STATE OF MINNESOTA
DEPARTMENT OF COMMERCE

In the Matter of the Proposed Adoption of Rules Relating to Cancellation, Nonrenewal and Renewal With Altered Terms of Commercial Liability Insurance

STATEMENT OF NEED AND REASONABLENESS

Minnesota Statutes, sections 72A.17 - 72A.32 entitled Regulation of Trade Practices prohibit unfair methods of competition and unfair, deceptive and otherwise prohibited trade practices. Minnesota Statute 72A.19 subd. 2 provides the Commissioner with rule making authority in regard to the cited sections.

In addition Minnesota Statute 45.023 provides the Commissioner with the authority to adopt rules whenever necessary for the proper discharge of his duties. Administrative Law Judges in several contested cases have supported the Commissioner's authority to promulgate rules under this statute.

Complaints have been received by the Department of Commerce pertaining to midterm cancellations of many types of what are known as Commercial Liability Insurance. One area of major impact has been in regard to the midterm cancellation of insurance policies covering automobiles, trucks and other vehicles which are not within the definition of private passenger vehicles and are commonly known as commercial policies or fleet policies. These policies are in many instances a vital requirement for the affected insureds to continue in business. In the case of regulated carriers loss of insurance may mean loss of their licenses and permits to operate.

Cancellation of policies may jeopardize or in some cases actually terminate the insured's legal right to continue to do business as in the case of common carriers. In almost every instance prudent business practices dictate that lack of insurance places the business in jeopardy. A recent court decision in Iowa and administrative action taken by the Commissioners of Insurance in the State of Oregon and Florida have prohibited cancellations of these types of insurance policies during their terms. The Governor of New Jersey has placed a moratorium on such cancellations.

Insureds when negotiating the contract presume that the insurer will honor its contract for the entire term, accordingly termination prior to the end of the term of the contract is not something an insured can or does plan for. Because of this the insureds are often unable to find substitute insurance prior to the effective date of the cancellation. Midterm cancellation also has a negative effect upon how other insurers view the insured as a risk no matter what the justification for the

cancellation is. The negative effects of a midterm cancellation increase proportionately to the shortness of the notification period.

The past experience of most businesses has been that their commercial liability policies were renewed as a matter of course with only modest premium increases. The current market conditions are such that even businesses that should be considered good risks are now finding that their policies are not being renewed or are renewed with such significant changes in the terms as to carry all the negative impact of cancellation. Accordingly these rules are neccesary to address these situations as well.

2700.2400 SCOPE

Because the problems addressed by these rules are not unique to any particular type of commercial liability insurance, the rules have the broadest application possible. Certain types of insurance that are regulated by other agencies, or are unique enough that these rules would be inappropriate, or the policyholders of which would either be harmed or not benefit from these rules have been excluded.

Workers' compensation and employers' liability insurance are related coverages that have a significant separate body of law and rules governing them. A separate agency regulates this area. Minnesota Statute Section 176.185, Subdivision 1 already governs cancellation of such policies.

Ocean marine insurance is a unique type of insurance that would receive little if any benefit from these rules. Further there would probably be harm caused as to availability of this type of coverage if these rules would apply.

Reinsurance is so different from normal types of insurance and involves contracts between insurance companies not the public so that these rules would not be appropriate for that type of insurance.

Accident and Health insurance is also significantly different from commercial liability policies so that it would be inappropriate for these rules to apply to those types of policies. At this time the problems relative to other types of commercial liability policies doesn't exist as to accident and health.

2700.2410 MIDTERM CANCELLATION

This part specifies the only grounds upon which cancellation may be based. They are set forth as Items A-H. It enforces the presumption that there is a binding contract made at the time the policy is initially entered into which contemplates performance by both parties during the term

specified in that contract. Only extraordinary reasons should allow the insurer with its superior bargaining & economic position to aborgate that responsibility.

Items A and B pertain to matters that would negate the original bargain made between the parties. Items C-H set forth the only acceptable basis upon which events occuring after the contract is entered into would allow for cancellation.

