

**HB**

**216**

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# FISCAL NOTE

STATE OF ALASKA  
2005 LEGISLATIVE SESSION

Fiscal Note Number 1  
Bill Version CSHB 116(L&C)  
(H) Publish Date 4/4/05

Revision Date/Time (Note if correction): \_\_\_\_\_ Dept. Affected Commerce  
Title Property/Casualty Insurance RDU Insurance (116)  
Regulation Component Insurance  
Sponsor Labor & Commerce  
Requester House Labor & Commerce Component No. 354

**Expenditures/Revenues** (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
<b>TOTAL OPERATING</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

<b>CAPITAL EXPENDITURES</b>						
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<b>CHANGE IN REVENUES ( )</b>						
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**FUND SOURCE** (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1007 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
<b>TOTAL</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>

Estimate of any current year (FY2005) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2006 budget proposal:

**POSITIONS**

Full-time						
Part-time						
Temporary						

**ANALYSIS:** (Attach a separate page if necessary)

This legislation relates to insurance rate-making and form filing, and does not financially impact the operations of the division

Prepared by Linda S. Hall, Director Phone 907-465-7820  
Division Insurance Date/Time 3/16/05 5:53 PM  
Approved By Edgar Hatchford, Commissioner Date 3/16/2005  
Agency Commerce, Community & Economic Development

# Alaska State Legislature

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**Representative Tom Anderson**  
District 19 - Anchorage

## Sponsor Statement for HB 216

### **Title: "An Act relating to insurance rate-making and form filing."**

Under existing law property/casualty insurance rates and forms are subject to the insurance commissioner's prior approval before they may be put in place. While maintaining the insurance commissioner's authority to oversee rate changes, a key component of the bill is its creation of a percentage "flex band." HB 216 allows an insurer to make rate increases and decreases within the flex band without having to first obtain the insurance commissioner's prior approval. Rate changes outside of the flex band must be filed with the insurance commissioner for her review before the rates are put into effect. For forms, HB 216 gives the insurance company a choice. The insurer may seek the commissioner's prior approval, or the insurer may file the form with the commissioner for a period of time before the form is used.

HB 216 has three basic purposes. First, the bill will create an environment where insurers compete more vigorously on rates and products offered to consumers. Second, HB 216 will encourage insurers who are in the Alaska market to stay here and will attract new insurers to Alaska. This will result in more competition, which will give consumers more choices and more competitive prices. Third, HB 216 is in line with the national movement away from strict government price controls toward a more flexible, more competitively oriented system for the regulation of insurance rates and forms.

HB 216 is the result of discussions among insurance companies, agents and the Director of Insurance and her staff. The discussions started last July and have been ongoing over the past nine months. The participants in this effort used the flex-rating model law adopted by the National Conference of Insurance Legislators (NCOIL) as a starting point. Some elements of the NCOIL model were adopted - others were discarded. However, HB 216 is consistent with the NCOIL model's goal of modernizing state insurance regulation. We believe that HB 216 will create a more dynamic, more competitively oriented insurance market in Alaska. The competition on rates and forms that HB 216 will encourage will benefit Alaska insurance consumers.

I urge your support of HB 216.

**Sectional Analysis**  
**CSHB216**

Prepared by Rita Nowak  
Property Casualty Insurance Association of America

**Alaska House Bill 216**  
**Sectional Analysis**

**Summary of Alaska House Bill 216**

House Bill 216 proposes the following changes to the current property and casualty rate and form review process:

**Flex-Rating**

- Insurers would have the option of submitting rate filings excluding medical malpractice, workers' compensation, and assigned risk rates under a flex-rating procedure (a 10% band) without prior approval. Rate changes outside of the flex band would still be subject to prior approval.
- Advisory organizations would not have the option of submitting filings under the flex-rating approach.
- Impaired or insolvent insurers operating under a rehabilitation plan, an order of supervision, or an impaired financial condition would be precluded from submitting filings under the flex-rating procedure.
- Insurers submitting a rate filing for a new product or coverage will be precluded from submitting filings under the flex-rating procedure.

**Form Filings**

- Insurers would have the option of submitting form filings under a file and use approach with a thirty-day waiting period. When an insurer chooses this option, a signed self-certification form from an authorized company officer or a state filings manager stating that the filing complies with Alaska statutes must be included with the form filing. However, the Director would still have the authority to disapprove any form violating Alaska statutes. Insurers will be able to continue to submit form filings under the current prior approval provisions.
- The bill includes specific monetary penalties for insurers submitting materially false or misleading compliance certificates.

**Consent to Rate (Section 4)**

- Language was added to further explain the reasons(s) for the need to use a rate in excess of a filed rate for a specific risk.

**Technical and Conforming Changes**

- Technical and conforming changes were made to Title 21 to take into account the new provisions.

**Following is a detailed sectional analysis of House Bill 216:**

**Section 1 AS 21.09.110(b)**

This law specifies filing requirements for policy forms and rates requiring approval under Alaska Statutes § 21.39 (rates and rating organizations) and § 21.42 (insurance contracts).

**Section 2 AS 21.39.040(a)**

Rate filings are to be submitted under the specified filing procedures, AS § 21.39.041 (prior approval), or AS § 21.39.210 (flex-rating), AS 21.39.220 (file and use, filing of rates, supplementary rate information, and supporting information).

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Sectional Analysis

**Section 3 AS 21.39.040(d)**

This section pertains to the situation where an insurer does not provide sufficient information in its rate filing. The Director shall require the insurer to furnish specific information upon which the insurer supports the filing.

**Section 4 AS 21.39.040(g)**

Upon written application of an insured that states the reasons for unusual or extrahazardous characteristics not otherwise contemplated in a filed rating plan, an insurer may file a rate for use on a specific risk that exceeds a rate provided by an otherwise applicable filing.

**Section 5 AS 21.39 (New Section: 21.39.041)**

Except for workers compensation prospective loss cost filings and assigned risk pool rates by certain rating organizations, insurers and rating organizations must file medical malpractice, workers compensation, and assigned risk rating systems specified under Alaska law. Such filings must be made with the director for the purpose of review and approval prior to use.

Filings made pursuant to this requirement are subject to a 15-day waiting period before they become effective, but the director may extend the waiting period for up to an additional 15 days. If the waiting period is extended, the director must so notify the insurer or rating organization within the initial waiting period that additional time is required for consideration of the filing. If the director determines the filing meets the requirements of these provisions, it must be approved.

This law specifies such filings must include the effective date, or in the absence of a specific effective date, the insurer or rating organization may specify a reasonable period after approval for the filing to be effective.

Upon written application of the insurer or rating organization, the director may permit a filing to become effective before the expiration of the 15-day waiting period specified by this law. Filings are deemed to meet the requirements of Alaska law regarding rates and rating organizations unless the director disapproves the filing within the specified waiting period.

If a filing is not accompanied by the information supporting the filing, and the director does not have sufficient information to determine whether the filing is in compliance with applicable provisions of Alaska law, the insurer must be required to furnish the information supporting the filing. Under such circumstances, the waiting period will commence as of the date the required information is furnished. Such information may include the insurer or rating organization's experience or judgment, or the experience of other insurers or rating organizations, any interpretation of statistical data relied upon for the filing, and any other factors relevant to the filing.

When an insurer or rating organization fails to provide such information within 30 days of receiving the director's request, and upon receiving a written application for an extension of the waiting period submitted within the initial 30 day response period, the director may extend the waiting period for an additional 15 days. The director may deem an insurer or rating organization's failure to provide requested information as a request to withdraw the filing from further consideration.

If within the initial review period established by this law, the director determines a filing fails to meet the requirements of these provisions, the director must send the insurer or rating organization making the filing a written notice of disapproval. Such notice must indicate the

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manner in which the filing fails to meet the requirements of this law and must specify the filing will not become effective.

**Section 6 AS 21.39.050(c)**

Additionally, if at any time subsequent to the review period provided established by these provisions, and after notice and hearing in accordance with this law, the director determines a filing does not meet the requirements of Alaska law, he or she must give each insurer or rating organization making the filing an order specifying the manner in which the filing fails to meet the requirements set forth by these provisions.

**Section 7 AS 21.39.070(b)**

Deviations permitted to be filed will remain effective for a period of at least one-year from the effective date unless, with the director's approval, the insurer withdraws the deviation or the deviation is otherwise terminated under specified provisions of Alaska law.

**Section 8 AS 21.39.110(a)**

This law specifies that groups, associations, or other organizations of insurers which engage in joint underwriting or joint reinsurance, are subject to Alaska law regarding rates and rating organizations, except those provisions regarding flex rating. Moreover, joint reinsurance is subject to provisions regarding examinations, penalties, and hearing procedures and judicial review under Alaska law regarding rates and rating organizations.

**Section 9 AS 21.39 (New Sections: 21.39.210 and 21.39.220)**

**Section 21.39.210 (Flex-rating)**

Unless a rate level change pertains to workers compensation, medical malpractice, or assigned risk plans, this law permits increases or decreases in an insurer's rate level to take effect without prior approval. However, such rate level changes must reflect a cumulative rate level increase or decrease for all coverages, calculated from the effective date to 12 months before the effective date, of not greater than 10 percent.

This law permits insurers to make multiple rate filings during any 12-month period if the cumulative rate level change, as calculated from the effective date to 12 months before the effective date, is not greater than 10 percent.

For policies governed under these provisions, filings producing rate level changes within the limitations specified by this law are effective without prior approval and may take effect on the date specified in the filing. However, such filings will not be effective earlier than the date the filing is received by the division. Rate level changes may not be applied to a policy until the beginning of the policy period.

Furthermore, filings submitted pursuant to these provisions must include exhibits showing the calculation of the overall rate level change and the insurer's expense provisions. Loss cost adjustment filings must include supporting information showing how the loss cost adjustment is calculated and the director may request additional information if he or she does not have adequate information upon which to determine whether the filing is in compliance with Alaska law regarding rates and rating organizations.

