INSURANCE
DEPARTMENT OF BANKING AND INSURANCE
DIVISION OF INSURANCE

Reporting Financial Disclosure and Excess Profits

Adopted Amendments: N.J.A.C. 11:3-20.3, 20.5 and 11:3-20 Appendix

Proposed: March 15, 2004 at 36 N.J.R. 1279(a).

Adopted: August 10, 2004 by Holly C. Bakke, Commissioner, Department of Banking and Insurance

Filed: August 10, 2004 as R., 10024 d. 228 **with substantial 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-5.6 through 5.16 and sections 67, 68, 69 and 82 of P. L. 2003, c.89.

Effective Date: September 7, 2004

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: Allstate New Jersey Insurance Company, State Farm Insurance Companies and the Insurance Council of New Jersey.

COMMENT: Two commenters expressed concern with the Appendix, Excess Profit Exhibits-Instructions, Exhibit Eight. One commenter stated that the proposed rules include a definition for extraordinary loss, which is calculated on an individual calendar-accident year basis for all coverages combined. The commenter questioned if the extraordinary loss calculation is allowed for all seven calendar-accident years to be reported in its 2003 report filed July 1, 2004, or whether it is only allowed for the current calendar-accident year 2003 and those going forward. The commenter recommended that this should be allowed for all seven individual calendar accident years contained in the excess profit report. The commenter questioned if all seven individual calendar-accident years were allowed to be calculated, do they use the latest ultimate loss development reported this year or do they have to go back to the reports when the individual calendar-accident years were first reported and use those ultimate loss developments in their calculations. The commenter suggested that the Department clarify in these rules that insurers are allowed to use the latest ultimate loss development reported because it would make the report accurate and easier for the insurer and the Department to administer.

The second commenter stated that in the previous year's report, extraordinary losses were not calculated for individual years. The commenter stated that all necessary data is available and extraordinary losses could be readily calculated using last year's Excel spreadsheet in a manner similar to the way extraordinary loss was calculated for the entire time period. The second commenter suggested that the Department approve this method.

RESPONSE: The extraordinary loss carry forward may be used for the entire 15-year period. The latest loss development factors as shown on Exhibit 9 are to be used. For the eighth and older years, the loss development as of year seven (the last time it is shown on Exhibit 9) is to be used. For years 1996 and prior, insurers need only calculate the extraordinary loss carry forward if it is to be used in the current report. Otherwise, it does not have to be calculated.

COMMENT: Two commenters requested that, when referring to the Extraordinary Loss in Exhibit 8, the term "calendar year" should be replaced with the term "calendar-accident year," in order to make it consistent with the language used in the definition section of this rule. Additionally, one commenter also recommended that the first sentence in Exhibit Eight Instructions be revised to read as follows (deletions in brackets, additions in boldface): "Exhibit Eight shows the extraordinary loss incurred and amount reinvested into New Jersey in each of the last 17 [CYs] **calendar-accident years** and carry forward used in each of the last 19 AYs by coverage along with the total."

RESPONSE: The Department disagrees with the commenter. The Department's use of the term "calendar year" in Exhibit 8 is appropriate and refers to information from the actual calendar year. The Department did not intend to use the term "calendar-accident years" as that term is defined in the rule because it has a different meaning.

COMMENT: One commenter stated that proposed N.J.A.C. 11:3-20 Appendix Input Sheet Exhibit 8 Instructions Item 1 should be amended to read (additions in boldface):

> "Item 1: List any extraordinary loss paid in the applicable CYs. **You will need to compute the extraordinary losses, if any, for CYs prior to 2003, as well as for CY 2003 and forward. The latest available ultimate loss development should be used in calculating the extraordinary loss for prior CYs.**

RESPONSE: The Department agrees with the commenter but cannot make this change because it would be a substantive change that requires additional public comment. The Department anticipates addressing this issue in a future proposal. However, while reviewing Exhibit 8, Item 1 of the Instructions in the course of considering this comment, the Department noted a discrepancy between the instructions and the rule to which they relate. Accordingly, the Department has made the following technical change on adoption.

The Department is amending Exhibit 8, Item 1 of the Instructions to be consistent with N.J.A.C. 11:3-20.9(b) which refers to extraordinary loss… "incurred" not "paid."

COMMENT: One commenter recommended that the term "excess profit" used to describe Item 2 in the instructions section of Exhibit 8 be changed to "Extraordinary loss."

RESPONSE: The Department agrees with the commenter and has made this technical change on adoption. The Department notes that Item 2 incorrectly references the term “excess profit.” No “excess profit,” can be listed pursuant to Item 2 of Exhibit 8 because Exhibit 8 only addresses “extraordinary loss.” Excess profit is addressed in Exhibit 7 and its corresponding spreadsheets. The corresponding spreadsheets and Exhibits associated with Exhibit 8 address “extraordinary loss,” not “excess profit.” In order to be consistent with N.J.A.C. 11:3-20.9, the Department is amending Item 2 in the Instructions for Section Eight to read:

“List any extraordinary loss used…”

COMMENT: One commenter stated that in Row 13 of Exhibit 8 of the Spreadsheet, the term “calendar-accident year extraordinary loss paid” should be changed to “calendar accident year extraordinary loss.” The commenter stated that including the word “paid” in the term implied that the loss cannot be stated until the company’s payments reach extraordinary levels, which is not the case.

