REPORT OF THE
STATE CORPORATION COMMISSION'S
BUREAU OF INSURANCE ON

The Feasibility of Creating A Liability Insurance Residual Market Facility and Joint Underwriting Association

TO THE GOVERNOR AND
THE GENERAL ASSEMBLY OF VIRGINIA

Senate Document No. 12

COMMONWEALTH OF VIRGINIA
RICHMOND
1988

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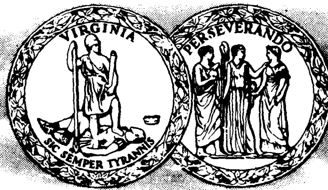

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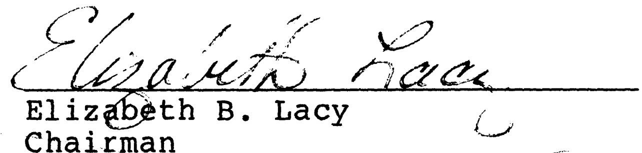
December 8, 1987

TO: The Honorable Gerald L. Baliles
Governor of Virginia
and
The General Assembly of Virginia

The report contained herein is pursuant to Senate Joint Resolution No. 134 of the 1987 Session of the General Assembly of Virginia.

This report represents the response of the State Corporation Commission's Bureau of Insurance to the legislative directive to study the feasibility of creating a liability insurance residual market facility and joint underwriting association to assure the availability of liability insurance.

Respectfully submitted,



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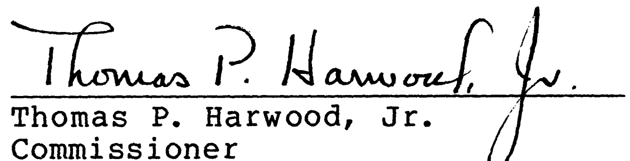

Thomas P. Harwood, Jr.
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EXECUTIVE SUMMARY

During the 1987 Session, the General Assembly adopted Senate Joint Resolution No. 134 which requested the State Corporation Commission's Bureau of Insurance to study the feasibility of creating a liability insurance residual market facility and joint underwriting association (J.U.A.) to assure the availability of liability insurance. As stated in the resolution, all insurers writing liability insurance in Virginia would be required to participate and share in the expenses and profits or losses of such facility and association on a fair and equitable basis.

Legislative Request

This study was requested by the General Assembly because:

1. The insurance industry has had a history of cycles which at times has made insurance unaffordable, unavailable, or both;

2. There are individuals and businesses in certain professions and occupations that are unable to purchase liability insurance at all or only at very high rates; and

3. Action should be taken to facilitate the availability of liability insurance at fair and equitable rates so that professions and businesses may be able to serve the public interest at all times regardless of the insurance climate.

The Liability Crisis

In 1985 the insurance climate in Virginia and across the country changed significantly. After several years of competitive pricing practices, insurers began to increase their rates and some insurers discontinued writing certain lines of coverage altogether. Purchasers of commercial, professional, and municipal liability coverage were suddenly faced with the problem of obtaining adequate liability coverage at affordable rates.

The shortage of adequate, affordable liability insurance became so severe that in 1986 and 1987 a number of measures were taken in Virginia to help alleviate the liability crisis. Some of these included the establishment of a market assistance plan, the creation of a medical malpractice joint underwriting association, the enactment of legislation allowing the formation of group self-insurance pools for local governments, the enactment of legislation allowing the formation of risk retention groups, the enactment of a law allowing the establishment of self-insurance pools for underground storage tank owners and operators, passage of the Birth-Related Neurological Injury Compensation Act, and passage of House Bill 1234 and House Bill 1235. Changes in tort law were also enacted including placing a $350,000 cap on punitive damages, limiting the liability of corporate officers and directors, revising the statute of limitations for minors in medical malpractice actions, granting limited

immunity to members of local governing bodies, and imposing sanctions for frivolous lawsuits.

Survey of Other States

The Bureau of Insurance reviewed the insurance laws of the fifty states to determine which states had established a joint underwriting association for commercial or professional liability insurance. Twenty-nine states have statutory language which gives their commissioners the authority to activate a medical malpractice joint underwriting association, and in nineteen of these states a joint underwriting association has been activated. Eighteen states have enabling legislation which allows for the formation of joint underwriting associations for other types of liability coverage. Of these, three states have activated joint underwriting associations. Massachusetts has a joint underwriting association which provides coverage for liquor liability. Florida has a joint underwriting association which provides coverage for commercial property and casualty insurance that cannot be obtained in the voluntary market. Minnesota has a joint underwriting association for liquor liability and another joint underwriting association for other commercial liability coverage.

Advantages and Disadvantages of Establishing a J.U.A.

Joint underwriting associations assure the availability of coverage that cannot be made reasonably available in the voluntary market. It may be in the public interest to establish a joint underwriting association whenever the lack of available insurance protection forces businesses to close down and professionals to discontinue their services.

While joint underwriting associations help the problem of availability they do not alleviate the problem of affordability. Joint underwriting associations initially charge the same rates as private insurance carriers because there is no other credible loss experience available. In addition, policyholders are usually required to pay a premium surcharge to help maintain a stabilization reserve fund which is used to cover deficits in loss reserves and ensure solvency.

Some of the disadvantages of establishing a joint underwriting association are as follows:

1. A joint underwriting association does not solve the fundamental problem which created the availability crisis in the first place.

