

November 4, 2008

CIRCULAR LETTER TO ALL MEMBER COMPANIES

Re: Guidelines for the Establishment of Escrow

The Bureau is advised by the Department of Insurance that the Department has issued Bulletin Number 08-B-06 dated October 28, 2008 directed to Presidents of member companies and dealing with the Bureau's implementation of private passenger automobile rates effective January 1, 2009 over the disapproval of the Commissioner. A copy of the Bulletin is attached. The purpose of this circular letter is to provide to the companies the Bureau's concerns with this Bulletin and the Bureau's understanding concerning the Department's intent in issuing this Bulletin. While the Bureau has had no direct input concerning this Bulletin, the Bulletin is substantively identical to the Department's Bulletin Number 02-B-1 dated January 31, 2002 with respect to the implementation of rates over the Commissioner's disapproval of the Bureau's 2001 Auto rate filing. The Bureau did have significant communications with the Department concerning Bulletin Number 02-B-1 and advised its member companies of the results of those communications by (link) [Circular Letter A-02-4](#) dated February 7, 2002. The Bureau has had no indication from the Department that the Department's position in Bulletin Number 08-B-06, (issued as a result of the Bureau's implementation of rates arising out of the February 1, 2008 Auto filing) has changed from its position with respect to Bulletin Number 02-B-1 (issued as a result of the Bureau's implementation of rates arising out of the May 1, 2001 Auto filing).

As set forth in the Bureau's Rules and Regulations on Implementation and Escrow Procedures, companies are required to place into an escrow account the purportedly excessive or unfairly discriminatory portion of the premium collected on all policies to which the disapproved rates apply. Companies must maintain records necessary for each company to determine by policy the difference, if any, between the rates collected by each company and the rates ultimately determined to be the approved rates. The methods by which each company accomplishes this directive are left to each company. The Bureau provided, by Circular Letter A-08-8 dated September 29, 2008 and Circular Letter A-08-9 dated October 20, 2008, information currently available regarding the rates implemented by the Bureau and the rates approved by the Commissioner. The rates ultimately determined to be the approved rates will not be known until the Bureau's appeal of the Commissioner's Order is resolved. If a company needs further information to maintain its records, please advise us and we will attempt to assist you with those records.

As the Bureau advised with respect to the implementation of escrow arising out of its 2001 Auto filing, the Bureau suggests that any company whose internal accounting may be adversely affected by the guidelines dealing with Accounting and Financial Statement Reporting requirements set forth in the Department's Bulletin Number 08-B-06 advise the Department in advance as to the problems the guidelines may cause and the methods by which that company will address the issues in its financial reporting.

As always, companies are required to adhere to the rules and regulations adopted by the Bureau that were furnished to the companies in the Bureau's Circular Letter A-08-9 dated September 29, 2008. Companies should consult with their own legal counsel with respect to the methods adopted for compliance with the Bureau's rules and regulations and with respect to the Department's Bulletin Number 08-B-06. If you or your counsel have any questions, please feel free to contact the Bureau.

Very truly yours,

F. Timothy Lucas

Personal Lines Manager

FTL:dms

A-08-10

Attachment

North Carolina Department of Insurance
Jim Long, Commissioner

BULLETIN

Number 08-B-06

TO: All North Carolina Rate Bureau Member Companies

SUBJECT: Guidelines for the Establishment of Escrow Subject to Future Refunds for the North Carolina Private Passenger Automobile Filing dated February 1, 2008

DATE: October 28, 2008

ATTENTION: PRESIDENT

On September 18, 2008 the Governing Committee of the North Carolina Rate Bureau (“the Bureau”) voted to appeal the order dated September 11, 2008 issued in the 2008 automobile rate case by the North Carolina Commissioner of Insurance (“the Commissioner”). The Commissioner’s Order disapproved the Bureau’s filed rates and ordered an overall rate level decrease of –16.1% for non-fleet private passenger cars and –11.2% for motorcycle liability. The Governing Committee further voted to implement overall rate levels of +9.4% for cars and 0.0% for motorcycle liability and to implement the filed bodily injury and property damage increased limits factors. The Bureau’s decisions were announced by two separate Circular Letters To All Member Companies, dated September 29, 2008 and October 20, 2008.

