REPORT OF THE STATE
CORPORATION COMMISSION ON

Hearings Held to Investigate and Determine the Availability and Affordability of Insurance Coverage in the Commonwealth

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

House Document No. 22

COMMONWEALTH OF VIRGINIA
RICHMOND
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STATE CORPORATION COMMISSION

January 5, 1988

TO: The Honorable Gerald L. Baliles
Governor of Virginia
and
The General Assembly of Virginia

The report contained herein is pursuant to House Joint Resolution No. 261 of the 1987 Session of the General Assembly of Virginia.

This report represents the response of the State Corporation Commission to the legislative directive to conduct hearings to investigate and determine the availability and affordability of insurance coverage in the Commonwealth.

Respectfully submitted,

Elizabeth B. Lacy
Chairman

Preston C. Shannon
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TABLE OF CONTENTS

EXECUTIVE SUMMARY

Legislative Request

Problems in obtaining liability insurance at reasonable and affordable prices continue to be faced by many businesses, public entities, and professions in Virginia today. The insurance consumer has been confronted with escalating premium rates, lower policy limits, higher deductibles, and a narrowing of insurable risks. In some cases, insurance is not available at any cost. When examining the availability and affordability of insurance coverages considered essential or required by law, many of these consumers are expressing concern and outrage at what has been labeled the liability insurance "crisis".

The 1987 General Assembly passed several measures directed at easing the "crisis". Proposals for tort reform as well as insurance reform produced various new statutes aimed at the liability insurance problems being faced by Virginians. In addition, a number of legislative studies were requested to continue the examination of the insurance climate in Virginia, including House Joint Resolution 261. According to the Resolution, recent higher than normal premium increases, unexpected policy cancellations, and the unavailability or limited availability of particular lines of insurance have affected practically everyone. The Resolution further stated that "hearings are needed to determine whether insurance coverage is available at adequate and affordable levels for those persons who are in good faith entitled to obtain through the voluntary market an adequate level of such coverage which is required by state law or by reasonable or prudent business practices, and to determine whether rates for such coverage are excessive, inadequate or unfairly discriminatory". The Commission was therefore directed to hold hearings to investigate and determine the availability and affordability of insurance coverage in the Commonwealth. The Resolution also requested that the Attorney General's Office participate in these hearings. A discussion of the current insurance climate in Virginia by Attorney General Terry is found in Appendix A.

The 1987 General Assembly also passed House Bill 1235 which, among other provisions, created § 38.2-1905.1 requesting that the State Corporation Commission report annually on the level of competition, availability, and affordability for certain lines and subclassifications of commercial liability insurance in Virginia and then conduct hearings on whether competition is an effective regulator of rates. The first such report was completed in November, 1987 and released to the members of the General Assembly. This present study, pursuant to House Joint Resolution 261, was conducted as a supplement to that report on competition in Virginia and was directed toward a review of the liability insurance problem from the public's perspective.

Public Meetings

In response to the study request of House Joint Resolution 261, the State Corporation Commission directed the Bureau of Insurance to conduct public meetings around the state to determine the extent of insurance problems actually being faced by the Virginia consumer. Bureau staff organized and conducted these meetings in five localities - Roanoke, Richmond, Norfolk, Fairfax, and Winchester - to hear the

concerns of those consumers willing to step forward and relate their experiences about attempting to obtain adequate and affordable insurance. Transcripts of the meetings are available from the Bureau upon request.

Testimony Highlights

A total of 46 people testified at the five public meetings. Organizations that were represented included the Virginia Nurses Association, Virginia Council of Nurse Practitioners for the Southwest Region, Northern Virginia Council of Nurse Practitioners, National Alliance of Nurse Practitioners, National Organization for OB-GYN and Neonatal Nurses, Medical Society of Virginia, Virginia Independent Automobile Dealers Association, Virginia Pest Control Association, National Federation of Independent Businesses in Virginia, Virginia Van Pool Association, Northern Virginia Family Day Care Association, Frederick County Fruit Growers Association, and Virginians for Fair Rates and Fair Compensation. In addition, Bureau staff heard from nine nurse practitioners, five physicians, three lawyers, two community association presidents, two family home day care providers, two cab drivers, a driving school owner, a moving and storage firm owner, a wrecker service owner, a realtor, a restaurant owner, two homeowners, a charter boat operator, an ice skating arena manager, a school superintendent, a county administrator, a gymnastics school operator, two consumers of health services, a corporate secretary of a multi-bank holding company, and a medical center administrator.

Individuals from many segments of our society and from all areas of the Commonwealth came forward to testify about their concerns over the current insurance climate in Virginia. What was heard at the meetings was that many Virginians are being affected by the high premium increases, unexpected policy cancellations, and the unavailability or limited availability of particular lines or subclassifications of insurance that has characterized the liability insurance "crisis" nationwide.

Due to the general nature of public meetings and the relatively small number of individuals who spoke, the testimonies may not be representative of each business area and are offered only as examples of what has occurred to business owners and managers in Virginia. Excerpts of the testimony have been presented verbatim so that members of the General Assembly are provided an accurate account of the specific concerns of the Virginia insurance consumer.

Conclusions

As previously noted, the testimony offered at the five public meetings is being presented as supplemental information to the report on competition developed by the Commission. And while that report identifies the specific lines and subclassifications where competition may not be an effective regulator of rates, one general conclusion drawn from the public meetings held pursuant to House Joint Resolution 261 is that the cost of liability insurance is a serious problem facing many business owners, public entities, and professionals in Virginia.

The issue of cost was most clearly seen with the nurse practitioners. Faced with a 2500% increase in premiums this year, more nurse practitioners than anyone else came forward at the public meetings and pleaded for help. The aggregate coverage available to them was decreased from 3 million dollars to 1 million dollars while their premiums increased from $58 to $1,500, causing many nurse practioners to consider leaving the field because they simply cannot afford the insurance.

The report on competition in Virginia that was developed by the Commission is an expansive source of information in determining the availability and affordability of liability insurance in Virginia. Therefore, while the findings of this current study conducted pursuant to House Joint Resolution 261 may provide supplemental information from the consumer's perspective, any specific conclusions or recommendations are deferred to those made in the Commission's report.

GENERAL ASSEMBLY OF VIRGINIA -- 1987 SESSION

HOUSE JOINT RESOLUTION NO. 261

Requesting the State Corporation Commission to hold hearings to investigate and determine the availability and affordability of insurance coverage in the Commonwealth.

Agreed to by the House of Delegates, February 7, 1987
Agreed to by the Senate, February 19, 1987

WHEREAS, recent higher than normal premium increases, unexpected policy cancellations, and the unavailability or limited availability of particular lines of insurance have affected practically everyone; and

WHEREAS, despite all of the problems Virginia citizens and businesses have experienced in this regard, the State Corporation Commission has not conducted any hearings to determine if, in fact, insurance coverage is available at adequate and affordable levels; and

WHEREAS, such hearings are needed to determine whether insurance coverage is available at adequate and affordable levels from insurers authorized to transact business in this Commonwealth or in a particular geographic area for those persons who are in good faith entitled to obtain through the voluntary market an adequate level of such coverage which is required by state law or by reasonable or prudent business practices, and to determine whether the rates for such coverage are excessive, inadequate or unfairly discriminatory; and

WHEREAS, it is important to protect policyholders and the public against the adverse effects of the unavailability of any class, line or type of coverage at adequate levels and from excessive, inadequate or unfairly discriminatory rates; now, therefore, be it

RESOLVED by the House of Delegates, the Senate concurring, That the State Corporation Commission is requested to conduct hearings to investigate and determine the availability and affordability of insurance coverage in the Commonwealth.

The Office of the Attorney General is requested to participate in these hearings.

The State Corporation Commission shall report its findings by December 1, 1987 to the General Assembly.

INTRODUCTION

Problems in obtaining liability insurance at reasonable and affordable prices continue to be faced by many businesses, public entities, and professions in Virginia today. The insurance consumer has been confronted with escalating premium rates, lower policy limits, higher deductibles, and a narrowing of insurable risks. In some cases, insurance is not available at any cost. Many of these consumers are expressing concern and outrage at what has been labeled the liability insurance "crisis" when examining the availability and affordability of insurance coverages considered essential or required by law. Increased consumer dissatisfaction is also apparent with insurance companies' administration of claims settlement procedures as well as procedures for policy termination and non-renewal.

The effects of the current insurance climate are being felt across the Commonwealth and nationwide. Police departments are decreasing patrols and cities are dismantling playgrounds either because of a lack of municipal liability insurance or because of restrictions placed on the coverage when it can be found. Many obstetricians are leaving their field. The number of nurses - especially nurse practitioners - is also shrinking as these service-oriented professionals find it increasingly difficult, if not impossible, to obtain malpractice insurance. The escalating costs of medical malpractice insurance is showing up in the bills to patients, possibly placing quality medical care out of reach for many individuals. Day care facilities are closing because the increased cost for premiums cannot be passed on to the consumer; organizations are finding fewer volunteers willing to serve as board of directors members for fear of being sued, and business owners are risking their personal finances by going "bare" because the cost of liability insurance has become unmanageable.

