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The Availability and Pricing of Liquor Liability Insurance in the State of Michigan

**A market study issued by
Commissioner R. Kevin Clinton**

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Executive Summary

The Michigan Liquor Control Commission (MLCC) is the regulatory agency responsible for enforcing the Michigan Liquor Control Code of 1998 (the Act). Beginning April 1, 1998, the Act required liquor licensees to show proof of financial responsibility of at least \$50,000. Liquor licensees typically meet this requirement by purchasing a liquor liability insurance policy, but it can also be met by a surety bond or through membership in a limited liability pool created pursuant to the Michigan Compiled Laws (MCL) 500.6506.

The Commissioner of the Office of Financial and Insurance Regulation (OFIR) regulates the insurance marketplace. Michigan Compiled Laws 500.2409b requires the Commissioner to issue an annual report and certify whether liquor liability insurance is reasonably available at a reasonable price in Michigan.

The MLCC may waive liquor licensees' proof of financial responsibility requirement if the Commissioner certifies in an annual report prepared pursuant to the MCL 500.2409b that the market lacks reasonable availability of liquor liability insurance at a reasonable premium.

For the calendar year ended December 31, 2010, OFIR collected and analyzed data from different sources to determine whether liquor liability insurance is available in Michigan at a reasonable price. As a result of the study, the Commissioner concludes that liquor liability insurance is available in Michigan at a reasonable price.

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Introduction

Regulation of liquor sales in Michigan began with the enactment of PA 8 of 1933, known as the Dram Shop Act. This act was subsequently modified by PA 176 of 1986 and then repealed and replaced by PA 58 of 1998, the Michigan Liquor Control Code of 1998 (the Act). The MLCC is the regulatory agency responsible for enforcing the Act. Among other provisions, the Act prohibits the sale of liquor to minors and intoxicated persons. Liquor retailers that violate the laws are subject to fines, license revocation, and private rights of actions for physical damage, injuries, and deaths caused by intoxicated persons. Requiring liquor retailers to assume the liability for the illegal sale of liquor promotes responsibility in the sale of liquor and provides for a means of recovery for persons injured by the intoxicated person. To protect against these potential liabilities, liquor retailers typically purchase liquor liability insurance. Liquor liability insurance covers the legal defense costs in a liquor retailer's liquor liability lawsuits and pays the judgment of a settlement or award, up to the policy limits.

In 1985 and 1986, liquor liability licensees experienced the harsh side of the insurance market's underwriting cycle. Rates were high, availability of liquor liability insurance was scarce, and many Michigan liquor retailers were conducting business without insurance. To address this situation, the legislature passed PA 176 of 1986, which made substantial modifications to the Dram Shop Act. These amendments benefited both liquor retailers and the general public. Liquor retailers benefited from shortened timeframes under which injured parties could file notice of a claim, the rebuttable presumption that no liquor licensee, other than the last licensee, to sell, give, or furnish liquor to a minor or visibly intoxicated person was presumptively responsible, and the elimination of lawsuits by relatives of the intoxicated person. Requiring liquor retailers to show proof of financial responsibility to obtain or renew their liquor licenses and stronger sanctions for violations of the Act were intended to benefit the general public.

The first public hearing was held in October 1987 to determine whether liquor liability insurance was reasonably available in Michigan at a reasonable premium for liquor retailers in accordance with PA 173 of 1986. At the hearing, liquor retailers unanimously stated that liquor liability insurance was not reasonably available at a reasonable premium. However, the Commissioner found that, based on estimated loss ratios, projected profits, and the closeness of the premium charges to expected losses, liquor liability insurance was available at a reasonable premium. During 1986 and 1987, studies by the Commissioner showed that there were insurers writing liquor liability coverage in Michigan, including two limited liability pools. Beginning April 1, 1988, the Act required liquor licensees to show proof of financial responsibility of at least \$50,000. Liquor licensees typically meet this requirement by purchasing a liquor liability insurance policy, but it can also be met by the licensee providing a surety bond, cash, investment deposit, or letter of credit.

