SB 216

Department of Fiscal Services

Maryland General Assembly

FISCAL NOTE

Senate Bill 216 (Senator Pinsky*, et al.*)
Finance

Property and Casualty Insurance - Personal Lines - Rate Making

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The bill repeals competitive rating for private passenger motor vehicle insurance and homeowners insurance. This repeal reestablishes the prior approval method of rate regulation for these lines of insurance. This bill requires the Maryland Insurance Commissioner to order an insurer to refund the excessive portions of premiums collected, except for minimal refunds, if the Commissioner disapproves a personal lines property and casualty rate as excessive. If a refund is ordered, the Commissioner may order the insurer to pay interest at a rate set by the Commissioner. The bill also requires the Commissioner to review all rates in personal lines property and casualty insurance that were in effect between July 1, 1995 and September 30, 1997 under competitive rating. The bill also repeals (1) a provision that allowed the use of underwriting standards that had not been subject to statistical validation under some circumstances; and (2) the requirement of a three-year study regarding the use of those underwriting standards.

Fiscal Summary

State Effect: Potential indeterminate decrease in revenues from the insurance premium tax. Indeterminate increase in general fund expenditures in FY 1998 and in FY 1999, reflecting the one-time cost of reviewing rates in effect from July 1, 1995 to September 30, 1997.

Local Effect: None.

Small Business Effect: Potential meaningful impact on small businesses as discussed below.

Fiscal Analysis

Background: Chapter 352 of 1995 established competitive rating for those lines of insurance for which market competition seems to exist, including homeowners insurance and automobile insurance. Theoretically, the increased freedom of competitive rating relative to the prior approval method would allow companies to change rates as the market changes, and compete for business without going through a lengthy approval process, yet still allow the State some authority to intervene.

According to the MIA, between July 1, 1995 and October 11, 1996, 36 companies filed premium changes for homeowners insurance policies sold in Maryland. Some of the changes were decreases, while others were increases. The average of all premium changes filed was +3.4% and the weighted average, which takes into account the market share of each of the 36 companies, was +6.9%. During the same time period, 52 companies filed changes for private passenger auto insurance policies sold in Maryland. The average of all premium changes filed was +3.9% and the weighted average was +2.3%. It is noted that last year Maryland's two largest homeowner insurers raised their rates, on average, by 8% and 17%, with increases of as much as 44% in certain parts of the State. Auto insurance rates increased by as much as 70% in some parts of the State.

State Revenues: A return to the prior approval method could delay the implementation of a rate change filed by an insurer by approximately two months. To the extent that prior approval delays or prevents private passenger motor vehicle or homeowners insurance rate increases, revenues from the 2% insurance premium tax would decrease.

In addition, any premium refunds ordered as a result of the bill would result in a decrease in revenues from the premium tax. The number and amount of any premium refunds cannot be determined at this time. It is noted that there may be an indirect effect from insurers setting rates lower than they otherwise would have in order to avoid the possibility of a refund. If rates decrease for this reason, revenues from the premium tax would also decrease.

State Expenditures: The bill requires the Insurance Commissioner to review under prior approval standards all personal property and casualty insurance rates that were in effect between July 1, 1995 and September 30, 1997 under competitive rating. In order to review these filings MIA will need to hire one contractual analyst for a period of 15 months at a cost of about $50,635 ($30,381 for nine months in fiscal 1998 and $20,254 for six months in fiscal 1999). This is based on a contractual analyst spending 2.11 hours per filing reviewing an estimated 1,177 filings. In addition to review by an analyst, MIA sends major rate filings out to consulting firms for actuarial review. Expenditures would increase further depending on how many rate filings are sent out. The average cost per filing is $2,000 (20 hours per filing at $100 per hour). For illustrative purposes, if 135 filings (five filings for each of the 27 months during the period of competitive rating) were sent out for review, the total cost for these actuarial services would be $270,000 ($162,000 in fiscal 1998, $108,000 in fiscal

1999).

Small Business Effect: Insurance agents and brokers, nearly all of which are small businesses, may experience a loss of commission income, which is based on premiums charged, during any delay in the implementation of a private passenger motor vehicle or homeowners insurance rate increase filed by an insurer under prior approval. However, to the extent that prior approval delays or prevents private passenger motor vehicle or homeowners insurance rate increases, policyholders would benefit from lower rates.

The number of policies and the amount of premiums that might be affected by a refund order cannot be determined at this time. To the extent that small agencies and small premium finance companies would have to handle any refunds, the administrative burden and expenses of these companies would increase. In addition, refunds of premiums may result in a loss of commission income for agents and brokers. However, to the extent that policyholders receive refunds or insurers set rates lower than they otherwise would have in order to avoid a refund order, policyholders would benefit from lower rates.

Additional Comments: On November 19, 1996, the Insurance Commissioner announced proposed regulations establishing guidelines for use in determining when a rate change for a personal lines filing is excessive. Under the proposed guidelines, a premium rate increase will be scrutinized only if (1) the increase is 15% or more over the previous rate; or (2) the expected loss ratio is less than 65%, i.e., less than 65 cents of each premium dollar is to be spent to pay claims. If either circumstance exists, the Commissioner may conduct a public hearing to determine whether the rate is excessive. The guidelines require the Commissioner to consider the reasonableness of the insurer's expenses, the insurer's operating methods and anticipated expenses, the reasonableness of provisions for contingencies and profits, and whether the rate is likely to produce a profit that is unreasonably high in relation to services provided. As of this writing, the regulations are still pending.

Information Source(s): Maryland Insurance Administration, Department of Fiscal Services

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