The 1987 General Assembly requested several legislative studies to examine the insurance climate in Virginia including House Joint Resolution 261 which directed the State Corporation Commission to hold hearings to investigate and determine the availability and affordability of insurance coverage in the Commonwealth. In conducting the study for House Joint Resolution 261, the State Corporation Commission directed the Bureau of Insurance to conduct public meetings around the state to determine the extent of insurance problems actually being faced by the Virginia consumer. Bureau staff organized and conducted these meetings in five localities - Roanoke, Richmond, Norfolk, Fairfax, and Winchester - to hear the concerns of those consumers willing to step forward and relate their experiences about attempting to obtain adequate and affordable insurance. The Attorney General's Office also participated in all five public meetings. A discussion of the current insurance climate in Virginia by Attorney General Terry is found in Appendix A. Transcripts of the meetings are available from the Bureau upon request.

Several legislative measures were also passed by the General Assembly that were directed at easing the liability insurance "crisis". No discussion of the current insurance climate would be complete without a review of this ongoing legislative and regulatory activity that is being undertaken at the state as well as the federal level. Much of the testimony offered by those attending the Bureau's public meetings must be put into the context of these regulatory efforts that began after signs of a liability

insurance "crisis" became apparent in 1985. An overview of recent legislative activity can be found in Appendix B.

One recent bill, however, has a direct effect on this study and therefore will be briefly discussed here. House Bill 1235, among other provisions, created § 38.2-1905.1 requiring the State Corporation Commission to study the level of competition among insurance companies for personal injury or property damage liability lines or subclassifications of insurance for a commercial entity. An annual report is to be submitted to the General Assembly indicating the level of availability and affordability of those lines or subclassifications. In this study, the Bureau of Insurance is to identify those lines and subclassifications of insurance where competition may not be an effective regulator of rates. Through hearings, the Commission is then to determine whether competition is in fact effective.

The first annual report on the Level of Competition, Availability and Affordability in the Commercial Liability Insurance Industry (hereinafter referred to as the "Commission's Report on Competition") was completed and released to members of the General Assembly in November, 1987. The research for the report involved an indepth review of the level of competition in the commercial insurance industry through surveys to all insurers licensed to sell property and casualty insurance in Virginia, surplus lines companies, insurance agents, and consumers, as well as a review of the general Virginia market conditions and demand factors. In addition, the Commission's Report on Competition provides a comprehensive discussion of the liability insurance problem in Virginia. According to the results of that report, availability for most lines and subclassifications of commercial liability insurance appears to have improved considerably over the past year. Prices have started to level off as insurance companies' balance sheets have improved. All lines and subclassifications, however, have not yet been affected by the general turnaround of the profit cycles towards greater competition and availability. Since that report is a more expansive source of information in determining the availability and affordability of insurance in the Commonwealth, the findings of this current study conducted pursuant to House Joint Resolution 261 may provide supplemental information from the consumer perspective but any conclusions or recommendations are deferred to those made in the Commission's Report on Competition.

Although not specified in House Joint Resolution 261, much of the discussion in this current report about problems in obtaining and affording insurance has centered on commercial liability lines. Almost all of the consumers that came forward to discuss their concerns at the public meetings were businesses, public entities, and professions testifying about the effects of the liability insurance "crisis" on their professional livelihood. Since few individuals expressed concern about property damage or personal lines of insurance - except for personal auto insurance which is being reviewed under a separate study - this report will focus on an identification of the issues relating to commercial liability insurance. This is not to say that the "crisis" has not affected the personal lines but only that little evidence of such problems were apparent from the public meetings. The exception to this is the major problem facing family home day care providers who cannot afford commercial liability insurance but also can no longer obtain adequate coverage under their homeowners policies. These entities, while somewhat of an anomaly because they are businesses that are frequently insured under personal lines coverage, will be included in the public meeting testimony highlights.

The primary objects of concern for this study, therefore, are Virginia businesses, public entities, and professions that need affordable liability coverage in order to function and prosper. Since the findings of this study may provide supplemental information for the Commission's Report on Competition and subsequent hearings held pursuant to House Bill 1235, the highlights of the testimony from the public meetings held pursuant to House Joint Resolution 261 have been organized by the lines and subclassifications of insurance identified in the Commission's Report on Competition as being potentially non-competitive.

SUMMARY OF PUBLIC MEETINGS

Procedure for HJR 261 Study

Bureau staff organized and conducted five public meetings around the state to allow consumers the opportunity to come forward and express their concerns about being able to obtain and afford insurance coverage. Meetings were held in Roanoke, Richmond, Norfolk, Fairfax, and Winchester. Court stenographers recorded the entire proceedings for each meeting and transcripts are available from the Bureau of Insurance.

A total of 46 individuals testified at the public meetings. Individuals from many segments of our society and from all areas of the Commonwealth came forward to testify about their concerns over the current insurance climate in Virginia. What was heard was that many business owners, public entities, and professionals are being affected by the high premium increases, unexpected policy cancellations, and the unavailability or limited availability of particular lines of insurance that has characterized the liability insurance "crisis" nationwide. The Commission expresses its sincere appreciation to all of those consumers who were willing to share their concerns, thus providing the opportunity to gain additional insight into the nature of the liability insurance problem in Virginia.

This section highlights excerpts of the actual testimony offered. Due to the general nature of public meetings and the relatively small number of individuals who spoke, the testimonies may not be representative of each business area and are offered only as examples of what has occurred to business owners and managers in Virginia. As previously mentioned, any determination of the actual extent of the problem in Virginia will be left to the research and hearings conducted by the State Corporation Commission pursuant to § 38.2-1905.1.

Organization of Testimony/Findings of the Commission's Report on Competition

The Commission's Report on Competition reported that based on the study's findings, competition appears to be an effective regulator of rates for many subclassifications and types of coverages. Some of the generally competitive areas identified in the report include:

I. Premises/Operations Liability

- A. Trade Contractors Not Engaged In Commercial Construction
- B. Habitational Properties
- C. Retail and Wholesale Operations
- D. Other Service and Mercantile

II. Commercial Umbrella Liability

On the other hand, based on an analysis of the research, demand factors, and general market conditions, the Commission has reasonable cause to believe that

competition may not be an effective regulator of rates for the entire insurance lines of products and completed operations liability (including discontinued operations), environmental impairment liability, liquor liability, and directors and officers liability. In addition, competition may not be effective for the following subclassifications and types of coverage in otherwise competitive lines of insurance:

I. Premises/Operations Liability

A. Contractors Liability

1. Commercial contracting
2. Hazardous waste
3. Pest control/exterminators

B. Government or Municipal Liability

1. Government entities (including public officials liability)
2. Law enforcement agencies
3. School divisions
4. Public housing

C. Recreational Liability

1. Special events
2. All other recreational activities

D. Day Care/Child Care Liability

II. Professional Liability

A. Medical Professional Liability
B. Lawyers Professional Liability
C. Insurance Agents Errors and Omissions
D. Architects Errors and Omissions
E. Engineers Errors and Omissions
F. Real Estate Agents Errors and Omissions

Because this study being conducted pursuant to House Joint Resolution 261 is viewed by the Commission as a supplement to the Report on Competition, these categories will be used to organize the highlights of the testimony from the five public meetings.

Testimony on Potentially Non-Competitive Lines

Excerpts of the testimony have been presented here verbatim so that members of the General Assembly are provided an accurate account of the specific concerns of the Virginia insurance consumer.

