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The Honorable Guy Guzzone
Chair of the Senate Budget and Taxation Committee
Miller Senate Office Building, 3 West
11 Bladen Street
Annapolis, MD 21401

The Honorable Ben Barnes
Chair of the House Appropriations Committee
House Office Building, Room 121
6 Bladen Street
Annapolis, MD 21401

RE: 2024 p42 MIA Report on Maryland Auto Rate Filings in Calendar 2024

Dear Chair Guzzone and Chair Barnes:

Enclosed, please find the *Report on Maryland Auto Rate Filings in Calendar 2024* prepared by the Maryland Insurance Administration as mandated by the Joint Chairmen's Report on the Fiscal 2025 State Operating Budget (SB 360) and the State Capital Budget (SB 361) and Related Recommendations ("Joint Chairmen's Report"). *See* p. 42.

Five printed copies and an electronic copy of this report have been mailed to the DLS library for its records.

Should you have any questions regarding this Report, please do not hesitate to contact me or the MIA's Associate Commissioner of External Affairs and Policy Initiatives, Jamie Sexton at jamie.sexton@maryland.gov.

Respectfully yours,

Marie Grant

Marie Grant
Acting Insurance Commissioner

cc: The Honorable Bill Ferguson. President of the Senate
The Honorable Adrienne A. Jones, Speaker of the House of Delegates
Sarah T. Albert, Department of Legislative Services (5 copies)

Maryland

INSURANCE ADMINISTRATION

Maryland Automobile Insurance Fund
Rate Filing Decisions in Calendar Year 2024

Marie Grant
Acting Insurance Commissioner

January 1, 2025

For further information concerning this document contact:

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I. Introduction

The Joint Chairmen's Report for the 2024 Session (the "2024 JCR") included a request that the Maryland Insurance Administration ("MIA") submit a report concerning rate filings submitted by the Maryland Automobile Insurance Fund ("Maryland Auto") during Calendar Year 2024. Specifically, the 2024 JCR stated:

> *All automobile insurance companies in Maryland are required to file notification and justification of insurance rate changes with the Maryland Insurance Administration (MIA) in accordance with Title 11 of the Insurance Article. In addition, Maryland Auto rates are reviewed under §20-507 of the Insurance Article, which provides that "the Commissioner shall consider not only the rating principles under Title 11, Subtitle 3 of this article but also the statutory purpose of the Fund under § 20-301..." The committees are interested in rate filing activity by Maryland Auto and the associated review process administered by MIA. The committees request that MIA submit a report listing each rate filing made by Maryland Auto in calendar 2024 including the date filed and proposed effective date, specifying the date and review outcome of each rate filing as approved, still under review, or determined to be excessive or inadequate by the commissioner. For each rate filing, the commissioner shall note whether Maryland Auto considered affordability of its rates, any affordability methodology used by Maryland Auto, the effect such use had on the rate filing and how the commissioner considered the "statutory purpose of the fund" in reviewing the rates. For rate filings determined to be excessive or inadequate, MIA should provide information on any corrective actions recommended and Maryland Auto's progress in implementing the corrective actions.*

Maryland Auto submitted one commercial automobile and two private passenger automobile ("PPA") rate filings during Calendar Year 2024. The MIA retained a property and casualty actuarial consulting firm, Taylor & Mulder, to independently review these rate filings.

This Report begins with a summary of the statutory standards that govern the MIA's review of Maryland Auto rate filings. It proceeds with an overview of each rate filing submitted by Maryland Auto during Calendar Year 2024 that includes: Taylor & Mulder's findings; whether and how the use of an affordability methodology or Maryland Auto's statutory purpose affected the MIA's review; whether the filing was approved, disapproved, or withdrawn; and any corrective action that the MIA recommended or mandated in relation to methodologies Maryland Auto employed to establish rates in the filing.

II. Statutes that Govern the MIA's Review of Maryland Auto Rate Filings

Maryland Auto's statutory purpose, as stated in § 20-301(a) of the Insurance Article,[1] is "to provide the financial security required under § 17-103 of the Transportation Article to those eligible persons that are unable to obtain it from an Association member." Maryland Auto was established to function as an insurer of last resort by providing generally required vehicle liability insurance to drivers that are unable to obtain it through the voluntary market due to their high risk

[1] Unless otherwise indicated, any statutes referenced in this Report are within the Insurance Article of the Annotated Code of Maryland.

profile, typically evidenced by their driving records. In accordance with § 20-507(d), the Commissioner considers Maryland Auto's statutory purpose when reviewing its filed rates.

