
% Not Subject to Liens	0%	43.1%
Claims with Collateral Sources not Subject to Liens where Collateral Sources had an Impact on Settlement	N/A	556,000
Estimated Impact	N/A	28,000
Estimated Impact - % of Total Award	N/A	5%
Net Reduction to Collateral Source Savings Due to Right of Subrogation	7.5%	1.0%*
Previously Recognized Collateral Sources	N/A	0.2%
Net Impact of Collateral Source Changes	0	0.8%

*(1.0 - .431) x 1.8%

EXHIBIT I
(cont.)

Net Impact of Collateral Source Offset on Claims Over $25,000 Adjusted to Total Loss Costs, including Allocated Loss Adjustment Expense

$25,000 and over Claims Dollars as a % of Total Claims Dollars (est.)	75%
Estimated Allocated Expense as % Total Loss x ALAE	33%
Net Impact of Total Loss and ALAE: 0.8% x .75 x (1 - .33) =	0.4%

EXHIBIT II

FLORIDA

COLLATERAL SOURCES - CLAIMS UNDER $25,000
WITH COLLATERAL SOURCES

	Products	All Other
Total Indemnity Paid - Claims with Collateral Sources	$ 36,500	$149,215
Indemnity Paid on Claims with Liens	5,000	16,300
Indemnity Paid on Claims without Liens but with Right of Subrogation		
Statutory	13,500	33,750
Contractual	0	67,200
Indemnity Paid on Claims not Subject to Subrogation where Collateral Sources Influenced Settlement	18,000	29,965
Net Indemnity Payments where Some Offset Could be Made	0	2,000
Total Indemnity for Claims Less Than $25,000	170,648	816,506
% of Total Indemnity Available for Additional Offset	0	0.2%
Estimated Additional Offset for Claims Under $25,000 Adjusted to Total Loss Costs Including Allocated Loss Adjustment Expense (cf Exhibit I) (0.2% x .25 x (1 - .33)) =	0	0.0%

EXHIBIT III

FLORIDA

JOINT & SEVERAL PAYMENTS
CLAIMS OVER $25,000

	Products	All Other
Total Indemnity Payments	$1,296,000	$16,380,000
Additional Payments Due to Joint & Several	232,000	568,000
Reduction in Potential Savings Due to File Review	232,000 *	568,000 **
Net Savings	0	0

*1 Claim - death case - expected economic losses high enough to cover additional payment

**2 Claims - 1 death case - estimated settlement value may be close to economic value; therefore, additional payment of $193,000 would still be required (policy limits paid out at that time)

1 permanent total case - estimated settlements probably will cover custodial care (i.e., economic loss); therefore, no savings due to law change.

CLAIM REVIEW DATA ELEMENTS

	CLAIMANTS 1	2	3
Claim Number:	_____	_____	_____
Policy Number:	_____	_____	_____
Policy Limit ($):	_____	_____	_____
Claimant Name:	_____	_____	_____
Policyholder Name:	_____	_____	_____
State of Accident:	_____	_____	_____
Date of Accident (mm/dd/yy):	_____	_____	_____
Date Reported (mm/dd/yy):	_____	_____	_____
Date Closed (mm/dd/yy):	_____	_____	_____
RESERVE			
Incurred Indemnity ($)	_____	_____	_____
Incurred Expense ($)	_____	_____	_____
POLICY COVERAGE ISSUES - yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
Impact on settlement - major	[ ]	[ ]	[ ]
minimal	[ ]	[ ]	[ ]
CLAIMANT INFORMATION			
Date of Birth - (mm/dd/yy)	_____	_____	_____
Injured in Course of Employment? yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
Did Claimant return to work? yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
male/female:	_____	_____	_____
married: yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
INJURY INFORMATION (DISABILITY)			
1. None	[ ]	[ ]	[ ]
2. Temporary Total	[ ]	[ ]	[ ]
3. Temporary Partial	[ ]	[ ]	[ ]
4. Permanent Partial	[ ]	[ ]	[ ]
5. Permanent Total	[ ]	[ ]	[ ]
6. Death	[ ]	[ ]	[ ]
COLLATERAL SOURCES			
Available: yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
Type of Source:			
Medicare	[ ]	[ ]	[ ]
Social Security	[ ]	[ ]	[ ]
Group Health	[ ]	[ ]	[ ]
Blue Cross/Blue Shield	[ ]	[ ]	[ ]
Workers Compensation	[ ]	[ ]	[ ]
No Fault	[ ]	[ ]	[ ]
Wage Continuation	[ ]	[ ]	[ ]
Other	[ ]	[ ]	[ ]
Amounts Paid ($)	_____	_____	_____

	CLAIMANTS 1	2	3
Lien: yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
statutory	[ ]	[ ]	[ ]
contractual	[ ]	[ ]	[ ]
Did presence of collateral sources influence settlement value? yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
Impact on settlement: major	[ ]	[ ]	[ ]
minimal	[ ]	[ ]	[ ]

DEFENDANT INFORMATION

	DEFENDANTS 1	2	3
Multiple Defendants: yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
% Liability assessed to Plaintiff:	_____	_____	_____
% Liability assessed to each defendant:	_____	_____	_____
Were any defendants unable to pay? yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
If yes - % of Liability:	_____	_____	_____

SUIT INFORMATION

	CLAIMANTS 1	2	3
Was a suit filed? yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
If yes, disposition of suit:			
1. Settled prior to trial	[ ]	[ ]	[ ]
2. Settled during trial	[ ]	[ ]	[ ]
3. Plaintiff verdict	[ ]	[ ]	[ ]
4. Defense verdict	[ ]	[ ]	[ ]
5. Appeal	[ ]	[ ]	[ ]
6. Other	[ ]	[ ]	[ ]
Amount ($):	_____	_____	_____

DAMAGES

1. Specials			
a. Medical ($)			
Present:	_____	_____	_____
Future:	_____	_____	_____
b. Loss Income ($)			
Present	_____	_____	_____
Future	_____	_____	_____
c. Other ($)			
Present:	_____	_____	_____
Future:	_____	_____	_____

2. General Damages

a. Pain and Suffering ($)	_____	_____	_____
b. Permanency/Disfigurement ($)	_____	_____	_____

	CLAIMANTS 1	2	3
3. Punitive(Exemplary) Damages			
a. Alleged - yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
b. Granted - yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
c. Influence on settlement - yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
major	[ ]	[ ]	[ ]
minor	[ ]	[ ]	[ ]
4. Prejudgment Interest - yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
If yes, what was the amount?	_____	_____	_____
ESTIMATED DAMAGE VALUE(Full Liability):	_____	_____	_____
ESTIMATED SETTLEMENT VALUE:	_____	_____	_____
Joint and Several Additional Payments:			
yes	[ ]	[ ]	[ ]
no	[ ]	[ ]	[ ]
If yes, what was the amount?	_____	_____	_____

St. Paul Fire and Marine Insurance Company
St. Paul Mercury Insurance Company
Medical Professional Liability
State of Florida

ADDENDUM

In 1986, Florida passed a number of changes to the tort system. We have reviewed the tort changes and their potential effect on our medical professional liability experience. Our review is based on a study of over 300 Florida closed claims. The total effect of the bill based on this evaluation was very small.

Evaluation:

Of the 313 closed claims that were studied, only four claims would have been effected by the law for a total effect of about 1% savings. (Exhibit A) Furthermore, all of these savings would have been eliminated if the courts had assigned only 10% more of the blame on our insureds than our claim department had estimated. It's highly likely that there would have been no savings on these claims had the bill been in effect. (Exhibit B)

Our study covered all of our Florida physicians, surgeons and hospital claims that closed in 1983 and 1984. Economic loss was determined based on the plaintiff's medical loss, weekly wage, and time lost from work. These losses were reduced for the time value of money.

We added the noneconomic loss cap to the total economic losses. The cap is $450,000 times the portion of negligence assigned to our insured. We compared this maximum award under the new law to the amount that the St. Paul actually paid on behalf of our insured.

The conclusion of the study is that the noneconomic cap of $450,000, joint and several liability on the noneconomic damages, and mandatory structured settlements on losses above $250,000 will produce little or no savings to the tort system as it pertains to medical malpractice.

Comments on other provisions of the bill:

a. Collateral source offset

The medical malpractice provisions prior to this act provided for subrogation against collateral providers. The effect of this subrogation would be similar to the effect of the collateral source rule. Therefore, the net effect of eliminating the subrogation and allowing collateral sources is negligible.

b. Itemization of Damages

Damages were itemized in our evaluation of this tort reform and no savings were shown. They are probably already implicitly itemized by either juries or our claim department when settling claims. We expect no savings from this provision.

St. Paul Fire and Marine Insurance Company
St. Paul Mercury Insurance Company
Medical Professional Liability
State of Florida

ADDENDUM
(Continued)

c. Frivolous Suit Protection

This provision can either work for or against us depending on who wins the case. No savings are expected from it.

d. Additur/Remittitur

This provision can also work for or against us. No savings are expected.

e. Punitive Damages

The legislation reduces the monetary incentive for punitive damage cases, but not total award amounts. Since these cases often have a retaliatory incentive, no savings are expected.

f. Timing of Effects

The tort changes made in Florida apply to losses occurring on or after July 1, 1986. On a claims-made policy, they will effect only the portion of our expected losses with accident date after July 1, 1986. This will impact the equivalent of our first year losses.

g. Conclusion

The tort law changes effective July 1, 1986 in Florida will, hopefully, have a positive impact on loss costs for occurrences after that date. However, to forecast the effect is highly speculative. Our evaluation of prior losses showed little or no savings under key provisions of the law and our analysis of other provisions show no expected savings. Our best estimate is no effect from the tort changes.

It can be hoped that the adoption of these tort changes will have an intangible effect on society, and further work to mitigate future loss trends. However, the trends in medical malpractice have been very high. The effect of the reform needs to be very strong to stem such trends.

