

INSURANCE  
DEPARTMENT OF BANKING AND INSURANCE  
DIVISION OF INSURANCE

Reporting Financial Disclosure and Excess Profit

Adopted Amendments: N.J.A.C. 11:3-20.3, 20.4, 20.5, 20.6, 20.7, 20.8, 20.9, 20.10 and 11:3-20 Appendix

Proposed: March 18, 2002 at 34 N.J.R. 1093(a)

Adopted: October 29, 2002 by Holly C. Bakke, Commissioner, Department of Banking and Insurance

Filed: October 29, 2002 as R. 2002 d.386, **with substantive and technical changes** not requiring additional public notice and comment (see N.J.A.C. 1:30-.3).

Authority: N.J.S.A. 17:1-8.1 and 17:29A-5.6 through 5.16

Effective Date December 2, 2002

Expiration Date: January 4, 2006.

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

The Department received eight written comments on the proposed amendments during the comment period. Comments were received from five carriers (Alliance of America Insurers, Allstate New Jersey Insurance Company, New Jersey Manufacturers Insurance Group, Selective Insurance Group, Inc., State Farm Insurance Company); and three trade associations (Independent Insurance Agents, Insurance Council of New Jersey and the National Association of Independent Insurers).

COMMENT: Several commenters suggested that the Department amend the definition of terms found in N.J.A.C. 11:3-20.3 to include "excess liability" as it is used in the definition of

“exempted types.” The commenters believe this amendment is necessary in order to provide guidance to insurers on the treatment of excess liability.

RESPONSE: This change will be incorporated in the Department’s subsequent proposal since it constitutes a substantive change that requires a new comment period and is not within the scope of this proposal.

COMMENT: One commenter expressed concern with the proposed definition of “direct business.” The commenter stated that the proposed definition excludes all reinsurance premiums and loss recoveries from the calculation.

The commenter stated that while the exclusion of reinsurance premiums and recoveries may be proper for quota share reinsurance, excess limits reinsurance, and stop loss reinsurance (these types of reinsurance involve the allocation of normal risk with a return period of one to three years which fits in the excess profits law three year period, and could be used as a device to evade the excess profits law by upstreaming the risk and the excess profits away from the primary carrier), this would not be proper for catastrophic reinsurance. The commenter stated that catastrophic reinsurance involves risk over a period of 25 or more years. For example, a catastrophic reinsurance policy may protect against comprehensive coverage losses from a 100 year storm. The commenter contends that the purchase of catastrophe reinsurance is a prudent expense for an insurer. The commenter stated that Hurricane Andrew caused \$100 million in auto comprehensive coverage losses in Florida for State Farm alone. The commenter argued that a similar force hurricane hitting New Jersey could wipe out an auto insurer if it is not reinsured. Catastrophic reinsurance also cannot be used as a device to evade the excess profits law by upstreaming the risk and the excess profits away from the primary carrier unlike other forms of

reinsurance. The excess profits calculation needs to allow catastrophic reinsurance as an expense and any catastrophic reinsurance recoveries as an offset to losses.

RESPONSE: The Department disagrees with the commenter. Consistent with rate indications, all excess profit reports shall be made on a direct basis. Catastrophic reinsurance is a large part of the homeowner's insurance premium. However, it has a negligible impact for private passenger automobile insurance since it only applies to comprehensive coverage. Also, it is very difficult to allocate a countrywide catastrophic reinsurance treaty, to New Jersey, then to private passenger automobile, and then to comprehensive coverage. It is not possible for the Department to verify this data from NJ page 14, of the IEE or the Annual Statement. It is highly unlikely that this negligible amount will make a difference between an excess profit and an excess loss. This provision will not be included in the excess profit regulation, but may be addressed in an individual company filing.

COMMENT: One commenter stated that the definition of "actuarial gain" in N.J.A.C. 11:3-20.3 should be amended to read (additions in boldface):

"'Actuarial gain' means the remainder obtained by subtracting the allowance for profit and contingencies from underwriting income, which remainder may be positive or negative. The allowance for profit and contingencies is determined by the Clifford formula as 3.5 percent of Earned Premium or 5.38 percent on a pre-tax basis, using the Federal corporate tax rate of 35 percent. Actuarial gain shall allow as an expense the cost of catastrophe reinsurance and shall require as an offset to incurred losses incurred reinsurance recoverables from catastrophe reinsurance.

