

INSURANCE  
DEPARTMENT OF BANKING AND INSURANCE  
DIVISION OF INSURANCE

**Rate Process for Limited Rate Changes;** Calculations for Private Passenger Automobile Insurance Rate Changes

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

Authorized By: Holly C. Bakke, Commissioner, Department of Banking and Insurance

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.

Calendar Reference: See Summary below for explanation of exception to the calendar requirement.

Proposal Number: PRN 2003-293

Submit comments by September 19, 2003 to:

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The agency proposal follows:

**Summary**

The Department of Banking and Insurance (Department) is amending N.J.A.C. 11:3-16B, Expedited Process; Calculations for Private Passenger Automobile Insurance Rate Changes, as a result of the June 9, 2003, enactment of section 42 of P.L. 2003, c.89 (the "Act"). The Act provides a well-balanced solution to the immediate automobile insurance availability crisis facing New Jersey consumers, insurers and regulators. These amendments are also necessary in order to make this rule consistent with amendments the Department is proposing to N.J.A.C. 11:3-16, Rate Filing Requirements: Voluntary Market Private Passenger Automobile Insurance

(see notice of proposal published elsewhere in this issue of the New Jersey Register). The proposed amendments to that subchapter modernize what will be considered standard rate making methodology by replacing the current calculation (the “Clifford Formula”) with a Return on Equity calculation.

The Department is amending the heading of the subchapter by replacing the phrase “Expedited Process” with the phrase “Rate Process for Limited Rate Changes” prior to “Calculations for Private Passenger Automobile Insurance Rate Changes.” The Department is also amending N.J.A.C. 11:3-16B.1(a), the headings of N.J.A.C. 11:3-16B.3 and 16B.4, and text in N.J.A.C. 11:3-16B.4(a) and 16B.6(i) to delete references to “expedited” and “expedited process” and replace them with references to “limited” and “rate process for limited rate changes.” The Department believes this new text more accurately reflects the nature of the rate filings addressed in the subchapter.

The Department is amending paragraph (b)1 in N.J.A.C. 11:3-16B.1, concerning to whom the subchapter applies, by adding the phrase “affiliated groups of insurers” pursuant to section 42 of the Act.

The Department is also amending the definition of “written premium” found in N.J.A.C. 11:3-16B.2, by replacing the term “earned premium” therein with the term “written premium.” The Department is also changing the definition of “rate change” to track the amendments to N.J.S.A. 17:29A-46.6 enacted by P.L. 2003, c. 89. These amendments provide that “rate change” means a rate increase of no more than seven percent overall or not more than 10 percent in any single coverage.

In addition, the Department is amending N.J.A.C. 11:3-16B.3 by substituting the reference to “the 16B Checklist” with a reference to “Exhibit A” in the subchapter Appendix.

The Department is also amending N.J.A.C. 11:3-16B.4(c)2i by reducing the number of years included in the average on which the selected age-to-age factors are based from seven to five, and adding text to N.J.A.C. 11:3-16B.4(c)3 indicating that for loss trend factors, all data must be based on paid, not incurred/arising, claims. The verb “computed” is also being added to the first sentence of this paragraph in order to make it a grammatically complete sentence. The Department is also proposing to delete the reference in N.J.A.C. 11:3- 16B.4(c)3ii to “COLL” (collision) because data on collision claims is not included in data on the effect of catastrophes. The Department is also amending N.J.A.C. 11:3-16B.4(d)1 and 4 to reflect the proper page number of New Jersey data on the insurer’s annual financial statement filed with the Department. N.J.A.C. 11:3-16B.4(d)5 is being deleted since the Act transfers and consolidates the Unsatisfied Claim and Judgement Fund to the New Jersey Property-Liability Insurance Guaranty Association. The Department is also proposing to amend N.J.A.C. 11:3-16B.4(d)6 by recodifying it and deleting a reference to the “Clifford Formula” therein and replacing it with “Return on Equity Formula.” N.J.A.C. 11:3-16B.4(d)7 is being recodified as (d)6 and amended by changing the reference from (d)6 to 5.

In accordance with the Act, the Department is amending N.J.A.C. 11:3-16B.5(a), (b) and (c) by substituting the references therein to “three” percent with “seven” percent and replacing the reference to “five” percent in (c) with “10” percent. N.J.A.C. 11:3-16B.5(d) is being amended, and subsection (e) is being added, to track amendments to N.J.S.A. 17:29A-46.6(f) and (g), enacted by the Act, which relate to the timing of the submission of limited rate change filings.