Exhibit A

FLORIDA STATE TORT REFORM EVALUATION

EFFECT OF NONECONOMIC DAMAGES CAP, APPORTIONMENT OF LIABILITY, AND MANDATORY STRUCTURED SETTLEMENTS

FLORIDA PHYSICIANS' AND SURGEONS' DATA

LOSS SEVERITY	1984 INCURRED LOSS & LAE	PROJECTED PERCENTAGE SAVINGS	PROJECTED LOSS DOLLAR SAVINGS
EMOTIONAL	$759,962	0.0%	$0
TEMPORARY	$5,867,384	0.0%	$0
PERMANENT PARTIAL	$12,424,121	0.0%	$0
PERMANENT TOTAL	$8,347,000	0.0%	$0
DEATH	$9,337,688	4.5%	$420,196
TOTAL	$36,736,155	1.1%	$420,196

COUNTRYWIDE PHYSICIANS' AND SURGEONS' DATA

LOSS SEVERITY	1985 INCURRED LOSS & LAE	PROJECTED PERCENTAGE SAVINGS	PROJECTED LOSS DOLLAR SAVINGS
EMOTIONAL	$8,217,941	0.0%	$0
TEMPORARY	$81,499,529	0.0%	$0
PERMANENT PARTIAL	$110,004,377	0.0%	$0
PERMANENT TOTAL	$80,695,313	0.0%	$0
DEATH	$99,481,842	4.5%	$4,476,683
TOTAL	$379,899,002	1.2%	$4,476,683

Medical Professional Liability
State of Florida

Exhibit B

FLORIDA CLOSED CLAIM STUDY

CLAIMS PRODUCING SAVINGS UNDER JULY 1,1986 LEGISLATION

LOSS SEVERITY	ECONOMIC LOSS	INSURED NEGLIGENCE	INDEMNITY PAYMENT	NONECONOMIC CAP	PROJECTED SAVINGS
TEMPORARY	$0	0%	$66	$0	$66
TEMPORARY	$0	0%	$194	$0	$194
DEATH	$10,000	3%	$38,975	$11,250	$17,725
DEATH	$5,000	25%	$350,000	$112,500	$232,500

CLAIMS PRODUCING SAVINGS UNDER JULY 1,1986 LEGISLATION
ASSUMING 10% GRLATER LIABILITY ASSIGNED TO INSURED

LOSS SEVERITY	ECONOMIC LOSS	INSURED NEGLIGENCE	INDEMNITY PAYMENT	NONECONOMIC CAP	PROJECTED SAVINGS
TEMPORARY	$0	10%	$66	$45,000	$0
TEMPORARY	$0	10%	$194	$45,000	$0
DEATH	$10,000	13%	$38,975	$56,250	$0
DEATH	$5,000	35%	$350,000	$450,000*	$0

* INSURED LIABILITY EXCEEDS CLAIMANT LIABILITY

EXHIBIT 6(a)
DATE 2/12/87
HB 420

Embargo until 11 AM, Tuesday, December 9, 1986
For information contact:
Bob Hunter - (305) 239-4200
Jay Angoff - (703) 549-8050

NATIONAL INSURANCE CONSUMER ORGANIZATION

Tort Reform Will Not Reduce Insurance Rates, Say 100+ Florida Insurers

More than 100 insurance companies have told the Florida Insurance Department that the state's recently enacted "tort reform" law will reduce general liability insurance premiums by an average of just over 1%, according to newly-released documents filed with and analyzed by the Florida Insurance Department.

At the annual meeting of the National Association of Insurance Commissioners in Orlando, Florida, National Insurance Consumer Organization President J. Robert Hunter released a summary of 277 filings by 104 insurers licensed in Florida which calculate the effect of the 1986 Florida tort reform law. 175 of the filings, or 63%, show no savings from tort reform, while none show a savings of more than 10%. The average reduction for all property/casualty lines was 1.2%; for general liability -- which includes day-care, municipal and products liability -- the average reduction was 1.3%. In contrast, Florida general liability insurers increased premiums by an estimated 120% in 1985 and 1986.

Hunter also released documents prepared by State Farm Fire and Casualty Co., Great American West, Inc., and the Insurance Services Office -- the insurance industry group that issues "advisory" rates -- demonstrating that tort reform in general would have little or no effect on rates. State Farm, for example, told the Kansas Insurance Department that restricting joint and several liability and limiting punitive damages would have no impact, while capping damages for pain

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Alexandria, Virginia 22314
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and suffering would reduce rates by no more than 1%. Great American West, on the other hand, told the Washington Insurance Department that tort reform could well raise rates.

The Insurance Services Office said its advisory rates would not reflect any reduction due to tort reform, and emphasized to its member companies that "any beneficial effects of tort reform cannot be quantified with any degree of accuracy" (emphasis ISO's). On the other hand, when in 1975 New York enacted tort reform that would expand liability and thus raise insurance costs, ISO immediately raised its advisory rates by 5% and provided complete actuarial justification for the increase, according to another document released by Hunter.

"It is ironic that ISO can tell us how much rates should rise when tort law expands, but can't tell us how much rates should fall when tort law is limited," Hunter said.

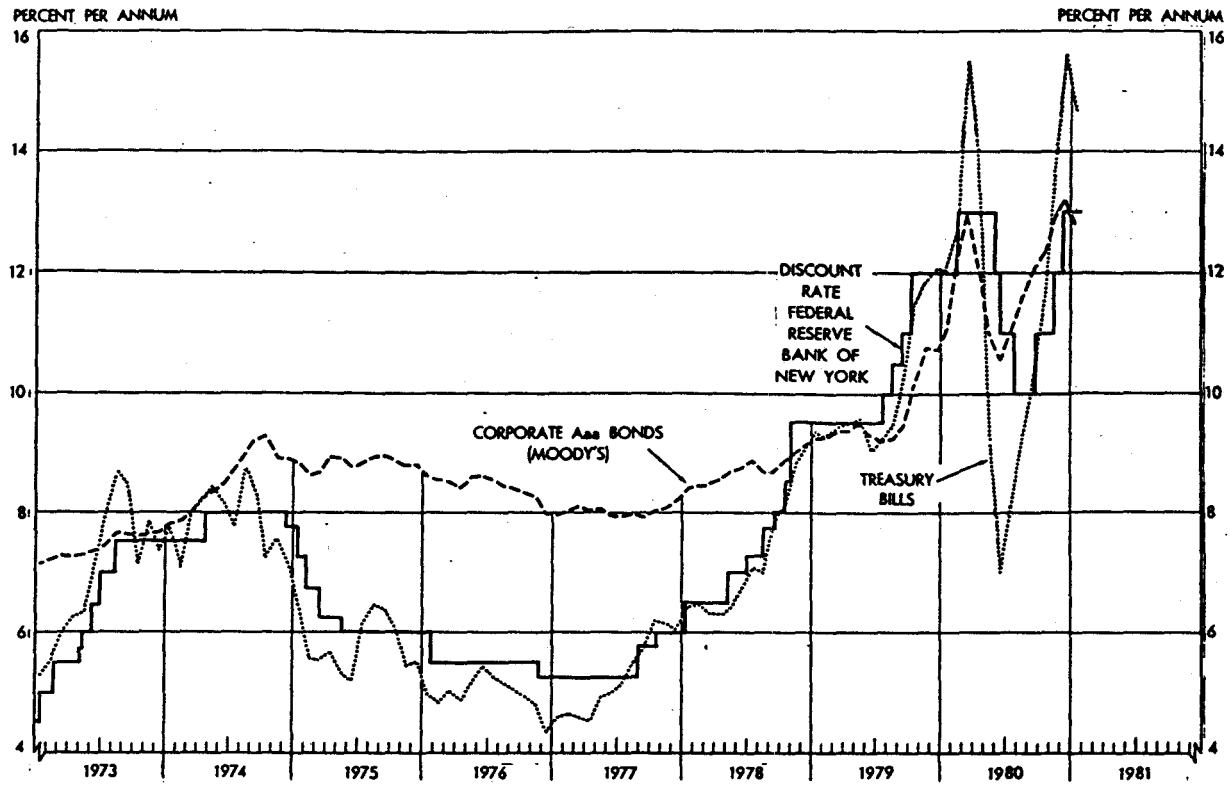
On the basis of the State Farm, Great American West, Florida Insurance Department and ISO documents, as well as previously released rate filings by Aetna and St. Paul, Hunter asked the President of the NAIC to take emergency action to ensure that insurance commissioners in states enacting tort reform roll back all rate increases that have taken effect since the reforms were enacted. "While reasonable minds may differ on whether it is good public policy to reduce insurance rates by limiting compensation to seriously injured people, it is surely not good policy to limit compensation to injury victims and get nothing in return," Hunter said.

The National Insurance Consumer Organization is an independent, non-profit, non-partisan consumer organization which monitors the insurance industry. It was founded by Hunter, an actuary and a former Federal Insurance Administrator, in 1980.

EXHIBIT 6(b)
DATE 2/12/81
HB 420

INTEREST RATES AND BOND YIELDS

Short-term interest rates came down somewhat in January and early February from their December peaks, but longer-term bond yields registered smaller declines.



