STATE OF MINNESOTA

OFFICE OF THE COMMISSIONER   DEPARTMENT OF COMMERCE

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July 6, 1995

Ms. Maryanne V. Hruby
Executive Director
Legislative Commission to Review Administrative Rules
55 State Office Building
100 Constitution Avenue
St. Paul, Minnesota 55155

Re: Credit Involuntary Unemployment Insurance
        Amended Statement of Need and Reasonableness

Dear Ms. Hruby:

The Minnesota Department of Commerce published a Notice of Intent to Adopt Rules Governing Credit Involuntary Unemployment Insurance in the June 26, 1995 issue of the State Register. The Department previously sent to you a copy of the Statement of Need and Reasonableness for these proposed rules.

The Department found it necessary to prepare an Amended Statement of Need and Reasonableness. A copy of this amended document is enclosed. This new amended document will replace the Statement of Need and Reasonableness previously sent to you.

To afford all interested parties adequate opportunity to review the Amended Statement of Need and Reasonableness and to comment if they so desire, the Department will extend the comment period deadline from July 26, 1995 to August 9, 1995. A copy of this Notice of Extension is attached, and should appear in the State Register on July 10, 1995.

If you have any questions about these rule, please contact me at 296-6593.

Sincerely,

JAMES E. ULLAND
Commissioner of Commerce

By: _____

Donna M. Watz
Staff Attorney
(612) 296-6593

AN EQUAL OPPORTUNITY EMPLOYER

Proposed Permanent Rules Governing Credit Involuntary Unemployment Insurance

NOTICE OF EXTENSION OF COMMENT PERIOD

The Minnesota Department of Commerce published a Notice of Intent to Adopt Rules Without a Public Hearing for the above-referenced rules in the June 26, 1995 issue of the State Register. The Department has prepared an Amended Statement of Need and Reasonableness for the proposed rules. To provide adequate time and opportunity for interested parties to review and comment on the proposed rules and the Amended Statement of Need and Reasonableness, the Department is extending the deadline for submitting comments or requests for hearing from July 26, 1995 to August 9, 1995 at 4:30 p.m. A copy of the proposed rules may be found in the June 26, 1995 issue of the State Register, Volume 19, Number 52, pages 2472-2478.

To submit comments or to receive a copy of the Amended Statement of Need and Reasonableness, please contact Donna M. Watz, Staff Attorney, 133 East Seventh Street, St. Paul, Minnesota 55101, (612) 296-6593.

James E. Ulland
Commissioner of Commerce

STATE OF MINNESOTA

DEPARTMENT OF COMMERCE

IN THE MATTER OF THE PROPOSED ADOPTION OF RULES RELATING TO THE SALE OF CREDIT INVOLUNTARY UNEMPLOYMENT INSURANCE	AMENDED STATEMENT OF NEED AND REASONABLENESS OF PROPOSED RULES

INTRODUCTION

The Department of Commerce prepared a Statement of Need and Reasonableness (SNR) dated June 23, 1995. Subsequently the Department discovered items in the SNR that required amendment. This Amended Statement of Need and Reasonableness dated July 5, 1995, is intended to replace the June 23, 1995 SNR in its entirety. To provide adequate time for public review and comment, the Department will be publishing in the State Register a Notice of Extension of the Comment Period for the proposed rules. The new comment period deadline is extended from July 26, 1995 to August 9, 1995.

STATEMENT OF AUTHORITY

Minnesota Statutes, section 62B.12 authorizes the Commissioner of Commerce ("Commissioner") to promulgate rules and to establish rates for credit involuntary unemployment insurance ("CIUI"). Such rules are necessary to execute the laws relating to insurance companies subject to the Commissioner's regulation, supervision and examination responsibilities pursuant to the provisions of Minnesota Statutes, Chapter 60A.

The Commissioner was not obligated to promulgate a rule unless and until four or more insurers who planned to write CIUI in Minnesota agreed to pay for the cost of promulgation of any rules authorized with such moneys being deposited in a special account in the state

treasury. Conditions of this requirement have been satisfied. Eight insurance companies submitted checks totaling $100,000 which has been deposited with the State Depository. The Rules referred to under the above caption are being proposed pursuant to the authority granted the Commissioner under Minnesota Statutes, sections 62B.12 and 45.023.

FACTS ESTABLISHING NEED AND REASONABLENESS

The Minnesota Legislature determined that a need for CIUI existed in the State of Minnesota and HF No. 555, as amended, was passed into law effective May 25, 1993 as Chapter 343, Laws of Minnesota for 1993.

As directed by the Legislature, the Commissioner is proposing rules identified as Minnesota Chapter 2761 to accommodate the sale and regulation of CIUI.

Comments and suggestions relative to the issuance of CIUI policies were solicited by publishing a Notice of Solicitation of Outside Opinion and Comment in the State Register on June 6, 1994. Responses were received from two interested parties with one being the Consumer Credit Insurance Association and the other the Legal Services Advisory Report. Input received from these sources was given consideration when the proposed rules were being promulgated.

It was the intention of the legislation that rules were needed to implement the sale of this form of credit insurance, that it was relatively new in a regulatory context except for a few states such as New York and Nebraska, and that the basis for premium rates was complex and subject to change. Funding by four prospective industries was implemented under direction of the legislature. Upon reflection on the New York regulations, which were reported to have taken over one year to adopt under staff direction by a department actuary, and the complexity of the resulting regulations, it was clear the services of a consulting actuary over a protracted

period was warranted. The resulting proposed rules are a competent combination of Commerce Department regulatory experience and the specific report and recommendations on rate making by the consulting actuary.

The input from the key industry representatives provided an outline framework familiar to them as a regulated industry based on existing credit life and accident and health regulations and the CIUI models in the process of adoption by the National Association of Insurance Commissioners in cooperation with the various industry trade groups.

Every effort was made to assure that the proposed rules adequately protect policyholders without unduly limiting the ability of insurers to exercise their business opportunity.

Section by Section Analysis

Part 2761.0100 Purpose and Authority.

These proposed rules were prepared to reasonably reflect the content of Minnesota Statutes, section 62B.12. This subpart clarifies that the intent of the proposed rules is to implement the legislature's intent under section 62B.12.

Part 2761.0200 Definitions

This part defines key terms and lays the groundwork for the remainder of the rules and the underlying rate making development.

