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Legislation Enacted in Washington State May Have Increased Homeowners Insurance Claim Costs by as Much as \$190 Million Over Two Years, According to a New Report From the Insurance Research Council

MALVERN, Penn.—Mar. 30, 2011—According to a new study from the Insurance Research Council (IRC), evidence suggests that legislation adopted by the Washington State Legislature in 2007 and approved in a statewide voter referendum may have caused an increase in homeowners insurance claim costs in the state. It is estimated that claim costs were as much as \$190 million greater than they otherwise would have been in the two-year period following the law's enactment. The Insurance Fair Conduct Act, commonly referred to as R-67, eased restrictions for aggrieved insurance claimants filing lawsuits alleging bad faith against their own insurance companies, and authorized the payment of virtually unlimited punitive damages to bad-faith claimants, in addition to the payment of actual damages, attorneys' fees, and court costs.

To assess the impact of the new law, IRC compared claim frequency and severity loss trends in Washington with frequency and severity trends for a group of four states with similar first-party bad-faith laws that were in effect before Washington implemented R-67. For homeowners insurance, IRC documented a significant increase in average claim payments following the implementation of the new law. Although average claim payments also increased in the control group of states, the average increase in Washington was 17 percentage points greater than in the control group states. When changes in claim frequency are also taken into account, IRC estimates that R-67 may be responsible for a 21.9 percent increase in average claim costs for every insured dwelling in the state. With approximately 1.9 million insured exposures in Washington, total excess costs potentially attributable to R-67 for 2008 and 2009 are estimated to equal \$190 million.

The implementation of R-67 was expected to alter the incentives influencing the insurance claim settlement process. The potentially unlimited punitive damages possible under R-67 were expected to discourage insurers from questioning or investigating some claims that might have been fraudulent or might have included excessive charges. The expectation was that more questionable claims would be paid and that claim settlement amounts would be higher, on average, as insurance companies sought to reduce the risk of potential punitive damage awards.

"These findings suggest that major changes to the financial incentives insurers and claimants face in the claim settlement process can have a significant impact on claim settlement behaviors and outcomes, and, ultimately, insurance claim costs," said Elizabeth Sprinkel, senior vice president of the IRC. "This is important information for legislators to consider when contemplating major changes in liability rules and standards, such as was the case with R-67."

IRC also examined the effect of R-67 on uninsured motorists claims, but found less potential impact -- \$17.4 million in potential increased costs for 2008-2009. The smaller impact on uninsured motorists claims may be due to a variety of factors, including the possibility that the R-67 may not have been challenged or applied in major litigation involving uninsured motorist coverage. IRC was unable to estimate the impact on no-fault PIP claims due to the fact that a control group including multiple states with no-fault PIP benefits could not be constructed. It was confirmed, however, that much of the first-party bad-faith activity following the enactment of R-67 has involved PIP claims.

For more detailed information on the study's methodology and findings, contact David Corum by phone at (484) 831-9046 or by e-mail at corum@TheInstitutes.org, or visit IRC's Web site at www.ircweb.org. Copies of the study are available at \$140 each (printed copy) or \$125 (PDF).

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