# Department of Legislative Services
Maryland General Assembly
2010 Session

## FISCAL AND POLICY NOTE

Senate Bill 401 (Senator Pugh, *et al.*)
Finance

**Maryland Automobile Insurance Fund - Acceptance of Premiums on Installment Basis**

This bill authorizes the Maryland Automobile Insurance Fund (MAIF) to accept premiums on an installment basis only for 12-month personal lines policies subject to the approval of the Insurance Commissioner; requires the Executive Director of MAIF to submit an annual report to the Commissioner regarding MAIF's prior-year surplus and net direct premiums; and specifies the manner in which premium finance companies are to refund unearned premiums in the event of cancellation of a MAIF policy.

The provisions relating to MAIF accepting premiums on an installment basis take effect October 1, 2010, and apply to all policies and contracts issued by MAIF on or after October 1, 2010. The provisions relating to premium finance agreements take effect July 1, 2011, and apply to all agreements entered into on or after July 1, 2011.

The remaining provisions of the bill take effect July 1, 2010.

## Fiscal Summary

**State Effect:** General fund revenues decrease minimally if MAIF lowers its premiums due to the bill. Expenditures are not affected. The required evaluations and reports can be handled with existing resources.

**Local Effect:** None.

**MAIF Effect:** MAIF's nonbudgeted expenditures increase minimally due to processing monthly installment payments. MAIF's nonbudgeted revenues from installment fees increase correspondingly to cover additional expenditures; the magnitude of the increase depends on the amount of the monthly fee. Increases in fee revenues may be offset by decreases in premium revenues to the extent that MAIF is able to lower its premiums as a result of the bill.

**Small Business Effect:** Minimal.

## Analysis

*Framework of MAIF's Installment Payment Plan*: Beginning October 1, 2010, MAIF may accept premiums on an installment basis for 12-month personal lines policies, subject to the approval of the Commissioner. The Commissioner must ensure that MAIF's installment payment plan:

- requires an insured's initial premium payment to be at least 15% of the total premium;
- is structured and administered to ensure that MAIF does not provide insurance coverage to an insured unless MAIF has received the actuarially justified premium payment;
- offers a maximum of 9 installment payments on the 12-month policy;
- allows insureds to make premium payments in any commercially acceptable form; and
- allows the fund to impose an administrative processing fee of up to $8 per payment on insureds participating in the installment plan.

MAIF may not discriminate among insureds by charging a different written or earned premium based on the payment option selected by an insured or on whether the fund producer is employed by a public or private entity. Additionally, MAIF may not pay a fund producer a higher commission to place an insured in an installment payment plan over any other option, including a premium finance agreement. With respect to personal lines auto insurance written through MAIF, an independent insurance producer is required to provide the insured with a written disclosure form that compares the costs and terms of premium financing with MAIF's alternative payment plan.

*Communication of Payment Options:* Any written and electronic communication, including MAIF's web site, that affects the placement of coverage by MAIF or a fund producer must include a statement that advises applicants and insureds of available payment options. The statement must inform an applicant or insured that payment options include (1) MAIF's installment plan; (2) a premium finance agreement; or (3) payment of the policy in full. The statement must be included in written or electronic communication when an applicant or insured is issued a new policy; is issued a reissuance, rewrite, or renewal of an existing policy; or incurs additional premiums under an existing policy.

*Determination of Whether MAIF's Surplus Is Excessive:* Under the bill, the Commissioner may determine that MAIF's surplus is excessive. In making such a determination, the Commissioner must retain an independent actuary and hold a public hearing. Then, the Commissioner must report to the Senate Finance Committee and the House Economic Matters Committee on the status of the surplus and recommendations for potential distributions of any excess surplus. The recommendations must consider the trends of MAIF's annual year-end total surplus and MAIF's net direct written private passenger auto premiums. The Commissioner's recommendations must also be consistent with the fact that:

- surplus funds were derived from commercial automobile and private passenger automobile premiums and the investment earnings on those premiums;
- adequate surplus funds protect the driving public from a statutorily authorized assessment; and
- the total surplus grows and diminishes depending on external market factors.

*Cancellation of Premium Finance Agreements:* Beginning July 1, 2011, in the event of a cancellation of a MAIF policy, a premium finance company must credit or refund to the insured any unearned premiums due under the policy and any unearned finance charges, calculated by the actuarial method. The premium finance company must credit or refund the insured within 15 days after receipt of the unearned premium on the insured's policy.

