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Minnesota Department of Commerce

STATEMENT OF NEED AND REASONABLENESS
(Provided to Governor's office on May 19, 2008)

Proposed Amendments to Rules Governing Credit Life, A&H Insurance, chapter 2760.

I. INTRODUCTION

The Minnesota Department of Commerce (Department) proposes adoption of new permanent rules governing rates and forms for life insurance and accident and health (A&H) insurance that is sold in connection with credit transactions such as consumer finance loans. The proposed rules would replace existing Minnesota Rules, Chapter 2760. The primary purpose of the proposed rules is to provide better value to consumers by improving policy benefits and reducing policy rates. In addition, the new rules will streamline the rate approval process and facilitate a fair and stable marketplace for credit insurance products.

II. BACKGROUND OF MINNESOTA REGULATION OF CREDIT INSURANCE

Credit insurance is insurance on a debtor in connection with a specific loan or other credit indebtedness, but does not include insurance provided in connection with mortgage loans. Minnesota Statutes, in chapter 62B, authorize and regulate three kinds of credit insurance in Minnesota: credit life insurance, credit A&H insurance (frequently referred to as "credit disability" insurance), and credit involuntary unemployment insurance.

Credit involuntary unemployment insurance (IUI) is regulated under Minnesota Rules, chapter 2761, and is not affected by the proposed new rules, which relate solely to credit life and credit A&H insurance. Chapter 2761 was adopted in 1995, and the Department concluded after reviewing that chapter, and reviewing the premiums and claims experience for credit IUI, that the rules for credit IUI do not need to be updated. The prima facie rates are much simpler, and the amount of premiums is much smaller than for life and A&H insurance.

Each type – credit life, credit A&H, and credit IUI – may be issued on either an individual policy or group policy basis. For the insured debtor, credit insurance ensures that a specific loan or indebtedness (for example, a new car loan) will be paid in the event of the debtor's death or loss of income through disability or involuntary unemployment. For the lender, credit insurance provides protection against loan defaults. A recent study of credit insurance by the Federal Reserve Board[1] reports broad and consistent consumer satisfaction with credit insurance.

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[1] Appendix 1. All appendices are hereby made part of the Department's record in support of the proposed rules.

Like most insurance products, credit insurance is regulated primarily at the state level, and all fifty states regulate credit insurance. Credit insurers report annually to the National Association of Insurance Commissioners ("NAIC") their information about credit insurance sales, rates, and claims experience, and the NAIC provides this information to the states. Because of its status as the national organization for state insurance regulators, and its access to information, the NAIC is a recognized source of information about the insurance industry in general. State regulators rely on it for information and special projects concerning credit insurance.

Minnesota has comprehensively regulated credit insurance since the passage of Minn. Stat. Ch. 62B in 1967. Chapter 62B establishes a general scope of regulation (62B.01); defines terms (62B.02); authorizes the types of policies mentioned above (62B.03); limits the size of policies relative to debts (62B.04); establishes term periods, requiring refunds in the event of loan prepayment (62B.05); and mandates policy provisions, rates, forms and policy delivery terms (62B.06–.08). Chapter 62B also prescribes certain claims standards (62B.10); and gives consumers the option to use existing insurance policies instead of a new credit insurance policy, when a lender requires insurance as security for a loan (62B.11). Under the statutes, the Commissioner of Commerce has the authority to make rules, which are subject to judicial review (62B.12–.13); and the ability to impose sanctions for violations of orders concerning credit insurance (62B.14). Rules regulating credit insurance were first promulgated under 4 MCAR 1.9091–1.9100, and were later recodified under Minnesota Rules, chapter 2760. The centerpiece of the existing rules is the regulation of prima facie rates, as amended in 1977 and again in 1987.[2]

III. INTRODUCTION TO THE NEED FOR THE PROPOSED RULES

The Department recognizes that regulation of a complex industry should evolve over time, especially since the industry itself is evolving. The existing credit insurance rules explicitly recognize the changing nature of credit insurance rates and the possible need for future revisions. Minnesota Rules, part 2760.0800, entitled "Continuing Study," provides as follows:

"The commissioner of commerce feels it necessary to observe that the maximum rates as well as any approved deviations established and permitted in this chapter are not to be considered as the final solution to the rate problems in credit insurance in this state. Study of the matter will therefore be continued by the division [of the Department], reports from the companies will be required, and further statistics will be accumulated. It is hence deemed appropriate that this matter be called up at a later date for further review and adjustment as the findings might dictate."

In the 20 years since the last rule amendments, the credit insurance industry has changed dramatically. Many of these changes can be identified in the following three sources:

[2] A copy of Administrative Law Judge Jon Lunde's report recommending adoption of the 1987 rule amendments is attached as Appendix 2.

- an October, 2007 Special Report on credit insurance by AM Best Research ("Best Report")[3],
- a 2001 NAIC publication in the Department's files, Credit Life Accident & Health Insurance by State 1997-1999, and
- a 2007 NAIC publication, Credit Life Insurance and Credit Accident & Health Insurance 2002-2006[4].

The changes include the following:

- **Industry consolidation:** In 1999 the NAIC database showed 57 writers of credit life insurance in Minnesota. By 2006 there were 33. For A&H insurance, the corresponding numbers were 52 and 36.