2. Insurers may pull out of an already restricted market to avoid participation in a joint underwriting association.

3. Some joint underwriting associations have not operated successfully and are in financial trouble.

4. Some risks are not commercially insurable, i.e. environmental impairment liability and nuclear energy liability.

Recommendations

Based on the findings contained in this study, the State Corporation Commission recommends enacting a law, patterned after the Medical Malpractice Joint Underwriting Association provided for in Chapter 28 of Title 38.2 of the Code of Virginia, which would empower the Commission to activate a commercial liability insurance joint underwriting association. The Commission would be given the authority to determine, after hearing, whether certain lines or subclassifications of commercial liability insurance could no longer be made reasonably available in the voluntary market and the Commission could activate a joint underwriting association at that time.

SENATE JOINT RESOLUTION NO. 134

Requesting the Bureau of Insurance to study the feasibility of creating a liability insurance residual market facility and joint underwriting association to assure the availability of liability insurance.

Agreed to by the Senate, February 27, 1987
Agreed to by the House of Delegates, February 25, 1987

WHEREAS, the insurance industry has had a history of cycles ranging from one in which insurance has been readily available and affordable for all persons, professions and businesses to one in which rapid increases in premiums and tighter underwriting practices have made insurance unaffordable, unavailable or both; and

WHEREAS, there are individuals and businesses in certain professions and occupations which serve important societal purposes and are dependent on insurance protection that are currently unable to purchase liability insurance at all, or if able to do so, may only at exceedingly high premium rates; and

WHEREAS, it is appropriate that action be taken to facilitate the availability of liability insurance coverage to such persons, professions and businesses at fair and equitable rates during the downturn in the insurance cycle so that they may be able to serve the public interest at all times regardless of the insurance climate; and

WHEREAS, a reasonable precedent for the establishment of a liability insurance residual market facility is the Basic Property Insurance Residual Market Facility and Joint Underwriting Association which is provided for in Chapter 27 of Title 38.2 of the Code of Virginia; now, therefore, be it

RESOLVED by the Senate, the House of Delegates concurring, That the Bureau of Insurance is requested to study the feasibility of creating a liability insurance residual market facility and joint underwriting association whereby all insurers writing liability insurance in Virginia will be required to participate and share in the expenses and profits or losses of such facility and association on a fair and equitable basis.

The Bureau shall complete its work and report its findings and recommendations to the General Assembly prior to the 1988 Session.

INTRODUCTION

In 1987 the State Corporation Commission's Bureau of Insurance was requested by the General Assembly to study the feasibility of creating a liability insurance residual market facility and joint underwriting association to assure the availability of liability insurance in Virginia. This study was requested because liability insurance had become unavailable or unaffordable for many individuals and businesses whose livelihood depended upon adequate insurance protection. Physicians, nurses, architects, corporate directors, day-care centers, and municipalities were among the hardest hit by the liability insurance crisis. It is necessary to understand the origins of the crisis as well as the efforts taken to alleviate the crisis in order to determine the need for establishing a joint underwriting association and its potential impact on the insurance climate in Virginia.

The Liability Crisis

In 1985, after several years of competitive pricing practices, insurers began to increase their rates and some insurers discontinued writing certain lines of coverage altogether. This change in market conditions was so drastic that it became known as a "liability insurance crisis." Certain economic conditions led to the crisis.

Between 1979 and 1984 the property and casualty insurance industry in the United States began to experience dramatic increases in underwriting losses. At the same time, intense competition for market share among insurers forced premiums down to inadequate levels, compounding the financial loss to insurers. Until 1983 investment income had been able to offset underwriting losses. However, as interest rates declined, so did investment income. The result was a reduction in insurers' surplus.

Insurers tried to compensate for their increased losses by raising prices and withdrawing from segments of the market that had produced large claims. Soaring costs and a shortage of liability insurance took a toll on businesses, professionals, and local governments across Virginia. Some were forced out of business; others were forced to "go bare" because they could no longer afford the coverage being offered or they were unable to obtain insurance at any cost.

A number of measures were taken in Virginia between 1986 and 1987 to help alleviate the liability crisis. Many of these measures were designed to address the availability problem while others were designed to address the problem of affordability. Several changes in tort law were also enacted to ease the crisis. These measures can be summarized as follows:

Measures Taken to Ease Availability Problems

1. The Virginia Market Assistance Plan was established and became operational in Janaury, 1986. This was a voluntary plan which was created to assist commercial insurance buyers in obtaining difficult-to-place commercial lines

liability coverages. Because of the improved availability for the various lines for which the Plan was established, the Plan was dissolved by the Commissioner of Insurance in April, 1987.

2. A medical malpractice joint underwriting association was activated in November, 1986. This was established pursuant to Chapter 28 of Title 38.2 of the Code of Virginia for the purpose of providing medical malpractice insurance which was not reasonably available in the voluntary market. As of August, 1987, 292 physicians had secured coverage through the program.

3. Group self-insurance pools for municipalities were given the authority to form pursuant to the 1986 enactment of Chapter 11.1 in Title 15.1 of the Code of Virginia. The regulation of these pools was assigned to the State Corporation Commission which, effective September 1, 1987, issued rules governing these group self-insurance pools. So far two pools have been licensed by the State Corporation Commission.