RESPONSE: The Department agrees with the commenter. N.J.A.C. 11:3-20.9(b) uses the phrase “extraordinary loss…incurred,” not “paid.” Therefore, the Department is changing the term from “Calendar Year Extraordinary Loss Paid” to “Calendar Year Extraordinary Loss Incurred” on the spreadsheet in order to be consistent with the rule.

COMMENT: One commenter stated that the newly adopted amendments to N.J.A.C. 11:3-16 refer to the return on equity formula when calculating the allowance for profit and contingencies. The return on equity formula may also be updated when an insurer files for a change in rates. The commenter stated that when there is a change in the return on equity rate, they would expect the new rate to be used in calculating the allowance for the current calendar-accident year and future calendar-accident years until the rate is subsequently changed. The commenter stated that in the year of a change in the rate, a blended rate should be used by averaging the old rate and new rate based upon the number of months in effect during the year. The commenter noted that the formulas in the spreadsheet recalculate all seven of the calendar-accident years reported using the new rate. The commenter suggested that the Department correct the spreadsheet so that the previous calendar-accident years are not impacted by the change in the rate. The commenter believes that the return on equity that is appropriate for the current year is not necessarily appropriate for prior years.

RESPONSE: The commenter's comment refers to the return on equity formula, which is found in N.J.A.C. 11:3-16. The Department cannot address the commenter's concerns by amendments to these rules (N.J.A.C. 11:3-20), the Department would have to propose changes N.J.A.C. 11:3-16 which is beyond the scope of this proposal.

COMMENT: One commenter stated that the newly adopted regulations allow for an additional expense allowance (Rate Filing Requirements – N.J.A.C. 11:3-16, see 35 N.J.R. 5604(a)) if your actual expenses for commissions, other acquisition and general expenses, are less than the cap established each year by the Department. The cap is determined based upon the insurer's marketing method and is calculated as a percentage of direct earned premium. These percentages are provided annually by the Department on May 31st. The commenter stated that they would expect to update the expense allowance each year for the current calendar-accident year. The commenter noted that the formulas in the spreadsheet recalculate the expense allowances for all seven calendar-accident years using the new percentages. The commenter believes that the spreadsheet should be corrected so the previous calendar-accident years are not impacted by current year changes in the expense cap allowance. The expense ratio that is appropriate for the current year is not necessarily appropriate for prior years.

RESPONSE: The Department disagrees with the commenter. The Department believes that it is appropriate to use the most updated information for all seven years, which is reflected by the current caps that it utilizes for the seven-year period instead of using a different cap each year.

COMMENT: One commenter stated that the introduction of "extraordinary loss" in the excess profit calculation is intended to create an allowance for profit in the experience period if the company had experienced extraordinary losses leading up to that period. The commenter noted that the calculation allows for the "carry forward" of 15 years of extraordinary losses to each applicable accident year in the experience period (the experience period is seven years).

The Exhibit 8 Instructions of the Excess Profit Worksheet are consistent with the intent of the proposed regulations. The commenter stated that the user is instructed to enter 15 years of extraordinary losses in Item 1. The user is then instructed to assign those extraordinary losses to the applicable accident years as stated in Items, 2.1 through 2.19.

The commenter contends that in the Exhibit 9 Instructions, it is noted that the Carry Forward of Extraordinary Loss (Item 29) is taken from Exhibit 8, Item 2. The commenter stated that by taking values from Item 2, the calculation is not consistent with the intent of the proposed regulation. The commenter stated that Item 2 is simply the previous seven calendar-accident years used (assigned) portion of the extraordinary loss, not the pervious 15 years of these losses and how they were assigned to the applicable years. Therefore, by taking values from Item 2, only extraordinary losses from the past seven years can generate an allowance against the applicable seven-accident years used in the Excess Profit calculation. The commenter stated that this does not create the "carry forward" intended by the proposed regulations.

The commenter stated that the worksheet should sum the contribution from 15 years worth of extraordinary losses to each accident year (that is, sum of the accident year row). The total extraordinary loss assigned to each individual accident year should be used as an allowance against the same calendar-accident year in Exhibit 9. The commenter stated that when working within the actual excel spreadsheet, Item 29 in Exhibit 9 should be referring to values within Column 1 (the assigned amount of extraordinary loss to each accident year), not Row 35 (the portion of the year's extraordinary losses that were assigned to all accident years), in Exhibit 8.

Finally, the commenter suggested that, with regard to the Annual Statement data contained in Cell A308 of the Inputs Sheet, the data should be for Bodily Injury (BI) and Uninsured Motorists (UM), not just Bodily Injury.