- **Decline in net written premiums:** Net written premiums are a measure of the new business being put on the books. For example, for a single premium level benefit policy, if an insurer collects a premium of $1000 for a 5-year loan, the written premium is $1000, but the premium earned in that year is only about 1/5 of the single premium or $200. If a loan is paid off or the insurance otherwise terminates, then the refunded premium is deducted from the gross written premiums, giving a net number. Between 1999 and 2006, credit life insurance premium in Minnesota fell from almost $40 million to $17 million, and during that same period, credit A&H premiums fell from over $53 million to $25 million.

- **Change in loss ratios:** Starting in 2001, the Department has taken enforcement action against certain credit insurers to require them to reduce their rates so that their expected loss ratio (claims incurred compared to premiums earned) would ultimately be 50%. This has resulted in increased industry-wide loss ratios according to NAIC statistics. Credit life loss ratios in Minnesota have increased from a weighted average of 37 percent in the period 1997-1999 to 43 percent in the period 2002-2006, a 16% increase. Credit A&H loss ratios, also increased, from 29 percent in the period 1997-1999 to 33 percent in the period 2002-2006, a 14% increase. The proposed reduced prima facie rates and related increased minimum policy benefits will further increase the industry-wide loss ratio.

- **Development of competitive non-insurance products:** Recent changes in federal law allow lenders to issue debt cancellation and debt deferment contracts to borrowers, and prohibit state insurance regulation of this type of contract.

The Department has been concerned about the fairness of premiums for consumers, given that the market-wide average loss ratio is still well below the 50% level, and as

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[3] Appendix 3.

[4] This publication is available for purchase at www.naic.org.

noted above has taken enforcement actions against certain companies for violation of Minn. Stat. § 62B.07 and the current implementing rule, Minn. Rule Pt. 2760.0200, which establishes a presumptive 50% loss ratio. For example, one case was heard by the Minnesota Court of Appeals, In the Matter of Universal Underwriters Life Insurance Company, 685 N.W.2d 44 (Minn. Ct. App. 2004).

However, such company-by-company rate review has proven to be cumbersome and unduly costly for both the Department, which has limited actuarial and legal resources, and for the companies, which have inadequate regulatory standards by which to measure their rate performance. There is a consensus that the existing rules no longer provide effective guidance for the Department's review of credit insurance rates and forms.

Given the need to update and streamline regulation, the Department proposes to replace the existing rules in their entirety with the proposed rules. The proposed rules are intended to achieve a number of important policy goals in the regulation of credit insurance:

- **Ensure consumers are receiving a fair value for their premium dollars:** This proposal will help to ensure the industry, as a whole, is meeting loss ratio expectations. Although the current rule sets forth a 50% loss ratio for credit insurance policies, enforcement on a company by company basis is difficult and can produce mixed results. By adopting *prima facie* rates based on industry experience, which are then adjusted periodically based on updated information, the state can ensure that the credit insurance industry is providing reasonable benefits in relation to premiums and that consumers are therefore getting good value for credit insurance products purchased in Minnesota.

- **Enhance benefits for consumers:** This proposal will produce more generous policy benefits for Minnesota consumers. Under the proposed rule, companies may use *prima facie* rates only if their policies provide certain specified benefits that are generally richer than what is currently available in Minnesota. These richer benefits include for example: (1) an increase in eligibility and termination to age 70 (compared to age 65 under the existing rule); (2) guaranteed issue of $15,000 in life insurance without medical underwriting; (compared to no guaranteed issue amounts under the existing rule); (3) a limitation on the suicide exclusion for life insurance to no more than six months (compared to two years under the existing rule); and (4) a limitation on applying pre-existing condition exclusions to no more than six months (compared to twelve months for longer-term credit A&H policies under the existing rule).

- **Balance insurer need for reasonable expense allowances and profits with protection against excessive rates:** The current NAIC Model requires a 60% loss ratio. However, the Department has reviewed the factors listed in Minn. Stat. § 62B.07, which directs the Commissioner to "give full consideration to and make reasonable allowances for underwriting expenses, including but not

limited to, claim adjustment expenses, general administrative expenses including costs for handling return premiums, compensation to agents, expense allowances to creditors, if any, branch and field expenses and other acquisition costs, the types of policies actually issued and authorized as defined in section 62B.03, clauses (1), (2), (3), (4), (5), and (6), and any and all other factors and trends demonstrated to be relevant." The Department has received descriptions of these expenses in rate filings and in administrative hearings regarding rate levels, and believes that the new base prima facie rates, in combination with the enhanced benefits, provide a reasonable allowance to the above-listed factors. Therefore the Department is continuing to use the 50% loss ratio guideline from the existing rule.

- **Establish a stable, competitive credit insurance marketplace:** The creation of a *prima facie* rate promotes stability in the credit insurance marketplace. Credit insurance is unique compared to other kinds of insurance because the product is sold through creditors, and consumers do not typically have the opportunity to shop for coverage among insurers. As a result, competitive forces do not operate as they do in other insurance markets. Establishment of a *prima facie* rate that is neither excessive nor inadequate will ensure a level playing field among insurers so insurers compete based on service and product offerings.