4. A new chapter was added to Title 38.2 of the Code of Virginia in 1987 for the purpose of allowing the formation and operation of risk retention groups. Risk retention groups are corporations or associations formed for the primary purpose of assuming and spreading all or any portion of the liability exposure of its members. Members of a risk retention group must have a similar or related business liability exposure. There have not been any risk retention groups chartered in the Commonwealth; however, 21 groups chartered outside of the Commonwealth have filed the necessary information with the Commission to operate in Virginia.

5. A new law was enacted on July 1, 1987 which allows for the establishment of group self-insurance pools for underground storage tank owners and operators who are unable to meet the financial responsibility requirements set forth in Title 62.1 of the Code of Virginia. The State Corporation is in the process of promulgating rules for the formation and operation of these pools.

6. The Birth-Related Neurological Injury Compensation Act was passed in 1987 to provide funding for certain injuries to infants at the time of labor, delivery, or during the immediate post-delivery period. This program will become operational January 1, 1988.

Measures Taken to Ease the Affordability Crisis

1. With the enactment of House Bill 1234 in 1987, an amendment to Chapter 22 of Title 38.2 was made to require all liability claims for personal injury or property damage filed against policies insuring commercial entities to be reported to the Commission.

2. House Bill 1235 amended Chapter 2 of Title 38.2 in 1987 by requiring insurers of certain commercial policies to provide notice to policyholders of reduction in liability coverage as well as notice of any rate increases of more than 25%.

3. House Bill 1235 also made several changes in Chapters 19 and 20 of Title 38.2 by requiring insurers to consider Virginia loss experience whenever it is relevant and actuarially sound and to require the State Corporation Commission to submit an annual report to the Attorney General and the General Assembly to indicate the level of competition among companies insuring commercial entities in Virginia.

Tort Reform Measures

A number of tort reform measures were also enacted in 1987. These included placing a $350,000 cap on punitive damage awards, limiting the liability of corporate officers and directors, revising the statute of limitations for minors in medical malpractice actions, granting immunity to members of local governing bodies except in cases of gross negligence, limiting jury service exemptions, and imposing sanctions for frivolous lawsuits. These measures were enacted pursuant to the recommendations made by the joint legislative subcommittee established in 1986 under Senate Joint Resolution No. 22.

HOW JOINT UNDERWRITING ASSOCIATIONS OPERATE

A joint underwriting association is a pooling mechanism that provides coverage otherwise not available in the voluntary market. Generally, a joint underwriting association is activated upon a directive by the insurance commissioner after determining that a specified coverage is no longer available in the voluntary market. All insurers licensed to write property and casualty insurance in a state where the joint underwriting association is activated are usually required to become members of the joint underwriting association as a condition of their authority to continue writing business in that state.

Joint underwriting associations generally operate through servicing carriers which issue the policies, handle the collection of premiums, and process claims. Joint underwriting associations operate subject to the supervision of a board of directors which consists of representatives of the insurance companies participating in the joint underwriting association.

Most joint underwriting association laws provide that if the association experiences a deficit from losses, policyholders are assessed some specified percentage of their annual premium. Some laws require that a stabilization reserve fund be established to finance deficits in loss reserves. This fund is maintained by means of a surcharge on the joint underwriting association's policyholders until the fund reaches a certain level deemed appropriate by the commissioner. Most laws require any remaining deficit to be recovered from the member insurers participating in the association. In most cases, a member insurer is required to pay the deficit assessment based on the proportion that the net direct premium of such member written during the preceding calendar year bears to the aggregate net direct written premiums in the state by all members of the joint underwriting association. Most joint underwriting association laws also contain provisions which allow insurers to recover their assessments. The most common method of recoupment is through a prospective rate increase. In Virginia, member insurers of the medical malpractice joint underwriting association are allowed to recover any assessments made by the association by deducting the member's share of the deficit from future premium taxes due the Commonwealth.

SURVEY OF OTHER STATES

The Bureau of Insurance began its study by surveying the insurance laws of the fifty states to determine which states had established a liability insurance joint underwriting association or had passed enabling legislation providing the commissioner or director of insurance with the necessary authority to establish a liability insurance joint underwriting association. A review was made of medical malpractice joint underwriting associations as well as other types of commercial or professional liability joint underwriting associations.

Medical Malpractice J.U.A.s

Twenty-nine states have the statutory authority to activate a medical malpractice joint underwriting association, and in nineteen of these states such a joint underwriting association has been established. These states are shown below:

States Where a Medical Malpractice J.U.A. Has Been Established	States Where a Medical Malpractice J.U.A. May Be Established
* California	Alabama
Florida	Arizona
Kansas	Colorado
* Maine	Delaware
Massachusetts	Hawaii
Minnesota - activated in 1985	Idaho
Montana - reactivated in 1985	Iowa
Nevada - became a stock company	Kentucky
New Hampshire	Missouri
* New Jersey	Vermont
New York	
* Ohio	
Pennsylvania	
Rhode Island	
South Carolina	
* Tennessee	
Texas	
Virginia - activated in 1986	
Wisconsin	

* No longer writing business

In June, 1987 a report entitled "Financial Condition of Medical Malpractice J.U.A.s" was prepared by the Alliance of American Insurers for the National Coordinating Committee on Medical Malpractice Joint Underwriting Associations. This committee was originally created in the late 1970's and was reactivated in 1985. One of its charges was to collect data on the financial condition of the medical malpractice joint underwriting associations that had been operating since the late 1970's, i.e. the joint underwriting associations in Florida, Kansas, Massachusetts, New Hampshire, New York, Pennsylvania, Rhode Island, South Carolina, Texas, and Wisconsin. The major findings contained in this report can be summarized as follows:

1. Five joint underwriting associations were estimated to have insufficient funds to pay all existing claim liabilities. These joint underwriting associations were Massachusetts, New Hampshire, New York, Rhode Island, and South Carolina. Massachusetts had the largest deficiency with $182.3 million and South Carolina had the smallest with a $4.1 million deficiency. The other five joint underwriting associations in Florida, Kansas, Pennsylvania, Texas, and Wisconsin appeared to have sufficient funds to pay existing claim liabilities.

