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**ADDITIONAL INFORMATION**

**TO MEMBERS OF THE COMMERCIAL AUTOMOBILE RESIDUAL MARKET  
STANDARDS SUBCOMMITTEE**

**FOR THE MEETING OF:**

**Thursday, March 22, 2018 at 10:30 a.m.**

**CRMS**

**18.04 Commercial Residual Market Issues**

Attached is the list of commercial residual market issues compiled by the Subcommittee, updated to reflect efforts to date. (Docket #CRMS18.04, Exhibit #3)

**CRMS**

**18.06 Standards for Validating the Principal Place of Business**

Proposed standards to be used by Servicing Carriers and Exclusive Representative Producers for validating Principal Place of Business are attached for the Subcommittee's consideration. (Docket #CRMS18.06, Exhibit #1)

**CRMS**

**18.07 Program Oversight and Auditing**

To assist the Subcommittee in its efforts to develop underwriting standards for managing the commercial residual market, attached is a description of CAR's proposed plan for a Focus Audit. (Docket #CRMS18.07, Exhibit #1)

JOHN METCALFE  
Director – Residual Market Services

Attachments

Boston, Massachusetts  
March 16, 2018

## Commonwealth Automobile Reinsurers

### Commercial Automobile Residual Market Standards Subcommittee

#### Commercial Residual Market Issues – Status as of March 22, 2018

The Subcommittee has compiled and prioritized a list of issues identified in its deliberations for continued discussion. The Subcommittee will formulate recommendations to the Commercial Automobile Committee for each item.

#### 1. Standards for Determining and Substantiating Principal Place of Business

At the December, 2017 and February 2018 meetings, discussion took place relative to the determination or substantiation of a risk's Principal Place of Business in order to confirm eligibility for placement in the MA commercial residual market. To address difficulties in substantiating Principal Place of Business arising from technological advances in today's marketplace, the Subcommittee recommended changes to Rule 2 - Definitions of CAR's Rules of Operation to include the nerve center test. The Subcommittee will next consider developing standards for substantiating the principal place of business for companies and producers to utilize.

**STATUS:** The Governing Committee approved the recommendation of the Commercial Automobile Committee to amend the definition of Principal Place of Business contained in Rule 2 – Definitions to incorporate the nerve center test. The proposed Rule changes were forwarded to the Division of Insurance for consideration in late February. If approved, staff will develop and publish a Bulletin providing further guidance to industry participants in determining a corporation's Principal Place of Business.

The Servicing Carriers have provided staff with examples of documentation that each uses to support the validation of a risk's principal place of business. This information was used to develop the standards that the Subcommittee will be considering at its meeting (separate attachment).

#### 2. Non-Fleet Private Passenger Types

The Subcommittee has discussed difficulties in confirming eligibility for risks classified as non-fleet private passenger types. At future meetings, the Subcommittee will further discuss potential enhancements including, but not limited to:

- Improvement of underwriting standards to encourage consistency among Servicing Carriers
- Validation of business entity
- Collection of Business Owner/Operator Information
- Sharing of Information

**STATUS:** As directed by the Subcommittee, staff is in the process of gathering information from Servicing Carriers relative to procedures used and documentation accepted to validate business entity and licensing. Based on the information collected and committee discussions to date, staff will draft standard procedures for consideration at a future meeting. In addition, staff will draft an operator exclusion endorsement and corresponding amendments to the manual rules for Subcommittee consideration in order to allow for the exclusion of a business owner not listed as an operator. Finally, staff is researching possible amendments to the manual rules that may provide further guidance relative to risks more appropriately written in the private passenger residual market with a business use classification.

### 3. Program Oversight and Auditing

After preparing and implementing recommendations resulting from discussion of various underwriting issues, the Subcommittee will review current audit procedures to ensure enhanced program oversight.

**STATUS:** At its February 2018 meeting, the Governing Committee indicated the need for CAR staff to begin developing an audit program for the commercial residual market. Accordingly, staff has developed a recommendation to begin performing a Focus Audit as preparation for the development of a more formal Audit Plan (separate attachment).

### 4. Radius of Operations for Truck and Bus Classifications

The Subcommittee noted that the radius of operation for truck and bus classes are not consistent. Pursuant to Rules 52 and 72 of CAR's Commercial Automobile Manual, radius for trucks is determined using the street address of principal garaging, and for buses using the motor vehicle's registration. The Subcommittee should discuss whether a change to either manual rule should be recommended.