Item A. Nonpayment of premium

The first reason, non-payment of premium, is the most obvious. It is one of the conditions that an insured must perform to discharge their part of the contract. If the insured does not perform this basic part of the contract then the insurer need not perform theirs.

Item B. Misrepresentation or fraud made by or with the knowledge of the insured in obtaining the policy or in pursuing a claim under the policy

This item, like the first, is based upon the idea that if the insured did not perform it's portion of the contract by making truthful representations to the insurer the insurer did not enter into the contract with full knowledge as to the risks and other matters that would be involved in its performance of the contract. Because the contract would have been obtained improperly the insurer should have the right to cancel that contract.

Item C. Actions by the insured occuring during the term of the policy that have substantially increased or substantially changed the risk insured

Item C provides that if the insured during the term of the contract substantially increases the risks or changes the nature of the risk insured that this might give rise to the insurers right to cancel. This recognizes that an insurers agreement to insure a risk is based upon its evaluation of the situation as it exists at the time the contract commences. It is expected that the situation will not change significantly during the term of the contract. If the insured acts in such a manner which alters that situation it is reasonable that the insurer should be able to decline to insure the altered risk since it is not the situation that the contract was premised upon.

Item D. Refusal of the insured to eliminate known conditions that increase the potential for loss after notification by the insurer that the condition must be removed

A change must occur that is so substantial that it results in a basic change in the situation upon which the contract was premised so that had that situation existed at the

inception of the contract the insurer would have not entered into the agreement or would have substantially altered it. Trivial changes would not give rise to a right to cancel.

Item D should be read in conjuction with Item C since risks known to the insurer at the time the contract is entered into are presumed to be part of the bargain that that insurer made and which it is insuring against. Conditions which occur after the contract is entered into would not automatically give rise to a right of cancellation. However, the insurer should have the right to demand that the insured return the situation to the condition that existed at the time the contract was entered into. The insured on the other hand has the right to be told of what such risks are and have the opportunity to correct them so as to keep the policy in force rather than the conditions giving rise to an automatic right of cancellation even if they are corrected. The purpose is to enforce the performance of the original bargain.

Item E. Substantial change in the risk assumed, except to the extent that the insurer should reasonably have foreseen the change or contemplated the risk in writing the contract

The considerations discussed in regard to Item C are generally applicable to Item E. Insurance policies are basically a contract between an insurance company and a policyholder to insure that policyholder against the risks posed by a certain set of circumstances. The insurance company bases its decision to insure a policyholder and what the charge for doing that upon its and other insurance companies experience in similar circumstances. The entire process involved is premised upon the evaluation of a known set of circumstances. Therefore, where there has been a substantial change in the risk assumed the entire evaluation process that went into the negotiation of the contract are invalidated by the change. In those circumstances the insurance company never intended nor expected to cover that type of a risk and the policyholder wasn't bargaining for that risk to be covered. Accordingly since the basis for the contract no longer exists the parties should be able to terminate the contract. In this type of case, of course, it would always be the insurer that would be likely to do this.

This right is qualified by the condition that if the insurer could reasonably have foreseen the change or contemplated the risk they can not use the change as a reason for cancelling the contract. This makes the company responsible for using its experience and the information available to it to evaluate possible future changes that may occur during the policy period and to consider them in the negotiation of the contract. If they could have reasonably done this and made it a part of their evaluation then when such changes occur the failure of the

company to do so should not give it an excuse to cancel the policy. The intent of this item being to only allow it to apply to situations where the substantial changes are unforeseeable.