2. No joint underwriting association other than Texas had ever assessed its members even though private insurers may be assessed to cover deficits in each of these states except Kansas and Pennsylvania.

3. In 1985, the market share of each joint underwriting association ranged from as little as 3.2% in Pennsylvania to 87.4% in Rhode Island.

4. Three joint underwriting associations had a negative cash flow in 1985. These were Kansas, Florida, and Wisconsin.

According to a 1986 report written by a Legal Action Task Force appointed by the Insurance Commissioner of Washington State, two medical malpractice joint underwriting associations have been successful. Nevada's joint underwriting association became profitable and is now a stock company and Ohio's joint underwriting association remained solvent and has refunded some of the stabilization reserve fund. The last policy issued by the Ohio J.U.A. was in 1980.

Other Commercial or Professional Liability J.U.A.s

In addition to medical malpractice joint underwriting associations, eighteen states have passed enabling legislation which allows for the formation of joint underwriting associations for other types of commercial or professional liability coverage. Of these, three states have activated joint underwriting associations. These states are shown as follows.

States Where a Liability J.U.A. May Be Established	States Where a Liability J.U.A. Has Been Established
Arizona	Florida (currently being established)
California	Massachusetts
Colorado	Minnesota
Kentucky	
Maryland	
Montana	
New Hampshire	
New York	
North Carolina	
Ohio	
South Carolina	
Tennessee	
Utah	
Vermont	
Washington	

The joint underwriting association in Massachusetts provides coverage for liquor liability. Florida's joint underwriting association provides coverage for commercial property and casualty insurance that cannot be obtained in the voluntary market and Minnesota has both of these types of joint underwriting associations.

The legislation authorizing Florida's joint underwriting association was passed in 1986 and has been challenged in court by the insurance industry. The matter has been filed in Florida's district court, but has not yet been heard. In the meantime, an order mandating the implementation of the association's plan of operation has been issued by the insurance commissioner. In order to be eligible for this joint underwriting association, coverage must be unavailable in the voluntary market, including the market assistance plan and the surplus lines market. Also, coverage must be required by law or the insured must demonstrate that failure to secure coverage would substantially impair the business' ability to operate. Finally, the risk must be considered insurable by the Risk Underwriting Committee which is a three-member committee appointed by the insurance commissioner, the market assistance plan, and the industry. All licensed property and casualty insurers are required to participate in the joint underwriting association. Deficits may be offset by assessments made against both policyholders and insurers participating in the plan.

Massachusetts has a liquor liability joint underwriting association which requires the participation of all insurers licensed to write personal injury liability coverage in the state. The joint underwriting association has only been in operation since 1986 and had a $10 million written premium volume in 1986. Figures on the association's annual operating expenses were not available at the time of the survey. The association may recover any deficits by an assessment against its policyholders, or a prospective rate increase, or both.

In addition to a liquor liability joint underwriting association which was established in 1985, the state of Minnesota enacted legislation in 1986 to implement a joint underwriting association to provide liability insurance coverage to persons or

entities unable to obtain insurance through ordinary methods if the insurance is required by law or is necessary to earn a livelihood or conduct a business and serves a public purpose. Before the joint underwriting association provides coverage, an attempt is made to obtain coverage through the market assistance plan. The joint underwriting association is prohibited by statute from issuing either products liability coverage or environmental impairment liability coverage. It is also exempt from writing medical malpractice coverage and liquor liability coverage since other state insurance pools exist to provide these coverages. The association is specifically authorized by statute to provide coverage to day-care providers, foster parents and homes, developmental achievement centers, group homes, and sheltered workshops for mentally, emotionally, or physically handicapped persons, and citizen participation groups. Every insurer authorized to write property and casualty insurance in the state is required to become a member of the association as a condition of retaining a license to do business in the state. As of the end of September, 1987 the association had issued 150 policies. The association's written premium volume in 1986 was $160,000 and its annual operating expense for 1986 totaled $71,000. Any deficits remaining after the stabilization reserve fund has been exhausted are required to be offset by assessments levied against all member insurers participating in the plan. Assessments may be deducted from the member's past or future premium taxes due the state. The Minnesota J.U.A. has been given the authority to issue general liability coverage for the following types of businesses:

Riding stables
Waterslides
Landfills
Day care providers
Foster parents and foster homes
Developmental achievement centers
Group homes
Sheltered workshops
Citizen participation groups
Non-profit agencies (both general liability and directors and officers)
Resorts
Crane operators
Paid guardian programs (professional liability)
Ladder equipment testing services
Watershed districts (public officials)
Asbestos abatement contractors
Design engineers
Public health professionals
Ski jumps
Water resources engineers
Industrial safety and health consultants
Structural engineers
Maternal and child health care coordinators
Mechanical contractors
Systems analysis/software design and program services
County park districts
Special events coverage for community celebrations
Canoe outfitters

