jir™

September, 1983
Vol. 2, No. 1

journal of insurance regulation

Published by the National Association of Insurance Commissioners

Editorial Staff

Overview

REGULATION OF GROUP AUTOMOBILE INSURANCE

by

Karen Vanderhoof-Forschner

INTRODUCTION

The name of the game in the 1980s and 1990s is clearly distribution, especially for industries that have similar products, such as the personal automobile and homeowners' policies. This is why group automobile is becoming increasingly important to insurers.

Group automobile is a product design and method of distribution that reduces the expense portion of an insurance policy. And, under some conditions because of loss reduction techniques, it also reduces a group's chance for loss.

This is a product that can allow the independent agents to recapture market share from the highly successful captive agency companies, such as State Farm and Allstate. It also can assist life/health insurers (via existing group benefit contracts) and financial services firms (via their numerous existing and potential insured contracts) to have their property/casualty affiliates develop premium in a short period of time. However, more importantly, this product offers the promise of increased competition for the insureds' business.

HISTORY

Group automobile insurance started in 1925 when the Palmetto Fire Insurance Company issued a master policy and certificate plan to the Chrysler Corporation and the purchasers of cars respectively. Although the master policy was issued in Michigan and the certificates were issued countrywide, premiums were reportedly reduced 25-30 percent. Palmetto quicky came under fire from agents and insurance commissioners of various states. The agents were upset about an insurance distribution system that circumvented the agency system. (There was no licensed agent countersignature on the out-of-state certificates.) The insurance commissioners were upset that Palmetto felt their certificates were outside of the state regulation of insurance covering state residents. This led to several court battles over the commissioners' right to cancel Palmetto's license based on Palmetto's violation of state regulations requiring the use of a state licensed agent. One additional note, without an agent on the policy, there was no agent's commission. By 1927, Palmetto reinsured its business and faded away. However, alternate forms of distribution of insurance products had been born.

In the late 1920s and early 1930s insurance companies started issuing fleet policies to employers with these policies covering both employer and employee cars. The plans passed on the savings via fleet discounts and schedule and experience rate credits. Some of the savings came from the agent's commission. These programs were prohibited on the basis that the rates were not commensurate with similar risks which were not in the group; therefore, the rates were considered *unfairly discriminatory*.

Things were quiet for awhile, then mass merchandising of insurance re-emerged in the 1950s. Through the strong effort of agent associations many states enacted *fictitious group* statutes and other forms of prohibitory rulings.

The 1950s and 1960s saw the aggressive growth of the direct writing and "captive" agency distribution systems. Both of these systems were based on concepts similar to group automobile, i.e., lowered distribution cost (through reduction of the amount paid to the middle person, the agent) which was passed on to the insured.

In 1963, Imperial Casualty and Indemnity Insurance Company started to write automobile insurance for Standard Oil cardholders. Independent agents blocked the development of this competitive form of distribution.

In the mid to late 1960s, alternate distribution systems started to flourish, and many insurers once again entered the group automobile market. Both true group and franchise group were being developed and written. There were approximately thirty-three companies offering group automobile programs, all passing the savings on to the consumer and most trying to reduce agents' commissions.

Now the independent agents were losing market share to several alternate distribution methods—the direct writers, captive agency insurers, mass marketers, and group automobile writers. Independent agents once again started a lobby to prevent the writing of group products. State statutes and administrative rulings constructed such a patchwork of regulation that insurers could not realize their concept of one streamlined plan.

Even more serious was the failure of the insurers to plan their product and marketing strategies thoroughly. Many of the planned expense reduction techniques never came about. Planned automation was never installed, planned use of the "group technique" never materialized, and planned use of payroll deduction was never implemented. Also, insurers never aggressively promoted their group automobile products for fear of upsetting their agents or the independent agents.

Then the recession hit. Employers could no longer afford to contribute toward automobile insurance for their employees. People were laid off, put on early retirement, or fired. Many businesses and plants closed. The companies offering group plans as a benefit to their employees became displeased by insurers who were quick to cancel the policy, leaving the employees mad at the employer. Mass marketing and group automobile plans soon were unpopular with most insurers, agents, and employers.

However, at the same time, employee benefit writers (group accident and health and life insurers) started to investigate this new employee benefit. Some investigation was conducted by the subcommittee on New Forms of Employee Benefits of the American Council of Life Insurance (ACLI). Slowly but surely the insurers represented on this subcommittee started to establish or acquire property/casualty insurance companies and began their entry into the group automobile marketplace. This committee was quickly disbanded when the leading personal lines insurers' (State Farm and Allstate) lawyers took measures to ensure that the ACLI strongly adhere to the life insurance business.