*Annual and One-time Reporting Requirements:* On or before March 15 of each year, the Board of Trustees of MAIF must certify to the Board of Directors of the Industry Automobile Insurance Association MAIF's prior year-end total surplus and MAIF's prior year net direct written private passenger automobile premiums. On or before March 31 of each year, the Executive Director of MAIF must submit a report to the Commissioner containing the same information.

As noted above, if the Commissioner determines that MAIF's surplus is excessive, the Commissioner must submit a report to the Senate Finance Committee and the House Economic Matters Committee on (1) the status of the surplus; and (2) the Commissioner's recommendations for potential distributions of any excess surplus, including premium rate adjustments for MAIF insureds. The first report must be submitted on or before October 1, 2010, and a second report must be submitted on or before October 1, 2013, or two years following the inception of MAIF's installment plan, whichever is later.

The Executive Director of MAIF, in consultation with the Commissioner and other appropriate State agencies, must develop criteria for evaluating the impact and effectiveness of MAIF's installment payment plan. The evaluation, due to the Commissioner on or before March 31 of each year, must study the impact of the installment plan on the:

- cost of automobile insurance;
- number of insured and uninsured motorists in the State;
- number of policies in force per geographic area;
- duration of the policies in force; and
- frequency of payment methods used by insureds, including MAIF's installment payment plan, premium finance agreements, and cash and credit card payments.

Upon receipt of the report, the Commissioner must determine the impact and effectiveness of MAIF's installment payment plan, including a review of complaints received by the Commissioner relating to the plan and complaints relating to premium finance agreements. On or before December 1 of each year, the Commissioner must submit a report to the Senate Finance Committee and the House Economic Matters Committee on the impact and the effectiveness of MAIF's installment payment plan, and a determination as to whether MAIF's surplus is excessive.

By December 31, 2010, the Commissioner must study the enforcement of eligibility criteria for MAIF insurance coverage and submit a report to the Senate Finance Committee and House Economic Matters Committee. The report must include the Commissioner's recommendations to encourage MAIF insureds to obtain coverage from private insurers. By June 30, 2012, the Office of Legislative Audits must evaluate the overall costs of MAIF's installment plan and submit a report to the same committees. The legislative auditors' report must include:

- an evaluation of initial start-up and ongoing operating costs associated with the installment payment plan;
- the reduction of investment income resulting from implementation of the payment plan;
- the amount of earned but uncollected premiums and costs associated with collecting bad debt;
- the payment methods used by insureds including the extent to which insureds use MAIF's installment plan versus premium finance agreements, credit cards, and cash payments; and
- any other pertinent information requested by the auditors.

**Current Law/Background:** Created by the General Assembly in 1972, MAIF provides automobile liability insurance to residents of the State who are unable to obtain policies in the private insurance market. MAIF is authorized to insure a person who owns or leases a vehicle registered in the State, has a valid State driver's license, and has made good faith attempts to obtain a policy from at least two private insurers and has been rejected or refused for any reason other than nonpayment of premiums. In other states, private insurance companies share in insuring those unable to obtain insurance (known as the residual market) through an assigned risk plan in their respective state.

MAIF may not provide directly or indirectly for the financing of premiums or accept premiums on an installment basis. A premium owed to MAIF may be financed by a premium finance company registered with the Insurance Commissioner.

Thus, policyholders who are unable to pay their total insurance premium in advance must use the services of a premium finance company. The policyholder enters into a premium financing agreement, where the premium finance company pays the policyholder's total premium to MAIF and the policyholder agrees to repay the loan with finance charges and service fees in installments.

The finance charge and initial service fee that a premium finance company may assess include all interest, fees, and charges incident to the premium finance agreement and the resulting extension of credit. The allowable finance charge under a premium finance agreement is 1.15% for each 30 days, charged in advance. The finance charge is computed on the amount of the entire premium loan advanced, including taxes and fees, after the insured's down payment, if any, from the insurance contract's date of inception or the premium's due date. Premium finance companies typically require a down payment ranging from 11% to 15% of the premium with 10 additional installment payments to pay the outstanding balance owed.

The maximum initial service fee permitted is $20 for actual expenses. The fee is not refundable on cancellation or repayment. In addition, a premium finance company may charge an electronic payment fee of up to $8 for actual expenses incurred if the insured elects to pay the premium finance company with an electronic payment, including payment by credit card or debit card.

The Insured Division is funded through premiums, investment income, and when necessary, a surcharge on premiums statewide. MAIF is required to assess a surcharge on the Maryland automobile insurance industry whenever (1) the surplus of the Insured Division falls below the assessment threshold of 25% of the average net direct written premiums for the previous three years; and (2) there is an operating loss. As shown in **Exhibit 1**, the Insured Division's surplus is projected to total $101.8 million by the end of calendar 2010.