Pursuant to § 20-507(a) of the Insurance Article, premiums for policies issued by Maryland Auto are determined by its Executive Director and subject to the Commissioner's authority under Title 11, Subtitle 3. Rates established pursuant to Title 11, Subtitle 3 (Competitive Rating) do not have to be approved by the Commissioner before they go into effect, though Maryland Auto has sought the MIA's approval of its proposed rates prior to implementation. The Commissioner has authority to disallow rates set under this Subtitle if she determines, pursuant to § 11-306, that they are unfairly discriminatory, excessive, or inadequate. The Maryland Supreme Court has said that, "[u]nfair discrimination, as the term is employed by the Insurance Code, means discrimination among insureds of the same class based upon something other than actuarial risk." *Insurance Commissioner v. Engleman*, 345 Md. 402, 413 (1997).

Regarding the adequacy requirement, § 11-306(b)(3) provides that:

A rate may not be held to be inadequate unless:

(i) the rate is unreasonably low for the insurance provided and continued use of the rate would endanger the solvency of the insurer; or

(ii) the rate is unreasonably low for the insurance provided and the use of the rate by the insurer has had, or if continued will have, the effect of destroying competition or of creating monopoly.

Unlike a typical insurer, Maryland Auto is not currently subject to financial performance standards, such as minimum surplus requirements, under the Insurance Article. When Maryland Auto's year-end surplus drops below the assessment threshold calculated pursuant to § 20-404, it accesses funding to ensure its solvency through an assessment on Industry Automobile Insurance Association members (the "industry").[2] Separate calculations are made on an annual basis to determine whether and the extent to which an assessment of the industry is required to fund Maryland Auto's commercial auto division or PPA division, respectively. The Commissioner's authority under §11-306(b)(3) to disallow rates set by Maryland Auto on the basis of inadequacy hinges on whether the rates "endanger the solvency" of Maryland Auto. One reasonable interpretation of this provision is that rates "endanger" Maryland Auto's solvency if they will not generate revenue sufficient to ensure that Maryland Auto's year-end surplus is above the assessment threshold calculated pursuant to § 20-404.

Prior to 2017, rates filed by Maryland Auto could not take effect unless they were approved by the Commissioner in accordance with Title 11, Subtitle 2 (Prior Approval Rate Making).[3] Over the past ten years, Maryland Auto has eroded its surplus by consistently setting PPA rates significantly below indicated rates, to the point that an assessment on the industry will

[2] § 20-101(c) defines "[Industry Automobile Insurance] Association member" as "an insurer [other than Maryland Auto] that is licensed to write motor vehicle liability insurance or motor vehicle physical damage insurance in the State."

[3] *See* 2017 Maryland Laws Ch. 509 (S.B. 910), which enacted changes to § 20–507 that became effective on July 1, 2017.

be triggered in 2025.[4] Notably, this will be the first time that Maryland Auto has required assessment funding since 1989 (based on operating losses in calendar year 1988). The Commissioner's authority to intervene is somewhat limited under current law because Maryland Auto is not subject to minimum surplus requirements or prior approval rate making standards under the Insurance Article.

Maryland Auto used an affordability index to cap or limit liability base rates for policyholders who reside in certain ZIP codes under both PPA rate filings it submitted during Calendar Year 2024. This methodology is subject to § 11-306(e)(4), which provides that "a rate may not be based wholly or partly on geographic area itself, as opposed to underlying risk considerations, even though expressed in geographic terms." This methodology is also subject to § 11-319, which requires that the use of territory as a factor in establishing automobile insurance rates be actuarially justified.

III. Commercial Automobile Rate Filing Submitted on August 21, 2024

All rate filings, whether subject to prior approval or competitive rating standards, include the overall indicated rate change and the overall proposed rate change. The "indicated rate change" is the difference between the current rate level and the indicated rate level (i.e., the rate level that actuaries have projected necessary to achieve a balance between the expected premium income and the expected losses and expenses). The "proposed rate change" is the rate change that the insurer actually proposes to implement.

On August 21, 2024, Maryland Auto submitted a commercial automobile rate filing with an effective date of October 25, 2024. Maryland Auto did not apply territorial rating or an affordability index to determine rates set forth in the commercial filing. The overall indicated rate change was 3.1%, and the overall proposed rate change was 3%. The 0.1% variation between the indicated and proposed rate is due to the fact that Maryland Auto did not propose any rate increase for its garage, taxi, or sedan products, although a 0.8% increase for these products was indicated. The MIA did not consider this slight variation significant enough to impact the adequacy of the proposed rate, so long as the indicated rate was verified.

