STATE OF ARIZONA FILED

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STATE OF ARIZONA

DEPARTMENT OF INSURANCE

In the Matter of: **LOSS RATIO STANDARDS AND *PRIMA FACIE* RATES FOR CREDIT PROPERTY INSURANCE AND CREDIT UNEMPLOYMENT INSURANCE**	)	Docket No. 03A-092-INS **ORDER**

On June 3, 2003, the Director of Insurance initiated this proceeding to establish loss ratio standards and *prima facie* rates for credit property insurance and credit unemployment insurance in accordance with A.R.S. §20-1621.05 and Arizona Administrative Code ("A.A.C.") R20-6-604.03(A). Pursuant to the Notice of Hearing, interested persons were invited to submit written comments to the Director and to appear at the hearing on July 24, 2003. The record in this proceeding closed on September 15, 2003. On October 6, 2003, Hearing Officer Harold Merkow issued a "Report and Recommendation", a copy of which is attached and incorporated by this reference. The Director hereby adopts the Hearing Officer's Report and Recommendation, including all findings and analysis therein, and enters the following Order:

1. The loss ratio standard for both credit property insurance and credit unemployment insurance shall be 50%, effective January 15, 2004.

2. The *prima facie* rates for credit property insurance set forth in Exhibit A of the Hearing Officer's Report and Recommendation shall be effective January 15, 2004.

3. The *prima facie* rates for credit unemployment insurance set forth in Exhibit B of the Hearing Officer's Report and Recommendation shall be effective January 15, 2004.

4. Insurers may file for approval and use of deviated rates that are higher than the

prima facie rates established by this Order. Deviations shall be filed in accordance with the process and standards set forth in A.R.S. §20-1610 for credit property insurance or A.R.S. §20-1621.05 for credit unemployment insurance. Deviations may be filed if loss ratios have exceeded 50% and insurers shall use the Credibility Tables for Credit Property and Credit Unemployment Insurance attached hereto as Exhibits C1 and C2 respectively. Insurers may file such deviations immediately and are responsible to make such filings sufficiently in advance of January 15, 2004 to permit a January 15, 2004 effective date.

DATED this 15th day of October 2003.

CHARLES R. COHEN, Director
Arizona Department of Insurance

COPY of the foregoing mailed
this 15th day of October 2003 to:

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STATE OF ARIZONA

DEPARTMENT OF INSURANCE

In the Matter of: LOSS RATIO STANDARDS AND *Prima facie* RATES FOR CREDIT PROPERTY INSURANCE AND CREDIT UNEMPLOYMENT INSURANCE	Docket No. 03A-092-INS HEARING OFFICER'S REPORT AND RECOMMENDATION

A Public Hearing was conducted on July 24, 2003 to consider objections to the Department's proposed loss ratio standards and *prima facie* rates for credit property insurance and credit unemployment insurance, which rates have been proposed pursuant to Arizona Administrative Code provisions R20-6-604.03.

Based on the information and documentation presented before, during and after the public hearing, the undersigned finds the following:

1. The Department undertook an actuarial review of the credit property and credit unemployment insurance industries and determined the actual experiences of companies which wrote such insurance;

2. Actual loss ratios for the various plans by the lenders, as determined by the Department, were well below 50% for each product offered;

3. Based on the actual loss ratios, the Department concluded that all plans offered by all lenders required adjustment in order to create equitable loss ratios;

4. The Department prepared schedules of such adjustments for each plan

offered by the various lenders, which schedules are presented in this public hearing as the proposed adjustments to the *prima facie* rates allowed by law;

5. The Department's methodology in assessing the need for adjusting *prima facie* rates for credit property and credit unemployment insurance was contested. One of the bases for the contest is that the Department should have used a component rating method for determining whether loss ratios by insurers meet the statutory requirements. The contestants argued that the Department should look at each company's costs of doing business as well as its commission schedules when determining whether its rates meet the loss ratios demanded by the department and, the contestants argue, if the Department had applied component rating, the rates proposed by the Department are too low;