Subpart 2. "Authorized Insurer" is a defined term needed to reflect the types of statutory lines underwriters that are authorized to issue policies of credit involuntary unemployment insurance. During the course of the passage of Chapter 343, Laws of Minnesota for 1993, there was confusion over whether both, or either, of life and property and casualty companies could write this coverage. In the 1994 legislative session, a remedial, clarifying amendment

was enacted. The effect was to clarify that both life and health companies, as well as property and casualty companies, were eligible and empowered to underwrite CIUI.

Subparts 3, 4, and 9 define the terms "claims," "claims incurred" and "premiums earned." Minnesota Statutes, section 62B.07, subdivision 8, prescribes the information required to be reported annually by insurers selling all forms of credit insurance. However, this statutory provision was written in connection with credit life and credit disability insurance and not with credit involuntary unemployment insurance in mind. Although the coverages operate in a similar manner, there are differences. It is reasonable and necessary to identify and define those unique or different aspects of CIUI. This is what the definitions of "claims," "claims incurred" and "premiums earned" accomplish in these proposed rules. These defined terms will make those elements of the reporting requirements more clear.

Subparts 5 and 8 define the terms "closed-end credit" and "open-end credit." These terms operate in tandem and provide necessary definitions to coordinate the use of prima facie rate schedules which may apply different rates depending on how frequently the premiums are collected. Historically, on loans or other credit instruments, repayment will be contracted monthly over a specific period of time at a level payment. Just as common currently is "open end" credit plans allowing multiple advances or draws either in cash or as retail purchases from time to time. By defining the current types of open-end credit in Subp. 8, we identify those cases where the monthly premium rates apply. Otherwise, a single premium at the beginning of a closed-end installment loan would use the appropriate single premium rate structure.

Subpart 6. "Compensation" is defined by cross-reference to the amended Chapter 62, Minnesota Statutes, and is new and unique to the sale, coverage and rate determinations developed under this rule and CIUI.

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Subpart 7. "Credit involuntary unemployment insurance" is defined by direct reference to the amended Chapter 62, Minnesota Statutes. It incorporates words already defined in law and clarifies that the definition appearing under section 62B.02, subd. 3a, also applies to the proposed rules.

Subpart 10. "Unemployment" is a new element in credit insurance. The definition of this term is necessary to ensure uniform application of the law. Other laws and other states' rules were researched with the conclusion that it was reasonable to use a local definition from the parallel area of unemployment compensation. Minnesota Statutes, section 268.04, subd. 23, was the source for this needed and key definition. In adopting only the first sentence of the statutory definition, the more specific basis for coverage has been developed for benefit plans in Part 2761.0400, including a variety of conditions similar to the one contained in Minnesota Statutes, section 268.04, subd. 23.

Subpart 11 defines a new term called "waiting period." The provision for a waiting period is necessary to minimize the possibility of covert (insured) antiselection where an insured secures a loan or makes a purchase with the knowledge of his/her impending layoff. This provision is only applied at the inception of a closed end loan, but can also be applied to new cash advances or credit card purchases when made. The trigger date for the beginning of the waiting period is different from the date of the closed-end loan where the advance and obligation to repay is normally coincidental; however, an open-end credit agreement may not result in a coincidental advance but delayed for an indeterminate time. No benefits are payable if involuntary unemployment occurs during the waiting period regardless of how long the customer is unemployed.

These definitions are the same as apply to sales of credit life and accident and health insurance in Minnesota Rule Part 2760.0100.

Part 2761.0300 <u>Policy Forms and Related Materials</u>

Subpart 1, <u>Filing Requirements</u>, contains the same fundamental policy review procedure required by Minnesota Statutes, section 62B.07 which previously applied only to credit life and credit disability insurance, but now also now applies to credit involuntary unemployment insurance. This filing requirement is necessary to ensure that companies offering CIUI are complying with Minnesota law and to construct over time local experience which may result in adopting different loss experiences and premium assumptions.

Subpart 2 of Part 2761.0300 entitled "<u>Loss Ratio</u>" establishes the requirement that each insurer filing rates for CIUI coverage must provide to the Commissioner the rate formulas upon which its rates are based <u>if</u> the insurer plans to use rates other than those appearing in the schedules included in these proposed rules. This filing requirement is essential to the regulation of rates for CIUI. The proposed rules establish a "safe harbor" or a level of rates that are presumed reasonable, based on actuarial research and study. If an insurer elects to use a different rate, the insurer must establish why the alternative rate is reasonable. Filing of rate formulas is a critical component of this analysis.

The "loss ratio" refers to a principle applied to other credit insurance, and is a means of determining whether the insurance product is reasonably priced. The proposed rule under this subpart of Part 2761.0300 follows the principle that reasonable consideration should be given as to whether an anticipated loss ratio of "claims incurred" to "premiums earned" exceeds 50 percent. This loss ratio also tracks an existing presumption of reasonableness as a fundamental basis for premiums, the loss ratio by following the principle, applied to other credit insurance written under prima facie rates, that reasonable consideration be given as to whether an

anticipated loss ratio of "claims incurred" to "premiums earned" of 50 percent is developed. See Minnesota Rule Part 2760.0200 as this principle is applied to credit life. This assumption is absent any specific statutory direction for CIUI and is considered reasonable to support the development of the prima facie rates schedules in this rule. This basic principle will also be applied to different benefit plans that must be filed in connection with the rate making methodology and determination of premium rates for such alternate plans to maintain consistency.

Subpart 3 of Part 2761.0300, entitled Eligibility Statement, addresses the relationship between "unemployment" as defined in the proposed rules and the conditions for receiving unemployment compensation benefits in Minnesota. Each borrower opting for this coverage and paying or financing the premium should be aware of this underwriting provision. The policy or certificate must conspicuously and specifically indicate to the applicant or insured that the applicant or insured might lose coverage under the CIUI policy if he or she is no longer considered to be unemployed under Minnesota law. Considerable reliance is placed on the information taken at the time of application. The rule under subpart 3 is necessary and reasonable to draw special attention to this circumstance.

Part 2761.0400 Standard Benefit Plans. This part of the rules establishes the requirements for CIUI plans to be offered in Minnesota. These requirements were developed to complement the most common forms of credit terms, closed-end and open-end.