The Department is amending N.J.A.C. 11:3-16B.6(a) to track the statutory amendments to N.J.S.A. 17:29A-46.6(c), made by the Act regarding the standard for review of limited rate

change filings. N.J.A.C. 11:3-16B.6(d) and (f) are being amended to reflect the new time frames by which the Commissioner shall render his or her decision, and the length of time that the Department may extend its review of a limited rate change filing.

The Department is deleting the current 16B checklist in the Appendix and replacing it with a revised checklist, referred to as Exhibit A, which reflects the current amendments, and also references the corresponding Department rule for the requested information.

A 60-day comment period is provided for this notice of proposal and, therefore, pursuant to N.J.A.C. 1:30-3.3(a)5, the proposal is not subject to the provisions of N.J.A.C. 1:30-3.1 and 3.2 governing rulemaking calendars.

### **Social Impact**

These proposed amendments will potentially have a positive impact on consumers due to the likely increase in the number of insurers that will come to New Jersey as a result of the promulgation of these amendments and other current rule proposals, as well as the passage of the Act. In recent years, several insurers have withdrawn from the New Jersey auto insurance market, and it is possible that other insurers may file withdrawal applications in the future. The resulting decrease in competition among the remaining insurers has impeded regulatory efforts to reduce automobile insurance rates. Amending these rules to clarify and simplify the limited rate change process should result in current automobile insurers being more inclined to remain in the New Jersey market, and may attract other insurers to enter the New Jersey market.

These proposed amendments will have a beneficial impact upon insurers by clarifying the rules applicable to limited rate change filings for auto insurance with respect to the computation of investment income pursuant to the Return on Equity Formula, the claims data on which loss

trend factors shall be based, the number of years to be considered when calculating the straight average of the age to age factors, and the other revisions mentioned in the summary above. These clarifications should make it easier for more insurers to utilize the limited rate change process, thereby improving the efficiency of their operations.

The abbreviated time frames for an extension of the Department's review of a limited rate change filing, and for the Commissioner to render a decision regarding a limited rate change request, will have no impact on the Department. These amendments, therefore, benefit insurers by reducing the Department's review time and the time for the issuance of the Commissioner's decision.

#### **Economic Impact**

The Department does not anticipate any economic impact on the Department or insurers as a result of the proposed amendment replacing the reference to the "Clifford Formula" in the rule with a reference to "Return on Equity Formula." The amendment merely tracks the reference for the formula considered to be standard ratemaking methodology under the Department's proposed amendments to N.J.A.C. 11:3-16, Rate Filing Requirements: Voluntary Market Private Passenger Automobile Insurance. Additionally, the amendments add the phrase, "affiliated group of insurers" as provided in section 42 of the Act.

The Department anticipates that the proposed amendments that reduce the age-to-age factor from seven to five; delete the reference to "COLL;" and add text indicating that, for loss trend factors all data must be on a paid basis, will have a minimal, if any, economic impact on insurers.

The Department believes that the amendments – consistent with the statute – will have a salutary affect on rates consumers pay. The amendments will allow more prompt rate decisions,

but do not guarantee any particular result. In some cases, the Department anticipates that timely rate decisions may moderate requests for rate increases and lead to more stable rates. When there is a significant time lag between rate filings and rate decisions, insurers tend to compensate by asking for more substantial rate changes. The amendments also make it easier for companies to file for reductions in rates. The amendments also will reduce the likelihood of “defensive” rate requests, by allowing companies that forego making an request under the limited rate change process in one year to request up to twice the allowable rate in the following year.

#### **Federal Standards Statement**

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

#### **Jobs Impact**

Although the Department does not anticipate that the amendments alone will result in the generation or loss of jobs, it believes that the package of statutory and regulatory amendments of which it is a part, taken as a whole, will contribute to the attractiveness and competitiveness of the New Jersey automobile insurance market and help preserve and expand employment in the automobile insurance industry and in insurance agencies and brokerage firms. The Department invites interested persons to submit any data or studies about the jobs impact of these proposed rules with their written comments.

#### **Agriculture Industry Impact**

The Department does not expect any agriculture industry impact from these proposed

amendments.

### **Regulatory Flexibility Analysis**

Pursuant to the New Jersey Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq., a "small business" means any business resident in this State which employs fewer than 100 full-time employees; is independently owned and operated; and is not dominant in its field. Some insurers affected by these rules may meet this definition.