- **Simplify administration and enforcement:** The proposed rules will be easier for the Department to administer and contain built-in enforcement mechanisms. The *prima facie* rate will reduce time and expense spent on company-specific rate reviews by the Department, thus potentially saving tax dollars. The triennial rate review process will ensure industry rates remain up to date without the need for additional rulemaking. And the proposal includes a "mandatory downward deviation" in rates for those specific companies that have unacceptably low loss ratios at *prima facie* rates based on the company's actual claims experience. Simpler administration and more enforcement will be fairer for insurers and ensure greater protection for consumers.

The proposed rules will also achieve a number of other reforms such as clarity of refund methodology, applicability to variations in benefits, and flexibility for large creditors to have rates that are portable from one insurance company to another. The need for and reasonableness of the rules are discussed in more detail below.

IV. ALTERNATIVE FORMAT

Upon request, this Statement of Need and Reasonableness can be made available in an alternative format, such as large print, Braille, or cassette tape. To make a request, contact Susan Bergh, at the Minnesota Department of Commerce, 85 7th Place East, Suite 500, St. Paul, Minnesota 55101, phone 651-296-8458, email Susan.Bergh@state.mn.us.

V. STATUTORY AUTHORITY

The Department of Commerce's statutory authority to adopt the rules is set forth in Minn. Stat., §§ 45.023, and in Minn. Stat., § 62B.12 which provides: "The commissioner may, after notice and hearing, issue rules the commissioner deems appropriate for the supervision of §§ 62B.01 to 62B.14." Under this statute, the Department of Commerce has the necessary statutory authority to adopt the proposed rule amendments.

VI. REGULATORY ANALYSIS

Minn. Stat., § 14.131, sets out seven factors for a regulatory analysis that must be included in the Statement of Need and Reasonableness. Paragraphs (1) through (7) below quote these factors and then give the response from the Department of Commerce.

1. A description of the classes of persons who probably will be affected by the proposed rule amendment, including classes that will bear the costs of the proposed rule amendment and classes that will benefit from the proposed rule amendment.

Affected classes of persons will be insurance company issuers of credit life and credit disability insurance; lender and creditor producers of such insurance including banks, finance companies, credit unions, automobile dealers, and retailers; borrowers; and the Department of Commerce.

Insurance company issuers and lender creditor producers will bear the "costs" of premium rate reductions, computer program system changes, and insurance policy and certificate form amendments. They will also benefit from scheduled and predictable premium rate review and revision, administrative simplification, and clarification of compliance standards.

Consumer borrowers will benefit from reduced premium rates or expanded policy benefits, or both, while retaining a high level of consumer protection.

The Department of Commerce will benefit from improved administrative efficiencies while maintaining consumer protection.

2. The probable costs to the Department of Commerce and to any other agency of the implementation and enforcement of the proposed rule amendment and any anticipated effect on state revenues.

The Department of Commerce may incur rulemaking costs estimated to be $8,000. All or some portion of this cost may be passed to insurance companies subject to the proposed rule provisions.

Credit life and credit A&H insurance premiums are subject to a premium tax of 2.0%. The premium tax revenue to the state in 2006 is estimated to be $1,003,028, based on the total earned premiums in 2006. If the proposed rules had been in effect in 2006, the estimated premium tax revenue would have been somewhat less due to reduced premium

rates. However, sales of credit insurance products could increase or decrease in the future, resulting in additional variations in premium tax revenue.

3. A determination of whether there are less costly methods or less intrusive methods for achieving the purpose of the proposed rule amendment.

The Department of Commerce considered the enforcement history of the current rules, compared the methodology with the model regulation promulgated by the National Association of Insurance Commissioners (NAIC), and concluded that the proposed rules are the least costly and intrusive method for achieving the purpose as defined in statute. Most of the language is taken from the existing rules or from the NAIC's Consumer Credit Insurance Model Regulation (NAIC Model Regulation)[5]. Any modifications were technical in nature and were determined by the Department's actuary in consultation with insurers, an actuarial consultant, and an NAIC consumer representative.

According to the NAIC's 2007 report, from 1997 through 2006 the national credit insurance industry had credit life insurance loss ratios in the range of 41 percent to 43 percent, with an average of 42 percent. The comparable national numbers for credit A&H insurance were 39 percent to 50 percent, with an average of 46 percent. Other states have prima facie rates for life insurance ranging from $0.29 to $0.80 per year per $1000 of initial coverage, and prima facie rates for A&H insurance similarly vary widely. Minimum loss ratio requirements in other states are primarily in the 50 percent to 60 percent range. Given the lack of uniformity in state regulation, there was no clear model for a regulatory structure. Therefore the proposed rules have been developed based on a review of other states' experience, and appear to our experts to be the least costly and intrusive method for providing consumers with reasonable rates in relation to the benefits.

4. A description of any alternative methods for achieving the purpose of the proposed rule amendment that were seriously considered by the Department of Commerce and the reasons why they were rejected in favor of the proposed rule amendment.

The primary purpose of the current and proposed rules for credit life and credit A&H insurance is "to protect the interests of debtors and the public in this state by providing a system of rates, policy form, and operating standards for the transaction of credit life and credit accident and health insurance," as stated in section 2760.0010 of the proposed rules. Minn. Stat. § 62B.07 directs the Commissioner to "give full consideration to and make reasonable allowances for underwriting expenses, including but not limited to, claim adjustment expenses, general administrative expenses including costs for handling return premiums, compensation to agents, expense allowances to creditors, if any, branch and field expenses and other acquisition costs, the types of policies actually issued and authorized as defined in section 62B.03, clauses (1), (2), (3), (4), (5), and (6), and any and all other factors and trends demonstrated to be relevant."