In January 1989, another public hearing was held to determine whether allowing formation of limited liability pools to issue liquor liability insurance policies was still needed. Only a few insurance company representatives attended this hearing and no one testified. No liquor licensees attended the hearing, and subsequently, the Commissioner received several no comment letters. Given the appearance that the market was adequately supplying this insurance, the Commissioner issued an order precluding the formation of any new limited liability pools to write liquor liability insurance.

The Commissioner of OFIR regulates, among other things, the liquor liability insurance marketplace. Michigan Compiled Laws 500.2409b requires the Commissioner to issue an annual report and certify whether liquor liability insurance is reasonably available and reasonably priced in Michigan. If, based on this annual report, the Commissioner certifies that liquor liability insurance is not available or is not available at a reasonable premium; the MLCC may waive the proof of financial responsibility requirement in accordance with MCL 436.1803(2). This report is the 20th report issued to meet this requirement.

Elements Considered in Determining Availability and Pricing of Liquor Liability Insurance

Michigan Compile Laws 500.2409b requires the report to be based on relevant economic tests, but not limited to those in Section 2409b. Therefore, this report is based on the following list of factors which shall be considered by the Commissioner for the purpose of determining the availability and pricing of liquor liability insurance in Michigan:

Factors

- (a) The extent to which any insurer controls the liquor liability insurance market in this state, or any portion thereof.**
- (b) Whether the total number of companies providing liquor liability insurance in this state is sufficient to provide multiple options to liquor licensees.**
- (c) The disparity among liquor liability insurance rates.**
- (d) The overall rate level must not be excessive, inadequate, or unfairly discriminatory.**
- (e) Any other factors the commissioner considers relevant.**

Data Collection

Admitted and surplus lines insurers writing business in Michigan are required to annually file reports, in addition to annual and quarterly financial statements, with the OFIR. One of the required reports for insurers authorized to write casualty insurance is to complete Form FIS 0118, Municipal/Liquor Liability Report of Premiums and Losses for Michigan. One purpose of the form is to collect data to use in the evaluation of the availability and pricing in the Michigan liquor liability insurance marketplace. The MLCC also provided data identifying the number of licensees insured by each insurer. Finally, a Commissioner inquiry was sent to the 20 insurers that represent more than 60 percent of the liquor liability insurance market to obtain data relative to the rates charged for liquor liability insurance by those companies.

Data Analysis

Factor (a) The extent to which any insurer controls the liquor liability insurance market in this state, or any portion thereof.

In order to determine the extent to which any carrier controls the liquor liability insurance market in Michigan, OFIR examined the data provided by the MLCC. The MLCC 2010 data showed there were 203 insurers providing at least the minimum (\$50,000) liquor liability financial responsibility coverage to 16,100 retail liquor establishments through an insurance policy. The MLCC reported that 99% of the licensees used a liability insurance policy to prove they are meeting the financial responsibility requirement.

Appendix A illustrates the market share percentages of insurers, ranked by the number of liquor licensees and businesses for which coverage has been written over the past 3 years. Appendix A shows that there has been considerable movement with insurers entering and exiting the liquor liability market. The free movement of insurers in and out of the yearly top 20 insurers is an indicator of a competitive market.