The Department has determined that the proposed amendments are reasonable and necessary for the purposes expressed herein. These rules will apply to all voluntary private passenger automobile insurers, except those that only write the "exempted types" of coverage. The kind of information referenced in the amended rules must be assembled with uniformity and reported with consistency in order to promote a stable and healthy marketplace. Consequently, these amendments impose a regulatory requirement that is even-handedly applied, without regard to business size. The Department also notes that these proposed amendments do not impose any new recordkeeping or reporting requirements on insurers. Rather, the amendment to N.J.A.C. 11:3-16B.4(c)2ii reduces the number of years of data that an insurer must include in a limited rate change filing calculation as described in the Summary above. In addition, the amendment to N.J.A.C. 11:3-16B.4(c)3ii merely removes an anomaly in the current text by deleting the reference to collision data therein with respect to the effect of catastrophes. Because collision claims cannot, by definition, be caused by catastrophes, the deletion of that reference from this subparagraph will have no effect on companies' current reporting and recordkeeping practices.

Finally, N.J.S.A. 17:29A-46.6 provides no differentiation in compliance requirements specifically based on insurer size. For these reasons, the proposed amendments provide no

differentiation in compliance requirements based on insurer size.

The Department anticipates that the future annual cost of compliance with these rules should be consistent with, or less than, the current annual cost. The use of professional services currently required by these rules (for example, actuaries, claim professionals, underwriter professionals, etc.) will continue to be necessary, at costs which vary with the individual professional.

### **Smart Growth Impact**

The proposed amendments will have no impact on the achievement of smart growth or the implementation of the State Development and Redevelopment Plan.

**Full text** of the proposal follows (additions indicated in boldface **thus**; deletions indicated in brackets [thus]):

#### SUBCHAPTER 16B. [EXPEDITED PROCESS;] **RATE PROCESS FOR LIMITED RATE CHANGES**; CALCULATIONS FOR PRIVATE PASSENGER AUTOMOBILE INSURANCE RATE CHANGES

##### 11:3-16B.1 Purpose and scope

(a) The purpose of this subchapter is to set forth the [expedited] process for a private passenger automobile insurer or rating organization to file **limited rate** changes to its rating system as permitted by N.J.S.A. 17:29A-46.6.

(b) This subchapter shall apply to rates filed by:

1. All insurers, **affiliated groups of insurers** and rating organizations writing or transacting private passenger automobile insurance in the voluntary market in this State; and

2. (No change.)



- (c) (No change.)

#### 11:3-16B.2 Definitions

The following words and terms, as used in this subchapter, shall have the following meanings, unless the context clearly indicates otherwise.

...

"Rate change" means a rate increase of no more than [three] seven percent overall or not more than [five] 10 percent in any single coverage. Rate change also means any decrease in rates or a change in rates that is revenue neutral.

"Written premium" ("WP") means direct, [earned] written premium net of dividends paid or incurred.

#### 11:3-16B.3 [Expedited filings] **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. (No change.)
  2. A checklist that sets forth the information in [the 16B Checklist] Exhibit A in the subchapter Appendix incorporated herein by reference;
  - 3.-5. (No change.)
- (b) (No change.)

11:3-16B.4 [Expedited process] **Rate process for limited rate changes;** calculation for private passenger automobile insurance

(a) General requirements for [expedited] **limited** rate **change** filings are as follows:

1. – 3. (No change.)

(b) (No change.)

(c) Ultimate loss and loss adjustment expense (“LAE”) shall be determined by:

1. (No change.)

2. New Jersey loss development factors (LDFs) by coverage, either combined (loss and ALAE) or separately;

i. The selected age-to-age factors shall be based on the latest five-year X HI/LO average, that is, using a straight average of the latest [seven] **five** age-to-age factors, excluding the highest and the lowest.

ii.- iv. (No change.)

3. Loss trend factors shall be based on either annual selections from the latest approved ISO filing in NJ, or the latest available NJ Fast Track data, **computed** separately for severity and frequency by coverage (BI, PIP, PD, COMP, COLL). **All data must be based on paid, not incurred/arising, claims.**

i. (No change.)

ii. For [COLL and] COMP, filers may use country-wide Fast Track data to smooth out the effect of catastrophes;

4.- 6. (No change.)

(d) Expenses shall be determined by group of coverages (liability versus physical damage) from the total of:

1. Three year average of commissions and brokerage expense ratios based on the NJ page 14 [15] of the insurer's latest annual statement filed with the Department and calculated as ratios to NJ WP;

2. - 3. (No change.)

4. Three year average of taxes, licenses and fees ratios, based on the NJ page 14 [15] of the insurer's latest annual statement filed with the Department and calculated as ratios to NJ WP; **plus**

[5. The most recent Unsatisfied Claim and Judgement Fund assessment for liability coverages; plus]

[6.]5. Profit and contingency provisions reflecting investment income computed pursuant to the ["Clifford Formula"] **Return on Equity Formula** in N.J.A.C. 11:3-16.10(a).