**STATUS:** Staff is in the process of researching the genesis of revisions to the determination of radius class for bus classes, as well as the procedures of other states' residual markets, and will report on its research at a future meeting. In addition, staff is researching Servicing Carrier procedures for determining and documentation accepted to substantiate radius class, including the application of the 80/20 rule for intermediate radius classes, in order to draft standard procedures for Subcommittee consideration.

### 5. Rating Territory for Non-Zone Rated Public Classes

The Subcommittee noted that Rule 72.C.2. sets forth the determination of rating territory for public automobile classes. For non-zone rated risks, the rating territory is defined as the highest rated territory through or in which the public vehicle operates. However, the language does not specifically address the determination of territory for those risks that travel outside of Massachusetts. The Subcommittee should discuss whether an amendment to the determination of rating territory is recommended.

**STATUS:** Staff is researching the plans of other states to develop amendments for Subcommittee consideration at a future meeting.

### 6. Producer Requirements

The Subcommittee should review the provisions of Rule 14 – Exclusive Representative Producer Requirements of CAR's Rules of Operations in order to consider whether amendments are warranted. In addition, the Subcommittee has suggested potential enhancements to CAR's Producer Management System, including:

- The development of a producer profile that shows the distribution of the agency's book by classification.
- Reports that highlight those producers with significant volumes of any classifications or those with significant increases in any of the classifications.
- Using these reports, CAR may direct a Servicing Carrier to perform an audit of a producer's book of business to determine if any questionable practices were occurring.

## 7. Information Sharing

The Subcommittee has discussed opportunities to share information that may not be proprietary in nature or in conflict with statute and/or regulation, but that would be beneficial to the administration of the program (such as previous underwriting actions by a Servicing Carrier relative to cancellation for ineligibility, etc.). The Subcommittee will compile a list of data elements and collection methods.

## 8. Covered Automobiles

In order to protect against duplicate exposure within the commercial residual market, the Subcommittee should discuss whether limitations of certain ISO symbols are appropriate for the commercial residual market.

**STATUS:** Staff is researching FMCSA requirements to ascertain under what circumstances restrictions regarding the use of symbol 1 coverage would be appropriate and feasible.

## 9. Miscellaneous Risk Classification Issues

At a future meeting, the Subcommittee will discuss whether the language in the rating manual should be clarified to ensure consistency among Servicing Carriers in classification of risks. Examples raised to date include:

- Buses – Social Service vs. School vs. NOC
- Garage – Dealer Risk with some Repair vs. Repair Risk with some Dealer

## 10. Cancelled Risks being placed on other policies to avoid owed premium

The Subcommittee should further discuss this issue to determine whether strengthened controls are feasible and beneficial to the residual market.

## 11. Zone Rating for Truck and Bus Classifications

Subcommittee members noted that the use of garaging and/or registration location in the determination of radius class has enabled some risks to qualify for zone rating, even if the vehicles rarely, if ever, travel to that location. In addition, the Subcommittee noted that there are different rating methodologies for the physical damage coverages of the intermediate and long distance radius classes.

**STATUS:** In conjunction with its next rate filing, staff is in the process of a thorough analysis of zone rates, including primary rating factors and physical damage rating procedures. The Subcommittee will postpone its discussions of this topic until staff has completed its efforts in this regard.

### **Servicing Carrier Standards for Validating the “Nerve Center” Principal Place of Business**

In determining whether a risk is eligible for placement in the commercial automobile residual market, Servicing Carriers are required to validate whether or not the risk’s declared principal place of business meets the “nerve center” test. As such, operations taking place in the corporation’s “nerve center” would include, but not be limited to:

- Computer/monitoring systems that track the location of the vehicles
- Scheduling systems for vehicle operations and corresponding routes
- Systems for responding to vehicles requiring roadside or emergency assistance
- Payroll systems
- Depending upon the business operation, commensurate hours of operation
- Telephone systems to handle customer service, driver assistance, maintenance and repair, vendor and/or employee communications
- Treasury management systems for disbursing and collecting funds
- Administrative activities to support business operations

Note that a mail drop box, a bare office with a computer, or a location where executives only occasionally meet, does not qualify as Principal Place of Business for the purpose of determining eligibility for cession to the MA residual market.