Item F. Loss of reinsurance by the insurer which provided coverage to the insurer for a significant amount of the underlying risk insured. Any notice of cancellation pursuant to this item shall advise the policyholder that he or she has ten days from the date of receipt of the notice to appeal the cancellation to the commissioner of commerce and that the commissioner will render a decision as to whether the cancellation is justified because of the loss of reinsurance within five business days after receipt of the appeal

Reinsurance is a complex area of insurance. Briefly but certainly not completely, reinsurance is a means by which insurance companies attempt to spread the risk of loss in regard to any particular policy among more than the single company that issued the policy. It is viewed as a prudent business practice which is necessary for the financial wellbeing of insurance companies. Accordingly when the other company or companies that agreed to share a particular risk no longer wish to continue to do so it means that the issuing company would then be 100% responsible for that risk. This may be an unacceptable situation for the company. It may be based upon prudent business decisions and in some instances it is based upon legal requirements in regard to the amount of insurance that a company is able to offer. Reinsurance allows a company to offer more coverage to more people than it could if it only relied upon its own financial situation. Accordingly as the amount of reinsurance drops the amount of coverage that can be offered by the company also drops. Therefore if nothing else changes a company might find itself legally prohibited from continuing to offer the same amount of coverage it did prior to the loss of reinsurance. Accordingly some of the policies will have to be dropped for the companies to satisfy the various regulatory requirements. Because the question of whether loss of reinsurance would result in circumstances of this type is a judgement decision and because reinsurance is constantly being terminated and new reinsurance agreements replacing old there is a possibility that this particular exemption could be abused. Therefore a right of appeal to the Commissioner of Commerce has been granted to anybody who has been cancelled under this particular provision. If upon that appeal it is determined that a substantial loss of reinsurance justifing a cancellation did not occur the commissioner may order that the policy be reinstated.

Item G. A determination by the commissioner that the continuation of the policy could place the insurer in violation of the insurance laws of this state

In certain respects Item G is an expansion and a more general statement of what applied as to Item F in regard to loss of reinsurance. Because of declining profits, devaluation of assets, claims losses or many other reasons the financial status of a company may be such that it cannot continue to offer coverage to the number of policyholders or in the amount it has been offering it in the past. Therefore, some policyholders or some limits of coverage must be reduced to bring the company into compliance with the laws of the state. This may mean that policyholders are cancelled not through any fault of their own but because of the financial status of the company. However, to not allow for cancellation on this basis would mean that a company would be compelled to violate the laws of the state. While it may appear on a short term basis, to be a detriment to the policyholders that are cancelled on a long term basis it would pose a greater risk for them to continue to be insured by a company that may not have the financial wherewithal to meet the commitments of a policy that they have issued.

Item H. Nonpayment of dues to an association or organization, other than an insurance association or organization, where payment of dues is a prerequisite to obtaining or continuing such insurance; provided, however, that this provision for cancellation for failure to pay dues shall not be applicable to persons who are retired at 62 years of age or older or who are disabled according to social security standards

This particular item is somewhat analogous to the nonpayment of premiums criteria in Item A. The right to participate in a policy issued by an association or organization is in many cases premised upon membership in that organization. If you are no longer a member therefore you no longer meet the qualifications of those that can be insured under that association's plan of insurance. Membership and participation in an association is a basic premise in the offering of group rates There is a body of law that is intended to prohibit facetious groups or groups created or existing only for the purpose of offering insurance. To uphold the philosophy that membership is a condition to being entitled to the benefits of insurance coverage from such groups then that membership must be real. Accordingly where nonpayment of dues or membership fees would in almost every instance result in termination from the group if insurance was not involved then a policy issued to you as a member of that group must also terminate when your membership does.

Subpart 2. Notice.

For cancellation under part 2700.2410 subpart 1 item B-H a thirty day time period is required. Traditionally the periods of thirty or sixty days have been used for most cancellation notices under the terms of insurance contracts. Accordingly thirty days is a period of time that everyone is familiar with and fits with practices of companies and expectations of

policyholders. Minnesota also has several other cancellation statutes in regard to other types of insurance. For example, Minnesota Statute Section 65B.19 in regard to automobile insurance provides for a thirty day right of appeal and a sixty day notice of cancellation or nonrenewal. Other statues pertaining to homeowners nonrenewal and cancellation or nonrenewal of workers' compensation policies also use either thirty or sixty day periods.