Filings made pursuant to these provisions are considered to be in compliance with Alaska's insurance laws. But, if the director determines the filing fails to meet the requirements of Alaska's insurance laws, he or she must issue an order specifying the specific provisions of

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**Sectional Analysis**

Alaska law the insurer has violated and identifying the reasons the filing is not in compliance. Moreover, the order must state a reasonable date on when the filing is no longer effective. Orders issued pursuant to these provisions do not affect any contract issued or made prior to the effective date of the order.

These provisions do not apply to rating organizations or impaired or insolvent insurers operating under a rehabilitation plan, order of supervision, or an impaired financial condition as determined by the director.

**Section 21.39.220(New) (File and use, filing of rates, supplementary rate information, and supporting information)**

Insurer rate level increases or decreases falling outside the limitations provided under AS 21.39.210(a) (flex rating), are subject to file and use provisions under this law, unless otherwise exempt under another provision of Alaska law regarding rates and rating organizations. Such rate filings must be submitted to the director under these file and use provisions. Where an insurer is operating under a rehabilitation plan, order of supervision or an impaired financial condition as determined by the director, rate filings must be submitted to the division under the prior approval provisions of Alaska law. Filings must also be submitted for new products or coverage introductions that do not have a rate on file under the file and use provisions.

Additionally, insurers must file all rates, supplementary rate information, and supporting information with the director at least 30 days prior to the proposed effective date of a filing. Such filings must be reviewed within 15 days, but that period may be extended for an additional 15 days if the director gives the insurer or rating organization notice within the initial 15 day period stating additional time for consideration of the filing is necessary. For purposes of this law, the waiting period is the 30-day period following the date the director receives the filing.

Filings made pursuant to these provisions must include an effective date, which may not be before the end of the waiting period. If the insurer or rating organization applies in writing, the director may permit the filing to become effective before expiration of the waiting period. Filings are deemed to meet the requirements of this law and to become effective unless disapproved within the waiting period. Additionally, the director must disapprove a rate if he or she determines it does not meet the requirement of Alaska's insurance laws.

If a filing is not accompanied by the information supporting the filing, and the director does not have sufficient information to determine whether the filing is in compliance with applicable provisions of Alaska law, the insurer will be required to furnish the information supporting the filing. Under such circumstances, the waiting period will commence as of the date the required information is furnished. Such information may include the insurer or rating organization's experience or judgment, or the experience of other insurers or rating organizations, any interpretation of statistical data relied upon for the filing, and any other factors relevant to the filing. When an insurer or rating organization fails to provide such information within 30 days of receiving the director's request, and upon receiving a written application for an extension of the waiting period, the director may extend the waiting period for an additional 15 days, if such application is made within the initial 30 day response period. Filings may be disapproved for failure to provide requested information during the response period. Notices of disapproval must indicate a reasonable future date on which the filing is to be considered no longer effective.

If, within the specified waiting period, the director finds a filing does not meet the requirements of Alaska law regarding rates and rating organizations, the director must send the insurer or rating organization which made the filing, written notice of disapproval. Such notice must specify the

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**Sectional Analysis**

manner in which the filing fails to comply with this law and must state a reasonable future date on which the filing is to be considered no longer effective.

Filings and supporting information will be open to public inspection after the director completes the review of the filing.

**Section 10 AS 21.42.120(b)**

Insurers and rating organizations must submit filings for prior approval under AS 21.42.123 (form filing subject to prior approval) or AS 21.42.125 (form filing subject to file and use).

**Section 11 AS 21.42.120**

This law permits the director to order an insurer or rating organization to submit a specific insurance document or form, or a type of insurance document or form for prior approval if the director believes such approval is necessary for the protection of the public.

**Section 12 AS 21.42 (New Sections 21.42.123 and 21.42.125)**

**Section 21.42.123 (Form filing subject to prior approval)**

Prior approval filings must be made at least 30 days before the effective date of such filing. At the conclusion of the 30-day period, the filed form is considered approved unless it has been affirmatively disapproved by order of the director before the end of the 30-day period. If the director approves the form before the end of the required 30-day period, such approval constitutes a waiver of the unexpired portion of the waiting period.

Additionally, the waiting period for approval or disapproval may be extended for up to an additional 30 days if the director gives the insurer or rating organization notice within the initial 30 day period. In the absence of a prior approval or disapproval, forms subject to an extended waiting period are deemed approved at the end of the extended period. However, the director may, at any time after the notice, and for cause shown, withdraw the approval.

Insurers or rating organizations may be required to revise a filing in order to meet the prior approval filing requirements under Alaska's insurance laws. If an insurer or rating organization fails to provide requested information within 30 days after such request by the director, or within an additional 15 day period granted upon the insurer or rating organization's written request, such failure will be deemed a request by the insurer or rating organization to withdraw the filing from further consideration.

Filings made pursuant to these provisions must state and effective date or otherwise specify a reasonable time period after approval for the filing to be effective. Furthermore, prior approval filings will be open to public inspection after such filings become effective.

**Section 21.42.125 (Form filing subject to file and use; penalties)**

File and use filings must be filed with the director for a waiting period of at least 30 days, but that period may be extended by the director or the insurer or rating organization for up to an additional 30 days if notice is given as required by this law. Such notice must be given within the initial 30 day period and the filing may become effective at the end of the waiting period unless disapproved by the director within the time of the waiting period.

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Filings must state an effective date that must be after the waiting period but, upon the insurer or rating organization's written request, the director may permit a reviewed filing to become effective before the expiration of the waiting period.

File and use forms must include a signed compliance certificate certifying the filing complies with Alaska's insurance laws. Compliance certificates must be signed by an authorized officer of the filing organization or the organization's state filings manager and state that, to the best knowledge of the signor, the filing complies with applicable laws.

In addition to other penalties provided by law, if an insurer or rating organization submits a materially false or misleading compliance certificate, the director may require the organization to submit future form filings for prior approval. Moreover, a person violating these requirements regarding compliance certificates may also be subject to civil penalties of up to \$25,000 for each violation. Filings that do not include a signed compliance certificate will be reviewed under the prior approval procedure pursuant to Alaska law.

This law also permits the director to require insurers and rating organizations to provide additional information demonstrating that a file and use filing meets the requirements of Alaska's insurance laws, or the director may require such organizations to revise a filing to meet those requirements. The director must consider an insurer or rating organization's failure to provide information required pursuant to this provision as a request to withdraw the filing from further consideration. File and use filings will be open to public inspection after the filing becomes effective.

**Section 13 AS 21.39.050(a)**

This law also repeals AS 21.39.050(a) pertaining to the disapproval of filings.

# Alaska State Legislature

## House of Representatives



Official Business

State Capitol  
Juneau, AK 99801-1182

### SECTIONAL ANALYSIS FOR HB 216

BY: Representative Tom Anderson

This law modifies the following sections of Alaska Statutes: 21.09.110(joint underwriting or joint reinsurance); 21.39.040, 21.39.040(d) and 21.39.040(rate filings); 21.39.050(c)(disapproval of filings); 21.39.070(b)(deviations); 21.39.110(a)(joint underwriting or joint reinsurance); and 21.42.120(filing, approval of forms). It also adds the following sections to Alaska Statutes: 21.39.041(prior approval); 21.39.210(flex-rating); 21.39.220(file and use, filing of rates, supplementary rate information, and supporting information); 21.42.123(form filing subject to prior approval); and 21.42.125(form filing subject to file and use; penalties). Additionally, this law repeals 21.39.050(a) (disapproval of filings).

#### Section 1 AS 21.09.110(b)

This law specifies filing requirements for policy forms and rates requiring approval under Alaska Statutes § 21.39 (rates and rating organizations) and § 21.42 (insurance contracts).

#### Section 2 AS 21.39.040(a)

These provisions require each insurer to file every manual, minimum, class rate, rating schedule or rating plan, rating rule, and any modification thereto which an insurer proposes to use. However, such information is not required for marine risks which are not written according to manual rates or rating plans and commercial insurance for which the director of insurance authorizes an informational filing pursuant to this law. Filings submitted pursuant to these provisions must be in accordance with Alaska Statutes §§ 21.39.041(prior approval), 21.39.210(flex-rating), and 21.39.220(file and use, filing of rates, supplementary rate information, and supporting information). They must also state the proposed filing effective date and the character and extent of the coverage contemplated.

#### Section 3 AS 21.39.040(d)

Pursuant to AS 21.39.040(d), if the director has insufficient information to determine if a filing meets the requirements of this law, the director must require the insurer to furnish information supporting the filing.

#### Section 4 AS 21.39.040(g)

Upon written application of an insured that states the reasons for unusual or extra hazardous characteristics not otherwise contemplated in a filed rating plan, an insurer may file a rate for use on a specific risk that exceeds a rate provided by an otherwise applicable filing.

**Section 5 AS 21.39 (New Section: 21.39.041)**

Except for workers compensation prospective loss cost filings and assigned risk pool rates by certain rating organizations, insurers and rating organizations must file medical malpractice, workers compensation, and assigned risk rating systems specified under Alaska law. Such filings must be made with the director for the purpose of review and approval prior to use.

Filings made pursuant to this requirement are subject to a 15-day waiting period before they become effective, but the director may extend the waiting period for up to an additional 15 days. If the waiting period is extended, the director must so notify the insurer or rating organization within the initial waiting period that additional time is required for consideration of the filing. If the director determines the filing meets the requirements of these provisions, it must be approved.

This law specifies such filings must include the effective date, or in the absence of a specific effective date, the insurer or rating organization may specify a reasonable period after approval for the filing to be effective.

Upon written application of the insurer or rating organization, the director may permit a filing to become effective before the expiration of the 15-day waiting period specified by this law. Filings are deemed to meet the requirements of Alaska law regarding rates and rating organizations unless the director disapproves the filing within the specified waiting period.

If a filing is not accompanied by the information supporting the filing, and the director does not have sufficient information to determine whether the filing is in compliance with applicable provisions of Alaska law, the insurer must be required to furnish the information supporting the filing. Under such circumstances, the waiting period will commence as of the date the required information is furnished. Such information may include the insurer or rating organization's experience or judgment, or the experience of other insurers or rating organizations, any interpretation of statistical data relied upon for the filing, and any other factors relevant to the filing.