The MIA requested that Taylor & Mulder review the filing and assess the reasonableness of the methods and assumptions that Maryland Auto used to calculate the indicated rate change. On October 1, 2024, Taylor & Mulder submitted a report of its findings. In its report, Taylor & Mulder explained the process that Maryland Auto used to calculate the indicated rate change as follows:

[4] A chart showing indicated and proposed rates under Maryland Auto rate filings submitted between March of 2014 and November 2023 is included in MIA and Maryland Auto's Joint 2024 JCR report entitled *Methods for Determining Auto Insurance Rate Affordability*, which can be accessed at: https://insurance.maryland.gov/Consumer/Appeals%20and%20Grievances%20Reports/Joint-Chairmens-Report-Methods-for-Determining-Auto-Insurance-Rate-Affordability.pdf.

[Maryland Auto] used a method that weights [adjusted] historical loss and loss adjustment expense (LAE) ratios with the permissible loss ratio (PLR) based on the credibility of the historical data to determine their indicated rate need. The Company uses five years of historical premium and loss data brought to the level of the prospective policy period by using current rate level procedures and trending premium and losses to the prospective policy period. The PLR is calculated as one minus selected prospective expenses and profit provisions. After the credibility weighted loss and LAE ratio has been determined, this ratio is then loaded for expenses and profit to determine the indicated rate change. This is a commonly used actuarial method.[5]

Taylor & Mulder concluded that the methods and assumptions Maryland Auto used to calculate the indicated rates under its commercial filing were reasonable and consistent with applicable law. The MIA agreed with Taylor & Mulder's conclusion, and deemed the filing "approved" on October 2, 2024.

In its report, which the MIA shared with Maryland Auto, Taylor & Mulder suggested improvements to the process Maryland Auto used to calculate indicated rates in the filing. Specifically, Taylor & Mulder suggested that Maryland Auto use a shorter experience period (three rather than five years) that is closer to the effective date to guide their prospective frequency and severity trends so that they are more indicative of current loss trends and socioeconomic factors. Taylor & Mulder explained that basing prospective frequency and severity trends on data from year ending June 30, 2022, through June 30, 2024, instead of December 31, 2019, through June 30, 2024, would more accurately reflect changes in inflation and driving behavior since the COVID-19 pandemic ended. Furthermore, Taylor & Mulder suggested that Maryland Auto continue to monitor any trends seen in the ratio of Unallocated Loss Adjustment Expense (ULAE) to loss and Allocated Loss Adjustment Expenses (ALEA) to determine if a shorter time horizon should be considered for this provision. The MIA will assess the extent to which Maryland Auto implements these suggested improvements to its commercial rate making process when it reviews the next commercial rate filing that Maryland Auto submits.

IV. Private Passenger Automobile Rate Filing Submitted on June 10, 2024

On June 10, 2024, Maryland Auto submitted a PPA rate filing with an effective date of August 25, 2024. The overall indicated rate change was 18.1%, and the overall proposed rate change was 11.2%. Maryland Auto applied an affordability index to cap liability premiums for all policyholders residing within 55 selected ZIP codes, regardless of the financial status of the individual policyholders, at 3.3% of the overall median household income for the respective ZIP codes.

The MIA requested that Taylor & Mulder assess the impact that the proposed rates would have on policyholder surplus and whether the proposed application of an affordability index was

[5] While §11–306 allows for commercial market rate filers to include a profit provision, Maryland Auto does not include a profit provision in their filings. Commercial carriers may take less than the indicated rate in order to remain competitive in the market or gain market share.

compliant with rate setting principles set forth in the Insurance Article. In a report summarizing its analysis, Taylor & Mulder commented that "Maryland Auto will have to increase premiums substantially closer to the indicated rate change to ensure that they do not issue [a PPA] assessment."

Taylor & Mulder discussed the affordability index in its report, and noted that the selection of 3.3% of median household income as the threshold for affordability does not have any support in the filing and that "there is no actuarial justification for limiting premium at this level." Taylor & Mulder found that, not only does the affordability index appear not to be based on underlying risk differences, but that it "is apparently designed to specifically prevent the recognition" of differences "in risk across different geographic regions." Further, Taylor & Mulder concluded that by setting a maximum limit on the premium that can be charged in certain zip codes, Maryland Auto may be creating the potential for adverse selection within those areas. Taylor & Mulder noted, "individuals within those areas that would be charged a higher rate on the admitted market may seek coverage under Maryland Auto" and that loss ratios in zip codes limited by application of the affordability index would be high relative to unlimited zip codes. This is due to the premium being artificially suppressed and because the premium is low enough for high risks that policyholders in these zip codes are worse than average.