SOURCE: SEE TABLE BELOW

COUNCIL OF ECONOMIC ADVISERS

[Percent per annum]

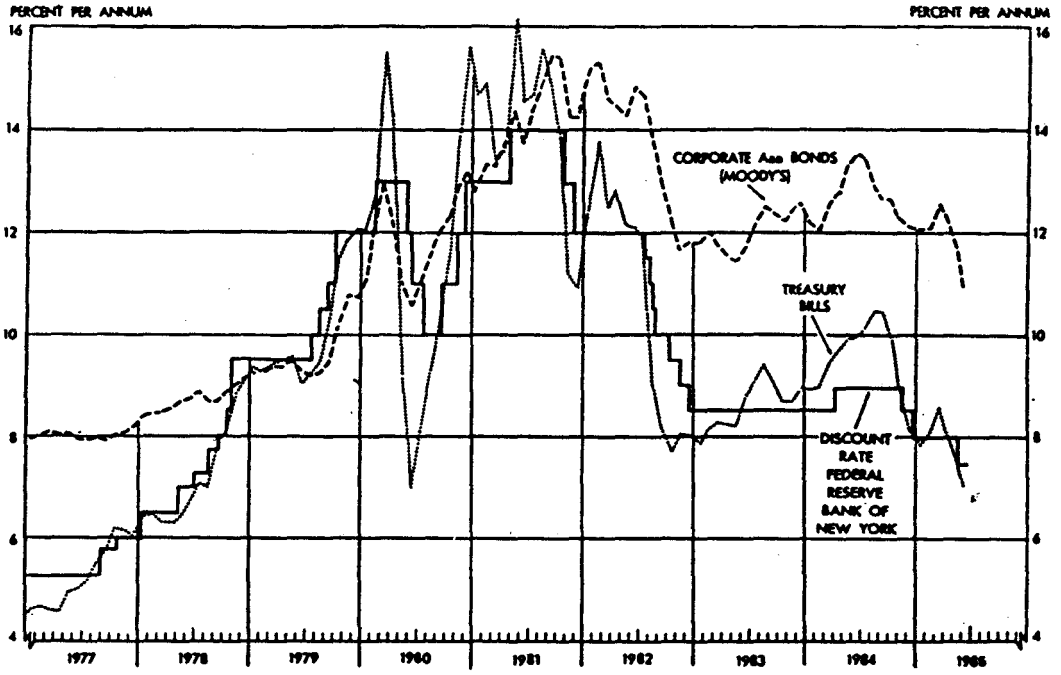
Period	U.S. Treasury security yields: 3-month bills [1]	Constant maturities [2]: 3-year	Constant maturities [2]: 10-year	High-grade municipal bonds (Standard & Poor's) [3]	Corporate Aaa bonds (Moody's)	Prime commercial paper, 4–6 months [4]	Discount rate (N.Y. F.R. Bank) [5]	Prime rate charged by banks [5]	New-home mortgage yields (FHLBB) [6]
1975	5.838	7.49	7.99	6.89	8.83	6.33	6.25	7.86	9.01
1976	4.989	6.77	7.61	6.49	8.43	5.35	5.50	6.84	8.99
1977	5.265	6.69	7.42	5.56	8.02	5.60	5.46	6.83	9.01
1978	7.221	8.29	8.41	5.90	8.73	7.99	7.46	9.06	9.54
1979	10.041	9.71	9.44	6.39	9.63	[4] 10.91	10.28	12.67	10.77
1980	11.506	11.55	11.46	8.51	11.94	12.29	11.77	15.27	12.65
1980: Jan	12.036	10.88	10.80	7.21	11.09	12.66	12–12	15¼–15¼	11.87
Feb	12.814	12.84	12.41	8.04	12.38	13.60	12–13	15¼–16¾	11.93
Mar	15.526	14.05	12.75	9.09	12.96	16.50	13–13	16¾–19½	12.62
Apr	14.003	12.02	11.47	8.40	12.04	14.93	13–13	19½–19½	13.03
May	9.150	9.44	10.18	7.37	10.99	9.29	13–12	*18½–14	13.68
June	6.995	8.91	9.78	7.60	10.58	8.03	12–11	14–12	12.66
July	8.126	9.27	10.25	8.08	11.07	8.29	11–10	12–11	12.48
Aug	9.259	10.63	11.10	8.62	11.64	9.61	10–10	11–11½	12.25
Sept	10.321	11.57	11.51	8.95	12.02	11.04	10–11	11½–13	12.35
Oct	11.580	12.01	11.75	9.11	12.31	12.32	11–11	13½–14½	12.61
Nov	13.888	13.31	12.68	9.55	12.97	14.73	11–12	14½–17¾	13.04
Dec	15.661	13.65	12.84	10.09	13.21	16.49	12–13	17¾–21½	13.28
1981: Jan	14.724	13.01	12.57	9.65	12.81	15.10	13–13	21½–20	13.28
Week ended:									
1981: Jan 10	13.601	12.72	12.31	9.57	12.59	14.66	13–13	20½–20	----------
17	15.318	12.91	12.53	9.47	12.76	15.35	13–13	20–20	----------
24	15.595	13.32	12.72	9.66	12.91	15.40	13–13	20–20	----------
31	15.199	13.13	12.74	9.89	12.98	15.02	13–13	20–20	----------
Feb 7	14.657	13.41	12.95	9.85	13.07	14.90	13–13	20–19½	----------
Feb 14	15,397	----------	----------	----------	----------	----------	13–	19½–	----------

[1] Rate on new issues within period; bank-discount basis.
[2] Yields on the more actively traded issues adjusted to constant maturities by the Treasury Department.
[3] Weekly data are Wednesday figures.
[4] Beginning November 1, 1979, data are for 6 months paper.
[5] Average effective rate for year; opening and closing rate for month and week.
[6] Effective rate (in the primary market) on conventional mortgages, reflecting fees and charges as well as contract rate and assumed, on the average, repayment at end of 10 years. Rates beginning January 1973 not strictly comparable with prior rates.
* Range of 18½–19.

Sources: Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Home Loan Bank Board, Moody's Investors Service, and Standard & Poor's Corporation.

INTEREST RATES AND BOND YIELDS

Interest rates fell again in June.



SOURCE: SEE TABLE BELOW

COUNCIL OF ECONOMIC ADVISERS

[Percent per annum]

Period	U.S. Treasury security yields			High-grade municipal bonds (Standard & Poor's) [3]	Corporate Aaa bonds (Moody's) [4]	Prime commercial paper, 6 months [5]	Discount rate (N.Y. F.R. Bank) [6]	Prime rate charged by banks [6]	New-home mortgage yields (FHLBB) [7]
	3-month bills [1]	Constant maturities [2]							
		3-year	10-year						
1979	10.041	9.72	9.44	6.39	9.63	10.91	10.28	12.67	10.78
1980	11.506	11.55	11.46	8.51	11.94	12.29	11.77	15.27	12.66
1981	14.029	14.44	13.91	11.23	14.17	14.76	13.41	18.87	14.70
1982	10.686	12.92	13.00	11.57	13.79	11.89	11.02	14.86	15.14
1983	8.63	10.45	11.10	9.47	12.04	8.89	8.50	10.79	12.57
1984	9.58	11.89	12.44	10.15	12.71	10.16	8.80	12.04	12.38
							Open-close	Open-close	
1984: May	9.90	12.75	13.41	10.55	13.28	10.87	9.00–9.00	12.00–12.50	12.18
June	9.94	13.18	13.56	10.71	13.55	11.23	9.00–9.00	12.50–13.00	12.10
July	10.13	13.06	13.36	10.50	13.44	11.34	9.00–9.00	13.00–13.00	12.50
Aug	10.49	12.50	12.72	10.03	12.87	11.16	9.00–9.00	13.00–13.00	12.43
Sept	10.41	12.34	12.52	10.17	12.66	10.94	9.00–9.00	13.00–12.75	12.53
Oct	9.97	11.85	12.16	10.34	12.63	10.16	9.00–9.00	12.75–12.00	12.77
Nov	8.79	10.90	11.57	10.27	12.29	9.06	9.00–8.50	12.00–11.25	12.75
Dec	8.16	10.56	11.50	10.04	12.13	8.55	8.50–8.00	11.25–10.75	12.55
1985: Jan	7.76	10.43	11.38	9.55	12.08	8.15	8.00–8.00	10.75–10.50	12.27
Feb	8.22	10.55	11.51	9.66	12.13	8.69	8.00–8.00	10.50–10.50	12.21
Mar	8.57	11.05	11.86	9.79	12.56	9.23	8.00–8.00	10.50–10.50	11.92
Apr	8.00	10.49	11.43	9.48	12.23	8.47	8.00–8.00	10.50–10.50	12.05
May r	7.56	9.75	10.85	9.08	11.72	7.88	8.00–7.50	10.50–10.00	12.06
June p	7.01	9.04	10.14	.....	10.92	7.36	7.50	10.00	.....
Week ended:									
1985: May 18	7.69	9.75	10.89	8.90	11.77	7.96	8.00–8.00	10.50–10.50	.....
25	7.28	9.43	10.60	9.03	11.50	7.60	8.00–7.50	10.50–10.00	.....
June 1	7.22	9.36	10.39	8.83	11.27	7.54	7.50–7.50	10.00–10.00	.....
8	7.03	8.97	10.00	8.68	10.93	7.31	7.50–7.50	10.00–10.00	.....
15	7.21	9.06	10.12	8.75	10.88	7.40	7.50–7.50	10.00–10.00	.....
22	6.73	8.90	10.08	8.76	10.86	7.21	7.50–7.50	10.00– 9.50	.....
29	7.06	.....	.....	.....	.....	.....	7.50–	9.50–	.....

[1] Rate on new issues within period; bank-discount basis.

[2] Yields on the more actively traded issues adjusted to constant maturities by the Treasury Department.

[3] Weekly data are Wednesday figures.

[4] Series excludes public utility issues for January 17, 1964 through October 11, 1964 due to lack of appropriate issues.

[5] Bank-discount basis. Prior to November 1, 1979, data are for 4–6 months paper.

[6] Average effective rate for year; opening and closing rate for month and week.

[7] Effective rate (in the primary market) on conventional mortgages, reflecting fees and charges as well as contract rate and assumed, on the average, repayment at end of 10 years. Rates beginning January 1973 not strictly comparable with prior rates.