Subpart 1, General Standard. This provision establishes one of the most critical elements of these proposed rules—that premiums charged for CIUI coverage must be reasonable in relation to the benefits provided. This standard is used by the department in examining and approving rates and policy forms filed by other insurers in other lines of insurance. Determining what is reasonable must take into account the specific facts of each case. However, to provide

guidance to regulated insurers wishing to sell CIUI in Minnesota, the department has analyzed the market and is establishing by these rules "safe harbors" or prima facie rates that will be viewed by the department as being reasonable. One of these safe harbors pertains to rates that produce a loss ratio as previously discussed of at least 50%.

Subpart 2, <u>Basic Prima Facie Rates for Closed-End Credit</u>. Installment loans and retail installment contracts have historically made up the vast majority of personal credit extensions to individuals for personal, family, or household purposes. These are the credit plans calling for monthly installments of principal and interest under a predetermined schedule over 12 to 36 months for personal cash loans, up to 48 to 60 months for motor vehicle and certain other durable and recreational goods and vehicles and, more recently, second mortgage or home equity loans of 120 to 180 months. These customary credit terms are the most convenient to apply corresponding policy benefits under a fixed and certain schedule of predetermined prima facie rates.

Subpart 2 of Part 2761.0400 establishes the procedure for determining single premium rates for closed-end credit plans, using Schedule A under Part 2761.0700, that will be considered prima facie reasonable and acceptable within the limits established by these rules. This procedural description is necessary to maintain uniform use of the schedules under Part 2761.0700.

Subpart 2 of Part 2761.0400 also outlines the terms to be included in the basic plan of insurance to which the prima facie rate applies. These defined coverage terms are needed to ensure that the rates determined will apply to similar products with an actuarial predictably.

Clause A allows insurers to only have age restrictions on debtors that attain the age of 66 or older. This is because of the leeway afforded employers under the law to terminate employees who have attained the age of 65 and in certain cases.

Clause B sets forth the acceptable exclusions from coverage under the basic plan. The four classes of individuals included under clause B are those that are not considered to be full time employees and not subject to involuntary unemployment. Persons who are self-employed govern their own employment, and are not viable candidates for CIUI. Seasonal workers or persons working less than 30 hours a week are not intended to be covered by CIUI, because of their limited work periods. Subclause (4) is necessary to prevent employees from purchasing CIUI only when they are aware that their employment is about to be terminated. Insurers need some protection from this potential risk. This problem is also addressed by the establishment of waiting periods.

Clause C establishes exclusions from CIUI coverage for those aspects of employment interruptions that are not considered involuntary as to their cause, or if the interruption is readily predictable. CIUI coverage is not intended to apply to situations where the employee is in control of his or her termination or unemployment. Subclause (9) excludes coverage for disability caused by accident, sickness, disease or pregnancy. This exclusion anticipates that the employee would have other insurance to cover these situations. The exclusions included under clause C are common ones found in other state rules. These types of occurrences are considered in determining rate/risk formulas.

Clause D establishes the requirement that any waiting period applicable to the CIUI policy may not exceed 60 days after initiation of the loan. Although waiting periods may be needed to avoid risks due to debtors purchasing CIUI insurance just before being laid off from work,

waiting periods must be reasonable in length. The department believes that 60 days is a reasonable length for such waiting periods.

Clause E sets forth the minimum level of benefits payable under the CIUI policy based on the term of the debt to be protected by the coverage.

The extent to which these benefits differ from credit life (mortality risk) and accident and health (morbidity) risk is that unemployment is presumed not only to be temporary but, in most cases, resolvable and not related to the various terms of the loan so as to assure payment in full. It would be an adverse and self-fulfilling outcome to frustrate legitimate efforts to reinstate one's gainful employment. Also and key to the availability of the coverage is that premiums are determined and only affordable if this assumption is accepted in the development of the formula. It is reasonable to assume that the partial period related to the term of the credit but not coincidental is the only basis on which this type of coverage benefits would be affordable. The open-end credit assumption is based on the longest term of benefits due to its indeterminable nature and infinite combination of advances and possible repayment terms and periods of time

Clause F is needed to clarify the expected dollar amount of benefits in relation to each loan or advance. This is consistent with clause E and similar contract limits in the case of other forms of credit insurance designed to satisfy monthly debt but not constitute cash proceeds beyond that obligation. The determination of each individual premium amount relies on the specific repayment terms in its calculation unlike ordinary life insurance or accident and health policies.

Clause G. Similar to the purpose of the specificity of clause F, within each benefit period corresponding to, say, a monthly installment period, it is unlikely the duration of covered

unemployment will coincide with the repayment terms. Should the period of covered unemployment be less than a month, each day will be calculated and equal to 1/30 of the amount due in monthly benefits.

Clause H. This protects the individual who purchased or has an ongoing credit arrangement on which CIUI is evidenced by a certificate on a master policy as opposed to individual policies. A creditor may stop offering CIUI, for example on a prospective basis, withdraw from the master policy, yet this clause provides the reasonable and needed continuation of existing contracts according to the terms in the individual certificates.

Subpart 3, Basic Prima Facie Rates for Open-End Credit. An increasingly popular credit method is the credit extended as a flexible, self-replenishing line of credit typically offered through the use of a credit card, voucher, or other arrangement with a lender or merchant. Because the outstanding balance is not predictable over future time periods, a single advance premium cannot be determined with any accuracy to reflect the outstanding debt level and periodic obligation such as a monthly payment on closed-end loans. Therefore, a premium rate consistent with the standard plan, but available to be calculated from time to time in connection with the monthly payment level commonly expressed as a percentage of the then existing outstanding balance due, has been provided under this subpart 3

Subpart 3 cross-references Schedule B in Part 2761.0700. By conforming to the standards set forth on this Schedule B, the insurer offering CIUI will be within the range of rates considered to be reasonable and acceptable. These prima facie rates have been established based on actuarial studies and reports conducted by Milliman and Robertson on the same basis as closed-end credit. However, only one universal assumption on coverage, and the basis for repayment (over 60 months) makes sense because of the potential for an infinite variety of credit advances and repayment options.

Similar to subpart 2, subpart 3 of Part 2761.0400 sets forth specific requirements in clauses A through D that apply to the open-ended credit plan in order for the prima facie rates to apply.

Clause A allows insurers to only have age restrictions on debtors that attain the age of 66 or older. This is because of the leeway afforded employers under the law to terminate employees who have attained the age of 65 and in certain cases.

Clause B contains the same exclusions as found previously under subpart 2, clause B of Part 2761.0400. These exclusions are acceptable because they involve classes of individuals who are not full-time and not subject to involuntary unemployment. (See discussion in this Statement of Need and Reasonableness for Part 2761.0400, subpart 2, clause B.)