In its report, Taylor & Mulder identified a disconnect between the goal of the affordability index and the methodology. This can be seen in two potential issues that arise with the use of the cap: (1) the affordability index is not able to protect lower-income households in medium income or high-median income zip codes; and (2) the affordability index may limit the premium for high or medium income households residing in low-median income zip codes. Taylor & Mulder concluded that the application of the affordability index in certain ZIP codes means that other ZIP codes must receive larger rate increases in order to realize the needed rate change. "This means that non-limited ZIPs are unfairly subsidizing the rates of the 55 limited ZIPs."

The MIA shared Taylor & Mulder's report with Maryland Auto, and met with Maryland Auto to discuss the report and concerns about the inadequacy of the rates that Maryland Auto selected. The MIA shared its view that Maryland Auto's application of the affordability index to suppress rates in certain ZIP codes: (1) uses territory as a factor in setting rates in a manner that lacks actuarial justification, in violation of § 11-319; (2) bases rates on geographic area, as opposed to underlying risk considerations expressed in geographic terms, in violation of § 11-306(e)(4); and (3) is unfairly discriminatory, in violation of § 11-306(b)(1)(ii).

On September 18, 2024, Maryland Auto withdrew the (then pending) PPA rate filing it submitted on June 10. Maryland Auto relayed its intent to submit another PPA rate filing by early October. The MIA urged Maryland Auto to propose actuarially sound rates that align with the indicated rates in its next filing. However, as discussed in Section V of this Report, Maryland Auto's subsequent rate filing (submitted on October 9, 2024) also raised issues of adequacy and actuarial justification relating to Maryland Auto's application of an affordability index.

V. Private Passenger Automobile Rate Filing Submitted on October 9, 2024

On October 9, 2024, Maryland Auto submitted a PPA rate filing with an effective date of January 17, 2025. The overall indicated rate change was 18.1%, and the overall proposed rate change was 12.8%. As it did under its prior withdrawn PPA filing, Maryland Auto applied an affordability index to cap liability premiums for policyholders in certain ZIP codes at 3.3% of the median household income for the respective ZIP codes. The affordability index was applied to 50 ZIP codes under the new filing, as opposed to 55 ZIP codes under the prior withdrawn filing. Maryland Auto indicated that liability premium rates for approximately 18% of its policyholders (6,399 out of a total 35,461 policyholders) were limited by the affordability index under the new filing.

The MIA requested that Taylor & Mulder analyze how Maryland Auto's proposed rate change would impact policyholder surplus and the need for Maryland Auto to issue future assessments on the industry. The MIA also requested that Taylor & Mulder evaluate whether Maryland Auto's application of the affordability index to certain ZIP codes under the filing comported with actuarial standards codified in the Insurance Article.

On October 18, 2024, soon after undertaking its review of the PPA rate filing, Taylor & Mulder sent an objection to Maryland Auto. The reason for the objection was that the indicated and proposed rates in the filing were calculated based on an assumption that the proposed rate change went into effect on August 25, 2024. However, the effective date for the proposed rate change under the filing was January 17, 2025.

On November 1, 2024, Maryland Auto responded to Taylor & Mulder's objection by submitting an amendment to the pending PPA rate filing. The amendment modified the filing in three ways:

- It changed the effective date for the proposed rate change from January 17, 2025 to January 24, 2025;
- It increased the indicated rate change from 18.1% to 19.3%; and
- It increased the proposed rate change from 12.8% to 13.8%.

