Statement of Need and Reasonableness for the Proposed Change in the Rates for the Liquor Liability Assigned Risk Plan

Minnesota Statutes, section 340A.409, subdivision 3 (g), requires that rates used by the Assigned Risk Plan (ARP) for liquor liability insurance must be on an actuarially sound basis. This is a change from the prior law which required premiums to be based on the rates used in the market. Given the new directive, the rate structure used by the ARP was reviewed by the Commerce Department actuary. Based on an analysis of the experience of the ARP and of the Transcontinental and Columbia Casualty Insurance companies, and with reference to the Rate Level Study of Liquor Liability done by Tillinghast, Nelson and Warren, Inc. in 1985 for The Insurance Federation, an overall rate decrease of 16.7% is recommended for the ARP. Larger or smaller rate decreases can be justified using the cited data. However in the opinion of the actuary the proposed rates are the most reasonable. The amount of decrease varies between the three classes. The proposed rates for the ARP are shown below:

ARP Basic Limit Rate for Vendors with Three or Fewer Incidents in the Last Three Years

Bars	$1.70 per $100 of liquor receipts
Restaurants	$1.17 per $100 of liquor receipts
Package Stores	$ .34 per $100 of liquor receipts

The rates for vendors with four or more incidents in the last three years would be unchanged.

The basic data for this analysis are the total premiums and losses for liquor liability insurance as reported by Transcontinental Insurance Company, a subsidiary of CNA Insurance Companies. Transcontinental is the major writer of liquor liability insurance in Minnesota, writing 87% of the market in 1986. The basic data from CNA is summarized in the chart below.

Minnesota Liquor Liability Cummulative Data as of 12/31/87

Accident Year	Written Premium	Earned Premium	Paid Loss & Expense	Incurred Loss & Expense	Undeveloped Loss Ratio
1983	2,656	1,713	2,096	2,778	1.62
1984	1,941	2,375	1,629	2,593	1.09
1985	9,969	6,997	1,262	3,518	.50
1986	18,604	16,375	434	4,342	.27
1987	17,422	18,139	16	1,635	.09

The ARP was established in late 1984 because of the sharp restriction in the market place. The withdrawal or insolvency of several companies which had previously written liquor liability coverage on a monoline basis resulted in Transcontinental's predecessor, Columbia Casualty, also owned by CNA, becoming virtually the only monoline writer. At the same time the rate for the coverage increased dramatically. The ARP adopted the basic limit rates used by Columbia Casualty effective 11-1-84.

CNA did not provide any actuarial justification for the rates they were using. Concerned about the rate level, the Insurance Federation of Minnesota hired Tillinghast, Nelson & Warren, Inc., an actuarial consulting firm, to review the rates. The Tillinghast report concluded that the ARP rates were within the range of reasonableness; in particular "Experience indications as of January 1, 1985, vary from 4.0% higher to 18.7% lower than the proposed assigned risk rate level, depending on the source data utilized and the assumption regarding general overhead expense".

The dramatic rate increase promulgated by CNA in late 1984 had a significant effect on loss experience clearly shown in the above chart. However, CNA is not able to quantify the rate change. Consequently, the rate analysis in this review was based on the most recent three years of data. This data also incorporates a second rate increase of 10.9%, effective June 1, 1985, when CNA shifted the book of business from Columbia Casualty to Transcontinental.

In any rate review, expected loss development is a key part of the analysis. Although the CNA loss development is the most recent available and is based on Minnesota experience, there is concern that the CNA reserves may be overly conservative. The CNA development patterns are significantly worse than any seen before in Minnesota, despite changes in the law designed to reduce loss costs. It is the department's belief that as losses are settled, these reserves will develop downward. The true answers, of course, will not be known until the claims are closed. In the interim, the industry patterns as stated in the Tillinghast Report were used for loss development because they reflect a greater period of experience. The development in the most recent year was additive rather than multiplicative, reflecting the need for increased stability in this period.

As mentioned before, there was no way to adjust premiums to current rate level. There was also no way to adjust for premium deviations, either credit or debits. Given this, it was not appropriate to adjust losses for inflation. Instead, it was assumed that the average loss ratio reflected current conditions. The developed losses were increased 5% to allow for loss cost increases in excess of premium growth during the year the proposed rates will be in effect, a percentage based on the Tillinghast study.

The permissible loss ratio of 59.5% was also based on the Tillinghast study. This is a break-even loss ratio, offsetting the fact that no adjustment was made for investment income.

Once the overall rate indication of -16.7% was developed, it was necessary to distribute the effect by class. Although the class data is relatively new and of limited credibility, it should be given some recognition. The premium and loss data shown in the chart below indicates that restaurants and package stores have had significantly fewer losses than bars. The ratios for the former are approximately half of the bars' ratio.

1985 - 1987 Minnesota Liquor Liability by Program as of 12/31/87
(dollars in thousands)

	Earned Premium	Incurred Loss + Alloc Exp	Undeveloped Loss Ratio
Bars	18,829	6,015	.32
Restaurants	11,856	1,866	.16
Package Stores	4,120	597	.14
Other	5,858	671	.11
Total	40,663	9,149	.23

The chart below compares the old ARP rate with the new ARP rate. The reductions reflect the differences by class shown in the chart above, with the decreases for restaurants and package stores being twice as large as the decrease for bars. When these changes are averaged, using CNA's distribution of earned premium as weights, the overall effect is -16.7%.

Rates Changes Proposed for the ARP

	Old Rate	New Rate	% Change
Bars	$1.89	$1.70	-10%
Restaurants	$1.52	$1.17	-23%
Package	.42	.34	-20%

Small Business Consideration

Minnesota Statutes §14.115 requires that an agency when proposing a new rule or an amendment to an existing rule which may affect small businesses, shall consider the impact on small businesses and in particular certain specified considerations as to the impact on small businesses.

It is the department's position that the nature of this rule, since it sets the rate for the Liquor Liability Assigned Risk Plan and by statute must be done on an actuarial sound basis, does not allow for deviations in regard to the impact on small businesses. A rate which would not be actuarially sound cannot be set for small businesses. The rate must be based on the risk each type of business presents to satisfy this requirement. Because the actual premium paid is based on sales volume the rate applied to that volume automatically reduces or raises the premium paid in accordance with the size of the business. In addition it is the department's belief that by and large all of the entities that would likely be obtaining insurance through the Assigned Risk Plan would be small businesses. Accordingly the impact on this type of business is considered throughout the rulemaking process. However, once again the department is working within the constraints of the statutory requirement of establishing an actuarily sound rate.

As to the specific requirements of subdivision 2 of section 14.115 the department does not believe that:

(a) the establishment of less stringent compliance or reporting requirements for small businesses applies in this instance since there are no compliance or reporting requirements.

(b) the establishment of less stringent schedules or deadlines for compliance or reporting requirements for small businesses applies in this instance since we are only establishing a rate for insurance.

(c) The consolidation or simplification of reporting compliance requirements for small businesses is applicable because its a rate establishment rule.

(d) The establishment of performance standards for small businesses to replace design or operational standards required in the rule is applicable because there are no design or operational standards.

(e) The exemption of small business from any and all requirements of the rule is applicable because of the nature of the rule.