1. In the **Premises/Operations Liability** line of insurance, under the subline of contractors liability, one type of coverage identified In the Commission's Report on Competition as potentially troubled was **pest control/exterminators.** The President of the Virginia Pest Control Association, speaking on behalf of his membership - representing over 150 pest control companies throughout the Commonwealth - and from personal experience, testified about the dramatic increase in premiums plaguing this industry. The following are excerpts from his testimony:

> I testified before Senator Parkerson's subcommittee studying tort reform [Senate Joint Resolution 22] and detailed the severe problems that the pest control industry was experiencing with regard to general liability insurance. In that testimony, I laid out the following facts:
>
> 1. There were only three carriers willing to write new coverage for pest control operators (PCOs) in Virginia. The rates charged for that coverage were outrageous — over $5.00 per hundred revenue — and not at all in keeping with our industry's claim experience.
> 2. The Commonwealth of Virginia, through the Virginia Pesticide Law, required PCOs utilizing restricted-use pesticides to carry a minimum of $100,000 in general liability coverage.
> 3. Since the Commonwealth had singled out our industry as being required to carry general liability insurance, then the Commonwealth had a moral obligation to see that coverage was not only available, but affordable. Coverage which becomes outrageously high is, for all practical purposes, unavailable.
>
> In my own business, I have watched my liability insurance premiums jump from just over $3000 in 1982 to over $20,000 last year. My policy is due for renewal this month. I received their quotation last week, and there was a 48 percent increase reflected in that premium over this current year. The year before, the increase in premium was 59 percent.
>
> At the time I received my renewal, I received a call from an insurance agency in North Carolina . . . they wanted to quote on my coverage . . . . After giving the agency some facts and figures, . . . the price [quoted] for coverage would be $27,000 for the year. My [original] agent said he could write with [a surplus lines carrier] ... I agreed to a quotation. Several days later, I received a call from the agent in N.C. who had been contacted by the Virginia surplus lines underwriter inquiring as to why the N.C. underwriter was allowed to quote a Virginia client N.C. rates. The botom line in this scenario is that the N.C. quotation of $27,000 was withdrawn and a new figure of $58,000 was quoted - a 120 percent differential.
>
> I appeal to the Insurance Commissioner and to the Attorney General to immediately look into this situation and determine why a $27,000 premium in N.C. has to be $58,000 in Virginia. Experience is not the culprit. It would surprise me if the experience of the N.C. pest control operators is any better than that of Virginia operators.

It is imperative that we get to the bottom of this rate disparity issue and remove the insurance hocus pocus game that has brought so much hardship to so many business people.

2. Also in the **Premises/Operations Liability** line of insurance, under the subline of government or municipal liability, one type of coverage identified in the Commission's Report as potentially troubled was **government entities.** The county administrator for Frederick County testified about the difficulties in finding adequate coverage for municipalities. The following are excerpts from his testimony:

> My county lost its insurance coverage, it was cancelled with no right to renew and we were fortunate to go with the Virginia Municipal League Group Insurance Pool. The underwriters with the group are very strict about what types of activities we allow. Particularly in the Parks and Recreation field we have cancelled several programs which we had routinely carried when we could procure [traditional] insurance, such as caving, gymnastics and several other activities.
>
> When I first came into this business as County Administrator, our annual premium was around $30,000 a year for all lines of coverage with a $10 million umbrella and now its $257,000 a year with excess coverage of one million dollars. And we were fortunate to get into the Virginia Municipal League Pool that, if I'm not mistaken, is not available to localities with populations in excess of 70,000. So I don't know what our Henrico's and Chesterfield's and larger counties and municipalities are doing as far as insurance and reinsurance, but it is a very serious situation.
>
> I was curious if it's possible if the industry could - if they decide to cancel a municipality - provide some criteria as to why they are cancelling a locality. Because in our particular case, under general liability, we had not filed a claim in 10 years. And on landfills there is no coverage at all for long term and short term environmental impairment. We are out there on our own and we can't buy a tail. If we could, I am sure we would attempt to, but the long term pollution from a landfill is a real possibility. You never know if it's going to occur. And if it does, the general fund is the one that's going to pay for it.
>
> It [the Virginia Municipal League Pool] is the only thing that would fill the void. Believe me, that we had no choice - no choice whatsoever. If you can understand that. Blanket cancellation throughout the Commonwealth and it's totally uncalled for, totally unfair and not three years ago the commercial carriers were breaking our doors down trying to sell us insurance. And within one year's time because interest rates dropped and the investments weren't as good for the insurance comanies, they started taking their losses and we were the result of it.

3. Another type of coverage under the subline of government or municipality liability insurance identified as potentially troubled was **school divisions.**

The Winchester area school superintendent testified about the problems faced in this area. The following are excerpts from his testimony:

> The problems we have had are primarily in the area of umbrella insurance. This is where our biggest concern and most critical crisis occurred.
>
> In August 1985, the school board entered into a 3-year contract on a renewable basis for all of the school system's insurance. The insurance was up for renewal August 1, 1986. On Friday, July 25 1986, our agent was called by the insurance underwriter of the school system's umbrella insurance advising him of a new rate, subsequently advising in writing on Monday, July 28, 1986. Our current coverage was to expire at midnight July 31st - four days later. We were advised by our agent that the premium for $5 million of umbrella liability coverage was going from $7,000 to $80,000 - over a one thousand percent increase. It is important to note that we had not had a liability claim against the system in the past 20 years - evidence that there was no legitimate reason for such an increase.
>
> Upon receipt of this information, the school board was somewhat under pressure and requested an extension on the coverage until other alternative coverage could be acquired. This request was denied. With regard to the enormous rate increase the explanation from the underwriter was that a substantial error had been made by the underwriter in setting the premium rate for the previous year. There was no explanation with regard to the unwillingness to extend coverage until such time further insurance could be acquired. After an investigation of the circumstances by the Bureau of Insurance, we were informed that the company was not in violation of the Unfair Trade Practices Act and/or insurance regulations of Virginia. I wrote a letter back to the Bureau stating that there is something wrong with the standards of conducting insurance business within the Commonwealth of Virginia that allows public bodies to be treated in such a manner.
>
> The school board recently purchased coverage through the Virginia School Boards Association premier plan. [Special legislation was passed in 1987 that allows school boards to get coverage negotiated through the Virginia School Board Association through a bid process.] I would hasten to add that we acquired $5 million worth of liability umbrella coverage at a cost of $9,984 -a far cry from $80,000. My personal opinion is that they [the original company] simply did not want to write the insurance.

4. In the **Premises/Operations Liability** line of insurance, under the subline of recreational liability, the category of **all other recreational activities** was one type of coverage identified as potentially troubled. Presidents from two community associations shared their similar experiences in having their organizations' coverage nonrenewed. The following are excerpts from their testimonies:

> (The first community association representative) - For the past several years, the community association has had a policy which provided one million dollars

worth of liability and medical protection. Included in our recreational center are tennis courts, children's playground equipment, a pool with supporting facilities, and an open "common area". In the 12 years that the recreation center has been in existence, there has not been one claim against us.

In early April 1987, we were notified that the company would no longer provide coverage for our community property because they were getting out of that part of the insurance market. Early April is about 6 weeks prior to us opening up the pool. You can imagine there was quite a bit of scrambling to find additional coverage or coverage just for the pool because it would have been irresponsible on our part to open up that pool without proper and adequate coverage.

We checked with several licensed insurance companies. None of these carriers were issuing new policies of this type. What we were forced to do was to go with a surplus lines broker. The problem, besides the short notice on cancelling our policy, was that to get another policy we paid approximately six times the cost for half the amount of coverage. The former one million dollar policy included medical and liability coverage and cost us $553 annually. The new policy of a half a million dollars of just liability coverage costs us $3,200 a year. That's a six times increase. If we had wanted to go with an equivalent one million dollar policy, that would have been nine times the cost of our original policy.

I guess what we would ask is that some type of rule be enforced that companies need to give more notice that just prior to opening up your pool that they're going to cancel your policy, and also that some type of explanation accompany the cancellation notice. We would have worked with the company if they would have said to us, it's your playground equipment that's causing the problem and that's why we are going to cancel you. We would have thought seriously about taking the playground equipment out of there, but there was no reason given other than the company was chosing to get out of that market segment.

(The second community association representative) - Our insurance was with the same company as [the first speaker] and just prior to the 45 days before our opening this year, we also received a letter cancelling our insurance. This was quite odd in that [the first speaker] had contacted me when he received his letter and I had called the company to see if our policy was still good. I was asured that everthing was okay and two weeks later I got a cancellation [nonrenewal] letter in the mail. So with a lot of scurrying around, we were able to secure coverage, but at about a 400 percent increase in our liability. As an aside, we have been organized for 20 years and only had one minor medical claim last year for a broken arm in cleaning the pool.

5. In another example of the category of **all other recreational activities,** a small charter boat owner from the Tidewater area testified about the effects of premium increases on his business. The following are excerpts from his testimony:

My interests are representative of a whole lot of other people in the business that are having the same problem as I am. My insurance has gone from $750 in 1984 to $3,300 last year. And I talked to a colleague of mine who just renewed his policy this year - his has been going up the same rate as mine - and this year the premium doubled from $3,000 to $6,000.

I've never had a claim. My agent said to pay it [last year's higher premium] because all the company wants me to do is balk because they don't want to insure this business anyway. Ten or 12 years ago, there was one boat that a water spout hit. The boat turned over and some people were drowned. That's the only accident I know about. I don't know how the insurance companies are basing their claims because I have talked to numerous other charter boat operators and they have never had a claim but their insurance is going up the same rate.

A lot of businesses can pass their increases on to the consumer. We're in a dying trade around here anyway. I mean, our business is dropping because of the pollution and things like this. We just cannot pass it on. It's going to put us out of business is what it's coming down to.