Grain buyers and grain warehouse operators (grain storage/buyers bonds)
Private security firms
Banker's blanket bonds
Hydrogeologists
Medical equipment sales and rental

Of the fifteen states that have been given the statutory authority to establish a commercial or professional liability joint underwriting association but have not yet done so, twelve states have the authority to activate one or more facilities for any line of property and casualty insurance not available in the voluntary market. Arizona, California, Colorado, and Tennessee exclude hazardous waste or environmental impairment liability insurance from the lines required to be offered by the joint underwriting association. Three states have been given the authority to activate a liability joint underwriting association for a specific class of insurance. In Washington, for example, the authority exists for a day-care liability joint underwriting association only. In South Carolina a professional liability joint underwriting association for architects and engineers, etc. may be activated as well as a legal professional joint underwriting association. A medical malpractice joint underwriting association has already been created in South Carolina. In Kentucky three separate facilities may be activated for medical malpractice insurance, legal professional liability insurance, and commercial insurance (excluding hazardous waste and environmental impairment liability insurance).

Of the same fifteen states that have been given the statutory authority to establish a liability joint underwriting association but have not yet implemented such a program, all have set up market assistance plans to deal with the problem of insurance availability. In fact, all fifty states except for seven have set up market assistance plans. Those states which have never established a market assistance plan to help deal with the recent liability crisis are Alaska, Iowa, Massachusetts, Nebraska, Oregon, West Virginia, and Wyoming.

ADVANTAGES AND DISADVANTAGES OF ESTABLISHING A JOINT UNDERWRITING ASSOCIATION

Joint underwriting associations assure the availability of coverage that cannot be made reasonably available in the voluntary market. All insurers licensed to write a specified line of coverage are required to participate and share in the losses and expenses of operating the program. Joint underwriting associations are a type of pooling mechanism that can be used to help alleviate the problem of insurance availability. Joint underwriting associations provide a public service by offering protection to individuals and businesses that might otherwise have to "go bare." It may be in the public interest to establish a joint underwriting association whenever the lack of available insurance protection forces businesses and professionals to close their doors or discontinue their services, especially when the elimination of those services may adversely affect the citizens of Virginia.

One of the drawbacks of relying on a joint underwriting association is that while it does help the problem of insurance availability it does not alleviate the problem of affordability. Joint underwriting associations initially charge the same rates as private insurance carriers because there is no other credible loss experience available. In addition, policyholders are usually required to pay a premium surcharge to help maintain a stabilization reserve fund which is used to cover deficits in loss reserves and ensure solvency.

Insurers are generally opposed to the establishment of joint underwriting associations for several reasons. First of all, the insurance industry is a competitive business and if a particular line of coverage becomes unavailable, there is usually a valid reason why insurers are unwilling to write the coverage. Establishing a joint underwriting association will not solve the fundamental problem that exists for that line of coverage. Secondly, joint underwriting associations may restrict the market even further by forcing some insurers to withdraw from the market altogether in order to avoid participation in the association. Finally, some of the medical malpractice joint underwriting associations that have been established are experiencing financial problems which may be attributed to increased loss frequency and severity as well as inadequate premium levels and reserves. It should also be mentioned that some risks are considered commercially uninsurable because the loss exposure cannot be accurately measured or the exposure extends beyond the financial ability of any company to underwrite. Therefore, many companies are opposed to a joint underwriting association that provides coverage for all lines of liability insurance unless certain lines such as environmental impairment liability and nuclear energy liability are excluded.

RECOMMENDATIONS

The State Corporation Commission concludes that there are valid arguments supporting the decision to give the Commission the statutory authority to establish a joint underwriting association for any line or subclassification of commercial liability insurance.

The State Corporation Commission recognizes the cyclical nature of the insurance business and acknowledges that during the "hard market" when certain lines of insurance become unavailable, the establishment of a mechanism that will ensure adequate protection for the citizens of the Commonwealth may well be considered in the public interest. However, the market in Virginia appears to be showing signs of improvement and the establishment of a joint underwriting association may not be considered necessary at this time. The recent dissolution of the Virginia Market Assistance Plan lends credence to this point of view.

The State Corporation Commission, therefore, recommends that the General Assembly enact a law which will give the Commission the statutory authority to activate a commercial liability insurance joint underwriting association should the need arise for such a joint underwriting association at some future point in time. Such a law should be modeled after the Medical Malpractice Joint Underwriting Association found in Chapter 28 of Title 38.2 of the Code of Virginia. The Commission would be given the authority to determine, after hearing, whether certain lines or subclassifications of commercial liability insurance could no longer be made reasonably available in the voluntary market and the Commission could activate a joint underwriting association at that time. Certain lines or subclassifications could be exempted from the joint underwriting association if those lines or subclassifications were deemed to be outside of the scope of the joint underwriting association.

The Appendix at the back of this report contains proposed language which could be added as a new chapter under Title 38.2 of the Code of Virginia. This would serve as the enabling statute to establish a joint underwriting association for certain lines or subclassifications of commercial liability insurance if those lines or subclassifications became unavailable in the voluntary market.

CONCLUSION

The State Corporation Commission recommends proposing legislation which will provide the Commission with the statutory authority to activate a liability insurance joint underwriting association if it is determined that certain lines or subclassifications of commercial liability insurance cannot be made reasonably available in the voluntary market. The State Corporation Commission suggests that the establishment of such a joint underwriting association not be made mandatory at this time. The insurance cycle appears to be heading in a more competitive direction again and a number of measures have already been taken to help deal with the liability insurance crisis.