When an insurer or rating organization fails to provide such information within 30 days of receiving the director's request, and upon receiving a written application for an extension of the waiting period submitted within the initial 30 day response period, the director may extend the waiting period for an additional 15 days. The director may deem an insurer or rating organization's failure to provide requested information as a request to withdraw the filing from further consideration.

If within the initial review period established by this law, the director determines a filing fails to meet the requirements of these provisions, the director must send the insurer or rating organization making the filing a written notice of disapproval. Such notice must indicate the manner in which the filing fails to meet the requirements of this law and must specify the filing will not become effective.

**Section 6 AS 21.39.050(c)**

Additionally, if at any time subsequent to the review period provided established by these provisions, and after notice and hearing in accordance with this law, the director determines a filing does not meet the requirements of Alaska law, he or she must give each insurer or rating organization making the filing an order specifying the manner in which the filing fails to meet the requirements set forth by these provisions.

**Section 7 AS 21.39.070(b)**

Deviations permitted to be filed will remain effective for a period of at least one-year from the effective date unless, with the director's approval, the insurer withdraws the deviation or the deviation is otherwise terminated under specified provisions of Alaska law.

**Section 8 AS 21.39.110(a)**

This law specifies that groups, associations, or other organizations of insurers which engage in joint underwriting or joint reinsurance, are subject to Alaska law regarding rates and rating organizations, except those provisions regarding flex rating. Moreover, joint reinsurance is subject to provisions regarding examinations, penalties, and hearing procedures and judicial review under Alaska law regarding rates and rating organizations.

**Section 9 AS 21.39 (New Sections: 21.39.210 and 21.39.220)**

Section 21.39.210 (Flex-rating)

Unless a rate level change pertains to workers compensation, medical malpractice, or assigned risk plans, this law permits increases or decreases in an insurer's rate level to take effect without prior approval. However, such rate level changes must reflect a cumulative rate level increase or decrease for all coverages, calculated from the effective date to 12 months before the effective date, of not greater than 10 percent.

This law permits insurers to make multiple rate filings during any 12-month period if the cumulative rate level change, as calculated from the effective date to 12 months before the effective date, is not greater than 10 percent.

For policies governed under these provisions, filings producing rate level changes within the limitations specified by this law are effective without prior approval and may take effect on the date specified in the filing. However, such filings will not be effective earlier than the division receives the date the filing. Rate level changes may not be applied to a policy until the beginning of the policy period.

Furthermore, filings submitted pursuant to these provisions must include exhibits showing the calculation of the overall rate level change and the insurer's expense provisions. Loss cost adjustment filings must include supporting information showing how the loss cost adjustment is calculated and the director may request additional information if he or she does not have adequate information upon which to determine whether the filing is in compliance with Alaska law regarding rates and rating organizations.

Filings made pursuant to these provisions are considered to be in compliance with Alaska's insurance laws. But, if the director determines the filing fails to meet the requirements of Alaska's insurance laws, he or she must issue an order specifying the specific provisions of Alaska law the insurer has violated and identifying the reasons the filing is not in compliance. Moreover, the order must state a reasonable date on when the filing is no longer effective. Orders issued pursuant to these provisions do not affect any contract issued or made prior to the effective date of the order.

These provisions do not apply to rating organizations or impaired or insolvent insurers operating under a rehabilitation plan, order of supervision, or an impaired financial condition as determined by the director.

Section 21.39.220(New) (File and use, filing of rates, supplementary rate information, and supporting information)

Insurer rate level increases or decreases falling outside the limitations provided under AS 21.39.210(a) (flex rating), are subject to file and use provisions under this law, unless otherwise exempt under another provision of Alaska law regarding rates and rating organizations. Such rate filings must be submitted to the director under these file and use provisions. Where an insurer is operating under a rehabilitation plan, order of supervision or an impaired financial condition as determined by the director, rate filings must be submitted to the division under the prior approval provisions of Alaska law. Filings must also be submitted for new products or coverage introductions that do not have a rate on file under these file and use provisions.

Additionally, insurers must file all rates, supplementary rate information, and supporting information with the director at least 30 days prior to the proposer's effective date of a filing. Such filings must be reviewed within 15 days, but that period may be extended for an additional 15 days if the director gives the insurer or rating organization notice within the initial 15 day period stating additional time for consideration of the filing is necessary. For purposes of this law, the waiting period is the 30-day period following the date the director receives the filing.

Filings made pursuant to these provisions must include an effective date, which may not be before the end of the waiting period. If the insurer or rating organization applies in writing, the director may permit the filing to become effective before expiration of the waiting period. Filings are deemed to meet the requirements of this law and to become effective unless disapproved within the waiting period. Additionally, the director must disapprove a rate if he or she determines it does not meet the requirement of Alaska's insurance laws.

If a filing is not accompanied by the information supporting the filing, and the director does not have sufficient information to determine whether the filing is in compliance with applicable provisions of Alaska law, the insurer will be required to furnish the information supporting the filing. Under such circumstances, the waiting period will commence as of the date the required information is furnished. Such information may include the insurer or rating organization's experience or judgment, or the experience of other insurers or rating organizations, any interpretation of statistical data relied upon for the filing, and any other factors relevant to the filing. When an insurer or rating organization fails to provide such information within 30 days of receiving the director's request, and upon receiving a written application for an extension of the waiting period, the director may extend the waiting period for an additional 15 days, if such application is made within the initial 30-day response period. Filings may be disapproved for failure to provide requested information during the response period. Notices of disapproval must indicate a reasonable future date on which the filing is to be considered no longer effective.

If, within the specified waiting period, the director finds a filing does not meet the requirements of Alaska law regarding rates and rating organizations, the director must send the insurer or rating organization, which made the filing, written notice of disapproval. Such notice must specify the manner in which the filing fails to comply with this law and must state a reasonable future date on which the filing is to be considered no longer effective.

Filings and supporting information will be open to public inspection after the director completes the review of the filing.

### **Section 10 AS 21.42.120(b)**

Insurers and rating organizations must submit filings for prior approval under AS 21.42.123 (form filing subject to prior approval) or AS 21.42.125 (form filing subject to file and use).

### **Section 11 AS 21.42.120**

This law permits the director to order an insurer or rating organization to submit a specific insurance document or form, or a type of insurance document or form for prior approval if the director believes such approval is necessary for the protection of the public.

### **Section 12 AS 21.42 (New Sections 21.42.123 and 21.42.125)**

#### Section 21.42.123 (Form filing subject to prior approval)

Prior approval filings must be made at least 30 days before the effective date of such filing. At the conclusion of the 30-day period, the filed form is considered approved unless it has been affirmatively disapproved by order of the director before the end of the 30-day period. If the director approves the form before the end of the required 30-day period, such approval constitutes a waiver of the unexpired portion of the waiting period.

Additionally, the waiting period for approval or disapproval may be extended for up to an additional 30 days if the director gives the insurer or rating organization notice within the initial 30 day period. In the absence of a prior approval or disapproval, forms subject to an extended waiting period are deemed approved at the end of the extended period. However, the director may, at any time after the notice, and for cause shown, withdraw the approval.

Insurers or rating organizations may be required to revise a filing in order to meet the prior approval filing requirements under Alaska's insurance laws. If an insurer or rating organization fails to provide requested information within 50 days after such request by the director, or within an additional 15 day period granted upon the insurer or rating organization's written request, such failure will be deemed a request by the insurer or rating organization to withdraw the filing from further consideration.

Filings made pursuant to these provisions must state and effective date or otherwise specify a reasonable time period after approval for the filing to be effective. Furthermore, prior approval filings will be open to public inspection after such filings become effective.

#### Section 21.42.125 (Form filing subject to file and use; penalties)

File and use filings must be filed with the director for a waiting period of at least 30 days, but that period may be extended by the director or the insurer or rating organization for up to an additional 30 days if notice is given as required by this law. Such notice must be given within the initial 30 day period and the filing may become effective at the end of the waiting period unless disapproved by the director within the time of the waiting period.

Filings must state an effective date that must be after the waiting period but, upon the insurer or rating organization's written request, the director may permit a reviewed filing to become effective before the expiration of the waiting period.

File and use forms must include a signed compliance certificate certifying the filing complies with Alaska's insurance laws. Compliance certificates must be signed by an authorized officer of the filing organization or the organization's state filings manager and state that, to the best knowledge of the signor, the filing complies with applicable laws.

In addition to other penalties provided by law, if an insurer or rating organization submits a materially false or misleading compliance certificate, the director may require the organization to submit future form filings for prior approval. Moreover, a person violating these requirements regarding compliance certificates may also be subject to civil penalties of up to \$25,000 for each violation. Filings that do not include a signed compliance certificate will be reviewed under the prior approval procedure pursuant to Alaska law.

This law also permits the director to require insurers and rating organizations to provide additional information demonstrating that a file and use filing meets the requirements of Alaska's insurance laws, or the director may require such organizations to revise a filing to meet those requirements. The director must consider an insurer or rating organization's failure to provide information required pursuant to this provision as a request to withdraw the filing from further consideration. File and use filings will be open to public inspection after the filing becomes effective.

**Section 13 AS 21.39.050(a)**

This law also repeals AS 21.39.050(a) pertaining to the disapproval of filings.



DIVISION OF INSURANCE

Frank H. Murkowski, Governor

March 31, 2005

The Honorable Tom Anderson  
Alaska House of Representatives  
House Labor & Commerce Committee  
State Capitol, Room 408  
Juneau, AK 99801-1182

RE: HB 216 – An Act relating to insurance rate-making and form filing

Dear Representative Anderson:

During the hearing on HB 216 on March 21, 2005, Representative Rokeberg asked for information on what other states use for flex-rate bands, how much time it takes to get rates approved and what are typical rate changes. This letter and its attachment provides the requested information.

Please see the attached chart that summarizes the flex-rate laws of other states.

To provide information on typical rate changes, we have looked at rate filings that have been submitted to the division since January 1, 2000 for several different lines of business. For personal lines, personal auto and homeowners lines rate history from 3 different companies for each line are shown below.