6. The Commission's Report on Competition only examined commercial lines of insurance. One of the subclassifications of premises/operations liability that was identified as being potentially troubled - **day care/child care liability** - has a counterpart in personal lines of insurance which has shown serious availability and affordability problems and therefore will be discussed here. The problems faced by family home day care providers were well documented in a study conducted last year by the Bureau of Insurance pursuant to House Joint Resolution 93 which was reported to the 1987 General Assembly in House Document 32. In the present public meetings, two providers representing the Northern Virginia Family Day Care Association - an organization of over 300 family day care providers who are taking care of up to five children at one time in their homes - testified on behalf their personal experiences as well as of family day care providers in general. The following are excerpts from their testimonies:

Two years ago, family home day care coverage was being cancelled in mid-term. For most of us, as of August 1985, we no longer had liability coverage. Many dropped out of child care at that time. And I'm talking about child care providers who had been taking care of children for maybe 15 years.

Many others held on thinking that maybe in the new year things would open up. They did not. At the time of the cancellations, most day care providers were going to homeowners policies that would write a rider. In the spring of 1986, we had five companies that would write the homeowners coverage. This type of coverage was somewhat limited but at least we were still getting it. We should have commercial liability but those plans are too expensive. Those companies that will provide riders on homeowners policies will only cover up to three children. For family day care providership to be a financially viable career option, most providers need to be able to care for

about five full-time children in their homes. If we who are long-term providers don't stay in business, parents who are looking for day care are left with the unregistered, unlicensed, uninsured kind of provider.

We felt we were being dealt with unfairly. We were told that we were a high-risk group; but yet there were not the claims to support this. And when this was brought up, then we were told that we had the potential of being a high risk. We are the ones that take care of 85% of the infants that are in child care. We are the ones that in some areas take up to 70% of the care of preschoolers. We also take care of a large group of school-age children, special needs children, and children of parents who have unusual hours. We are the ones who are out there almost like a service, but we feel like we are being abused by not being able to cover ourselves. We are vulnerable, and we want coverage.

Today, the availability of family home day care coverage is no better than it was two years ago. One company that came into the market last year is sending out nonrenewal notices across the board this year [including one to one of the providers testifying].

So far, in my personal search for family home day care insurance this year, I have gotten quotes anywhere from $823 per year up to $1,260 a year. This is after I paid $500 for my coverage last year. Now the thing is, even when we are talking about paying $1,200 or almost $1,300 for this insurance, they are saying that we cannot have a pool, we cannot have a dog, and they make all of these other exceptions. The latest one I heard was that I cannot have any play equipment in my back yard. I do not know of a day care provider that does not have play equipment in the back yard. So what they are saying is that they do not want to insure family day care providers.

7. In the **Professional Liability** line of insurance, the subclassification of **medical professional liability** was identified as being potentially troubled. This area was the most frequently discussed type of insurance at the five public meetings held around the state. In addition to nine nurse practitioners who came forward representing several different nursing organizations (Virginia Nurses Association, Virginia Council of Nurse Practitioners for the Southwest Region, Northern Virginia Council of Nurse Practitioners, National Alliance of Nurse Practitioners, and National Organization for OB-GYN and Neonatal Nurses), testimony was also provided by five physicians and a medical center administrator.

The following are excerpts of the testimonies offered by these individuals:

Testimony From Nurse Practitioners:

Major changes have recently occurred in liability coverage for speciality nurses and nurse practitioners insured by policies underwritten by Chicago Insurance Company (CIC). Those changes have resulted in an increase in premiums from $58 to $535 annually for speciality nurses and from $58 to $1,500 annually for nurse practitioners. Further, the aggregate coverage was

decreased from $3,000,000 to $1,000,000 and nurse practitioners who are not current insureds were excluded from the plan. This premium would be unaffordable to any nurse practitioners whose average annual salary is $26,000. In addition, CIC has indicated that this coverage will not be available at all in the future.

[NOTE: Medical malpractice rates fall under Virginia's delayed effective date law where insurers must obtain approval for their rates from the State Corporation Commission prior to using them. The Chicago Insurance Company has claimed exemption from this prior approval pursuant to the recently enacted federal Risk Retention Act. The Commission is currently contesting the authority of risk retention groups' ability to raise premium rates without complying with the Virginia Insurance Code's rate and policy form filing requirements but this matter has not been resolved at this time.]

According to information from the American Nurses Association, CIC issued a statement that their decision regarding nurse practitioners' coverage was not based on the analysis of experience it has sustained for this and other categories of nurses. Indeed, data from an actuarial study indicate that there were 21 claims in the past four years resulting in $820,000 in claims and expenses. These are national statistics representing 3,400 nurse practitioners. The average claim was approximately $39,000 against a policy which guaranteed $1,000,000 in coverage per incident, hardly the data base for raising the premium to $1,500 annually for current insured and not accepting new applicants.

A problem that seems to continue to puzzle me is that I have been covered as a nurse practitioner by [an agent for CIC] for 12 years, and only in the last two years was I asked to mark anything that I was other than a nurse, and not a nurse practitioner. So they have not really been keeping claims data accoring to the speciality areas as well as nurse versus nurse practitioner.

We believe that the proposed elimination of malpractice coverage by CIC for nurse practitioners is an undesirable amd uninformed act, and will be harmful to the people of Virginia for the following reasons:

1. Nurse practitioners are high quality providers whose practices have traditionally supplied health care services in areas where physicians couldn't or wouldn't serve [e.g., rural and inner city areas]
2. Nurse practitioners have traditionally been low-cost providers. While providing services in their speciality areas comparable with those provided by physicians, . . . their salaries range from one-third to one-quarter that of physicians. In a time of budget deficit and concern about the costs of health care, it is not in the public interest to allow low-cost and efficient providers to be forced out of practice.
3. The majority of nurse practitioners care for rural and indigent populations, working in rural health clinics, prisons, urban health departments and other underserved areas. Nurse practitioners have

made modern health care accessible to many Virginians previously unable to obtain it.

Some nurse practitioners with incomes below the average will not be able to afford the increase premium. The ramifications are broad. If the nurse practitioner does not take out liability insurance but is covered by the employing agency, this eventally translates into higher costs to the health care consumer. Considering that over one-half of the nurse practitioners' patients have annual incomes of under $10,000, this translates into more tax monies needed to subsidize health care costs. Additionally, nurse practitioners who cannot afford the premium may leave the rural areas, thus decreasing the accessibility of health care services to many Commonwealth citizens.

I do not understand. I have kept my nose clean. I have followed the rules. I have appropriate supervision. I have no claims against me after ten years in practice. I am admittedly practicing in the high risk area of obstetrics and gynecology, but my patients and my employers have been happy with my work; but none of this matters to the company who underwrites my insurance. A good record counts for nothing.

Testimony From a Medical Center Administrator:
In medical malpractice, there really are two components. One is the professional malpractice with the physician group and the other is the hospital, itself. On the hospital side, it tends not to be as hot an issue ... but nontheless I think it is something that is very, very important. And when I give you some of the numbers on what our costs are, it is something that I think is alarming and is something that eventually is going to be a very major problem.

I can go back to 1970 when the medical malpractice cost at my medical center was under $10,000. Ten years ago, it was in the range of $72,000 and presently, this year, for the same level of coverage we're paying $275,000. Over the past two years, our premium has increased 218 percent or $188,000. That is an astronomical increase that we've had to bear and our experience at our particular institution, we don't feel, has indicated any reason for those premium increases.

So we feel that while right now the hospital has been able to cover that cost, we're covering from fewer and fewer payers . . . so it's tougher for us to be able to absorb these premium increases. Right now, it amounts to about $19 per day of the cost of hospitalization.

So it's something that we are cncerned about. We are afraid of what the increase might be next year. It's available, but it's available at an ever increasing and escalating cost and the patient will ultimately pay that bill.

Testimony From Physicians:
In the past year, as a result of efforts from both the Insurance Commissioner's Office and the Medical Society of Virginia, the underwriting

asociation [Joint Underwriting Association - JUA] has been activated and at least insurance is now available to physicians, where a year ago there were certain specialities that could not obtain insurance. Right now the problem is affordability of the insurance.

We [the Medical Society of Virginia] would like to go on record as saying we are very concerned about the professinal liability insurance issue. We would also like to say we are concerned with and would like to put it on record that the curent rate increase proposed by St. Paul's of 47 percent in part is caused by their change in using experience from Virginia to a national rate, and we are also very interested in the Insurance Commission and the Attorney General and how they will look at this change. [Note: The State Corporation Commission recommended, and St. Paul's accepted, a 15% increase in rates.]

I think our general concern is that all of this is driving not only the cost of practice or the cost of health care to patients up, it's also driving physicians out of business. They're electing not to practice medicine when I think these very people could probably provide the least expensive care. I think there is great concern.