[7.]6 Total capped expenses shall be determined from the sum of (d)3 through [6]5 above.

(e)-(k) (No change.)

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

(a) If the overall indicated change as determined in N.J.A.C. 11:3-16B.4 is an increase of [three] **seven** percent or more, the filer shall request an overall increase of no more than [three] **seven** percent.

(b) If the overall indicated change as determined by N.J.A.C. 11:3-16B.4 is less than [three] **seven** percent, the filer shall request no more than the overall rate change that is indicated.

(c) Filers shall be permitted to seek single coverage increases of up to [five] **10** percent provided the rate change is indicated by coverage and the overall increase does not exceed [three] **seven** percent.

(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, or to a filing reflecting a statutory change in coverage.**

**(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 not more than once within a 24 month period.**

11:3-16B.6 Review; general principles; action

(a) If the Commissioner determines that the filing [will not produce rates that are excessive, are inadequate for the safety and soundness of the insurer, or are unfairly discriminatory between risks in this State involving substantially the same hazards and expense elements] **includes all the information and calculations required to support the rate change,** then the Commissioner shall approve the filing.

(b) – (c) (No change.)

(d) The Commissioner shall render a decision **on a filing requesting an increase of up to three percent** within [45] **30** days [of] **after** receipt of the filing. **A decision on a filing**

**requesting an increase of more than three percent, but not more than seven percent, shall be rendered within 45 days after receipt of the filing.**

(e) (No change.)

(f) In the event additional time is needed to act on a complete rate change filing, [the Department may seek an extension of time from] the Commissioner[, which shall not exceed 60 days from receipt of the filing] **may extend the time periods for review specified in (d) above by no more than 15 days.**

(g) – (h) (No change.)

(i) If a filer has a pending application for [an expedited] **a limited** rate change pursuant to this subchapter, the filer shall promptly amend such pending filing to reflect any rate change approved in accordance with N.J.A.C. 11-16.6.

## APPENDIX

[16B Checklist

- (1) Cover letter
- (2) Manual pages
- (3) Certification
- (4) Filer's name
- (5) Effective date for new and renewal policies
- (6) Number of exposures affected
- (7) Rating examples
- (8) Average premium, current and proposed by coverage
- (9) Calculations showing proposed rates are in compliance with N.J.S.A. 17:29A-36
- (10) Calculation of projected earned premium
- (11) Derivation of on-level factors and submission of a rate history
- (12) Derivation of annual premium trends (if submitting company data) or annual selections (if using ISO factors) and derivation of the premium trend period
- (13) Calculation of ultimate loss and LAE
- (14) Derivation of loss development factors
- (15) Derivation of annual loss trends (if submitting Fast Track data) or annual selections (if using ISO factors) and derivation of the loss trend period
- (16) Derivation of unallocated loss adjustment expense factors
- (17) Derivation of factors to reflect applicable law changes
- (18) Derivation of the full-credibility percentages and standards (if submitting company data)
- (19) Derivation of the complements of credibility, i.e. the loss ratio trend factors
- (20) Calculation of permissible loss and LAE ratios
- (21) Derivation of expense ratios
- (22) Derivation of profit and contingency provisions reflecting investment income
- (23) Credibility-weighted indications by coverage and overall
- (24) Territorial indications by coverage (if not proposing uniform base rate changes by territory)
- (24) Completed N.J.A.C. 11:3-16 Appendix - Exhibit E.]

## Exhibit A

Section	Description	Page Number
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>	
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><li>• Overall change smaller of indicated change or three percent</li><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><li>• Includes Company file number</li><li>• Includes New/Renewal effective dates</li></ul>	
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	Required Indications by Types Sold: <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 separately</li><li>• Both split &amp; CSL: separate BI &amp; PD (with UM), with CSL either allocated or done separately [two or three indications]</li></ul>	

- 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)

  - 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)2 Loss Development Factors based on average of last five years, that is, excluding high and low (middle three of five years)

  - 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 & 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 Profit provision based on Return on Equity Formula
- 16B.4(d)7 Total Capped Expenses is sum of 3 through 6 above
- 16B.4(e) Permissible Loss Ratio is 1 minus (d)7
- 16B.4(f)1 DOBI Standard Credibility  
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 (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 percent or indicated change	
16B.5(c)	Request by coverage limited to smaller of + five percent or indicated change	
16B.5(d)	Last limited rate change filing approved at least 12 months ago	Yes / No

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