Sources: Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Home Loan Bank Board, Moody's Investors Service, and Standard & Poor's Corporation.

EXHIBIT 6(c)
DATE 2/12/8
HB 420

UNITED STATES GENERAL ACCOUNTING OFFICE

WASHINGTON, D.C. 20548

FOR RELEASE ON DELIVERY

Expected about 9:00 a.m.

Monday, April 28, 1986

STATEMENT OF

JOHNNY C. FINCH, SENIOR ASSOCIATE DIRECTOR

GENERAL GOVERNMENT DIVISION

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT

COMMITTEE ON WAYS AND MEANS

HOUSE OF REPRESENTATIVES

ON

PROFITABILITY OF THE PROPERTY/CASUALTY

INSURANCE INDUSTRY

Mr. Chairman and Members of the Subcommittee:

We are pleased to appear before the Subcommittee again to assist it in its deliberations on the subject of the insurance industry. At your request, we will address our remarks today to (1) the property/casualty industry's pricing strategies, particularly as they are affected by "cash flow underwriting"; (2) industry profitability; (3) the cyclical nature of that profitability; (4) the financial outlook for the industry; and (5) the current difficulties in the property/casualty industry, specifically as they relate to the medical malpractice and general liability insurance lines.

In addressing these issues, we will make the following points. Property/casualty companies have used a pricing strategy which sacrificed underwriting profit margins in order to generate cash for investment purposes. As a result of this strategy, the property/casualty industry has made, depending upon whose estimates are used, between $50 and $75 billion in net gains over the last 10 years. Furthermore, like many other businesses, property/casualty underwriting is subject to profitability cycles. While underwriting losses have mounted since 1980, estimated data for 1985 indicates that the underwriting cycle has turned and is now moving in a positive direction. Indeed, the industry itself is projecting substantial net gains over the next 5 years.

The current difficulties in liability insurance are found principally in certain liability insurance lines. Two lines frequently mentioned by the media within a crisis context are general liability and medical malpractice. These lines, however, represent a small portion, less than 10 percent, of the total property/casualty business. Furthermore, as compared to some reported premium increases, our computations show that, with smaller increases in earned premium revenues, these lines could break even.

I will now discuss these points in greater detail. In doing so, I will explain the sources of our data and the scope of our work.

PROPERTY/CASUALTY COMPANY PRICING STRATEGIES

A property/casualty company derives its income from two principal areas: underwriting gains, which are the excess of premiums over claims and expenses, and investment gains. Because of investment gains, a property/casualty company can have net income even though its premium revenues alone are not large enough to cover claims and expenses.

Thus, the ability to offset underwriting losses with investment income plays an important role in a company's pricing strategy--that is, the amount it charges for the insurance that it offers. For a number of years, many companies have employed a pricing strategy known as cash flow underwriting. Basically,

companies have been willing to accept lower premiums for certain insurance lines in order to encourage sales and obtain funds for investment. In essence, the strategy has been to sacrifice underwriting gains for investment gains. For example, in 1984, claims, expenses, and policyholder dividends exceeded premium revenues by almost 18 percent.

The companies, however, have taken this risk because they expected to make up the premium shortfall through investment income. Through the increased volume of premiums resulting from this pricing approach, companies were able to generate a larger amount of net cash flow which they could then invest to earn additional investment income. For instance, over the 5-year period 1980-1984, when the industry's claims and expenses exceeded premiums by about 9 percent, its underwriting loss was about $45 billion. Even so, the industry had $82 billion in investment gain which, when offset against its underwriting losses, resulted in a net gain of about $37 billion. The investment gain was made possible, at least in part, by the industry's pricing strategy which generated about $66 billion in net cash flow. The industry was then able to invest these funds at favorable rates.

From 1975 to 1983, investment gains, in the aggregate, have exceeded underwriting losses by a fairly wide margin. However, this situation changed in 1984, when underwriting losses for the industry were $19.4 billion while investment gains were $17.9 billion. Reacting to this result, some companies have sharply raised premiums.

PROFITABILITY OF THE PROPERTY/CASUALTY INDUSTRY

We developed a financial overview of the property/casualty insurance industry using financial data for the 10-year period 1976 through 1985. We obtained the 1976-1984 data from Best's Aggregates and Averages and the 1985 data from Best's Insurance Management Reports, dated December 30, 1985. The 1985 data were estimated by Best's since final 1985 operating results were not, and are still not, available. While Best's reports omit figures for many small or new companies, we believe that the data are representative of the overall financial results of the property/casualty industry.

In the table below, we show sources of property/casualty income broken out by underwriting gains, investment gains, and total gains. This table clearly illustrates the results of the industry's pricing strategy to obtain investment income at the expense of underwriting income. While property/casualty companies had about $65 billion in underwriting losses, they also earned about $140 billion from their investments during this 10-year period. Overall, the industry had a net gain of about $75 billion.

All Companies -- Consolidated Basis
1976 through 1985
($ in billions)

Underwriting gains/(losses)	Investment gains	Net gains
($65.2)	$140.2	$75.0

We would like to make two points about our figures which may differentiate them from figures developed by others. First, the investment gains include net investment income and both realized and unrealized capital gains. We recognize that unrealized gains are just that, unrealized, and therefore, are subject to investment risks which could result in lower or higher amounts. However, we have chosen to include unrealized gains in our figure because it is within a company's control to manage its investment portfolio so as to realize these gains while the investments are profitable.

Second, the underwriting losses do not reflect policyholder dividends. We consider these dividends to be voluntary, not mandatory, distributions by the companies. Since the companies are not required to make these distributions, we have chosen to exclude them from our underwriting loss figure.

Even if we adjusted our figures to exclude unrealized gains and to include policyholder dividends (the approach used by the industry for its calculation), the industry's net gain for this 10-year period would still be $51 billion. In either case, it is within management's discretion to realize investment gains or to not pay policyholders' dividends.

CYCLICAL NATURE OF INDUSTRY PROFITABILITY

While it is important to look at the figures for the most recent years, it should be noted that over the longer period the property/casualty industry has demonstrated profit and loss cycles. We believe that data covering longer periods give a more complete picture of the industry's profitability.

Unlike most other industries, the property/casualty insurance industry is flexible with respect to capacity or supply. During profitable periods insurance companies can increase their capacity, take varied and greater risks, and generally lower their premium rates to achieve a greater market share. Such actions result in price competition as other firms lower their prices to retain their market share. Price competition results in a change from favorable premium profit margins to unfavorable margins, resulting in the underwriting profit and loss cycles.

Attachments I and II illustrate the cyclical nature of the property/casualty industry profitability. Attachment I shows the year-by-year underwriting and investment results for the 12-year period from 1974 through 1985. Column 2 in that attachment, underwriting gains and losses, illustrates the cyclical nature of the industry. The earlier cycle bottomed out in 1975 with a $3.65 billion loss and peaked in 1978 with a $2.55 billion gain. Since 1980, underwriting losses have mounted again. However, estimates indicate that the loss cycle bottomed out in 1985 and that the cycle has now turned upward.

Attachment II illustrates the cyclical nature of property/casualty stock companies over the past 40 years. For purposes of illustration, we used the combined ratio concept, a ratio of claims and expenses to premium income. The attachment reflects the industry's underwriting results and premium pricing strategy; it does not include investment results. As can be seen, stock companies have had several underwriting cycles since 1945.

FINANCIAL OUTLOOK FOR THE INDUSTRY APPEARS FAVORABLE

From all indications, it appears that the trend towards larger underwriting losses has peaked. Available industry estimates show that over the next 5 years the industry expects substantial net gains. Our calculations, made from the industry estimates, indicate an expected net gain before taxes of more than $90 billion over the years 1986-1990.

Analysts of the industry also generally predict favorable industry prospects. For example, an August 1985 study by Salomon Brothers, Inc.,[1] forecast that premiums written will grow at a 12 percent annual rate over the 1985-1989 period. The same study forecasts a 10 percent growth rate for incurred losses over the period. The study forecasts further that total industry profits will rise annually at a rate of 25 percent over the same period. More recently, the Best's Insurance Management

[1]Salomon Brothers, Inc., Property/Casualty Insurance Organizations, Five-Year Review and Outlook, 1985 edition, August 1985.

Reports, dated December 30, 1985, estimated that net premiums written in 1985 would increase by 21 percent over net premiums written in 1984.

PROBLEMS IN MEDICAL MALPRACTICE AND GENERAL LIABILITY LINES

Although the financial outlook for the industry as a whole appears favorable, the current difficulties in liability insurance are more pronounced in certain lines. Two insurance lines often mentioned in the context of high premiums and lack of availability are medical malpractice and general liability. General liability insurance includes coverage of items like day care centers, asbestos removal, and municipalities. The following examples are illustrative of some reported difficulties individuals and businesses have encountered recently:

--In February, the government's interagency Tort Policy Working Group reported on a survey of day care providers which found that insurance policies had been cancelled or not renewed for 40 percent of the respondents and the majority of those with continuing coverage had experienced premium increases of between 200 and 300 percent.

--In March, the American Medical Association testified before this Subcommittee that malpractice insurance rates for obstetricians in Maryland increased by 130 percent last summer.

--The March 24, 1986, issue of Time reported the story of one asbestos removal company whose policy increased in cost from $9,361 to over $450,000, an increase of almost 5,000 percent, despite never having been sued.

The medical malpractice and general liability lines, however, do not represent a major portion of the total property/casualty insurance business. Attachment III shows, for 1985, the relationship of these two lines to other property/casualty lines. The data were estimated by Best's which reports on 27 insurance line categories. For our purposes, we have grouped certain lines into one category; for example, personal and commercial automobile liability is shown as automobile liability.