8. In the **Professional Liability** line of insurance, the subclassification of **lawyers professional liability** was also identified as being potentially troubled. The following are excerpts from the testimony offered by one lawyer:

I have been practicing [law] for 22 years, the last nine in Virginia. And as I saw my liability insurance increase, I made inquiries with [my agent]. And one criticism that I noted was that when I asked them why my rates were increasing from, let's say mine, from $400 to $700 to $1,200 in the course of two years when I have never had a complaint filed against me, I asked them why and they mentioned the numerous litigation and judgements they had to pay.

I asked them could they give me documentation; were they using national figures, or were they using Virignia figures. The documentation was never sent to me; however, I did get from them a statement that when I sent a letter indicating that I had a client threaten to sue me two years ago — it never amounted to anything, but I indicated that I should inform them that there was a potential lawsuit — they considered that letter a claim.

It seems to me that if they can use those kinds of statistics as claims to warrant increases in insurance, then I think the Commission should be looking over their shoulder.

Other Testimony Reviewed

Some of the problems and concerns expressed at the five public meetings should be alleviated by the legislation reviewed in Appendix B that has been enacted in the last two years. For instance, the Virginia Independent Auto Dealers Association

complained that insurance companies were not giving its members renewal quotes until after the policy's anniversary date (sometimes as long as 30-60 days after). And frequently the renewal quotes were much higher than the previous year. In another situation highlighted in the previous section, the superintendent of a school system received notice four days prior to the anniversary date of the school system's coverage that the premium for 5 million dollars coverage was going from $7,000 to $80,000. And there had been no liability claim on the policy in twenty years. In both of these cases, the provision under House Bill 1235 requiring companies to notify commercial insureds 45 days in advance if the premium renewal rate increases more than 25% should relieve the time constraints in shopping around for lower priced coverage.

The Virginia Independent Auto Dealers Association as well as an individual representing a bank holding company also expressed concern about the unavailability of D & O coverage. The Board of Directors for the Auto Dealers had no coverage and chose to run the risk of going bare. We also talked with day care associations who's voluntary board operated without insurance. One of the tort reform measures mentioned earlier limits the liability of officers and directors except in the case of gross negligence. It is hoped that this bill will revise the efforts of voluntary board members of many organizations who had become unwilling to serve for fear of being sued.

The re-activation of the Joint Underwriting Association should help the many physicians who attended the meetings who were concerned that their already expensive medical malpractice rates would climb even higher. While by no means inexpensive, at least medical malpractice insurance for doctors is available. In addition, medical malpractice rates benefited by another House Bill 1235 provision requiring that Virginia experience be used in the rate setting process when St Paul's, a major medical malpractice writer, settled for a 15% increase in rates this year after originally requesting a 47% increase. The smaller increase was accepted when the rate filing was examined in light of Virginia data.

Most of the other individuals who testified expressed concerns about the dramatic increase in their insurance premiums over the last few years. Many questioned why their coverage had been nonrenewed or rates were raised when no claims had been made against the policy. Some complaints were procedural and were resolved at the meeting while others were more rhetorical.

CONCLUSION

Availability for most lines and subclassifications of commercial liability insurance appears to have improved considerably over the past year. Prices have started to level off as insurance companies' balance sheets have improved. All lines and subclassifications, however, have not yet been affected by the general turnaround of the profit cycle towards greater competition and availability. House Joint Resolution 261 was passed by the 1987 General Assembly as one of many attempts to continue efforts directed at easing the problems of obtaining adequate and affordable liability insurance. The study resolution requested that the State Corporation Commission conduct public meetings to investigate and determine the availability and affordability of insurance coverage in the Commonwealth.

Five public meetings were organized around the state to provide Virginia consumers the opportunity to come forward and express their concerns. A total of 46 people testified. Organizations that were represented included the Virginia Nurses Association, Virginia Council of Nurse Practitioners for the Southwest Region, Northern Virginia Council of Nurse Practitioners, National Alliance of Nurse Practitioners, National Organization for OB-GYN and Neonatal Nurses, Medical Society of Virginia, Virginia Independent Automobile Dealers Association, Virginia Pest Control Association, National Federation of Independent Businesses in Virginia, Virginia Van Pool Association, Northern Virginia Family Day Care Association, Fredrick County Fruit Growers Association, and Virginians for Fair Rates and Fair Compensation. All in all, Bureau staff heard from nine nurse practitioners, five physicians, three lawyers, two community association presidents, two family home day care providers, two cab drivers, a driving school owner, a moving and storage firm owner, a wrecker service owner, a realtor, a restaurant owner, two homeowners, a charter boat operator, an ice arena manager, a school superintendent, a county administrator, a gymnastics school operator, two consumers of health services, a corporate secretary of a multi-bank holding company, and a medical center administrator.

The testimony offered at the five meetings is being presented as supplemental information to the Commission's Report on the Level of Competition, Availability and Affordability in the Commercial Liability Insurance Industry. And while the Commission's Report on Competition identifies the specific lines and subclassifications where competition may not be an effective regulator of rates, one general conclusion drawn from the public meetings is that the cost of liability insurance is a serious problem facing many business owners, public entities, and professionals in Virginia.

The issue of cost was most clearly seen with the nurse practitioners. Faced with a 2500% increase in premiums this year, more nurse practitioners than anyone else came forward at the public meetings and pleaded for help. The aggregate coverage available to them was decreased from 3 million dollars to 1 million dollars while their premiums increased from $58 to $1,500 causing many nurse practioners to consider leaving the field because they simply cannot afford the insurance.

Because the Commission's Report on Competition is a more expansive source of information in determining the availability and affordability of liability insurance in Virginia, the findings of this current study conducted pursuant to House Joint Resolution 261 are presented as supplemental information from the consumer's perspective. Any specific conclusions or recommendations based on the public meetings conducted pursuant to House Joint Resolution 261 are deferred to those made in the Commission's Report on Competition as required by § 38.2-1905.1.

APPENDIX A

ATTORNEY GENERAL'S PERSPECTIVE

HJR 261 REPORT TO THE GENERAL ASSEMBLY

STATE-BASED RATEMAKING AND THE AVAILABILITY AND AFFORDABILITY OF INSURANCE

MARY SUE TERRY
ATTORNEY GENERAL OF VIRGINIA

I appreciate this opportunity to offer comments relating to a matter of continuing concern to citizens throughout the Commonwealth, the affordability and availability of insurance. First, however, I wish to thank the Bureau of Insurance for making it possible for my Office to participate in the five public hearings conducted pursuant to House Joint Resolution 261. Second, and of equal importance, I wish to express my gratitude to the citizens of Virginia, the business owners and managers, the doctors, lawyers, nurses and other professionals, and to the public officials who took the time to attend the public hearings and present their views. Their experiences and their insights contribute significantly to our formulation of public policy initiatives, and I am grateful for their generous participation.

When one reflects upon the events of the past eighteen months, one fact leaps to the forefront. That fact is that insurance protection is a vital part of modern life. Nearly all individuals in our society, as well as business enterprises of all types and sizes, are exposed to a number of risks. The purpose of the insurance industry is to offer protection from the dangers of unexpected financial loss and uncertainty by promising to reimburse an insured's relatively large loss in return for the payment of a much smaller but certain expense, the insurance premium. Insurance has such a beneficial impact on the people and businesses of Virginia that it is difficult to imagine how our economy could function without it. Yet, that is precisely the threat that confronts us by what has come to be called the "liability insurance crisis." It is a crisis that has victimized all sectors of our economy and society.

Small businesses, municipalities, professionals, day care centers, trucking firms and countless others have suffered as a result of the unavailability and unaffordability of insurance in the Commonwealth. Addressing these problems has been one of my top priorities over the past year, the earliest of my efforts culminating in House Bills 1234 and 1235 which were sponsored by Delegate Tom Moss of Norfolk and passed unanimously in the 1987 Session of the General Assembly. I believe it is appropriate at this time to reflect on how we perceived insurance problems one year ago, how we addressed them during the last session of the General Assembly, and what we expect the impact of those reforms to be.

I. The Problem

More than a year ago, we became critically aware of, and testimony at the HJR 261 hearings continues to draw our attention to, the fact that Virginians across the Commonwealth have been paying dramatically higher prices for liability insurance. In some cases, they are receiving far less coverage at much greater cost. In other cases, they are unable to secure insurance coverage at any price. As a result, the liability

insurance crisis has siphoned off financial and human resources from our schools, from colleges, from cities and counties, from our hospitals and health clinics and from businesses large and small. It has become a problem of curbed potential and cuts in productivity. Time and money have been spent securing and paying for insurance rather than conducting the businesses and professions intended to be protected by that insurance.

What has caused this problem? Some say that it is the result of the boom and bust cycle of the insurance industry. Others say that eager lawyers and renegade juries are to blame. My research, however, has led me to a different conclusion. I am convinced that a major cause of the problem in Virginia is that there is not necessarily a direct relationship between the losses suffered by Virginians and the insurance rates they are asked to pay. A year ago, I suggested to the General Assembly that the solution to the problem was to forge the missing link, and I believe that that is precisely what has been accomplished. The insurance regulatory reform measures enacted by the General Assembly last February ensure that Virginia losses are considered in setting Virginia rates. In addition, the legislation requires the insurance industry to open its accounting books and provide certain information necessary both to examine more fully income from investments and to monitor how money is set aside and disbursed by insurance companies to resolve insurance claims.