RESPONSE: The Department disagrees with the commenter. Consistent with rate indications, all excess profit reports shall be made on a direct basis. Catastrophic reinsurance is a large part of the homeowner's insurance premium. However, it only has a negligible impact for private passenger automobile insurance since it only applies to comprehensive coverage. Also, it is very difficult to allocate a countrywide catastrophic reinsurance treaty, to New Jersey, then to private passenger automobile, and then to comprehensive coverage. It is not possible for the Department to verify this data from NJ page 14, of the IEE or the Annual Statement. It is highly unlikely that this negligible amount will make a difference between an excess profit and an excess loss. This provision will not be included in the excess profit regulation, but may be addressed in an individual company filing.

COMMENT: One commenter objected to N.J.A.C. 11:3-20.5 which addresses the excess profits report. The commenter's concerns were specifically about the use of case incurred losses. The commenter stated that proposed N.J.A.C. 11:3-20.5(b)1, 2, 3 and 4 switch loss and allocated loss adjustment expense (ALAE) reporting from paid losses developed to ultimate pursuant to the regulations to case incurred losses developed to ultimate pursuant to the regulations.

The commenter stated that it supports the change to case incurred losses for losses, but does not support this change for ALAE. The commenter stated that unlike losses, it does not determine case incurred ALAE. Instead, it determines incurred ALAE expenses by developing paid ALAE to ultimate. The commenter stated that it did not know how other insurers handled ALAE. The commenter believes that the excess profits report should allow the option for carriers to develop incurred ALAE by either using paid ALAE or case incurred ALAE.

The commenter suggested amending proposed N.J.A.C 11:3-20.5(b)4 to read (additions in boldface):

“Case incurred ALAE or paid ALAE developed to an ultimate basis.”

RESPONSE: If the filer does not determine case incurred ALAE, then in such a situation, case incurred ALAE shall be zero, because it will be included in bulk IBNR. Therefore, no changes to the spreadsheet are necessary.

COMMENT: One commenter suggested that the Department amend N.J.A.C. 11:3-20.5(f) as follows:

“An officer of the insurer shall certify on the excess profit report forms that the report complies with all statutory and regulatory requirements to the best of his or her information, knowledge and belief. The officer shall sign his or her name and provide title and date, and phone number.”

RESPONSE: This change will be incorporated in the Department’s subsequent proposal since it constitutes a substantive change that requires a new comment period and is not within the scope of this proposal.

COMMENT: One commenter believes that the loss reserve calculations required in Exhibits Three and Four are not appropriate for its business because they do not develop certain charges for a long enough period.

The commenter stated that the requirement of calculating a selected factor for the development of losses by using a prescribed formula is not likely to produce results as accurate as its loss reserving method.

RESPONSE: The company can incorporate a tail factor, which is based on the company's own data to address inconsistencies in its loss reserving method.

COMMENT: One commenter expressed concern about N.J.A.C. 11:3-20.5(b)2. This provision is being amended to require paid, unpaid and incurred ALAE. The commenter stated that the Department assumes that insurers reserve allocated loss adjustment expenses (ALAE) on a case by case basis. The commenter stated that many insurers reserve ALAE on a bulk basis. The commenter respectfully requested that the Department amend these rules to accommodate such insurers by enabling them to indicate either paid ALAE or case incurred ALAE.

RESPONSE: It appears that the comment addresses N.J.A.C. 11:3-20.5(b)3 rather than paragraph (b)2. In such a situation, case incurred ALAE shall be zero, because it will be included in bulk IBNR.

COMMENT: One commenter expressed concern with N.J.A.C. 11:3-20.6(a), the reporting requirements for insurance holding company systems. The commenter believes that these proposed amendments are not clear. The commenter stated that at times these rules refer to a group of companies and at other times the rules state that "an individual insurer within an insurance holding company system shall certify an excess profits report."

RESPONSE: This provision requires individual insurers that are part of a holding company system to submit a single report for the group. For example, if there are four companies in a holding company system, there is only one report, not four individual reports submitted. N.J.A.C. 11:3-20.6(b) permits the Commissioner to order a complete excess profit report for any individual insurer in an insurance holding company system.