Clause C of subpart 3 contains the same exclusions as found under clause C of subpart 2, with the exception of subclause (12). The exclusions under this clause C generally apply to employment interruptions not considered to be involuntary as to cause or if the interruption is readily predictable. (See discussion in this Statement of Need and Reasonableness for Part 2761.0400, subpart 2, clause C.) A drafting error omitted subclause (12) inadvertently. This exclusion should also be applicable to open-end credit as there is no basis for differentiation. Final rules should correct this oversight.

Clause D of subpart 3 applicable to open-end credit plans is identical to clause D of subpart 2, discussed above. As indicated above, waiting periods are needed and reasonable to avoid risks due to the purchase of CIUI insurance only when the person expects to be laid off from work.

Options are afforded with commensurate rate differentials for benefits with an elimination period of 30 days after "unemployment" commences, or retroactive back to the onset of "unemployment."

Subpart 4 of Part 2761.0400 is entitled "Re-eligibility." This provision is needed to allow for coverage to recommence if benefits under the CIUI plan are interrupted, for example, by temporary reemployment. Re-eligibility is a condition factored in by Milliman and Robertson and provides for a basis to restart benefits provided benefits have already been paid but not exhausted during the same credit contract. The provisions under this subpart 4 are important to afford the insured certain protections that are necessary and reasonably expected by a person purchasing CIUI coverage.

Subpart 5, Joint Coverage. Benefit plans are available to joint debtors under this part of the standard benefit plan and have been factored in the prima facie rate base. It is reasonable to assume that joint borrowers, but no more than two, can be issued a single certificate as in the case of joint life or joint disability coverages where repayment is reliant on more than one borrower. The rate of 175% of the specified single rate of coverage is needed and reasonable, as indicated by the following example:

Example of Joint Coverage

Premium Calculation

Assume that a single life rate of 40¢ is made up of the following prices:

claims	=	20¢	(50%)
commission	=	12¢	(30%)
prem. tax	=	1¢	(2.5%)
admin.	=	5¢	(12.5%)
profit	=	2¢	(5%)
		40¢	(100%)

Assume joint coverage increases claims to 39¢ (simultaneous claims do not pay double benefits). Administrative costs should still be 5¢, and commissions, profit, and premium taxes are still the appropriate %'s of premium. The gross premium is then calculated as:

$$(39¢ + 5¢) \div (1 - .30 - .025 - .05)$$
$$= 44¢ \div .625 = 70¢$$
$$70¢ \div 40¢ = 1.75$$

Separate coverage for multiple obligors is seen as an uneconomical alternative given the factors described in this example.

Subpart 6, <u>Presumption of Reasonableness</u>. If insurers follow the guidelines provided in this part of the rules, the insurers have the assurance that the department will consider their policy forms and rates to be reasonable. The purpose of determining these basic benefit plan rates is to establish a reasonable expectation that the business can be written profitably under the assumptions and no additional proof need be submitted with policy filings relying on these rate schedules.

Part 2761.0500 <u>Refunds of Premium</u>

This Part 2761.0500 is necessary to extend the procedures and requirements of Minnesota Rules Part 2760.0400 (pertaining to credit life and credit accident and health insurance) to CIUI policies. This Part 2761.0500 is patterned closely after Part 2760.0400. Consistency in rules pertaining to all types of credit insurance makes compliance with state law easier for insurers offering more than one type of credit insurance product.

The provisions of clause A are needed and reasonable because loans are prepaid and unearned premiums should be available to the insured on a fair and reasonable basis. Minimum refunds are reflective of administrative costs associated with tendering small sums.

A common method is necessary and applicable where the amount of coverage declines over a period of time, such as the unpaid balance of a loan scheduled to be paid off in equal monthly installments of principle and interest. The declining balance of the loan and the scheduled life insurance coverage for example are the same. The relationship is based on the sum of the number of months in a year beginning with $12 + 11 + 10 + 9 \ldots = 78$ (the denominator of the fraction). As time lapses in months, the remainder is expressed, say, after 6 months as $6 + 5 + 4 + 3 + 2 + 1 = 21$ (the numerator). $21 / 78 = 27$ percent as opposed to 50 percent under the pro rata method. CIUI differs from this standard model in paying only monthly installments and only in certain cases sufficient to extinguish the unpaid balance. It is reasonable to apply the necessary refund for unearned coverage and pre-paid premium in event of prepayment in full but not as a penalty to customers nor can the level or pro rata method be justified. In this case, it is reasonable to strike a balance using both methods of calculation then using the "mean" between the two as the amount of the refund. After six months, 50 percent would be $50 on a $100 premium and $27 under the rule of 78s. The CIUI refund would be the dollar value between these two or $38.50.

Clause B pertains to CIUI coverage that is paid for in a single advance premium. The use of the "sum of the digits" (or the rule of 78s) is a well known mathematical and practical accepted method for determining return of unearned premium and as is the pro rata method and represent an appropriate compromise of value until available data indicates otherwise.

The $5 minimum refund amount included under clause C of Part 2761.0500 is based on the model recommended by the NAIC and takes into consideration the administrative costs in

tendering the refund. One dollar refunds would cost more to administer then the benefit and absorbing this cost would find its way into the ultimate costs of coverage to be bore by all.

Clause D defines the events of termination and the basis for determining the unused or unearned portion of the premium. The first three subclauses identify obvious times when termination occurs. Subclause (4) provides an opportunity for the insurer to request the Commissioner's approval of an alternative procedure to determine a termination event. This latitude is necessary, since CIUI is a new area of regulation, and the rules may not contemplate all aspects that could arise under this provision of the rules.

2761.0600 Prohibited Practices

This Part 2761.0600 recognizes the often unique relationships between an insurance agent and financial institutions in the case of credit insurance. General rules of conduct found in Minnesota Statutes, section 72A.20 and Minnesota Rules Parts 2700 and 2795 are adopted, interpreted and refined in this Part 2761.0600 into several concise provisions that describe unfair trade practices.