6. None of the companies which offer credit property and credit unemployment insurance were able to provide sufficient and satisfactory evidence to the Department to account for its rate components;

7. The Department's methodology for calculating adjustments to *prima facie* rates was also contested on the basis that the Department did not consider prospective loss experiences of insurers, especially because of the increase in unemployment rates as a result of broader economic conditions;

8. The Department's conclusions about rate adjustments for credit property and credit unemployment insurance were also contested on the basis that, if the Department adjusted rates too low, lenders would stop offering credit property and credit unemployment insurance as part of an insurance packet in connection with a sales finance transaction;

9. The Department's process of rate adjustments for credit property and credit unemployment insurance was also contested on the basis that the Department should have employed outside actuaries to determine companies' administrative costs, profits and losses as well as other expenses;

10. The Department's methodology and results of assessing the need for adjusting *prima facie* rates for credit property and credit unemployment insurance was supported by the Center for Economic Justice, however, the Center for Economic Justice proposes that the Department adopt a loss ratio standard of 60%;

11. The effective date for implementing adjustments to *prima facie* rates for credit property and credit unemployment insurance must be reasonably established in order to give insurers enough time to re-program their systems.

Based on the comments received and the Department's responses to those comments, the undersigned recommends that the Director ADOPT the analysis of the Department, that the Director ADOPT the *prima facie* rate adjustments proposed by the Department for credit property and credit unemployment insurance rates as suggested by Exhibits A and B to this report and that the Director ORDER that such adjusted rates take effect ninety (90) days from the date of the Director's Order.

The Department has responded to the objections raised regarding the establishment of loss ratio standards for credit property and credit unemployment insurance by insisting that, because the market is one of reverse competition and because experience shows that the issuing companies pay out far less than 50% in claims, the consumer's ability to obtain value for these products must be balanced against a fair return to the insurers. The Department insists that it should follow historic precedent and NAIC guidance in setting loss ratio standards and that a 50% loss ratio standard is appropriate. The undersigned agrees. The marketplace is unable to set a loss ratio standard simply because of the way these insurance products are marketed. Department intervention is therefore necessary to establish the balance between the consumers' interests and the insurers right to earn a profit. Reliance on an established standard and echoing back to historical precedence are dependable methods for setting the loss ratio standards. While the Center for Economic Justice advocates for a higher loss ratio standard, the undersigned recommends that the Director adopt the Department's calculation for a loss ratio standard for credit property and credit unemployment insurance of 50%.

Objections were also raised to the Department's methodology, namely, using loss ratios instead of component ratings, and the objectors urge the Director to discard the Department's methodology in favor of component ratings for each insurer. As shown in the Department's reports, component rating methodology was employed by the Department to consider each insurer's experience and expenses. Unfortunately, companies were unable to comply with the Department's data call and the Department was powerless to calculate actual expenses when deciding on *prima facie* rates. The Department would have been remiss in accepting insurers' assumptions without adequate documentation and any analysis based on those assumptions would not have been actuarially based. Furthermore, the Department did consider cost components that were available to it when it analyzed the level for *prima facie* rates.

The suggestion that companies' records be analyzed by outside actuaries is not warranted under the circumstances. Even if the Department's resources were not adequate, the companies did not provide enough information for **any** actuary to do a cost component analysis. Analysis by outside actuaries of actual experience by the companies would not yield a result any different than the Department's loss ratio calculations and would not add anything to the decision to be made by the Director.

Further, since these rates are *prima facie*, if an individual insurer presents cogent evidence to the Department that the *prima facie* rates are unfavorable, that insurer may be granted a deviation from the *prima facie* rates. Calculating credit property and credit unemployment rates for <u>each</u> insurer who does business in the State of Arizona would lead to fragmented and disparate rates. Because consumers are typically not free to compare rates among insurers at the time these insurance products are sold, a theoretical rate comparison ability would be a chimera. A unitary rate structure for credit property and credit unemployment insurance sales is more protective of the consumer and, since the Department has been generous in factoring in margins for insurers' protection, individual component rating is unwarranted.

