STATE OF NEW YORK
INSURANCE DEPARTMENT
25 BEAVER STREET
NEW YORK, NEW YORK 10004

George E. Pataki
Governor

Howard Mills
Superintendent

The Office of General Counsel issued the following opinion on November 3, 2005 representing the position of the New York State Insurance Department.

RE: Minimum Premium

Questions Presented:

1) May an authorized insurer issue a commercial general liability policy for which the premium is priced as a function of the insured's sales and which requires the payment of a minimum premium amount irrespective of the level of actual sales?

2) Would the location of the covered company in an "Enterprise Zone" have any bearing on this matter?

3) May an unauthorized insurer that issues a commercial general liability policy through a licensed excess line broker impose a percentage-based minimum earned premium?

Conclusions:

1) Whether an authorized insurer that issues a commercial general liability policy that is based on the insured's annual sales may impose a percentage-based minimum earned premium is dependent upon the insurer's ability to prove that the minimum earned premium filed equals the cost associated with issuing the policy. A percentage-based (rather than a flat charge) minimum earned premium would not be acceptable unless the percentage was limited so that it did not exceed the expenses of writing the business.

2) The location of the insured in an "Enterprise Zone" is irrelevant to this inquiry. While an insurer that is writing a special risk insurance policy (commonly referred to as the Free Trade Zone) is not required to file the rates or policy forms for such insurance, the insurer "must still satisfy the governing standards set forth in the Insurance Law and regulations." N.Y. Comp. Codes R. & Regs. tit. 11, § 16.0 (1995) (Reg. 86). Thus, whether such insurer may impose a percentage-based minimum earned premium is dependent upon the insurer's ability to prove that the minimum earned premium filed equals the cost associated with issuing the policy. A percentage-based (rather than a flat charge) minimum earned premium would not be acceptable unless the percentage was limited so that it did not exceed the expenses of writing the business.

3) An unauthorized insurer that issues a commercial general liability policy through a licensed excess line broker is not prohibited from imposing a percentage-based minimum earned premium, subject to N.Y. Ins. Law § 3428(a) and (d) (McKinney 2000 & Supp. 2005).

Facts:

A company has been offered general liability coverage from an insurer authorized to conduct business in the State of New York. The premium for this coverage is calculated at a fixed rate for each $1000 of sales based on an assumption that there will be $10,000,000 in sales annually. If sales exceed or fall below this target, the premium price is proportionately increased or reduced. However, in the event that sales fall below 80% of the target, total premium will be calculated on the basis of sales of 80% of the target, irrespective of the actual sales figure. In other words, in the event that sales fall short of the projected target, the insurer is effectively imposing a minimum premium.

Analysis:

Minimum Premium

N.Y. Ins. Law § 2303 (McKinney 2000) sets the standards for property/casualty insurance rates and it states: "Rates shall not be excessive, inadequate, unfairly discriminatory, destructive of competition or detrimental to the solvency of insurers. ..."

The Department has not disapproved minimum earned premium filings where the insurer has provided supportable evidence that the minimum earned premium equals the cost associated with issuing the policy. The purpose of allowing a minimum earned premium is to permit the insurer to recover the expenses of writing the business should the policy be canceled *prior to expiration*, or in the case of an auditable policy, where the audit results in a premium lower than the amount needed to cover the cost of writing the policy.

N.Y. Ins. Law § 3428(a) (McKinney 2000) states:

> Except as provided in subsection (e) of this section, whenever an insurance contract made or issued in this state is cancelled or otherwise terminated by the insured before the expiration thereof in accordance with the terms of such contract, the earned premium to be retained by the insurer shall be determined by the applicable rate filing, if any, otherwise in accordance with the provisions of such contract.

Thus, where an insured cancels a commercial general liability insurance policy, in accordance with the cancellation provisions of such contract, the insured is entitled to the return of any unearned premium based on the rates that the insurer filed with the Department, or where no rates have been filed (such as where the insurance is written in the Free Trade Zone, discussed *infra*), the unearned premium should be calculated based on the policy's provisions.

The Department has allowed minimum earned premium rates that have been in the form of a flat charge, rather than a percentage of the premium. Whether an authorized insurer that issues a commercial general liability policy, which is based on the insured's annual sales, may impose a percentage-based minimum earned premium is dependent upon the insurer's ability to prove that the minimum earned premium filed equals the cost associated with issuing the policy. A percentage-based (rather than a flat charge) minimum earned premium would not be acceptable unless the percentage was limited so that it did not exceed the expenses of writing the business.

In connection with the issue of the permissibility of the issuance of a policy of the type described above, it was also inquired as to the Department's enforcement in the event an authorized insurer violated the insurance law by marketing policies not in conformance with the law. The Department has very broad enforcement powers and has in the past required insurers found to have been in violation of the law to pay penalties, provide restitution to affected policyholders, and reform improper insurance contracts.