COMMENT: One commenter suggested that the Department amend N.J.A.C. 11:3-20.6(c) as follows (additions in boldface; deletions in brackets):

“Notwithstanding any provision of this section to the contrary, for purposes of evaluating the Excess Profit[s] Reports, the excess profit[s] computation shall be performed solely on the insurance holding company system’s combined **excess** profit report.”

RESPONSE: The Department agrees with the commenter and has made this technical change on adoption.

COMMENT: Two commenters recommended that the Department amend N.J.A.C. 11:3-20.9(a) to reflect the current intent of that provision. The commenter stated that, currently, N.J.A.C. 11:3-20.9(a) provides that if an insurer returns an excess profit to its policyholders and subsequent developments indicate that the excess profit was either nonexistent or overstated, an excess profit carry forward shall be established. However, N.J.A.C. 11:3-20.9(a) as proposed, provides that if an excess profit is returned by an insurer to its policyholders and subsequent reports indicate that additional excess profits are indicated, an excess profit carry forward shall be established. The proposed amendment materially alters this provision and the purpose of this alteration is unclear.

RESPONSE: An excess profit carry forward is only necessary if the insurer has a subsequent excess profit. If there is no excess profit, the carry forward is moot and has no impact. For example, in year 2000 an insurer has an excess profit. In 2001, the insurer shows an excess profit or a loss. If the insurer has a loss, no carry forward is necessary because they are not paying anything more. If it is a profit, then the insurer will carry forward from the excess profit paid in 2000 to offset the 2001 excess profit.

COMMENT: One commenter stated that there is some confusion as to the interpretation of N.J.A.C. 11:3-20.9 as amended. The commenter recommended that the Department provide a definition of “excess profit carry forward” which would be of help to resolve the confusion. The commenter stated that subsection (a) implies that profits in excess of excess profits returned (that is, “additional excess profits”) shall be carried forward, while subsection (b) provides that the excess profits carry forward shall be applied as a credit against future determinations of excess profits.

RESPONSE: An excess profit carry forward is only necessary if the insurer has a subsequent excess profit. If there is no excess profit, the carry forward is moot and has no impact. For example, in year 2000 an insurer has an excess profit. In 2001, the insurer shows an excess profit or a loss. If the insurer has a loss, no carry forward is necessary because it is not paying anything more. If it is a profit, then the insurer will carry forward from the excess profit paid in 2000 to offset the 2001 excess profit.

COMMENT: One commenter stated that Exhibit One should include a definition of “Excess Liability” (Col 1, items 3a-3f; Col 3A, items 3a-3e) so that all carriers will be consistent.

RESPONSE: The Department noted earlier that it will propose an amendment to N.J.A.C. 11:3-20.3 to include a definition of “excess liability” in a subsequent proposal.

COMMENT: One commenter stated that proposed N.J.A.C. 11:3-20.9(b) states that the insurer shall assign excess profits carry-forward credit to the latest three accident years of the filing in which there is an excess profit. Mathematically, the excess profit carry-forward credit should be



assigned to the most recent accident year of the filing so that the excess profits reports in the following two years do not nullify the credit.

The commenter suggested that the third sentence of proposed N.J.A.C. 11:3-20.9(b) should be amended to read (additions in boldface; deletions in brackets):

“In such filing year, the insurer shall assign the carry forward or a portion thereof to the latest [three AYs] of that filing.”

RESPONSE: It is the option of the insurer where and how to assign the carry forward in the three latest accident years of the filing. Assigning 100 percent to one year and 0 percent to the other two years is permitted. Therefore, no changes to the spreadsheet or regulation are necessary.

COMMENT: One commenter stated that in Exhibit Two it should not be necessary to show “unpaid bulk/IBNR losses” because of the variation that occurs from year to year.

RESPONSE: IBNR loss is not used in the calculation and is only required so that the Department can balance the data on the Annual Statement page 14, which are only available on a case plus IBNR basis.

COMMENT: One commenter stated that Exhibit Two, Column 3B requires that insurers indicate “unpaid bulk/IBNR losses.” Assuming that the terms “bulk IBNR” and “unpaid bulk/IBNR” have identical definitions, the commenter requests that such data not be required in this regulation. First, it does not appear that such data are necessary for the excess profits calculation. Second, because many insurers do not typically estimate bulk/IBNR by state, providing such data imposes an unnecessary burden on insurers.