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[5] Appendix 4

The Commissioner considered three methods for achieving this purpose.

The first method considered was a pure loss ratio standard, where the loss ratio is equal to the benefits to consumers divided by the premiums. This method requires the Commissioner to establish a minimum loss ratio that insurance companies must target in setting their rates. Each insurance company would be required to periodically review experience and revise premium rates if experience failed to meet the minimum loss ratio standard.

The loss ratio standard is not an efficient and effective method. Difficulties include the variation in loss ratio from year to year due to random fluctuations. This means that premium rate adjustments based solely on loss ratio will often produce excessive or inadequate rates in future years. In addition, the loss ratio standard allows the expense and profit portion of the premium to increase or decrease in proportion to the claims. This results in an inadequate expense allowance when claims are relatively low, and an excessive expense allowance when claims are relatively high. Accordingly, the Commissioner rejected this approach.

The second method is what can be described as a component analysis method. This method would require analyzing the statutory components of each rate on a company by company basis, setting a reasonable rate level for that company. While arguably the most equitable, the commitment of Department resources would be very expensive. Department staff would have to do a separate evaluation for each of at least 40 companies, and would have to periodically re-evaluate the rates for each company. There is considerable judgment involved in evaluating each component for reasonableness, and Department time would probably be taken up by lengthy disputes with companies.

The proposed rules use a third method, which is a combination of the previous two, combining the simplicity of a loss ratio standard with the equity of component analysis.

The Commissioner has reviewed an actuarial study of aggregate industry rate components, including claim experience, and determined a schedule of premium rates expected to produce a 50% loss ratio, on the average, based on past experience in the market. This schedule of premium rates is proposed as initial prima facie premium rates (presumed reasonable) for use by all insurance companies provided their future collective annual experience produces a loss ratio close to the 50% target. Some companies will have claim experience consistently different from the average, due to the population they insure or other factors, and they will then be required to deviate premium rates to reflect the difference between their actual claim cost and the expected claim cost built into the initial prima facie rates. Every three years, the Commissioner will review aggregate industry experience and adjust the schedule of prima facie premium rates to reflect the difference between actual and expected claim cost.

As a result, the allowable expense portion of the rates for all companies will uniformly be based on 50% of the new prima facie rates. The new prima facie rates are equal to the current rates for credit life insurance, and significantly lower for credit A&H insurance. The company's income is from this allowable expense portion of the rates and also the investment income earned by the companies, which is due to the receipt of premiums long before the payment of most claims. The Commissioner has determined that the result is a reasonable allowance for profit and expenses. Although it is somewhat lower than the current allowance under the current prima facie rates, the Commissioner expects that the current healthy and competitive market can be maintained at this reduced level of allowance for profit and expenses. Although increases or decreases in average claim costs will result in increases or decreases to the claims portion of the rates, the expense allowance will remain at the same level of 50% of the initial prima facie rates contained in the rules.

5. The probable costs of complying with the proposed rule amendment, including the portion of the total costs that will be borne by identifiable categories of affected parties, such as separate classes of governmental units, businesses, or individuals.

Initial compliance costs are roughly estimated at $500,000 and are estimated to be borne by insurance companies (80%) and lenders/creditors (20%) in connection with programming computer systems and refiling forms and premium rates. Some of this cost may be mitigated by coordination with other required actions, an opportunity facilitated by the implementation provision (section 2760.0110 below) requiring compliance 180 days after the effective date. Once the proposed rules are implemented, the annual cost of compliance will be less than under the current rule.

6. The probable costs or consequences of not adopting the proposed rule amendment, including those costs or consequences borne by identifiable categories of affected parties, such as separate classes of government units, businesses, or individuals.

The probable consequences of not adopting the proposed rules include excessive staff time for the Department in enforcing outdated rules, market instability and uncertainty, increased insurance company exits from the market, and diminution of related premium tax revenue over time as lenders/creditors convert to non-regulated debt protection products.

7. An assessment of any differences between the proposed rule amendment and existing federal regulations and a specific analysis of the need for and reasonableness of each difference.

Federal rules applicable to credit insurance are found in Regulation Z, 12 C.F.R. 226, issued by the Board of Governors of the Federal Reserve System to implement the Federal Truth in Lending Act. Section 226.4(d)(1) provides that voluntary credit insurance premiums may be excluded from the loan finance charge provided the coverage is not required and this fact is disclosed, the premium is disclosed, and the consumer signs an affirmative written request. §226.32(b)(1)(iv) applies to certain closed-end

home mortgage loans and provides that credit insurance premiums are included in the definition of points and fees. There are no conflicts between the proposed state rules and existing federal Regulation Z.

VII. PERFORMANCE-BASED RULES

Minn. Stat. §§ 14.002 and 14.131 require an agency that is developing rules to describe in the Statement of Need and Reasonableness how it considered ways it might afford flexibility for the regulated party in complying with the regulatory requirements being proposed while still meeting the agency's objectives.