The figures in this attachment show that the medical malpractice and general liability lines represent a relatively small portion of the industry. Medical malpractice premiums accounted for less than 2 percent of all property/casualty premiums written for 1985 and general liability premiums accounted for less than 8 percent. However, underwriting losses attributable to these lines accounted for almost a quarter of

all underwriting losses; medical malpractice being 5.6 percent and general liability being 18.3 percent. It should be noted, Mr. Chairman, that for certain companies that specialize in these liability lines, the proportion of the losses will likely be higher.

Despite the relatively large proportion of underwriting losses that the medical malpractice and general liability lines represent, attachments IV and V show that in 1984 these two lines could have broken even with smaller increases in premium rates than the rate increases presently being reported in the media. Attachment IV, for example, shows that for the medical malpractice line, a premium rate increase of 20 percent would have put this line at a break even point. Similarly, attachment V shows that for the general liability line, an approximate 30 percent increase in premium rates would have been sufficient to break even. (1984 is the most recent year for which we are able to make such estimates; the necessary data is not yet available for 1985.)

CONCLUSION

In conclusion, Mr. Chairman, available financial information for a recent 10-year period indicates that the profitability of the property/casualty industry has been cyclical in nature. The data further indicate that over this period the industry has been generally profitable. The industry's profitability has been lower in recent years;

however, the industry projects increasing premium volumes and more favorable prospects for the next few years. The data also show that while medical malpractice and general liability insurance have received considerable attention recently, they represent a relatively small portion of the industry overall. Finally, our calculations show that, for 1984, these lines could have broken even with smaller increases in premium rates than some premium rate increases currently being reported in the media.

That concludes my statement, Mr. Chairman. We would be pleased to respond to questions.

ATTACHMENT I

UNDERWRITING GAINS, INVESTMENT GAINS, COMBINED UNDERWRITING AND INVESTMENT GAINS: ALL COMPANIES -- CONSOLIDATED BASIS[a] YEARLY 1974-1985

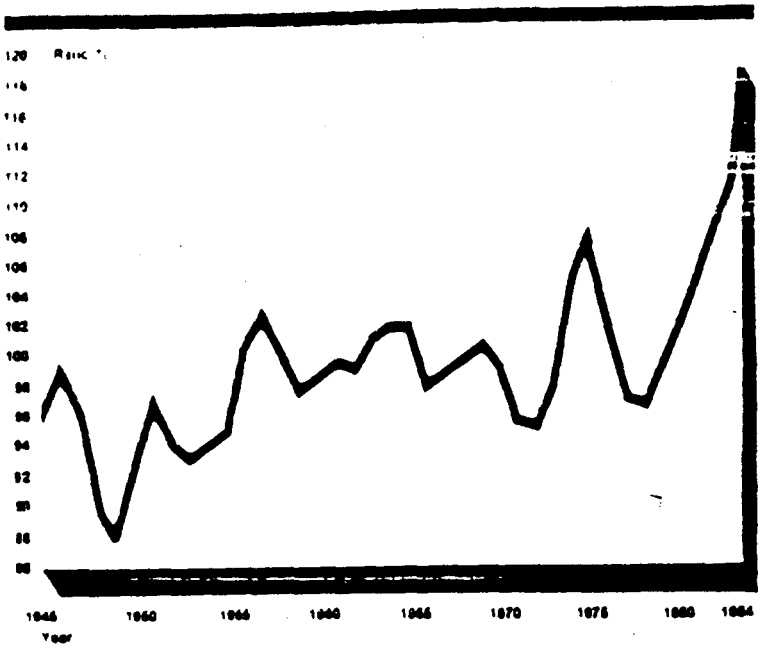
($ in millions)

Year	Underwriting gains/(losses)	Investment gains/(losses)	Total
1974	(1,974)	(2,443)	(4,417)
1975	(3,653)	7,009	3,356
1976	(1,726)	7,173	5,447
1977	1,926	5,063	6,989
1978	2,548	7,758	10,306
1979	24	11,610	11,634
1980	(1,712)	15,870	14,158
1981	(4,464)	10,858	6,394
1982	(8,303)	18,387	10,084
1983	(11,088)	19,441	8,353
1984	(19,379)	17,875	(1,504)
1985 Est.	(23,100)	26,200	3,100

[a]Consolidated totals eliminate double counting by excluding intercompany transactions between parent and subsidiary companies.

ATTACHMENT II

Combined Underwriting Ratios for Property/Casualty Stock Companies for the Years 1945-84[a]



Year	Ratio %	Year	Ratio %
1945	95.8	1965	101.9
1946	98.8	1966	98.1
1947	96.3	1967	98.9
1948	91.2	1968	100.0
1949	87.6	1969	100.6
1950	93.0	1970	99.3
1951	97.1	1971	95.8
1952	94.4	1972	95.4
1953	93.1	1973	98.2
1954	93.6	1974	105.0
1955	94.9	1975	107.5
1956	100.5	1976	102.0
1957	102.9	1977	97.0
1958	100.0	1978	96.6
1959	97.8	1979	99.6
1960	98.4	1980	102.4
1961	99.4	1981	104.9
1962	99.0	1982	108.7
1963	101.0	1983	111.8
1964	101.9	1984	119.0

[a]A combined ratio is a ratio of claims and expenses to premium income. Ratios below 100 represent underwriting gains and ratios above 100 represent losses.

 ATTACHMENT III

Net Premiums Written and Underwriting Gains/Losses
Estimated for All Insurance Lines for 1985
($ in billions)

Selected long-tailed insurance lines[a]	Net premiums written	Premiums as a percent of all lines	Underwriting gains/(losses) after dividends	Underwriting gains/(losses) as a percent of all lines
Automobile liability	$35.7	25.1%	($7.3)	29.0%
Workers compensation	16.8	11.8	(3.7)	14.7
General liability	11.1	7.8	(4.6)	18.3
Medical malpractice	2.6	1.8	(1.4)	5.6
Subtotal	66.2	46.5	(17.0)	67.6
Selected short-tailed insurance lines[a]				
Automobile physical damage	24.9	17.5	(0.3)	1.2
Homeowners multiple peril	15.0	10.5	(1.8)	7.1
Commercial multiple peril	11.7	8.2	(3.0)	11.9
Subtotal	51.6	36.2	(5.1)	20.2
All others[b]	24.5	17.2	(3.1)	12.3
Total all lines	$142.3	100%[c]	($25.2)	100%[c]

[a]Long-tailed insurance lines are lines characterized by third-party involvement (an injured party other than the insured) and by settlements that will occur in an unknown future time period. Short-tailed lines, on the other hand, typically involve only two parties (the insurer and the insured) and settlements that will take place within a relatively short time frame (generally a year or two) following a claim.

[b]Includes such long-tailed lines as reinsurance and group accident and health, as well as such short-tailed lines as burglary and theft, and aircraft.

[c]Does not add due to rounding.

 ATTACHMENT IV

Break Even Analysis for the Medical Malpractice Line in 1984
($ in millions)

Computation of Additional Earned Premiums Needed to Break Even:

Premiums earned	$1,707	
Net investment gains[a]	750	
Total Revenues		$2,457
Less:		
Net losses incurred	$1,913	
Expenses and dividends	868	
Total Outlays		2,781
Net income/(loss) before taxes		($323)[b]
Sales commissions on additional premiums ($323 / (1-.052) - $323)[c]		18
Additional earned premiums needed to break even before commission		$341
Percent additional earned premiums needed to break even (($341 / $1,707) x 100)		20.0%

[a]Does not include unrealized gains.

[b]Does not add due to rounding.

[c]Commissions paid on this line averaged 5.2 percent of premiums written.

ATTACHMENT V

Break Even Analysis for the General Liability Line in 1984
($ in millions)

Premiums earned	$6,251	
Net investment gains[a]	1,665	
Total Revenues		$7,916
Less:		
Net losses incurred	$5,456	
Expenses and dividends	4,100	
Total Outlays		9,556
Net income/(loss) before taxes		($1,640)

Computation of Additional Earned Premiums Needed to Break Even:

Sales commissions on additional premiums ($1,640 / (1-.121) - $1,640)[b]	226
Additional earned premiums needed to break even after commission	$1,866
Percent additional earned premiums needed to break even (($1,866 / $6,251) x 100)	29.8%

[a]Does not include unrealized gains.

[b]Commissions paid in this line averaged 12.1 percent of premiums written.

Attachment 6
EXHIBIT 6(d)
DATE 2/12/82
SB 420

INSURANCE SERVICES OFFICE

160 WATER STREET NEW YORK, N. Y. 10038

TELEPHONE: (212) 487-5000

COMMERCIAL CASUALTY ACTUARIAL DIVISION
RICHARD S. BIONDI, ASSOCIATE ACTUARY & MANAGER

October 15, 1975

RECEIVED
AUTO & COMPENSATION
INSURANCE BUREAU

OCT 15 1975

INSURANCE DEPT.
STATE OF N. Y.

Mr. Stanley A. Dorf, Chief Actuary
New York Insurance Department
2 World Trade Center
New York, New York 10038

Re: Comparative/Contributory Negligence -
Automobile Liability Rate Change Proposal

Dear Mr. Dorf:

Because of the change in the New York law from contributory negligence to comparative negligence, I.S.O. proposes to increase Automobile Liability (including Uninsured Motorists) rates by 5%. This proposed increase is based on a study of closed Automobile Liability claims in California, comparing the actual settlement under the comparative negligence law with the estimate of what it would have been under the earlier contributory negligence law. Enclosed is Exhibit 1 displaying the indicated rate changes by line and coverage based on the survey, and also the proposed changes of 5% for the liability coverages and "no change" for Personal Injury Protection. Exhibit 2 details the results of the claim study survey, showing number of claims, losses under both negligence laws, and comparative/contributory ratios, by line and coverage.

