

INSURANCE  
DEPARTMENT OF BANKING  
DIVISION OF INSURANCE

Rate Process for Limited Rate Changes: Calculations for Private Passenger Automobile Insurance Rate Changes

Adopted Amendments: N.J.A.C. 11:3-16B

Proposed: July 21, 2003 at 35 N.J.R. 3093(a)

Adopted: November 19, 2003 by Holly C. Bakke, Commissioner, Department of Banking and Insurance

Filed: November 19, 2003 as R. 2003 d. 500, **with substantive and technical changes** not requiring additional public notice and comment (see N.J.A.C. 1:30-6.3).

Authority: N.J.S.A. 17:1-8.1, 17:29A-46.6 and 17:29A-46.7 and section 42 of P.L. 2003, c. 89.

Effective Date: December 15, 2003

Expiration Date: January 4, 2006

**Summary** of Public Comments and Agency Responses:

The Department of Banking and Insurance (Department) received written comments from the following: The Alliance of American Insurers, New Jersey Manufacturers Insurance Group, State Farm Indemnity Company, the Independent Insurance Agents of New Jersey and one comment submitted jointly by the Insurance Council of New Jersey, the American Insurance Association and the National Association of Independent Insurers.

COMMENT: One commenter stated that pursuant to subsection (c) of N.J.A.C. 11:3-16B.4, rate process for limited rate changes: calculation for private passenger automobile insurance, the ultimate loss and loss adjustment expense is to be determined by three

factors. The commenter stated that it recognizes that it would not be proper to analyze all scenarios in the same way. The commenter recommended that some flexibility should be granted to insurers by not forcing the use of the three-out-of-five average for loss development factors as specified in N.J.A.C. 11:16B.4(c)2i. The commenter stated that this will permit insurers to choose the most appropriate loss development factor for the given circumstances.

RESPONSE: The Department disagrees with the comment. The Department believes that a uniform calculation is more appropriate for use in limited rate filings in order to ensure an adequate review within the time permitted. Insurers are permitted to use alternative calculations for regular rate filings filed pursuant to N.J.A.C. 11:3-16.6.

COMMENT: Several commenters expressed concern with N.J.A.C. 11:3-16B.4(c)3. This provision requires that the data used for loss trend factors be based on a paid basis, not an incurred or arising basis. One commenter stated that this means that large carriers cannot use their own trend data in the rate filing process for limited rate changes. The commenter stated that this is important for carriers that are growing or shrinking in size because they will have different loss trends. The commenter stated that carriers will not be able to use their most responsive data, incurred loss data, to reflect court cases. The commenter contends that for bodily injury liability, recent court decisions interpreting the verbal threshold have reduced incurred BI (Bodily Injury) liability losses. The commenter stated that paid loss data will not fully reflect these cases for years.

The commenters also contend that the Department's rules should permit carriers to use their own loss trend data. The commenters further believe that these rules should

permit the use of incurred loss data. The commenters stated that the Department may be concerned that carriers will pick and choose in each filing which data they will use in order to justify the largest rate increase. The commenters contend that this can be prevented, by requiring carriers to be consistent in their filings with the data that they use. The commenters believe that a carrier should be permitted to change data types only if good cause is shown to the Department. The commenters suggested amending this provision to read as follows (additions in boldface):

“Loss trend factors shall be based on either annual selections from the latest approved ISO filing in NJ, the insurer’s own data, or the latest available NJ Fast Track data, computed separately for severity and frequency by coverage (BI, PIP, PD, COMP, COLL). All data may be based either on paid or incurred/arising claims. For all filings made pursuant to this subchapter on or after the effective date of these amendments, an insurer or rating organization shall be consistent in its choice of source for trend factors and the use of either paid or incurred/arising claim data unless good cause is shown by the insurer or rating organization to the New Jersey Department of Banking and Insurance.”

Another commenter stated that paid frequencies are not a valid indicator of Bodily Injury and, to a lesser extent, PIP trends, as claims are often not paid during the exposure period. The commenter contends that this creates significant distortions when a company’s volume of business is changing materially and tends to extend the effects of a law change. The commenter requested that the Department amend this provision to permit loss trend factor data for BI and PIP to be based on incurred/arising claims in order to more accurately reflect frequency changes on those claims.