The primary purpose of both the existing and proposed rules is to assure that the premium charge paid by the borrower is not excessive in relation to the benefits provided by credit life and credit A&H insurance. The existing rules have become outdated The proposed rules prescribe a schedule of premium rates and corresponding policy benefits, and also provide for an insurance company to file for approval of a different schedule of premium rates and policy benefits, subject to a demonstration that the premium rates are not excessive in relation to the benefits. In addition, the triennial review will ensure that prima facie premium rates are updated to reflect changes in average claim cost. This is consistent with Department of Commerce objectives and provides sufficient flexibility for the regulated insurance company to comply with the rules.

VIII. ADDITIONAL NOTICE

In addition to the statutory requirements to publish notice in the *State Register* and to mail notice to the persons on the Department of Commerce rulemaking list, the Department has provided the following additional notice:

1. E-mailing the notice of the proposed rule amendments to the following trade organizations that represent insurance companies and creditors in Minnesota:

   a. Consumer Credit Industry Association
   b. Minnesota Financial Services Association
   c. Minnesota Retailers Association
   d. Minnesota Mortgage Brokers Association
   e. Insurance Federation of Minnesota
   f. Minnesota Automobile Dealers Association
   g. Minnesota Credit Union Network
   h. Minnesota Bankers Association
   i. American Council of Life Insurers
   j. Independent Community Bankers of Minnesota
   k. Minnesota Independent Insurance Agents
   l. Minnesota Attorney General's Office
   m. Citizen's Council on Health Care

2. Notifying the Consumer Representatives of the NAIC of the proposed rule amendments.

3. Placing a summary of the notice of rulemaking on the Department of Commerce web page at www.commerce.state.mn.us.

The Department's Notice Plan also includes giving notice required by statute. The Department will mail the proposed rules and Notice of Intent to Adopt to everyone who is currently registered to be on the Department's rulemaking mailing list under Minn. Stat. §14.14, subdivision 1a. The Department will also give notice to the Legislature per Minn. Stat. §14.116. The notice and proposed rules will be published in the *State Register* on August 11, 2008.

IX. CONSULTATION WITH FINANCE ON LOCAL GOVERNMENT IMPACT

Minn. Stat. § 14.131 requires an agency to consult with the Commissioner of Finance to help evaluate the fiscal impact and fiscal benefits of the proposed rules on units of local government. The Department has had an initial consultation with the Executive Budget Officer (EBO) for Commerce, Keith Bogut, to brief him on the purpose of the proposed rules and the impact they would have on the interested parties.

The Department has consulted with the Commissioner of Finance by sending to the Commissioner of Finance copies of the documents sent to the Governor's Office for review and approval by the Governor's Office prior to the Department publishing the Notice of Intent to Adopt.

X. COST OF COMPLYING FOR SMALL BUSINESS OR CITY

Minn. Stat. §14.127 requires the Department of Commerce to consider whether the cost of complying with the proposed rules in the first year after the rules take effect will exceed $25,000 for any small business or small city. The Department has determined that the cost of complying with the proposed rules in the first year after the rules take effect will not exceed $25,000 for any small business or small city.

The compliance costs of the proposed rules will be borne largely by the insurance companies who issue the policies, and they are all entities that do not qualify as small businesses. Some of this cost will also be borne by lenders/creditors, most of whom do not qualify as small businesses. For those that do, the Department is very confident that the cost of complying will not exceed $25,000 for any small business.

XI. LIST OF WITNESSES

A public hearing will be held on Wednesday, September 10, 2008, commencing at 9:30 A.M., in the Summit Room, Department of Commerce, 85-7th Place East, Suite 500, St. Paul, Minnesota. The Department of Commerce anticipates having the following witnesses testify in support of the need for and reasonableness of the rules:

1. Ms. Julia Philips, Life and Health Actuary, Department of Commerce – Financial Examinations.
2. Mr. William Burfeind, Executive Vice President of the Consumer Credit Industry Association (CCIA), will testify as to the CCIA's history of involvement nationally in credit insurance issues, its support for laws and regulations conducive to a stable credit insurance marketplace responsive to consumer needs and expectations, credit insurance industry trends supporting the need for updating the existing credit insurance rules in Minnesota, communications with credit insurance companies and other stakeholders about the proposed rules, and the credit insurance industry's support for the proposed rules.
3. Mr. Christopher H. Hause, FSA, MAAA, Hause Actuarial Solutions, Inc., will testify as to various actuarial aspects of the proposed rules, including but not limited to: (i) the reasonableness of the initial rates, joint factors, and formulas set forth in parts 2760.0050 and 2760.0060 as well as the likelihood these rates, factors, and formulas will achieve target loss ratios set forth in the proposed rules, (ii) the appropriateness and reasonableness of the refund formulas contained in part 2760.0070; (iii) the soundness and consistency of the adjustment mechanisms for future prima facie rate adjustments as set forth in part 2760.0080; and (iv) the reasonableness of the deviation procedures contained in part 2760.0090.
4. Mr. Steven Ostlie, Senior Counsel, Securian Financial Group/Minnesota Life Insurance Company (MLIC), will testify as to MLIC's involvement in the credit insurance market, both nationally and in Minnesota, and MLIC's support for updating and modernizing the rate-setting rules for credit insurance products sold in Minnesota.