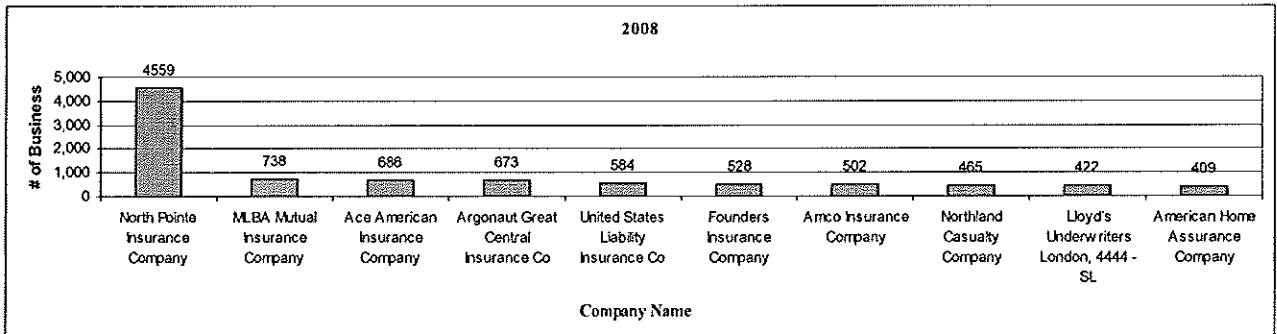
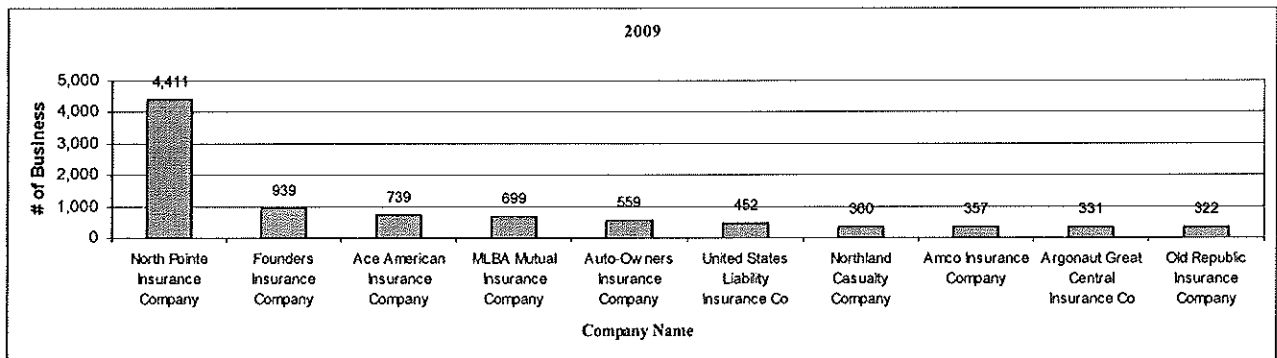
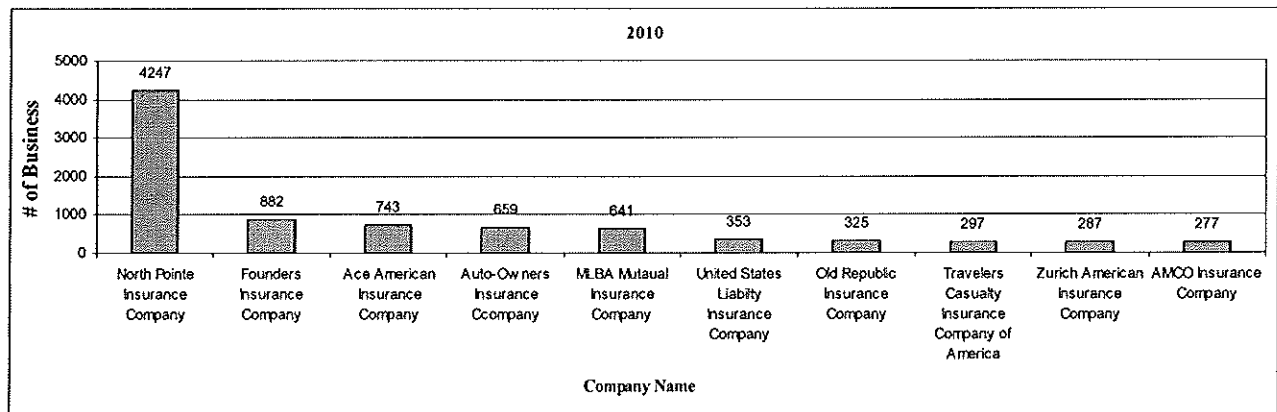
The data in Figure 1 and Appendix A demonstrates that competition exists in the liquor liability market in Michigan. Using the data submitted by carriers the Commissioner finds that:

- For the past three years, North Pointe Insurance Company has consistently held the largest market share of liquor liability insurance business in Michigan. Although there is a concentration of business with North Pointe, other carriers have been able to shift market position and enter and exit the market.
- In 2010, five carriers entered Michigan's listing of the top 20 liquor liability insurance providers by market share that were in the 2008 and 2009 reports. The five companies include, Harleysville Lake States Insurance Company, New Hampshire Insurance Company, Safety Casualty Insurance Company, West Bend Mutual Insurance Company, and Zurich American Insurance Company.
- Four carriers gained market share in 2010: Auto Owners Insurance Company, Frankenmuth Mutual Insurance Company, Founders Insurance Company, and Old Republic Insurance Company.
- Three carriers lost market share in 2010: Amco Insurance Company, MLBA Mutual Insurance Company, and Northland Casualty Company.
- Three carriers have maintained a stable position within the liquor liability market: Citizens Insurance Company of America, Michigan Millers Mutual Insurance Company, and United States Liability Insurance Company.

Factor (b) Whether the total number of companies providing liquor liability insurance in this state is sufficient to provide multiple options to liquor licensees.

As indicated under Factor (a), 203 insurers are providing liquor liability insurance to 16,100 liquor licensees in Michigan. Given the volume of carriers providing this coverage, liquor liability insurers are able to offer multiple options to businesses. Choices for retail liquor establishments to purchase liquor liability insurance in Michigan appear to be sufficient.

**Figure 1 - Three Year Comparison of Top Ten Insurers Based on Number of Businesses/Licenseses
(Changes in market share 2008 to 2010)**



Data provided by the Michigan Liquor Control Commission

Factor (c) The disparity among liquor liability insurance rates.

The diversity of rate classifications complicates comparisons of liquor liability insurance rates by insurers. While one insurer may offer a single rate by type of establishment such as bars and taverns, it is not unusual for another insurer to offer as many as eight rate classes based on the amount and type of entertainment. Insurers typically have different classes within license types which vary by percentage of revenues from liquor sales.

Besides rate classification systems, other rating tools within the liquor liability insurance market include the use of discounts, schedule rating, and individual risk modification that assign credits and debits of +/- 25% based on the licensee's claim experience and business practices. In addition to the requirement under MCL 500.2405 that compels carriers to develop and maintain a server training premium discount plan based upon the completion of a certified server training course that complies with the Act, carriers may design discounts that reflect differences in the exposure to potential hazards. Some activities for which licensees may earn premium credits include: establishment type, hours of operation, rules for handling an obviously intoxicated person, and security measures implemented by the proprietor. These rating tools create an environment in the liquor liability insurance market which allows licensees to be rewarded for certain business practices or penalized if licensees do not actively take steps to safely sell and manage liquor at their establishment. Due to these modifications and classifications it is difficult to compare liquor liability insurance rates.

Factor (d) The overall rate level must not be excessive, inadequate, or unfairly discriminatory.

The MCL 500.2403b(1)(d) provides among other things that a rate shall not be held to be excessive unless the rate is unreasonably high for the insurance coverage provided and a reasonable degree of competition does not exist with respect to the classification, kind, or type of risks to which the rate is applicable. Also, a rate shall not be held to be inadequate unless the rate is unreasonable low for the insurance coverage provided and the continued use of the rate endangers the solvency of the insurer. Finally, rates are not unfairly discriminatory if they are averaged broadly among persons insured on a group, franchise, blanket policy, or similar basis. In reviewing responses to the "Rate Survey of Selected Liquor Liability Carriers" sent out by OFIR for 2010 rate and minimum premium information, overall premium rate levels are not excessive, inadequate, or unfairly discriminatory in compliance with MCL 500.2403(1)(d).