The thirty day period was agreed to after extensive negotiations and discussions with insurers and insureds as to what the companies were capable of doing and what the insureds would like to have. A substantial consideration in picking the thirty day period, although not the exclusive criteria, was that the ability, at sixty days or further from the cancellation or nonrenewal date, of the company to have information in regard to such things as the proposed rate or change in terms. The longer the time period more speculative and less precise the information would be. It could mislead the policyholder as to what the situation would ultimately be. Thirty days is close enough to the effective date to allow the company to be precise in all respects in regard to the changes and conditions. The thirty day period was negotiated with the representatives of the insurance industry and was acceptable to them as a standard they felt that they could meet in a reasonable manner. Many comments have been received by the department from insurance companies and agents in regard to the prior midterm cancellation rules that were proposed indicating the inability of many companies to comply with the sixty day period of time.

Since nonpayment of premium is a very basic failure on the part of the insured to meet his or her obligations and is exclusively within the control of the insured, it was felt that it would be unfair to require the company to in effect carry the insured for thirty days at no cost. Because in some instances the reason for nonpayment may not be a mere willful failure on the part of the insured but may be an oversight or some other inadvertence a notice period was felt to be proper. The ten day period was arbitrarily picked as being a sufficient amount of time to allow the insured to respond. A shorter period of time, especially if the premium was significant or there was some question as to whether it was paid would not allow the insured adequate time to either raise the funds to pay it or to determine why the payment had not been received by the insurer. A longer period of time is subject to the same considerations in regard to the insurer providing free coverage. Therefore this time period is felt to be the fairest for both parties.

In regard to both notices, either the thirty day notice or the ten day notice specific reasons for the cancellation are required to be made. The insureds know the reason for cancellation and can, where circumstances merit, contest the cancellation on the basis that the reason is improper or not borne out by the facts or take whatever action is appropriate. Cancellation without a reason leaves the insured unable to

respond since they do not know the reason for the cancellation. Many of the complaints that the department received in regard to cancellation involved the inability of the insured to find out the reason for the cancellation or they were given non-responsive and non-explanatory reasons for cancellations such as failure to meet underwriting criteria.

Subpart 3. New policies.

The right to cancel a policy within ninety days from the time it was written contained in these rules is analogeous to similar rights with varying periods of time involved under other cancellations and nonrenewal rules and with the basic right under Minnnesota Law to cancel policies within a specified period after they are issued. The basic reason for this is that practice in most instances is for the insurance agent to issue a binder or even procure a policy for the insured prior to the time that the underwriters and other staff of the insurer have had a chance to fully evaluate the information in regard to the policyholder. The insurance company needs a certain minimum amount of time to evaluate that information and determine whether or not, based upon the total information they received, the risk they are insuring against is the same as was indicated to them in the preliminary documents by the insurance agent. Because commercial policies are based upon many more considerations and much more in the way of documentation than a homeowners or an automobile policy issued to a private individual, a period of ninety days was felt to be appropriate. Even if cancellation occurs under this provision a ten day notice is required to give the insured a certain minimal amount of time to secure replacement insurance.

Consideration was given to precluding this right of cancellation in the first ninety days or possibly limiting it to an extremely short period of time. These were dismissed because the result as indicated to the department by the insured companies would be that the insurance companies would have changed their method of doing business and not issued policies based upon representations by their agents. They would have ended the agents ability to bind the insurance company. This would have meant that instead of having a window of vulnerability as to cancellation within the first ninety days of a policy the companies would have created a situation where they would have taken 30,60 or 90 days or an even longer period of time to evaluate the risk before a policy was issued. This would have been an extremely radical change as to how the companies were doing business. It would have jeopordized the relationship of the insureds with their agents and, especially at the time of initial implication of such rule, would have probably resulted in businesses going uninsured for a certain period of time while the insurance company was making its evaluation. It would also have required businesses to start the development of this kind of information a business must provide an insurer long before current policies terminated. The effect of these changes would cause more harm than would be

generated in the way of benefits. Any benefit could be totally negated by legal and legitimate business practices of the insurance companies.