RESPONSE: The Department disagrees with the commenters and believes that paid claim data is more appropriate for use in the filings that are made pursuant to this subchapter. Paid losses are more stable than incurred claim data and are unaffected by

reserve inaccuracies. The Department believes that paid losses tend to reflect objective information and that their use avoids the possibility of errors of judgment. Insurers are not permitted to use internal loss trend data for limited rate filings. The Department also believes that uniform calculation is more appropriate for use in limited rate filings in order to ensure an adequate review with the time permitted.

COMMENT: Several commenters suggested amending N.J.A.C. 11:3-16B.4(d), which addresses how expenses shall be determined for rate changes. The commenters stated that expenses may vary greatly from coverage to coverage. The commenters contend that requiring expenses to be assigned to groups of coverages, as required by the current provision, as opposed to individual coverages, can cause significant inaccuracies.

The commenters suggested that insurers be given the option of determining expenses on a by-coverage basis. The commenters recommended that the Department amend this provision to read (additions in boldface):

“(d) Expenses shall be determined by coverage or group of coverages (liability or physical damage) from the total of...”

RESPONSE: The Department declines to amend this rule as suggested by these commenters. The proposed amendments ensure that the Department’s staff will be able to review an insurer’s limited rate change filing within the time frame allowed. Expenses listed by groups of coverages are verifiable with the insurer’s annual financial statements, while expenses listed by individual coverages are not.

COMMENT: One commenter expressed concern with N.J.A.C. 11:3-16B.5(d), which prevents a filer from filing more than one limited rate change request in any 12-month

period, except that this does not apply to overall reductions in rates or filings reflecting statutory changes.

The commenter stated that the one-time-per-12-month-period limitation would apply to revenue neutral filings and to regular rate filings in order to reflect regulatory changes in coverage. The commenter believes that there is no need to limit overall revenue neutral filings to one per 12-month period. The commenter questioned that, if an insurer wishes to broaden a coverage and is willing to cut the cost of a different coverage so that the change is overall revenue neutral, why should the carrier have to wait until the next 12-month period to take advantage of the limited rate filing process.

The commenter contends that changes in coverage can occur, such as changes in the PIP decision point review processes; precertification; and the medical fee schedule, all of which could impact the cost of the coverage. The commenter stated that there is no reason why such changes in rates should be delayed until the next 12-month period when the regulation precipitating the change would be effective before then.

The commenter stated that the limited rate change filing procedure can be construed to allow these exceptions to the one filing per 12-month period. Additionally, the Commissioner has the general statutory authority under the rating laws to allow the limited rate change filing procedures to cover other situations.

The commenter suggested amending N.J.A.C. 11:3-16B.5(d) to read (additions in boldface):

“(d) A filer may not have more than one rate-change request pursuant to this subchapter approved in any 12-month period; however, this limitation shall not apply to a filing for an overall reduction in rates, **a change that is revenue neutral**, or to a filing reflecting a statutory **or regulatory** change in coverage.”

RESPONSE: The Department disagrees with the commenter and believes that the current language is proper and consistent with N.J.S.A. 17:29A-46.6 as amended by section 42, of P.L. 2003, c.89. These rules address the amended rate filing process for limited rate changes. Insurers that wish to make multiple filings in a 12-month period may do so, but they must follow the process outlined in Rate Filing Requirements: Voluntary Market Private Passenger Automobile Insurance found at N.J.A.C. 11:3-16.

COMMENT: Several commenters recommended clarifying N.J.A.C. 11:3-16B.5(e) by amending it as follows (additions in boldface):

“An insurer not using this limited rate change process in a 12-month period may elect to file a proposed alteration to its rating system that will result in a rate change of not more than double the increase permitted pursuant to (a) above, if the filing complies with the requirements of N.J.S.A. 17:29A-46.6 and this subchapter, and a limited rate change has not been obtained more than once within a twenty-four month period.”

RESPONSE: The Department agrees with the commenter and has amended this provision accordingly. The Department believes this amendment reflects and clarifies the legislative intent that an insurer is prevented from having more than one alteration to its rating system that would result in a rate change of not more than double the increase permitted under N.J.A.C. 11:3-16B.5(a) approved and effective within a 24-month period.