At this point a number of independent agency companies started developing group automobile products for two reasons:

1. To protect their market share, and
2. To regain market share lost to the direct writers and captive agency insurers.

So, while companies like the Hartford voiced their opposition to group automobile products, they were actively developing a group automobile product.

In 1983, there are approximately thirty insurers selling or developing group personal lines products. More interestingly, people may soon be seeing the emergence of group automobile products sold by banks or other financial institutions.

DEFINITIONS OF TYPES OF AUTOMOBILE INSURANCE MARKETING

Group automobile insurance is insurance which is sold via the group technique and for which the employer contributes a portion of the premium. The following are characteristics of true group. It

1. Has a significant employer contribution—50 percent or more of the premium (approximately $100 to $300),
2. Uses account underwriting of the group and employer's industry,
3. Uses experience rating,
4. Insures all who want coverage,
5. Has medium to high participation levels (from 75 percent to 90 percent),
6. Has a master policy issued to the employer (This establishes the employer as a party to the contract. Certificates are issued to the employees. These certificates are virtually the same as policies.),
7. Has a collapsed rating classification system, i.e., four or five categories,
8. Has cessation of coverage when the employee is no longer eligible,
9. Has a commission scaled to premium volume (usually from 1 to 5 percent),
10. May have no employee options (The employer sometimes chooses a uniform plan of benefits that applies to all employees.), and
11. May have a conversion privilege to an individual policy for employees who are no longer eligible.

Contributory franchise automobile insurance includes all other combinations that do not meet the strict definition of true group automobile. These plans may have

1. A master policy and certificates (but more frequently individual policies are issued),
2. A small employer contribution (from $10 to $25 per employee),
3. An individual rating and classification system (A few insurers may choose to offer a collapsed system.),
4. A range of options for employees,
5. A conversion privilege,
6. Individual underwriting (only occasionally), and
7. A reduced commission scale.

There are several other marketing techniques. These include

1. *Agency*—Independent agents or exclusive agents solicit business.
2. *Mass Marketing*—Individual policies are sold at the place of employment and the premium is collected via payroll deduction. The employer has no involvement except to provide the payroll deduction facility.
3. *Direct*—This involves the insurer reaching the insured directly and not waiting for an agent to place the business with the company.
4. *Mail*—The insurer reaches the insured directly via mail. The insurer purchases mailing lists. This also includes catalog sales.
5. *Telemarketing*—Telemarketing involves reaching the insured using the telephone. This can be done via the computer. The author received several irritating phone calls from a computer that tries to get me to leave my name, number, and address after the beep—if I am interested in low cost insurance.
6. *Cable*—This is one of the most imaginative new methods of selling insurance, and it involves two-way interactive cable.

FEDERAL REGULATION

There are three areas of federal regulation that affect the writing of group automobile plans.

Employee Retirement Income Security Act

The Employee Retirement Income Security Act of 1974 (ERISA), which covers over 40 million employees and families, was passed to protect the worker and beneficiary interests in employee pension and welfare plans.

The Department of Labor (Office of Communications and Public Service) considers group automobile a type of welfare program, subject to the ERISA requirements. This requires the group automobile administrator to send in a summary plan description, plan documents, and all modifications to the Department of Labor.

Interestingly enough, the Internal Revenue Service offices in Connecticut and Washington, D.C. do not consider group automobile a type of welfare plan. Also, they will not accept the reporting of the annual statistics, reports, or actuarial data that are required by ERISA.

Insurers are taking two approaches toward the ERISA requirements:

1. An employer-sponsored group automobile insurance plan is subject to the reporting, disclosure, and fiduciary requirements of ERISA and the insurer's servicing group representative is available to assist the employer in complying with the requirements; or
2. Automobile insurance, whether or not it is sold on the true group basis, is not an ERISA reporting item. Until they are notified otherwise, the insurers will so inform the employers.

Taft-Hartley

In order for group automobile to grow rapidly many people believe that union support is vital. One key is a union push to amend the Taft-Hartley Act. This amendment would include group automobile in the list of permissible fringe benefits for which unions can seek employer contributions. The

Labor-Management Relations Act of 1947 applies where the employees are engaged in activities which affect interstate or foreign commerce and requires the establishment of a trust fund which must be administered jointly with equal representation by union and management trustees. Payments are made by employers, as a result of collective bargaining solely for the purpose of providing welfare benefits to employees who are union members and their families.