**Exhibit 1**
**Maryland Automobile Insurance Fund**
**Insured Division Surplus**

| | 2007 | 2008 | 2009 | Estimated 2010 |
|---|---|---|---|---|
| **Ending Surplus** | $184,753,525 | $138,701, 648 | $124,491,650 | $101,873,650 |

Note: MAIF operates on a calendar-year basis for its financial statements in accordance with State regulations for insurance companies. 2009 results are preliminary. Year-end adjustments and reserve changes may significantly alter the results.

Source: Department of Legislative Services, Maryland Automobile Insurance Fund

MAIF's surplus funds totaled $124.4 million as of December 31, 2009, which is $14.3 million lower than 2008 totals, and $60.3 million lower than calendar 2007 totals. The insured division's 2010 ending surplus is projected to decrease by $22.6 million year-over-year to $101.8 million.

**State Revenues:** MAIF is subject to the 2% premium tax administered by the Maryland Insurance Administration (MIA). General fund revenues from the premium tax decrease to the extent MAIF is able to lower its premiums because of the bill. Any such decrease in revenues cannot be accurately estimated but is assumed to be minimal. MIA anticipates that MAIF will make one filing subject to the $125 filing fee as a result of the bill.

**MAIF Effect:** MAIF's nonbudgeted revenues increase to the extent its policyholders choose to pay premiums on an installment basis. MAIF advises that it has approximately 60,660 private passenger policies in force and that most policyholders currently finance their premiums through a premium finance company. Some installment payments may be submitted by electronic fund transfer, but the majority are likely to be paid by check.

MAIF advises that it may only require limited, additional staff support to process the payments because existing staff who currently process payments from premium finance companies can likely be diverted to processing direct payments. MAIF further advises that it is likely to charge a fee that roughly equals its cost to implement direct billing. It is assumed that the installment fee that MAIF charges policyholders is similar to that charged by other insurers. These fees range between $4 and $8 per month but are more typically in the neighborhood of $5 per month. *For illustrative purposes only*, if MAIF charges a $5 monthly fee to 15,200 policyholders, its revenues increase by $684,000 annually.

To the extent MAIF's fee revenues exceed its additional expenditures, MAIF can lower its premium rates. Under current law, the minimum security required on a motor vehicle liability insurance policy for the bodily injury or death of a single individual is $20,000. The minimum security required increases to $40,000 for the bodily injury or death of more than one individual. The minimum security required for property damage is $15,000, in addition to interest and costs.

MAIF advises that 98.6% of its approximate 66,660 policyholders have selected the minimum $20,000/$40,000 liability coverage. As shown in **Exhibit 2**, the average premium cost per MAIF "20/40" policy ranges from $625 for Lower Eastern Shore policyholders to $1,861 for Baltimore City policyholders.

**Exhibit 2**
**Average MAIF Premium for 20/40 Liability Coverage**
**(as of February 2010)**

| Territories | 20/40 |
|---|---|
| Lower Eastern Shore | $625 |
| Outer Montgomery County | 933 |
| Outer Prince George's County | 963 |
| Inner Montgomery County | 1,161 |
| Inner Prince George's County | 1,089 |
| Outer Baltimore County | 1,259 |
| Inner Baltimore County | 1,413 |
| Baltimore City | 1,861 |
| Rest of the State | 876 |

Note: These rates are based on a policy for a 30-year-old male with no points and do not include collision or comprehensive coverage. Coverage for a 21-year-old driver would be higher.

Source: Maryland Automobile Insurance Fund

MAIF advises that the bill may save MAIF policyholders between $200 and $400 per year.

**Small Business Effect:** Small premium finance companies that finance MAIF insurance premiums may experience a loss of business to the extent MAIF policyholders choose to pay premiums on an installment basis. Small businesses that purchase insurance through MAIF and currently use premium finance companies may experience savings to the extent MAIF's fees are lower than the fees and interest charged by their premium finance companies. Any such impact is assumed to be minimal.

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## Additional Information

**Prior Introductions:** A similar bill, SB 419 of 2009, received a hearing from the Senate Finance Committee, but no further action was taken. Likewise, HB 406 of 2009 received a hearing in the House Economic Matters Committee, but no further action was taken. SB 603 of 2008, a similar bill as amended by the Senate Finance Committee, only passed second reading. Its cross file, HB 32, received a favorable with amendments report from the House Economic Matters Committee; no further action was taken.

**Cross File:** None.

**Information Source(s):** Maryland Insurance Administration, Maryland Automobile Insurance Fund, Department of Legislative Services (Office of Legislative Audits)

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