*Personal Auto Rate Change History*

*Company A*

Rate Change	Effective Date	Flex-rating
7.0%	8/8/2000	
4.8%	4/22/2002	Yes
8.2%	8/30/2002	No
5.7%	9/8/2003	Yes

Had the flex-rating method proposed in HB 216 been available when these filings were made, the April 2002 filing would have qualified to be filed under the flex-rating provisions. The August 2002 would not qualify since the total rate change in the 12 months prior to August 30, 2002 is 13.4%, which is greater than the 10% flex band. The September 8, 2003 filing would

again qualify for flex-rating since it is the only change in the previous 12 months and the change is less than 10%.

**Company B**

Rate Change	Effective Date	Flex-rating
1.4%	5/15/2000	
5.9%	8/1/2001	Yes
18.2%	1/1/2003	No
10.1%	10/1/2003	No
-0.10%	5/15/2004	Yes
-0.30%	12/15/2004	Yes

Had the flex-rating method been available when these filings were made, the August 2001 rate change would have qualified to be filed under the flex-rating provisions. Neither the January 2003 filing nor the October 2003 filing would qualify for flex-rating as the changes are greater than 10%. The May 2004 filing would qualify for flex-rating since the combined rate change in the 12 months between May 15, 2003 and May 15, 2004 is 9.99%. The December 2004 filing would also qualify for flex-rating since the 2004 filings have a combined impact of -0.4% which is within the flex band.

**Company C**

Rate Change	Effective Date	Flex-rating
8.0%	8/24/2000	
8.3%	2/4/2002	Yes
2.7%	7/22/2002	No
5.4%	2/24/2003	Yes

Had the flex-rating method been available when these filings were made, the February 2002 filing would have qualified for flex-rating. The July 2002 would not qualify for flex-rating since the total rate change over the 12 months between July 22, 2001 and July 22, 2002 is 11.2%. The February 2003 rate change would qualify for flex-rating since the combined rate change between February 24, 2002 and February 24, 2003 is 8.2%.

*Homeowners Rate Change History*

**Company A**

Rate Change	Effective Date	Flex-rating
2.4%	5/22/2000	
15.0%	1/21/2002	No
6.2%	7/22/2002	No

Had the flex-rating method been available when these filings were made, the January 2002 filing would not qualify for flex-rating since the change is greater than 10%. The July 2002 filing also would not qualify for flex-rating since the combined rate change for the 12-month period from July 22, 2001 to July 22, 2002 is 22.1%.

Company B

Rate Change	Effective Date	Flex-rating
-0.6%	4/15/2000	
-6.4%	6/15/2001	Yes
12.3%	6/15/2002	Yes
13.2%	10/1/2003	No

Had the flex-rating method been available when these filings were made, the July 2001 filing would qualify for flex-rating. The June 2002 filing would qualify for flex-rating since the combined rate change over the 12-month period from June 15, 2001 to June 15, 2002 is 5.1%. The October 2003 filing would not qualify for flex-rating since the combined rate change from October 1, 2002 to October 1, 2003 is 13.2%.

Company C

Rate Change	Effective Date	Flex-rating
3.0%	7/6/2000	
3.0%	8/30/2001	Yes
10.4%	3/5/2003	No

Had the flex-rating method been available when these filings were made, the August 2001 filing would qualify for flex-rating since it is less than 10% and the only filing in the 12 months prior to August 30, 2001. The 2003 filing would not qualify for flex-rating since the change is greater than 10%.

Commercial Lines

For the commercial lines, filings submitted by Insurance Services Office, Inc. are considered to be representative of the rate changes for individual companies. Please note however, under HB 216 filings submitted by a rating organization are not eligible for flex-rating.

*General Liability Rate Change History*

Rate Change	Effective Date	Flex-rating
-5.7%	12/1/1999	
-6.2%	10/1/2000	No
4.5%	10/1/2001	Yes
-4.4%	10/1/2004	Yes

Had the flex-rating method been available when these filings were made, the October 2000 filing would not qualify for flex-rating since the combine rate change between October 1, 1999 and October 1, 2000 is -11.5%. Both the 2001 and 2004 filings would qualify for flex-rating since they are the only changes within the 12-month period prior to the effective dates and both are less than +/-10%.

*Commercial Auto Rate Change History*

Rate Change	Effective Date	Flex-rating
4.2%	9/1/2001	
2.5%	10/1/2003	Yes
1.2%	10/1/2005	Yes

Had the flex-rating method been available when these filings were made, both the 2003 and 2005 filings would qualify for flex-rating since the changes are less than 10% and they are the only changes in the 12-month period proceeding the effective date.

*Commercial Property Rate Change History*

Rate Change	Effective Date	Flex-rating
-2.5%	11/1/2001	
-9.8%	11/1/2002	Yes
-8.0%	2/1/2004	Yes
-4.1%	2/1/2005	Yes

Had the flex-rating method been available when these filings were made, the 2002, 2004 and 2005 filings would qualify for flex-rating since there is only one filing in a 12-month period and the changes each fall with the flex band.

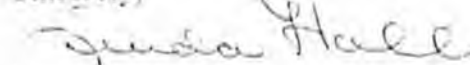
Filing Review Time

To demonstrate the length of time that it takes a filing to be approved we looked at rate filings that were closed during February 2005. There were a total of 77 rate filings that were closed with an average time of 40 days.

Number of Days to Close	Number of Filings
Less than 15 days	21
15 days	16
16-30 days	9
31-49 days	7
50-100	15
More than 100	9

Thank you for the opportunity to address the issues that were asked at the hearing. If you need additional information, please let me know.

Sincerely,



Linda S. Hall  
Director

Summary of Other State Flex-Rating Laws			
State	Flex Range	Lines of Business	Comments
Alabama	+/-10%	Commercial property and casualty insurance excluding workers compensation, medical malpractice and other lines with proposed rate increases of 10% or more	Rate filings subject to the flex range are file and use. Rate filings outside the flex range are prior approval. Personal lines rates are prior approval.
Kentucky	+/-25%	Personal and commercial lines of business.	The flex band applies to <i>any classification of risks in any rating territory</i> within a 12-month period. Rates outside the flex band are prior approval.
Louisiana	+/-10%	Personal and commercial lines of business.	Only one rate increase per classification in any 12-month period. A reduction in rates for a classification may be approved at any time. Flex rate filings become effective not less than thirty days after date of filing. Rate filings outside the flex range are prior approval.
New Jersey	+/-7%; +/-5%	Personal auto and homeowners respectively.	This is a limited rate filing prior approval process for minor rate changes that requires limited supporting information and a decision within 30-45 days.
Oklahoma	+/-15%	Workers compensation	
Oregon	+/-15%	Specified commercial liability lines such as products liability, medical malpractice, liquor law, child care, and a few others.	Oregon is generally file and use with the exception of rate changes exceeding the +/- 15% for the specified lines. Rates for the specified lines falling outside this band are prior approval.
South Carolina	+/-7%	Personal auto, fire, homeowners	Filings within the flex band become effective without prior approval provided no more than one rate increase for auto and no more than 2 rate increases for property, with the second rate increase subject to prior approval, may be implemented during any 12-month period. Rates outside the flex band are prior approval. Department position is that the maximum percentage change is 25% to any one policyholder.

Sectional Analysis for Amendments to HB216

Section	Statute	Change	Purpose or Effect
1	21.09.110(b)	Amend	Remove the word "approval" and replace it with "filing" as all forms and rates will no longer require approval. However, filings are still required.
2	21.39.040(a)	Amend	Add "loss cost adjustment" to the required list of types of rates that must be filed. Does not add new filing requirements but clarifies a new type of filing that did not exist when this statute was originally enacted.
3	21.39.040(d)	Amend	New language is added to reference that this section applies to Section 5 and Section 9 and similar language is proposed to be deleted from these sections to eliminate redundancy. Language stating when a filing is open for public inspection has been deleted as this is addressed in the prior approval, flex-rating and file and use sections.
4	21.39.040(g)	Amend	Delete the word "extrahazardous" as this concept can be incorporated in the word "unusual". Allow special filings for rates that are lower than the filed rate in addition to rates that are higher. Clarifies that prior approval or file and use filing methods apply to these filings.
5	21.39.041(a)	Amend	Add mortgage guaranty to list of prior approval filings. Replace "chapter" with "title" for consistency.
5	21.39.041(c)	Amend	Replace "chapter" with "title" for consistency.
5	21.39.041(d)	Amend	Delete duplicate requirement for supporting information as this language appears in Section 3. Replace "may deem" with "shall consider" as deem is not terminology generally used.
5	21.39.041(f)	Amend	Replace "chapter" with "title" for consistency.
7	21.39.070(b)	Repeal	Removes the requirement that a deviation filing remain in effect for one year for consistency with 21.39.210 that allows more than one filing in a 12 month period.
9	21.39.210(a)	Amend	Add mortgage guaranty to list of prior approval filings for consistency with Section 5.
9	21.39.210(c) and (d)	Amend	Replace "chapter" with "title" for consistency.
9	21.39.220(d)	Amend	Replace "chapter" with "title" for consistency.
9	21.39.220(e)	Amend	Replace "rate" with "filing" for consistency.

9	21.39.220(f)	Amend	Delete duplicate requirement for supporting information as this language appears in Section 3.
9	21.39.220(g)	Amend	Add language to clarify when a filing becomes open for public inspection.
9	21.39.220(h)	Amend	Replace "chapter" with "title" for consistency.
12	21.42.123(a)	Amend	Clarify that a filing must be disapproved by order only when the disapproval occurs after the review period or the after the filing has been previously disapproved.
12	21.42.123(b)	Amend	Clarify that a filing must comply with the title not just with the filing process.
12	21.42.125(c)	Amend	Replace "materially false or misleading" certificate with "incomplete or inaccurate" certificate to describe when an insurer may no longer be able to submit form filings under file and use procedures.

