

STATE OF MINNESOTA
DEPARTMENT OF COMMERCE

In the Matter of the Proposed
Rules Governing Regulation of
Self-insurers Under the Minnesota
No-fault Automobile Insurance
Act, Minnesota Rules, parts
2700.6100 to 2700.7400

STATEMENT OF NEED
AND REASONABLENESS

STATEMENT OF AUTHORITY

Minnesota Statutes § 65B.48, Subdivision 3a, authorizes the Commissioner of Commerce to adopt rules necessary to the effective implementation of Minnesota Statutes § 65B.48, Subdivision 3. Minnesota Statutes § 65B.48, Subdivision 3, allows for self-insurance under the No-fault Automobile Insurance Act where the applicant for self-insurance authority or the self-insurer demonstrates a continuing undertaking to pay tort liabilities and basic economic loss benefits under the No-fault Act, and where the applicant or self-insurer has the administrative and financial capabilities to

satisfy those obligations. Minnesota Statutes § 65B.48, Subdivision 3a, authorizes the Commissioner to adopt rules establishing: (1) reporting requirements, (2) standards regarding financial and administrative capabilities, (3) financial security requirements, and (4) other reasonable requirements to promote effective self-insurance.

FACTS ESTABLISHING NEED AND REASONABLENESS

The proposed rules are necessary to the fair and effective regulation of self-insurance under the No-fault Act, and reasonably address that need.

Part 2770.6100 Purpose.

This part of the rule is necessary to establish the overall purpose of these rules. It is consistent with the statutory authority for the rules as cited above.

Part 2770.6200 Definitions.

Certain terms affect the intent and scope of the rules, and it is necessary to define those terms. Those definitions which have more substantive effect are described more fully. According to subpart 3, certified financial statements include balance sheets, income statements, and statements of changes in financial position. These three statements together provide a comprehensive overview of an entity's financial condition. Each is routinely prepared for organizations with significant financial interests. Requiring that all statements be certified by a certified public accountant ensures that generally accepted accounting practices and procedures are used in their preparation, thus promoting equity and fairness in the regulation of self-insurers and potential self-insurers. The requirement that a parent company's financial statements encompass the positions and conditions of all subsidiaries is discussed below.

Subparts 7 and 9 identify a parent company-subsidary relationship as being the relationship between the subsidiary and the ultimate parent in the corporate structure of which the subsidiary is a part. The importance and reasonableness of this assumption are discussed below.

Part 2770.6300 Application requirement.

Part 2770.6300 allows only those persons or entities that have been approved by the Commissioner, that have followed the established application procedures, and that satisfy the established authorization standards, to self-insure. It is necessary to state these procedural requirements in order to minimize unauthorized self-insurance due to misunderstanding or intent.

Part 2770.6400 Application procedures.

Subpart 1 requires that all applications for self-insurance authority be made on forms provided by the Commissioner. This requirement is necessary to ensure equity in the evaluation of all applicants, and to promote efficiency in the application process.

Subpart 2 requires certified financial statements for the applicant's four most recently ended fiscal years. The requirement that the financial statements be certified is based on the fact that financial statements issued for public/investor consumption are most relevant to the regulatory task of monitoring financial condition. Uncertified statements, such as management reports, may omit important facts regarding financial condition. Four years' statements (indicating five years' financial results) are necessary to

assess the applicant's recent financial history, and allow regulatory personnel to identify possibly important financial trends and cycles. Financial statements of parent companies are requested because of the financial interdependence that sometimes exists between parents and subsidiaries. Parent company behavior may quickly and substantially affect the financial condition of a subsidiary. Financial strength of a subsidiary may be illusory if a parent company is in poor financial health. It is necessary, therefore, that the financial condition of a parent company be monitored along with the subsidiary's financial condition.

Subpart 3 requires a \$500 application fee, as required by Minnesota Statutes § 65B.48, Subdivision 3.

The potential financial interdependence of a subsidiary and its parent company has already been mentioned as justification for monitoring the financial health of the parent company. Financial interdependence is also the basis for authorizing a subsidiary to self-insure even though the subsidiary fails to satisfy all of the financial standards for self-insurance authorization (see below). The reasoning here is that there is no good reason why a subsidiary failing to meet the financial standards in part 2770.6500 should be prevented from self-insuring if the subsidiary's parent company meets those standards and if the subsidiary can access the resources of the parent company. Subpart 4 requires, in such situations, that the

parent company agree to assume the subsidiary's liabilities under the No-fault Act. The assumption of liability agreement is necessary to ensure access to the parent company's financial resources.

The intent of Subpart 5 is to ensure that the governing body of a political subdivision has authorized self-insurance. The potential and widespread public consequences of an ill-considered decision to self-insure makes the requirement both reasonable and necessary.

60 days is a reasonable length of time for considering and acting on an application to self-insure. According to Subpart 6, the 60-day period begins running once all application materials have been received. Providing the deadline will ensure prompt action on applications.

Part 2770.6500 Authorization standards.