XII. RULE-BY-RULE ANALYSIS

2760.0010 PURPOSE. This rule states a purpose of protecting the interests of debtors and the public by providing a system of rate, policy form, and operating standards for the transaction of credit life and credit A&H insurance. The language of the section is taken from the NAIC Model Regulation.

2760.0020 DEFINITIONS. This rule provides sixteen definitions for technical terms used in the credit insurance industry. Subparts 5, 6, 10, 11, 13, 14, and 16 are from the NAIC Model Regulation. Subparts 4, 9, and 12 are from the previous Chapter 2760. Subparts 2, 3, 7, 8, 15, and 17 were developed to be used with the new rule. These terms are not defined in statute.

2760.0030 RIGHTS AND TREATMENT OF DEBTORS. This rule newly provides additional consumer protections for situations that arise in connection with credit life and credit A&H insurance programs. Subparts 1 through 5 are from the NAIC Model Regulation. Subparts 6 and 7 have been added for clarification of technical issues.

Subpart 1. Multiple plans of insurance. This subpart requires that if a creditor offers credit insurance the debtors be informed of each plan of insurance for which the debtor is

eligible and the premium charge for each. This gives consumers a choice among the full range of products offered by the creditor.

Subpart 2. Substitution. This subpart states that when a creditor requires insurance as security for a debt, the debtor may furnish the insurance through any insurer authorized in the state, and requires the creditor to inform the debtor of this right. This subpart reflects the statutory requirement set forth in Minn. Stat. sec. 62B.11. This allows consumers an option to purchase credit insurance or use existing coverage if they are already adequately protected by insurance sufficient to pay off the debt.

Subpart 3. Termination of group consumer credit insurance policy. This subpart assures that debtors who have prepaid for coverage under a group credit insurance policy will have that coverage for the entire period for which the premium has been paid or until the loan ends, even if the group policy is terminated. Further, debtors who are paying premiums on a monthly basis are to be given thirty days notice of termination unless the coverage is replaced by the same or another insurer without a lapse of coverage. This ensures that needed coverage remains in place, or that the consumer has advance knowledge of its loss.

Subpart 4. Remittance of premiums. This subpart requires the creditor to remit the premium charge to the insurance company within sixty days after the premium charge is added to the debt. This furthers the purpose of accurate monitoring and timely reporting of business to the insurance company.

Subpart 5. Refinancing of debt. This subpart requires the termination of insurance coverage and a refund of unearned premium, whenever the debt is discharged due to refinancing, before any new insurance can be issued in connection with the refinanced debt. In addition, in situations where a consumer chooses to insure the refinanced debt, this subpart requires the insurer to use the original effective date of coverage for applying policy provisions such as pre-existing condition exclusions, at least to the extent of the amount and term of the debt outstanding at the time of the refinancing. This protects the consumer – especially a consumer who may have suffered a decline in health – from losing important benefits due to the change in policies resulting from the refinancing. Section 2760.0700 of the current rule provides similar protections by giving the consumer the right to elect continuation of the old policy. That is replaced in this new rule with a provision that requires insurers to apply the effective date of the old policy to the terms of the new policy.

Subpart 6. Open-end credit benefit amount. This subpart establishes the benefit amount for educational, agricultural, and horticultural open-end credit accounts to be the amount for which the premium was last paid irrespective of the actual amount of indebtedness at the time of death. This subpart implements the requirements of Minn. Stat. 62B.04, subd. 1, paragraph 3, which provides the following: "(3) Notwithstanding clauses (1) and (2), insurance on educational, agricultural, and horticultural credit transaction commitments may be written on a nondecreasing or level term plan for the amount of the loan commitment."

Subpart 7. Maximum aggregate provisions. This subpart provides that if a debtor is covered under multiple certificates of insurance exceeding the group policy total limit, then the excess insurance remains in effect unless the insurer cancels the excess insurance and provides a refund or credit of the associated premium and any related finance charges. This gives the insurer an incentive to monitor the debtors insured under the group policy and refund the premiums for any insurance that was issued over the group policy total per-person limit. If the insurer does not do so, and the debtor has paid the premiums for the higher amount, then the insurer must pay that debtor's claim at the higher amount.

2760.0040 DETERMINATION OF REASONABLENESS OF BENEFITS IN RELATION TO PREMIUM CHARGE. The rule states that rates based on a target loss ratio of 50% will satisfy the statutory requirement that premium rates are reasonable in relation to benefits. The rule also recognizes, consistent with the statute, that a lower or higher loss ratio may be necessary for the premium rates to be adequate and not excessive, as calculated based on the new rule section 2760.0080. The rule creates a conclusive presumption that the prima facie rates in the rule, as adjusted in the future under the rule, are reasonable. The previous rule created a presumption of reasonableness for the prima facie rates that was difficult to interpret and enforce. The language was developed by the Department for the new rules to ensure clarity and simplify enforcement.

2760.0050 CREDIT LIFE INSURANCE RATES. This rule sets out the initial prima facie rates to be used by insurers for credit life insurance coverage with specified minimum benefits. These rates will be modified in the future to reflect changes in experienced claim levels, but the modified rates will retain the same level of provision for expenses and profit.