COMMENT: Several commenters stated that N.J.A.C. 11:3-16B.3(a)1 and 4 seem to have redundant effective dates and should be clarified, or one should be deleted.

RESPONSE: The Department agrees with the commenter and has removed from N.J.A.C. 11:3-16B.3(a)4 the statement regarding the memorandum information that should be included in the cover letter, and restated it in N.J.A.C. 11:3-16B.3(a)1. This information should be part of the cover letter (N.J.A.C. 11:3-16B.3(a)1) not the mandatory pages (N.J.A.C. 11:3-16B.3(a)4). Corresponding revisions have been made to Exhibit A of the rule. The Department notes that it is not deleting or adding any requirements on insurers as a result of this change.

COMMENT: One commenter suggested that Exhibit A, Section 16B.3(a)3 be amended by deleting the reference therein to “No territory above 1.35 (incl. expense fees),” in light of the abolition of the 1.35 rating cap that will be implemented by carriers when the proposed territorial rate regulations are adopted.

RESPONSE: The Department disagrees with the commenter. This cap will remain in effect until rate filings made in accordance with the Department’s private passenger automobile insurance territorial rating rules, N.J.A.C. 11:3-16A, are approved.

COMMENT: One commenter suggested that Exhibit A, Section 16B.3(a)3 be amended as follows (additions in boldface; deletions in parenthesis):

“Overall change smaller of indicated change or three percent’ should be amended to reflect the new 7 percent limit and should be amended to read, ‘Overall change smaller of indicated change or seven (three) percent’.”

“Coverage change smaller of indicated change of five percent’ should be amended to reflect the new 10 percent limit and should be amended to read, ‘Coverage change smaller of indicated change or ten (five) percent’.”

RESPONSE: The Department agrees with the commenter that the provisions in the Exhibit as proposed relating to the maximum change on an overall basis and by coverage are incorrect. Since these items are duplicative and are found in N.J.A.C. 11:3-16B.5, the Department is removing these items from this section of the checklist, and amending the references to N.J.A.C. 11:3-16B.5 in the Exhibit accordingly.

COMMENT: One commenter stated that Exhibit A, checklist Section 16B.4(d)5, should be amended to read (additions in boldface):

“For liability in filings made prior to 2004, UCJF provision is latest established by Commissioner (5.00 percent as of March 1, 2002).”

RESPONSE: The Department disagrees with the commenter. Upon adoption, the Department is deleting from the Exhibit A checklist the reference therein to N.J.A.C. 11:3-16B.4(d)5. This reference is being deleted in order to render Exhibit A consistent with the deletion of N.J.A.C. 11:3-16B.4(d)5, which was included in the Notice of Proposal. The Department is also recodifying Exhibit A, checklist Sections 16B.4(d)6 and 7 as 16B.4(d)5 and 6. This change is also necessary to make Exhibit A consistent with the recodification of N.J.A.C. 11:3-16B.4(d)6 and 7 as N.J.A.C. 11:3-16B.4(d)5 and 6 included in the proposal.

The Department notes that the Pedestrian PIP costs, and the Uninsured Motorists costs, formerly a portion of the “UCJF” and “JUA/MTF” assessments, now administered by PLIGA, are to be included in the expenses provided for rate filings.



COMMENT: One commenter stated that Exhibit A, Section 16B.5(a)-(b) should read (additions in boldface; deletions in brackets): “Request overall limited to smaller of + [three] seven percent or indicated change.”

RESPONSE: The Department agrees that as proposed this item was incorrect and has made this amendment on adoption. The Department has also made a grammatical change by deleting the plus sign.

COMMENT: One commenter stated that Exhibit A, Section 16B.5(c) should read (additions in boldface; deletions in brackets): “Request by coverage limited to smaller of + [five] ten percent or indicated change.”

RESPONSE: The Department agrees that as proposed this item was incorrect and has made this amendment on adoption. The Department has also made a grammatical change by deleting the plus sign.