Insurers have revised their classification structures to better reflect the market's conduct. Many insurers, for example, now divide the restaurant and bar/tavern classifications into subgroups according to the ratio of food to liquor served, or the type and amount of entertainment offered. Where risk classifications for rating purposes were previously based on six to seven classes of retail liquor licenses, insurers now further segment these classes based on various characteristics of the individual business. This practice enables an insurer to attract low risk business with a license class with lower rates while maintaining an acceptable loss ratio by having higher rates for higher risk licensees. This change in underwriting approach is good for licensees because they can tailor their insurance coverage to meet their business needs.

Factor (e) Any other factors the commissioner considers relevant.

Two additional factors that the commissioner considers relevant in the liquor liability insurance market in Michigan include the declining presence of surplus lines carriers in this market and the exceptional quality of insurers based on A.M. Best ratings.

Non-Admitted Insurers (Surplus Lines)

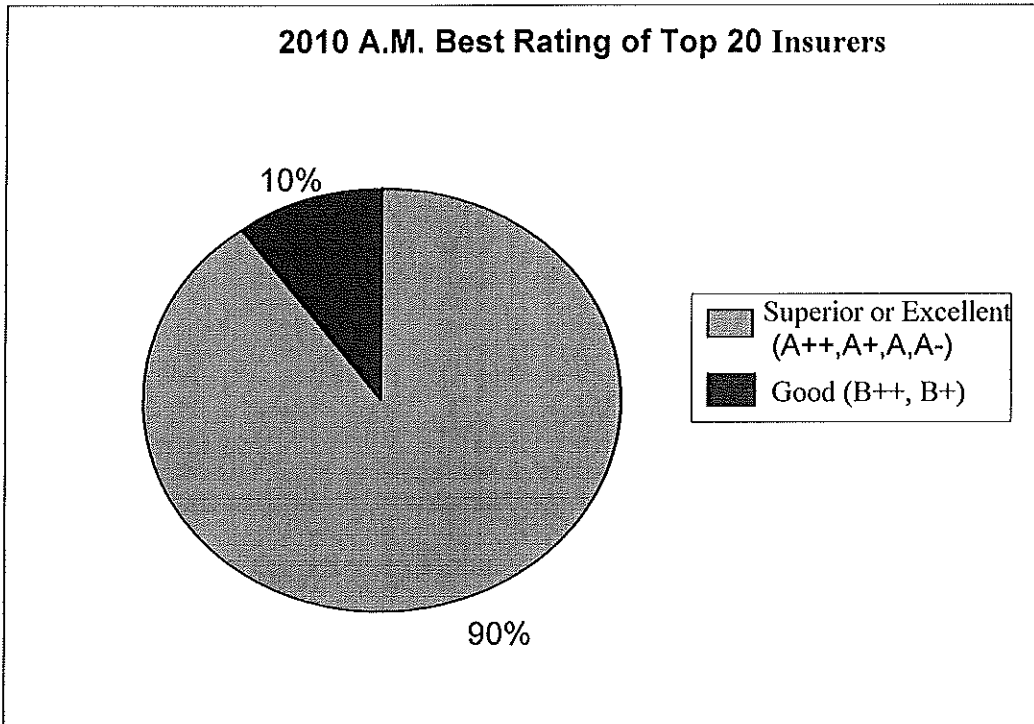
There are two categories of insurers offering coverage in the liquor liability market: “admitted” and “non-admitted.” Non-admitted insurers are also referred to as Surplus Lines insurers. Over a five year comparison, Figure 3 illustrates fewer surplus lines carriers provide coverage in the liquor liability insurance market. The presence of fewer Surplus Lines carriers may be due to increased availability of coverage being offered in the admitted market. Although a surplus lines market exists, liquor liability insurance is primarily purchased through the admitted market.

