FY 2021 OPERATING BUDGET
RESPONSE TO DEPARTMENT OF LEGISLATIVE SERVICES
BUDGET ANALYSIS
MARYLAND AUTOMOBILE INSURANCE FUND TESTIMONY
MARK D. McCURDY, EXECUTIVE DIRECTOR

Transportation and Environment, Subcommittee
Delegate Marc Korman, Chair
Delegate Carol L. Krimm, Vice-Chair
February 10, 2020

Public Safety, Transportation and Environment, Subcommittee
Senator Cory V. McCray, Chair
February 21, 2020

We deeply appreciate the work of the analyst and the opportunity to provide information to the committee. While Maryland Auto does not receive state budgeted funds, we are proud of our relationship with the State and encouraged by the strong interest and transparent information exchange that this forum provides.

Maryland Auto is continuing its important financial improvements that started in the summer of 2015. At that time, the entity's combined ratio had risen to 135%, and was projected to continue to climb, while surplus was in a steep decline. At the end of 2019, however, the combined ratio had been lowered to 106% (see chart 1). This represents an improvement of approximately $23.2 million. Similarly, the year-end surplus level turned from a yearly decline to an increase of $7 million in 2019. These are the best matrixes for judging a financial turnaround, and I applaud the cost efficiencies and innovative work that lead to these dramatic improvements.

These 2019 results mean that Maryland Auto continues to serve its role in the insurance market without a cost to the rest of Maryland's drivers. Since 1989, the time of the last assessment, Maryland Auto has insured 2,711,179 Maryland families, and written over $4.3 billion of premium without an assessment on the driving public. This is a unique success and an example of the best of government programs.

Requested Responses:

1. Maryland Auto should comment on the financial health of the Insured Division and the likelihood of imposing an assessment in the future and the impact that the assessment would have on the automobile insurance premiums of Marylanders.

The employees at Maryland Auto have improved Maryland Auto's financial results dramatically. As noted above, the combined ratio has improved from 135% to 106%, and accordingly the rate in the erosion of surplus has slowed considerably. As fully explained below, surplus is a key to avoiding an assessment under Insurance Article §20-404.

Year-end surplus for 2019 was $42 million, which is $21 million above the assessment trigger and which is $7 million more than the surplus at year-end 2018. With continued active management, Maryland Auto hopes to avoid an assessment through 2020 and beyond.

The Assessment

<u>Background</u>

Automobile insurance is required by State law. The Maryland Automobile Insurance Fund ("Maryland Auto") was created as the automobile insurer that would be required to offer insurance to anyone who could not be insured in the private market. This is, obviously, a challenging role as the private industry will attempt to insure the better risks, leaving a poorer pool of remaining drivers to be insured at Maryland Auto.

Recognizing this, from its beginning in 1973 the Legislature authorized an assessment mechanism to provide a periodic cash infusion to Maryland Auto. This helps mitigate the inevitable tension between affordability and sustainability. Maryland Auto would not always be able to consistently achieve financial success based solely on premiums received from policyholders who were all rejected by the private market. It would be similar to expecting a health insurer that insured only people with pre-existing conditions to be consistently profitable. The Affordable Care Act could not be successful without subsidies. There has not been an assessment since 1989.

Maryland's approach is unique. Other states created entities that assign high risk drivers to each licensed automobile insurer in proportion to their market share. These assigned risk pools require insurers to accept risks that generally lose money and which the insurer would not otherwise accept. In addition to claims costs, insurers bear the cost of administering the pool. In this way, all insurers, and ultimately their policyholders, subsidize the residual market in assigned risk pool states. As reported by the *Insurance Information Institute* (March 2015), "Residual market programs are rarely self-sufficient. Where the rates charged to high-risk policyholders are too low to support the program's operations, insurers are assessed to make up the difference."

Massachusetts shows this. Its population is similar in size to Maryland, and it has an active assigned risk program. Under its system, according to the Massachusetts Department of Insurance, carriers are assigned risks by the Massachusetts Auto Insurance Plan (MAIP) when they have been turned down by at least one insurer in the private market. These assigned risks are placed by MAIP with insurers in proportion to the insurer's market share.

To cover the cost of insuring the assigned risks, insurers include the cost as an overall expense in automobile rate filings. Today this amounts to approximately $15 per policyholder in the State. In the past it was much higher, and it has never been free. This cost is a general expense and does not appear as a separate item in premium billing or on the declaration page and policyholders are not advised of this charge. In addition, insurers are subject to an assessment to cover all the expenses and administrative costs of operating the MAIP.