RESPONSE: Bulk and IBNR losses are identical; the two definitions are interchangeable. IBNR loss is not used in the calculation and is only required so that the Department can balance the data on the Annual Statement page 14, which are only available on a case plus IBNR basis.

COMMENT: One commenter stated that in Exhibit Two, Column 3B requires further clarification as to whether “unpaid bulk/IBNR losses” are separate or identical definitions. The commenter questioned whether this data are even needed in an excess profits calculation particularly when we do not use state specific information on “bulk/IBNR.”

RESPONSE: Bulk and IBNR losses are identical; the two definitions are interchangeable. IBNR loss is not used in the calculation and is only required so that the Department can balance the data on the Annual Statement page 14, which are only available on a case plus IBNR basis.

COMMENT: One commenter stated that in Exhibit Three, although paid-loss plus unpaid-case-loss development factors would be more stable than paid-loss development factors, the continued use of formula-driven development factors instead of company-selected development factors can distort estimates of ultimate losses. The commenter contends that some of their companies have had changes in case reserving practices, which would distort this formula-driven method of calculating ultimate losses. An appropriate amendment would give the carriers flexibility in determining what ultimate losses are to be reported.

RESPONSE: The company can incorporate a tail factor, which is based on the company’s own data to address inconsistencies in its loss reserving method.

COMMENT: One commenter suggested that the Department amend N.J.A.C. 11:3-20 Appendix Excess Profits Exhibits - Instructions Exhibit Eight to add after the instructions from Item 5C (additions in boldface):

“Item 5D: Catastrophe reinsurance recoverables,” and add after Item 11C,

“Item 11D: Catastrophe reinsurance premiums,” and amend Item 16 to read,

“Item 16: =Item2 + Item 3 - Item 4 - Item 5C + Item 5D - Item 7 - Item - Item 9 - Item 10 - Item 11C -Item 11D - Item 14.”

N.J.A.C. 11:3-20 Appendix Input Forms and Exhibits Exhibit 8 should be amended to add after Item 5C,

“Item 5D: Catastrophe reinsurance recoverables \_\_\_\_\_”

“Item 11D: Catastrophe reinsurance premiums \_\_\_\_\_”

RESPONSE: The Department disagrees with the commenter. Consistent with rate indications, all excess profit reports shall be made on a direct basis. Catastrophic reinsurance is a large part of the homeowner’s insurance premium. However, it has a negligible impact for private passenger automobile insurance since it only applies to comprehensive coverage. Also, it is very difficult to allocate a countrywide catastrophic reinsurance treaty, to New Jersey, then to private passenger automobile, and then to comprehensive coverage. It is not possible for the Department to verify this data from NJ page 14, of the IEE or the Annual Statement. It is highly unlikely that this negligible amount will make a difference between an excess profit and an excess loss. This provision will not be included in the excess profit regulation, but may be addressed in an individual company filing.

COMMENT: One commenter stated that under the current excess profits regulations in Exhibits 1 and 8, UCJF assessments are subtracted from premiums rather than accounted for as an expense. Assessments are expenses and should be treated as such. The proposal requires that all of the excess profits computations based on premium be made after UCJF assessments are subtracted. The result is that the premium used to compute the Company's permissible profit is artificially reduced. The commenter contends that the calculation of actual profit as a percentage of premium is artificially inflated.

The commenter suggested that the Department amend N.J.A.C. 11:3-20 Appendix Excess Profits Exhibits - Instructions and Exhibit 1 to delete line 1A entirely and the instructions related to it.

The commenter also believes that N.J.A.C. 11:3-20 Appendix Excess Profits Exhibits - Instructions should be amended following the instructions for Items 11C and 11D to read:

“Item 11E: UCJC assessments” \_\_\_\_\_”

“Item 11E: UCJF assessments \_\_\_\_\_”

and amend Item 16 to read (additions in boldface):

“Item 16: =Item2 + Item 3 - Item 4 - Item 5C +Item 5D - Item 7 - Item 8 - Item 9 - Item 10 - Item 11C -Item 11D - Item 11E - Item 14.”

RESPONSE: The Department agrees with the commenter and will address its concern in a subsequent proposal. The commenter's suggested change is a substantive change that will require new comment period.