Subpart 1. Initial prima facie rates. This subpart establishes the initial prima facie rates for credit life insurance. These rates were derived from an actuarial analysis of insurer claim experience, insurer operational expenses, and the revised minimum policy benefit provisions in the new rules. For credit life insurance, these rates are equal to the current prima facie rates. The actuarial analysis shows that the enhanced benefits should result in sufficient additional claim costs to achieve a 50% loss ratio with no change in prima facie rates.

Subpart 2. Application to certain contracts. This subpart establishes the minimum policy benefit provisions that correspond to the new prima facie life insurance rates in the rule. These minimum benefit provisions are more generous to consumers than the benefit provisions in the current rule. For example, policies must be offered to debtors up to the age of 70, compared to 65 in the current rule. Older debtors will have, on the average, higher claim costs for life insurance. As another example, the new benefits do not allow exclusion of preexisting medical conditions beyond six months, and do not allow the use of medical history to screen out debtors when the debt is below $15,000. The level of $15,000 was set so as to balance the cost of medical screening with the risk of

antiselection by debtors with medical conditions who may take out a loan in order to purchase credit life insurance.

Subpart 3. Other reasonable rates. This subpart provides a financial incentive for insurers to insure consumers with preexisting medical conditions since the rates are slightly higher if coverage for these conditions is included, reflecting the average cost of this coverage. Also, this subpart allows insurers to use the prima facie rates in situations where the insurer uses medical history ("evidence of insurability') to exclude coverage for some applicants, but only if the initial indebtedness or account limit is above $15,000 or the applicant purchases coverage more than thirty days after the effective date of the indebtedness. The overall purpose of this section of the rules is to create a framework that gives insurers a financial incentive to enhance benefits and forgo the cost of medical underwriting, especially for smaller loans under $15,000, thereby expanding the availability and improving the quality of coverage for more consumers.

Subpart 4. Insurance application forms. This subpart permits the insurer to use the same application form whether or not the underwriting questions on the form are used, which will reduce administrative costs.

2760.0060 CREDIT A&H INSURANCE RATES. This rule sets out the initial prima facie rates to be used by insurers for credit A&H insurance coverage with specified minimum benefits. These rates will be modified in the future to reflect changes in experienced claim levels, but the modified rates will retain the same level of provision for expenses and profit.

Subpart 1. Initial prima facie rates. This subpart establishes the initial prima facie rates for credit A&H insurance. These rates were derived from an actuarial analysis of insurer claim experience, insurer operational expenses, and the revised minimum policy benefit provisions in the new rules. For credit A&H insurance, these rates are significantly lower than the current prima facie rates. The actuarial analysis shows that the enhanced benefits and reduced prima facie rates should result in a 50% loss ratio.

Subpart 2. Application to certain contracts. This subpart establishes the minimum policy benefit provisions that correspond to the new prima facie credit A&H insurance rates in the rule. These minimum benefit provisions are more generous to consumers than the benefit provisions in the current rule. For example, policies must be offered to debtors up to the age of 70, compared to 65 in the current rule. Older debtors will have, on the average, higher claim costs for credit A&H insurance. As another example, the new benefits do not allow exclusion of preexisting medical conditions beyond six months, and do not allow the use of medical history to screen out debtors when the debt is below $15,000. The level of $15,000 was set so as to balance the cost of medical screening with the risk of antiselection by debtors with medical conditions who may take out a loan in order to purchase credit A&H insurance.

Subpart 3. Other reasonable rates. This subpart provides a financial incentive for insurers to insure consumers with preexisting medical conditions since the rates are

slightly higher if coverage for these conditions is included, reflecting the average cost of this coverage. Also, this subpart allows insurers to use the prima facie rates in situations where the insurer uses medical history ("evidence of insurability') to exclude coverage for some applicants, but only if the initial indebtedness or account limit is above $15,000 or the applicant purchases coverage more than thirty days after the effective date of the indebtedness. The overall purpose of this section of the rules is to create a framework that gives insurers a financial incentive to enhance benefits and forgo the cost of medical underwriting, especially for smaller loans under $15,000, thereby expanding the availability and improving the quality of coverage for more consumers.

Subpart 4. Insurance application forms. This subpart permits the insurer to use the same application form whether or not the underwriting questions on the form are used, which will reduce administrative costs.

2760.0070 REFUNDS OF UNEARNED PREMIUMS. This rule sets out the timing and methods for computing the refund of unearned premiums when either the insurance coverage or the indebtedness is terminated prior to the scheduled maturity date. The required methodology will generally produce a larger refund amount than the methods in the current rule, according to the consulting actuary who prepared the actuarial study. The insurer is required to promptly issue a refund upon notice from either the debtor or the creditor.

Subpart 1. Charges on single premium consumer credit insurance contract. This subpart states that refunds will be based on a full month of coverage only, with 16 days or more rounded up to the next month, and 15 days or fewer rounded down to the prior month, which will reduce administrative costs. The dollar amounts being rounded are typically small, and the overall effect on consumers is neither a gain nor a loss. This language was developed by the Department based on a similar provision in the NAIC Model Regulation.

Subpart 2. Fulfillment of refund formula filing requirement. This subpart gives the formulas for the amount to be refunded. This language was developed by the Department with assistance from the consulting actuary.