Internal Revenue Service Code

It is generally accepted that the employer's contributions to a reasonable plan of group automobile benefits are includable as a general business expense and are tax deductible to the employer as an "ordinary and necessary" business expense. However, the current Internal Revenue Code considers the employer's contribution as includable in an employee's taxable income (except that portion of the contribution that covers the no-fault and medical expenses of the accident and health benefits for the employee and the employee's family).

A tax amendment is needed which would exclude from employee gross income that amount contributed by an employer on behalf of an employee, spouse, and dependents under a qualified group automobile plan. However, federal legislation allowing nontaxable status may not be as significant a factor as originally predicted. Even if the employer contribution is considered taxable income to the employee, the cost to the employee should be considerably lower than the cost of an individual automobile policy. It is felt that with the commission and administrative expense reduction the average annual current private passenger premium can be reduced approximately 15 percent.

The reduction would be as follows:

1. Average Annual Premium	$275
15 percent reduction based on the group technique	-41
New Average annual premium	$234
2. With 50 percent contribution	
Employer Payment	$117
Employee Payment	$117
3. Total cost to employee = $117 + $35 (tax on employee's payment at a 30 percent tax rate)	$152

The savings to the employee is $123, a reduction of 45 percent. *This of course ignores the fact that without group automobile insurance the employee would have paid tax on the full $275 premium of the individual private passenger policy.* Therefore the real tax consequence is related to the additional $117 of income received by the employee.

STATE REGULATION

There is a patchwork of state regulation for group automobile insurance. Some states have enacted regulations that truly encourage the writing of group automobile coverages. Some states have enacted enabling regulations which are designed to discourage the development of group automobile. And some states have laws that specifically prohibit the writing of group personal lines coverage.

However, more interesting are the states whose laws are silent on the issue and the insurance department takes an interpretive stand. Two states that have identical regulations will have two entirely different stands on whether or not group automobile can be written in the state. Many times a strong independent agents' lobby will influence this interpretation. Too bad the general public does not have an equally strong lobby.

Contract Format

Group automobile arrangements can be issued under one of three possible contract formats:

1. *Individual Policy*—This is the standard policy format that everyone is familiar with in the current individual private passenger system.

2. *Master Policy and Certificates*—The "master policy" is the contract given to the employer and clarifies the duties of the insurer and employer, e.g., the method of payment by the employer and the dates that such payment is due. The "certificate" is given to the employee and states the employee's coverage number, coverages, limits, insureds, duties, and rights. The employee is not a party to the contract between the employer and insurer. This certificate is very similar to a policy.

   Connecticut has a specific enabling regulation that allows the use of this form of contract. Florida allows the use of master policy and certificates by interpretation in order to encourage the development of group personal lines insurance. Ohio, by interpretive bulletin No. 18 dated April 19, 1958—written 25 years ago by then Superintendent of Insurance—Arthur I. Vorys, prohibits every aspect of group personal lines insurance.

3. *Group Blanket Policy*—A master policy is issued to the employer to cover a group's members. The underwriting unit is the group, and covered members of the group are not even individually identified to the insurer. The member's coverage number is the master policy number. Also, it is up to the employer to supply the necessary insurance booklet explaining coverages to the insured. Michigan is the only state that specifically permits the writing of this coverage.

Antidiscrimination

The antidiscrimination regulation (unfair discrimination) is the most widely cited law used to prohibit the writing of group personal lines insurance. Every state has a law that in effect prohibits rates that are "unfairly" discriminatory.

It is by legal interpretation that the lower rate, developed by the application of the efficient distribution system of group personal lines insurance, is deemed in violation of the rating laws. This law also can be used to prohibit the "broad averaging" of the existing rating categories. It is felt that broad rates unfairly discriminate because certificate/policyholders may receive rates higher or lower than their counterpart in the private passenger market. If their loss experience is the same then their rates should be the same. However, this argument ignores the fact the rates are based on *two* segments: the *expense* portion and the *loss* portion.

Kentucky, in an effort to prevent the development of group personal lines insurance, passed KRS 304.12-210. This requires the use of current individual rating plans and policies. There can be no discounts, average rating, or master policy and certificates.

States that allow, by interpretation, the writing of group personal lines recognize several things:

1. The expense portion of the premium is separate from the loss portion. Therefore, passing the savings on to the insured does not reflect any differences in loss potential.
2. There are a variety of risk classification systems other than the typical Insurance Services Office categories.
3. Through loss reduction techniques and education, an insured can become a better risk. (This is the logic behind driver's training.)