Clause A of subpart 1 prohibits the insurer or the financial institution for which the insurer provides insurance coverage from depositing premiums into a non-interest bearing or below-rate bearing account in that financial institution. This provision may address an obvious prohibited practice, but it is included to ensure that all parties deal with each other at arms-length. In particular, financial institutions control terms and conditions of deposit accounts and there should be no situation where that control could result in an intended or unintended benefit between the parties. Clauses B and C similarly prohibits the indirect benefit to the master policyholder by regular forbearance of the remittance of premiums due on certificates issued. This includes withholding premiums due from the agent or broker at the disposition of the insurer.

Clauses D and E provide a broad prohibition against yet to be crafted schemes which would benefit the master policyholder, agent, broker or financial institution where they are a party to the issuance of a policy or certificate of CIUI insurance. All of these prohibitions serve to clearly identify such schemes and provide needed latitude for others any of which would serve to defeat the statutory maximum compensation in Minn. Stat. § 62B.08, Subdivision 6, and this rule subpart 2.

Subpart 2, Limitation on Compensation. This provision is statutory and establishes a maximum amount of compensation to be paid to a creditor for CIUI policies. The maximum of 30% of net written premium has been determined by the legislature to be adequate to compensate the creditor for placing the insurance.

Subpart 3, Application. This subpart 3 of Part 2761.0600 clarifies that the maximum allowable commission or compensation referred to in subpart 2 applies to both a single premium advance system or any outstanding balance system. The critical element is to put a cap on the commission or compensation, regardless of the method of credit. This subpart is needed to provide uniform compliance and enforcement of the law.

2761.0700 Premium Rates

Premium rates have been recalculated for accuracy and convenient use by insurers filing and using approved CIUI policies and the standard benefit plans. This reasonable method of implementing the actuarially-based premiums structure tracks Minnesota Rule Part 2760.9910, Schedule A and 2760.9920, Schedule A-1 for displaying resulting rates for easy reference in typical, normal usage as in the existing credit accident and health industry standard benefit plans. The background for the reasonableness of these needed benefit plan rate schedules is

discussed as follows. The following discussion is taken from the report of the consulting actuary Milliman and Robertson.

Determination of Credit Involuntary Unemployment Prima Facie Rates

I. **Introduction**

Milliman and Robertson used an analytical approach to developing premium rates for credit involuntary unemployment insurance (IUI) has been used in the preparation of these rules. A theoretical framework was developed for calculating net single premiums for a variety of benefit coverages, and these rates in turn are used as a basis for developing gross premium prima facie rates. Monthly outstanding balance rates are developed that are consistent with the assumptions used in calculating the financed single premium rates.

Final rates are the end product of a series of basic assumptions, some of which are educated guesses in that they are "reasonable," but not founded on experience. The choice of the antiselection factors (described later) is an example of such an assumption. Gross premiums are calculated to be twice the level of net premiums. This presumes a benefits-to-premium loss ratio of 50%. Net premiums in turn are calculated as the present value of anticipated claims costs which are incurred in each month of a given loan. The claims costs are determined as (i) the anticipated benefits to be paid out once an eligible insured becomes unemployed, times (ii) the probability of eligible unemployment. The present value of such benefits to be paid out is determined by developing a continuance table of claimants by duration of unemployment. All present values are calculated assuming a 3.5% effective interest rate applied monthly.

The theoretical approach used and the selection of assumptions chosen to generate the prima facie rates for an overall unemployment rate of 4% is as follows. The attached Appendix displays the arithmetic development of the continuance table on a monthly interval basis from published data using non-monthly intervals of measurement of unemployment (which is the way the Department of Labor chooses to tabulate such data).

II. **Definitions and Variables**

1. n = term of loan in months.

2. w = waiting period in months after loan initiation before eligibility for coverage becomes effective; no benefits are payable for unemployment which occurs during the waiting period. This helps reduce covert customer antiselection.

3. s = benefit period in months; i.e., the maximum number of consecutive benefits which will be paid for a single unemployment occurrence.

4. e = elimination period in months before benefits begin accruing; no benefits are paid for the first e months after unemployment.

5. re = retroactive elimination period in months; benefits will be paid for the first (re) months if the insured is still unemployed at the end of (re) months.

6. u = overall unemployment rate expressed as a percent; this figure is taken from the U.S. Department of Labor's publication *Employment and Earnings*. Seasonally adjusted rates are used for both national and individual state statistics.

7. p = percentage of overall unemployment rate which is newly unemployed each month; if the rate of unemployment is $u\%$, this is the percentage of people in the work force that must become unemployed each month such

that the rate of overall unemployment remains u%. For example, if 1% of the population needs to become newly unemployed each month to maintain a static overall unemployment rate of 3%, then p = 33-1/3%.

8. b = percent of total unemployed eligible for benefits; only insureds who become unemployed <u>involuntarily</u> are eligible for benefits. The percentage of such individuals eligible can be approximated by looking at reasons for unemployment as defined in *Employment and Earnings*. "Job losers" is a reasonable benchmark to review.

9. a_r = antiselection factor in the rth month of the loan; insureds who buy unemployment coverage may have a perception or even a knowledge of being at greater risk for unemployment. This factor begins at 2.00 in the first month of a loan, decreases to 1.15 over the next nine months, and remains level thereafter. The choice of the level of these factors was not based on experience.

10. i_p = interest rate used to calculate the net single premium from the monthly net premiums.

III. **Present Value of Benefits for an Unemployed Insured (PVB)**

For an insured who becomes unemployed in loan month r, the present value of future benefits of $1 per month (nonretroactive elimination period) from the time of unemployment is:

$$\substack{e \\ w}PVB_r^s = \sum_{t=e+1}^{s+e} (1+i_B)^{-t} \cdot (1/2d_t + R_t) \, for \, 1 \le r \le n-s-e$$

$$= [\sum_{t=e+1}^{n-r} (1+i_B)^{-t} \cdot (1/2d_t + R_t)] + (1+i_B)^{-(n-r+1/2)} \cdot (3/8d_{n-r+1} + 1/2R_{n-r+1})$$

for n - s - e + 1 ≤ r ≤ n - e - 1

$$= (1+i_B)^{-(n-r+1/2)} \cdot (3/8d_{n-r+1} + 1/2R_{n-r+1}) \textit{ for } r = n - e$$

where

r = loan month $(1 \le r \le n)$

d_t = percentage of unemployed that become ineligible for further benefits during the

t^{th} month of unemployment; these values are derived in the Appendix

R_t = percentage of unemployed remaining after t months of unemployment;