COMMENT: One commenter stated that it is their understanding that the Return on Equity (ROE) calculation method, as described in the amendments to N.J.A.C. 11:3-16, ‘Rate Filing Requirements: Voluntary Market Private Passenger Automobile Insurance’, proposed contemporaneously with these proposed amendments, works as follows. The proposed standard premium to surplus ratio is 2 to 1. The commenter believes that a company is entitled to earn up to 12 percent profit on the surplus supporting private passenger automobile premiums written in New Jersey at a 2 to 1 ratio. However, any investment income on surplus in excess of the 2 to 1 ratio is not considered in the ROE calculation method and does not count against the allowable 12 percent profit on the

amount of surplus derived from the premium to surplus limitation imposed on well-capitalized companies.

The commenter stated that an interpretation different from that set above would penalize well-capitalized companies with devastating market implications. The commenter stated that such an interpretation would create an absolute disincentive for companies to maintain capital in excess of the 2 to 1 ratio. Out-of-State companies would likely transfer capital out of New Jersey subsidiaries to maximize their opportunity for a reasonable return on equity. Such a result would not be good for consumers, as less surplus would be available to support the needs of existing policyholders and new business growth. Nor is it consistent with the stated goals of both the Governor and the Commissioner for companies to invest in New Jersey.

The commenter stated that instead the Department must clarify its interpretation so as to encourage companies to maintain more surplus than the 2 to 1 ratio in order to be able to weather all sorts of storms, both political and weather related. Companies should not be required to include investment income on additional surplus that is in excess of the 2 to 1 ratio when making limited rate filings for the reasons stated above.

RESPONSE: The Department disagrees with the comment. If the investment income (on the additional surplus that is in excess of the 2 to 1 ratio) constitutes income generated from company's GAAP equity or surplus, then it is correct that such income is required to be included in the "underwriting profit & contingency" calculation, using the ROE method. Additionally, such income counts towards the overall target of 12 percent. The Department is of the view that the change in "underwriting profit & contingency" calculation from the Clifford formula to the ROE method and the imposition of a

minimum of 2 to 1 leverage ratio are positive decisions for both companies and consumers. The change to the ROE method is consistent with the stated goals of both the Governor and the Commissioner: providing the companies with the necessary tools for their operations and striving for rate adequacy, yet providing ample protection to consumers against excessive rates.

COMMENT: Finally, one commenter stated that this proposal does not contain a provision that would allow a company to adjust rate relativities (for example class factors, territorial base rates, limits, deductibles, etc.) within some wider band than the proposed ten percent limit. The commenter recommended that the rules be amended, so that companies may change certain criteria which may result in a maximum increase of more than 10 percent per individual on one coverage, as long as the Statewide increase in rates is no more than 10 percent by coverage and the total rate increase is no more than five percent. Such a provision would make this procedure more useful, thereby enabling companies to “true-up” or “right price” coverages more expeditiously and limiting the need for prior approval filings.

RESPONSE: The 10 percent limit applies only to the overall average change per coverage. The limit does not apply to individuals and territories. Increases to those groups may exceed 10 percent if a territorial indication is provided and the increase is justified for that territory.

**Summary** of Agency-Initiated Changes:

The Department is amending Exhibit A, Section 16B.4(c)2 to add the phrase “years’ factors.” The Department is amending this provision to clarify that the Department is requesting the middle three values out of the last five factors, not the second, third and fourth years out of five.

The Department is also amending Exhibit A, Section, 16B.4(d)5 to include the term “and Contingencies” in order to be consistent with the phrase used in recodified N.J.A.C. 11:3-16B.4(d)5. Exhibit A, Section, 16B.4(f)1 is being amended to read “DOBI Credibility Standard” instead of DOBI “Standard Credibility” which is also consistent with and clarify that this is a reference to the term “credibility standard” as used in N.J.A.C. 11:3-16B.4(f)1. Additionally, Exhibit A, Section 16B4(f)2 is being amended to add the term “Standards” to “Company Calculated Credibility” in order to be consistent with and clarify that this is a reference to the “credibility standard” as used in N.J.A.C. 11:3-16B.4(f)2.

### **Federal Standards Statement**

A Federal standards analysis is not required because the adopted amendments are not subject to any Federal requirements or standards.