We have also enclosed a copy of the "Call" letter used for this survey; in it can be found a sample copy of the questionnaire form and the general instructions for completing the form. The companies participating in the study write approximately 75% of the Automobile Liability premiums written by Insurance Services Office affiliated companies. All claims reported to us were settled very shortly after the changeover in negligence laws in California; thus, claims personnel completing these forms were in a good position to compare comparative vs. contributory settlements for their claims.

Very truly yours,

George Burger

George Burger
Actuarial Assistant

GB:cm
Enc.

New York

Automobile Liability Insurance

I.S.O. Proposed Rate Increases to Reflect the Change from Contributory to Comparative Negligence*

Coverage	Indicated Rate Change	Proposed Rate Change
Private Passenger		
Residual Bodily Injury	+ 4.1%	+ 5.0%
Personal Injury Protection	-	0.0
Property Damage	+ 4.6	+ 5.0
Uninsured Motorists	+13.0	+ 5.0
Total	+ 4.8	+ 4.4
Commercial		
Residual Bodily Injury	+ 6.8%	+ 5.0%
Personal Injury Protection	-	0.0
Property Damage	+ 6.9	+ 5.0
Uninsured Motorists	+ 0.1	+ 5.0
Total	+ 6.5	+ 4.7
Grand Total	+ 5.4%	+ 4.4%

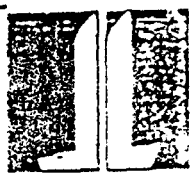
*Note that all percent changes are weighted on New York's premium distribution.

AUTOMOBILE LIABILITY INSURANCE
Effect of Change from Contributory to Comparative Negligence*

Coverage	(1) Number of claims	(2) Losses Under Contributory Negligence	(3) Losses Under Comparative Negligence	(4) Ratio ((3)÷(2))
Private Passenger Automobiles				
Bodily Injury	521	$1,098,811	$1,144,407	1.041
Property Damage	1,622	574,730	601,305	1.046
Uninsured Motorists	43	101,872	115,072	1.130
Total	2,186	$1,775,413	$1,860,784	1.048
Commercial Automobile				
Bodily Injury	318	517,285	552,522	1.068
Property Damage	1,018	361,123	386,135	1.069
Uninsured Motorists	9	48,305	48,339	1.001
Total	1,345	926,713	986,996	1.065
Grand Total	3,531	$2,702,126	$2,847,780	1.054

* NOTE: The above experience was taken from ISO's California Closed Claim Survey.

Exhibit 5
EXHIBIT 6(e)
DATE 2/12/8
HB 420



GREAT AMERICAN·WEST, INC.

200 S. MANCHESTER AVENUE
ORANGE, CA 92668
714/634-4600

April 23, 1986

Mr. Norman Figon
Rate Analyst
Washington Insurance Department
Insurance Building
Olympia, WA 98504

Re: American National Fire Insurance Company
Select Driver I Program
Select Driver II Program
Private Passenger Automobile
Rate and Rule Revision

Dear Mr. Figon:

In your letter of March 25, 1986, you indicated that we need to place a provision in our ratemaking to reflect the impact of the "tort reform" law. As an attempt to quantify, we reviewed twenty-four claim files, which represented all of our Private Passenger Automobile claims over $50,000 in the state of Washington since 1983. Of these twenty-four claims, we believe that the new law could have an impact on three claims. One claim involved a driver that was intoxicated. We estimate that we would not have paid $20,000 of the claim. On the other hand, there were two claims in which American National Fire would see an increase in its loss liability. These are contributory negligence cases in which our percent of the entire loss liability would increase. The impact of the law on these two is at least $100,000 on each of them.

From the above study, it does not appear that the "tort reform" law will serve to decrease our losses, but instead it potentially could increase our liability. We elect at this point, however, not to make an upward adjustment in the indications to reflect the impact of the "tort reform" law.

We request, therefore, that you reconsider the original filing of January 19, 1986, with an amended effective date rule of:

"For all policies written on or after June 2, 1986".

In our telephone conversation you mentioned a concern that we are selecting an increase less than our indications. Our plan of action is to take this increase, which we estimate to be slightly more than 14%, and to review the rates in the near future, such that we can effect a rate change six months after the effective date of this revision. We believe that this method will prove to be less disruptive on our book of business than other courses that we might have chosen.

We hope the above includes all the information that you need to expedite an approval of the filing.

Sincerely,

Kevin J. Kelley
Director of Actuarial

KK/nk

EXHIBIT 6(1)
DATE 2/12/8
Attachment 2 HB 420

State Farm Fire and Casualty Company

State Farm General Insurance Company

112 E. WASHINGTON ST.
BLOOMINGTON, ILLINOIS 61701

October 21, 1986

Mr. Ray Rathert
Kansas Insurance Department
420 S. W. 9th Street
Topeka, Kansas 66612

Ray:

Before any discussion of State Farm and tort reform, it must first be clearly understood that most of the problems in the liability field are in lines which State Farm does not write. Because of this, the impact of tort reform on our book of business is going to be considerably different from that of a major liability writer.

We have been requested by several insurance departments to come up with some estimate of the effect of newly passed tort reform ~~legislation on our~~ rates in their states. We know of no way this can be done actuarially. Consequently, we resorted to judgement.

The few enacted tort reform statutes usually include items such as:

1) Collateral source of indemnity

2) A non-economic cap

3) Joint and several restriction

4) Punitive damage limitation

5) Alternate methods of payment.

A sampling of commercial liability claims provided the following:

1) Collateral source of indemnity. The sample indicated that approximately 7% of our total indemnity losses were potentially subject to a collateral source. Only about a quarter of these reflected a known collateral source. In our judgement, 50% would be a very liberal estimate of the success in reducing damages due to the existance of a collateral source. The net savings from the collateral source change is thus about 1% (7% X 25% X 50%).

2) Non-economic cap. Non-economic caps are established at such a level that our sample indicated only very few claims would exceed the cap. It is our judgement that the loss savings resulting from the non-economic cap will not exceed 1% of our total indemnity losses.

3) Joint and several restriction. In our sample of liability claims, no claim was found that would have been affected by the joint and several restriction.

4) Punitive damage limitation. Again, in our sample, no punitive damage awards were found.

5) Alternative methods of payment. On our book of business, the savings due to alternative payment methods on future economic losses would be negligible in relation to our total indemnity losses.

Although we believe the effect of tort reform on our book of business would be small, we do believe that effective tort reform legislation can have a positive impact on not only pricing but also availability. It is important to keep in mind that tort reform, or absence thereof, is only one of many factors which influence pricing and availability. Any of these other factors can produce an opposite effect which could equal or outweigh any positive effect of tort reform.

Attached are liability rate comparisons for Kansas and surrounding states. As you know, we use ISO rates for monoline policies. Even in our package policies, the original liability loadings were also derived from ISO rates.

Again, as you know, we do review our rate levels at least annually. It will probably be several years before any effect from tort reform legislation can be expected to influence our experience. Anyway, hope these brief comments will be of some use to you in your discussions of this subject.

Best regards,

Bob

Robert J. Nagel
Assistant Vice President
State Filings Division

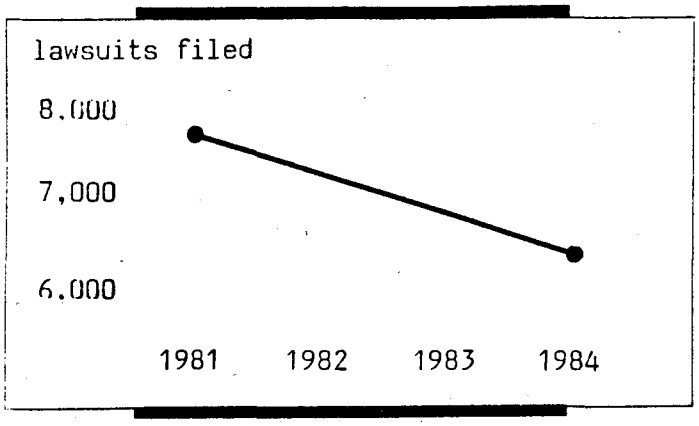
RJN:kc/1021

2/12/87
HB 420

INSURANCE COMPANIES ARE RAISING YOUR RATES AND BLAMING YOU FOR IT!

Montanans will decide this November whether to pass CI30 and vote away the constitutional right to be compensated for all injuries. But before you decide how you will vote, you should know what the insurance companies won't tell you.

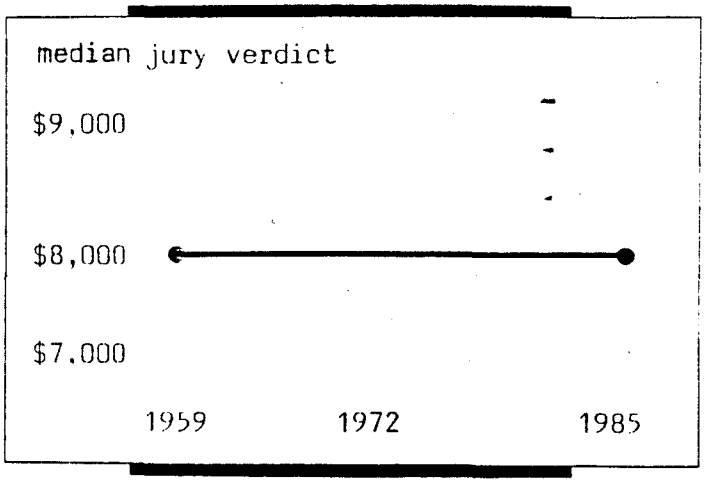
You've probably heard that the number of lawsuits has increased, and that's why insurance rates have increased -- BUT THIS IS NOT TRUE!



From 1981 to 1984, the number of lawsuits filed (tort, contract, real property rights) in Montana has decreased 16 percent, while the population increased 4 percent. Tort filings alone increased only as much as population did.

Source: National Center for State Courts

You've probably heard that the amount juries have awarded to victims has increased. BUT THIS IS NOT TRUE!