Insurer Quality

The A.M. Best Co. evaluates insurance companies and ranks them based on financial strength and operation. As a reputable resource in the insurance industry, A.M. Best ratings of insurers provides insight into their financial strength through an extensive process where it evaluates and assigns a rating. Secure financial ratings include: Superior - A++, A+; Excellent- A, A-; Good, B++, B+.

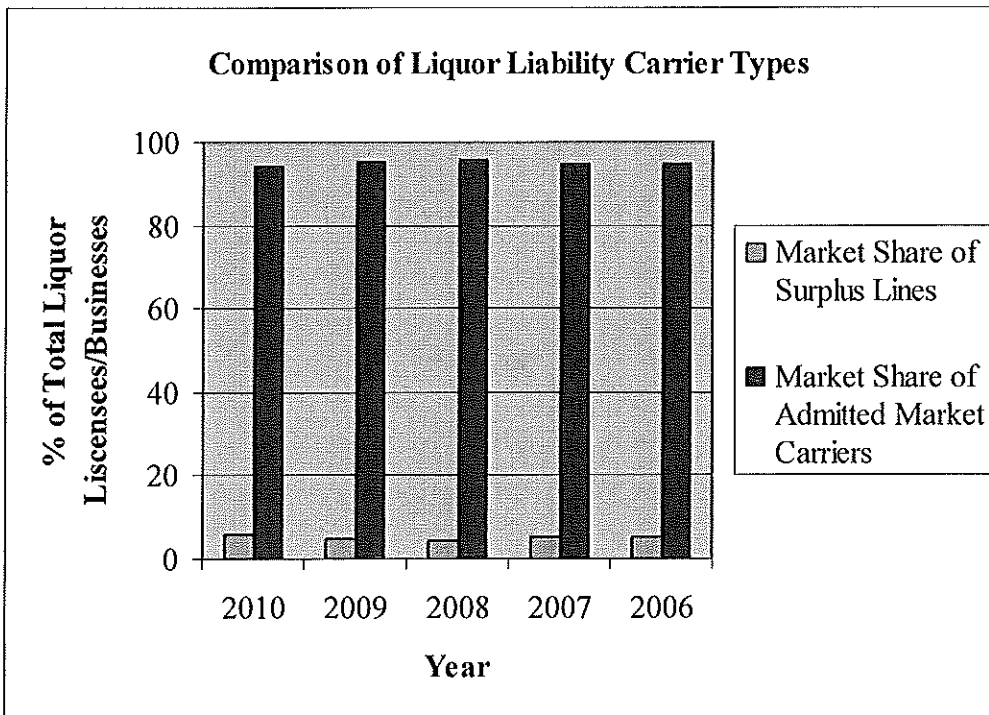
Exhibit 1 lists the A.M. Best rating of each liquor liability insurer identified as holding a place in the top 20 market share in 2010. Nineteen of 20 insurers were rated as “secure” by A.M. Best, while the remaining insurer was a non-rated surplus lines’ insurer. Eighteen of the 20 insurers rated secure by A.M. Best received superior or excellent rating, and 2 were rated good. This indicates that the Michigan liquor liability marketplace is a desirable market with financially strong insurers.

Figure 2



Source: A. M. Best

Figure 3



Source: Michigan Liquor Control Commission

Exhibit 1

**2010 Top 20 Liquor Licensees by Proof of Financial Responsibility Provider
(Market Share based on Covered Businesses)**