**LESSMEIER & WINTERS**  
LAWYERS - LLC

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Via Hand Delivery

March 17, 2005

The Honorable Tom Anderson, Chair  
Members of the House Labor & Commerce Committee  
State Capitol Room 408  
Juneau, Alaska 99801

Re: State Farm's Support for HB 216

Dear Representative Anderson:

On behalf of State Farm Insurance, we would like to express support for HB 216.

Currently, insurers must obtain "prior approval" from the Division of Insurance before adjusting rates upward or downward and before making products and product enhancements available to customers. Such "prior approval" systems were first instituted in the early 1900's as a way to make sure insurers charged enough to avoid insolvency, but they were not intended to help with insurance affordability. A 2001 Brookings Institute study perhaps best summarizes the problems with antiquated "prior approval" systems in today's modern market place. The study made the following conclusions about prior approval rate regulation:

1. Prior approval had little or no long-term effect on reducing overall price levels;
2. Prior approval tended to make coverage less available in the voluntary market;
3. Prior approval tended to create larger residual markets;
4. Prior approval tended to increase cost volatility for insurers and price volatility for consumers; and
5. Prior approval tended to increase subsidization of residual market insurance by those insureds in the voluntary market.

History in other states indicates clearly that both the Alaska insurance industry and insurance consumers will benefit by modernization of Alaska's regulatory system to allow rate flexibility and a use and file system for policy forms and endorsements. HB 216 does that, while at the same time preserving the Insurance Director's authority to regulate rates and forms.

Honorable Tom Anderson  
March 17, 2005  
Page 2

LESSMEIER & WINTERS  
LAWYERS - LLC

In conclusion, HB 216 will reduce entry barriers for insurers to do business in Alaska, encourage competition among insurers, allow insurers to respond more quickly to market conditions to the benefit of consumers and allow the Division of Insurance employees to spend their valuable time on activities that will better serve the insurance buying public such as regulation of solvency, market conduct and consumer complaints. Based on experience in other states, insurance availability should improve in the near term and insurance affordability may improve in the longer term. We thank you for your support of this bill.

Sincerely,

LESSMEIER & WINTERS  
Lobbyists For State Farm

By: Sheldon E. Winters  
Sheldon E. Winters

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March 16, 2005

To: Alaska State House of Representatives

I am writing to strongly encourage you to pass House Bill 216.

There is common acceptance by all observers that the current insurance regulatory system in Alaska needs to be reformed. Progressive Casualty Insurance Company and its affiliated and subsidiary companies (Progressive) agrees that insurance regulatory reform is necessary and in the best interest of all stakeholders. We believe that HB 216 is a huge step forward and will:

- Encourage competition, availability, and innovation in product design;
- Eliminate multiple layers of regulation;
- Facilitate the use of pricing and underwriting practices that are fair and actuarially supported;
- Provide speed to market so that forms and rates for new and existing products can be used within reasonable time frames;
- Eliminate outdated regulatory requirements that no longer serve valid regulatory objectives;
- Provide flexibility that allows insurers to innovate and compete effectively against new rivals in the rapidly converging financial services industry;
- Be administered by regulators who are professional, knowledgeable about the industry, and capable of effectively balancing the interests of consumers and insurers; and
- Provide regulation that is consistent, sensible, reliable, and in accordance with law.

A regulatory system with these attributes will foster competition and make reasonably and accurately priced insurance available to more consumers. It will also encourage capital investment and promote a healthy insurance market. This can only benefit consumers.

HB 216 fosters open competition, and in doing so, we believe establishes the optimal approach to rate regulation from both the consumer and industry point of view. Fostering competition curtails excess profits and improves insurance availability. Free market forces should be allowed to operate to assure the most efficient flow of services to the insurance-consuming public. Open competition rating laws, such as HB 216, are the embodiment of this philosophy.

If I can be of any assistance, or answer any questions pertaining to our support of this bill, please do not hesitate to call me directly at 916-864-6175.

Thank you for supporting HB 216.

Sincerely,

Marcus Linden  
Progressive Insurance  
Agency Auto Product Manager Alaska

Progressive Insurance supports HB 216 and strongly encourages you to <sup>Support</sup> pass CS House Bill 216.

~~This Committee Substitute~~  
We believe ~~HB 216~~ represents a win for consumers, regulators, and industry.

Consumers will benefit from this bill because it will stimulate further competition among insurance companies. Competition will be heightened for two reasons. One, we believe non-present carriers will see the passage of this bill as a sign that the State of Alaska and the Alaska DOI are serious about attracting new carriers. HB 216 makes it less burdensome for carriers to file their rates and maintain a program. States with a small market, such as Alaska, need to make it easier, not harder, for companies to do business, otherwise it just isn't worth it to carriers. ~~With the arrival of new carriers, Alaskans will gain more choices and likely lower premiums relative to the current market.~~ Competition will also be heightened because insurance carriers will feel more comfortable being aggressive with lower premiums. In the current environment, lowering rates is perceived to be a risky move because raising rates, if rates costs rise, might take longer than is desired, resulting in unprofitability. The more financially sound strategy is to maintain, rather than lower rates. The flex band is designed to allow carriers some wiggle room with respect to pricing. ~~If a carrier lowers rates and their costs suddenly rise, they own more quickly to maintain profitability and will be a dry run for the state's benefit.~~ Clearly consumers win if they have more choices and there is heightened competition among those choices.

This bill is a win for the DOI as well. Less time will be spent reviewing insurers' filings for a small rate change. Resources can be re-deployed more efficiently to ~~rate~~ rate and program changes. More time can be spent on other insurance issues of importance to Alaskans.

Finally, we like the bill because it reduces our administrative cost to conduct business in the state and allows us to more easily bring new products and services to Alaska. When we prioritize new programs to be rolled out in the US, the most heavily regulated states get put at the bottom of the list, if they make the list at all. This means consumers in Alaska are not benefitting from new innovations that could very well be saving them hundreds of dollars a year on car insurance. With the passage of this bill we hope to bring our product in Alaska up to par with other states. We believe this will generate growth for us as innovation helps us out perform our competitors and is one of the keys to our success.

Thank you for your time in hearing testimony on this bill. We support HB 216 and ask you for your support. ~~Thank you for your support.~~ <sup>Thank the CS and more</sup>  
<sup>it through the process.</sup>  
Sincerely,

Marcus Linden  
Agency Product Manager AK  
~~Progressive Insurance~~  
10929 Disk Drive  
Rancho Cordova, CA 95670  
916-864-6175

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Property Casualty Insurers  
Association of America

Shaping the Future of American Insurance

March 17, 2005

To: The Honorable Tom Anderson, Chair  
Members of the House Labor and Commerce Committee

From: Samuel Sorich, Vice President

Re: PCI's Support for HB 216

The Property Casualty Insurance Association of America (PCI) is an association of property/casualty insurance companies. There are nearly 200 PCI member companies writing insurance in Alaska. PCI members include Allstate, Progressive, Liberty Northwest, and GEICO.

PCI supports HB 216. Director Hall and her staff deserve to be commended for their regulatory efforts. However, current statutes force them to process and review every change in rates and forms, no matter how minor and no matter how well justified, before the change can be put into effect. This system burdens the Division staff and distracts them from other regulatory priorities. The system also has inherent delays which force consumers to wait for new rating plans and products.

Alaska's current regulatory system discourages insurers from innovating on rates and products, because any such changes face an often times lengthy review process. When the rates and products are finally improved, they may no longer relate to market conditions and consumer needs.

HB 216 addresses these problems. The bill preserves the Insurance Director's authority to regulate rates and forms but allows a degree of rate flexibility and offers an alternative to the current system of strict regulatory prior approval of policy forms. We believe that HB 216 will create a more dynamic, more competitively-oriented insurance market in Alaska. The competition on rates and forms that HB 216 will encourage will benefit Alaska insurance consumers.

HB 216 was developed over the past nine months by an industry-wide drafting group. The group included some PCI members and several other insurance companies and associations, including State Farm Insurance Company and the American Insurance Association which also support HB 216.

Sincerely,

A handwritten signature in cursive script that reads "Samuel Sorich".

Samuel Sorich  
Vice President

Testimony of John George representing Property Casualty Insurance Association of America. 3/21/05

This bill is a result of nine months of discussions among insurance companies, agents, the Director of Insurance and her staff. We have reached agreement on needed statutory changes which will significantly increase competition, provide public protection and improve the efficiency of the Division of Insurance.

HB216 has three basic purposes. First the bill will create an environment where insurers compete more vigorously on insurance rates and products. HB216 will encourage insurers who currently write insurance in Alaska to stay, will encourage companies with minimal writings to expand their book of business and will attract new insurers to Alaska. More competition is good for the public and a spreading of coverages among more carriers lessens our dependence on any one company. HB216 follows a national trend to a more competition oriented system for regulation of insurance which has shown benefits to consumers where similar regulatory modernization has occurred. And finally HB216 allows the Division of Insurance more efficiently allocate their resources to provide better consumer protection.

Discussions began using model legislation adopted by the National Conference of Insurance Legislators. Some of those ideas were incorporated some were discarded, but the current bill is consistent with the NCOIL model goal of regulatory modernization. The bill requires initial rates to be filed and approved by the Division of Insurance with subsequent filings within a narrow rate band to be filed and used without prior approval. This flex rating system allows companies to react quickly to market conditions without waiting months seeking prior approvals. The bill contains a certification process whereby companies certify that their filing meets statutory requirements. The Division of Insurance retains the authority to regulate, and apply sanctions on companies that fail to meet the required standards.

The bill as presently drafted has a few technical problems and some items need minor adjustments to accomplish the intended goals. The Director of Insurance and industry spokesmen are still working on language for several changes and we are confident that we will reach agreement on those issues. We had hoped to have a committee substitute bill ready for today's hearing but it is not ready yet.

I believe the Director of Insurance is on line today and I think it might be appropriate to get her comments on the bill and reserve testimony on the technical aspects of the bill until we have a committee substitute bill ready for consideration.

The final bill will truly be a cooperative effort supported by industry and regulators which will benefit the insurance buying public.