The insurers' objections to the Department's *prima facie* rates for credit unemployment insurance based on general economic activity should not lead to an abdication by the Department to set such *prima facie* rates. While acknowledging that the unemployment rate has risen due to a weak economy, no evidence exists to show the direction and velocity of unemployment rates for the foreseeable future and, based solely on the anecdotal evidence available now, the undersigned believes that the

Department took account of the overall economic environment when setting *prima facie* rates for credit unemployment insurance.

Overall, the objections raised to the proposed credit insurance *prima facie* rate adjustments are not persuasive. Based on the insurers' actual loss experience, revision of the credit property and credit unemployment insurance *prima facie* rates is in order. The Department's actuaries carefully calculated the necessary adjustment amounts in order to satisfy the 50% standard that is targeted by the Department. Accordingly, the undersigned recommends that the Director adopt the Department's proposed revisions to *prima facie* credit property and credit unemployment rates.

The undersigned further recommends that the Director adopt the Department's revised rates which are proposed as the *prima facie* rates, which rate schedules are attached hereto as Exhibits A and B. Although proposed rate setting by the Department was well-known to the insurers, the actual rates have not been adopted by the Director and some length of time will be necessary to implement the rates. The undersigned believes that 90 days from the date of the Director's Order is a fair amount of time to allow all of the insurers who offer these products to distribute the rate adjustments throughout their networks after adoption by the Director.

Respectfully submitted this 6th day of October 2003.

Harold J. Merkow

HAROLD J. MERKOW
Hearing Officer

EXHIBIT A

THE RECOMMENDED LOSS RATIO STANDARD IS 50%.

PROPOSED PRIMA FACIE RATES FOR CREDIT PROPERTY INSURANCE ARE:

1. SINGLE PREMIUM

If the insurer charges a single premium, the rate per 100 dollars of insured value shall be :

DUAL INTEREST........ $.50

SINGLE INTEREST......$.33

2. MONTHLY OUTSTANDING BALANCE

If premiums are payable monthly on an outstanding balance, the rate per 100 dollars of outstanding balance shall be :

DUAL INTEREST........$.08

SINGLE INTEREST......$.05

SINGLE INTEREST protects only the creditor's interest in the property.
DUAL INTEREST protects interests of both the borrower and creditor.

STATE'S EXHIBIT A

ARIZONA - CREDIT UNEMPLOYMENT PRIMA FACIE RATES

TABLE A

SINGLE PREMIUM RATES PER $10 OF MONTHLY BENEFIT PROVIDED

Maximum Benefit Period in Months	Non Retro Benefits 30 Day Elim.Period	Retro Benefits 30 Day Elim.Period
6	0.12	0.16
9	0.14	0.20
12	0.16	0.23
18	0.18	0.26
24	0.20	0.29
More than 24	0.21	0.31

NOTE: Single Premiums are obtained by multiplying the above rates by the term of the loan in months.

TABLE B

MONTHLY PREMIUM RATES PER $10 OF MONTHLY BENEFIT PROVIDED

Maximum Benefit Period in Months	Non Retro Benefits 30 Day Elim.Period	Retro Benefits 30 Day Elim.Period
6	0.14	0.18
9	0.17	0.23
12	0.19	0.27
18	0.21	0.30
24	0.23	0.33
More than 24	0.25	0.35

MONTHLY PREMIUM RATES PER $100 OF MONTHLY OUTSTANDING BALANCE

EXAMPLES:

Rates stated as $0.xx per $100 of outstanding balance per month should be consistent with the above rates. To satisfy this requirement the following formula may be used:

M = R x 10 x P

Where:

M = Monthly rate per $100 of outstanding balance
R = Rate per $10 of the monthly benefit term (from above Monthly Rates TABLE B)
P = Percent of outstanding balance required as the minimum monthly payment, but not less than 3.0% (to be expressed as a decimal in the formula).

Example (1): R = $0.30 (30 cents) per $10 of monthly benefit
For P = 5% P = Minimum monthly payment is 5%
Then M = .30 x 10 x .05 = $0.15 (15 cents) per $100 0f outstanding balance.