Subpart 1 establishes the standards that a political subdivision must meet in order to become and remain self-insured. Subpart 2 establishes standards for all other applicants and self-insureds.

No financial standards are established for political subdivisions because of their unique revenue-raising abilities. The 25-vehicle requirement is based on the assumption that an entity with fewer than 25 vehicles (political subdivision or otherwise) is unlikely to incur losses or claims often enough to maintain an efficient and effective claims management system. Minnesota Statutes § 65B.48, Subdivision 3, requires potential self-insurers to provide evidence of their ability to promptly administer claims. Subpart 1 is consistent with that requirement.

Subpart 2 establishes additional requirements for non-governmental entities. The financial requirements are designed to create a presumption that a self-insurer will be able to pay tort liabilities and economic benefits under the No-fault Act. To create this presumption it was determined that an entity would have to demonstrate stability (five years existence, positive net income), solvency (positive net funds flow, not recently in bankruptcy), and capacity (\$5,000,000 net worth). Considering the speed with which financial fortunes can change and the potential tort liabilities and No-fault Act obligations to which a self-insured is exposed, it was determined that the financial standards were minimal and necessary to create the presumption required to authorize self-insurance.

Part 2770.6600 Commissioner's decision.

Subparts 1 and 2 are necessary to establish the means by which approval or denial will be effected.

Part 2770.6700 Renewal.

To issue open-ended self-insurance authority would unnecessarily increase the risk that a self-insurer's deteriorating financial condition might go undetected, thus jeopardizing the interests of automobile accident victims. The renewal requirement is a reasonable measure intended to minimize the possibility of such an event occurring. The renewal requirement is also intended to minimize the problems that occur when self-insurers decide to purchase insurance without informing the Department of Commerce of the fact. The provision that ends self-insurance authority 150 days after the end of the self-insurer's fiscal year is necessary to enable the Commissioner to consider the self-insurer's most current financial statements at the time of renewal. (Under Part 2770.6900, Subp. 1, financial statements must be submitted within 120 days after the close of a fiscal year.)

Part 2770.6800 Security requirement.

This part requires all self-insurers to maintain a surety bond of \$100,000, or 125% of its outstanding liabilities, whichever is greater, for the use of the Commissioner when it is determined that the self-insurer is not fulfilling its legal obligations. This requirement is necessary to ensure that accident victims will not be denied rightful benefits due to a self-insurer's inability or unwillingness to comply with the No-fault Act. The requirement is applied to political subdivisions as well as private entities. Political subdivisions are not immune to financial or managerial difficulties. It was concluded, therefore, that these entities should be subject to the surety bond requirement.

Subpart 2 requires that the surety bond be executed on forms provided or approved by the Commissioner. This is reasonable and necessary to prevent the use of forms that may not provide the financial guarantee authorized by Minnesota Statutes § 65B.48, Subdivision 3, Clause 3 and required by this part.

Subpart 3 states the condition of the bond and provides that it must remain in force after cancellation for all liabilities incurred during the bond's effective dates. This provision is necessary order to ensure that some financial guarantee exists for all liabilities incurred while self-insured until those liabilities are extinguished.

Subpart 4 establishes the surety bond's penalty sum. It is necessary that the penalty sum at least be equal to the self-insurer's outstanding liabilities. The \$100,000 requirement will apply to self-insurers until such time as they are able to determine their experience while self-insured. The potential that a small number of claims could represent \$100,000 in liabilities reflects the reasonableness of the requirement. The additional 25% is required to ensure the availability of funds needed to manage a self-insurer's claims, should that become necessary.

Subpart 5 authorizes the Commissioner to use a bond in order to execute the self-insurer's obligations under the No-fault Act and to recover the costs of administering a self-insurer's claims. This provision is necessary to ensure the realization of the No-fault Act's fundamental objectives, which is to provide compensation to automobile accident victims.

Part 2770.6900 Reporting requirements.

Subpart 1 requires all self-insurer's to file financial reports necessary to the monitoring of their financial condition. The requirements are reasonable in that they attempt to ensure that the most recent information available is provided, and because they do not require the generation of any unique financial statements or reports not already available.

Subpart 2 requires self-insurers to update relevant information regarding their self-insurance program. This is necessary to ensure that the Department of Commerce is informed of important changes in a self-insurer's status. It is reasonable in that the information requested will be easily obtained, and because the timing of the report is intended to coincide with the self-insurer's renewal notification.

Subpart 3 requires self-insurers to annually report all paid and outstanding loss liabilities. This information is necessary to monitor compliance with the No-fault Act. It is reasonable in that the information requested will be easily obtained - assuming that the self-insurer's program is efficiently and effectively managed.

Part 2770.7000 Quarterly financial statements.

This part authorizes the Commissioner to require supplemental financial reports where there is cause for concern regarding a self-insurer's financial condition, but where termination of self-insurance authority does not seem warranted. This is a reasonable alternative to termination of authority in those situations where it will adequately protect the interests of actual and potential accident victims.

Part 2770.7100 Assigned claims plan, unfair practices.