$R_t = R_{t-1} - d_t$

i_B = interest rate used to calculate the present value of benefits

Note that PVB = 0 for r≤ w and r≥ n - e + 1

The Net Single Premium (NSP) per \$10/month for a plan with a benefit period of s months, a waiting period of w months, an elimination period of e months, and a coverage period of n months can then be expressed as follows:

$$_w^e NSP_n^s = 10 \cdot \sum_{r=w+1}^{n-e} (1=i_p)^{-r+1/2} \cdot {}_w^e PVB_r^s \cdot u \cdot p \cdot a_r \cdot b$$

If the plan includes a retroactive benefit, then the present value of benefits is:

$$\substack{re\\w}PVB_r^s = [\sum_{t=re}^{s+re-1}(1+i_B)^{-t}\cdot(1/2d_t+R_t)]-1/2(1+i_B)^{-re}\cdot d_{re}$$

for $1 \le r \le n - s - re + 1$

$$= [\sum_{t=re}^{n-r}(1+i_B)^{-t}\cdot(1/2d_t+R_t)]+(1+i_B)^{-(n-r+1/2)}\cdot(3/8d_{n-r+1}+1/2R_{n-r+1})$$

$$-1/2(1+i_B)^{-re}\cdot d_{re} \ for \ n-s-re \le r \le n-re$$

The net single premium per \$10/month for a retroactive benefit is given by

$$\substack{re\\w}NSP_n^s = 10\cdot \sum_{r=w+1}^{n-re}(1+i_p)^{-r+1/2}\,\substack{re\\w}PVB_r^s\cdot u\cdot p\cdot a_r\cdot b$$

Note that the above formulas take into consideration that benefits cannot be paid beyond the maturity of the loan.

Employment and Earnings shows monthly overall unemployment rates both seasonally adjusted and unadjusted. The rates we chose to develop the present value of benefits are those that are seasonally adjusted. The Appendix shows the detail of the numerical development of the values of d_t and R_t used to calculate the PVB values.

IV. Final Values and Prima Facie Gross Premiums

The following assumptions were made for p, u, b, and a_r:

$$p = 35\%$$

$$u = 4\%$$

$$b = 50\%$$

Loan Month r	Antiselection Factor a_r
1	2.00
2	1.90
3	1.80
4	1.70
5	1.60
6	1.50
7	1.40
8	1.30
9	1.20
10+	1.15

The discounted net single premiums for a benefit of $10 per month for various benefit periods and loan periods, waiting periods of 1 and 2 months, and a 30-day retroactive and nonretroactive elimination period are shown in the four tables below. As with the PVBs, an effective annual interest rate of 3.5% was used to calculate the various NSPs. That is, $i_p = i_B = (1.035)^{1/12}-1$.

Discounted Net Single Premiums for

IUI Benefit of $10 per month

Elimination period: 30 days retroactive
Waiting period: 1 month

Loan Term in Months	Benefit Period in Months				
	3	4	6	9	12
12	$ 1.73	$ 1.94	$ 2.17	N/A	N/A
24	3.35	3.81	4.34	N/A	N/A
36	4.92	5.61	6.43	$ 6.88	$ 7.13

	6.43	7.35	8.46	9.07	9.43
48	6.43	7.35	8.46	9.07	9.43
60	7.89	9.03	10.41	11.19	11.65
120	14.49	16.63	19.25	20.75	21.67

Elimination period: 30 days retroactive
Waiting period: 2 months

Loan Term in Months	- - - - - - - - - - - -Benefit Period in Months - - - - - - - - - -				
	3	4	6	9	12
12	$ 1.50	$ 1.67	$ 1.85	N/A	N/A
24	3.12	3.54	4.03	N/A	N/A
36	4.69	5.34	6.12	$ 6.55	$ 6.79
48	6.20	7.08	8.15	8.73	9.08
60	7.66	8.76	10.10	10.85	11.30
120	14.26	16.36	18.93	20.41	21.32

Elimination period: 30 days
Waiting period: 1 month

Loan Term in Months	- - - - - - - - - - - -Benefit Period in Months - - - - - - - - - -				
	3	4	6	9	12
12	$ 1.16	$ 1.30	$ 1.43	N/A	N/A
24	2.32	2.64	2.98	N/A	N/A
36	3.44	3.93	4.47	$ 4.82	$ 5.04
48	4.53	5.19	5.91	6.39	6.71
60	5.57	6.39	7.30	7.91	8.31
120	10.30	11.85	13.58	14.79	15.59

Elimination period: 30 days
Waiting period: 2 months

Loan Term in Months	- - - - - - - - - - -Benefit Period in Months - - - - - - - - - -				
	3	4	6	9	12
12	$ 0.99	$ 1.11	$ 1.21	N/A	N/A

24	2.15	2.45	2.76	N/A	N/A
36	3.27	3.74	4.25	$ 4.58	$ 4.78
48	4.36	4.99	5.69	6.15	6.45
60	5.41	6.20	7.08	7.67	8.06
120	10.13	11.65	13.36	14.54	15.33

The net single premiums shown above were then divided by the term of the loan in years to get discounted net annual premiums. These are shown in the four tables below:

Discounted Annual Premiums for
IUI Benefit of $10 per Month

Elimination period: 30 days retroactive
Waiting period: 1 month

Loan Term in Months	- - - - - - - - - - - -Benefit Period in Months - - - - - - - - - - -				
	3	4	6	9	12
12	$ 1.73	$ 1.94	$ 2.17	N/A	N/A
24	1.67	1.91	2.17	N/A	N/A
36	1.64	1.87	2.15	$ 2.29	$ 2.38
48	1.61	1.84	2.11	2.27	2.36
60	1.58	1.81	2.08	2.24	2.33
120	1.45	1.66	1.93	2.07	2.17

Elimination period: 30 days retroactive
Waiting period: 2 months

Loan Term in Months	- - - - - - - - - - - -Benefit Period in Months - - - - - - - - - -				
	3	4	6	9	12
12	$ 1.50	$ 1.67	$ 1.85	N/A	N/A
24	1.56	1.77	2.01	N/A	N/A
36	1.56	1.78	2.04	$ 2.18	$ 2.26
48	1.55	1.77	2.04	2.19	2.27
60	1.53	1.75	2.02	2.17	2.26
120	1.43	1.63	1.89	2.04	2.13

Elimination period: 30 days
Waiting period: 1 month

Loan Term in Months	-Benefit Period in Months-				
	3	4	6	9	12
12	$ 1.16	$ 1.30	$ 1.43	N/A	N/A
24	1.16	1.32	1.49	N/A	N/A
36	1.15	1.31	1.49	$ 1.61	$ 1.68
48	1.13	1.30	1.48	1.60	1.68
60	1.11	1.28	1.45	1.58	1.66
120	1.03	1.19	1.36	1.48	1.56

Elimination period: 30 days
Waiting period: 2 months

Loan Term in Months	-Benefit Period in Months-				
	3	4	6	9	12
12	$ 0.99	$ 1.11	$ 1.21	N/A	N/A
24	1.08	1.23	1.38	N/A	N/A
36	1.09	1.25	1.41	$ 1.53	$ 1.59
48	1.09	1.25	1.42	1.54	1.61
60	1.08	1.24	1.41	1.53	1.61
120	1.01	1.17	1.33	1.45	1.53

All premiums shown above are discounted at an effective annual interest rate of 3.5%.