Maryland Auto insures the same type of policyholders as MAIP in Massachusetts. Unlike MAIP, which involves an annual cost to insurers and their policyholders, Maryland Auto has, since 1989, insured millions of Maryland drivers without <u>any</u> cost to the State of Maryland, its taxpayers, the insurance industry or private insurance policyholders. Maryland Auto has been entirely self-sufficient and has paid all claims and expenses from premiums and investment income.

<u>Status of a Maryland Auto Assessment</u>

As the Massachusetts experience shows, if an assessment were to occur in Maryland, it would not be unusual by national standards. Nor would it likely be very large. As noted by the Maryland Insurance Commissioner: "Even at its peak, the MAIF assessment on the motoring public was minimal. The MAIF assessment has never exceeded $5 per policy, compared to assessments of over $200 per policy in other northeastern urban states." *Maryland Insurance Administration, Maryland Automobile Insurance Fund and the Private Insurance Market* (January 2004)

In general, whether an assessment occurs depends on whether Maryland Auto's surplus is below the trigger calculated under Insurance Article §20-404. For calendar year 2019, the trigger was approximately $21 million. Maryland Auto's surplus at year-end 2019 was $42 million and an assessment will not be declared for 2019. Maryland Auto is also projecting a surplus above the trigger for calendar years 2020 and 2021. Projecting to and beyond year-end 2022 is too speculative given the reactive role that Maryland Auto plays in the marketplace, and the fact that it, consistent with its role as the guaranteed insurer, cannot charge fully adequate rates, cannot control the flow of business and cannot fully control expenses (e.g. commissions are set by statute).

<u>Impact</u>

A Maryland Auto assessment has not occurred since 1989. Between 1977 and 1989, the Maryland Auto assessments totaled $126,214,097. Generally, the assessment was $3.00 to

$5.00 per policy. Maryland Auto policyholders paid the assessment just like all other policyholders in the State. (Insurance Article §20-406).

If a $5 assessment were imposed, this would generate $20 million to Maryland Auto based on approximately 4 million insured vehicles. At $5 per policy, the impact on insurers and policyholders would be minimal. The average private passenger auto premium in Maryland was $1,116 in 2015 (NAIC National Data Base 2017) and a $5 assessment would add less than ½ of 1% to the cost.

Under current law, Insurance Article §20-407, insurers could either recover this amount as a general expense in rate-making or bill each policyholder $5. Confusion and citizen concerns could be eliminated if insurers opted (or if the law were changed) to recover the cost through rate-making rather than billing individual policyholders.

2. Maryland Auto should comment on whether the extension of the premium tax exemption would help to avoid triggering an assessment.

The premium tax exemption should be extended. For calendar 2018, the premium tax exemption contributed $1,835,120 to Maryland Auto's surplus. This is a cumulative number and each year the exemption is in place, the total surplus is enhanced, making an assessment less likely each year. The Insurance Commissioner recently reviewed this exemption and noted that payment of the premium tax would have "reduced the Fund's surplus, causing the surplus amount to be closer to the assessment trigger. . ." The Commissioner noted that the surplus is still "nearing the assessment trigger." Therefore, to avoid an assessment in the coming years, Maryland Auto does need to retain the premium tax exemption.

3. Maryland Auto should comment on whether a lower down payment coupled with monthly service fees would be more attractive to its policyholders and the impact that this might have on utilization of installment payment plans. In addition, the agency should discuss its outreach efforts to inform potential policyholders of the benefit of utilizing Maryland Auto installment plans versus PFC-financed loans.

The current installment plan is the result of legislation passed in 2013. As the analysis notes, the combination of a high down payment requirement and a limited number of installment options have resulted in it being used by only 2% of Maryland Auto policyholders.

Consumers are hard pressed to opt for the required 20-25% down payment required by the statute for a Maryland Auto installment plan when a 10%-12% option is available through premium financing. Unlike the premium finance industry however, Maryland Auto does not charge interest, an application fee, or an electronic payment fee in order to attract more consumers at a lower, overall cost of financing.

