

INSURANCE  
DEPARTMENT OF BANKING AND INSURANCE  
OFFICE OF PROPERTY AND CASUALTY

Commercial Lines Insurance: Policy Form Standards  
Defense Costs Within Policy Limits

Proposed Amendment: N.J.A.C. 11:13-7.3

Authorized By: Steven M. Goldman, Commissioner, Department of Banking and Insurance

Authority: N.J.S.A. 17:1-8.1, 17:1-15e and 17:29AA-1 et seq.

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

Proposal Number: PRN 2008-55

Submit written comments by May 2, 2008 to:

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The agency proposal follows:

Summary

In the recent past, the medical malpractice liability insurance market has been strained in New Jersey, as well as throughout the nation. The issues of availability and affordability of medical malpractice liability insurance have been a matter of concern. The Department of Banking and Insurance (Department) amended N.J.A.C. 11:13-7.3 effective January 6, 2003 to permit policies for medical malpractice liability insurance to include defense costs within policy limits provided that such a provision conforms to specified standards. These standards include that the policy form shall provide a minimum limit of liability of \$1 million; defense costs shall

not reduce the portion of the limit of liability that remains available to pay claims until defense costs have been incurred in an amount that equals or exceeds 50 percent of the policy limit of the policy; and the portion of the limit of liability available to pay claims shall not be reduced to an amount less than 50 percent of the policy limit of liability, regardless of the amount of defense costs incurred. These standards also apply to lawyers and professional liability insurance policies that contain a provision that includes defense costs within policy limits.

Upon further consideration and review, the Department has determined that it is reasonable and appropriate to amend N.J.A.C. 11:13-7.3 to permit insurers to offer medical malpractice liability insurance policy forms that include defense costs within policy limits that do not meet the standards currently set forth in N.J.A.C. 11:13-7.3(c) if they meet the requirements in proposed new subsection (d). The proposed standards are that the policy form provides a minimum limit of liability of \$1 million and that the insurer at a minimum also offers the applicant a policy with identical limits providing defense costs outside of policy limits. In addition, the insurer shall maintain, for a period of five years from policy expiration, a certification with respect to initial applications and renewals in which a change is made to include defense costs within limits under the terms of the renewal policy. A sample of the certification form shall have been filed with the Department with the policy form providing defense costs within policy limits and shall confirm that a policy form providing defense costs outside of policy limits was offered and declined by the applicant, and that the applicant is aware that the amount available under the policy for payment of a liability claim will be commensurately reduced by the costs of defense. Finally, the insurer is required to file rates for medical malpractice liability insurance policies that include defense costs within policy limits that are commensurately reduced to reflect the coverage provided.

The Department believes that the additional flexibility afforded in the offering of medical malpractice liability insurance policies will enhance the availability and affordability of such coverage, and will provide the purchasers of such policies additional choices with respect to purchasing policies that include different coverage choices at commensurate costs based on the purchaser's needs.

The Department also proposes to amend N.J.A.C. 11:13-7.3(a)1 to clarify that the provision that no defense costs shall be charged against any deductible amount applies regardless of whether the policy provides defense costs within policy limits.

The Department also proposes to amend N.J.A.C. 11:13-7.3(a) to change the statutory reference to reflect the entirety of the act, and to recodify existing N.J.A.C. 11:13-7.3(d) as (e).

The Department also proposes to amend N.J.A.C. 11:13-7.3(c) to make grammatical changes as a matter of form.

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

The proposed amendments will provide additional coverage choices for medical malpractice liability insurance, which will enhance the choices available to purchasers of such coverage at different premium levels commensurate with the coverage provided. This will permit purchasers to obtain coverage based on their needs and not require them to pay for coverage not needed. This will also foster competition among insurers in providing various products with different coverage levels with respect to defense costs within limits.

### Economic Impact

Insurers seeking to offer medical malpractice liability insurance policy forms that include defense costs within policy limits that do not comply with N.J.A.C. 11:13-7.3(c) will be required to bear any costs associated with compliance with proposed N.J.A.C. 11:13-7.3(d). These costs are minimal and are optional to the company. The costs include developing, filing and maintaining the form to provide proof that the applicant was offered and declined coverage with defense costs outside of policy limits. These costs should not impose any undue burden on insurers. The Department believes that any costs are outweighed by the benefit of ensuring that applicants for such policies are aware of the choices they are making and the financial impact of those choices.

In addition, insurers must charge rates commensurate with the coverage involved to the extent any policy includes defense costs within policy limits. The Department does not believe that this imposes any undue costs on insurers in that it merely recognizes that rates should reflect the coverage provided. The other requirements in proposed new subsection (d) either reflect existing requirements or are intended to ensure that purchasers are given a choice of coverages. In addition, purchasers of medical malpractice liability insurance will be afforded additional choices so as to purchase coverages at costs commensurate with such coverage and that correspond to individual purchasers' needs. This, in turn, should enhance the medical malpractice liability insurance market, thereby benefiting insurers and purchasers of such coverage. No new professional services should be required to comply with the proposed amendments.