On December 10, 2024, Taylor & Mulder submitted a report summarizing its review of the pending PPA rate filing, as amended. Taylor & Mulder's concluded that the proposed rate change was inadequate, and offered the following explanation:

> *The discrepancy between the indicated rate change and the selected rate change, along with the consistent history of deteriorating surplus, suggests that the rates currently in force do not account for all costs associated with the transfer of risk from the insured to [Maryland Auto] and are therefore inadequate. Over time, this has led to a situation in which [Maryland Auto] may be considered to be effectively insolvent, requiring repeated infusions of capital in the form of industry assessments to continue to be able to pay claims and expenses.*

Taylor & Mulder projected that, due to Maryland Auto's significant statutory operating loss, it will require funding via a $21 - $22 million PPA assessment of the industry for Calendar Year 2024, to be assessed in Calendar Year 2025. Taylor & Mulder further projected that Maryland Auto will require funding via a $16 - $17 million PPA assessment of the industry for Calendar Year 2025, if its filed rate change takes effect on January 24, 2025 and it does not implement further rate increases during Calendar Year 2025. Taylor & Mulder concluded that "taking full [(i.e., indicated)] rate changes in future years will minimize the risk of requiring assessments and may over time contribute to lower costs for policyholders as greater invested assets could be used to offset expenses."

Finally, Taylor & Mulder concluded that "[t]he use of an affordability index to limit rates based on the median income in specific ZIP code areas is arbitrary, inconsistent with the Maryland Insurance Code, inconsistent with actuarial principles, may lead to adverse selection, may not accomplish the intended goal of the adjustment, and will lead to unfair price differentials."

On December 13, 2024, the MIA issued a determination letter approving Maryland Auto's PPA rate filing for implementation on January 24, 2025, and also ordering Maryland Auto to implement future rate increases and gradually eliminate its application of the affordability index. In the determination letter, the MIA noted that the overall proposed rated increase of 13.8% was not adequate and Maryland Auto's application of the affordability index in establishing rates for certain ZIP codes was unfairly discriminatory. The MIA went on to explain that it approved the rate filing, despite these concerns, because delay in Maryland Auto effectuating a rate increase would result in a larger deficit to be recouped via assessment on the industry (a cost that will likely be passed onto policyholders).[6] Finally, the MIA ordered Maryland Auto to take the corrective actions listed below.

- File with the MIA new proposed rates by May 1, 2025 with an expected implementation date of July 1, 2025. This filing must contain a plan to address any remaining inadequacy of Maryland Auto's PPA rates.
- Eliminate the use of the affordability index over a period of two years. The July 1, 2025 filing must address the gradual elimination of the affordability index so that, eventually, rates within the ZIP codes to which the affordability index currently applies are adequate and not unfairly discriminatory.
- On a going forward basis no later than December 31, 2026, rates in the ZIP codes to which the affordability index is currently applied shall comport with the requirements of § 11-319, and be actuarially justified and consistent with the territory to which the rates apply.

It should be noted that the determination issued on December 13, 2024 is subject to Maryland Auto's right to request a hearing pursuant to Title 11, Subtitle 5 of the Insurance Article.

[6] Pursuant to §§ 20-406 and 20-407, an Association member may recover its share of an assessment by imposing a surcharge on each policy of motor vehicle liability insurance or motor vehicle physical damage insurance that it writes, or as a rate filing cost.

VI. Conclusion

Availability and affordability of PPA insurance statewide is of critical importance to the MIA. Though the MIA does not believe that Maryland Auto's current use of the affordability index is permissible under Maryland law, the MIA remains committed to working with the Maryland General Assembly and Maryland Auto to develop options on affordability and how it can be incorporated into Maryland Auto's rates. The MIA believes that for Maryland Auto to continue to apply the affordability index in the future using the same methods used under its most recent rate filings, a statutory change will be needed. The MIA intends to conduct a study in 2025 on options to address affordability for PPA insurance in the statewide market.

It should be noted that the MIA may recommend further corrective action following the routine financial examination of Maryland Auto that is underway. The examination is being conducted pursuant to § 2-205(b)(2), which requires the MIA to conduct a financial examination of each domestic insurer at least once every five years. The scope of the examination will include Maryland Auto's financial condition, corporate governance, risk management, and controls. In reviewing Maryland Auto's financial condition, MIA examiners will consider the adequacy and reasonableness of Maryland Auto's rates and reserves. The MIA will retain an actuarial consultant to review Maryland Auto's pricing and reserving methodologies as part of the examination.[7] The MIA expects to share its draft Exam Report with Maryland Auto by May 30, 2025. Following the issuance of the final Exam Report, the MIA will monitor Maryland Auto's implementation of any corrective measures recommended or required therein.

[7] A financial examination of a typical insurer would also include an evaluation of whether the insurer meets minimum surplus requirements and whether there are any other risks to the insurer's solvency. Solvency risks are not evaluated to the same extent during an examination of Maryland Auto, because it is not subject to minimum surplus requirements and can access funding through an assessment on the industry pursuant to Title 20, Subtitle 4.