## AN ANALYSIS OF INSURANCE RATE REVISIONS UNDER FLEX-RATING SYSTEMS

### Introduction

A flex-rating system enables insurance companies to implement rate changes within a percentage band without approval from the regulator, but it ensures that larger changes must still undergo regulatory review before going into effect. Even small changes may still be disapproved if they do not meet the statutory requirements of being "not inadequate, excessive, or unfairly discriminatory."

This type of system allows insurers the flexibility to respond to competitive market conditions and adjust certain rates more quickly in accordance with the changing loss experience. It has the ability to stabilize the market by smoothing any fluctuations in the rate adjustments. Flexible rate revisions under this mechanism are not as volatile as rates that require prior approval. By reducing any sharp gyrations in the rate level, the system is beneficial to insurance consumers as price continuity is maintained. Flex-rating provides a reasonable plan that lessens regulatory burdens for both insurers and regulators without compromising consumer protection, and consumers benefit from a market environment characterized by healthy competitive forces and flexibility.

While lawmakers and regulators may recognize the benefits of flex-rating, there is some hesitancy to convert a less competitive rating law to a more flexible system. Understandably, they are concerned that insurance companies will seize upon the opportunity to implement rate changes very close to the threshold, knowing that these rates will not need regulatory approval.

This paper provides evidence showing that the scenario described above is not the case. A significant number of rate changes in flex-rating systems are in fact reductions. One reason for rate decreases under a flex-rating system is that insurers are allowed the flexibility to respond to competitive market conditions and determine appropriate rate level changes more quickly. If a competitive market exists, then this system, by definition, will allow some rates to change more quickly in accordance with the changing loss experience.

Flexible rate revisions are not as volatile as rates that require prior approval. Since companies are able to predict their losses more accurately under a flex system, they feel more comfortable in reducing rates if warranted because they realize they can increase them later if needed. This is not always the case under a prior approval system, since companies face an additional underwriting risk due to the time lag involved with the delays in the review process. What typically occurs in states with prior approval laws is that companies are hesitant to lower rates because they experience regulatory delays when subsequent increases are needed.

Because premiums are able to more accurately reflect projected losses under a flex-rating system, actual loss ratios (i.e., losses relative to premiums) are more likely to match targeted loss

ratios and favorable underwriting returns are produced. Companies are able to respond to changing loss experience more quickly under flex-rating than under prior approval and they can implement certain rate increases or decreases with all necessary flexibility, further strengthening the competitive system. As a result, policyholders see lower increases in their rates and sometimes even cost savings.

Congress could intervene in the regulation of the insurance business unless it is persuaded that greater regulatory modernization at the state level is occurring. Meetings and hearings in recent years have focused on flaws in the current state regulatory system, including the drag that supervised or administered rating laws have on consumer choice and industry competition and efficiency. Flex-based rates make it possible for insurers to compete more vigorously and swiftly on price, and Congressional leaders calling for more modernized insurance regulation have cited "speed-to-market" and competition-based pricing as crucial elements in regulatory modernization.

Effective consumer protection that focuses on local needs is the hallmark of state insurance regulation because local and regional markets and the needs of consumers in those markets are better understood within the state framework. Modernization of insurance rates is a key element to preserving state regulation of insurance, and state legislators can play a key role in making sure that modernization is implemented quickly and efficiently. State regulators are on time and on target to accomplish changes needed to modernize the system of insurance regulation in the United States. The PCI remains committed to working with them to enhance and improve the state regulatory system to foster a healthy and competitive insurance marketplace.

Flex-rating is a very logical and sound next step toward regulatory modernization, as free market forces would operate to a greater extent to assure the most efficient flow of services to the public. It makes little sense for insurance companies to take advantage of the flexible non-regulatory approval feature by implementing rate increases near the threshold, as they would simply lose business by encouraging their policyholders to go to other insurers. What does make sense is that a flex-rating approach would:

- allow insurers to better predict their losses, resulting in lower loss ratios;
- create lower rate increases and even decreases, to the benefit of consumers; and
- attract more insurers to enter the market, improving the level of competition in the state.

### **Personal Auto Rate and Loss Cost Activity**

This section discusses rating activity in the various states that have flex-rating laws. Currently, the following five states have auto insurance flex-rating systems in place:

- Kentucky – effective July 15, 1988, flex band of 25 percent
- Louisiana – effective January 1, 2004, flex band of 10 percent
- Pennsylvania – effective February 19, 1998, flex band of 10 percent
- Rhode Island – effective July 7, 2004, flex band of 5 percent
- South Carolina – effective March 1, 1999, flex band of 7 percent

In addition, some rating activity is provided for New York, a state that had a flex-rating law beginning on June 30, 1995. The law, however, sunset in August 2001.<sup>1</sup>

In each example, personal auto rate changes made in these states were not right at the upper limit. Insurance companies are not arbitrarily filing rate increases near the threshold, knowing they can get the maximum revision without insurance department approval. They do not treat the size of the flex band lightly, but instead make prudent rating decisions according to the changing loss trends and the competitive environment.

#### *Rate Activity in South Carolina*

By far, South Carolina appears to have received the greatest amount of attention with respect to the adoption of its auto flex-band law in 1999.<sup>2</sup> In a letter dated March 22, 2004, Dean Kruger, property and casualty chief at the South Carolina Department of Insurance, asserts, "The assumption used under the prior approval law was that requiring insurers to lower requested rate increases saves money for consumers. If such an assumption were accurate, then premiums should have increased during the implementation (of flex-rating). In fact, they dropped and this indicates that the competitive marketplace is the more effective in controlling rate levels. The key is to increase the number of market participants and a regulatory approach that causes insurers to not enter our marketplace has a cost to the consumer."

Included in Mr. Kruger's letter is an exhibit of major personal auto insurers and their rate activity since the flex system began (see Table 1). Revisions are no changes, decreases or increases beyond the 7 percent threshold that would require regulatory approval. Six of the 34 rate activities shown in the table were decreases and seven were increases above the threshold; the remaining 21, including "no change", are generally well below the maximum limit. Clearly, companies are not trying to take advantage of the new system by implementing rate increases at levels near the flex band. Another observation is the fact that rate changes were not automatically made each year, as seen for three insurers (Allstate, State Farm Fire and Casualty, and South Carolina Farm Bureau).

	1999	2000	2001	2002	2003
Allstate Insurance Co.	0.0%	1.5%	3.6%	No Change	1.6%
State Farm Mutual Auto	-0.3%	0.9%	5.9%	5.8%	-0.5%
Nationwide	-1.8%	4.7%	4.3%	3.9%	1.8%
State Farm Fire and Casualty	No Change	-4.8%	10.2%	11.6%	3.9%
GEICO	-10.3%	6.6%	9.9%	3.5%	1.9%
Allstate Indemnity Co.	New Program	5.0%	11.0%	12.75%	12.0%
South Carolina Farm Bureau	-4.53%	No Change	6.94%	0.01589%	7.26%

*Source: South Carolina Department of Insurance*

<sup>1</sup> It is not known whether the flex-band system will be reinstated by the New York General Assembly.

<sup>2</sup> Most likely, the spotlight has been on South Carolina due to the significant improvements flex-rating had on its residual market problem and the large increase in auto insurers entering the state.

### *Rate Activity in New York*

Like South Carolina, New York had a flex band of 7 percent for personal auto insurance. Although New York's flex-rating law sunset in 2001, information is presented on rate changes that took place in this state while the system was in effect and after the law sunset (see Table 2, compiled by the Progressive Group). These changes reflect rating activity conducted by 10 insurance groups representing more than 70 percent (71.5%) of the market.

As previously shown, insurers do not view flex-rating as an opportunity to raise their rates as much as possible. In fact, six insurers implemented rate changes substantially lower than the 7 percent band (Liberty Mutual, Metropolitan, Nationwide, New York Central, and Travelers all had small increases, while State Farm lowered its rates by 2.5%). One insurer (GEICO) had a rate change near the limit during flex, but filed the lowest change after the law sunset. These small increases resulted in GEICO's having the second lowest overall rate increase (8.5%) both during and after flex-rating (the lowest is Nationwide, with a combined 6.0% increase during and after flex). Three insurers (Allstate, 8.5%; AIG, 17.9%; and Progressive, 18.1%) had rate changes greater than the 7 percent band during flex-rating and needed regulatory review and confirmation before they were able to put their rates into effect.

The average increase among the 10 groups presented was 5.3 percent during flex-rating, less than half the average of 11.0 percent after the law reverted to prior approval. Clearly, New York drivers on average were better off during the flex-rating period than the prior approval period because their insurance rates did not go up as much. This is especially true for policyholders of seven of the 10 insurers (Allstate, Liberty Mutual, Metropolitan, Nationwide, New York Central, State Farm and Travelers).

Insurer Group	Rate Change During Flex-Rating	Rate Change After Flex-Rating Sunset
Allstate Insurance	8.5%	11.6%
American International Group	17.9%	15.5%
GEICO/Berkshire Hathaway	6.5%	1.9%
Liberty Mutual Insurance Group	0.0%	5.9%
Metropolitan Group	1.8%	11.3%
Nationwide Corporation	1.6%	4.3%
New York Central Mutual	4.0%	9.3%
Progressive Group	18.1%	15.0%
State Farm	-2.5%	21.8%
Travelers/Citigroup	2.5%	8.7%
Average	5.3%	11.0%

*Source: Progressive via Martin & Company*

*Rate Activity in Other States with Flex-Rating*

In addition to South Carolina and New York, other states with flex-rating systems have seen activity that should further ease concerns regarding any alleged rating opportunities. Information on these particular activities has been extracted from various newspaper articles and is presented in Table 3, along with the date of the article, the state affected and the company filing for the change. As before, all of the changes indicated are quite a bit lower than the established maximum beyond which insurance department approval is required, once again demonstrating that insurers are not trying to take advantage of the more competitive system.