**Full text** of the adoption follows (additions to proposal indicated in boldface with asterisks **\*thus\***; deletions from proposal indicated in brackets with asterisks \*[thus]\*):

11:3-16B.3 Rate process for limited rate changes; insurers and rating organizations

(a) An insurer and/or rating organization, pursuant to N.J.S.A. 17:33B-31, may file for a rate change in accordance with this subchapter. The insurer shall provide the following information in support of its filing:

1. A cover letter notifying the Department of its intention to make a rate change according to the provisions of this subchapter; **\*the company's file number,\*** a statement of the percentage and total dollar amount of the change in rates by coverage for each company included in the filing with subtotals by group of coverages (liability versus physical damage) and an overall total in the format of Appendix Exhibit E of N.J.A.C. 11:3-16 incorporated herein by reference; a statement containing the effective date of the change **\*for new and renewal policyholders\***; and the name, telephone number and mailing address of the company officer familiar with the filing to whom further inquiries regarding the filing may be directed;

2. - 3. (No change from proposal.)

4. The manual rating pages containing the territorial base rates by coverage to be implemented, accompanied by an explanatory memorandum showing the calculation of the new rates by coverage, using the existing rates by coverage as the starting point in the calculation. **\*[The memorandum shall also include the company's filing number and effective dates for new and renewal policyholders];\*** and

11:3-16B.5 Limitation on filer's rate request

(a) – (d) (No change from proposal.)

(e) An insurer not using this limited rate change process in a 12-month period may elect to file a proposed alteration to its rating system that will result in a rate change of not more than double the increase permitted pursuant to (a) above, if the filing complies with the requirements of N.J.S.A. 17:29A-46.6 and this subchapter, and \*[is made]\* **a prior filing for a proposed alteration as referenced in this subsection has** not **been approved and effective** more than once within a 24-month period.

## APPENDIX

EXHIBIT A

| <u>Section</u> | <u>Description</u>  | <u>Page Number</u> |
|----------------|---|--------------------|
| 16B.3(a)1      | <ul style="list-style-type: none"> <li>• Cover letter notifying DOBI of intention to modify rates</li> <li>• Statement of proposed changes (with \$ and %) by coverage</li> <li>• Exhibit E (% Change, \$ Effect, and Current/Proposed Expense Fee by coverage) (from N.J.A.C. 11:3-16)</li> <li>• Statement of Effective Date of Change</li> <li>• Name/Telephone/Address of Company Officer</li> </ul> <p><b><u>*Includes Company file number</u></b><br/> <b><u>*Includes New/Renewal effective dates*</u></b></p>         |                    |
| 16B.3(a)2      | This checklist  |                    |
| 16B.3(a)3      | <ul style="list-style-type: none"> <li>• Compliance with N.J.S.A. 17:29A-36</li> <li>• No class factor above 2.50</li> <li>• No territory above 1.35 (incl. expense fees)</li> <li>• No 65+ charged &gt; 1.25 x 65+ average</li> <li>• Compliance with N.J.S.A. 17:29A-46.6(e)</li> </ul> <p>*[•Overall change smaller of indicated change or three percent</p> <ul style="list-style-type: none"> <li>• Coverage change smaller of indicated change or five percent]*</li> <li>• Actuarial Certification of above</li> </ul> |                    |
| 16B.3(a)4      | <ul style="list-style-type: none"> <li>• Revised Manual Pages</li> <li>• Includes calculation of new rates</li> </ul> <p>*[•Includes Company file number<br/> • Includes New/Renewal effective dates]*</p>  |                    |
| 16B.3(a)5      | Rating Examples   |                    |
| 16B.4(a)1      | Indications by coverage based on three years of data (or two years if fully credible with that data)  |                    |
| 16B.4(a)2      | Liability data can be either at basic or total limits   | Basic/Total        |
| 16B.4(a)3      | <p>Required Indications by Types Sold:</p> <ul style="list-style-type: none"> <li>• Only split limit: separate BI &amp; PD (with UM)</li> <li>• Only CSL: CSL (with UM) with losses developed</li> </ul>  |                    |