Example (2): R = $0.30 (30 cents) per $10 of monthly benefit
For P = 3% P = Minimum monthly payment is 3%
Then M = .30 x 10 x .03 = $0.09 (9 cents) per $100 0f outstanding balance.

MONTHLY PREMIUM RATES PER $100 OF MONTHLY OUTSTANDING BALANCE

EXAMPLES for P = 3%: P = Minimum monthly payment is 3%

Maximum Benefit Period in Months	R (from above TABLE B) Non Retro Benefits 30 Day Elim.Period	M = R x 10 x .03 Non Retro Benefits 30 Day Elim.Period	R (from above TABLE B) Retro Benefits 30 Day Elim.Period	M = R x 10 x .03 Retro Benefits 30 Day Elim.Period
6	0.14	0.04	0.18	0.05
9	0.17	0.05	0.23	0.07
12	0.19	0.06	0.27	0.08
18	0.21	0.06	0.30	0.09
24	0.23	0.07	0.33	0.10
More than 24	0.25	0.08	0.35	0.11

8/18/2003

NOTE:
All of the the above are Single Life rates. Joint Life rates may not exceed 165% of the Single Life rates.

STATE'S EXHIBIT B

EXHIBIT C1

CREDIBILITY TABLE EXHIBIT V

EARNED PREMIUM	CLAIM COUNT	CREDIBILITY FACTOR
<24,000	<6	0
24,000 to 43,999	6-10	0.15
44,000 to 67,199	11-16	0.20
67,200 to 97,199	17-23	0.25
97,200 to 133,199	24-32	0.30
133,200 to 173,999	33-42	0.35
174,200 to 219,599	43-54	0.40
219,600 to 271,199	55-67	0.45
271,200 to 327,599	68-81	0.50
327,600 to 389,999	82-97	0.55
390,000 to 458,399	98-113	0.60
458,400 to 531,599	114-132	0.65
531,600 to 609,599	133-151	0.70
609,600 to 693,599	152-172	0.75
693,600 to 783,599	173-195	0.80
783,600 to 878,399	196-219	0.85
878,400 to 977,999	220-244	0.90
978,000 to 1,083,599	245-270	0.95
1,083,600 +	271+	1.00

IF INCURRED CLAIM COUNTS ARE AVAILABLE, USE THEM TO DETERMINE THE CREDIBILITY. IF NOT, USE ANNUAL EARNED PREMIUM. FOR 6-10 CLAIMS THE CREDIBILITY FACTOR IS 0.15.

THE EXPERIENCE PERIOD FOR THIS TABLE SHALL BE AT LEAST ONE FULL YEAR AND SHALL NOT EXCEED THREE SUCCESSIVE YEARS.

4/22/2003

EXHIBIT C2

CREDIBILITY TABLE

IUI EXHIBIT 8

ANNUAL EARNED PREMIUM	CREDIBILITY FACTOR
<24,000	0
24,000 to 43,999	0.15
44,000 to 67,199	0.20
67,200 to 97,199	0.25
97,200 to 133,199	0.30
133,200 to 173,999	0.35
174,200 to 219,599	0.40
219,600 to 271,199	0.45
271,200 to 327,599	0.50
327,600 to 389,999	0.55
390,000 to 458,399	0.60
458,400 to 531,599	0.65
531,600 to 609,599	0.70
609,600 to 693,599	0.75
693,600 to 783,599	0.80
783,600 to 878,399	0.85
878,400 to 977,999	0.90
978,000 to 1,083,599	0.95
1,083,600 +	1.00

NOTES:

(1) Use this Table to calculate T (the credible Loss Ratio)

If: A = Actual Incurred Loss Ratio
and: E = Expected Incurred Loss Ratio = 50% =.50
and: Z = The Credibility Factor from the above Table

Then: $T = (Z \times A) + ((1-Z) \times E)$

Rate Deviation Calculation Factor = T/E

(2) The experience period to which this table applies shall not be less than 1 year nor greater than 3 years.