The median jury verdict nationally has remained at about $8,000 since 1959, after adjustments for inflation. Data not available for Montana.

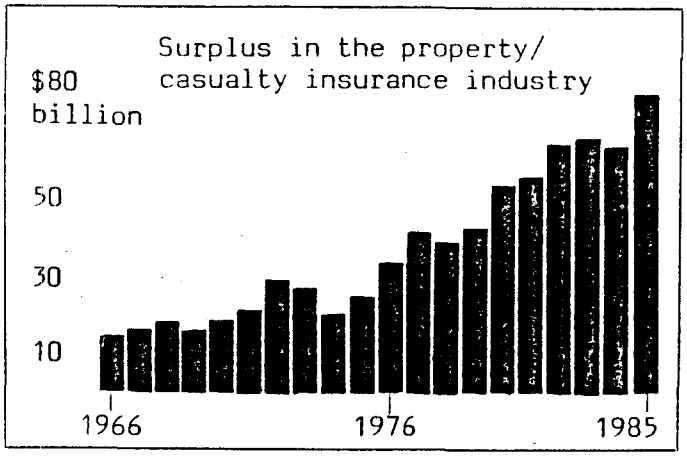
Source: Rand Institute for Civil Justice

You've probably heard that trial lawyers are paid too much money, and that they go out looking for victims. But trial lawyers are paid about 30 percent of the award, for their time and office costs. The system is set up this way so that everyone can afford a lawyer. This way low-income victims have the same privileges as the wealthy.

So how do we make the insurance companies play fair? Reforming the industry is the only way; throwing away our rights won't help, as many states have proved. For fair insurance premiums, Montana has to:

1. Allow all businesses to self insure.
2. Put the insurance industry under the same regulations that all industries have.
3. Provide reinsurance, so we aren't forced to depend on large foreign corporations.

You've probably heard that the insurance industry is having money problems. But the industry is alive and well and getting all the money they can off of Montanans.



In the last ten years, insurance companies have taken much more of our money than they have paid out. The increasing surplus shows that the industry is doing better and better.

Source: National Insurance Consumer Organization.

For more information, contact MontPIRG at 356 Corbin Hall, Missoula, MT 59812, or call 243-2907.

EXHIBIT 8
DATE 2/12/87
HB 420

STATEMENT OF THE

ALLIANCE OF AMERICAN INSURERS

BEFORE THE

MONTANA HOUSE BUSINESS AND LABOR COMMITTEE

HBN 420 -- DATA COLLECTION

I am Larry Soular, Manager of Company Operations Policy for the Alliance of American Insurers. The Alliance is a national trade association of over 175 property and casualty insurance companies. Members of the Alliance had property and casualty premiums totalling $34 million in Montana in 1985, and accounted for 7.4% of the premiums written in Montana.

We appreciate the opportunity to present our views on the data reporting requirements associated with House bill 420. Before addressing the specifics of House Bill 420, I would like to share with you the concerns our member companies have with regard to the lack of uniformity of the special data reporting requirements recently enacted in a number of states. I would also like to review briefly the types of financial and statistical information that are already reported by insurers on a routine basis.

Lack of Uniformity

During the 1986 legislative sessions, 17 states enacted supplemental data reporting laws and no two data reporting requirements are the same. This lack of uniformity imposes substantial time and expense burdens on insurers who have to develop special data collection procedures to respond to the variety of laws that have been enacted. Moreover, in many instances, it is unlikely that these special data collection efforts will provide information that is any more meaningful than that already being reported through the Annual Statement reporting or through the reporting done in conjunction with the rate review process.

To assure that data requests are implemented uniformly across the country, we believe that data collection proposals should be channeled through a national coordinating body such as the National Association of Insurance Commissioners. We also believe that calls for supplemental data must be carefully considered with the cooperation and participation of the insurance industry to assure that meaningful information is collected. Recognizing the need to address data collection in a more uniform manner, the NAIC recently appointed a Statistical Working Group to review data collection needs. The Working Group has been charged to:

A. Explore the mechanism for obtaining classification detail for commercial lines,

B. Review the Fast Track report and recommend improvements to assist in the identification of emerging trends or problems in commercial liability lines and explore the use of the NAIC state computer network to speed distribution of Fast Track information, (Fast Track is a quarterly report provided to Insurance Commissioners which shows the loss experience for a number of property and casualty insurance lines. The report is prepared jointly by the Insurance Services Office and by the National Association of Independent Insurers).

C. Recommend any necessary changes to the NAIC Statistical Handbook, and

D. Develop guidelines for the states to implement the procedures associated with the NAIC Statistical Handbook.

The Working Group will report on its recommendations by March 1, 1987.

It is our hope that regulators and legislators will carefully review the types of data already being reported by the insurance industry before determining whether additional special reporting is warranted. We also believe that the information being prepared by the NAIC Statistical Working Group will be of valuable assistance in addressing the data issue, and we request that legislators and regulators give the Working Group time to complete its assignments before additional special reporting requirements are considered.

Availability of Data

A great deal of financial and statistical data is already reported to insurance regulators which enable them to perform the analyses inherent in their statutory responsibilities. Two basic types of data are routinely compiled: financial and statistical.

Financial Data

Financial data are needed to measure the overall solvency and profitability of insurance companies. By requiring insurers to report specific types of financial data, state insurance regulators have direct access to insurers' most important financial information.

The Annual Statement is the primary source document for insurer financial information. It is designed to assist state regulators in evaluating an individual insurer's solvency and estimating individual insurer and overall industry profitability. All companies, regardless of their size or market share, are required to submit an Annual Statement in accordance with the specifications established by the National Association of Insurance Commissioners (NAIC) and their state of domicile.

The Annual Statement provides detailed information about assets and liabilities, including data on premiums, losses, reserves, expenses, dividends, taxes, and investments. In addition to its basic financial presentation, the Annual Statement includes numerous special schedules and supplements that contain more detailed information about particular lines of businesses (e.g., medical malpractice) or certain line items (e.g. expenses). The Underwriting and Investment Exhibit, the Page 13 Exhibit of Premiums and Losses, and the display of Five-Year Historical Data are frequently referenced examples of the basic data that are required as part of the Annual Statement. From these portions of the Annual Statement, detailed profit and loss information by line, market share information by line and state, and historic performance profiles can be calculated.

Schedule P of the Annual Statement is a representative example of the necessary analytical information that insurers report in addition to their basic "bottom line" financial data. Generally, Schedule P provides an analysis of reserve development for the so-called "long-tail" lines - those characterized by a time-lag between the occurrence that gives rise to the claim, the report of the claim, and the ultimate settlement. Examples of these long-tail lines include: automobile liability, other liability, medical malpractice, and the multi-peril coverages. Using Schedule P, the adequacy of historic loss reserve levels can be evaluated.

The Insurance Expense Exhibit is the most prominent of the supplements required in connection with the Annual Statement. It allocates expenses (e.g. loss adjustment expenses, acquisition expenses, taxes) to each Annual Statement line of business.

Statistical Data

The other basic type of information routinely reported to the states is statistical data. Like financial data, statistical data are derived from the individual business transactions conducted by an insurance company. They contain fundamental information about insurance coverages and the premium and loss experience related to those coverages. Statistical data are designed to assist regulators in analyzing whether insurers' rates meet the rate standards encompassed in the model rating law: that they

not be "excessive, inadequate or unfairly discriminatory." Statistical data are collected in all states, regardless of whether insurance rates for those states are introduced with the prior approval of the regulator, or are implemented by the company, subject to later regulatory review.

State laws and regulations empower insurance regulators to collect the statistical data necessary to evaluate the adequacy and fairness of the rates and rating plans being used in their states. In most cases, the regulatory agencies appoint designated statistical agents to perform this function on their behalf. The statistical agents develop detailed instruction books, called statistical plans, which define the data elements (e.g. line of business, coverage, class, state, territory, premium, etc.) as well as the formats and time frames for a company reporting.

The statistical agents perform comprehensive data quality procedures as part of their data processing function. Once the statistical data have been verified as valid, reliable, and accurate, they can be reported to regulators to assist them in determining whether existing rate systems are in compliance with the insurance statutes of their states.

The NAIC Statistical Handbook defines the content and format of the reports that the statistical agents produce on an annual basis - and identifies other reports that can be produced within a specified time of

their request. It streamlines the regulatory requirements to provide for an overview of statistical developments, giving the regulator the option to request more detailed statistics if they are needed.

In light of the amount of information available to regulators, it is critical to carefully examine what additional information is needed from insurers and potentially, from others who utilize the liability system. To respond to this question, it is essential to explore why the information is needed and how it would be reported, recognizing that the cost of collecting data is a significant addditional expense to insurers which will be reflected in higher costs to insurance consumers. Moreover, onerous data reporting laws also impose increased costs on state insurance departments which must devote resources to collect, review, analyze, and process the additional data.

Montana House Bill 420

The Alliance strongly opposes the additional data reporting requirements specified under House Bill 420. We believe the supplemental reporting requirements are unnecessarily burdensome to insurance companies, costly to insurance companies and to the state of Montana, and questionable with regard to the credibility and usefulness of the information gathered.

In addition to the expense burden imposed on insurers for providing the additional information for 20 types of insurance coverages, we are also concerned abut the small sample sizes that will result since the Montana

experience needs to be reported by company and by type of insurance coverage. The small volume of business which might be reported in some categories raises the question of whether this type of detail will provide the Department with credible information. This is especially true if this information is to be used to evaluate rates. Many of these lines, such as product liability and the professional liability coverages, are low frequency, but high severity lines. As a result, only a few large losses can make the difference between substantial profit or significant loss in Montana, especially for an individual company. Industry experience has shown that in order to draw meaningful conclusions about these lines, a large pool of data already collected and analyzed by insurance organizations must be utilized. Moreover, some of the data elements requested, such as investment income and expenses, are not normally separated by state and by line of business and will need to be allocated on an arbitrary formula basis.