Date of Article	State (Band)	Major Insurance Company	Action (line of business)
6/22/03	Kentucky (25%)	Kentucky Farm Bureau	6.6% increase in 2002 (auto); 10.0% increase in 2002 (homeowners)
6/22/03	Kentucky (25%)	State Farm	6.7% increase (homeowners); 0.5% increase (auto)
6/08/04	Kentucky (25%)	State Farm	5.3% decrease (auto)
1/23/04	Louisiana (10%)	USAA Group	2.2% decrease (auto)
3/04/04	Louisiana (10%)	Farmers	6.8% increase (auto)
1/21/05	Louisiana (10%)	State Farm	2.1% decrease (auto)
1/04/04	Pennsylvania (10%)	Erie	7% increase (auto)
8/09/04	Pennsylvania (10%)	Allstate	2.5% increase in Philadelphia; 6.8% in rest of state (auto)
6/12/04	Texas (30%)*	State Farm	2.2% decrease (auto)
6/12/04	Texas (30%)*	USAA	8.6% decrease (auto)
* Texas has since converted to a file-and-use rating system, effective December 1, 2004.			
Sources: Kentucky – <i>The Courier-Journal (Louisville)</i> , June 22, 2003 and June 8, 2004; Louisiana – <i>The Baton Rouge Advocate</i> , January 23, 2004, March 4, 2004, and January 21, 2005; Pennsylvania – <i>Erie Times-News</i> , January 4, 2004 and <i>The Philadelphia Inquirer</i> , August 9, 2004; and Texas – <i>San Antonio Express-News</i> , June 12, 2004			

The 2.1 percent reduction made by State Farm Mutual Automobile Insurance Company in Louisiana (effective February 15, 2005) affects about one-third of the state's drivers. This decrease meant annual savings of \$19.3 million for these motorists, or an average of nearly \$20 per policyholder. This is the first time in almost five years that State Farm has reduced its rates. According to the state's insurance commissioner, J. Robert Wooley, auto insurance rates have benefited from the flex-band rating system. "Insurers aren't as reluctant to reduce rates when business is good because they know they can also raise rates without incurring a political battle." Commissioner Wooley also remarked that smaller auto insurers in the state filed for rate reductions as well, while others raised their rates by smaller percentages than in the past few years.<sup>3</sup>

<sup>3</sup> Source: *The Baton Rouge Advocate*, January 21, 2005

*ISO Advisory Loss Cost Changes in States with Flex-Rating*

Another source connected to rating activity is the Insurance Services Office, Inc. (ISO), an organization that makes advisory prospective loss cost filings for companies that use their services. Based on aggregated data submitted by participating insurers, these loss costs are adjusted for development and trending to assist companies in creating their own independent rates. It is believed that rate changes made by companies using ISO advisory loss costs are not too different from these recommended changes.

Presented in Table 4 are recent advisory loss cost revisions for personal auto insurance for the five states that now have flex-rating systems. These figures are taken from ISO circulars made available to PCI.

Table 4 Insurance Services Office, Inc. Personal Auto Advisory Loss Cost Level Activity On Combined Total Limits					
State (eff. date; Flex-Band)	Kentucky (7/15/88; 25%)	Louisiana (1/1/04; 10%)	Pennsylvania (2/19/98; 10%)	Rhode Island (7/9/04; 5%)	South Carolina (3/1/99; 7%)
2000	-4.4%	N/A	-8.0%	N/A	-18.5%
2001	No change	N/A	-3.7%	N/A	No change
2002	+7.8%	N/A	+7.0%	N/A	No change
2004	+1.5%	No Change	-1.8%*	+8.4% (-0.8%**)	+1.5%

Notes:

- 1) All time periods are through the 4<sup>th</sup> quarter, except for 2002, which is through the 2<sup>nd</sup> quarter. Information for 2003 is not available at PCI.
- 2) N/A = not applicable (i.e., flex-rating has not taken effect yet)

\* A decrease of -1.8% was disapproved in Pennsylvania.

\*\* A decrease of -0.8% for basic limits is scheduled for implementation or approved effective 2<sup>nd</sup> quarter of 2005 in Rhode island.

Source: ISO Chief Executive Circulars

The loss cost revisions made by ISO were either substantially lower than the maximum limit allowed in the flex band or were actually higher than the threshold (such as the 8.4% increase in Rhode Island), the latter requiring prior approval by the regulator. None of these changes were only slightly lower than the threshold, thus taking advantage of the system as some may think. In fact, half of the changes shown in Table 4 are implemented decreases. This is especially true in Pennsylvania, where three of the advisory loss cost changes recommended by ISO since 2000 are reductions. Another notable one is the 18.5 percent decrease made by ISO, shortly after flex-rating was adopted in South Carolina.

### Other Positive Effects of Flex-Rating Systems

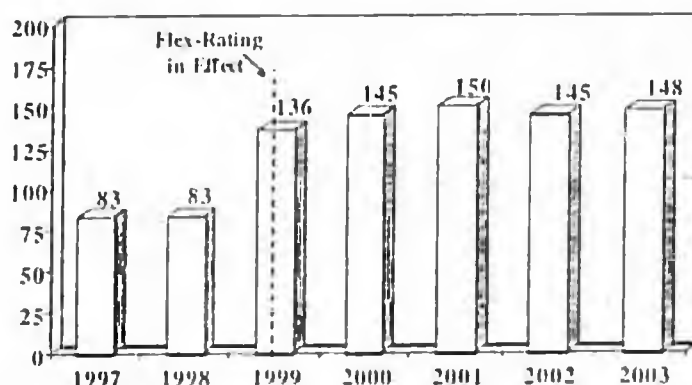
Although the primary purpose of this report is to show that rate changes are not influenced by the maximum level of the flex band, there are several other positive changes resulting from a flex-rating law that deserve mention. These are shown for South Carolina and New York.

#### South Carolina

In South Carolina, the positive effects from flex-rating are as follows:

- The number of auto insurers grew dramatically when South Carolina adopted the new flex-rating law (see Figure 1 for the trend). During 1997 and 1998, there were 83 companies writing auto insurance in this state. When the new law went into effect in 1999, the number soared to 136, a two-thirds increase. The number of insurers continued to rise, peaking at 150 in 2001. This quantity has remained fairly constant over the last three years.<sup>4</sup>

Figure 1  
South Carolina  
The Number of Auto Insurance Companies  
Accelerated After Flex-Rating



Source: SAIC

- South Carolina motorists paid an average of 4.4 percent, or \$34, less for auto insurance in 2000 (one full year after its flex-rating law began) compared to 1998 (\$732.53 in 2000 vs. \$766.23 in 1998).<sup>5</sup> This post-flex premium dropped to the same level seen three years earlier, in 1997.
- During the four-year period before flex-rating (1995 – 1998), the state's average personal auto loss ratio was 80.6 percent of premiums. After flex-rating (2000 – 2003), it fell nearly 12 percentage points, down to 68.7 percent.<sup>6</sup> Again, because rates can now be adjusted more quickly to reflect changing losses, the loss ratios are more in line with those projected. This resulted in the decline in average premium for the state's drivers.

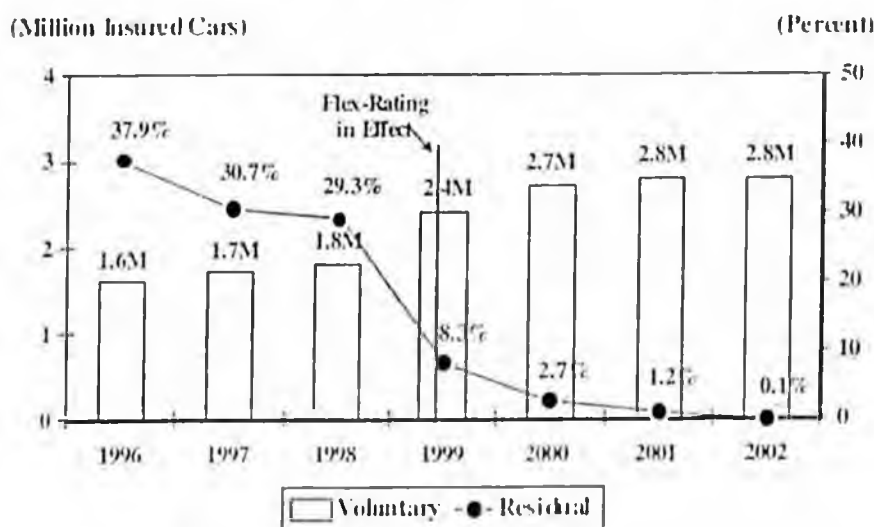
<sup>4</sup> Source: National Association of Insurance Commissioners

<sup>5</sup> Source: National Association of Insurance Commissioners, *State Average Expenditures & Premiums for Personal Automotive Insurance*

<sup>6</sup> Source: National Association of Insurance Commissioners

- Prior to flex-rating, the personal auto residual market in South Carolina was extremely problematic. The proportion of drivers in this group was one of the highest in the nation, representing between 29 percent to 38 percent of the state's entire insured population before the law was changed. This is in comparison to an average countrywide penetration of about 2 to 3 percent. After the 1999 change in rating law, South Carolina's residual market population dropped down to 8 percent during the year and is now less than 1 percent of the insured population. In contrast, its voluntary market grew about 75 percent, from a population of 1.6 million insured cars in 1996 to 2.8 million insured cars in 2002.<sup>7</sup> The largest increases in the voluntary market took place over the last three years after the conversion to flex-rating (see Figure 2), showing that the competitive market here is indeed working now.