The Connecticut regulation states:

> *...rates shall not be deemed to be unfairly discriminatory because different premiums result for policyholders with like loss exposures but different expense factors, or like expense factors but different loss exposures, so long as the rates reflect the differences with reasonable accuracy. Rates shall not be deemed to be unfairly discriminatory if they are averaged broadly among persons insured under a plan.*

Fictitious Group Laws

The fictitious group laws were originally established to prevent the insuring of individual insureds under an employer's automobile fleet plan. Later these laws were interpreted to prohibit the writing of insurance through an association, employer, or any other organization for a preferred rate. The logic is that membership in an organization does not make the risks better risks; therefore, the groups should not receive any preferred rates. There is a lot of crossover in the logic between the antidiscrimination, fictitious group, and rating laws.

A more thorough inspection reveals that this law is intended to prohibit insuring groups that were formed for the *sole reason* of offering low-cost insurance. Insurers also want to avoid the writing of insurance for such groups; their reason is to avoid adverse "selection" problems.

New Jersey interprets its fictitious group law as not prohibiting group personal lines insurance in groups arranged for purposes other than to obtain insurance. The Connecticut and Illinois regulations clarify this distinction and allow the writing of group automobile coverage. Colorado takes an interesting approach by requiring that the group has been in existence for at least two years prior to the offering of any mass merchandising or group automobile plan.

Underwriting

The underwriting of group automobile plans can be either on an individual basis, an account basis, or both. Many states establish basic criteria for determining how underwriting will be handled.

Colorado requires the account to have at least fifty eligible members with at least 50 percent of the eligible members agreeing in writing to participate in the group automobile plan. On an individual basis, the insurer must accept all eligible members wanting to participate. However, there are a few exceptions to the take-all-comers approach. Connecticut prohibits individual underwriting in group automobile, subject to a few exceptions. Illinois regulates the account underwriting by requiring the group to have at least ten employees. There is freedom to underwrite individually. New Jersey requires the account to have at least twenty-five enrolled people if the organization is domiciled or principally located in New Jersey.

Rating

Rate regulation of group personal lines insurance has been greatly influenced by the antidiscrimination and fictitious group laws (refer to the appropriate sections). This information will not be repeated, but several examples of state regulations are presented.

Colorado permits the broad averaging of rates. This is the "collapsed" rating scale mentioned in the definitions list. It requires the insurer to maintain separate statistical records to insure that mass merchandising costs are not transferred to individual automobile rates. The use of experience rating is allowed, as long as it is based on the experience that the group has had during the preceding insurance year or years. Connecticut allows rates to be broadly averaged and requires the insurer to maintain annual experience data on each case and to report this experience to the insurance department. New Jersey requires maintenance and reporting only if the plan provides some rate or coverage advantage not available from the same insurer on a nonplan basis.

Employer

There is very little regulation that pertains to the employer. However, the regulation that exists seems to have a sound objective. In Connecticut, the insurance code specifically states that the insurance commissioner may promulgate regulations concerning the continuation of policies during temporary interruptions of employment, including but not limited to strikes, layoffs, and other such occurrences.

Florida will not permit the writing of group automobile insurance when the employer has full control over the coverages and limits offered to its employees. So one uniform plan of coverage and limits is prohibited since the employee must have some control over the insurance decision. The employer must offer at least two plans of insurance coverage and limits.

New Jersey states that nonpayment by the employer cannot be regarded as nonpayment by employees. The employees must be notified and given ten days to remit the premium due. Also, the employer is required to keep the automobile insurance money collected separate from the corporation's or association's money.

Conversion Policy

The conversion policy regulation requires that the insurer offer an individual policy to each member who had group automobile coverage and is no longer eligible for the group policy. This conversion policy can be at nongroup rates. The insurer is required to accept the risk. Colorado specifically requires a conversion privilege for group automobile accounts. Connecticut requires that the insurer offer a conversion policy when the insured leaves the employer for reasons other than retirement. The insured must notify the insurer of the intent to accept a conversion policy within thirty days from leaving such employment. Illinois goes a step further in stating that the insurers must provide equal insurance coverage and limits through an individual standard policy of insurance in the same company when an employee terminates the connection with the group.

CONCLUSION

The diversity of regulation is inconsistent with the purpose of group automobile to bring to the consuming public the product they need in the most efficient and economical method. Why are some state insurance departments blocking the enabling regulation necessary to allow the marketing of this product if it is their charge to foster competition for the benefit of the insured?