Servicing Carriers should take advantage of the following options in determining risk eligibility relative to the principal place of business and “nerve center”:

- 1) Use of the Secretary of Commonwealth’s Corporations Division website to determine:
  - If the risk and/or the risk’s federal identification number (FEIN) is registered with the Corporations Division
  - Date of Origination
  - The identity of the risk’s officers, directors, partners and/or managers
  - The location of the risk’s principal office in Massachusetts
  - The state in which the risk was organized
  - Who signed the organizational documents for the risk
- 2) Use of an Internet search engine to determine if the risk has website for Massachusetts and/or other state operations and to verify office location(s) or if there is information relative to any of the corporate officers
- 3) Use of the RMV systems to determine if the risk’s officers, directors, partners and/or managers have a Massachusetts address/operator’s license and to determine if the risk previously was insured with a Massachusetts carrier
- 4) Review of loss runs, if available, to determine if the risk’s operations are in Massachusetts
- 5) Review of FMCSA filings, if applicable, to verify address on the risk’s new business application

The Servicing Carrier may also request the risk and/or Exclusive Representative Producer to provide additional information as noted, but not limited to the Exclusive Representative Producer Standards for Determining the “Nerve Center” Principal Place of Business. An SIU investigation may also be requested. As part of the underwriting process and/or SIU investigation, the risk’s principal/owner will be required to corroborate information collected by the writing Exclusive Representative Producer.

Pursuant to Rule 10 – Claims of CAR’s Rules of Operation, Servicing Carriers are required to conduct audits on representative samples of policies to verify garaging and policy facts. However, market conditions may warrant increased awareness and focus on specific classifications of business due to suspected fraud, increased loss experience, or other negative impacts on the commercial automobile residual market during the Servicing Carrier contract period. If such occasions occur, the specific classifications will be identified, through CAR’s committee process, for mandatory Servicing Carrier SIU investigations involving the principal place of business.

**Exclusive Representative Producer Standards for Determining the “Nerve Center” Principal Place of Business**

Exclusive Representative Producers should ascertain the following in determining risk eligibility relative to the principal place of business and “nerve center” prior to submitting a risk to their Servicing Carrier for placement in the commercial auto residual market:

- Whether the company is headquartered in Massachusetts and meets the definition of Principal Place of Business as specified in Rule 2 – Definitions of CAR’s Rules of Operation
- Whether company reports, documentation and financial records originate in the Massachusetts office
- How long has the company been at the Massachusetts location
- Whether the company has officers, directors, partners and/or managers residing in other states, and, if so, where
- Whether business/corporate decisions and orders solely emanate from the Massachusetts principal place of business of the company, and if not, described the corporate communications
- Whether the principal owner, officers, directors, partners and/or managers all reside in Massachusetts and if not, describe residency of each.
- The number of employees working out of the Massachusetts principal place of business. In Massachusetts? Out of state?
- Identify the registration of all vehicles. Registered in Massachusetts? Other states?
- Operators/Drivers for the company licensed/hired in Massachusetts
- How often the principal/owner of the company is in the company’s Massachusetts headquarter office
- Whether the payroll for the company is handled through the Massachusetts principal place of business location
- Hours of the Massachusetts principal place of business location of the company

At the Servicing Carrier’s request, the ERP/risk will be required to provide:

- A statement on the insured’s letterhead and signed by an executive officer describing its Massachusetts operations and confirming that risk meets the definition of Principal Place of Business as specified in CAR Rule 2
- Pictures of the MA location and garaging locations if different from MA mailing address
- Name and location of shop providing repair and maintenance on the vehicles
- Percentage of revenue derived from MA operations versus other states
- Tax returns
- A copy of the risk’s lease and/or other documents pursuant to the establishment of an operational office location in Massachusetts (utility bills, bank statements, tax documents, payroll records, workers comp. policy, etc.)

## Proposed Commercial Focus Audit

### Overview

At its February 14, 2018 meeting, the Governing Committee discussed staff's efforts to begin focus auditing of all Servicing Carriers in the commercial residual market. The Committee specifically noted concerns with Private Passenger Type (PPT) Non-Fleet and interstate bus risks as classes contributing most significantly to the growth of the residual market.

### Current Environment

Much of CAR's focus during 2017 has been to evaluate the risk concerns that have adversely impacted the commercial market and to develop a coordinated plan to improve results. The Commercial Auto Residual Market Standards Subcommittee is currently considering issues and identifying opportunities to standardize underwriting procedures among the Servicing Carriers. Procedure audits will be developed in the future from the standardization efforts of the Subcommittee. In the interim, staff will perform focus audits to gather additional information relative to Servicing Carrier handling of the above noted classes in order to aid in the development of standards and ensure consistent procedures going forward.