The September 29, 2008 Circular Letter provides as follows:

“As a result of the implementation of revised non-fleet private passenger automobile and motorcycle insurance rates over the disapproval of the Commissioner, in accordance with G.S. §58-36-25(b) . . . each individual company writing affected automobile or motorcycle insurance will be responsible for the establishment of and accounting for an escrow account in which to maintain ‘the purportedly unfairly discriminatory or excessive portion of the premium collected . . .’ (i.e. the difference between the -16.1% average reduction which has been ordered by the Commissioner and the +9.4% average increase for non-fleet private passenger automobile adopted by the Governing Committee and the difference between the -11.2% average reduction which has been ordered by the Commissioner for motorcycle liability insurance and the 0.0% average change adopted and Regulations on Implementation and Escrow Procedures is enclosed. Companies should consult legal counsel with respect to the mechanics of the escrow account.”

...

The October 20, 2008 Circular Letter provides, for purposes of establishing escrow, the expanded tables of bodily injury and property damage increased limits factors that result from the increased limits factors filed and implemented by the Bureau and those that result from the increased limits factors ordered by the Commissioner. These expanded tables were included in the Commissioner's Supplemental Order dated October 17, 2008.

The following guidelines will be utilized by the Commissioner in financial examinations and, in the event that the escrowed funds are ultimately distributed to policyholders, in refund examinations. These guidelines are provided to you at this time so that you may use them to avoid the many problems found during the examinations conducted for compliance with the refund orders in the 2001 and 2002 cases. Those examinations demonstrated a wide range of serious difficulties encountered by the many of the companies. In order to avoid compliance problems in the escrow for, and potential refund in, the 2008 rate case, companies should adhere to the following guidelines:

1. **Establishment of an Escrow Account:**

- (a) An escrow account supporting the escrow liability must be established with a qualified United States financial institution as defined in N.C. Gen. Stat. §58-7-26(c). An escrow account is required, unless there is a deviation that equals or exceeds the difference between the rates as ordered by the Commissioner and the rates as implemented by the Bureau, on a per coverage, per policy basis. An escrow account as defined by Black's Law Dictionary is "a bank account generally held in the name of the depositor and an escrow agent which is returnable to the depositor or paid to a third person on fulfillment of escrow condition" An escrow account should, therefore, be established with a third party financial institution so that "real" funds are available in the event that a refund is ordered. Standard bank forms are acceptable to establish the terms and conditions of an escrow account.
- (b) For purposes of escrowing and for calculating refunds in the future, policy is herein defined by term of coverage. Each six-month or one year term of coverage is, therefore, a separate policy. The amount to be escrowed and potentially refunded should be calculated for each individual policy, as herein defined, and records should be maintained accordingly.
- (c) Unless there is an offsetting deviation as described in (a) above, the amount placed in an escrow account for each policy must be based on the actual difference between the premiums collected by coverage and those that would have been collected using the Commissioner's ordered rates. This means each policy must be rated twice, and, where the premiums collected exceed the premiums that would have been collected using the Commissioner's ordered

rates, the difference must be placed in escrow. Calculations based on general formulae will not be acceptable.

- (d) Premiums collected for private passenger type exposures subject to these rates when written on commercial policies are also subject to escrow and refund procedures.
- (e) Policies subject to premium finance arrangements and the premium finance company utilized in each instance must be identifiable.
- (f) Companies are not required to escrow for "clean" risk ceded policies. The North Carolina Reinsurance Facility will escrow for these policies, but the companies shall maintain the records.
- (g) The escrow established for the 2008 rate case, as described herein, must be separate from any pending or future escrows.
- (h) Pooled escrow from subsidiaries held in a single account by a parent or pooled among subsidiaries is not acceptable.