Senate Joint Resolution 134 states that the Basic Property Insurance Residual Market Facility and Joint Underwriting Association which is provided for in Chapter 27 of Title 38.2 of the Code of Virginia is a reasonable precedent for the establishment of a liability insurance residual market facility. If proposed legislation is modeled after Chapter 27, a residual market mechanism will have to be implemented immediately. The State Corporation Commission has concluded that immediate implementation is not necessary and that the Medical Malpractice Joint Underwriting Association which is found in Chapter 28 of Title 38.2 of the Code of Virginia would serve as a more appropriate model for any proposed legislation. The Appendix contains suggested language for this proposal.

APPENDIX

CHAPTER 53.*

Commercial Liability Joint Underwriting Association.

§ 38.2-5300. Definitions. — As used in this chapter:

"Association" means a joint underwriting association established pursuant to the provisions of this chapter.

"Commercial liability insurance" means the commercial classes of insurance defined in §§ 38.2-117 and 38.2-118 but for the purposes of this chapter does not include medical malpractice insurance as defined in § 38.2-2800. The Commission may exclude from this definition any other line or subclassification of commercial liability insurance as it deems appropriate.

"Net direct premiums written" means gross direct premiums written in this Commonwealth on all policies of liability insurance less (i) all return premiums on the policy, (ii) dividends paid or credited to policyholders, and (iii) the unused or unabsorbed portions of premium deposits on liability insurance. For the purposes of this definition, "liability insurance" means the classes of insurance defined in §§ 38.2-117 through 38.2-119, and the liability portions of the insurance defined in §§ 38.2-124, 38.2-125 and 38.2-130 through 38.2-132.

§ 38.2-5301. Association activation; members; purpose; determinations by Commission; powers of association. — A. After investigation, notice, and hearing, the Commission shall be empowered to activate a joint underwriting association for any line or subclassification of commercial liability insurance if it finds that such insurance cannot be made reasonably available in the voluntary market for a significant number of any class, type, or group of risks to be insured under a

*Language is underlined to indicate differences between Chapter 28 and proposed Chapter 53.

commercial liability insurance policy. The association shall consist of all insurers licensed to write and engaged in writing the classes of insurance defined in §§ 38.2-117 through 38.2-119, and the liability portions of the insurance defined in §§ 38.2-124, 38.2-125 and 38.2-130 through 38.2-132 within this Commonwealth on a direct basis except those exempted from rate regulation by subsection C of § 38.2-1902. Each such insurer shall be a member of the association as a condition of its license to write such insurance in this Commonwealth.

B. The purpose of an association created under this chapter shall be to provide a market for any line or subclassification of commercial liability insurance on a self-supporting basis without subsidy from its members.

C. 1. An association created under this chapter shall not commence underwriting operations for any class, type or group of risks until it is activated by the Commission. At the direction of the Commission, the association shall commence operations in accordance with the provisions of this chapter.

2. If the Commission determines at any time that any line or subclassification of commercial liability insurance written by an association created under this chapter can be made reasonably available in the voluntary market for any class, type or group of risks, the association shall, at the direction of the Commission, cease its underwriting operations for that class, type or group.

D. The Commission shall also determine after investigation and a hearing whether the association shall be the exclusive source of commercial liability insurance for any class, type or group to be covered by the association and the type of policy or policies that shall be issued to any class, type or group. If the Commission determines that a claims-made policy will be issued to any such class, type or group, the Commission shall also provide for the guaranteed availability of insurance that covers claims that (i) result from incidents occurring during periods when the basic claims-

made policies are in force; and (ii) are reported after the expiration of the basic claims-made policies. The Commission may from time to time after an investigation and hearing reexamine and reconsider any determination made pursuant to this subsection.

E. Pursuant to this chapter and the plan of operation required by § 38.2-5304, the association shall have the power on behalf of its members to: (i) issue, or cause to be issued, policies of commercial liability insurance to applicants, subject to limits as specified in the plan of operation but not to exceed $1,000,000 for each claimant under any one policy and $3,000,000 for all claimants under one policy in any one year; (ii) underwrite the insurance and adjust and pay losses on the insurance; (iii) appoint a service company or companies to perform the functions enumerated in this subsection; (iv) assume reinsurance from its members; and (v) reinsure its risks in whole or in part.

§ 38.2-5302. Dissolution. -- A. When the association has ceased all of its underwriting operations by order of the Commission under subsection C of § 38.2-5301, it shall be subject during its continued existence to the following:

1. The association shall remain in existence for the sole purpose of completing its orderly dissolution;

2. The association shall refund to all of its members all preliminary assessments, contributions and other funds paid to the association that have not been reimbursed prior to dissolution; and

3. The board of the association shall satisfy and discharge its obligations and, subject to the approval of the Commission, shall have authority to do all other acts required to conclude its business affairs, including but not limited to, transfer of policies in force to approved carriers.

B. When the Commission finds the association has met its obligations incident to termination of its business affairs, the Commission shall by order issue a certificate of dissolution and the existence of the association shall cease.

§ 38.2-5303. Directors. -- A. The association shall be governed by a board of twelve directors. Two directors shall be appointed by each of the following three insurance industry trade associations: (i) the American Insurance Association; (ii) the Alliance of American Insurers; and (iii) the National Association of Independent Insurers. The Commission shall appoint two directors to represent insurers not affiliated with the insurance industry trade associations listed above. One director shall be appointed by each of the following two agent trade associations: (i) the Independent Insurance Agents of Virginia; and (ii) the Professional Insurance Agents Association of Virginia and the District of Columbia.