### Compliance Audit Overview

CAR's Compliance Audit Department currently conducts premium and claim statistical audits designed to test the quality of data reporting in accordance with the Commercial Statistical Plan. These audits address the accuracy of statistical reporting for ratemaking purposes. These audits are not intended to evaluate the quality of underwriting.

Compliance Audit also conducts claims Performance Standards and Special Investigations Unit (SIU) audits that measure the consistency of claims handling between the voluntary and residual markets, and the consistency of the audited company's SIU Department to industry Best Practices.

### Focus Audit Objective

The objective of the focus audit is to gather more detailed information regarding the Servicing Carrier's efforts to validate the *eligibility* of the risk in the residual market, validate the proper *classification*, and *rating* of the risk. Audit results should support the development of the residual market standards currently in process by the Commercial Auto Residual Market Standards Subcommittee.

### Focus Audit Sample Selection:

Staff has identified five classes of business on which to concentrate the initial focus audit based on concerns expressed in committee discussions to date, as well as an analysis of the five year loss ratios for each class. Staff has defined sample selections which will target 20 policies with losses for each Servicing Carrier within each of the five groupings for which data is reported. Samples from each group will not be randomly generated but will be selected intentionally by reviewing the associated statistical data and other supplemental resources utilized in the normal audit process. The five classes include:

1. Fleet Public Transportation: Charter Bus; zone rated (>200 miles)
  - Class Type 38 and Class Code 540900
2. Fleet Public Transportation: Charter Bus; intermediate (51 to 200 miles)
  - Class Type 37 and Class Code 549#00
3. Non Fleet Public Transportation: Charter Bus; zone rated (>200 miles)
  - Class Type 34 and Class Code 547900

## Proposed Commercial Focus Audit

4. Non Fleet Public Transportation: Bus Not Otherwise Classified; zone rated (>200 miles)
  - Class Type 34 and Class Code 587900
5. Private Passenger Type Non-Fleet: Vehicles used in business
  - Class Type 81 and Class Code 739100

All Servicing Carriers will also be asked to provide a count of risks that have been declined coverage through the residual market and a control report that identifies the reason(s) for declination. Staff will request documentation supporting the decision to deny coverage on a sample of the risks included on the control report. Sample selections will not exceed 20 risks in total.

### Requested Documentation

All Servicing Carriers will be audited remotely and concurrently. To obtain an accurate overview of residual market practices and procedures, CAR will require access to each Servicing Carrier's policy processing and claim systems. Access to all underwriting files including underwriting notes, premium systems, claim systems and SIU documentation where relevant will also be required. CAR may also follow up with additional requests while in the process of auditing.

For each sampled charter bus, the Servicing Carrier shall provide the Motor Carrier Number to enable verification of information through the Federal Motor Carrier Safety Administration (FMCSA).

### Focus Audit Report

CAR will produce a single audit report that objectively summarizes findings while not attributing results to a specific Servicing Carrier. The report objective is to provide an overview that is useful to the further development of standards pertaining to commercial automobile residual market issues.

For the five sampled groupings, the report will summarize information gathered and comment on:

- The eligibility of the risks in the residual market.
- The appropriateness of the classification of the risks.
- The appropriateness of the rating of the risks.
  - As CAR currently audits all Servicing Carriers biennially for the accuracy in rating based on statistical reporting, CAR will not conduct a complete rerating of the ceded policy but consider policy attributes with impact to rating.
- In accordance with Chapter III.B.3.e. of the Manual of Administrative Procedures, the report will comment on the Servicing Carrier's Loss Control Services including inspection of vehicles, driver and equipment evaluations, etc.
- Should the Servicing Carrier have obtained further information from the insured to research the sampled risks?
- Should the Servicing Carrier have forwarded the policy or loss to its SIU department for further investigation if it did not?

Specific to the those risks that have been declined coverage, CAR will compile an overall control report to share with the Committee and comment on both common and unique procedures employed by Servicing Carriers to confirm ineligibility for coverage in the MA commercial residual market.

## Proposed Commercial Focus Audit

### Audit Conclusion Procedures

The closing audit process will be primarily consistent with Chapter IX – Compliance Audit of the Manual of Administrative Procedures pertaining to the audits of Member Companies and Servicing Carriers. Findings will be included in the report as determined by CAR staff but will not identify results by naming Servicing Carriers.

The company may provide a response letter to the overall focus audit and include any additional comments it deems appropriate. Response letters will not be provided to the Committee without the Servicing Carrier's consent.

The report will be provided for consideration to the Compliance and Operations Committee and the Commercial Automobile Committee.