This part affirms self-insurers' status as reparation obligors and their responsibility to participate in the assigned claims plan. It also requires self-insurers to comply with any relevant provisions of the Minnesota Unfair Trade Practices Act. These provisions assure that self-insurers assume responsibilities and provide protection equal to that assumed or provided by No-fault insurers.

Part 2770.7200 Termination of self-insurance status.

This part requires self-insurers to inform the Commissioner after becoming insured. This is reasonable and necessary to ensure effective and efficient regulation of self-insurers. This part also states that self-insurance authority is terminated immediately upon becoming insured. This is necessary to prevent entities from claiming dual status or arbitrarily entering, leaving, and then reentering self-insurance status.

Part 2770.7300 Revocation of self-insurance authority.

This part authorizes the Commissioner to revoke self-insurance authority where the self-insurer (a) does not satisfy the standards established by the rules, (b) is not complying with a lawful order of the Commissioner, (c) is not complying with the No-fault Act, (d) is not complying with the rules, or (e) is not complying with any other statutory requirement, and if the Commissioner determines that the self-insurer is unable or unwilling to remedy the situation. This authority is necessary to implement the objectives of Minnesota Statutes § 65B.48, Subdivision 3 and 3a.

Part 2770.7400 Waiver of standards.

Subpart 1 authorizes the Commissioner to waive the financial standards provision of the rules under certain limited circumstances. Waiver is limited to those entities self-insured at the time the rules are adopted, and is limited to a period of three years. This provision is necessary to prevent undesirable and possibly severe dislocation to any current self-insurers that may not satisfy the standards. It is estimated that no more than two current self-insurers would be affected by this provision. This provision is reasonable in that it can only be applied to self-insurers that have demonstrated on-going compliance with the No-fault Act. The

provision allows a more orderly and reasoned transition to insured status.

Subpart 2 describes procedures that must be followed to obtain a waiver of standards. These procedures are necessary to reduce the likelihood of misunderstanding and to prevent arbitrary use of the waiver provision. The statement of standards and procedures set forth in subparts 1 and 2 are required by Minnesota Statutes § 14.05, subd. 4. Subpart 3 notes that a self-insurer can only receive a waiver of standards once. This provision is necessary to address the possibility that a self-insurer moving in and out of compliance will seek a waiver each time it is out of compliance. The three-year limitation will allow sufficient time to change to insured status, but will obtain the objective of having all self-insurers meet the standards of the rule.

SMALL BUSINESS CONSIDERATIONS

Minnesota Statutes § 14.115 requires that the impact of proposed rules on small businesses be considered in the development of those rules. Specifically, the statute, at subdivision 2, requires that less stringent compliance standards and reporting requirements for small businesses be considered. The statute also requires that methods designed to reduce the impact of the rules on

small businesses be incorporated into the rules if they are feasible and consistent with the statutory objectives associated with the rules.

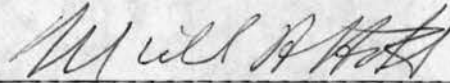
The Department does not believe the proposed rule will have an effect on small businesses as defined in the statute. The Department is not aware of any business currently self-insured and which has attempted to become self-insured which is a small business. The requirements of Minnesota Statutes § 65B.48, subd. 3, for financial condition and administration by self-insurers make it unlikely that self-insurance would be practical for a small business. On January 30, 1984, the Department published in the State Register a Notice of Intent to Solicit Outside Opinion concerning these rules and, in that notice, specifically solicited comments concerning how the rules may affect small businesses. No comments were received concerning small business considerations.

Despite this determination that small businesses would not likely be affected, the Department did consider whether the provisions of the rule might be modified to accommodate the interests of small businesses.

Most businesses included in the definition of small business found at Minnesota Statutes § 14.115, Subdivision 1, would not meet the authorization standards in part 2770.6500 of the rules. It seems unlikely that a business just small enough to be a "small business" would also have a net worth of \$5,000,000 or more. The question, then, is whether a relaxation of the standard should be incorporated into the rules so that more small businesses would be able to self-insure. This question was considered during the development of the proposed rules. The conclusion, however, was that relaxation of the standard would be inconsistent with the statutory objectives upon which the rules are based. An objective of Minnesota Statutes § 65B.48, Subdivision 3, is to ensure that self-insurers are able to pay any claims they may incur. Insofar as the minimum net worth requirement is a necessary and reasonable means to attain that objective, then relaxation of the standard would be inappropriate.

A small business authorized to self-insure would be affected by the rule's reporting requirements. Consideration was given to possible ways in which the requirements might be relaxed for small businesses or amended to reduce any burden on small businesses. It was concluded, however, that the data sought in the required reports is necessary to the attainment of the statutory objectives upon which the rules are based.

Each of the methods described at Minnesota Statutes § 14.115, subdivision 2 (a) - (e) was considered in proposing the rule. The provisions contained in the proposed rule are believed to be the minimum requirements necessary to achieve the legislative purposes.



Michael A. Hatch

Commissioner of Commerce