COMMENT: The Department notes that several commenters referred to what were editorial and formatting errors in the Department's rules that appeared on the Department's website. Those comments are grouped and listed below.

One commenter stated that the definitions of "AIRE charges" and "AIRE compensation" appear twice - once in brackets and once in regular type.

One commenter stated that the definition of "anticipated investment income" appears twice - once in brackets and once in bold type.

One commenter stated that in the Appendix, Input Sheet, the text of N.J.A.C 11:3-20.5(c)5 and (c)6 and N.J.A.C. 11:3-20.5(g), (g)1 and (g)2 inadvertently appear in this part of the Appendix.

One commenter stated that N.J.A.C. 11:3-20.6(a) should be amended as follows (additions in boldface; deletions in brackets):

"All private passenger automobile insurers that are part of an insurance company holding system shall file [a separate] one combined excess profit report under N.J.S.A. 17:29A-5.7 and N.J.A.C. 11:3-20.5. In compliance with this obligation [a] separate certifications and individual **excess** profit[s] reports [(Exhibit Ten)] may be filed for each insurer in an insurance holding company system. [The certification and individual excess profit report shall be filed by each company within the insurance company holding system and shall be attached to and accompanied by] and included with the combined excess profit report filed by the insurance company holding system."

One commenter stated that N.J.A.C. 11:3-20.7 should be amended to delete the definition of "excess investment income" which inadvertently appears within the text of this provision.

One commenter stated that N.J.A.C. 11:3-20.10 should be amended so that the proposal indicates that there is “(No change)” to section b (instead of subsection (a)).

One commenter stated that in Appendix, Exhibit One, the following language first appears in brackets and then appears in bold: “Exhibit One is to be completed using data for calendar year 1995. Exhibits substantially similar to Exhibit One are to be completed for each of the years 1998 through 1994.” Also, the full original text that is being deleted in this section appears twice.

One commenter stated that in Appendix, Exhibit Two, the language contained in this section does not accurately reflect the regulation’s current text. Additionally, the commenter stated that in Appendix, Exhibit Three, the first sentence in this section inadvertently deletes and then adds identical plus additional language to the regulation and appears to be missing the word “for,” and reads as follows (additions in boldface; deletions in brackets):

“One commenter noted errors in Exhibit Three, [states states shows the “development triangles” of [paid loss] paid Case Incurred Loss and ALAE for [BI/UM and PIP BI/UM and PIP **for each coverage.** [This exhibit is derived from Exhibit Two.]”

The commenter stated that in Appendix, Exhibit Four, the language deleted by the Department in Exhibit Three appears again under Exhibit Four. The words “EXHIBIT FOUR” appear twice. The paragraphs following the words ‘EXHIBIT FOUR’ appear twice and are not deleted.

The phrase “EXHIBIT [FIVE] FIVEFOUR” appears in the text and throughout the subsequent paragraphs, which also appear to contain language inadvertently included by the Department. For example, the first line in the first paragraph reads:

“Exhibit [Five] FiveFour - Part One, [Part One] Part 1., [states] staates shows countrywide direct...”

Also, the language contained in this section does not accurately reflect the regulation’s current text.

One commenter stated that in Appendix, Exhibit Five, this section inadvertently refers to Exhibit “SixFive.” Also, the original text, which is deleted by the Department, is subsequently reinserted.

Additionally, the commenter stated that in Appendix, Exhibits Six, Seven, Eight and Nine, typographical errors generally described with respect to the above Exhibits also appear in Exhibits Six, Seven, Eight and Nine.

The commenter also stated that in the Appendix, Input Forms and Exhibits, the language contained in this sections does not accurately reflect this section’s current text.

RESPONSE: The notice proposal that appears in the New Jersey Register does not contain these formatting errors. These errors apparently were contained in the text of the proposal that appeared in the Department’s website. The problems that resulted in the formatting errors have been addressed. The Department regrets an inconvenience created by the misprints that appeared on the website.

COMMENT: One commenter stated that Exhibit Three Part 2 requires that insurers utilize the formula for loss development factors provided in this regulation. However, uniform utilization of this formula by all insurers does not enable each insurer to account for circumstances unique to its company’s calculation of paid loss and unpaid case loss and will not even enable insurers to account for changes proposed in this regulation. The commenter suggested that each insurer

be able to utilize, with written justification, alternative loss development factors so that each insurer's data most accurately reflects its true financial situation.