Subpart 3. Refund or credit on the termination of certain single premium credit insurance. This subpart requires the insurer to provide a refund upon receiving notice of termination of single-premium credit insurance by the debtor. This subpart implements the requirements set forth in Minn. Stat. §§ 62B.05 and 47.59, subd. 10, which provide that a creditor is obliged to promptly provide a refund or alternatively provide a notice to the insurer, debtor, or third party originator regarding termination of a loan. Upon insurer receipt of such notice, a refund must be issued. In addition, under this subpart 3, credit insurance contracts must contain language or be accompanied by a notice informing the debtor how to obtain a refund if the insurance terminates. The language in this subpart was tailored to meet the requirements of existing Minnesota statutes and ensure that consumers receive the refunds they are owed. Policyholders in several other states with the NAIC Model Regulation have experienced problems with non-receipt of refunds and

in some cases there have been legal actions brought against insurers by policyholders or regulatory officials. This language in Subpart 3 should help minimize or eliminate such problems.

2760.0080 EXPERIENCE REPORTS AND ADJUSTMENT OF PRIMA FACIE RATES. This rule recognizes that prima facie rates should be periodically reviewed and adjusted to account for actual claim experience that may be greater or less than expected.

Subpart 1. Experience report filing. This subpart requires insurance companies to annually file with the Commissioner the standardized credit insurance experience report forms approved by the National Association of Insurance Commissioners. This language is from the NAIC Model Regulation.

Subpart 2. Rate review and adjustment. This subpart requires the Commissioner to triennially review the reported loss ratio experience and prima facie rates and adjust the prima facie rates to reflect the difference between the actual prima facie claim cost and the expected prima facie claim cost based on the 50% loss ratio specified in 2760.0040. There will be no rate change if this difference is de minimus, as defined in this subpart. The reasoning is that the cost to the insurer of implementing a small change outweighs the benefit of greater accuracy. An example of the adjustment would be if the total premiums are $100,000,000 and the claims are $70,000,000. The expected claims based on the 50% loss ratio are $50,000,000. The rate would be increased by 20% for the extra claims, which are $20,000,000 or 20% of the premium. The portion of the rate that goes toward expenses would not increase. Under a pure loss ratio approach, the rate would have increased 40%, because the claims are 40% higher than expected, and the premiums would have to be $140,000,000 to achieve a 50% loss ratio when claims are $70,000,000. In this example, the method used in calculating the new rate would result in savings to consumers of $20,000,000. This language was developed by the Department.

Subpart 3. Publication and effective date of adjustments. This subpart authorizes the Commissioner to publish revised prima facie rates by Bulletin, thereby avoiding the administrative cost of future rulemaking. The adjustments prescribed in the rule are based on an objective calculation requiring no subjective discretion. Any rate change is to be published by September 1 and become effective the following January 1, thereby providing lead time for insurers to efficiently implement the change. This language was developed by the Department.

2760.0090 PREMIUM RATE DEVIATION. This rule addresses situations where the insurer chooses to file policy form benefits more restrictive than required for use of prima facie rates, or when insurer experience falls outside the industry norms expected at prima facie rates. The language in this part was developed by the Department.

Subpart 1. Use of deviated rates. This subpart allows an insurer to file higher rates if the total claims for a plan of coverage are higher than the norm, and requires an insurer to file lower rates if the claims are lower than the norm. It permits an insurer having a loss ratio of 55% or more at prima facie to file for approval to use higher rates. Conversely, it

requires an insurer having a loss ratio of less than 42.5% at prima facie to file for and use lower rates. The increase or reduction is based on the claim difference.

For example, if an insurer has a block that has a 30% loss ratio at prima facie rates, then the insurer has to reduce the rates by the amount claims are less than expected. Thus if the block has $1,000,000 in premiums, expected claims are $500,000, and actual claims are $300,000, then the rates must be reduced to reflect the $200,000 difference, which is 20%.

Because the downward deviation is mandatory, while the upward deviation is voluntary, the rule establishes a larger downside tolerance before forcing the insurer to take action, in recognition that swings of up to five percent in individual company loss ratios are expected and not indicative of a significant deviation from the norm.

Subpart 2. Use of rates for accounts. This subpart allows rates to be separately calculated for large accounts. An insurer may file higher rates if the claims are higher than the norm, and may file for lower rates if the claims are lower than the norm. The increase or reduction is based on the claim difference, adjusted for the statistical credibility of the block of business.

For example, if an insurer has an agreement with a group of creditors to offer coverage, the group has a 30% loss ratio at prima facie rates, and it is 80% credible according to the credibility table in the rule, then the insurer may reduce the rates by 80% of the amount claims are less than expected. To illustrate, if the block has $1,000,000 in premiums, expected claims are $500,000, and actual claims are $300,000, then the difference multiplied by 80% is $160,000, and thus the rates must be reduced to reflect the $160,000 difference, which is 16%.

The remainder of the insurer's business is still separately subject to adjustment under Subpart 1.

EFFECTIVE DATE; WITHDRAWAL OF APPROVAL. The rule establishes a delayed effective date to permit efficient implementation and a schedule of dates for insurers and creditors to conform existing policies and related forms to the requirements of these rules.

XIII. CONCLUSION

Based on the foregoing, the proposed rules are both needed and reasonable.

Date: July 30, 2008

Glenn Wilson
Commissioner
Minnesota Department of Commerce