Insureds will be provided additional choices regarding the type of coverage they wish to purchase based on their individual circumstances. In addition to the payment of a reduced premium, as noted in the proposal Summary above, the amount available under the policy for payment of a liability claim will be commensurately reduced by the costs of defense. The economic impact upon an insured of choosing a policy that includes defense costs within policy limits will vary depending upon the number of claims filed against the policy, the costs of defending any filed claims and the amounts of any payments made based upon any liability to a claimant on the part of the insured.

#### 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

The Department does not anticipate that any jobs will be generated or lost as a result of the proposed amendments.

The Department invites commenters to submit any data or studies concerning the jobs impact of the proposal together with their comments on other aspects of the proposal.

#### Agriculture Industry Impact

The proposed amendments will not have any impact on the agriculture industry in New Jersey.

### Regulatory Flexibility Analysis

The proposed amendments may apply to small businesses, as that term is defined in the Regulatory Flexibility Act, N.J.S.A. 52:14B-16 et seq. To the extent the proposed amendments apply to small businesses, they apply to insurers transacting medical malpractice liability insurance in this State seeking to offer policies with defense costs within policy limits that do not fully comply with N.J.A.C. 11:13-7.3(c). Such insurers will be required to bear any costs associated with complying with the N.J.A.C. 11:13-7.3(d) as set forth in the Economic Impact above. As noted therein, these costs are minimal, reflect costs currently imposed, and are optional based upon a company's decision on whether to offer the policies described above. No new professional services should be required for compliance with the proposed amendments. The proposed amendments eliminate several current restrictions on the provision of medical malpractice liability insurance policies that include defense costs within policy limits. The requirement that the policy contain liability limits of not less than \$1 million is currently required pursuant to N.J.A.C. 11:13-7.3(c). The proposed amendments do require that rates be commensurately reduced to reflect the coverage provided, but this does not impose any new requirements on insurers. Rather, this merely reflects the requirements applicable to the establishment of rates prescribed in N.J.S.A. 17:29AA-10 that rates not be excessive, inadequate or unfairly discriminatory, and thereby reflect the risk for which the coverage provided. The proposed revised requirements that, at the option of insurers, may apply to medical malpractice liability insurance policies are intended to ensure that applicants are given a choice of coverage options and are aware of the available options, and to confirm that such options were, in fact, provided.

The proposed amendments do not provide any different reporting, recordkeeping or other compliance requirements based on business size. The proposed amendments set forth standards by which insurers may offer medical malpractice liability insurance policies that provide for defense costs within policy limits that do not comply with the standards set forth in the existing rules. These requirements are designed to ensure that applicants make informed choices and pay premiums reflecting the coverage provided. These goals do not vary based on business size.

#### Smart Growth Impact

The proposed amendments will not have an 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]):

11:13-7.3 Defense costs within policy limits

(a) No commercial insurance policy shall be issued or renewed on a form required to be filed pursuant to N.J.S.A. 17:29AA-[6] **1 et seq.** which contains a provision that includes defense costs within policy limits, except as provided in this section.

1. [No] **Regardless of whether the policy form provides defense costs within or outside of policy limits, no** defense costs shall be charged against any deductible amount.

(b) Lawyers and medical malpractice professional liability insurance policies may contain a provision that includes defense costs within policy limits provided it conforms to the standards set forth in (c) below **or, in the case of medical malpractice liability insurance, to the standards set forth in (d) below.**

(c) Lawyers and medical malpractice professional liability insurance policy forms [including the] **that include** defense costs within policy limits shall contain policy provisions, which may be in the form of a mandatory endorsement, so as to incorporate the standards set forth below into the terms of each policy[:].

1. – 3. (No change.)

**(d) Notwithstanding that they do not conform with (c) above, medical malpractice professional liability insurance policy forms that include defense costs within policy limits may be offered if:**

**1. The policy form provides a minimum limit of liability of \$1,000,000;**

**2. The insurer at a minimum also offers the applicant a policy with identical limits providing defense costs outside the limit of liability;**

**3. The insurer secures a certification on a policyholder notice signed by the applicant confirming that a policy providing defense costs outside the limit of liability was offered to the applicant and the applicant declined such coverage, and further confirming that the applicant is aware that the amount of coverage available for payment of a liability claim will be commensurately reduced based on defense costs. The notice shall be required with respect to initial applications. It shall not be required on renewals of existing policies unless a change is made upon renewal to include defense costs within limits. The form of the policyholder notice shall be filed with the Department with the filing of the policy form providing defense costs within limits, and the signed certifications shall be maintained by the insurer for a period of five years from the expiration of the policy; and**

**4. The insurer shall file rates for medical malpractice liability insurance policies that contain a provision that includes defense costs within policy limits which shall be commensurately reduced to reflect the coverage provided.**

[(d)] **(e)** (No change in text.)