A brief recap of the problems and the regulatory solutions reveals how far we have come. As many are aware, insurance companies file their rates with the State Corporation Commission ("SCC"). The SCC is charged with determining whether insurance rates meet the requirements imposed by law, namely that they are not excessive, inadequate, or unfairly discriminatory. The analysis performed by my Office, however, disclosed that, even though the SCC was authorized by law to obtain information from insurers about Virginia losses, that information was neither routinely requested nor supplied.

It stood to reason that if this information was not made available, there could be no confirmed correlation between losses experienced by Virginians and the rates they are asked to pay. Our research, however, led us to some specific discoveries regarding those losses. We learned from audited financial statements of the insurance industry for 1985 that for each liability insurance premium dollar paid by businesses in Virginia, only 17 cents was actually paid to settle claims. Nationwide that year, the average was 44 cents for every premium dollar paid. Adding to the 17 cents an amount sufficient to establish loss reserves required to cover anticipated losses, the total for Virginians' actual estimated losses was only 57 cents on the premium dollar in 1985. The nationwide average that year was $1.12. From audited financial statements of the insurance industry for the past year, we learned that for each liability insurance premium dollar paid by businesses in Virginia in 1986, only 20.6 cents was paid to settle claims. Nationwide, the average was 32.6 cents paid on the premium dollar. Adding in projected losses, the total earmarked for both actual and estimated losses was only 56.3 cents for each premium dollar paid by Virginians, as compared to 76 cents nationwide.

In view of data such as this, it is no wonder that the rate of return in 1985 for the general liability insurance industry in Virginia on an incurred basis was 37%. The rate of return nationwide was a negative 34%--i.e., a gain in Virginia of 37% and a loss nationwide of 34%. It is important to note that these calculations are developed on an incurred basis, not a cash basis. This means that money set aside to cover projected claims is counted as a "loss" on the industry's accounting books even though the money is invested and yields more money. On a cash basis in Virginia in 1985, the rate of return for commercial liability insurance was 168%. The nationwide rate of return was 67%.

Furthermore, recent studies indicate that the net after-tax earnings for the property and casualty insurance industry in the United States in 1986 were 12.7 billion dollars. These facts caused me--and still cause me--to have great concern that Virginians are not receiving full credit for their good loss record and that we are being asked to subsidize the poor loss records of other states.

II. The Regulatory Reforms

I am confident that the state-based regulatory reforms contained in House Bills 1234 and 1235 will ensure that Virginia's good loss record will carry the weight it deserves and benefit the Virginians who are responsible for that record. In addition to giving new weight to Virginia-specific data, the SCC will have access to information previously, as a practical matter, beyond its reach. For example, the SCC did not have access to certain information relating to insurance loss reserving practices. Specifically, there has been little information provided about money set aside to cover the losses the industry estimated it would have to pay in the future and the amount of money actually spent to resolve those estimated claims. The SCC has also lacked access to the full range of information on investment income, also crucial to determining whether rates are reasonable.

The new regulatory structure builds on and strengthens the regulatory framework already in place. The proposals are not radical departures from prior law. Rather, they expand upon prior law and merely require insurers to provide additional data necessary for the SCC to make more informed judgments as to the reasonableness of certain requested rate increases. Furthermore, they are limited in scope to the area where availability and affordability of insurance have been most acute--commercial liability insurance.

Finally, the new legislation begins with the assumption that open competition, where it is an effective regulator of rates, should continue to govern the pricing of liability insurance. But, where competition is not an effective regulator of rates, the new legislation provides a simple six-step process for ensuring that rates are reasonable.

1. Annual Report

The proposals first require the State Corporation Commission to report annually to the General Assembly on the availability, affordability and level of competition for lines of commercial liability insurance.

2. Designated Lines

If the SCC determines in the course of its investigation that it has reasonable cause to believe competition is not effectively regulating a particular line or class of commercial liability insurance, that line or class shall be so designated in the annual report.

3. Supplemental Report and 4. Hearing

A hearing or hearings will then be held to determine whether, in fact, competition is effectively regulating rates for each designated line or class. Prior to the hearing, insurance companies writing each designated line or class must file with the Commission a supplemental report providing certain required information. If, as a result of the

information and hearing, the SCC determines that competition is working to regulate rates for a particular line or class, any insurer writing that form of insurance may continue to use the current "file-and-use" rate filing procedures.

5. Delayed Effective Date for New Rates; Actuarial Analysis

On the other hand, if the SCC finds for a particular designated line or class that competition is not an effective regulator of rates, and an insurer wishes to change its rates for the line or class, two things happen.

First, the requested rates increase is transferred from file-and-use procedures to "delayed effect" procedures. This means that the use of newly filed rates will be delayed for sixty days while the staff at the SCC performs an actuarial analysis to ensure that those rates are reasonable.

Second, an insurance company submitting a rate must also submit the information required to perform this analysis. The SCC is empowered to request data on, among other things, loss reserves, loss receiving practices, and investment income, some of which was not previously available.

6. Claims Reporting

A final data reporting requirement was specifically imposed by House Bill 1234. It provides that insurance companies must periodically report data relating to the claims made against them and the resolution of those claims. This data is important for two purposes.

The first is to assist in ratemaking, so that the SCC and the General Assembly can make a critical examination of insurance company reserving practices.

The second is to help both the SCC and the General Assembly determine whether the tort reform proposals enacted already or to be enacted in the future are, in fact, working.

III. Prospects for the Future

I do not want to see the insurance industry denied a fair rate of return. I will not stand by, however, and allow Virginia ratepayers to pay excessive rates to cover insurance industry losses in other states. Accordingly, I am committed as Attorney General, and as the constitutional officer charged with representing the consumer before the SCC, to continue to press for fair and reasonable insurance rates. If necessary, I will authorize our Division of Consumer Counsel to secure an actuarial analysis and provide expert testimony at rate hearings. That is what we have done with the workers' compensation insurance rate hearings before the SCC each of the past two years. When rate hearings were held in the fall of 1986, the industry sought a 7% rate increase. We had our own actuarial analysis performed and recommended a 10% reduction in rates. The SCC ultimately ordered a 2.4% rollback of workers' compensation insurance rates. This year, in rate hearings before the SCC, the National Counsel on Compensation Insurance, a rate service organization representing the insurers, asked for a 19.7% rate increase. Again, my Office presented testimony indicating that the SCC should trim the rate by nearly 10% rather than increase the existing rate. Ultimately, the SCC declined to grant an increase in premium for workers' compensation insurance. While I stand by my judgment that the rate decrease would have been justified, I am gratified in knowing

that holding the premium steady represents some 80 million dollars that will be saved by Virginia workers' compensation insurance ratepayers this year.

When SCC regulators must step in to address problems caused by the breakdown of competition, I expect that intervention to strengthen rather than stifle the Virginia business climate. Good government promotes good business. I am committed, therefore, to a balanced approach to the liability insurance crisis. In addition to insurance regulatory reforms, I supported the tort reforms enacted as part of the solution to the problem of increasing costs for shrinking liability insurance coverage. For example, the General Assembly limited the liability of directors and officers of stock and non-stock corporations. It enacted my legislative proposal granting complete immunity from liability to individuals who serve voluntarily as officers and directors of non-profit organizations and limited liability for those who are paid for their services to such organizations. The General Assembly also reduced the number of individuals who may be exempted from jury service and it enacted penalties for lawyers and claimants who file frivolous claims and defenses in our State courts. These important changes and others will help maintain Virginia's enviable record of responsible trial awards.

What can we expect in the years ahead? In my judgment, we have not only formulated corrective measures, but we have also turned this crisis into an opportunity. I am confident that economic development opportunities will emerge from this difficult situation. Yet, it is unrealistic to expect an abrupt change in insurance rates. Problems that have emerged over time, problems that are ingrained in our economic and insurance systems, require time to be resolved. The approach demanded is one of balance, reason and patience. That is precisely how I view the reforms enacted thus far. I am confident that the new regulatory tools placed in the hands of the SCC will narrow the gap between insurance profits in Virginia and those in other states, while still yielding a reasonable rate of return for the insurance industry. I am confident, too, that these tools will also help to stabilize rates over the next few years, smoothing the roller-coaster pattern of rates that has followed the boom and bust cycle of the insurance industry.