In the *2015 Report on Maryland Auto Insurance Fund Installment Payment Plans – January 19, 2016*, the Maryland Insurance Administration concluded that a typical Maryland Auto policyholder could save over $200 by using the installment plan instead of premium financing. Noting the low utilization rate of the existing plan, the Administration also stated:

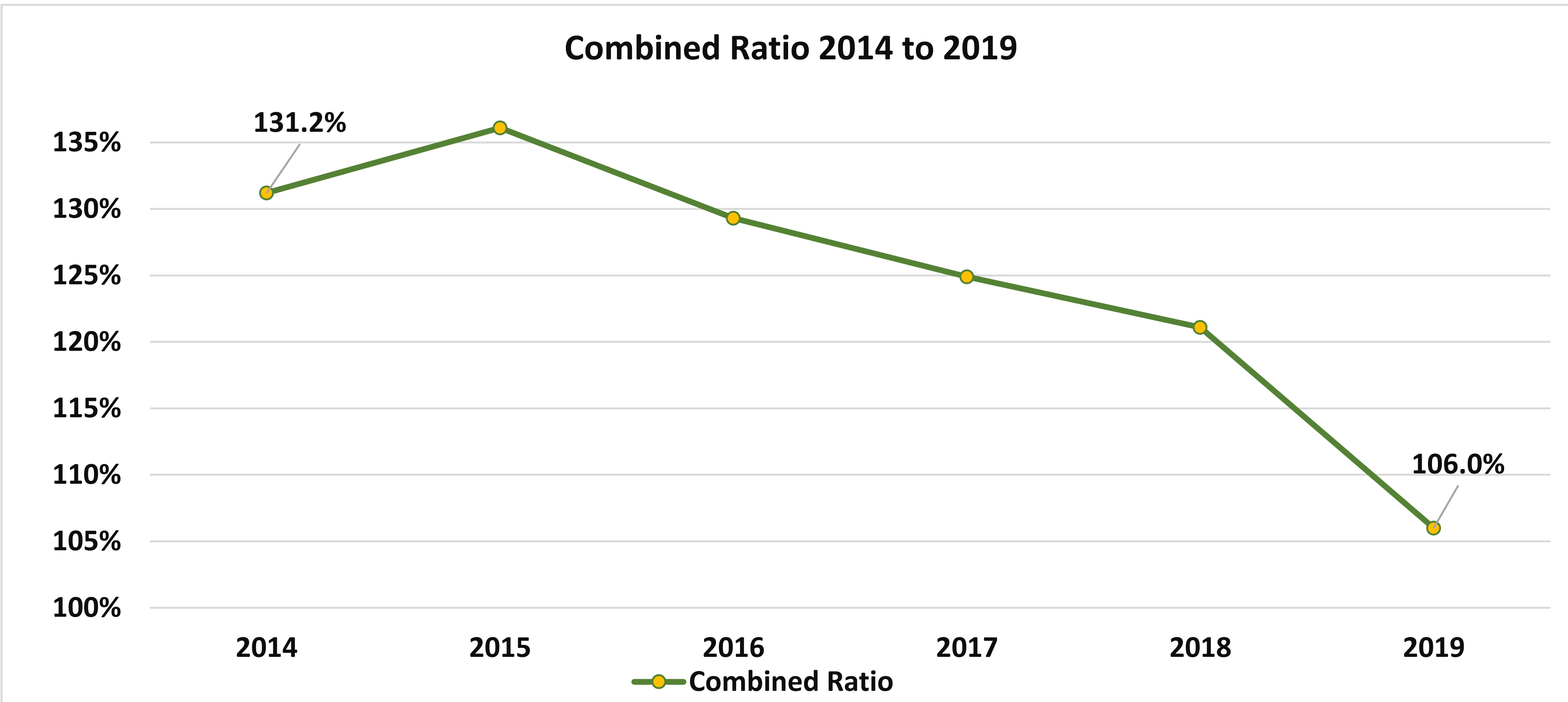
> *"With additional research and perhaps, the implementation of new installment plan parameters and strategies, the MAIF installment payment plan option could realize its maximum potential and become fully effective.*
>
> *The underutilization of the MAIF installment payment plan options requires additional research and discussion. The MIA intends to research and discuss the advantages and disadvantages of implementing a disclosure form requiring a prospective policyholder's acknowledgment that the applicant understands the MAIF installment payment plan option and expressly declines the option."*

In the intervening four years since the report, we are unaware of any additional research or discussion conducted by the Maryland Insurance Administration to improve Maryland Auto's installment plan utilization rate.

Maryland Auto supports three solutions in this area: 1) a signed disclosure requirement, 2) a lower down payment percentage, and 3) an increase in the allowable number of payments. Each of these steps would increase utilization and would benefit Maryland policyholders.

Any decision to expand the current installment plan is beyond Maryland Auto's authority and would require legislation. Maryland Auto would, of course, support any installment plan legislation that helps qualified individuals purchase and maintain an insurance policy provided it does not impact our financial solvency.

Chart 1


Combined Ratio 2014 to 2019
131.2%
106.0%
135%
130%
125%
120%
115%
110%
105%
100%
2014
2015
2016
2017
2018
2019
Combined Ratio