2. **Accounting and Financial Statement Reporting Requirements:** Pursuant to N.C. Gen. Stat. §58-2-165(c), the following accounting and reporting requirements are prescribed for all funds subject to escrow:

- (a) **Statutory Statements:** All funds subject to escrow collected or to be received must be reported in a consistent manner in each statutory financial statement filed with this Department including the annual statement, quarterly statement, semi-annual statement and any monthly statement that may be specifically required.
- (b) **Accounting and Reporting:** The escrowed premium amounts will be charged to an expense account and reported as a separate write-in entitled "2008 Private Passenger Auto Escrow" under *Aggregate Write-Ins for Underwriting Deductions* in the Statement of Income. The corresponding liability will be recorded and reported as a separate write-in entitled "2008 Private Passenger Auto Escrow" under *Aggregate Write-Ins for Liabilities* in the Liabilities, Surplus and Other Funds section of the Balance Sheet.
- (c) **Escrowed Asset:** The escrowed assets must be disclosed in the Notes to Financial Statements under *Other Items* as segregated funds. The escrowed asset will not be required to be shown as a write-in under *Aggregate Write-Ins for Invested Assets* in the Assets section of the Balance Sheet. Interest earned on the escrowed account is not required to be escrowed.

- (d) Interest Payable on Potential Refund of Escrowed Amount: The potential interest payable to policyholders for the escrowed amount pursuant to N.C. Gen. Stat. §58-36-25 is not required to be accrued/reported as a liability or escrowed. The interest payable must be disclosed in the Notes to Financial Statements under *Contingencies*.
- (e) Separate Escrow Account: Escrow accounts must be held and reported by the direct writer and not the reinsurer. Pooled escrow from subsidiaries held in a single account by a parent or pooled among subsidiaries is not acceptable.
- (f) Accounting Records: Each insurer is to maintain records in accordance with N.C. Gen. Stat. §58-2-185. The records are to be in sufficient detail to support the escrow balance on a per policy basis. These records shall be maintained until released from obligation to do so by Order of the Commissioner.

3. **Refunds:**

- (a) If refunds are ordered under N.C. Gen. Stat. §58-36-25, the only offsets against the refund amount that shall be allowed are deviations (which are to be considered when calculating the amount for escrow) and unpaid premiums specifically attributable to each policy subject to refund. Neither dividends nor unpaid premiums attributable to policies not subject to refund may be used to offset the refund amount.
- (b) If refunds are ordered under N.C. Gen. Stat. §58-36-25, companies' refund calculations and procedures may be examined by the Department of Insurance pursuant to N.C. Gen. Stat. §58-2-131. Such examination shall be made electronically and all records should be maintained in order to facilitate the examination. Companies that do not properly maintain records or follow established regulations and statutes may be subject to penalties pursuant to N.C. Gen. Stat. §58-2-70.
- (c) If refunds are ordered under N.C. Gen. Stat. §58-36-25, the amounts refunded from escrow shall bear an interest rate to be computed by the Bureau pursuant to N.C. Gen. Stat. §58-36-25. The Bureau shall provide to the Department its calculation of the initial interest rate within 30 days from the effective date of the Bureau's implemented rates, which effective date is deemed to be January 1, 2008. The Bureau shall further provide updated interest rate calculations on each anniversary date as specified in N.C. Gen. Stat. §58-36-25.

4. **Maintenance of Records:**

- (a) Each insurer is to maintain records in accordance with 11 NCAC 19.0102, 19.0104, 19.0106, and 19.0107. Said records shall be maintained in sufficient detail such that, in the event of a refund, each policy can be re-rated upon examination. These records shall be retained until released from obligation to do so by order of the Commissioner.

Any questions concerning these requirements should be directed to Mr. Robert C. Mack, Deputy Commissioner of Property & Casualty Division, at (919) 733-3368.

cc: North Carolina Rate Bureau
Young Moore and Henderson