But there is more to this story than stabilizing rates and narrowing the profitability gap. Through appropriate oversight of the insurance industry, coupled with meaningful and balanced tort reform, the opportunity within the crisis will surely emerge. We can turn the crisis of affordability and availability into an economic development opportunity. As rates in Virginia reflect lower losses in Virginia, businesses will have a competitive edge over rivals in other states that do not have Virginia's enviable loss record. Hopefully, then, businesses can devote more of their financial resources to developing, producing, marketing and delivering their services and products and fewer to meeting the insurance crisis.

I am encouraged that individuals in the public and private sector have demonstrated a willingness to work together to address this critical problem. That is the reason we in Virginia are in the vanguard of insurance reform. As Virginians, we have in our hands a legacy that respects the integrity and the responsibility of the individual. We have in our hands a heritage that balances personal initiative and social responsibility. It is a tradition that allows us to provide a bold and balanced response to the liability insurance crisis, a response that stands squarely in the finest tradition of Virginia government. Our insistence on state-based insurance rates places our economic and financial future as Virginians once more in our hands, and, as I have said on many occasions, that is precisely where we want it.

With these comments comes my commitment to the continued effort which must be made to deal with the insurance availability and affordability problems facing Virginia, its citizens, and its business and professional communities.

APPENDIX B

A REVIEW OF RECENT LEGISLATIVE ACTIVITY

RECENT VIRGINIA LEGISLATIVE/REGULATORY ACTIVITY

1986

1. Legislative Studies

The 1986 General Assembly directed several efforts toward easing the liability insurance "crisis" which had become apparent in Virginia the year before. A legislative subcommittee was charged by Senate Joint Resolution 22 with the examination of the causes, effects, and possible solutions to the problems experienced by political subdivisions, businesses and citizens of the Commonwealth in obtaining adequate and affordable liability and related insurance coverage. The subcommittee also examined the tort reparations system, including a review of the ability of that system to ensure an equitable method of determinng liability and assessing damages, and the impact of that system on the cost and availability of liability insurance. In a separate study, requested through House Joint Resolution 93, the General Assembly asked the State Corporation Commission's Bureau of Insurance to examine the problems that had resulted in the high cost of liability insurance for day care centers and family day care homes. The needs of day care providers had been separated from the general legislative subcommittee study because of the unique problems faced by the day care industry where higher insurance prices - when insurance was even available - could not be passed on to many of its consumers who use the services more out of necessity than desire. These studies provided the first legislative review of the effects of the liability crisis.

2. Regulatory Actions

In addition to the studies, legislation was passed in 1986 (pursuant to House Bill 469/Senate Bill 137) to allow local governments to form self-insurance pools for the purpose of providing insurance coverage for municipalities and their employees for acts or omissions arising out of the scope of their employment. Another bill (House Bill 140) was enacted requiring insurers to give 45 days written notice of cancellation or non-renewal of commercial liability insurance policies, except in the case of non-payment of premium where only 15 days would be required. In addition, a market assistance program, created in December of 1985, went into operation to assist commercial insurance buyers in obtaining difficult to place commercial lines of liability insurance. This program was specifically designed to assist in the placement of municipality liability insurance (excluding pollution coverages), insurance for day care providers, liquor liability insurance, and products liability for businesses with annual sales of three million dollars or less. And finally, a joint underwriting association for medical malpractice was established after one of the major writers of that coverage in Virginia announced plans to begin non-renewing policies, leaving about 600 doctors with no other liability insurance available to them.

1. Regulatory Action - Insurance Reform

The 1987 General Assembly continued these efforts and increased the pace of enacting measures to ease the liability insurance problems being faced by Virginia consumers. In an attempt to make insurance companies more accountable for their actions, two insurance reform bills were passed. House Bill 1234 provided for all liability claims for personal injury or property damage made against policies insuring commercial entities to be reported on an annual basis to the State Corporation Commission. This report will include such information as 1) claims by the type of coverage, 2) the amount of all reserves established in connection with such claims and all adjustments made to those reserves, updated on a quarterly basis until final settlement or judgment; 3) the amount paid by the insurer in satisfaction of the settlement or judgment; 4) the total number of claims and the average amount of each claim; and 5) attorney's fees and expenses paid by the insurer in connection with such claim or defense to the extent these amounts are known. Such information is intended to provide a clearer understanding of the claims experience for many lines of commercial insurance.

House Bill 1235 requires insurers of certain commercial insurance policies to provide the insured with written notice of reduction in liability coverage for personal injury or property damage as well as notice for an increase in the rate for such coverage of more than 25%. These notices of reduction in coverage or rate increase must be given at least 45 days prior to the policy's effective date and must comply with the same types of provisions required for notification of cancellations and non-renewals. This supplements the law passed in 1986 that requires 45-day notice in the event of policy cancellation or nonrenewal. The requirement for this notice of reduction in coverage does not apply, however, when the reduction in coverage is made for an entire line of business.

Another provision of House Bill 1235 requires the State Corporation Commission to study the level of competition among insurance companies for personal injury or property damage liability lines or subclassifications of insurance for a commercial entity. In this study, the Bureau of Insurance is to review competition and identify those lines of insurance where competition may not be an effective regulator of rates. An annual report will be submitted to the General Assembly indicating the level of availability and affordability of those lines or subclassifications. Through hearings on those lines or subclassifications, the State Corporation Commission is then to determine whether competition is in fact an effective regulator of rates. If competition is found to be effective for each line being reviewed, rates will continue to be filed with the Bureau of Insurance before use but no prior approval will be required as is now the case for most lines of liability insurance. If, however, competition is found to be an ineffective regulator of rates, rate provisions must be filed by the insurance company at least 60 days before the proposed effective date. During this period, the rates will be reviewed by the State Corporation Commission to assure that the proposed revision is not excessive, inadequate or unfairly discriminatory.

The intent of the insurance reform legislation was to provide the State Corporation Commission with the necesary tools to assure that insurance companies will be held accountable for the rates they set.

2. Regulatory Action - Tort Reform

As previously noted, a joint legislative subcommittee was created in 1986 pursuant to Senate Joint Resolution 22 to review the liability insurance problem in general. Although this study was continued for a second year, several tort reform bills were introduced in the 1987 General Assembly Session as a result of the review of the liability insurance problem by legislators on the subcommittee. The bills resulting from that study that passed in 1987 did so on the assumption that some type of control needed to be placed on the tort reparations system in order to provide insurance companies with a greater amount of predictability in estimating the amount of claims they might have to pay.

The tort reform measures that passed included Senate Bill 402 which placed a $350,000 monetary cap on the amount of punitive damages that can be awarded in personal injury cases. Senate Bill 403 limited the classes of people who may claim exemption from serving on juries in civil and criminal cases. Senate Bill 404 and its equivalent House version (House Bill 1088) limited the liability of corporate officers and directors in proceedings brought by or on behalf of shareholders of the corporation; a revision of the statute of limitations for minors in medical malpractice actions was accomplished through Senate Bill 405 (and its equivalent House version House Bill 1094); House Bill 1083 provided for sanctions to be imposed on attorneys who file frivolous lawsuits or who otherwise misrepresent the merits of any pleadings or motions; and finally, immunity was granted to members of local governing bodies for lawsuits arising from the conduct of their affairs except where such lawsuit involves the appropriation of funds or is the result of internal or willful misconduct or gross negligence through HB 1084.

Indicating that the work of the Senate Joint Resolution 22 subcommittee had only just begun, the 1987 General Assembly, through Senate Joint Resolution 109, continued the study for a second year. The focus of the study this year was to evaluate the need for and effects of implementation of various alternative dispute resolution techniques. The committee is to report their findings to the 1988 General Assembly.

The intent of the supporters of tort reform is that these measures might affect the predictability of claims and ultimately assist in stablizing the insurance premiums. Although it will take a few years for the effect of tort reform to become apparent, the results of some studies now being conducted at the national level suggest that a comprehensive set of changes in state tort laws could significantly reduce the costs of some liability claims.

3. Regulatory Action - Alternatives

One example of a type of alternative dispute resolution technique is the Virginia Birth-Related Neurological Injury Compensation Act which was enacted into

law by the 1987 General Assembly. The Act called for a fund to which doctors, hospitals and malpractice insurers would have to contribute. The fund would then would help finance the care needed by children who have suffered brain damage at birth because of oxygen deprivation or mechanical injury. The fund is designed to provide for children who are asphasic - unable to speak or comprehend speech - cannot walk and require lifelong care. The intention was that the fund be the only legal recourse for infants who suffer neurological injuries at birth in Virginia, thus limiting the possibility of outrageous claims settlements against physicians which would further affect the rates paid for medical malpractice insurance.

Another alternative to traditional insurance mechanisms is found in the federal creation of the Risk Retention Act. At the state level, the 1987 General Assembly passed House Bill 1168 which provides for the State Corporation Commission's regulatory authority over risk retention groups and purchasing groups. While preempted by the federal government from much of the normal state regulatory efforts, risk retention groups operating in Virginia are now subject to the State Corporation Commission's regulatory authority over financial solvency, false and deceptive practices, policy content as regards companies selling to purchasing groups, compliance with motor vehicle fiancial responsibility laws, licensing of agents, and payment of premium taxes.