Figure 2  
South Carolina  
Positive Effects of Flex-Rating  
Trends in Voluntary and Residual Market



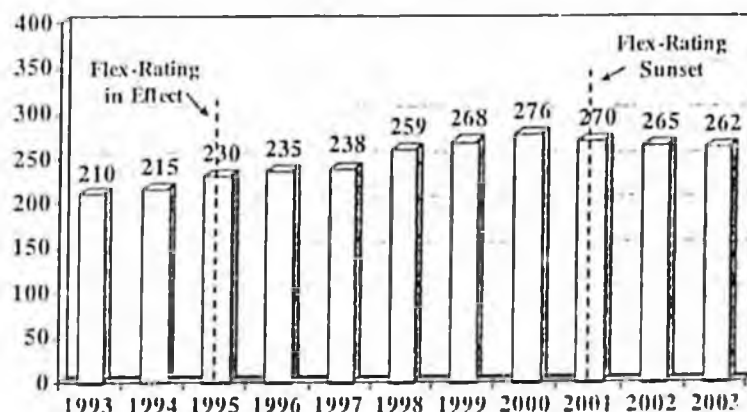
Source: AIPSO

#### *New York*

Like South Carolina, one positive outcome of a conversion to flex-rating from prior approval is the growth in the number of personal auto writers in New York. Figure 3 illustrates this trend from 1993 to 2003. When flex-rating went into effect in 1995, there was an increase of 7 percent in the number of insurers (230 insurers in 1995 compared to 215 the previous year). The level continued to grow, accelerating to 276 insurers five years later. However, the New York flex-rating law sunset in 2001, and what resulted after its dissolution was an immediate reduction in auto insurers. The number of writers dropped steadily after flex-rating was removed, from a high of 276 writers prior to the sunset down to 262 writers now.

<sup>7</sup> Source: Automobile Insurance Plans Service Office

Figure 3  
Trend in New York Personal Auto Insurers  
After Flex-Rating Went into Effect  
and After Flex-Rating Sunset

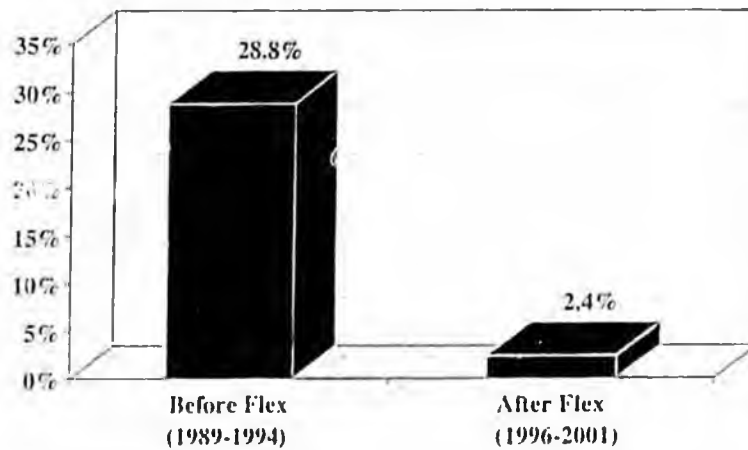


Source: NAIC

Another observed benefit is that the average personal auto premium for New York slowed down after its new system was implemented. Figure 4 illustrates the change in average premium between New York for a consistent period of time before and after its flex-rating plan went into effect. The periods selected are 1989 – 1994 before flex and 1996 – 2001 after flex. Prior to flex, the average premium rose 28.8 percent from 1989 to 1994. During the same length of time, but post enactment of its new rating law (1996 – 2001), the premium experienced only a 2.4 percent increase.<sup>8</sup> This is because certain rates were allowed to change more rapidly to more accurately reflect the trends in loss experience, resulting in less volatile rate revisions than under a prior approval system.

<sup>8</sup> Source: National Association of Insurance Commissioners, *State Average Expenditures & Premiums for Personal Automotive Insurance*

Figure 4  
New York  
Five-Year Personal Auto Premium Growth  
Before and After Flex-Rating



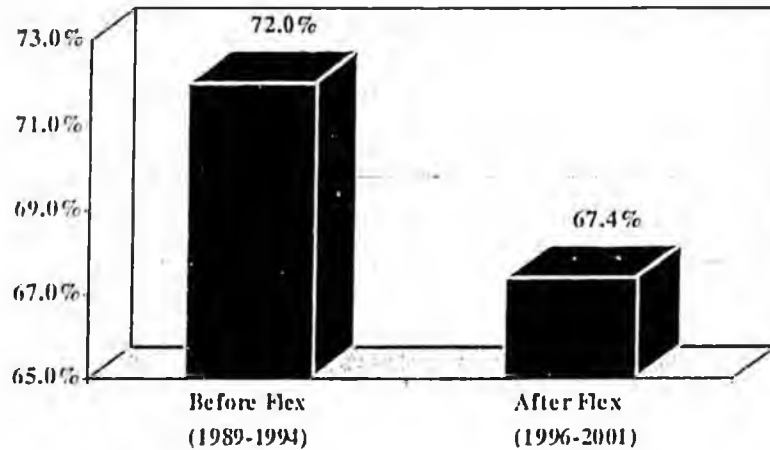
Source: NAIC

The reduced change in average premium growth for New York after flex-rating took place is supported by the fact that the loss ratio also went down. The loss ratio declined after the change in law because more filings were approved more rapidly under this system, permitting the losses relative to the premiums to be closer to what was projected. Having an actual loss ratio closer to the projected amount means a greater likelihood for anticipated profitability results and less need for future rate increases for customers.

The following illustration shows the average personal auto loss ratios before and after New York's flex-rating effective date. Again, the periods examined, before flex and after flex, are respectively 1989 – 1994 and 1996 – 2001<sup>9</sup> (see Figure 5).

<sup>9</sup> Source: National Association of Insurance Commissioners, *Report on Profitability by Line and by State*. NAIC uses a simple arithmetic average to generate mean loss ratios over time.

Figure 5  
New York  
Average Personal Auto Loss Ratios  
Before and After Flex-Rating



Source: NAIC

During the period prior to New York's flex-rating law, the average loss ratio was 0.720 (i.e., 72.0% of earned premiums). After the new law went into effect, the loss ratio for the same length of time dropped to 67.4 percent, a reduction of nearly 5 points. This decline in loss ratio stemmed from insurers' being able to adjust their rates on a more timely basis to more accurately reflect losses under flex-rating. And lower loss ratios mean lower premium increases.

#### *Comparison of Average Premiums By Rating Law*

Rate regulatory systems generally fall into two categories: "prior approval" and "open competition" (or "competitive rating"). Competitive rating is the more efficient method of setting insurance rates because it is self-adjusting. Insurers are better able to respond to current loss trends and greater innovation is encouraged. Open competition creates an environment that permits a more responsive and substantial expansion of coverage availability. If insurers set rates too high or too low, the market adjusts to drive rates to the competitive level. In addition, innovation will be stimulated, thus making a wider variety of product, price and service combinations available to consumers.

Rate levels are also found to be lower in competitive rating states than in states with prior approval laws. Presented in Table 5 are the 2002 average personal auto premiums, separated between groups of non-competitive prior approval states (including state-made and bureau-made), flex-rating and open competition states that fell under these categories during that year.

<b>Table 5</b> <b>Average Personal Auto Insurance Premiums – 2002</b> <b>Comparison of Rating Laws</b>	
Group of States by Type of Rating Law	Annual Average Premium
Prior Approval (incl. State- and Bureau-Made)	\$940.63
Flex-Rating	\$862.00
Open Competition	\$826.01
<i>Prior Approval: AL, AK, CA, DE, GA, HI, LA, MA, MS, NE, NV, NJ, NM, NY, NC, ND, OK, TN, WA, and WV</i> <i>Flex-Rating: KY, PA, SC, TX</i> <i>Open Competition: AZ, AR, CO, DC, FL, ID, IL, IN, IA, KS, ME, MD, MI, MN, MO, MT, NH, OH, OR, RI, SD, UT, VT, VA, WI, and WY</i> <i>Connecticut is not included in any group because its liability rates are subject to prior approval and its physical damage rates are subject to open competition.</i>	
<i>Source: PCI, based on data compiled by the National Association of Insurance Commissioners</i>	

As a group, the states with non-competitive prior approval laws and state- and bureau-made rates have a higher average personal auto premium than states with more competitive rating laws. The auto premium is 9 percent higher than flex-rating states (\$940.63 vs. \$862.00) and 14 percent higher than open competition states (\$940.63 vs. \$826.01). Of course, it must be noted that other factors contribute to the level of premiums as well, the most important being the amount of insured losses that occur. This comparison nevertheless shows that in states where insurers are allowed to operate more competitively, their customers have more affordable insurance.

### Studies Discussing the Benefits of Open Competition

The subject of insurance rate regulation has been one of great interest over the last thirty years. Regulators and other governmental bodies, insurers, academicians, and economists all have conducted in-depth research to examine the different regulatory approaches. They conclude that an open competition rating law provides more benefits to both insurers and the public than does a non-competitive prior approval law. Findings from several studies or cases are cited below:

- "A review of the particular alternatives (to the competitive rating law), especially a return to prior approval, indicates that these problems would be made worse, not better, by the alternative approaches."<sup>10</sup>
- "If consumers in competitive rate states fare as well or better than they did in 'non-competitive' rate states, there appears to be no empirical economic justification for the regulation of automobile insurance rates by regulatory authorities, especially when

<sup>10</sup> Source: State of New York Insurance Department, *The Open Rating Law and Property-Liability Insurance: An Evaluation of Insurance Price Regulation, 1977*

considering the costs of regulating rates."<sup>11</sup>

- "...prior approval regulation of rates entails direct and indirect costs and serves no useful purpose in modern, competitively structured insurance markets. Rather, the insurance-buying public would benefit from deregulation of rates."<sup>12</sup>
- Justice Black stated that the philosophy of a less regulated market...  
"rests on the premise that the unrestrained interactions of competitive forces will yield the best allocation of our economic resources, and lowest prices, the highest quality and the greatest material progress, while at the same time providing an environment conducive to the preservation of our democratic, political and social institutions."<sup>13</sup>

*The Property Casualty Insurers Association of America (PCI) is a trade association consisting of more than 1,000 insurers of all sizes and types, and representing 38 percent of the total property/casualty insurance business and 48 percent of the personal auto business in the nation.*

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<sup>11</sup> Source: Witt, Robert C. and Miller, Harry. *Bar's Review*, Vol. 81, No. 8, Dec. 1980. "Is Auto Insurance Rate Regulation Necessary?"

<sup>12</sup> Harrington, Scott E. AEI-Brookings Joint Center for Regulatory Studies; *Insurance Deregulation and the Public Interest*, 2000

<sup>13</sup> *Northern Pacific R. Co. vs. United States* 356 U.S. 1 (1958)