B. If any of the foregoing associations fail to appoint a director or directors within a reasonable period of time, the Commission shall have the power to make the appointments.

§ 38.2-5304. Plan of operation. -- A. Within forty-five days of the date the Commission makes a determination to activate a joint underwriting association pursuant to subsection A of § 38.2-5301, the directors of the association shall submit to the Commission for review a proposed plan of operation consistent with this chapter.

B. The plan of operation shall provide for economic, fair and nondiscriminatory administration and for the prompt and efficient provision of insurance. For purposes of administration and assessment, the plan of operation shall provide for the establishment of separate accounts for each line or subclassification of

commercial liability insurance for which the association was created. The plan shall contain other provisions including (i) preliminary assessment of all members for initial expenses necessary to commence operations, (ii) establishment of necessary facilities, (iii) management of the association, (iv) assessment of members to defray losses and expenses, (v) reasonable and objective minimum underwriting standards, (vi) acceptance and cession of reinsurance, (vii) appointment of servicing carriers or other servicing arrangements, (viii) the establishment of premium payment plans, (ix) procedures for determining amounts of insurance to be provided by the association, (x) procedures for the recoupment of preliminary assessments and temporary contributions by members, and (xi) any other matters necessary for the efficient and equitable operation and termination of the association.

C. The plan of operation shall be subject to approval by the Commission after consultation with the members of the association and representatives of interested individuals and organizations. If the Commission disapproves all or any part of the proposed plan of operation, the directors shall within fifteen days submit for review an appropriate revised plan of operation. If the directors fail to do so, the Commission shall promulgate a plan of operation. The plan of operation approved or promulgated by the Commission shall become effective and operational upon order of the Commission.

D. Amendments to the plan of operation may be made by the directors of the association, subject to the approval of the Commission.

§ 38.2-5305. Policy forms; applicants to be issued policies; cancellation of policies; rates; examination of business of association. -- A. All policies issued by the association shall be subject to the group retrospective rating plan and to the stabilization reserve fund required by § 38.2-5306. No policy form shall be used by the

association unless it has been filed with the Commission and either (i) the Commission has approved it or (ii) thirty days have elapsed and the Commission has not disapproved it as misleading or in violation of public policy.

B. Policies shall be issued by the association after receipt of the premium, or portion of the premium prescribed by the plan of operation, to applicants that (i) meet the minimum underwriting standards, and (ii) have no unpaid or uncontested premium due as evidenced by the applicant having failed to make written objection to premium charges within thirty days after billing.

C. Any policy issued by the association may be cancelled for any one of the following reasons: (i) nonpayment of premium or portion of the premium; (ii) suspension or revocation of the insured's license; (iii) failure of the insured to meet the minimum underwriting standards; (iv) failure of the insured to meet other minimum standards prescribed by the plan of operation; and (v) nonpayment of any stabilization reserve fund charge.

D. The rates, rating plans, rating rules, rating classifications, premium payment plans and territories applicable to the insurance written by the association, and related statistics shall be subject to the provisions of Chapter 20 of this title. Due consideration shall be given to the past and prospective loss and expense experience for <u>the line or subclassification of commercial liability</u> insurance written and to be written in this Commonwealth, trends in the frequency and severity of losses, the investment income of the association, and other information the Commission requires. All rates shall be on an actuarially sound basis, giving due consideration to the group retrospective rating plan and the stabilization reserve fund, and shall be calculated to be self-supporting. The Commission shall take all appropriate steps to make available to the association the loss and expense experience of insurers writing or having written

the same line or subclassification of commercial liability insurance in this Commonwealth.

E. All policies issued by the association shall be subject to a nonprofit group retrospective rating plan to be approved by the Commission under which the final premium for all policyholders of the association, as a group, will be equal to the administrative expenses, loss and loss adjustment expenses, and taxes, plus a reasonable allowance for contingencies and servicing. Policyholders shall be given full credit for all investment income, net expenses and a reasonable management fee, on policyholder supplied funds. Any final premium resulting from a retrospective adjustment will be collected from the stabilization fund set forth in § 38.2-5306. The maximum premium for all policyholders as a group shall be limited as provided in § 38.2-5306.

F. 1. The association shall certify to the Commission the estimated amount of any deficit remaining after the stabilization reserve fund has been exhausted in payment of the maximum final premium for all policyholders of the association. Within sixty days after such certification, the Commission shall authorize the association to recover from the members their respective share of the deficit.

2. Members shall be permitted to recover any assessment made by the association under subdivision 1 of this subsection by deducting the members' share of the deficit from future premium taxes due the Commonwealth. The amount of premium tax deduction for each member's share of the deficit shall be apportioned by the Commission so that in the aggregate the total premium tax deduction permitted for all members in any one taxable year shall not exceed 0.05 of one percent of the direct gross premium income for the classes of insurance in the account for which the member insurer is assessed. To the extent that the said 0.05 of one percent is reached

in any one taxable year any amount not so offset may be carried over to a subsequent year or years.

G. In the event that sufficient funds are not available for the sound financial operation of the association, subject to recoupment as provided in this chapter and the plan of operation, all members shall, on a temporary basis, contribute to the financial requirements of the association in the manner provided in this chapter. The contribution shall be reimbursed to the members by the procedure set forth in subsection F. 2. of this section.