For each benefit period, then, the highest discounted net annual premium is used to develop discounted gross monthly premiums. Net annual premiums were doubled to derive gross premiums (this presumes a 50% loss ratio). These values were then divided by 12. For example, for a 30-day retroactive benefit of three months

coverage with a one-month waiting period, the highest discounted net annual premium is $1.73 for a $10 per month benefit. Doubling this and dividing by 12 yields a gross discounted monthly premium of $0.29 per $10 of monthly IUI benefits.

Credit Involuntary Unemployment Insurance Premium Rates
Monthly Rates Per $10 of Monthly Benefit for Financed Single Premiums
(Schedule A)

Benefit Period in Months	Nonretroactive Benefits for a 30-Day Elimination Period		Retroactive Benefits for a 30-Day Elimination Period	
	30-Day Waiting Period	60-Day Waiting Period	30-Day Waiting Period	60-Day Waiting Period
3	$0.19	$0.18	$0.29	$0.26
4	0.22	0.21	0.33	0.30
6	0.25	0.23	0.36	0.34
9	0.27	0.25	0.38	0.37
12	0.28	0.27	0.40	0.38

Single premium rates are determined by multiplying the above rates by the term of the loan in months.

V. **Monthly Outstanding Balance Rates**

For monthly outstanding balance coverage, where premiums are collected monthly, the net premium is calculated from above discounted monthly premiums, but increased to reflect a zero interest (discount rate) for 120 months. Eliminating the discount factor increases the monthly rate by about 17%. This is appropriate because (i) premiums are collected monthly so there should be no discounting, and (ii) the 120-month term is used as an approximation for open-end coverage.

Credit Involuntary Unemployment Insurance Premium Rates
Monthly Rates Per $10 of Monthly Benefit for Premiums Payable Monthly
(Schedule B)

Benefit Period in Months	Nonretroactive Benefits for a 30-Day Elimination Period		Retroactive Benefits for a 30-Day Elimination Period	
	30-Day Waiting Period	60-Day Waiting Period	30-Day Waiting Period	60-Day Waiting Period
3	$0.23	$0.21	$0.33	$0.31
4	0.26	0.24	0.38	0.35
6	0.29	0.27	0.42	0.40
9	0.31	0.30	0.45	0.43
12	0.33	0.31	0.47	0.45

Rates stated as $0.xx per $100 outstanding balance per month should be consistent with the above rates. For example, if a credit card required a minimum payment of 5% of the balance, a rate of $0.40 per $10 of monthly benefit could also be stated as $0.20 per $100 of outstanding balance because $10 is 5% of $200. As another example, if the minimum required payment is 3% of the outstanding balance, the $0.40 per $10 of monthly benefit rate translates to $0.12 per $100 of outstanding balance.

Distribution of Unemployeds by Month of Unemployment

In order to calculate the PVBs for a newly unemployed insured, it is necessary to estimate how long the insured might be unemployed. *Earnings and Employment* does not provide that information directly. Instead, monthly surveys of sample households provide data from which unemployment numbers and percentages are estimated. Specifically, seasonally adjusted unemployment estimates by length of unemployment are given using the following time intervals:

Seasonally Adjusted Estimate

Interval	Percent Unemployed
less than 5 weeks	35.2%
5-14	29.4
15-26	14.8
27 weeks or longer	20.5

The above percentages are averages of monthly overall unemployment rates from 1993 through September 1994.

The survey data which is not seasonally adjusted has a somewhat finer breakdown by interval since unemployment began:

Not Seasonally Adjusted Estimate

Interval	Percent Unemployed
less than 5 weeks	31.1%
5-10	20.5
11-14	9.2
15-26	15.8
27-51	9.6
52 weeks or longer	13.8

If we make the assumption that the percentage of unemployeds between 5-14 weeks and over 26 weeks is distributed in the same proportion whether or not the data is seasonally adjusted, we can derive a more detailed estimate for seasonally adjusted rates:

Modified Seasonally Adjusted Estimate

Interval	Percent Unemployed
less than 5 weeks	35.2%
5-10	20.3
11-14	9.1
15-26	14.8
27-51	8.4
52 weeks or longer	12.1

In order to make this estimate applicable for insurance purposes, the distribution of unemployeds must be estimated by monthly intervals. To accomplish this, the following formulas and assumptions are used:

Formula to Spread Unemployed Distribution to Monthly Intervals

Variable	Meaning	Days in Interval
A	% u/e/less than 5 weeks = 1-34 days	34
B	% u/e 5-10.99 weeks = 35-76 days	42
C	% u/e 11-14.99 weeks = 77-104 days	28
D	% u/e 15-26.99 weeks = 105-188 days	84
E	% u/e 27-51.99 weeks = 189-364 days	176
F	% u/e 52+ weeks = 365-546 days	182

Assume 1 month = 30.33 days

Assume further that unemployment figures are uniformly distributed within an interval.