4. Legislative Studies

The 1987 General Assembly also passed several study resolutions - in addition to House Joint Resolution 261 - to continue the examination into the liability insurance "crisis". Senate Joint Resolution 142, for example, requested that the State Corporation Commission's Bureau of Insurance study the cancellation and non-renewal of automobile insurance policies by insurance companies to determine whether additional state regulation was needed in this area. The resolution justified the study, stating in part that (1) Virginia citizens deserve to be protected from unjustified policy cancellations and non-renewals; (2) motorists may resort to driving uninsured because of their inability to secure insurance coverage at affordable rates after being cancelled or non-renewed; (3) some motorists are forced to seek coverage with Virginia's assigned risk plan after being cancelled or non-renewed; (4) many policyholders feel that they are not being given adequate notification of their cancellation or non-renewal; and (5) automobile insurance policy cancellations and non-renewals are sources of much anger and frustration for consumers who do not consider themselves as high risks. Based on the study's research which included a review of auto insurance laws in other states, a review of cancellation and nonrenewal practices of insurers in Virginia, and two public meetings to hear consumer concerns, the State Corporation Commission concluded that several changes in the insurance code may be needed to protect the public from unjustified cancellations and nonrenewals of their auto insurance policies. These proposed changes will be reported to the 1988 General Assembly Session.

Another study, Senate Joint Resolution 134, requested that the State Corporation Commission's Bureau of Insurance study the feasibility of creating a liability insurance residual market facility and joint underwriting association to assure the availability of liability insurance. This study was requested by the General

Assembly because (1) the insurance industry has had a history of cycles which at times has made insurance unaffordable, unavailable, or both; (2) there are individuals and businesses in certain professions and occupations that are unable to purchase liability insurance at all or only at very high rates; and (3) action should be taken to facilitate the availability of liability insurance at fair and equitable rates so that professions and businesses may be able to serve the public interest at all times regardless of the insurance climate.

Joint underwriting associations assure the availability of coverage that cannot be made reasonably available in the voluntary market. Some members of the General Assembly suggested that it may be in the public interest to establish a joint underwriting association whenever the lack of available insurance protection forces businesses to close down and professionals to discontinue their services. While joint underwriting associations help the problem of availability they do not alleviate the problem of affordability. Policyholders are usually required to pay a premium surcharge in addition to the base premium to help maintain a stabilization reserve fund which is used to cover deficits in loss reserves and ensure solvency. And not only does a joint underwriting association fail to solve the fundamental problem which created the availability crisis in the first place but its very existence could lead to insurers pulling out of an already restricted market to avoid participation.

Based on the study's research which included a review of JUA structures in other states and a discussion of the pros and cons , the State Corporation Commission concluded that a broad-based JUA be established for troubled commercial lines, to be activated by the General Assembly when needed.

RECENT FEDERAL LEGISLATIVE/REGULATORY ACTIVITY

Response to the liability insurance "crisis" has not been limited to the state legislatures. Activity has also increased at the federal level and may continue to do so for some time. The full impact of federal involvement in an area traditionally regulated by the states is yet to be seen but the likelihood that the federal involvement will cease in the near future is doubtful. Therefore, a brief review of this activity will provide a more accurate account of the current insurance climate. The two most far-reaching federal actions include passage of the Risk Retention Act and hearings on the repeal of the McCarran Ferguson Act.

1. Risk Retention Act

Last year, President Reagan signed the Liability Risk Retention Act of 1986 into law. The goal of the legislation was to help address the problems of availability of liability insurance through the formation and operation of risk retention groups and purchasing groups. Similar legislation, limited to product liability and completed operations liability insurance, was enacted five years earlier through the Product Liability Risk Retention Act of 1981. The 1981 law preempted certain state laws and regulations that tended to inhibit the formation of product liability risk retention

groups and purchasing groups. The 1986 legislation expands the scope of this preexemption to enable risk retention and purchasing groups to provide not only product liability insurance, but other types of liability insurance as defined in the bill.

With respect to risk retention groups, the 1981 law contemplated that the state in which the group was chartered would retain its authority to regulate the group, while non-chartering states would have more limited regulatory authority. The 1986 law retains this distinction, but augments the authority of the non-chartering states to regulate solvency, trade practices, and other matters. The law contains other provisions intended to ensure that risk retention groups and purchasing groups are appropriately supervised by regulatory authorities. Included is an annual reporting requirement to the insurance commissioner of the group's domiciliary state. The law also mandates the inclusion of a loss reserve opinion rendered by a qualified loss reserve specialist. As previously noted, the 1987 Virginia General Assembly passed a law pursuant to House Bill 1168 providing for state regulation of risk retention groups and purchasing groups in the Commonwealth.

The intention of the federal law was to provide new avenues for businesses seeking liability insurance that was otherwise unavailable or unaffordable. While it is too soon to quantify or assess the impact of this legislation on the availability or affordability of liability insurance, many groups affected most by these problems in Virginia appear to be attempting to create risk retention groups or purchasing groups under the Risk Retention Act. There are approximately 25 risk retention groups that have given notice to the State Corporation Commission of their intention to do business in Virginia. In addition, there are 132 purchasing groups that have submitted plans for operation in Virginia. A review of these groups indicates that they cover classes of insurance that have experienced availability and affordability problems (these include medical professional liability, products liability, day care liability, and recreational liability). The risk retention concept could play a major role in Virginia to alleviate extreme market cycles by providing alternatives to the traditional market.

2. Review of the McCarran Ferguson Act

Also last year, Senator Metzenbaum (D-OH) introduced legislation to repeal the McCarran Ferguson Act, the law that provides the business of insurance with exemption from federal antitrust laws. Believing that lack of competition is "very much" responsible for the liability insurance squeeze, he sought to bring insurance activity back under federal scrutiny. Since that time, several bills have been introduced to either have the McCarran Ferguson Act fully repealed or greatly amended. This activity has been tabled while the Senate Judiciary Committee reviews nominees for the Supreme Court but may reappear once that process is completed.

The McCarran Ferguson Act contains two major points: 1)it gives states responsibility for regulating and taxing the insurance industry, and 2) it exempts the "business of insurance" from federal antitrust laws. The antitrust exemption is limited to: 1) pooling and analysis of statistical data necessary for ratemaking purposes, 2) joint underwriting of risks that no single insurer could assume, and 3) development of standardized insurance policy forms that are intended to make the insurance product more understandable to consumers.

The antitrust exemption is available only where state governments regulate these activities but there is no antitrust immunity for insurance companies that engage in any boycott, coersion or intimidation.

Those in favor of repealing or amending the McCarran Ferguson Act blame the current liability insurance "crisis" on the lack of effective competition in the insurance industry. They note that the insurance industry is exempt from federal prohibitions against price-fixing and other anti-competitive practices and yet the price of liability insurance is skyrocketing. They point to the large premiums charged for certain lines of liability insurance and the large operating profit allegedly chalked up by property and casualty insurers in 1986 as proof of insurance company collusion. They believe that the availability and affordability of insurance can only be improved by the same mechanisms of competition encountered by other businesses. They also claim that requiring insurance companies to live by federal rules of free competition would not disrupt state regulatory programs and that the federal antitrust laws would still allow insurance companies to engage in joint activities that are in the public interest.

Those opposed to modifying the McCarran Ferguson Act in any way argue that such action would not solve the insurance crisis and in fact would worsen the problem. They argue that the antitrust exemption is totally justified due to the nature of the industry where a price must be set without knowing the cost of the product. Insurance companies must make educated projections based on predicted future losses, economic factors, legal standards, and a number of other variables. As a result, they claim, insurance companies must act jointly to gather any data available to make their estimates as accurate as possible. They also claim that stiff competition already exists in the industry and that the repeal of the exemptions would only have an adverse affect on affordability and availability. The application of antitrust laws to some of the current rating activities for traditional insurers, such as the pooling of statistics and the development of manuals and forms, may eliminate benefits which could result in a loss of savings to the consumer. In addition, these individuals claim that recent trends toward the development of insurance pools and residual market mechanisms for hard-to-place risks require the sharing of information and that alternative measures such as these may be in jeopardy If the McCarran Ferguson Act is repealed or amended.

The 1987 Virginia General Assembly passed two resolutions (House Joint Resolution 293 and House Joint Resolution 330) memoralizing Congress to repeal the immunity from the antitrust laws granted to the insurance industry, to subject insurance companies to the rules of the competitive marketplace applicable to other firms, recognizing the historic right of the states to regulate and tax the business of insurance. House Joint Resolution 293 added a request that legislation be enacted requiring insurers to report certain information regarding their profitability and designating as a crime the reporting of inaccurate information. As mentioned previously, federal scrutiny of the McCarran Fersuson Act will probably be reactivated in 1988.