Subpart 4. Longer term policies.

Because some policies are issued for a period in excess of one year a method of determining what the operative date was for any notices was required. Accordingly the most logical date, the anniversary date of the policy, was used.

2700.2420 NONRENEWAL

Subpart 1. Notice required.

This subpart requires thirty days notice prior to the expiration of the policy, of the intent of the company not to renew. The thirty day period was picked for the same reasons discussed in regard to the thirty day cancellation notice. In the past insurance companies have given extremely short notices of their intention not to renew. This has worked an extreme hardship upon the policyholders when faced with obtaining coverage within a very short period of time. As discussed earlier the process of obtaining most commercial liability insurance requires the provision of a great degree of information to the insurance company. Discussions with various insurers who responded to the earlier proposed rule indicated that they could meet a thirty day requirement in this respect even when they found the sixty day requirement difficult to comply with. For policyholders it gives them sufficient notice to contact other insurers and develop the information needed to obtain coverage.

Subpart 2. Exceptions.

This section states a very obvious reason as to when a notice would be superflous and of no benefit to anyone.

2700.2430 RENEWAL WITH ALTERED RATES.

Subpart 1. General.

In certain instances even though the policy is technically renewed the insurance company for a variety of reasons changes certain terms and conditions. Generally this is in regard to the dollar amount of coverage or deductibles. Sometimes rates are increased or other changes are made that result in the new policy being significantly different from the insured's point of view from the policy it purports to replace. In such circumstances the insured is in the same situation as if they were nonrenewed or even cancelled. In effect they don't have the same coverage they had before. In some instances this may mean that their coverage no longer complies with licensing and other requirements. Because the effect of the renewal with altered terms is similar to cancellation or nonrenewal the same

notice requirements apply. The same reasons for the thirty day time period and other aspects of the requirement discussed previously would also be applicable.

There is a difference in the requirements of this particular part that relates to the reasons that were discussed in regard to allowing the cancellation of a policy within the first ninety days after issuance. In certain instances because it is necessary to obtain additional information from an insured or to evaluate the information the insured has already given, coverage is extended but the rate is not set or in some cases coverage is extended and certain conditions are subject to change. Policyholders accept this because the alternative is to have no insurance. It is a reasonable business decision on their part to do so. Insurers feel that it is a necessary requirement that they be allowed to change terms after the issuance of the policy for the same reasons described in regard to the cancellation within the first ninety days. To provide for the necessary business requirements of both parties but still not require that a policyholder be bound by terms and conditions that they were not aware of, this section provides that the policyholder, when they finally receive the information as to rates, deductibles and other information, has a right to cancel the renewal policy within thirty days after receipt of the notice. A premium can be charged on a pro rata basis.

Subpart 2. Exception.

"(a) rates" or excess rates also known as "consent to rate" rates are unique types of rates that generally apply only to a single insured and are based upon an evaluation process of the insured. Accordingly the insured generally is aware of what the rate would be and negotiates many of the changes. Accordingly the harm of a renewal with altered rates does not apply to these particular situations. The relief that subpart 1 grants would be of little if any benefit. In addition compliance would impose a burden on the process of calculating these rates with little if any benefit to the insureds.

2700.2440 INTERPRETATION AND PENALTIES

Subpart 1. Rules not exclusive.

This part was added for the clarification purposes for all parties that might be dealing with these rules. These rules are not intended to be the only source of relief in regard to the practices prohibited by the rules and should not be deemed to preclude anybody from pursuing other rights that they may have. The intent of these rules is to grant additional rights and to clarify rights that already exist, not to preempt any recourse someone may have who is prejudiced by actions dealt with by these rules.

Subpart 2. Penalties.

For purposes of clarification and so that all aspects pertaining to the conduct being regulated by these rules are contained in one place, the penalties for violations are repeated as subpart 2.