RESPONSE: The commenter's suggestion that the data should be for Bodily Injury (BI) and Uninsured Motorists (UM), as opposed to just Bodily Injury, has already been addressed by the Department. The Department's March 15, 2004 adopted amendments to these rules added the following language to N.J.A.C. 11:3-20.4(d)2: "including uninsured and underinsured motorist coverages." See 36 N.J.R.1426(a).

The Department agrees with the commenter, and has amended the proposal on adoption to change the references in Exhibit Nine, Items 28, 29 and 30 to reference the sum of the accident year carry forwards used, instead of the total by report year. The following changes are necessary in order to render the revised text consistent with the suggestions made by the commenter, as well as with the amendments to these rules the Department adopted on March 15, 2004 (see 36 N.J.R. 1426(a)), which changed the calculation for excess profit to seven years. These changes are made by substituting "23" for all references to "19" in the locations specified below. Without this technical change of substituting 23 for all references to 19 (including

Exhibit Seven), these Exhibits may cause companies to incorrectly show an excess profit because of an inaccurate calculation.

Exhibit 7, substitute **23** for 19 regarding the last number of AYs by coverage along with the total.

Exhibit 7, Item 2 substitute **2.23** for 2.19

Exhibit 8, substitute **23** for 19 regarding the last number of AYs by coverage along with the total.

Exhibit 8, Item 2 substitute **2.23** for 2.19

Exhibit 8, Item 5 substitute **5.23** for 5.19

Exhibit 9, Item 28 = Exhibit 7, "Excess Profit Total Column" Replaces "Item 2"

Exhibit 9, Item 29 = Exhibit 8, "Extraordinary Loss Total Column" Replaces "Item 2"

Exhibit 9, Item 30 = Exhibit 8, "Reinvestment Total Column" Replaces "Item 2"

Federal Standards Statement

A Federal standards analysis is not required because these amendments regulate the business of automobile insurance, which is governed by Title 17 of the New Jersey Statues, 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 ion brackets with asterisks ***[**thus**]*):**

APPENDIX

EXCESS PROFIT EXHIBITS – INSTRUCTIONS

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INPUT SHEET

Exhibits One – Seven (No change.)

Exhibit Eight

All data in Exhibit 8 is for the New Jersey business only and is for the CY Year 0 through Year –16 and is for all coverages combined.
Item 1: List any extraordinary loss *[paid]* ***incurred*** carry forward in the applicable CYs.
Item 2: List any *[excess profit]* ***extraordinary loss*** * carry forward used in the applicable AYs.
Item 4: List any funds reinvested into New Jersey in the applicable CYs.
Item 5: List any reinvestment carry forward used in the applicable AYs.

Exhibit Nine

(No change.)

EXHIBITS ONE –SIX (No change.)

EXHIBIT SEVEN

Exhibit Seven shows the excess profit paid in each of the last 17 CYs and carry forward used in each of the last *[19]* ***23***AYs by coverage along with the total.
Item 1 is the excess profit paid by the company as stated in the Input Sheet.
Item 2.1 through *[2.19]* ***2.23*** are the excess profit carry forwards used in the applicable AYs as stated in the Input Sheet.
Item 2 is the total of Items 2.1 through *[2.19]* ***2.23***
Item 3 = Item 1 – Item 2.

EXHIBIT EIGHT

Exhibit Eight shows the extraordinary loss incurred and amount reinvested into New Jersey in each of the last 17 CYs and carry forward used in each of the last *[19]* ***23***AYs by coverage along with the total.

Item 1 is the extraordinary loss incurred by the company as stated in the Input Sheet. For Year-1 through Year-7, the values shall be those values calculated in the previous year's report. For Year-8 through Year-15, the value shall be calculated when that year was last used in the excess profit calculation.
Items 2.1 through *[2.19]* *2.23* are the extraordinary loss carry forwards used in the applicable AYs as stated in the Input Sheet.
Item 2 is the total of Items 2.1 through *[2.19]* *2.23*
Item 3 = Item1 – Item 2.
Item 4 is the amount reinvested into New Jersey by the company as stated in the Input Sheet.
Item 5.1 through *[5.19]* *5.23* are the reinvestment carry forwards used in the applicable AYs as stated in the Input Sheet.
Item 5 is the total of Items 5.1 through *[5.19]* *5.23*
Item 6 = Item 4 – Item 5.

EXHIBIT NINE

Exhibit Nine uses the data developed in Exhibits One through Eight to calculate excess profit and any ordinary loss for AYs Year –3, Year-2 and Year-1, as well as a seven-year total
The sources of data for Exhibit Nine follow.
Item 1 – 27 (No change from proposal.)
Item 28 = Exhibit 7, *[Item 2]* *Excess Profit Total Column*.
Item 29 = Exhibit 8, *[Item 2]* *Extraordinary Loss Total Column*.
Item 30 = Exhibit 8, *[Item 5]* *Reinvestment Total Column *.
Item 31 – Item 36 (No change from proposal.)

APPENDIX
INPUT FORMS AND EXHIBITS

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