As mentioned earlier, the Montana Insurance Department will also incur substantial additional costs to collect, review, analyze, and process the additional data. We understand the Insurance Department estimates that the additional costs to implement House bill 420 will be $400,000. Currently, the entire Insurance Department budget is only $700,000.

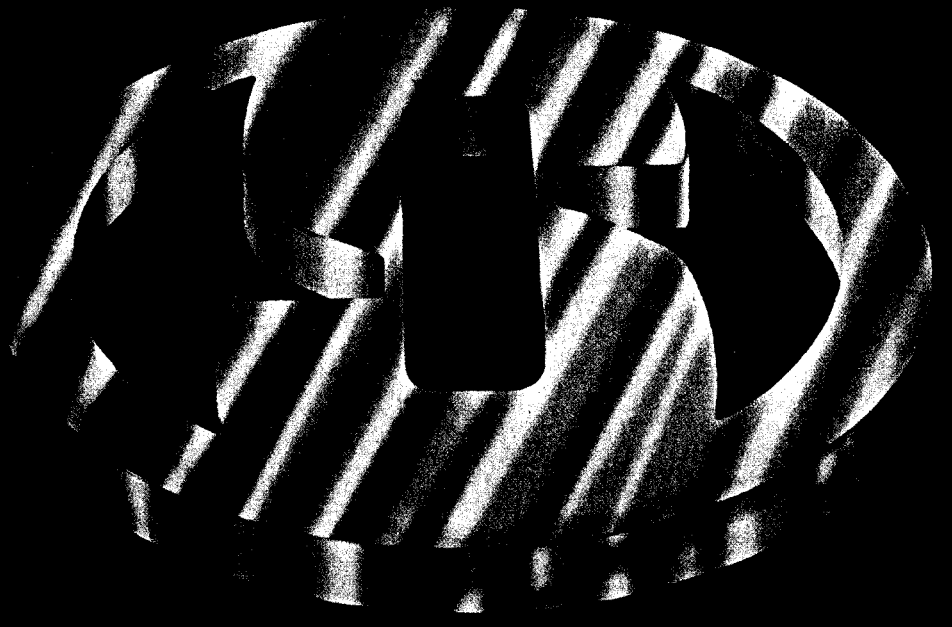
We believe the penalties for failure to comply with the data reporting requirements are unreasonable. The bill provides for a penalty of $10,000 plus a daily penalty of $200 until the data reporting is complied with.

These types of penalties, combined with the additional costs of providing the data, may lead some insurers to question the efficacy of continuing to do business in Montana, and as a result availability problems may increase.

Thank you for the opportunity to comment. I would be happy to answer any questions you might have.

ISO Insurance Issues Series

Insurance Data: A Close Look



Insurance Services Office, Inc.

Among the matters the study will examine are the amount of the claim, the cause of the claimant's injury (such as defective product sold by the insured), the type of claim (closed or open), the economic impact to the claimant (such as wage loss), the existence of collateral sources (such as Medicare), the allocated loss adjustment expense (such as the cost of defending against the claim), and the amount of any punitive damages.

About twenty-four insurers will participate. They will represent almost 80% of the countrywide general liability insurance premiums written. While no insurer will participate in all of the 27 states selected, the insurers participating in each state collectively will represent at least 50% of the general liability premiums written in that state.

CONCLUSION

Some industry critics have advocated additional data reporting requirements as an outgrowth of their perceived need to substantiate or disprove insurer explanations for price increases and coverage availability.

Given the importance that regulators, consumers, and insurers already place upon sound, efficient data collection mechanisms, it is unlikely that additional data reporting requirements will provide any measurable increase in benefits. Insurers already provide comprehensive financial and statistical data that can be used to evaluate solvency, estimate profitability, or measure the proper relationships between rates and coverages. In addition, the two projects being sponsored by ISO are specially designed to provide maximum amounts of information about the relative impact on claim costs of various tort reforms, as well as other information that will supplement the discussions of public policymakers reviewing the industry's recent performance.

EXHIBIT 10
DATE 2/12/87
HB 313
Executive Action

AMENDMENTS TO HOUSE BILL NO. 313

AMENDMENTS AS FOLLOWS:

1) Title, line 9
Following: "16-2-103,"
Insert: "16-2-106,"

2) Title, line 10
Following: "16-2-203,"
Strike: "16-2-302, 16-2-303,"

3) Title, line 14
Following: "16-2-104"
Strike: "THROUGH"
Insert: ", 16-2-105,"
Following: "16-2-301"
Insert: "THROUGH 16-2-303"

4) Page 2, line 18
Following: "liquor"
Strike: "and the sale of table wine"

5) Page 4, line 12
Following: "liquor"
Strike: "and wine"

6) Page 8, line 8
Following: "liquor"
Strike: "and"
Following: "table"
Strike: "wine"

7) Page 10, line 23
Following: "liquor"
Strike: "and"
Following: "table"
Strike: "wine"

8) Page 11, line 5
Following: "liquor"
Strike: "and"
Following: "table"
Strike: "wine"

9) Page 12, line 24
Following: "liquor"
Strike: "or"
Following: "table"
Strike: "wine"

10) Page 13, line 7
Following: "liquor"
Strike: "or"
Following: "table"
Strike: "wine"

11) Page 15, line 3 through line 15
Following: "rate of" on line 3
Strike: the remainder of line 3, lines 4 through 14 in their entirety and line 15 through "section"
Insert: "$1.75 a liter"

12) Page 16, line 22
Following: line 21
Insert: "at the rate"
Following: "of"
Strike: ":"

13) Page 16, line 23, through page 17, line 9
Strike: lines 23 through 25 on page 16 and lines 1 through 8 on page 17 in their entirety and line 9 through "section"
Insert: "65 cents a liter"

14) Page 19, line 24
Following: line 23
Insert: "Section 13. Section 16-2-106, MCA, is amended to read:
"16-2-106. Purchase price in advance. A store <u>The state warehouse</u> manager <u>and other authorized state warehouse employees</u> may sell to any person <u>licensee</u> such liquor as that person <u>licensee</u> is entitled to purchase in conformity with the provisions of this code and the rules made thereunder, provided that no

delivery shall take place until the purchaser has paid the purchase price.""
Renumber: subsequent sections

15) Page 21, line 18 through page 22, line 11
Following: line 17 on page 21
Strike: sections 16 and 17 in their entirety
Renumber: subsequent sections

16) Page 24, line 9
Following: "is to"
Strike: "maintain a system for the importation and sale of wine by the state through <u>the</u> state liquor facilities <u>warehouse</u> and"

17) Page 49, line 11
Following: "that"
Insert: "originally"

18) Page 49, line 14
Following: "not"
Insert: "originally"

19) Page 49, line 22
Following: "license."
insert: "A licensee may purchase liquor from another licensee if the liquor was originally purchased from the state warehouse."

20) Page 58, line 21
Following: "16-2-104"
Strike: "through"
Insert: ", 16-2-105,"
Following: "16-2-301"
Insert: "through 16-2-303"

21) Page 58, line 24
Following: "Sections"
Strike: "39, 40"
Insert: "38, 39"

VISITORS' REGISTER

BUSINESS AND LABOR COMMITTEE

BILL NO. House Bill No. 420 DATE February 12, 1987

SPONSOR Rep. Timothy J. Whalen

NAME (please print)	REPRESENTING	SUPPORT	OPPOSE
Gary Overfelt	Self	X	
[illegible]	Ind Agents Assn		X
[illegible]	Alliance of Am Insurers		X
[illegible]	Alliance of American Insurers		X
[illegible]	American Insurance		X
Randy Grey	State Farm + NAII		X
[illegible]	Women's Lobbyist Fund	X	
[illegible]	[illegible]		X

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VISITORS' REGISTER

BUSINESS AND LABOR COMMITTEE

BILL NO. House Bill No. 622 DATE February 12, 1987

SPONSOR Rep. Raymond Brandewie

NAME (please print)	REPRESENTING	SUPPORT	OPPOSE
JAMES W. [illegible]	[illegible]	✓	

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BUSINESS AND LABOR COMMITTEE

BILL NO. House Bill No. 640 DATE February 12, 1987

SPONSOR Rep. Bernie Swift

NAME (please print)	REPRESENTING	SUPPORT	OPPOSE
Tom [illegible]	[illegible]		X
Gary Overfelt	Self		X
[illegible]	MBADA	X	
Jim Murry	Mont. AFL-CIO		X

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BUSINESS AND LABOR COMMITTEE

BILL NO. HJR 15 DATE February 12, 1987

SPONSOR Rep. Timothy Whalen

NAME (please print)	REPRESENTING	SUPPORT	OPPOSE
Tom Boland	Self	X	

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BUSINESS AND LABOR COMMITTEE

BILL NO. House Bill No. 585 DATE February 12, 1987

SPONSOR Rep. Dorothy Bradley

NAME (please print)	REPRESENTING	SUPPORT	OPPOSE
GENE PHILLIPS	NTS		X
JAY DOWNEN	MTA	X	

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BUSINESS AND LABOR COMMITTEE

BILL NO. House Bill No. 626 DATE February 12, 1987

SPONSOR Rep. Harry Fritz

NAME (please print)	REPRESENTING	SUPPORT	OPPOSE
Bruce Parrill	[illegible]	✓	
Matthew [illegible]	Ass. St. [illegible]	✓	
Jackie Amsden	self	✓	
[illegible]			
[illegible]		✓	
[illegible]	[illegible]		

IF YOU CARE TO WRITE COMMENTS, ASK SECRETARY FOR WITNESS STATEMENT FORM.

PLEASE LEAVE PREPARED STATEMENT WITH SECRETARY.

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