RESPONSE: The company can incorporate the data into the tail factor, which is based on the company's own data to address inconsistencies in its loss reserving method

COMMENT: One commenter stated that Exhibit Eight provides that the excess profit shall be calculated based on the latest three accident years of that filing. The commenter contends that enabling insurers to calculate an excess profit based only on the latest three accident years is too short of a period and will result in too much variation in and distortion of data.

RESPONSE: The Department cannot address the commenter's concern by rule. The three-year time period is mandated by N.J.S.A. 17:29A-5.8, and would require a statutory change which is beyond the scope of these rules.

COMMENT: One commenter stated that in Exhibit Four, the formula-driven developed values will cause distortions in the development adjustments because variation in case reserves will lead to variation in development factors which will lead to fluctuation in estimated ultimates.

RESPONSE: The company can incorporate a tail factor, which is based on the company's own data to address inconsistencies in its loss reserving method.

COMMENT: One commenter stated that there are two technical aspects of the regulation that warrant mention. As currently written, the regulation would require Medical Payments coverage to be combined with PIP payments coverage on Section C of the Input Sheet. However, the



format for annual reporting combines Medical Payments coverage with Bodily Injury and Uninsured Motorist coverage. If the regulation is adopted as proposed, payments for PIP will not balance on the Annual Statement. Instead, the commenter suggests that the proposal be amended to allow companies to continue to combine Medical Payments with Bodily Injury and Uninsured Motorist coverage and report PIP independently. Secondly, the Appendix to the rule instructs that ratios are expressed as decimals and are rounded to the third decimal point. Although the templates display three decimal points, the formulas included therein do not round to the third decimal point.

RESPONSE: The Department agrees with the commenter on both points. These technical changes are being made upon adoption.

COMMENT: One commenter questioned when it must come into compliance with the revised reporting elements. There is some confusion as to whether insurers must report under the proposed revisions contained in this proposed regulation or under the reporting revisions of the existing regulation. To remove this confusion, the commenter requests that language be added to the proposal to clarify that compliance with the amended regulations is optional in 2002 and not mandatory until 2003.

RESPONSE: Insurers that made filings prior to the effective date of the adoption of these rules are only mandated to comply with the rules in effect at the time of the filing. Subsequent filings shall be governed by these adopted amendments.

COMMENT: One commenter expressed concern over the continued use of the Clifford formula that was developed in 1972. The formula assumes market conditions that were in existence some

30 years ago. Since these conditions no longer exist, the Clifford formula should no longer be mandated. Member companies requested that the proposed regulation eliminate this requirement.

RESPONSE: The Department cannot address the commenter's concern by rule. N.J.S.A. 11:29:A-5 states that the same profit and contingency load used for prior approval rate filings should also be used for excess profit reports. The proposed change would need to first be addressed in N.J.A.C. 11:13-16, which is beyond the scope of this proposal.

COMMENT: One commenter expressed concern regarding the level at which a company has to report. Currently, this threshold is 150 car years over a three year period of time. This level is an extremely low threshold for such an extensive reporting requirement. Moreover, since each company has to use its own experience in generating ultimate losses, there is no credibility in individual company development at this low volume level. It also complicates the reporting process for smaller-sized companies. The commenter recognizes that the 150-earned car year threshold is set by statute and not by regulation. The commenter would encourage the Department to consider a legislative effort to increase the threshold to a higher and more reasonable volume level.

RESPONSE: The Department cannot address the commenter's concern by rule. The 150 exposure threshold over a three-year time period is mandated by N.J.S.A. 17:29A-5.8, and would require a statutory change which is beyond the scope of these rules.

COMMENT: One commenter stated that the "input sheets" require the collection and reporting of both Direct Unpaid Bulk/IBNR Loss and Direct Unpaid Bulk/IBNR, ALAE, on an accident

year basis for the eight calendar years included in the report. However, this data does not appear to be carried forward into the excess profits calculation beyond its initial input. The gathering and reporting of this information is time-consuming and appears to have no bearing on the calculation. The commenter requests that this data not be required in the report.

RESPONSE: IBNR loss is not used in the calculation and is only required so that the Department can balance the data on the Annual Statement page 14, which are only available on a case plus IBNR basis.