Free Trade Zone[1]

N.Y. Ins. Law § 6301(a) (McKinney 2000), subject to § 6301(b) and (c), authorizes the Superintendent to create exemptions from the requirement of the filing of special risk insurance policy forms and rates for authorized insurers. It states:

> (a) Notwithstanding any provision of this chapter, the superintendent shall, pursuant to regulations promulgated by him, permit exemption from filing requirements only with respect to rates and policy forms, where applicable, for any of the kinds of insurance authorized to be written in this state.
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> (b) No exemption pursuant to subsection (a) hereof shall be permitted in relation to the kinds of insurance set forth in paragraph one, two, three, fifteen, eighteen or twenty-three of subsection (a) of section one thousand one hundred thirteen of this chapter, or to coverage for personal lines to natural persons for non-business purposes. However, any risk pursuant to paragraph one, two or three of such subsection of such section of this chapter or personal lines risk (except private passenger, non-fleet automobile insurance) shall be exempt pursuant to subsection (a) hereof if it is included by the superintendent on the list maintained by him pursuant to subsection (a) of section six thousand three hundred three of this article.
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> (c) An exemption granted pursuant to this section shall apply only to authorized insurers complying with this chapter, except that it shall not apply to insurers subject to article sixty-six of this chapter. The exemption shall not be an exemption for joint underwriting or joint reinsurance transactions pursuant to section two thousand three hundred seventeen of this chapter.

N.Y. Comp. Codes R. & Regs. tit. 11, § 16.0 (1995) (Reg. 86) states:

> This part implements article 63 of the Insurance Law and establishes methods, procedures and reports for licensing, facilitating, monitoring and verifying compliance with the requirements of the Insurance Law. In effect, article 63 allows special risks that are jumbo in dimensions [sic] or exotic in nature to be written, free of filing rates or policy forms, in what is sometimes called the "Free Trade Zone." Although filing is not required, rates and policy forms applied to special risks must still satisfy governing standards set forth *in the Insurance* Law and regulations.

Although the rates and policy forms for insurance written in the Free Trade Zone are exempt from filing, an insurer is still bound by the same standards that are applied to rates that are required to be filed. N.Y. Comp. Codes R. & Regs. tit. 11, §16.5 (1995) (Reg. 86) states:

> The rates applies [*sic*] to policies issued pursuant to section 6301 of the Insurance Law shall not be excessive, inadequate, unfairly discriminatory, destructive of competition, detrimental to insurer solvency, or otherwise unreasonable. Each insurer shall maintain in its files the premium charged for each special risk and the basis for the rate or premium.

Thus, for the same reasons discussed above with respect to insurers that are subject to rate filing requirements, an insurer writing in the Free Trade Zone "must still satisfy the governing standards set forth in the Insurance Law and regulations." N.Y. Comp. Codes R. & Regs. tit. 11, § 16.0 (1995) (Reg. 86). Thus, whether such insurer may impose a percentage-based minimum earned premium is dependent upon the insurer's ability to prove that the minimum earned premium filed equals the cost associated with issuing the policy. A percentage-based (rather than a flat charge) minimum earned premium would not be acceptable unless the percentage was limited so that it did not exceed the expenses of writing the business.

Unauthorized Insurers

N.Y. Ins. Law § 2302(a) (McKinney 2000) states in relevant part: "This article shall apply to all kinds of insurance written on risks or operations in this state by an insurer **authorized** to do business in this state...." (emphasis added.) Thus, unauthorized insurers are not subject to Article 23 of the New York Insurance Law. In that regard, an unauthorized insurer that issues a commercial general liability insurance policy through a licensed excess lines broker is not prohibited by Article 23 from imposing a percentage-based minimum earned premium.

N.Y. Ins. Law § 3428(a) and (d) (McKinney 2000 & Supp. 2005) apply to unauthorized insurers. The minimum earned premium that an unauthorized insurer may retain upon policy cancellation is the amount provided for in the policy, whether shown in a flat dollar, percentage or other amount.

Financing and Retention of Premium

Finally, in cases where premiums are financed, N.Y. Ins. Law § 3428(e), provides as follows:

> Whenever an insurance contract, issued by or on behalf of an authorized insurer or insurers, the premiums for which are advanced under a premium finance agreement as defined in section five hundred fifty-four of the banking law, is cancelled, upon such cancellation the authorized insurer or insurers shall return the gross unearned premiums due under the insurance contract or contracts, on a pro rata basis to the bank, lending institution, premium finance agency or premium finance company, for the benefit of the insured, provided, however, that such authorized insurer or insurers shall be entitled to retain a minimum earned premium on the policy of ten percent of the gross premium or sixty dollars, whichever is greater.

N.Y. *Ins. Law* § 3428(e) (McKinney Supp. 2005).

Thus, when a policy's premiums have been financed, and the policy is canceled, an authorized insurer may not retain more than ten percent of the gross premium, or $60, whichever amount is greater. This maximum retention does not apply to unauthorized insurers.

For further information you may contact Supervising Attorney Michael Campanelli at the New York City office.

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1 The "Enterprise Zone" concept has no bearing on the N.Y. Insurance Law. Enterprise Zones (known in New York as "Empire Zones") are intended to promote economic development in the area designated as such. The term "Free Trade Zone" is, however, an insurance concept and is discussed in the accompanying text.