Duration of Unemployment By Month	Formula
0-1	$30.33 \times A \div 34$
1-2	$(34 - 30.33) \times A \div 34 + (60.67 - 34) \times B \div 42$
2-3	$(76 - 60.67) \times B \div 42 + (91 - 76) \times C \div 28$
3-4	$(104 - 91) \times C \div 28 + (121.33 - 104) \times D \div 84$
4-6	$(60.67) \times D \div 84$
6-7	$(188 - 182) \times D \div 84 + (212.33 - 188) \times E \div 176$
7-12	$(364 - 212.33) \times E \div 176$
12-18	F

Unemployment Month	Numerical Results	
0-1	.8922 x .352	= .314
1-2	.1078 x .352 + .6349 x .203	= .167
2-3	.3651 x .203 + .5357 x .091	= .123
3-4	.4643 x .091 + .2063 x .148	= .073
4-6	.722 x .148	= .107
6-7	.0714 x .148 + .1383 x .085	= .022
7-12	.8617 x .085	= .073
12+	.121	= .121
		1.000

Unemployment Month	Adjusted Results
0-1	.314
1-2	.167
2-3	.123
3-4	.073
4-5	.064
5-6	.043
6-7	.022
7-8	.018
8-9	.016
9-10	.015
10-11	.013
11-12	.011
12+	.121
	1.000

From the above table, monthly terminations were derived as a percentage of unemployeds in month 1:

Unemployment Month	Percent Unemployed	d_t	R_t
1	31.4%	46.8%	53.2%
2	16.7	14.0	39.2
3	12.3	15.9	23.3
4	7.3	2.9	20.4
5	6.4	6.7	13.7
6	4.3	6.7	7.0
7	2.2	1.3	5.7
8	1.8	0.6	5.1
9	1.6	0.3	4.8
10	1.5	0.6	4.2
11	1.3	0.6	3.6
12	1.1	0.3	3.3
13+	12.1	3.3	0.0

One final adjustment was then made: The terminations column, d_t was "delayed" one-half month. That is, one half the d_t in any month t were pushed into the next month, t + 1. This is for two reasons: (1) the original unemployed percentages were essentially mid-interval figures, and (2) people with insurance coverage will suffer some malingering, particularly as benefit dates draw near. The final adjusted, d_t, R_t used to develop the PVBs, then, are:

Unemployment Month	d_t	R_t
1	23.4%	76.6%
2	30.4	46.2
3	15.0	31.2
4	9.4	21.8
5	4.8	17.0
6	6.7	10.3
7	4.0	6.3
8	1.0	5.3
9	0.4	4.9
10	0.4	4.5
11	0.6	3.9
12	0.4	3.5
13+	3.5	0.0

The above values of d_t and R_t along with 3.5% interest were used to calculate the $_w^e PVB_n^s$ for various values of e, s, w, and n.

2761.0800 Standard Premium Rate Changes - Unemployment Rate Variable

The use of a means to adjust basic benefit plan scheduled rates for changes in the unemployment rate factor from time to time is needed and will avoid the need to do formal rulemaking in the future to track these changes. The use of bands is reasonable to avoid unduly frequent and possibly confusing changes. The mid-point of each band was used to create the proportional factor for the adjustment. This is reasonable and can be done simply by the insurer from time to time based on a generally available statistical source. The range of unemployment rates would appear to cover the historical fluctuations experienced in Minnesota. It is reasonable also to recognize that it takes time for changes in rates to be formulated, published and acted upon by insurers. A 90-day period before mandatory changes are required is provided as unemployment rates decline. As rates increase, there is no requirement that CIUI rates be increased.

2761.0900 Coordination and Publication of Current Standard Benefit Plan Prima Facie Rates

To assist in the orderly application of legal rates for CIUI, the Department of Commerce will make complete standard benefit plan rate charts public by publication in the State Register and in a timely fashion to be available before the end of the 90-day period for mandatory rate decreases.

2761.1000 Rate Making Methodology and Determination of Premium Rates

The assumptions and actuarially determined basis for creating the prima facie rates is a lengthy and complicated process not easily reduced to concise and commonly understood terminology. The exception may be the application of the unemployment rate variable in Part 2761.0800 of these proposed rules. Therefore, to completely convey to those insurers intending to file policies, the underpinnings of the methodology for the rates used in the standard benefit plans, a complete digest of the premium development process has been incorporated in this statement of need and reasonableness. The basis described in the Determination of Credit Involuntary

Unemployment Price Fair Rates beginning on page 18 is also a guide for submission of alternate but equivalent nonstandard plans authorized in Part 2761.1100.

2761.1100 Use of Benefit Plans Different From the Standard Benefit Plans

It is reasonable to assume that benefit plans other than closed-end or open-end with single or joint debtors may be needed to respond to credit or market circumstances. So long as the rate making methodology and determination of premium rates follow essentially the same pattern and reasonable assumptions as the development of the standard benefit plans, other plans will be considered if properly supported. However, to ensure compliance with Minnesota law and these proposed rules, such alternative benefit plans and rates must be filed with the Commissioner for approval before use in Minnesota.

2761.1200 Application

The proposed rules, once adopted, shall apply to any existing group policy no later than the renewal or anniversary date of the group policy next following final adoption of these rules. It has taken considerable time and significant input from insurance industry representatives to reach the final format for these rules. No further considerations are known at this time which would warrant deferral. Both the industry and the Department are in a position to act on suitable filings promptly upon final adoption of these rules.

SMALL BUSINESS CONSIDERATION

The proposed rules for insurance and regulation of CIUI policies are applicable only to insurance companies. Accordingly, the Commissioner does not believe that the proposed rules impact upon a small business as defined by Minnesota Statutes, section 14.115.

Small businesses should benefit indirectly from the availability of CIUI coverages because lenders will be less reluctant to extend credit for purchase of certain products manufactured or marketed by small businesses.

EXPENDITURE OF PUBLIC MONEY BY LOCAL PUBLIC BODIES.

Minnesota Statutes, section 14.11, subdivision 1 does not apply because adoption of these rules will not result in additional spending by local public bodies in excess of $100,000 per year for the first two years following adoption of the rules.

IMPACT ON AGRICULTURE LANDS

Minnesota Statutes, section 14.11, subdivision 2 does not apply because adoption of these rules will not have an impact on agricultural land.
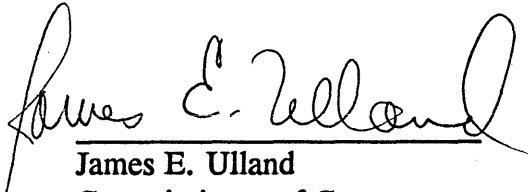
DEPARTMENTAL CHARGES

Minnesota Statutes, section 16A.1285, subdivisions 4 and 5 do not apply because the rules do not establish or adjust departmental charges.

CONCLUSION

Based on the foregoing, the proposed Rules Governing Credit Involuntary Unemployment Insurance are needed and reasonable.

Dated: July 5th, 1995

James E. Ulland
Commissioner of Commerce