COMMENT: One commenter stated that the development adjustment calculation contained in Exhibit 3A, Parts 4-6 in its proposed form does not represent a comparison of the ultimates reported in one year's excess profits report to the next year's excess profits report. The elimination of the oldest accident year in the triangles on Exhibit 3A, Parts 4 and 5 creates the inconsistency in this comparison. By eliminating this accident year in Exhibit 3A, Part 5, the Incremental LDFs in Col (A) of Part 2 in one year's excess profits report will be different than the Incremental LDFs in Col (A) of Part 5 in the next year's excess profits report. If the intent of the development adjustment is to compare the ultimates from one excess profits report to the next excess profits report, then the proposed calculation does not appear correct. We request that the Department clarify its intent in this particular calculation.

RESPONSE: This represents a substantial change that cannot be incorporated on adoption, but will be addressed in the Department's subsequent proposed amendments to these rules.

COMMENT: One commenter stated that although it is unclear whether these proposed regulations will be adopted by July 1, 2002, the date insurers must file their excess profit reports

with the Department pursuant to N.J.A.C. 11:3-20.4(b), it respectfully requests that insurers be permitted to use the existing regulation for reports due July 1, 2002. Insurers have already begun preparing their excess profit reports due July 1, 2002 and are basing their preparation on the requirements of the existing regulation. Requiring that insurers' July 1, 2002 reports reflect amendments adopted just prior to July 1, 2002 may result in late filed reports and inadvertent errors.

RESPONSE: Insurers that made filings prior to the adoption of these rules are only mandated to comply with the rules in effect at the time of the filing.

COMMENT: One commenter stated that the underlying assumptions that went into the derivation of the 3.5 percent target operating profit are no longer accurate in New Jersey's current auto marketplace. The Clifford Formula assumes that insurers can earn a return of 6 percent on "required surplus" and 1 percent on "additional surplus." Clifford then used a premium to surplus ration of 2:1 as being optimal. At the time the Clifford formula was developed, it assumed that the industry was actually operating at closer to 1:1 and therefore, "additional surplus" and "required surplus" were of equal value. Averaging the 6 percent and 1 percent valued for each of the segments of surplus, the formula arrived at a target operating profit of 3.5 percent. Regardless of the validity of the target returns on each type of surplus, the assumption that the industry is running at 1:1 is clearly not accurate in today's marketplace.

RESPONSE: The Department cannot address the commenter's concern by rule. N.J.S.A. 11:29:A-5 states that the same profit and contingency load used for prior approval rate filings

should also be used for excess profit reports. The proposed change would need to first be addressed in N.J.A.C. 11:13-16, which is beyond the scope of this proposal.

#### Federal Standards Statement

A Federal standards analysis is not required because these rules regulate the business of automobile insurance, which is governed by Title 17 of the New Jersey Statutes, and 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]\***):

11:3-20.6 Reporting requirements for insurance holding company systems

(a) – (b) (No change from proposal.)

(c) Notwithstanding any provision of this section to the contrary, for purposes of evaluating the Excess Profit\*[s]\* Reports, the excess profit\*[s]\* computation shall be performed solely on the insurance holding company system's combined **\*excess\*** profit report.

(d) – (e) (No change from proposal.)

## APPENDIX

## EXCESS PROFIT EXHIBITS--INSTRUCTIONS

In all Exhibits, dollars are stated as whole numbers, and ratios are expressed as decimals \*[rounded]\* to the third decimal place. Where a three-year sum is expressed as a ratio, the ratio required is the ratio of three years' dollar figures and not the sum of the three ratios. The Exhibits attached are 2002 exhibits. Where exhibits for later years must be reported, the filer is required to submit Exhibits which are substantially similar to the attached Exhibits to report the later years' data and which contain all information, including dates, adjusted accordingly.

## INPUT SHEET

The Input Sheet consists of four sections:

Section A is for the Bodily Injury Liability \*, Medical Payments coverages \* and Uninsured/Underinsured Motorist coverages (BI/UM).

Section B is for the Property Damage Liability coverage (PD).

Section C is for the Personal Injury Protection \*[and Medical Payments coverages]\* (PIP).

Section D is for Comprehensive, Collision and other miscellaneous Physical Damage coverages (Phys Dam).

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