Subpart 3. Notices required.

As these rules require notices in a variety of instances and because the question has often arisen in regard to notices required by statute, by rule or for other reasons in regard to insurance contracts as to what constitutes adequate notice, those requirements have been specified in this subpart.

Because agents are often a critical factor in the process of obtaining replacement insurance and to give the agent as much time as possible to begin that function for the policyholder, notice must also be given to any agent of record in addition to the policyholder.

Repealer

These rules contain a repealer date of September 30, 1987. Because the problems addressed by these rules are a relatively recent phenomenon the industry and others who have commented on the situation feel that it would be likely not to occur in the future. Because it was not felt to be prudent to allow rules to continue to exist which address a problem that may have abated, the repealer date was included in these rules. If the problem would continue the department would be able to readopt the rules or seek statutory relief to address the problem.

Small Business Consideration

As is the case with most rules governing the conduct of insurance companies, especially trade practices, the intent is to benefit the policyholder. Every company no matter if they qualify as a small business or not must be subject to the same requirements or the group intended to be protected, the policyholder, would find that they have less rights if they deal with a company that qualifies as a small business then if they were dealing with a company that did not. While this may result in a lesser burden upon companies that qualify as small businesses it would defeat the purpose of protection of the policyholder. It might also have a negative effect upon the small business insurance company in that their policyholders would preceive that they have less protection then if they purchase their insurance from non-small insurance company. The result of reducing the requirements would be loss of business rather than a reduction in regulatory burden for insurers that are small businesses. In promulgating these rules all of the considerations required by Minnesota Statute 14.115 were addressed.

In regard to the considerations under subpart 2, item A would not be applicable since there are no compliance or reporting requirements. In the instance where "compliance" under these rules might be deemed to be the notice period, if a small business could use a period of time less than thirty days in which to give the required notices this would be counter productive and not appropriate to the intention of the rules.

For the reasons discussed in the preceding paragraphs changing schedules or deadlines for compliance or reporting requirements as discussed in item B would defeat the purpose of the rules and would probably be counter-productive for small business rules.

Item C would not be applicable for the reasons previously discussed in regard to items A and B.

Item D would not apply because of the nature of the rules. There are no design or operational standards in the rules.

The exemption of small businesses for reasons discussed in the opening paragraphs would also not be acceptable.

The small businesses that are probably most affected by these rules are not insurers but rather the small businesses that will now gain some protections and rights in regard to their insurance policies they did not have before. To give any insurance companies exemptions from these rules would be to reduce the rights of small businesses that are policyholders. The department concluded that the intent of the rules was protection of policyholders, small business or not, and therefore all insurance companies, be they small business or not, must meet the same standards to insure equal protection to all their policyholders.

Small businesses have been a part of the promulgation of these rules since inception. It was the complaints of many of these small businesses as to midterm cancellations, inadequate notice of nonrenewals, and the problems that they brought to the attention of the department that gave rise to these rules. The input of the various businesses be they small businesses or not, that are affected by midterm cancellations and nonrenewals was a part of this process even when not directly solicited. The department has had a number of articles and stories reported in the newspapers both in regard to rules themselves and the problem of midterm cancellation, which resulted in further contact with various businesses, small and large, explaining what the problems are and the kind of relief wanted. The problems and the rules were widely reported in the news media. The department is aware of no practical way of giving greater notification than has already occurred. The department will be making a mailing to every insurance company licensed in the State of Minnesota of the proposed rules.

Department personnel who may testify in regard to these rules are Richard Gomsrud, Department Counsel, Rey Harp, Deputy Commissioner, Gary La Vasseur, Deputy Commissioner, Tom O'Malley, Assistant Commissioner, William Kyle, Supervisor of Analysts Property Casualty, Don Peterson, Supervisor of Analysts Property Casualty, John Ingrassia, Supervisor of Analysts Life Health, and Michael A. Hatch, Commissioner of Commerce.