	Insurer	Licenses	Market Share	Direct Premiums Written	Loss Ratios	A.M. Best Rating
1	North Pointe Insurance Company	4,247	26.3%	\$5,372,160	13.6%	A-
2	Founders Insurance Company	882	5.4%	\$1,556,472	29.6%	A-
3	Ace American Insurance Company	743	4.6%	\$11,759	46.7%	A+
4	Auto-Owners Insurance Company	659	4.0%	\$15,226	0%	A++
5	MLBA Mutual Insurance Company	641	3.9%	\$935,431	17.3%	B++
6	United States Liability Insurance Company	353	2.1%	\$302,322	16.5%	A++
7	Old Republic Insurance Company	325	2.0%	N/A	N/A	A+
8	Travelers Casualty Insurance Co. of America	297	1.8%	N/A	N/A	A+
9	Zurich American Insurance Company	287	1.7%	\$26,580	0%	A+
10	Amco Insurance Company	277	1.7%	\$28,281	0%	A+
11	Scottsdale Insurance Company - S/L	274	1.7%	\$549,375	0%	A+
12	American Safety Casualty Insurance Company	269	1.6%	N/A	N/A	A
13	Northland Casualty Insurance Company	261	1.6%	\$217,516	28.7%	A+
14	Frankenmuth Mutual Insurance Company	256	1.5%	\$115,697	0%	A
15	Michigan Millers Mutual Insurance Company	243	1.5%	\$267,576	0%	B++
16	New Hampshire Insurance Company	239	1.4%	\$39,604	0%	A
17	Argonaut Great Central Insurance Company	234	1.2%	(\$8,927)	(33.6%)	A
18	West Bend Mutual Insurance Company	202	1.2%	N/A	N/A	A
19	Citizens Insurance Company of America	200	1.2%	43,551	0%	A
20	Harleysville Lake States Insurance Company	197	1.2%	\$251,878	0%	A
SUMMARY						
	Licenses with Top 20 Insurers	11,086	68.8%			
	Licenses with Other Insurers	5014	31.1%			
	Total Report of Licensees Using Insurance					
	As Their Financial Responsibility	16,100				
	Licenses Using Methods Other Than Insurance					
	To Meet Financial Responsibility	142	.8%			
	Liquor Control Commission's Reported Licensees	16,242				

Loss Ratio % = Loss Incurred / Premiums Earned , 0% means No Losses were Reported by the insurer, N/A means No Premiums or Losses Reported by the insurer, N/R means Not Rated, Source: Michigan Liquor Control Commission Liquor licensee records and Office of Financial and Insurance Regulation's FIS 0118 form.

Conclusion

Having considered each factor, identified in MCL 500.2409b for the purpose of determining whether liquor liability insurance is available in Michigan at a reasonable price, the Commissioner finds:

Although the liquor liability insurance market is dominated by one insurance company, there is no indication that competition does not generally exist in this market. Consistently over the last 3 years, the top 20 writers shared no more than 69.9% of the market, which includes a declining share of surplus lines insurers. The top 20 insurers controlled 64.8% of the market in 2010 declining from 69.9% in 2009 but increasing from 2008's 75.4% share. The data also indicates a lack of market barriers with 5 companies entering the top 20 for market share, 4 companies gaining market share, 4 companies losing market share, and that of 3 companies remaining fairly stable from 2008 to 2010.

In 2010, based on the most recent available data, there were 203 companies providing liquor liability coverage in the form of a liquor liability insurance policy or coverage endorsed under a general liability insurance policy with 29 of these companies in the surplus lines market.

The diversity of rate classifications and other rating tools within the liquor liability insurance market complicates specific rate comparisons.

The liquor liability insurance market has softened since the 1980s. The Commissioner has not received any information regarding licensees having a problem with the availability of liquor liability insurance in all geographic areas and to all types of business in Michigan.

Fewer surplus lines carriers provide coverage in the liquor liability insurance market which may be due to increased availability of coverage being offered in the admitted market. A majority of the top 20 liquor liability insurance carriers in Michigan have achieved a superior or excellent A.M. Best rating.

Certification

Based on the analysis and findings contained in this report, I certify that liquor liability insurance is reasonably available in Michigan at a reasonable premium.



R. Kevin Clinton

Commissioner of Financial and Insurance Regulation

7-8-11

Date