- separately
  - Both split & CSL: separate BI & PD (with UM), with CSL either allocated or done separately [two or three indications]
  - Only Package: PACK (with UM) with losses developed separately
- 16B.4(b)1 Earned Premium by coverage by accident year
- 16B.4(b)2 On-Level factors based on company NJ rate changes
- 16B.4(b)3 Comp & Coll Premium Trend Factors from ISO or internal data (with data and methodology used for internal)
- 16B.4(c)1 NJ incurred loss and incurred ALAE (may be combined) by accident year by coverage (paid loss OK for COMP and COLL).
- 16B.4(c)2 Loss Development Factors based on average of last five years excluding high and low (that is middle three of five \*[years]\* **\*years' factors\***)
- BI/PIP developed to 87 months, tail factor of 1.05
  - PD/Comp/Coll developed to 51 months, tail factor of 1.00
- 16B.4(c)3 Loss Trend Factors based on latest approved ISO filing or latest available NJ Fast Track, separately for frequency and severity by coverage. For Fast Track, 12 quarter rolling average used. For COMP, countrywide Fast Track data permitted. Must use paid claims (not incurred claims).
- 16B.4(c)4 ULAE Factor is ratio of incurred ULAE to incurred Loss + ALAE, and comes from latest three available IEEs.
- 16B.4(c)5 Law changes accounted for:
- AICRA (effective 3/21/99) (all coverages)
  - Primary Seatbelt (effective 5/1/00) (one percent BI and PIP)
  - Graduated Licensing (effective 1/1/01) (one percent BI, PD, PIP, COLL)
- 16B.4(c)6 Catastrophe Factor permitted for Comp from either ISO or internal data (minimum 10 years)



- 16B.4(d)1 Commission and Brokerage Expenses based on NJ WP from Page 14 (three-year average)
- 16B.4(d)2 General Expense and Other Acquisition Expense based on CW EP from IEE (three-year average)
- 16B.4(d)3 Expenses (1 and 2 above) capped by N.J.A.C. 11:3-16 Appendix H Calculation (see [www.nj.gov/dobi](http://www.nj.gov/dobi) for current expense caps)
- 16B.4(d)4 Tax, License, and Fee Expense based on NJ WP from Page 14 (three-year average)
- \*[16B.4(d)5 For Liability, UCJF provision is latest established by Commissioner (5.00 percent as of March 1, 2002)]\*
- 16B.4(d)\*[6]\*  
\*5\* Profit **and Contingencies**\* provision based on Return on Equity Formula
- 16B.4(d)\*[7]\*  
\*6\* Total Capped Expenses is sum of 3 through \*[5]\* above
- 16B.4(e) Permissible Loss Ratio is 1 minus (d)6
- 16B.4(f)1 DOBI \*[Standard]\* Credibility **Standards**\*  
BI/PD/CSL/PACK at total limits: 4,000 claims  
BI/PD/CSL/PACK at basic limits: 3,000 claims  
PIP/COMP/COLL: 3,000 claims
- 16B.4(f)2 Company Calculated Credibility  
**Standards**\*(optional)
- 16B.4(f)3 Credibility determined using square root rule, minimum 50 percent.
- 16B.4(g) Complement of credibility assigned to Loss Ratio Trend (Loss Trend divided by Premium Trend), trend period is effective date of last filing to proposed effective date.
- 16B.4(h)1 Projected Ultimate Loss + LAE Ratio is (c) / (b)
- 16B.4(h)2 Raw indication is (h)1 / (e)
- 16B.4(h)3 Credibility-weighted indication is as described

|              |  |          |
|--------------|--|----------|
| 16B.4(h)4    | Overall indication is weighted average by latest year's earned premium   |          |
| 16B.4(i)     | If proposing territorial changes, territorial indication based on three years of data with credibility standard of 3,000 claims per territory (complement is statewide indication above or current relativity) |          |
| 16B.4(j)     | If expense fees changing, standard expense fee calculation. For other items changing, changes based on three-year relative loss ratios.  |          |
| 16B.4(k)     | Alternate Methodology permitted (optional, see regulation)   |          |
| 16B.5(a)-(b) | Request overall limited to smaller of *[+ three]* <b>*seven*</b> percent or indicated change   |          |
| 16B.5(c)     | Request by coverage limited to smaller of *[ + five]* <b>*ten*</b> percent or indicated change   |          |
| 16B.5(d)     | Last limited rate change filing approved at least 12 months ago  | Yes / No |

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