H. The Commission shall examine the business of the association as often as it deems appropriate to make certain that the group retrospective rating plan is being operated in a manner consistent with this section. If the Commission finds that it is not being operated in a manner consistent with this section, it shall issue an order to the association, specifying (i) how its operation is not consistent and (ii) stating what corrective action shall be taken.

§ 38.2-5306. Stabilization reserve fund. -- A. When an association is activated under § 38.2-5301, a stabilization reserve fund shall be created. The fund shall be administered by five directors appointed by the Commission, one of whom shall be a representative of the Commission, two of whom shall be representatives of the association, and two of whom shall be representatives of the association's policyholders.

B. The directors shall act by majority vote with three directors constituting a quorum for the transaction of any business or the exercise of any power of the fund. The directors shall serve without salary, but each director shall be reimbursed for actual and necessary expenses incurred in the performance of his official duties as a

director of the fund. The directors shall not be subject to any personal liability with respect to the administration of the fund.

C. Each policyholder shall pay to the association a stabilization reserve fund charge equal to one-third of the annual premium due for the commercial liability insurance issued through the association until the fund reaches a level deemed appropriate by the Commission. The means of payment shall be set forth in the plan of operation and such shall be separately stated in the policy. The association shall cancel the policy of any policyholder who fails to pay the stabilization reserve fund charge. Upon the termination of any policy during the term of the policy, payments made to the stabilization reserve fund shall be returned to the policyholder on a pro rata basis identical to that applied in computing that portion of the premium which is returned to the policyholder.

D. All moneys received by the fund shall be held in a separate restricted cash account under the sole control of an independent fund manager to be selected by the directors. The fund manager may invest the moneys held, subject to the approval of the directors. All investment income shall be credited to the fund. All expenses of administration of the fund shall be charged against the fund. The moneys held shall be used solely for the following purposes: (i) to reimburse the Association for any and all expenses, taxes, licenses and fees paid by the Association which are properly chargeable or allocable to the stabilization reserve fund; or (ii) to pay any retrospective premium charge levied by the Association. Payment of retrospective premium charges and other authorized payments shall be made by the directors upon certification to them by the association of the amount due. If all moneys accruing to the fund are exhausted in payment of retrospective premium charges, all liability and obligations of the association's policyholders with respect to the payment of

retrospective premium charges shall terminate and shall be conclusively presumed to have been discharged.

E. The association shall promptly pay the fund manager of the fund all stabilization reserve fund charges that it collects from its policyholders and any retrospective premium refunds payable under the group retrospective rating plan provided for in this chapter.

F. Upon dissolution of the association, all assets remaining in the fund shall be distributed equitably to the policyholders who have contributed to the fund under procedures authorized by the directors. Distribution of assets remaining in the fund shall be made after final disposition of all claims, expenses, and liabilities against the fund, including reimbursement of preliminary organizational assessments made pursuant to subsection B of § 38.2-5304.

§ 38.2-5307. Participation in association by insurers. -- Each insurer that is a member of the association shall participate in the temporary contributions to finance the operation of the association in the proportion that the net direct premiums written by each member during the preceding calendar year bears to the aggregate net direct premiums written in this Commonwealth by all members of the association. However, the net direct premiums written by each member shall exclude that portion of premiums attributable to the operation of the association. Each insurer's participation in the association shall be determined annually on the basis of such premiums written during the preceding calendar year in the manner set forth in the plan of operation.

§ 38.2-5308. Review of actions or decisions of association. -- Any insurer, applicant or other person aggrieved by any action or decision of the association or of any insurer as a result of its participation in the association, may appeal to the board

of directors of the association. The decision of the board of directors may be appealed to the Commission within thirty days from the date the aggrieved person received notice of the board's action.

§ 38.2-5309. Annual statements. -- The association shall file an annual statement with the Commission within three months of the close of each fiscal year. The annual statement shall contain information on its transactions, condition, operations and affairs during the preceding fiscal year. The form and content of the annual statement shall be subject to the Commission's approval. The Commission may at any time require the association to furnish additional information on its transactions, condition or any matter connected with the association considered to be material and of assistance in evaluating the scope, operation and experience of the association.

§ 38.2-5310. Annual examination into affairs of association. -- The Commission shall examine the affairs of the association at least annually. The examination shall be conducted and the report of the examination filed in the manner prescribed in §§ 38.2-1317 through 38.2-1321. The expenses of each examination shall be borne and paid by the association.

§ 38.2-5311. Public officers or employees. -- No member of the board of directors of the stabilization reserve fund who is a public officer or employee shall forfeit his office or employment, or incur any loss or diminution in the rights and privileges associated with his office or employment, because of membership on the board.

§ 38.2-5312. Commissions for placing and servicing risk with association. -- For any commercial liability insurance policy issued by the association, the commission payable to the person that places the risk with the joint underwriting association or services the risk shall be limited to five percent of the annual premium for the policy or $1,000, whichever is less.

§ 38.2-5313. Liability. -- There shall be no liability imposed on the part of and no civil cause of action of any nature shall arise against the association, its board of directors, its agents, its employees, any service carrier, any participating insurer or its employees, any licensed producer, the Commission or its authorized representatives, or their members or employees, or any other committee established by the board of directors for any statements or actions made by them in good faith in carrying out the provisions of this chapter.